The Monthly Bulletin

SygniaSygnals

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By Kyle Hulett
Head of Investments

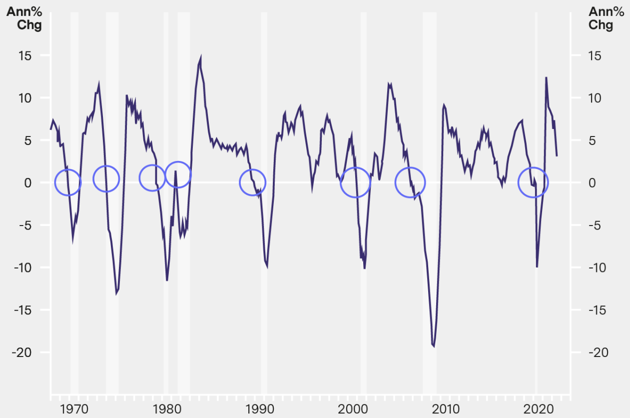
Market review

Global markets sold off sharply in June. The US officially entered bear market territory as the Fed tightened the base rate by 75bps – its biggest hike since 1994. The ensuing sell-off resulted in US markets falling 24% from January peaks and put one topic on every talk show: recession. Fed Chair Jerome Powell's stated aim of 3.4% base rates in the US by year end caused business sentiment to sour. These sentiments were echoed globally as the World Bank again revised its global growth outlook for 2022 down to only 2.9%, down from April's 3.2% estimate and January's 4.1% estimate.

> One major indirect effect of US rates rising faster than before is a stronger dollar.

While risks exist, a soft landing for the US is nonetheless surprisingly plausible. If inflation moderates over the coming 6 to 12 months, the Fed and the yield curve will be in balance. In this context, the lower growth expectations reflected in oil prices are perversely positive for global markets. Some economic indicators suggest plain sailing ahead, and the usual "recession warning" indicators are not flashing red. The yield curve and the US Leading Economic Index (LEI) are positive. The latter historically contracts year-on-year (YoY) in the lead-up to recessions, but its last reading was 3.0% YoY – far from recession-warning territory (Chart 1).

Chart 1: The US leading economic indicator is still positive



Note: Shading denotes NBER-designated Recessions
Source: BCA

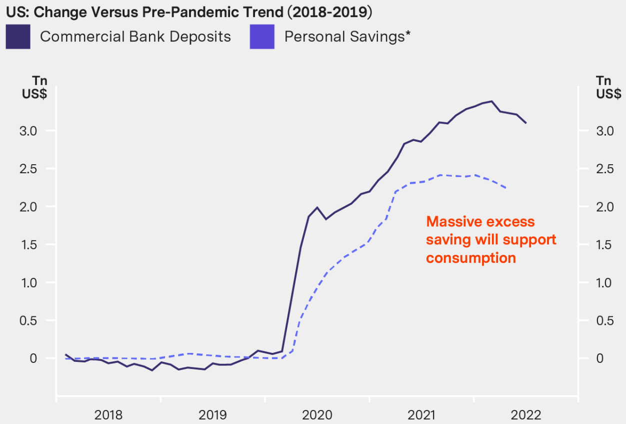
US – High interest rates won't throw the US into a deep recession

- **Rising inflation sparks recession fears.**
- **House prices likely to cool but not crash.**

US inflation surprised to the upside at a historic 8.6%, with Fed Chair Powell responding: "My colleagues and I are acutely focused on returning inflation to our 2% objective." The inflation headwinds pushed the University of Michigan's consumer-sentiment survey down to its lowest reading since 1978.

A recession in the US is unlikely for a couple of reasons. First, core inflation continued to fall, from 6.2% to 6% YoY, as did inflation breadth measures. With mortgage rates increasing by more than 2% so far this year and the shelter sub-index comprising about a third of the core CPI index, a dip in demand for homes is likely to ease inflation conditions. US house prices will cool but not crash, as tepid homebuilding over the last decade has pushed the average age of US residential capital stock to its highest level since 1948, while the homeowner vacancy rate is at an all-time low.

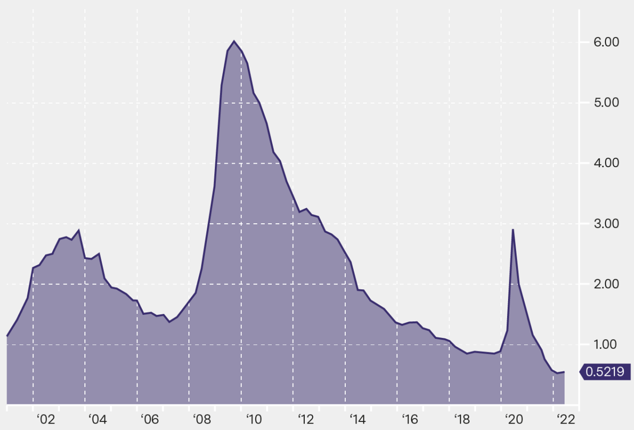
Chart 2: US personal savings and bank deposits will support consumption



