The Monthly Bulletin

SygniaSygnals

September 2023

We are exceptionally pleased to announce a new feature in Sygnia Sygnals: a monthly economics commentary by Professor Haroon Bhorat, our Independent Non-Executive Chairperson who has recently joined Sygnia's Investment Committee as an Investment Advisor.

Professor Bhorat is an Economics professor at UCT, where he also directs the Development Policy Research Unit. He serves on President Cyril Ramaphosa's Presidential Economic Advisory Panel, playing a critical role in SA's economic development strategy. His extensive research encompasses labour economics, poverty and income distribution. He has co-authored several books and has published over 150 academic articles, books and working papers and was recently appointed to the editorial advisory board of the World Bank Economic Review. Professor Bhorat has a PhD in Economics from Stellenbosch University, has studied at the Massachusetts Institute of Technology and was a research fellow at Cornell University. He is a non-resident Senior Fellow at the Brookings Institution, an Institute of Labor Economics Research Fellow, and an Honorary Research Fellow at the Human Sciences Research Council. His expertise is sought after by international organisations that include the International Labour Organization, the United Nations Development Programme (UNDP) and the World Bank. In terms of his public policy roles, Professor Bhorat is a member of numerous international committees and panels, including the Advisory Board of the UNDP's 2020 Human Development Report and the World Bank's Advisory Board of the Commission on Global Poverty. He is on the advisory board of the Partnership for Economic Policy, the United Nations University's World Institute for Development Economics Research and the International Economics Association. He has advised various SA government departments, including the Department of Labour, the Presidency and the National Treasury. He recently became an advisor to the SA Parliament's High-Level Panel on Acceleration of Change and Transformation and previously advised former Presidents Thabo Mbeki and Kgalema Motlanthe, as well as two past finance ministers. He serves on the boards of two JSE-listed companies: Pick 'n Pay Limited (non-executive director) and Sygnia Limited (chairman).

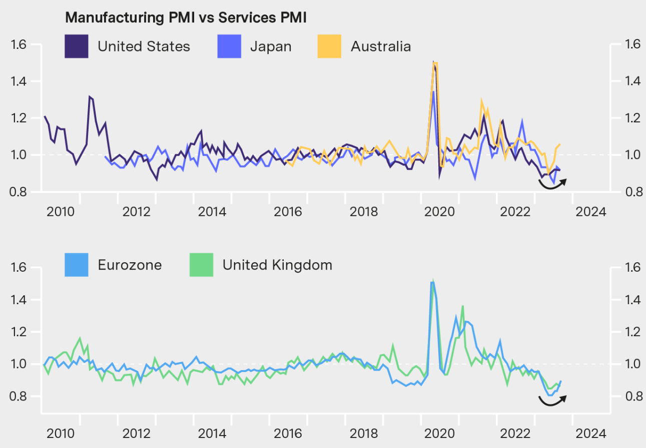
Market review

By Kyle Hulett
Co-Head: Investments

Markets declined by almost 10% in August before recovering slightly. Tensions heightened after Fitch downgraded the US credit rating, driving US real bond yields to their highest level since 2009. These anxieties were exacerbated by China's deflationary challenges and concerns over energy inflation. While China's economic deceleration has helped stabilise commodity prices, European natural gas prices shot up by nearly 40% as a result of potential disruptions in the global supply of liquefied natural gas from Australia. Concurrently, oil prices reached a nine-month peak, further intensifying overarching inflation concerns.

