Capricorn Asset Management
a member of Capricorn Group

Economic Update

The financial markets recovered roughly half of its losses over the past month following the carnage of March. The JSE is up 30% from its lows, global shares 26%, and listed property 19%. The ten-year bond yield has fallen back from 12.4% to 11%. The currency is "only" 5% weaker this month, and oil is at US$15 per barrel. Newswires have turned to debates about how to lift lockdowns, rather than extend them. So, are we out of the woods yet? Hardly.

The markets are about half-way back to where it all started, and the real economic damage is only now gradually becoming clearer. The next round of economic data releases is shaping up to be atrocious. Unemployment is set to surge. In the USA it will be close to 20%, that is truly unprecedented. In Namibia and South Africa, already high unemployment of 30%+ will rise further. Business and consumer confidence will be deeply shaken. Creditworthiness of sovereigns, firms and individuals will deteriorate.

The global economy is now expected to contract sharply by -3.1% this year with developed markets (DM's) at -5.1% and emerging markets at (EM's) at -0.5%. The latter is only helped by China not shrinking. In Namibia and South Africa deep contractions are also expected, ranging anything from -7% to -10% in real terms. This has not happened in modern history. It can also easily turn out to be worse if, say, the return to normal economic activity takes even longer.

This is an environment in which inflationary forces will be weak. In fact, deflation, the persistent downtrend in price levels, which is more damaging than moderate inflation, is a greater danger than inflation. In DM's inflation will hardly reach 1% and in EM's remain below 4%. We expect inflation to average 3.7% in SA and 2.4% in Namibia this year. The 77% crash in the oil price will be a strong disinflationary force in the global economy.

Governments had no choice but to react aggressively to prevent economic collapse. In SA stimulus of 500billion rand was unveiled and in Namibia 8.1billion Namibian dollars. In the USA a plan was put into motion that will cost 2tn dollars, and in Europe 2tn euros worth of measures are being taken albeit haltingly. Japan has announced virtually unlimited spending in order to prevent melt-down.

This "whatever-it-takes" stance has also been adopted by monetary policy makers. Interest rates have been slashed in developed economies (DM's) as well as emerging markets (EM's). First by the Fed – to virtually zero. Then by 60 other Central Banks (CB's). Bank of Namibia has now lowered policy rates by a cumulative 275bp of which 200bp was in March and April.

The CB's of several DM's have unleashed QE (quantitative easing). This means that they are buying interest bearing assets in virtually all their domestic markets, ranging from sovereign debt to corporate bonds. This injects liquidity into their systems and lowers interest rates across the board. And they are doing it in staggering proportions. The Fed and the ECB promised 2tn dollars – each. And Japan is not far behind. This injection was necessary because liquidity evaporated, markets "froze", and economies came to a hard stop as a result of the physical lock downs.

These liquidity enhancing measures and spending plans will, no doubt lead to higher indebtedness. Government deficit to GDP ratios of 10% will become commonplace, in DM's as well as EM's. In Namibia and SA, it will be worse if the hit to Government revenue is larger than expected. This is a situation that will require close scrutiny with the Namibia Budget expected soon and the actual revenues received over the next fiscal year.

How to survive a worldwide economic crisis

"It's only when the tide goes out that you discover who's been swimming naked." Warren Buffet

This quote of Warrant Buffett is no doubt once again extremely relevant in current times. The quote relates to the fact that when all goes well, or it being high tide, it's not always appreciated which investment managers apply a conservative approach in an effort to achieve portfolio performance.

The modern investment management world has become overly infatuated with investment performance, driven by their clients need for consistent outperformance. This has caused many investment managers to ignore the other key pillars of good investment management. The result of this is that managers who do balance portfolio performance with the other pillars of investment management such as good credit quality, appropriate investment duration, adequate liquidity and asset diversification do not always receive the necessary accolades. However, when the tide goes out and times gets tough, such as now, and liquidity dries up, credit quality drops and interest rates spiral out of control, then it becomes clear who the "good" investment managers have been all along.

At Capricorn Asset Management, our portfolio management team have been tempered by a host of economic crises since the early 1990's. Over this period, our team have witnessed many local and global market events that have affected the investment markets in many ways, such as:

- The Dot-Com Bubble (1999)
- 9/11 attacks on the World Trade Centre (2001)
- Saambou Bank Failure (2002)
- The SARS pandemic (2003)
- Sub-Prime Crises (2008)
- European Debt Crises (2009)
- African Bank Failure (2014)
- Chinese Stock Market Crises (2015)
- Grexit and Brexit (2014 and 2017)
- South African downgrades (2017)
- US/Chinese trade wars (2019)

During all these events we, and most importantly our clients, have prevailed and we have taken new learnings from each crisis and incorporated them into our investment management processes to improve the robustness thereof. As such, we always place a very high premium on liquidity and maintain a very strong emphasis on interest rate risk and, even more importantly credit risk with high portfolio diversification.

Our money market investments are held almost exclusively in only the top tier banks both in Namibia and in South Africa as well as Government of Namibia Treasury Bills. The exposure to any single bank does not exceed 20% of any portfolio and as a result, an investment in our funds are well diversified in terms of credit risk. Furthermore, currently the South African Reserve Bank and Bank of Namibia have both introduced enhanced measures to support the banking sectors in South Africa and Namibia as the banking industry is key to any economy.

In conclusion, we've been swimming with our swimsuits on and as this "Covid-19 Tide" goes out, we wish to assure you that we are highly comfortable that our very conservative investment approach will withstand the test of time, as we have done many times in the past.

As interest rates have been cut by 2% over the last two months, overall investment rates are now lower. This will cause the fund returns of all money market type investments to decrease over the next few weeks, as maturities within the funds' will then be reinvested at lower rates. In light of this we have decided to temporarily close the Capricorn Enhanced Cash Fund for new investors and for additional investments and deposits of existing investors until further notice in order to protect the higher yielding returns of the existing investors on this fund. In doing this, we are keeping the existing investors within the fund in mind

to ensure that new inflows do not dilute the returns of all other investors. Withdrawals will continue to be allowed as normal.

We do however wish to point out that all our other money market and fixed interest funds are still open for new investors. This includes our Capricorn Selekt Fund, Capricorn Investment Fund, Capricorn High Yield Fund and Capricorn Bond Fund. The Capricorn Stable Fund is also recommended. Investors should consider their risk appetite and long term investment goals before making any changes to their investment portfolios.

Should you wish to find out more on these products please contact our sales team at cam.service@capricorn.com.na or 061-299 1950.

Supporting our Community

Capricorn Asset Management have allocated N$ 500 000 to support our community in these challenging times posed by the Covid-19 pandemic.

The poor and vulnerable communities supported includes:

- Dolam Children's Home
- Baby Haven Orphanage
- The Lemon Tree
- Family of Hope Services
- Side by Side Early Intervention Centre
- Imago Dei
- Gondwana Care Trust
- Pupkewitz Foundation

There has never been a more urgent need for everyone in Namibia to work together to support our community.

#WeAreStrongerAsOne