The Monthly Bulletin

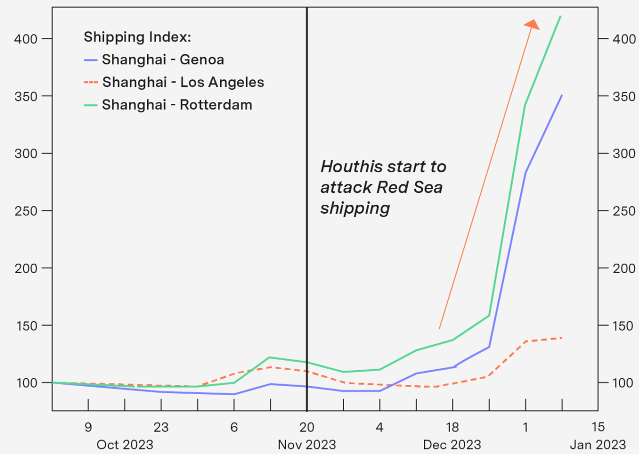
Sygnia Sygnals

February 2024

Chart of the month – Geopolitical risks spike

By Kyle Hulett
Co-Head: Investments

Asia-Europe shipping costs spike



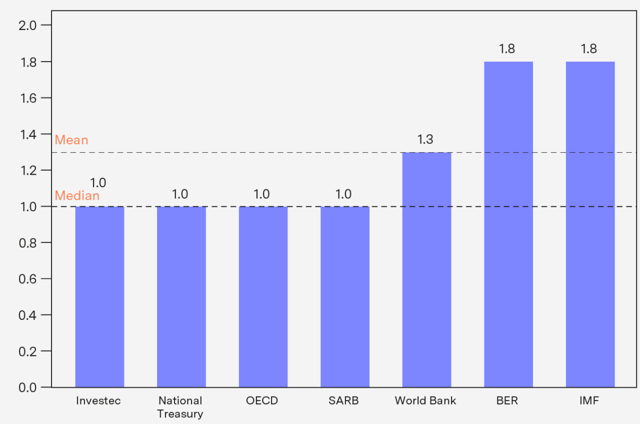
Note: Series are rebased to Oct 2023=100; source: Drewry Shipping Consultants Ltd
Source: Alpine Macro

- Geopolitical tensions in the Middle East have risen sharply after the US and UK launched airstrikes on Houthi targets in Yemen to stop it attacking ships in the Red Sea. This has triggered the biggest diversion of international trade in decades, rerouting ships away from the Suez Canal to take much longer and more expensive routes around southern Africa. Global supply chains have been disrupted and freight costs have surged (see chart).
- The Israel/Gaza conflict was being played out by proxies until recently, but Iran has declared its willingness to engage when required. Tehran has launched missiles at Iraq, Syria and Pakistan and seized an oil tanker previously embroiled in a US sanctions bust-up, showing its strength over the Strait of Hormuz – a key conduit for Gulf oil exports. The probability of escalation in the Middle East has risen but is still not our base case. Impacts are limited for now, but maintaining this status is dependent on the timing of the reopening of the Suez Canal.
- Increasing geopolitical tensions in Russia/Ukraine have prompted NATO's allies to launch a series of military exercises called Steadfast Defender from February to May this year. It will be the largest such operation since the Cold War, with participation from 90 000 troops from all 31 allied countries and Sweden. The oil price rose 8% intramonth, caution is warranted.

South Africa – "It's the economy, stupid!"

By Haroon Bhorat
Chair: Investment Committee

2024 GDP forecasts for South Africa by institutional macro model estimate



Source: National Treasury (2023), BER (2023), SARB (2023), IMF (2023), OECD (2023), Investec (2024), World Bank (2024)

- Now that the various institutions in South Africa and beyond have crunched their 2024 macro modelling numbers, it proves interesting to cross-check their projections on key economic indicators. The most obvious, and possibly the most important of these, are of course the gross domestic product (GDP) growth projections.
- As the chart above illustrates, the average growth rate projection for South Africa for 2024 across the models stands at 1.3%, while the median consensus is 1% economic growth. Let that sink in for the low-growth trap we find ourselves in. Note, however, that the International Monetary Fund and the Bureau of Economic Research in particular are much more positive, projecting growth of 1.8% for the year. As with all such models, these are prone to error – so expect regular adjustments to these numbers across the year!
- The real story for me lies in South Africa's relative economic growth levels. If we look back at 2021, world GDP growth was 6.2%, emerging markets (EMs) were at 7% and South Africa was at 4.7%. Simple ratios tell us that in 2021 the world was growing 0.32 times faster than South Africa and EMs 0.49 times faster. Now fast forward to 2023, when the world grew 3.7 times faster and EMs 5.7 times faster than South Africa. 2024 is looking slightly better, but the rest of the world and EMs are still growing 1.9 times and 3 times faster than us, respectively.