Driven by artificial intelligence demand, input-related stocks saw a significant uptick, with Nvidia surpassing earnings expectations and experiencing further growth. However, it is interesting to observe geopolitical dynamics in the advancing technology space. The recent US executive order to restrict US investments in specific Chinese technology sectors that pose significant national security risks (like semiconductors, quantum computing and AI) will inevitably affect monetary flow patterns. The prevailing sentiment that US-engineered technology should not bolster China's modernisation and global outreach has already caused discernible shifts in capital allocation strategies. Funding in US dollars for venture capital and private equity funds focusing on China plummeted to US$14bn in 2022 from a staggering US$95bn in 2021. The new directive will further reduce these financial flows. The Chinese economy remains of concern. In response to escalating concerns over deflationary pressures and a sagging property market, the People's Bank of China announced cuts to its mortgage rates for the first time since the great financial crisis, but the market believes further stimulus is required. President Xi attended the BRICS summit in Johannesburg, where the membership was expanded from five nations to eleven in an ambitious push to expand global influence. Top oil exporter Saudi Arabia joined the bloc along with Iran, Egypt, Argentina, Ethiopia and the United Arab Emirates. No advancements were made on the Black Sea grain deal, and geopolitical risks may even escalate. The use of naval drones by Ukraine could render the entire Black Sea a no-go zone and significantly compromise Russian naval superiority and energy exports (with China and East Asia hit hardest), leaving the reinstatement of safe passage for grain exports dead in the water.

Chart 1: Economic momentum swinging from services back to manufacturing



Source: BCA

In the US, remarkable consumer endurance has maintained inflation above the 2% mark, prompting the US Federal Reserve (the Fed) to again underscore its commitment to curtailing it. Ex-president Donald Trump was booked on felony charges in Georgia, highlighting the US presidential election risks on the horizon. Stocks historically underperform in election years, particularly if the incumbent president or ruling party loses. While party change is not currently the expected outcome for 2024, a recession could swing it.

Advanced purchasing managers' indices (PMIs) show a slowing global economy. Service sector activity is deteriorating across most major economies, reflecting the economic impact of the aggressive interest rate increases and the unwind of the Covid imbalances. The manufacturing sector is showing some green shoots as spend switches back to a more balanced service/product blend after the covid distortions, but whether it is enough to offset the services slowdown remains to be seen.

US – downgraded but exceptionalism continues

- **Despite multiple indictments, Donald Trump leads Republican polls for 2024; Biden's approval lags.**
- **Fitch downgrades US credit rating; inflation rises but immediate market impact is limited.**

Indicted to the fourth power...
Donald Trump became the first former US president to have a police mugshot, with the picture going viral on social media as Trump posted "Never Surrender". It was the fourth time Trump has been processed as a criminal defendant this year, but he is using the publicity as part of his campaign for the Republican presidential nomination. Polls show him leading his nearest Republican rival for next year's election by as much as 40 percentage points. Trump faces 91 criminal charges across four jurisdictions and will face trial on 4 March, just as the 2024 presidential race heats up. Current data favour the Democrats, but Biden's falling job approval could be a problem if the economy decelerates into the 2024 election.

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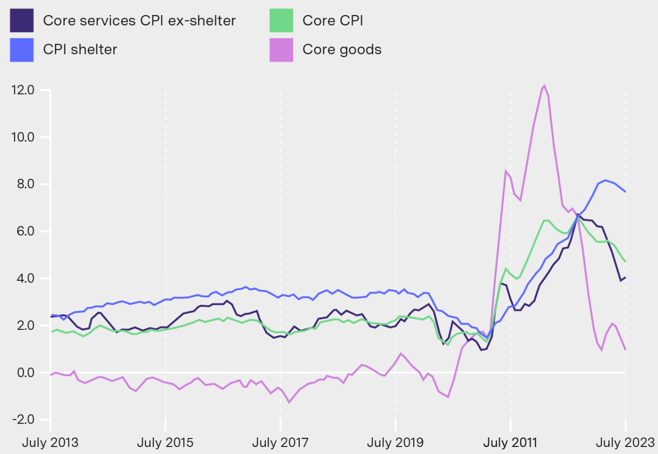
Downgraded...
In a surprise announcement, ratings agency Fitch downgraded its US rating from AAA to AA+. Fitch pointed to an "erosion of governance" and "repeated debt limit stand-offs and last-minute resolutions", as well as the worsening fiscal outlook, with Fitch forecasting the deficit to rise to 6.9% in 2025. Debt as a percentage of GDP is expected to rise to 118.4% in 2025 – 2.5 times that of the AAA median debt/GDP of 39.3%. The decision drew immediate criticism, with Treasury Secretary Janet Yellen calling it "arbitrary" and "outdated" and Harvard University professor Larry Summers describing it as "bizarre and inept". But the downgrade will not force bond investors to sell US Treasuries, as the majority of mandates were changed after the 2011 US downgrade by S&P. Additionally, US government bonds are all dollar-denominated, meaning the risk of a sovereign default is zero. The impact on the bond market will therefore be limited, and inflation will continue to be the main driver of US assets.

