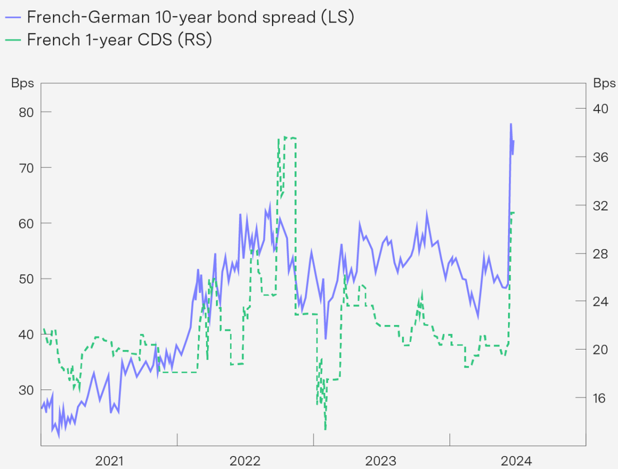
The Monthly Bulletin
SygniaSygnals
July 2024

Chart of the month – Geopolitical and societal risks rise

By Kyle Hulett
Co-Head: Investments



According to the World Economic Forum's survey of leaders, the top two global risks for 2024 – after extreme weather – are AI-generated disinformation and societal and political polarisation, with the latter linked to the former. Geopolitical and societal risks rose further in June after a number of election surprises around the world, including results in South Africa, Mexico and India and early election announcements in the UK and France.

- In Mexico, the peso and Mexican stocks collapsed after Claudia Sheinbaum's surprise landslide victory brought about a near super-majority in congress. While the tailwinds of Chinese manufacturing's relocation to Mexico have outweighed the costs of the hard-left ruling Morena party's redistributive policies in recent years, the sustainability of these policies is now under question and has investors concerned.
- Investors dumped stocks in India and triggered a $386 billion wipeout in the Indian stock market after Narendra Modi's victory was not as decisive as expected. Prime Minister Modi's setback reduces the likelihood of an acceleration in structural reforms and increases political uncertainty.
- In South Africa, the rand, bonds and equity markets rallied on the news that the ANC, IFP, PA, RISE and DA, representing 68.4% of the national vote, had struck an agreement to form a Government of National Unity (GNU) and had voted Cyril Ramaphosa in for his second term as president. The alliance is expected to deepen and widen reforms, but the deal is only a preliminary framework. There will be challenges from the MKP and the EFF, who were both left out in the cold.
- In Europe, eurozone equities sold off 7% from their 6 June highs and French bond yields widened on surprise early French legislative elections. However, French President Emmanuel Macron's gamble to call snap parliamentary elections has backfired: Marine Le Pen's radical right-wing National Rally party and a rising far-left coalition are leading in the polls, and the market is worried about extreme economic policies and possible European Union exits.
- The UK is heading to early elections on 4 July. According to an IPSOS survey, the Conservatives have lost up to a third of the voters who would have backed the party just four months ago. The polls predict a historic defeat, with even the Chancellor of the Exchequer at risk of losing his parliamentary seat in what would be a first per House of Commons data going back to 1906.
- After the latest US presidential debate, Trump's lead in the election polls has surged, but extreme policies by Trump are not yet reflected in markets. Trump wants to limit immigration, enact 10% tariffs on all US imports and cut corporate tax rates to 20% while increasing fiscal support. These would all be inflationary and would worsen an already ballooning US budget deficit.

Is the financial grass greener on the other side?

By Haroon Bhorat
Chair: Investment Committee

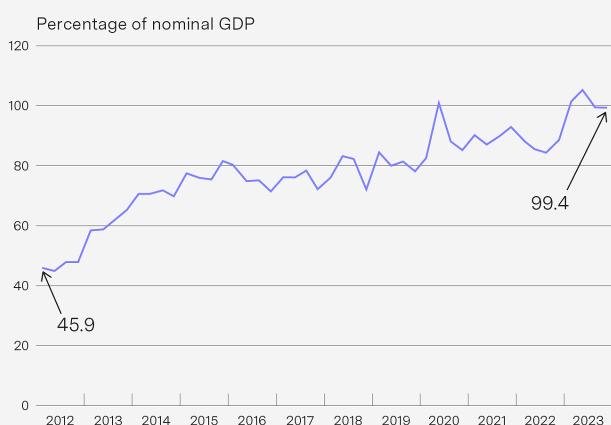
The SARB recently released its first biannual Financial Stability Review for 2024, covering a variety of topics of interest to our clients – you are encouraged to download the review and read it in detail! One issue that has clearly concentrated the minds of the investment community in South Africa is the nature and extent of foreign investor outflows from South Africa, which have been coupled with steadily declining domestic capital market depth and liquidity. Specifically, the review points to three key results worth highlighting: Firstly, the bond market has become increasingly dominated by government bond issuance, with government's share of total outstanding bonds rising from 60% in 2008 to its current 81%. In simple terms, government debt is crowding out private sector debt, leading to a much more ossified and homogenous bond market.