- Given that the world economy – including EMs – continue to struggle, the reason for the *growing gap in GDP growth rates* is principally down to South Africa-specific factors – what the media loves to call “own goals”. These are already very well documented, but the decline in rail, port, energy, water, road and related infrastructure has been so dramatic that it has essentially shaved off between 1 and 2 percentage points of South Africa’s GDP growth.
- Based on the IMF 2024 projections, then, if we were able to flip a switch and completely reverse our infrastructure crisis, economic growth could be sitting as high as 4%.

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Top-performing Sygnia funds

By Steven Empedocles
Head: Indexation

1-month absolute performance

Rank	1 month	Return
1	Sygnia Life Berkshire Hathaway Portfolio	11.8%
2	Sygnia FANG.AI Global Equity Fund	9.6%
3	Sygnia 4th Industrial Revolution Global Equity Fund	6.7%
4	Sygnia Itrix MSCI US ETF	6.1%
5	Sygnia Itrix S&P 500 ETF	5.9%

- The weak rand and strong US market drove performance in January. The Berkshire Hathaway Fund had a great month, driven by its robust businesses and robust capital position. The FANG stocks drove up the overall US market.
- Similarly, over the past 12 months the weak rand and the Magnificent Seven were the only game in town, driving the FANG.AI Fund, the two US ETFs, US-focused Berkshire and the World Fund, which is dominated by its 70% allocation to the US.

12-month absolute performance

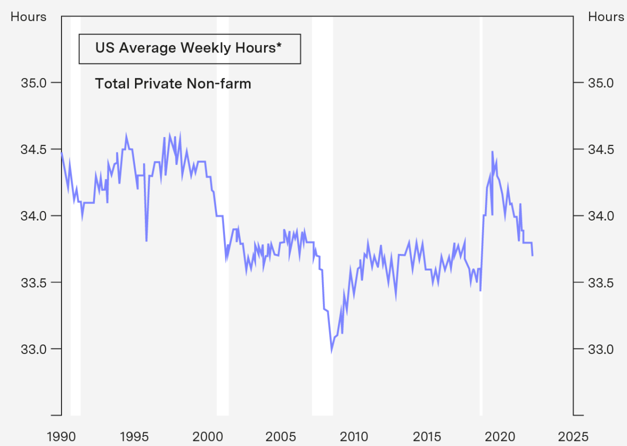
Rank	12 month	Return
1	Sygnia FANG.AI Global Equity Fund	80.0%
2	Sygnia Life Berkshire Hathaway Portfolio	33.9%
3	Sygnia Itrix MSCI US ETF	30.7%
4	Sygnia Itrix S&P 500 ETF	30.0%
5	Sygnia Itrix MSCI World ETF	25.3%

US – Trump’s “landslide” Iowa win

By Mish-Al Bassadien
Senior Portfolio Analyst

- Despite the increased political risk, the S&P 500 climbed to a record high in January.
- US election fever is heating up after DeSantis finished a distant second to Donald Trump in the Iowa caucuses and pulled out of the presidential race. Trump claimed that his victory catalysed the Chinese market crash: “China had a crash yesterday in their stock market. You know why? Because I won Iowa.” Trump went on to win the New Hampshire primary, putting him well ahead of Nikki Haley. Trump’s charge to the Republican nomination is fuelling a speculative frenzy in obscure stocks tied to his candidacy.
- US inflation continues to fall. Shelter inflation accounts for 44% of core consumer price index inflation and 18% of core personal consumption expenditure inflation, and the Zillow Observed Rent Index indicates that rental inflation could drop to 2% by mid-year.
- Meanwhile the US consumer remains resilient. The US retail sales release delivered a positive signal, with the retail sales control group surging its most since July, while US jobless claims fell to a 16-month low. US Q4 GDP delivered a positive message, well above consensus at 3.3% and driven by strong consumption. Mortgage rates in the US fell to their lowest level in eight months, and the average for a 30-year fixed loan was 6.6%.
- The implication is that growth will remain resilient as inflation continues to moderate, which will allow the Fed to start cutting rates by mid-year.
- The key to the recession question is US employment. Despite the unemployment rate not rising, the employment market is softening. Weekly hours have been declining for more than a year and are back to 2009 levels, while job hiring is back to 2018 levels. Companies stop hiring before they start firing. If the unemployment rate moves up, it may lead to a recession –historically, a recession has taken place every time the three-month moving average of unemployment has risen by more than 0.33%. Our base case remains no US recession in 2024.