Inflation 2.0...
July inflation numbers released in August showed an increase to 3.2%, the first increase after 12 consecutive months of declines. The slight increase from 3% in June was primarily attributable to energy costs. While July's print is manageable at face value, expectations centre higher for the August print. A second inflation wave would echo history, and the last few points approaching the 2% target have proven notoriously hard to achieve. Q3 growth estimates are well above trend, single-family building permits suggest that residential investment has bottomed out, and retail sales are strong. The Fed has made phenomenal progress in cooling inflation from 9.1% to 3% in a year, but its rhetoric is clear that further rate decisions will be driven by inflation outcomes. Records from the Fed's July meeting reveal that most participants still see considerable risks in inflation. This was reaffirmed at the Fed's economic conference in August, where Fed chair Jay Powell indicated that US inflation "remains too high", necessitating the central bank to either hold rates at their current level or raise them. The market expectation of potential interest rate increases and no cuts until at least June 2024 along with the credit downgrade has led to a consistent sell-off in US government bonds, which has taken yields on long-term debt to a 16-year high, with yield on the two-year US Treasury at 5.07%.

While rates are expected to remain higher for longer, further material hikes remain unlikely as other data continue to show a slowdown: S&P joined Moody's in cutting ratings on US banks amid a "tough climate", surplus savings from Covid are running out, new research from the San Francisco Fed confirms a much lower outlook for shelter inflation and China is exporting goods deflation.

Chart 2: CPI, % month-on-month; contribution to CPI, ppt



Source: Standard Chartered

Emerging markets – BRICS expands and growth shows green shoots

- **BRICS expands to 11 members, increasing economic influence but risking tensions.**
- **Emerging markets show early signs of recovery in manufacturing and global demand.**

A ton of BRICS…

The pre-BRICS message was clear: to form an alliance capable of challenging US hegemony and to reaffirm the quasi-multipolar world narrative for the next decade. Little progress was made in establishing a common currency, but proposals were made to incrementally decrease reliance on the US dollar and expand the use of member nation currencies. The summit yielded little tangible progress on the Ukraine conflict, though a fair amount of rhetoric around peace was passed around. BRICS was expanded from five to 11 members, adding several of the globe's largest energy producers and bringing together the developing world's biggest consumers, creating a bloc with outsized economic clout. Expanding BRICS is an attempt to create a more equitable multipolar world, but it could also create tensions between members and with the West, which could instead accelerate the trend towards a dangerous, bipolar world.

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EM rebound vs DM…

The relative performance of emerging markets (EM) against developed markets (DM) is primarily driven by three factors: the dollar, the manufacturing cycle and commodity prices. A strong manufacturing cycle, higher commodity prices and weaker dollar all benefit EMs over DMs. The slowdown in China and the swing from manufacturing back to services after the Covid pandemic have both held EMs back. However, based on the rebound in US capital expenditure intentions and the Swedish manufacturing index, which tends to exhibit more sensitivity to global growth than domestic developments, the global manufacturing cycle is showing early signs that it may improve over the coming months. Taiwan's latest update for July export orders also indicates a slowdown in contraction across its main export partners, suggesting that the DM demand rotation from goods to services is near an end. This could signal a bottom in the global manufacturing cycle, but it is too soon to tell.

