The big recovery: Is this a dead cat bounce?

Financial markets over the globe continued to recover strongly during last week. Despite horrible US unemployment data during April, where employers had cut jobs by a record 20.5 million to bring the US unemployment rate on 14.7%, the lowest since the 1930's, equity markets just bulldozed into a buying spree. The Dow Jones Industrial index had broken easily through the 24 000 level on Friday whereas the S&P500 started to test the 3 000 level again. The Dow had lost 37% of its value from its record high of 29 551 on 13 February 2020 to as low as 18 591 six weeks later by 23 March 2020. Up to its opening on Friday, the index already had recovered back by 29%. This typical V- format recovery is well known in equity markets just after a black swan incident, like after the 11 September 2011 twin towers attack in the US and the 2009 sub-prime crisis.

Most other equity markets followed the US over the last few weeks with strong increases. On the JSE, the ALSI ended Friday on 51 003. The index had lost 36.0% from its highest point this year of 59 001 on 17 January 2020 to 37 963 on 19 March 2020. Since then the ALSI had recovered strongly again by 34.6% to the close on Friday. On the capital market the R186 also had reached its highest point of 10.48% on 19 March 2020. Despite the downgrade of SA's sovereign debt to junk by Moody's that have led the way for RSA government bonds to be excluded last Thursday from the World Government Bond Index, the R186 had recovered to as low as 7.68% on Friday. This is an improvement of 25.4% or 2.8 percentage points within two months. Resources (2.4%) and Industrial shares (1.8%) continue their strong rally, despite the news that the South African Business Confidence Index had tumbled to 77, the lowest since 1985.

The question now remains if this is not a dead cat bounce as more and more devastating economic data for the second and third quarter will start to emerge in weeks to come? Can we therefore expect that equity and bond markets will just move in a W-formation and that another strong collapse is about to emerge? It seems that extend of the Covid-19 infection recovery and death rate that will determine how fast countries all over the world will abolish their lock downs holds the key. Together with the enormous economic stimulus packages that were introduced by most developed countries, economic growth can quickly recover. Share and bond markets seem to price in this scenario as financial markets continue to strengthen.

Domestically, the opening of some sectors of the economy last Friday also gave some momentum for foreign and domestic investors. As the mining, agriculture and retail sector forms the bulk of the opening of the economy, economic prospects for the second and third quarter may be better than expected. Clothing retailers last week saw a sharp increase in their share prices as shopping malls started to open again.

The Rand exchange rate started to emerge stronger last week. The currency gained 54 cents against the US$ and traded Friday afternoon on R18.33/$ against the R18.87/$ of the previous Friday. Against the Pound the Rand recovered by 80 cents from the previous week and ended Friday on R22.81 and R19.91 against the Euro down from R20.76.

This coming week investors' attention will concentrate on the release on Tuesday of South Africa's unemployment rate for the first quarter 2020. It is expected that the rate had gone up sharply to 35% from 29% during the fourth quarter last year (2019). The country's manufacturing production data for February (Tuesday), retail sales for March (Wednesday) and mining production for March (Thursday) will also be announced. Therefore, one can expect that equity prices will tend to move nervous during the week and will stay under pressure. Globally the UK and the EU will release their GDP growth rates for Q1 2020 on Wednesday, whilst most countries will publish their latest inflation rate data. The jobless claims data for the US next Thursday will once again be of high importance.

Dr Chris Harmse: Economist and Chief Investment officer

Rebalance Fund Managers

ABOUT THE AUTHOR

Dr Chris Harmse completed his doctorate degree in Economics at the University of Pretoria. Prior to entering the financial services industry, he was a lecturer and professor at the Department of Economics of the University of Pretoria between 1986 and 2005. Dr Harmse was awarded an extraordinary professorship at the School of Economics of the University of Pretoria in January 2006. He served on various Investment Committees and is extensively involved in economic research and asset management.

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