US employment market is softening



*Production and nonsupervisory employees.
Note: White areas represent NBER-designated recessions.
Source: BCA

Davos (World Economic Forum 2024) & crypto update

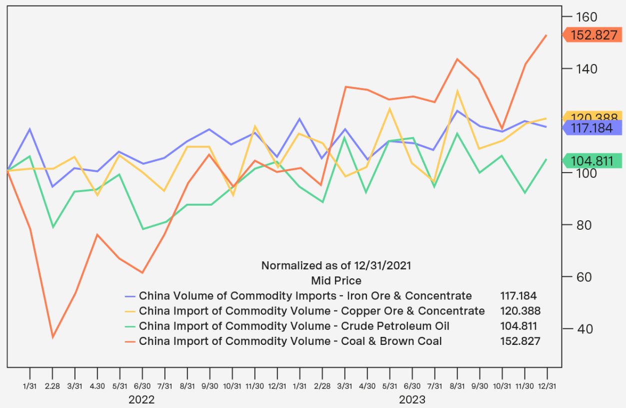
- The transformative potential of generative AI was a major talking point, with experts predicting its impact on all sectors. Given the potential for AI to disrupt employment, there was a focus on reskilling populations. The risks were also highlighted, with CEO of YouTube Neal Mohan stating, “The advent of this [generative AI] technology will lead to amazing things but will also be a tool that will be in the hands of bad actors.”
- AI replaced crypto as the Davos headline this year, but the approval and launch of the US spot Bitcoin ETFs made their own headlines. On the first day of the newly created and approved spot ETFs in the US, the Grayscale Trust is estimated to have seen outflows of $5bn, while the new ETFs gained inflows of $3.3bn. According to JPMorgan, the new ETFs are likely to attract inflows of up to $36bn, all funded from existing holdings, with the fee differentials being the largest driver – the Grayscale fee is 150 bps, compared to Blackrock’s 25 bps.
- Geopolitical instability was acknowledged as a risk to trade and supply chains, requiring leaders to adopt agile strategies and to foster international cooperation.

Commodities – Renewables demand holds the key

By Anton Swanepoel
Portfolio Manager

- Renewables was another key area of Davos 2024, with Luc Triangle, General Secretary of the International Trade Union Confederation, stating: “Developed countries have to assist in the financing of climate action in the developing countries.”
- The Goldman Sachs Commodity Index fell 12% in 2023 due to an increase in US oil production and a slowing economic recovery in China. This price weakness has continued into 2024.
- While Chinese equity prices continue to plummet, Chinese commodity import volumes continue to rise despite the Chinese property collapse (see chart).
- Looking forward, the consensus is positive on renewables, increasing demand for energy transition commodities. Copper, cobalt, nickel, lithium and related metal prices will be supported by the move to electric vehicles and alternative energy installations. New power stations, transmission grids and charging points all require significant new infrastructure.
- Sygnia’s active managers are generally bullish on the commodity complex for a variety of reasons: supply side disruptions, supply side closures, low inventories, continued strong demand in the West and seasonal strength. However, there is a mixed view on resource companies, particularly platinum. Some managers are concerned about poor capital allocations, negative cash flows and cost slippage; others are bullish on cheap valuations and rising commodity prices. Resource counters had a terrible year in 2023, and 2024 has started off in the same manner, with the resource index down over 7% in January.
- South African mining production shot up to 6.8% year-on-year in November, the second consecutive positive print and more than double the Bloomberg consensus forecast. This despite structural constraints in electricity supply and logistics.
- If global growth conditions continue to deteriorate, the macro environment will create a strong headwind. That said, further accommodative fiscal and monetary policies in China could boost demand for metals and pose upside risks to forecasts.
- Technical factors could support prices in the short term. Investors’ net long positions in 17 commodities have collapsed to multi-year lows, and BCA’s Technical Indicator for the Continuous Commodity Index is in oversold territory.