Secondly, the flight of foreign investors from both equity and bond holdings has reinforced this lack of diversity in capital markets. The data show that foreign holdings of JSE equities as a share of non-residents' holdings of domestic shares declined from about 40% in the middle of 2019 to its current 27.6%, representing a 31% decline in foreigners' appetite for South African stocks. Similarly, holdings of bonds fell more precipitously from 40 to 25%, no doubt reflecting a key concern around government's rising debt challenges.

Lastly, foreigners have not been alone in shifting funds abroad. Data from the SARB and World Bank show a sharp rise in local investors' foreign asset allocations immediately after each of the prudential limit increases in 2018 and 2022. Two sub-trends are clear in this preference for foreign investments: the 2022 rise in foreign allocations was larger than in 2018, and, where the 2018 increase was mainly a switch from domestic to foreign equities, investors also moved sharply away from bonds in 2022. Crucially, and perhaps not emphasised enough, is that the unutilised offshore capacity of domestic institutional investors – including collective investment schemes, retirement funds and long-term insurers – remains above zero. Put differently, these investors are not currently using their full offshore allocation.

Perhaps most importantly, as illustrated in the graphic below, these shifts are not short-term in nature. Indeed, they speak to at least a decade-long trend based on a steady relative rise in offshore asset allocations by domestic investors. The data thus show a steady and almost unabated increase in domestic institutional investors' offshore allocation as a share of nominal GDP, from 46% in 2012 to close to 100% currently. While this trend in part reflects a catch-up to other industrialised countries – where such foreign ownership limits also exist – the shift away from South African investment options is concerning.

Total offshore asset allocation as a percentage of GDP



Source: SARB and Bloomberg

Indeed, they reflect overall concerns around a secular decline in gross domestic product (GDP) – marked by infrastructure collapse, state delivery challenges and our emergence from state capture – perhaps all concentrated in rising government debt levels and increased perceived country risk. However, it should not be discounted that at the same time (particularly over the post-Covid period), there have been significant equity runs in foreign markets, led by the US economy. This has, of course, made the decision to shift funds abroad an even more compelling one.

"Crucially, and perhaps not emphasised enough, is that the unutilised offshore capacity of domestic institutional investors – including collective investment schemes, retirement funds and long-term insurers – remains above zero.

Top-performing Sygnia funds

By Phumlile Smith
Head: Manager Research

Optimism around reforms from the new GNU drove SA bonds and SA property to the top five rankings in June. The FANG. AI held the top two positions in the short term and is still in first place for the 12-month term. According to the NY Times, just 12 companies have led the S&P 500 by market valuation since the index was created in 1926: AT&T, Apple, Cisco, DuPont, Exxon Mobil, General Electric, General Motors, IBM, Microsoft, Philip Morris, Walmart – and Nvidia very briefly joined the list in June. Nvidia controls more than 80 percent of the market for the chips used in AI systems.

1-month absolute performance

Rank	1 month	Return
1	Sygnia Itrix FANG.AI Actively Managed ETF	7.3%
2	Sygnia FANG.AI Equity Fund	6.2%
3	Sygnia Listed Property Index Fund	5.7%
4	Sygnia Itrix MSCI Emerging Markets 50 ETF	5.2%
5	Sygnia Enhanced All Bond Fund	4.9%

12-month absolute performance

Rank	12 month	Return
1	Sygnia FANG.AI Equity Fund	42.8%
2	Sygnia Listed Property Index Fund	25.5%
3	Sygnia Itrix S&P 500 ETF	24.2%
4	Sygnia Itrix MSCI US ETF	21.1%
5	Sygnia Itrix S&P Global 1200 ETF	17.6%

