19 March 2020

COVID-19

Dear Quantum Asset Management Clients:

The confluence of recent market events has triggered an extremely violent fall in global and local investment markets. The world has arguably not seen anything similar in the past three decades. This could not have come at a worst time – last year we saw global economic growth starting to stagnate while South Africa entered a recession with economic growth being non-existent.

Despite this gloomy introduction, the Quantum Funds experienced very good returns during 2019 and has continued to do so until this most recent "Black Swan Event". Relative to our peers, we continue to deliver returns that are above the average of the relevant ASISA* categories. This cannot be attributed to any kind of foresight, but rather the fact that we have gradually de-risked our portfolios over time because of the slowing down in global growth and a stagnant South African economy. However, we are not escaping the current declines and the global contraction will continue to have a negative impact on all investment portfolios. However, as Multi-Managers our portfolios are well diversified between specialist managers and also asset classes and therefore substantially less volatile than markets in general.

* *ASISA – Association of Savings and Investments of South Africa.*

In the economic and financial world, a "black swan" refers to an unpredictable event that is beyond what is normally expected of a situation and has potentially severe consequences. Black swan events are characterized by their extreme rarity and their severe impact.

Most investment portfolios typically have exposure to local and global equity markets and other so-called riskier asset classes. It is these asset classes (Equities, Listed Property and even Bonds to a lesser extent), which have dropped significantly because of the current events.

However, it is also important to remember that the Quantum BCI Fund of Fund portfolios are not fully exposed to market volatility due to the diversification inherent in such portfolios by design and the limitations of Regulation 28 (Quantum BCI World Wide Flexible is not a Reg 28 portfolio but holds approximately 20% fixed interest assets). Consequently, these portfolios are exposed (albeit to a lesser extent) to the current market events and are not immune to the negative impact on returns experienced globally.

The Corona Virus is a massive humanitarian crisis that require us to focus on factors that we can control – and not those that we can't. Behavioural changes – such as extreme personal hygiene and social and physical distancing - is the key lever in containing the spread of the disease and much of the measures put in place, rely on people consistently doing the right thing.

15 George Storrar Drive Groenkloof Pretoria
PostNet Suite #402 Private Bag X06 Waterkloof 0145
Tel +27 12 346 0084 **Fax** +27 86 681 3489 **Email** info@quantumwealth.co.za **Web** www.quantumam.co.za

In managing investment portfolios, we are also focused on those factors within our control, rather than those we have no control over. Our investment portfolios are constructed using sensible investment principles such as diversification, rebalancing and the adoption of a long-term approach. These are factors within our control and have in the past proven to be the most effective approach to unpredictable financial markets and irrational human behaviour.

The investment committee will remain disciplined and robust in our decision making. We are realistic around the challenging short-term prospects for local and global markets, but we also remain optimistic for the long-term and determined in delivering financial resilience to our clients. This COVID 19 crisis, together with the oil price war, are significant events and although markets do from time to time experience major negative events, this latest crisis seems to dwarf all previous experiences in recent history.

There are three things that are certain –

Firstly, this is not a minor crisis, it is a major one on a global scale and unprecedented for the most.

Secondly, it WILL end, and normality will return to the world and markets. Whether this will be in a month's time or a year, nobody knows. Investors should not pay attention to all the sensation seeking social media which is filled with fake news.

Thirdly, although it is impossible at this time to measure what the full global impact will be, investment opportunities are created on the way down. Our focus will be on limiting risks, while also exploring those opportunities that will ultimately ensure a sustained process of value creation going forward. This will be done by following our robust and scientifically grounded investment processes in a disciplined manner.

Even if there was another 10% drop, eventually markets will snap back and capitulating now is, in all probability, exactly the wrong thing to do. We do understand the emotional impact experienced by investors globally, but we urge clients to refrain from making irrational and emotional investment decisions based on fear, or from trying to predict what markets will do next. Such strategies have an extremely high probability to destroy long-term value! In fact, such irrationality has time and time again proven to be the most disastrous investment strategies.

What is quite certain at this time, is that all abled countries and governments will do whatever it takes to support the financial markets, businesses and consumers – some of course are better abled than others!

All the best and remain safe!!

FC Greeff
Chief Executive Officer

For those who are interested, we include below an update on COVID-19 infections and other relevant information as at 18 March 2020 with credit to Kevin Lings of Stanlib. (please note there is more than one source of data, including the WHO and Johns Hopkins and the data does vary)

- *An estimated 205 452 people have been infected with COVID-19 globally (18 March 2020), although 82 091 have recorded and unfortunately 8 248 people have died from the virus. This means that the world is currently treating 115 113 active virus cases. Only 8 106 of these active cases are in China. Instead the highest number of active cases are now in Italy (26 062), which has become the epicenter of the virus.*