Chinese commodity import volumes continue to rise despite the property crisis



CNMVIROM Index (China Volume of Commodity - Iron Ore & Concentrate)
Source: Bloomberg

South African mining production shot up to 6.8% year-on-year in November, the second consecutive positive print and more than double the Bloomberg consensus forecast. This despite structural constraints in electricity supply and logistics.

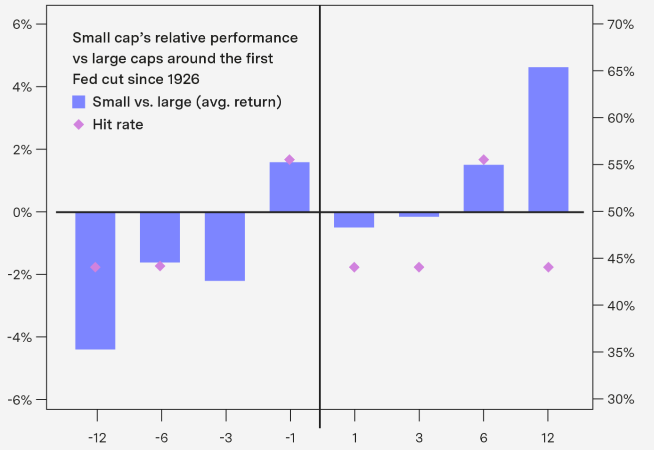
US small caps – Very attractive, but no need to rush

By Wessel Brand
Portfolio Manager

- While the S&P 500 Index is flirting with all-time highs, the Russell 2000 Index remains nearly 20% below its 2021 levels.
- Small caps’ valuations (based on the price to earnings ratio (P/E)) relative to large caps show small caps are at their cheapest level of the past decade, trading at P/E relative of 0.9, compared to a long-term average of 1.2.
- Small cap stocks are dominated by businesses that focus on the domestic US economy, while the S&P 500 companies are mostly multinationals. A strong US should therefore benefit small caps.

- Over 45% of debt for the Russell 2000 Index is floating rate, while the same debt accounts for only 9% for the S&P 500 Index. The fixed rate debt for the large cap index accounts for 91%. This suggests that small caps could benefit much more from falling rates than large cap stocks.
- Historically, small caps have outperformed 6 to 12 months after the first rate cut. Based on this, there is time, but the valuation discount is very tempting.

Small caps' relative performance to large caps relative to the Fed's first rate cut since 1926



Source: BoFA

Outlook – Soft landing still the base case, but risks have risen

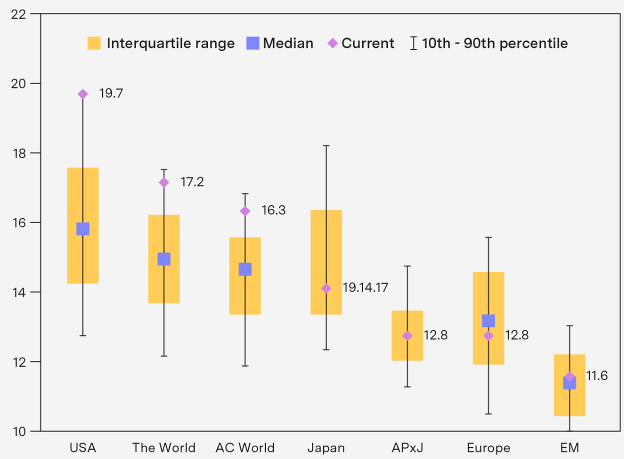
By Iain Anderson
Co-Head: Investments

- Geopolitical risk linked to presidential elections continues to rise. Not only with Trump's recent GOP win, but with Taiwan's ruling DPP's win of a third term, confirming the country's preference to remain independent of Beijing and keeping tensions between Taiwan and mainland China elevated.
- We remain underweight SA equities and neutral SA bonds.

