M1 CAPITAL
INVESTMENT MANAGEMENT

Where to for Markets?

Monthly Commentary February 2021

The SA equity market continued to perform better than global markets in February. Global flows continued to seek opportunities in emerging markets, in particular markets perceived to offer better value, such as South Africa. South African asset returns are compared to global asset returns in Table 1 below.

Table 1. South African and global asset returns for February 2021

SOUTH AFRICA		**Feb-21**	**YTD 2021**
Equity	FTSE/JSE ALSI	5.9%	11.4%
Bonds	FTSE/JSE ALBI	0.8%	0.8%
Money Market	STeFI	0.3%	0.6%
GLOBAL (ZAR)			
Equity			
- Developed markets	MSCI World	3.2%	4.7%
- Emerging markets	MSCI EM	1.4%	7.1%
Bonds	Bloomberg Barclays Global Aggr	-1.2%	0.4%
Gold		-5.9%	-5.9%
Oil		19.1%	31.6%
GLOBAL (USD)			
Equity			
- Developed markets	MSCI World	2.6%	1.5%
- Emerging markets	MSCI EM	0.8%	3.9%
Bonds	Bloomberg Barclays Global Aggr	-1.8%	-2.6%
Gold		-6.5%	-8.7%
Oil		18.3%	27.7%

The recovery trend begun in November 2020 continued with a number of shares which had declined due to the pandemic in 2020 recovering strongly. Conversely, shares which performed well in 2020 have been lagging in 2021. Table 2 below sets out returns for a sample of shares which performed well in 2020 versus a sample which underperformed, and their comparative returns for the year-to-date in 2021.

Table 2. Comparative returns in 2020 and 2021

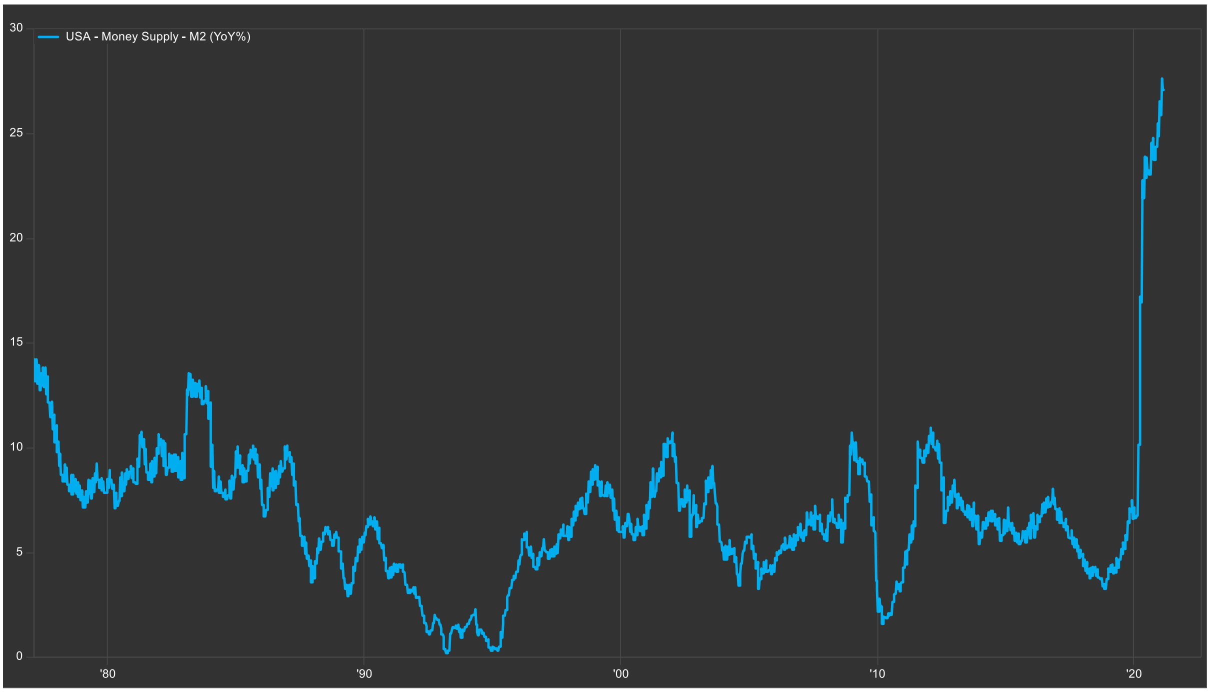
	2020	YTD 2021
Discovery	27.3%	-7.7%
Transaction Capital	18.0%	6.9%
Afrimat	29.6%	3.0%
Italtile	13.0%	9.2%
Sirirus Real Estate	20.6%	-2.3%

	2020	YTD 2021
Sappi	-24.8%	35.3%
MTN	-27.0%	20.8%
Motus	-31.5%	40.3%
KAP	-24.8%	28.2%
Redefine Properties	-56.0%	24.6%

The M1 Capital Equity Prescient Fund's exposure is focussed on shares similar to those on the left of the Table, and has correspondingly underperformed to date in 2021. The exposure is due to M1 Capital's approach of being a longer term investor in well-managed companies with a competitive advantage to peers. While this may be subject to periods of underperformance as markets fluctuate, it is M1 Capital's view this is the best way to grow capital over time.