- *Other countries with a large number of infections are Iran (17 361), Spain (13 910), Germany (10 082), South Korea (8 413), France (7 661), US (6 519), Switzerland (3 028) and the UK (2 642)*
- *The rate of increase in new infections in China continues to slow (see chart attached). Over the past ten days China has reported only 199 new infections (in total), which is an average of only around 20 a day. There is data to suggest that China is slowly starting to re-open supply chains, but the progress remains very slow. This is partly because of the high risk of re-infection, partly because global demand is weakening rapidly and partly because a large array of travel and other restrictions remain in place in China.*
- *Over the past few weeks the outlook for the Chinese economy in 2020 has obviously deteriorated significantly. Based on the most recent information we have, which includes a 20.5% year-on-year decline in retail sales during the first two months of 2020, we expect China GDP to contract sharply in Q1 2020 (possible around -5%y/y) with the weakness extended into Q2 2020. Consequently, we are now factoring in GDP growth of only 1.5% for 2020 as a whole, which is dramatically down from the 6.1% growth recorded in 2019.*
- *The focus, in terms of new infections, remains on Europe and the United States. For example, in the past five days the world has seen the number of new infections rise by 63 658. During those five days the increase in infections in Italy, Spain, Germany, France and the US account for around 60% of all new infections. (The United States has infections reported in all of their States).*
- *In contrast, the rate of increase in infections in South Korea continues to slow. In the past five days infections in South Korea have risen at an average of only 87 per day, which is well down on the early March daily increase of around 700 (see chart attached).*
- *South Africa is reporting a total of 116 infections, but no deaths. In response to the Covid-19 outbreak, on 15 March 2020, the South African government declared a national state of disaster in terms of the Disaster Management Act and introduced extensive travel restrictions, the closing of schools and the banning of gathering involving more than 100 people. These measures appear entirely appropriate.*
- *There is now a total of 157 countries reporting infections. This compares with 40 countries as recently as 26 February.*
- *Two weeks-ago Hong Kong announced that all adults (over the age of 18) will receive HK$10 000 (almost R20 000) in cash from the government as a form of fiscal stimulus. Hong Kong is in a unique position that it can afford this type of stimulus. At this stage the stimulus has done little to encourage economic activity.*
- *The US Federal Reserve cut interest rates by 50bps at an unscheduled FOMC meeting on 3 March and then by a further 100bps at a further unscheduled meeting on 15 March. The Federal Reserve also announced that they are re-initiating conventional QE and will look to purchase a further $500 billion government bonds and $200 billion mortgages backed securities. They have re-introduced their Commercial Paper Funding Facility and dramatically increased the size of the Repo marked. While these are bold measures from the Federal Reserve, they are likely to have only a limited impact on the world economy since the damaging economic effect of the virus is primarily caused by the isolation measures needed to contain the spread of the virus*
- *The SA Reserve Bank is expected to cut interest rates by 50bps this week.* [Not enough in my view]
- *In terms of a possible vaccine, numerous researchers have reported encouraging process. In particular, the first person in the US was injected with a vaccine this week. The person is a volunteer, does not have COVID-19 and*

is clearly a very brave lady. I think a total of 42 volunteer are involved in the trial, but it will be close to a year before the result can be confirmed

- *The overall mortality rate (worldwide) appears to have drifted up to around 3.8%, although in Italy the mortality rate is around 7.3%, largely as a result of the age profile of those infected in Italy. Elderly people are much more at risk as well as people with pre-existing serious medical conditions. In the absence of a vaccine the normal procedures for treating pneumonia, such as using ventilators, putting patients on antiviral and antibacterial treatment and using steroids, has proven relatively ineffective with people who have become more seriously ill. It is mostly up to the human body to fight the infection.*

- *The financial markets obviously continue to be substantially impacted by the spread of the virus. In particular, the SA equity market has lost around 38% of its value since 19 Feb, while the US equity market is down around 32%. In addition, the Rand/Dollar has weakened by more than 18% year-to-date in volatile trade. Most other emerging market currencies have also weakened very sharply in recent days including Mexico, Brazil, Russia, and Colombia. The SA bond market has declined very substantially in the past two days, hurt by desperate lack of liquidity.*

- *There are a number of scenarios circulating about the possible impact of the pandemic on the world economy – most of which have worsened significantly in recent days. We expect that Europe will incur a recession in 2020, while China could report positive growth of around 1.5%. It also seems highly likely that the US will experience a recession in H1 2020, which implies that the world economy is also likely to go into recession. Our GDP growth estimate for South Africa in 2020 has also been revised down to reflect a recession for the year as a whole, with the country already in recession at the end of 2019.*

- *At this stage it appears very likely that the virus will continue to spread at a fairly rapid pace in a number of countries over the coming weeks. Many countries have introduced some fairly extreme isolation measures, which hopefully start to show results in the coming weeks. Once the rate of new infections starts to subside the focus will switch to how countries try to get their economies going without the number of infections re-accelerating. This applies that the process of effectively dealing with COVID-19 is probably going to take longer than what most people currently anticipate.*