South Africa

By Viwe Gqiba
Investment Analyst

- **South Africa balances ties with East and West amid political shakeup aimed at unseating ANC in 2024.**
- **South African economy shows resilience with YoY growth despite power cuts and low consumer confidence.**

A local take on BRICS…

In his opening address, Ramaphosa twice used Xi's term "common prosperity". South Africa is attempting to play global powers off against each other, as the New Development Bank's $3 billion pledge to SA's energy transition supplements the $8.5 billion pot of loans originally secured from France, Germany, the US, UK and EU. President Xi visited Ramaphosa the day before the BRICS summit kicked off. As South Africa seeks to individualise, there is a risk of aligning too much with the East and alienating Western alliances – a difficult and dangerous balance that needs to be maintained.

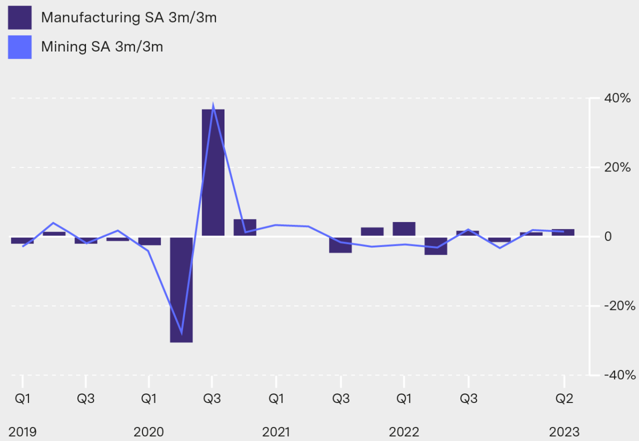
Election risks ticking up…

A coalition of seven political parties agreed on a multi-party charter in August, with the singular goal of dethroning the ANC in 2024 through a coalition government that partners with neither the ANC nor the EFF. The seven parties are the Democratic Alliance, the Inkatha Freedom Party, Freedom Front Plus, ActionSA, the United Independent Movement, the Spectrum National Party and the Independent South African National Civic Organisation. The ANC won 57.5% support in 2019, but some opinion polls have suggested a further dwindling of support. Political risks to the economy are on the horizon. Populist campaigning practices are more likely to take the press headlines as much-needed structural reforms remain stalled. The International Monetary Fund singled out a lack of reforms as a key concern. Public finances remain heavily constrained, and the mobilisation of private capital remains a compelling solution.

Chart 3: EM stocks are driven by the global manufacturing cycle

Source: BCA

Chart 4: Private sector resilience amidst record power cuts



Source: Bloomberg

The economy powers through...

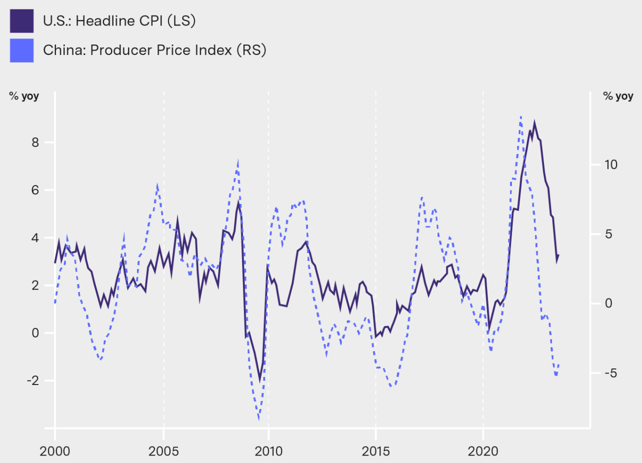
The South African economy may have averted a contraction in the second quarter. June mining and manufacturing output numbers released in August showed a 1.1% year-on-year (YoY) expansion, strongly above expectations, while manufacturing production surged by 5.5% YoY. This remarkable expansion amidst record power cuts suggests supply side stabilisation and speaks to the ability of private business to adapt. The South African Reserve Bank estimates that load shedding alone shaved 3.2% off GDP last year and another 2% in 2023. The 1.9% growth in 2022 is expected to fall close to flat through 2023. However, the consumer remains heavily constrained, as the Q2 FNB/BER Consumer Confidence Index posted its second-lowest reading since 1994. Inflation came in below expectations (July YoY 4.7%; estimate 4.9%) and reduced the likelihood of further rate increases, but the rand remains key to the rate outlook.

