Market Commentary | May 2020

Global risk appetite continued to rebound in May. Lockdowns were tentatively eased in key economies like the US, Europe and latterly also the UK, following on the prior easing of restrictions in China and Korea. Covid-19 daily cases and deaths in these economic centres declined from peak levels, providing some evidence that the initial surge of the pandemic may have been contained at levels below the pessimistic epidemiological models of March and early April. Monetary and fiscal support flowed into the world's major economies at high levels, and gave a tailwind to asset markets.

Socio-politically, the backdrop was more negative. Social tensions amid ongoing inequalities were inflamed by the lockdowns and unjust enforcement policies. Simmering racial tensions in the US exploded late in the month and will be a key factor in the forthcoming US presidential election. US-Sino relations remained strained on the back of trade tensions, the coronavirus origination, and the tough Chinese stance adopted in Hong Kong.

On balance, markets took their cue from the more optimistic Covid outlook and the wash of easy money. The MSCI ACWI rose by 4.4% in US$, with the S&P500 rising to within 10% of its February peak (peak to trough was down 34%) and the tech-heavy Nasdaq within 3% of the peak. Commodities including oil also traded firmer, although gold and the precious metals endured a more volatile period. US 10 year bond yields have settled into a narrow trading range of between 0.6-0.7%, with this recent stability providing support to EM bond markets.

In SA, the situation remained tense. The month was spent under level 4 lockdown, with tentative normalization of retail trade and more essential services being permitted. Nevertheless, the daily Covid caseload continued to climb steadily, especially in the Western Cape, as did the death rate. Although the month ended with SA moving to level 3 lockdown with substantially less restriction on movement and commercial activity, this is being done with cases still rising, and with the R transmission factor (the key measurement of viral spread) still being above 1. SA is not alone in this. It is a common observation in many emerging market economies outside the Far East. The risk of the disease burden surging from this point and overwhelming the health facilities has not yet been expunged in countries like SA, Brazil, Russia, Turkey and India, all of whom are reducing restrictions in step with developed markets, but none of whom has shown a definite peak in infection nor an R factor below 1, which is generally the case in the DMs.

The economic and Covid reality in SA gave markets pause, with the Rand steadying itself after much weakness, and ending the month 5.3% firmer at R17.55 against the US$. The JSE ALSI returned 0.3% for the month, with the Financial index returning -4.7%, the Industrial index -1.6%, while the Resources index gained +5.6%.

SA's economic growth outlook this year is highly uncertain, with questions around the depth and duration of the recession making downside risks difficult to quantity, but it seems likely that it will take some time for SA's GDP to return to 2019 levels. This interruption in the growth path has important implications for the SA fiscal outlook (which was already on a vulnerable path pre the pandemic outbreak). Fiscal risks have intensified in three ways: the current recession will result in a material revenue shortfall relative to budget forecasts; the recovery and stimulus plan will increase expenditure; and underperforming SOEs continue to remain a drag on the fiscus this year. With a double digit budget deficit likely this year (and limited improvement anticipated next year), it seems increasingly likely that SA no longer has the option of 'muddling through' - holding out the promise of economic reform whilst being slow to enact meaningful changes, resulting in a slow deterioration in public finances. The magnitude of the current recession will result in a sharp slide in the fiscal trajectory, with debt as a percentage of GDP not able to stabilise without meaningful adjustments to both economic growth potential as well as material fiscal reform.

SA bond yields rallied across the curve in May, buoyed by both a resumption in global risk appetite, as well as the positive psychology of SARB secondary market interventions as a backstop against potential potholes in market liquidity. The MPC cut interest rates by a further 50 bps to 3.75% at their May meeting, bringing cumulative rate cuts this year to date to 2.75%. The inflation outlook does appear very contained in the near term, and with inflation expectations well anchored at the mid-point of the target range, this provides scope for a meaningful interest rate response. A lack of demand pull inflation, together with lower oil prices, has raised the prospect of CPI actually breaching the lower end of the target range this year, but the MPC have indicated that they would look through any temporary breach, and only respond to second round effects (much as they would address a breach above the 6% upper target range). These downside risks to near term inflation could well result in a further fall in interest rates this year.

The short and medium end of the curve (out to around 10 years in maturity) has rallied significantly off the March and early April highs, on the back of the falling repo rate. Reflecting an improvement in global risk appetite, the longer end of the yield curve has also rallied materially in the last two months, but whereas yields out to 10 years are either below or close to pre-crisis levels, longer dated yields are settling at higher levels than their previous trading range. Given the substantial deterioration in the fiscal outlook, we feel that a higher risk premium at the longer end of the curve is warranted. In our view, a credible economic and fiscal recovery plan, with clear action points to address fiscal sustainability risks, will be required for longer dated SA yields to convincingly re-rate.

TANTALUM FUND PERFORMANCE

Tantalum Capital celebrated its 15th birthday on the 1 June and we want to thank all of our investors and supporters for the vital role you have played in our success this far. We are very proud of the company we have built and couldn't have done it without your support. To the end of April 2020, our Tantalum local only balanced fund is ranked 2 out of 14 funds* over 5 years. We are pleased with this long term, consistent performance. In May, the Tantalum balanced and equity funds benefited from core holdings in the resources sector like Anglo American, BHP, Northam and Amplats. Further contributors to performance were Siemens, MTN, Prosus, Sasol and Life Healthcare. Our fixed income positioning in the R209, R186 and R2037 also added to performance. Holdings in Molson Coors, AngloGold, Omnia, Forterra and Absa detracted from performance.

Looking ahead, the outlook remains highly uncertain. We have written previously about the post-lockdown period being a more risky and difficult period for emerging markets in general, and SA in particular. With limited fiscal space to provide fast and direct cash relief to damaged segments of the economy, SA will have to rely on the SARB's dosage of lower interest rates. This will take longer to play out. In addition, the size of the correct 'dose' will only become apparent once the economy is back in full swing. Covid restrictions will remain in place for many parts of the SA economy, both formal and informal. In particular, the leisure, catering and travel/hospitality services will remain hard-hit. We remain optimistic that a good maize harvest, firm metal prices, and low oil prices combine to relieve the pressure on SA, but business and consumer confidence remain at very low levels and will take time to repair. We thus remain patient in adding SA Inc shares to the portfolio, even though we continue to see great long-term value emerging. We have started to add hospital shares. We have also added some retail and banking exposure during the month, albeit at a modest pace given the uncertainties. We have made greater use of derivative overlays to cushion downside exposure in high beta shares.

As discussed in previous commentary, we increased our bond weightings in March and April to take advantage of attractive yields on offer. We have only marginally decreased duration into the recent rally as we feel that yields offer a reasonable risk premium (both relative to cash for short and medium dated yields, and relative to inflation at the longer end of the curve). In the absence of firm policy direction, we would require higher yields to allocate further portfolio exposure to nominal bonds at this juncture.

FUND	MAY '20 RETURN	ROLLING 12MTH RETURN
Tantalum BCI Strategic Income Fund	1.9%	7.5%
Tantalum IDS MNC Retail Hedge Fund	-0.4%	-0.9%
Tantalum Absolute Return Fund	1.5%	-3.6%
Tantalum Balanced Fund (Local Only)	0.9%	-6.2%
Tantalum BCI Balanced Fund (incl. Offshore)	-0.2%	2.1%
Tantalum Equity Fund	-1.1%	-15.0%
PPS Stable Growth Fund	0.1%	3.2%

All performance numbers are estimates until final approval by administrator
* Willis Towers Watson Full Discretion Domestic Only Mandate, April 2020