Globally the situation continues to be complicated. As is well-known, US monetary policy has been extremely accommodative resulting in an increase in money supply unprecedented in recent years. The year-on-year change in US money supply is set out in Chart 1 below.

Chart 1. Percentage annual change in US M2 Money Supply

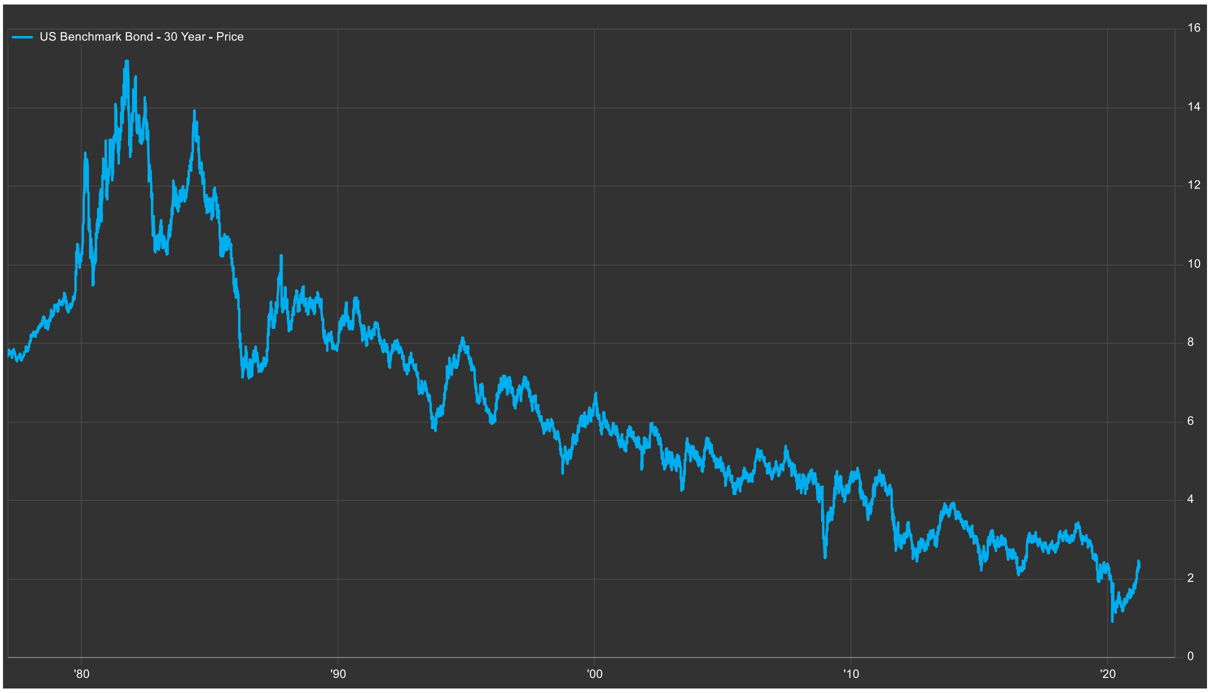


Source: Factset

This steep increase in US money supply has resulted in upward real asset market adjustment – global equities, commodities, bitcoin, and most recently property/real estate. Equity and commodity markets are liquid and have adjusted almost instantaneously. Bitcoin and cryptocurrencies appear to receive special media attention daily, and attract retail investor interest, making price movements for these assets especially steep. It is important to note the Bitcoin price movement is likely less due to its "new currency" status and more likely because of its USD-denominated nominal price which is able to respond to increases in USD money supply. Finally, property/real estate, as the least liquid asset class, appears to have taken some time, however here too US headlines in recent weeks have highlighted price increases.

So far not unexpected and in line with economic laws. The more important difference has been presented by the US bond market. Yields have not increased materially, certainly not anywhere near expecting future inflation. In this respect, real asset markets and US Treasuries have disagreed – equities and commodities have increased, while US bonds have not declined materially. The Treasury yield upward movement, well-covered in the media at the time of writing in March, has so far only retraced back to its longer term, downward, trend, leading up to the 2020 crisis. The US 30 year Treasury yield is presented in Chart 2 below.

Chart 2. US 30 year Treasury yield



Source: Factset

So the two sets of markets are disagreeing – real asset markets, represented by equities, commodities and property, and nominal or fixed interest assets represented by the bond market.

It is M1 Capital's view that in the face of this apparent disagreement, one set of markets – real or nominal – is currently wrong and there will be a corresponding adjustment.

One other point is also clear – if the bond market begins to price in inflation and yields rise, this will be negative for both fixed interest and real assets. In other words both equities and bonds can be expected to decline. Equities will likely decline more than bonds because of equities' longer duration. Higher interest rates are not only bad for asset markets but also for the US economy in that they discourage investment. With this in view it is highly likely the US Fed will engage in yield curve control and suppress long term yields through bond purchases. The ECB has already indicated intent to do precisely this.

M1 Capital equity funds, both local and global, prefer not to engage in temporary opportunity-seeking e.g. through recovering shares from 2020, or second-guessing the US bond market or the US Fed. Instead, the funds invest in assets which have performed well through cycles and present a better risk profile of safety, even at the cost of short term underperformance.