Outlook

By Iain Anderson
Co-Head: Investments

The US remains resilient, and a cyclical manufacturing turnaround is possible. Tailwinds augur good news over the coming months, but history suggests that the aggressive monetary tightening of the past year will eventually lead to an economic slowdown. While we expect inflation to remain sticky, it will fall along with growth as excess savings from Covid run out and China continues to export deflation. This is bullish for bonds and the dollar. As the global economy is not out of the woods quite yet, we remain cautiously positioned. Valuations favour non-US markets and currencies, but US markets and the dollar perform best during times of turmoil, even when that turmoil is driven by concerns about US solvency and credit ratings. Before the pullback in August we reduced our EM and China exposure and increased our exposure to the US, which has worked well. While Chinese authorities have announced a cut to existing mortgages for the first time since the global financial crisis, they are showing no signs of panic, so our base case is continued Chinese deflation and low growth. We will keep an eye on volatility and await strong signs of Chinese fiscal stimulus before re-entering the "cheaper" parts of the market.

Chart 5: China is exporting deflation



*USD terms; shows a 3-month moving average
Source: Alpine Macro

Haroon's Opinion

Professor Haroon Bhorat
Investment Committee Advisor

"Rate hikes are unlikely to end for 2023, and much of the conjecture around the peak of the interest rate cycle will depend on both inflation and inflationary expectations in South Africa and, crucially, in the US and Europe. Indications tentatively point to inflation moderation towards the end of 2023, with the possibility of rates dropping in the first half of 2024. Should the US in particular be unable to tame inflation and deal with banking stability issues, it is likely that the downcycle of domestic interest rates will be later in 2024.

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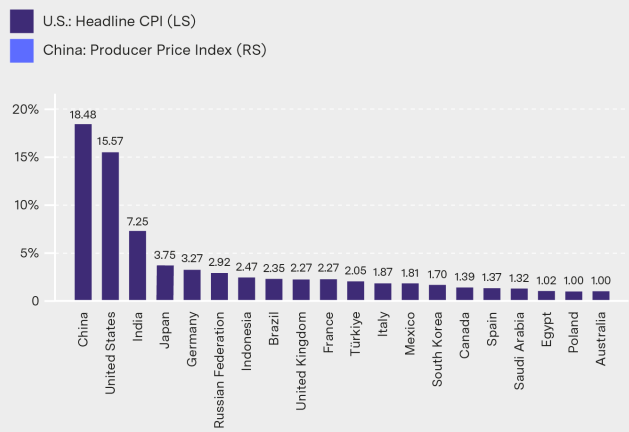
Both World Bank and International Monetary Fund projections indicate a global slowdown for 2023 relative to 2022, with economic growth projected at 2.7%, compared with 3.2% in 2023. However, despite higher growth rates projected for emerging markets (including China) relative to advanced economies, significant economic distress is shaping the emerging market outlook for 2023 and 2024. The key channel remains the very high global interest rate environment and spiking inflation rates in many emerging markets. When combined with record debt levels in emerging markets, these economies are essentially becoming poorer. Specifically, per-capita income growth in about one-third of emerging markets in the world economy will be lower than pre-pandemic levels by the end of 2024. There is a higher probability of financial crises playing themselves out in some key debt- and inflation-stressed emerging markets in the current macroeconomic environment. As the World Bank notes, should these coalesce around a few significant economies "the worst-case scenario would have arrived: the global economy would experience a deep downturn [in 2024]."

