AMPLIFY

Amplify SCI* Equity Fund

Fund Commentary

January 2021

Mohamed Mayet
Chief Executive Officer
Sentio Capital

> "All of the SA sectors are trading at discounts to their usual trading ranges against EM."

Overview

The year 2021 started on a volatile note

The start of 2021 saw a volatile month. The MSCI All Country World Index ended the month of January down 0.5% despite rallying 3.6% in the first three weeks of the year.

Market performance was initially supported by optimism surrounding fewer new Covid-19 cases, the continuing vaccine roll-out, the significant US fiscal stimulus package, and earnings beating expectations. The pullback at the end of the month seems to have been triggered by extended lock-downs in Europe, delays in vaccine roll-outs and, particularly, nervousness surrounding a high profile short squeeze on hedge fund positions in the US, leading to a substantial decrease in gross exposures.

A great month for emerging markets, not developed markets

MSCI Emerging Markets (EM), for the fourth consecutive month, posted a positive US$ total return in January of 3.1%.

All regions within MSCI World posted losses over the month, the worst being Europe (-1.4%) with Spain at -4.5%, Italy at -3.9% and Denmark's -3.7% recording the worst country performance. The North American and Pacific regions showed marginal losses of -0.9% and -0.5% respectively in January.

Within MSCI EM, the Asian region gained 4.4% in January, with heavyweights China and Taiwan returning 7.4% and 6.5% respectively. Excluding heavyweight China from MSCI EM would result in a January total dollar return of just 0.4%. The EMEA region posted a US$ total return of 1.1%, with MSCI South Africa returning 2.7%. The LatAm region lost 6.7% over the month.

In January, Energy and Health Care were the only equity sectors within MSCI World to show positive total returns. Consumer Discretionary and IT outperformed within MSCI EM, while Utilities, Real Estate and Financials showed the largest negative performance over the month.

Value is the best performing style

The Global Earnings Revision Ratio improved from 1.32 to 1.33 and remains above 1.00 (more upgrades than downgrades) in every region of the world. The Global Value Earnings Revision Ratio jumped from 1.20 to 1.50, the highest level on record in 30 years.

In terms of styles, Value remains the best performing style year to date (YTD) and has outperformed MSCI ACWI by 6.3%. Value is typically the best performing style in the Earnings Recovery stage of the cycle.

Global manufacturing is expanding

On the economic front, global manufacturing PMIs continued to expand, while at a slower pace, moderating to 54.4 in January 2021 from 55.0 in December 2020, with an even split between the economies that reported an improvement and those that did not.

In South Africa, trade is buoyed by commodities

In the South African macro environment, the SA Reserve Bank kept the repo rate unchanged at 3.50%, following 300bp in rate cuts in 2020. At the same time, tax revenues exceeded expectations, while trade continued to be strong, buoyed by firm commodity prices.

In commodities, oil prices gained 7.2%, while gold dropped 2.7% in the risk-on environment. Platinum held steady, while palladium saw a drop by almost 9% from lofty highs. Iron ore continued to be strong due to re-stocking ahead of the new Lunar Year in China.

The SA rand depreciated by 2.4% against the US dollar in January, its first monthly decline since April 2020.

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Inflows are shifting towards Brazil, SA and Turkey

After a combined US$41bn inflow in November/December 2020 into EM ex China, January saw a small outflow, and a shift from expensive Asia (U$8bn outflow), to cheaper Brazil, South Africa and Turkey (U$10bn inflow), as investors attempted to position for a recovery.

Stripping out the dual-listed companies, foreigners were net monthly buyers of SA equities to the value of R13.2bn, the second consecutive month of buying after a dearth since July 2019. The largest inflows were into SA Industrials to the value of R14.9bn (of which Naspers saw R10.8bn), while SA Financials had inflows of R1.0bn and SA Resources saw outflows of R2.7bn.

Market developments

SA equities had a strong January

In rand terms, SA equities delivered steady performance in January, up 5.2%. Large Caps dominated with a total return of 5.8%. Small Caps and Mid Caps returned 3.9% and 2.6% respectively. In January, the ALBI provided a monthly total return of just 0.7%. Following two months of solid total return performance (Nov: 17.5%, Dec: 13.7%), SA listed property came under pressure in January, shedding 3.2%.

Within equities, SA Industrials outperformed with a total return of 8.4%. Performance was driven by a recovery in Technology, 14.%, with Naspers and Prosus returning 15.2% and 9.2% respectively. SA Resources gained 5.1% in January, with General Mining up 5.6%. Platinum, however, lost 0.1%. SA Financials lost 2.6% in January, as Banks shed 3.7% with negative total return performance across the board. REITs lost 3.7% and Life Insurance shed 2.6% in January, dragged down by Discovery (-16.2%).

