December 2021 Newsletter

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Pleasantly Surprised by 2021

With new headlines inundating our news feeds every day it is easy for us as investors to lose sight of just how far we have come this year and how much positive economic progress has been made. Indeed, one need not look much further than our own equity market (up 36.0% over 12 months to the end of October 2021) to gauge the degree to which we have been benefactors of this positive growth. Likewise global markets, as measured by the MSCI All Countries World Index, are up 21.6% in dollar terms over the last year to the end of October.

A Great Year for Local Fund Managers

Even more encouraging is the fact that this growth has translated fully into the local fund market, with the average high equity balanced fund in South Africa returning over 25% for the last 12 months, while the average low equity balanced fund returned 15% over the same period to the end of October (as measured by peer-group average data published through Morningstar). Markets continued their positive trend during the month of November, with our local equity market up 4.5% in rand terms despite all the continuing worries faced by markets.

If one had no idea how markets had performed over the year these figures would surely come as a pleasant surprise. The last 12 months have not been without their fair share of risks (certainly that is the impression given by the news feeds), and yet markets have enjoyed a period of robust growth. What has been very encouraging from an investment perspective is that progress has or is being made on many of the worries faced by financial markets.

Throughout the year we have published newsletters covering topics including global inflation, the social and economic impacts of China's "Common Prosperity" regime, the path of global bond yields, global debt, as well as the economic effects of climate change, amongst others. As investors, it is important not only to be forward-looking, but also to be cognisant of the progress that has been made to date. Indeed, we have witnessed positive evolutions in many of these areas during the course of 2021, all of which have contributed to the strong returns enjoyed by investors.

Global Worries Begin to Ease

Possibly the most popular point of economic discussion outside of the Covid pandemic continues to be that of global inflation. At this stage most market participants agree that inflation will no longer prove transitory in nature but will steadily rise over time, lifting selected short-term rates, as well as bond yields along with it. Global markets, it would appear, have priced in the idea of the prospect of inflation to a large extent and have proved more resilient to potential jitters than expected. The re-appointment of Federal Reserve Chair Jerome Powell in October was met with little-to-no material movement in global markets, as was the announcement that the Fed will begin dialing back its $120bn monthly bond-buying program. The tapering of the Fed's bond-buying program comes as a result of the increased risk of inflation. In a recent statement, Powell said "The economy is very strong and inflationary pressures are high. It is therefore appropriate in my view to consider wrapping up the taper of our asset purchases ...perhaps a few months sooner." The support from the Federal Reserve will go a long way in preventing large, unexpected surges in inflation and should pave a more gentle, moderated path for inflation to increase over time. While we could see some market fluctuations as a result of the inflationary pressures, the potential volatility should largely be diminished by the extremely supportive monetary and fiscal policies.

Looking towards China, our October newsletter painted a mixed picture, with regulatory threats posing a material risk to growth and investment, while at a stock-picking level there are many green shoots on offer. Over the recent months the world's second biggest economy has been shaken by a significant downturn in the property sector as well as sustained energy shortages which have led to power rationing across parts of the country. During November, however, the Chinese economy experienced an increase in manufacturing activity and a boost in output, initiated by the stabilisation of power supply and commodity prices. Furthermore, Chinese regulators have begun to ease the pressure put on property developers by loosening the credit controls imposed as well as allowing more bond issuance. The effects of these positive steps culminated in China's official purchasing manager's index (a measure of the prevailing direction of economic trends in manufacturing) rising above 50 for November, indicating a return of the expansionary economic environment. These reforms, while currently relatively small in nature, are certainly a step in the right direction when making the investment case for Chinese exposure in a portfolio. Investors should continue to approach China with a healthy degree of caution, however it is encouraging to see positive progress being made.

The Emergence of the Omicron Variant

In the last week of November, the world was once again confronted with the arrival of its latest Covid-19 variant; the Omicron mutation. As is to be expected, the news renewed investor fears and uncertainty, and sparked a sell-off in global markets overnight. The USA S&P 500 equity index fell 2.3% and subsequently gained 1.3% in a day of capricious trading. Markets should be expected to remain nervy until a better understanding of the new variant is reached. At this stage it is too early for scientists, or indeed market participants, to form any inflexible conclusions about the Omicron variant and the effect it will have on global markets and long-lasting travel restrictions. What has caused concern, however, is the unprecedented set of genetic mutations linked to the variant. This has the potential to make current vaccines less effective in combatting the Omicron variant which could result in a greater degree of transmissibility. Encouragingly, South African doctors and those studying the virus have observed that so far the symptoms of Omicron appear to be milder than those of the Delta variant, with the majority of people infected experiencing coughs, fatigue, and body aches. So far no deaths have been recorded by the new variant.

Pharmaceutical company BioNTech is conducting the first set of labs tests on the new variant which should yield more concrete results by the second week of December. Until then investors should expect increased volatility and uncertainty in the markets which could potentially spill over into the new year. What is encouraging, however, is the fact that the population by now is well versed in dealing with the emergence of new variants and the periodic surge in Covid-related headlines. Francois Balloux, director of the UCL Genetics Institute in London was quoted saying that the latest variant is "most unlikely to fully escape immunisation provided by vaccination and prior infection. With high vaccination rates and promising drugs on the horizon, a possible B.1.1.529 wave should be far less painful to weather than the Alpha and Delta ones."

As investors look forward to taking some much-needed time off in December, it is important to look back at the past year and take stock of the positive progress that has been made. This year provides no better proof that those who stay the course and remain invested will be rewarded for their efforts. As Robert G. Allen, financial author and investment advisor once quoted, "How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case."