Interesting Factoid

Chart 6: The twenty largest economies in the world



GDP based on purchasing power parity (PPP), share of world (percent of world). PPP weights are the individual countries' share of total world GDP at PPP. PPP is a theory that relates changes in the nominal exchange rate between two countries' currencies to changes in those countries' price levels.
Source: IMF (2023)

The data above show that China is the single largest economy in the world when measured as a share of gross domestic product (GDP). Specifically, China contributes 18.5% to global GDP – compared to the USA at about 15.6%. Indeed, four economies alone – China, the USA, India and Japan – account for 45% of the world's GDP. The share of GDP is driven by both population size and GDP itself. Countries with large populations and thriving, productive economies will contribute the most to global GDP, while small economies that are very rich (think Switzerland, Luxembourg) or those with large populations that are poor (Nigeria and Bangladesh, for example) will not be significant contributors to world GDP.

It is crucial to remember that for many global companies, countries beyond high-income countries (such as those in this graphic – e.g. Mexico, Egypt, Indonesia, Turkey and Brazil) remain key target markets for their products and services. By this data, South Africa ranks 33rd out of a total sample of 197 countries. Not to be scoffed at! An interesting set of factoids to conclude: China's share of global GDP has increased by close to 650% since 1982, while that of India has expanded by 150%. Comparatively, the USA and Japan's contributions to world GDP have declined by 27 and 56% respectively. The rise of China and India really does mark a change in the dynamics of the world economy over the last 40 years.

Key indicators

		1 mo.	3 mos.	6 mos.	1 yr.	2 yrs.	3 yrs.	5 yrs.	10 yrs.
J203T	**FTSE/JSE All Share Index**	-4.8%	0.4%	-1.5%	15.8%	10.1%	14.9%	8.9%	9.5%
J200T	**FTSE/JSE Top 40 Index**	-5.6%	-0.6%	-1.5%	18.1%	11.0%	14.8%	9.5%	9.7%
J210T	**FTSE/JSE Resources 10 Index**	-9.6%	-13.9%	-9.8%	-0.2%	-0.8%	7.3%	11.3%	6.0%
J211T	**FTSE/JSE Industrials 25 index**	-5.1%	1.1%	0.5%	26.7%	13.7%	13.5%	8.6%	10.1%
J212T	**FTSE/JSE Financials 15 Index**	-1.8%	18.1%	5.9%	20.6%	13.7%	25.3%	4.6%	8.9%
J403T	**FTSE/JSE SWIX Index**	-4.9%	3.0%	-1.7%	11.3%	6.7%	11.8%	5.8%	8.0%
J433T	**FTSE/JSE Capped SWIX Index**	-4.8%	2.9%	-1.7%	10.9%	7.2%	14.6%	6.2%	7.8%
J303T	**FTSE/JSE CAPI Index**	-4.8%	1.2%	-1.8%	14.5%	9.7%	16.1%	9.0%	9.5%
J253T	**FTSE/JSE SA Listed Property Index**	0.9%	4.2%	0.4%	10.3%	3.2%	17.2%	-3.2%	2.6%
ALBI	**JSE All Bond Composite Index**	-0.2%	6.7%	1.8%	7.5%	4.4%	7.8%	7.7%	7.8%
STeFI	**STeFI Index**	0.7%	2.0%	3.9%	7.2%	5.8%	5.1%	5.8%	6.3%
	MSCI World Index in SA Rands	3.9%	2.2%	14.6%	28.4%	13.4%	12.5%	13.9%	16.2%
	Rand/US Dollar Exchange Rate	6.5%	-4.4%	3.2%	11.1%	14.4%	3.8%	5.2%	6.3%
	Rand/Euro Exchange Rate	4.8%	-2.7%	5.6%	19.9%	9.7%	0.5%	3.8%	4.2%
	Rand/Pound Exchange Rate	4.9%	-2.3%	8.0%	21.0%	9.8%	1.9%	4.7%	4.2%
	Headline CPI	0.9%	1.3%	3.5%	4.7%	6.3%	5.7%	4.9%	5.1%
	PPI	0.2%	0.5%	2.2%	2.7%	10.1%	9.1%	6.8%	6.2%