US Growth – US slowing but still resilient

By Steven Empedocles
Head: Indexation

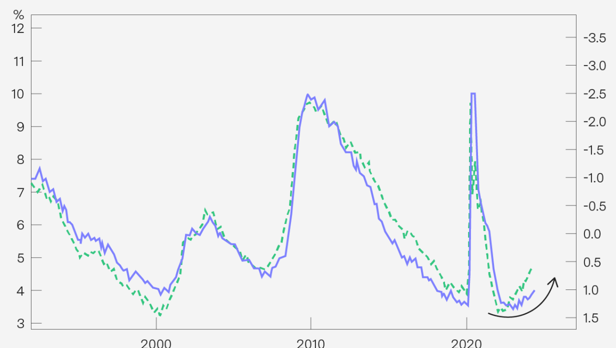
May's core personal consumption expenditure (PCE) – the Fed's favoured inflation gauge – moderated from 0.2% month-on-month (m/m) to 0.1% m/m. Importantly, core services ex-shelter contracted in April, their first monthly decline since January 2021. Shelter is the last hurdle for core PCE. Despite the good inflation numbers, Chair Jerome Powell described the data as "building confidence" at the June Federal Open Market Committee (FOMC) meeting – but still too soon to cut. The dot plot was adjusted from three cuts this year to only one. However, the central bank sees four cuts next year, up one from their earlier prediction for 2025.

The Fed's projections also lifted the outlook for core inflation from 2.6% to 2.8% in 2024, lowering the bar for further cuts if the labour market softens. This is important, as US job openings disappointed expectations, suggesting that the labour market is weaker than expected. Prior data were revised down as well, and the overall level of openings is at its lowest since February 2021.

The US unemployment rate unexpectedly ticked higher, from 3.9% to 4.0%. The Kansas City Fed's Labor Market Conditions Indicator, based on 24 variables, expects the US jobless rate to drift higher, which will have two important implications for the Fed: it will alleviate wage inflation and allow the Fed to focus on the dual mandate of employment and inflation.

The Kansas City Fed says US unemployment is weaker than the official indicator

U.S.: — Unemployment rate* (LS)
— Labour market conditions indicator: Level of activity** (inverted; RS)



*Truncated at GFC high
**Source: Kansas City Fed

Source: Alpine Macro

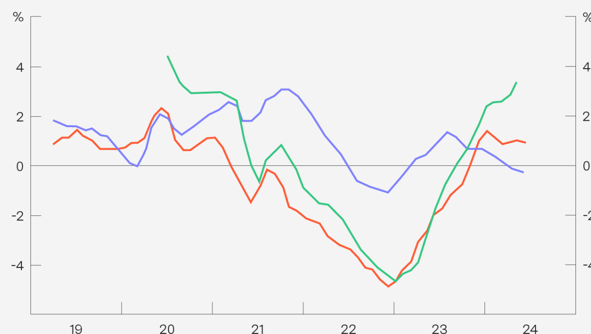
Rest of world growth – Synchronised growth rebound still questionable

By Bashaarit Khan
Portfolio Analyst

- Chinese data continued to indicate weak demand in May, with housing the key drag. Real estate investment will likely remain subdued, with capex expected at levels just sufficient to replace depreciation. This means that the total reduction of real estate investment could be around US$1tn–$1.4tn a year.
- Because of a shrinking working age population and labour force, China's economic growth relies solely on productivity. So far, its economy has managed a 5.3% growth rate despite a 0.4% drop in the labour force. Given the surplus production and lack of domestic demand, inflation and profits are likely to remain subdued.
- The rise in energy prices after Russian energy sanctions led to a severe contraction in European real wages, but this headwind has ended. European natural gas prices are down 90% from their peak, inflation has dropped and the ECB has cut rates. Real wages are rising, while the US is seeing a contraction in real wages. This should support European household confidence and lead to an increase in consumption – but the results of the latest German IFO survey show that sentiment deteriorated slightly in June.
- For now, the synchronised global rebound is still uncertain.

European real wage growth is recovering while US falters

Real wage growth: — US
— UK
— Euro Area



Note: Series shown as 3-month moving averages.

Source: BCA

> "Real estate investment will likely remain subdued, with capex expected at levels just sufficient to replace depreciation. This means that the total reduction of real estate investment could be around US$1tn–$1.4tn a year."