Portfolio performance

Contributors and detractors

The fund underperformed its benchmark during the month, with the regulation induced, structural underweight in Naspers accounting for virtually all of the underperformance. Further detractors included overweights in ABSA and FirstRand, Sibanye Stillwater and Harmony, as well as Property names Vukile and Growthpoint. Positions in global names Hoya, Adidas, PepsiCo, TJX and Inditex also detracted, due to weak overseas markets. Many of the domestic names have reversed performance sharply at the time of writing and are now contributing positively at the start of the new month.

Top contributions came from the underweights in Discovery, Capitec, Northam, Bidcorp and Multichoice, as well as overweights in Sasol, Huge Group and also global stocks Intel and Ebay.

Portfolio positioning

Welcome to the fifth quarter of 2020?

Anybody hoping to swiftly move on from the very challenging year of 2020 got disappointed. Within the first month of the new year, financial markets survived not just the US elections, Brexit and the 6 January riots but also a chaotic transition of retail investors to social media platforms, and historic short squeezes. Investors navigated the first signs of liquidity drainage in China, expansion of fiscal deficits in India and stimulus uncertainty in the US, quantitative easing (QE) to perpetuity in Australia, the collapse of the Italian government, appearance of new Covid-19 variances and delays in any meaningful opening-up of economies. One might be forgiven for despairing, but cutting through the 'noise', it is worth focusing on things that matter.

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The economic expansion still continues: For the past five months, global manufacturing PMIs have averaged a robust level of 54.3, very similar levels to those seen during 2017 and the first half of 2018. As the manufacturing cycle has rebounded, this is now being reflected in global trade too, which posted a second consecutive month of year-on-year growth. With most large economies likely to reopen from March/April, PMIs should remain robust in the coming months. Notably, all of the PMIs of the major economies in DM and EM are now above their pre-Covid-19 levels, up from 85% in the previous month. Meanwhile, the employment sub-index continued to hover close to the 50-expansion threshold for the second consecutive month. The services sector and its PMIs remain very sensitive to Covid-related restrictions. However, as we look ahead to the spring, we believe that warmer temperatures and vaccinations will help to reduce hospitalisations and fatalities, which will allow economies to reopen more fully, setting the stage for an increase in demand from March/April this year.

The above is being supported by more and more vaccines from a variety of sources being approved, bolstering 'prevention' as well as the 'protection'. While the focus is still very much on efficacy, or the potential of a vaccine preventing the disease, as long as the vaccines can continue to offer high levels of 'protection' the re-opening economics should perform. A risk is that mutations will outpace the development of vaccines, leading to extended uncertainty and ultimately impacting the re-opening scenario. For now, though, nearly all of the vaccines are extremely effective against severe disease and hospitalisations.

With the Fed not indicating any appetite to taper in the near term, markets continue to thrive. Furthermore, central bankers globally continue to pledge additional liquidity support should the global economy continue to suffer from the effect of the coronavirus. Extended fiscal stimuli by the US and Europe will also be an underpin, while China's moves to contain speculative exuberance will have to be watched.

Despite a strong start to the year for SA equities, stocks remain cheap! The MSCI SA multiple (at 10.9x) is now at a 32% discount to EM, with MSCI EM is trading at a 31% premium to its 5-year average and MSCI SA at a 19% discount to its 5-year average. This comes as MSCI SA has underperformed MSCI EM by 19% over the last 12 months and MSCI EM 2021 eps expectations have dropped 14% in US dollar terms over the last year but MSCI SA 2021 earnings forecasts have only been revised down by 1%. Relative mining earnings revisions account for much of the resilience in SA index earnings, while recent domestic trading updates all surprised to the upside, thus also likely resulting in positive earnings revisions. However, it is not just the SA mining sector that is now trading at a significant discount to EM peers. All of the SA sectors are trading at discounts to their usual trading ranges against EM. In addition, relative bond valuations also look cheap against the peer group, even after factoring in the lower rating from rating agency Moody's.

With the globe emerging from the Covid-19 pandemic, liquidity, economic data, valuations and positioning favour a risk-on scenario for now, which strongly favours cheap SA exposure. Therefore the fund is currently underweight expensive global exposure, and emphasises cyclical traits in its stocks through investments in resources, cheap SA Inc, as well as increasing cyclicality in other emerging markets. There are, however, risks, including tapering by central banks, disappointment in the speed of vaccine roll-out and other geo-political risks, which will be watched and managed through a very disciplined portfolio construction process.

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