Inflation fell to 5.1%, below expectations, and the February budget could see an increase to the wage bill, which would be negative – but we expect no major surprises. More significant is the election risk, tentatively scheduled for 22 or 29 May. Standard Bank's Simon Freemantle expects the ANC to slip to 47.5% support (down from 57.5% in 2019), requiring a coalition partner to form a government. The DA is expected to come in at 22.5% and the EFF at 11%.

- Chinese data continue to send deflationary signals. Although Q4 GDP came in at 5.2%, above the official target, it was below the expectation of 5.3%. The GDP deflator declined 1.5% year-on-year as China continues to export deflation. The property market is still deteriorating, with the contraction in new home prices and residential property sales deepening. China has announced a cut in the reserve rate requirement by 0.5%, which will provide 1 trillion yuan in liquidity. This cut is far above the 0.25% cuts seen throughout 2023 and signals a strong intention to support markets.
- Economies (and labour demand) are likely to accelerate in developed economies over the next few months thanks to easier financial conditions, a pick-up in housing and a stabilisation in global manufacturing, but the unemployment rate should be monitored for signs of a recession in early 2025. Our base case is still no recession; as Covid effects move out, the economy will recover as rates are cut. We remain overweight US equities despite their valuation premium (see chart).

US remains expensive but our preferred position



Source: Factset, Goldman Sachs

Tax season is upon us, and it's time to maximize your retirement annuities or tax-free savings accounts before February 29, 2024.

Keep these deadlines in mind:

Collection deadline:	**EFT deadline:**
Act by 2 PM, 22 February 2024.	Act by 2 PM, 26 February 2024
Remind me	**Remind me**

Do you have any questions or need to submit documents? Email us at instructions@sfs.sygnia.co.za.

Key indicators

		1 mo.	3 mos.	6 mos.	1 yr.	2 yrs.	3 yrs.	5 yrs.	10 yrs.
J203T	**FTSE/JSE All Share Index**	-2,9%	7,5%	-3,7%	-2,6%	4,4%	10,5%	10,6%	8,7%
J200T	**FTSE/JSE Top 40 Index**	-3,5%	6,8%	-5,9%	-4,1%	4,1%	10,1%	11,1%	8,8%
J210T	**FTSE/JSE Resources 10 Index**	-5,9%	-1,7%	-14,1%	-25,6%	-9,8%	2,2%	10,6%	4,4%
J211T	**FTSE/JSE Industrials 25 index**	-1,3%	9,5%	-5,2%	2,1%	6,8%	8,7%	11,8%	9,2%
J212T	**FTSE/JSE Financials 15 Index**	-2,9%	11,4%	3,0%	13,7%	12,3%	19,7%	4,8%	8,8%
J403T	**FTSE/JSE SWIX Index**	-2,8%	8,3%	-3,1%	-2,2%	3,0%	7,8%	7,4%	7,4%
J433T	**FTSE/JSE Capped SWIX Index**	-2,8%	8,3%	-2,9%	-2,0%	3,4%	10,5%	7,8%	7,2%
J303T	**FTSE/JSE CAPI Index**	-3,0%	7,5%	-3,6%	-3,1%	4,2%	11,6%	10,7%	8,7%
J253T	**FTSE/JSE SA Listed Property Index**	4,1%	24,8%	17,2%	15,8%	8,9%	17,7%	-0,7%	4,1%
ALBI	**JSE All Bond Composite Index**	0,7%	7,1%	6,1%	7,3%	6,9%	7,4%	7,8%	8,4%
STeFI	**STeFI Index**	0,7%	2,1%	4,2%	8,1%	6,8%	5,8%	5,9%	6,4%
	MSCI World Index in SA Rands	2,9%	15,5%	10,4%	25,2%	14,3%	16,1%	19,2%	14,9%
	Rand/US Dollar Exchange Rate	1,7%	-0,8%	4,6%	6,7%	9,6%	7,3%	7,0%	5,3%
	Rand/Euro Exchange Rate	0,0%	2,0%	3,0%	6,7%	7,9%	3,4%	5,9%	3,0%
	Rand/Pound Exchange Rate	1,6%	4,1%	3,5%	10,4%	6,8%	4,6%	6,4%	2,6%
	Headline CPI	0,0%	0,8%	2,6%	5,1%	6,2%	6,1%	5,1%	5,2%
	PPI	-0,6%	-0,2%	2,6%	4,0%	8,7%	9,4%	6,9%	6,2%