Outlook

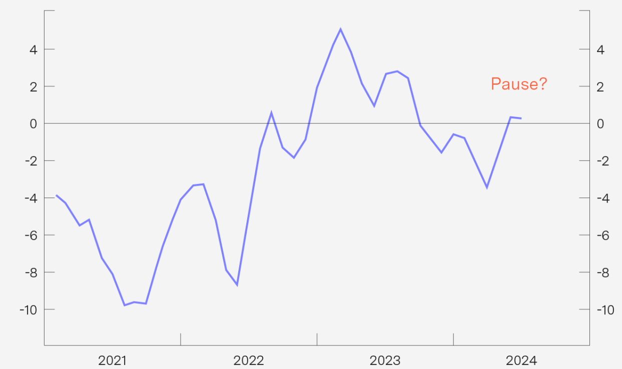
By Iain Anderson
Co-Head: Investments

- Politics is causing more volatility than economics, and geopolitical events will keep macro volatility elevated.
- The French parliamentary elections will take place from 30 June to 7 July. While volatility is expected to remain high, a full-blown EU financial crisis is unlikely. Even if the far-right National Rally wins the election, EU member economic constraints will reduce the impact of their policies (unless they want to leave the EU, which is unlikely at this point).
- The SA economy shrank in the first quarter of 2024, below expectations. Fortunately, after the GNU announcement, the FRA market is pricing in at least one 25bps rate cut from the SARB in September. Sygnia funds upgraded South Africa to neutral on the announcement, which has worked well, with bond yields falling 1%, the rand strengthening by around a rand and equities rallying 6%. Last night, Ramaphosa succeeded in holding the GNU together and announced his new cabinet. To accommodate all 11 GNU parties, the executive has grown to an enormous 32 cabinet members and 43 deputy ministers. The most market-friendly news is that Enoch Godongwana remains Finance Minister, thus ensuring continuity in fiscal prudence and structural reforms; the portfolios focused on policy reform include several improvements. Reforms take time, however, and the fragility and

constant gridlock of coalition governments remains a significant risk. We refrain from going overweight for now.

- In the UK, the opposition Labour Party has limited the number of non-market-friendly policies it can put in place. Tough fiscal constraints have been promised, but this will likely mean a continuation of low growth and poor investment opportunities for overseas investors.
- Chinese growth will likely remain constrained by the property market, which will hold back global trade – and hence emerging markets, Europe and Japan.
- The US FNIB small business uncertainty index has risen back to its highs of the previous Biden–Trump election face-off. As we near November's presidential elections, volatility may impact markets more meaningfully.
- Preliminary purchasing managers' index (PMI) numbers show that the US remained the global economic leader in June, despite signs that the rest of the world was accelerating even as the US slowed. US growth remains resilient, however, and cooling employment will allow the Fed to cut rates when required to stimulate growth. We remain overweight the US but are keeping an eye on inflation, the labour market and US politics.

A pause in ex-US global growth rotation



*Source: S&P Global
**Shown as a 3-month moving average. Source: S&P Global

Source: BCA

Key indicators

		1 mo.	3 mos.	6 mos.	1 yr.	2 yrs.	3 yrs.	5 yrs.	10 yrs.
J203T	**FTSE/JSE All Share Index**	4.1%	8.2%	5.8%	9.1%	14.2%	11.0%	10.6%	8.2%
J200T	**FTSE/JSE Top 40 Index**	3.7%	7.9%	5.5%	7.2%	14.5%	11.1%	10.9%	8.2%
J210T	**FTSE/JSE Resources 10 Index**	-3.7%	3.4%	4.3%	-1.3%	0.8%	3.3%	9.6%	4.8%
J211T	**FTSE/JSE Industrials 25 index**	1.6%	4.8%	5.7%	4.4%	19.5%	9.8%	10.7%	8.3%
J212T	**FTSE/JSE Financials 15 Index**	14.5%	17.1%	8.8%	24.5%	20.0%	18.9%	7.2%	7.5%
J403T	**FTSE/JSE SWIX Index**	4.1%	8.2%	5.8%	9.8%	11.9%	8.8%	8.0%	6.7%
J433T	**FTSE/JSE Capped SWIX Index**	4.2%	8.2%	5.7%	10.0%	11.7%	10.1%	8.7%	6.5%
J303T	**FTSE/JSE CAPI Index**	4.2%	8.2%	5.7%	9.2%	13.6%	11.3%	10.8%	8.2%
J253T	**FTSE/JSE SA Listed Property Index**	6.0%	5.5%	9.6%	26.3%	17.8%	11.7%	0.9%	3.2%
ALBI	**JSE All Bond Composite Index**	5.2%	7.5%	5.6%	13.7%	10.9%	7.6%	7.8%	8.2%
STeFI	**STeFI Index**	0.6%	2.0%	4.1%	8.5%	7.6%	6.4%	6.0%	6.6%
	MSCI World Index in SA rands	-1.0%	-1.0%	11.6%	16.5%	26.2%	16.1%	17.8%	15.3%
	Rand/US dollar exchange rate	-3.0%	-3.6%	-0.2%	-3.3%	5.6%	8.5%	5.3%	5.6%
	Rand/euro exchange rate	-4.3%	-4.3%	-3.1%	-5.0%	6.9%	4.9%	4.1%	3.0%
	Rand/pound exchange rate	-3.7%	-3.5%	-1.0%	-3.9%	7.7%	5.4%	5.2%	2.4%
	Headline CPI	0.2%	1.2%	2.3%	5.2%	5.8%	6.0%	5.0%	5.0%
	PPI	0.1%	1.7%	1.7%	4.6%	6.0%	8.8%	6.8%	6.0%