*Monthly, not annualized.
Source: BCA

China's reopening should improve global supply chain snarls, and transitory components such as shipping and freight conditions are improving alongside supply in key products like semiconductors and fertilisers. Some commodities may even follow the price of palm oil, which is now actually down after soaring prices encouraged production year to date and additional supply came online from Indonesia and Malaysia. As far as market expectations go, we see the five-year/five-year forward Treasury Inflation-Protected Securities breakeven inflation rate in line with the Fed's 2% core personal consumption expenditures inflation target. As a result of the US consumer's relatively strong footing, the Fed can afford to raise rates faster and harder than its peers. This is partly attributable to generous Covid support but also to appreciating asset prices, with average US household net worth growing 30% since the midst of Covid, compared to only 12% for the EU and UK. Chart 2 shows that excess household savings are now USD2.2 trillion higher than before the pandemic.

Chart 3: Number of unemployed persons per job opening in the US



Source: Bloomberg

These trends are likely amplified by some labour market statistics, particularly the US labour force participation rate, which was last recorded at 62.3% (1.1% below pre-pandemic levels). Wage growth has been most pronounced at the bottom end of income distribution, where higher wages are required to incentivise worker participation. A recovery in the participation rate could allow payrolls to grow alongside unemployment rates. There are currently about two job openings for every unemployed person in the US (compared to one job opening for every unemployed person in the UK) (Chart 3).

Historically, these are extraordinarily elevated levels and could suggest that policy tightening is not likely to lead to a surge in unemployment. US companies also have strong cash balances and low leverage, significantly reducing pressure on retrenchments.

By Chanté Burger
Portfolio Manager

China – "Let 100 flowers bloom"

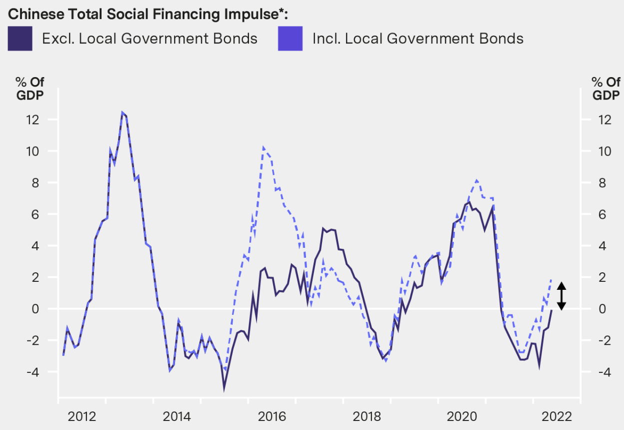
- **Promise of policy shifts to stimulate growth.**
- **Supply chains experiencing fewer disruptions.**

The monetary positioning of the other economic superpower, China, remains in stark contrast to the US. While the US walks a tightrope between inflation and recession, Chinese leaders ushered in yet another era of expansionary rhetoric in June. Over the next business cycle, the Xi Jinping administration has vowed to "let 100 flowers bloom", referencing a set of policy shifts aimed at improving growth in the Chinese technology sector through deregulation. Beijing's issuance of its second batch of gaming licenses after a seven-month freeze seems to be a step towards this promise.

An encouraging month of economic data provided further stock support, with an upside surprise to Chinese credit data in May.

Total new social financing rebounded to RMB2.79 trillion from RMB910 billion in April as bank-extended loans nearly tripled to RMB1.89 trillion. The increased levels of spending were backed by trade expansion, with the Chinese balance of payments enjoying tailwinds of a 16.9% increase in export growth, largely thanks to fewer disruptions across supply chains compared to a year earlier. China's relatively low 2.1% inflation figure came in below expectation and is ideal for the current global setting, paving the way for the Chinese Communist Party to enact a more expansionary monetary and fiscal policy. President Xi Jinping said China would "strengthen macro-policy adjustment and adopt more effective measures to strive to meet the social and economic development targets for 2022 and minimise the impacts of Covid-19." With real interest rates positive in China compared to -5% in the US, capital will flow.

Chart 4: Chinese credit data continue to surprise to the upside



*Excluding Equity Issuance.
Source: BCA

One major indirect effect of US rates rising faster than before is a stronger dollar. While not much of a game changer for the US, it does have some emerging market (EM) analysts thinking twice. A strong dollar impacts EM disproportionately, as international trade is financed primarily in dollars. With current account surpluses instead of deficits, however, EMs are much better positioned to handle a strong dollar this time around. Finally, the high oil price will see petrodollar flows increasingly steered toward EM assets in particular.

South Africa – Outsourcing the state

- **Wheels of justice for corruption turning slowly.**
- **State-owned enterprises failing dismally.**

Corruption dominated South African headlines in June, from President Cyril Ramaphosa's game farm robbery to the pending extradition of the Guptas and the suspension of a key PIC executive. Acting Chief Justice Raymond Zondo's reports remain a key line of attack for the Ramaphosa faction. The final instalment of the inquiry concluded the four-year, R1-billion investigation and recommended the prosecution of scores of high-ranking political officials. The total value looted from state coffers under Zuma's rule is estimated at R500 billion, but implicated individuals remain in senior government posts even as a wave of failing government entities washes over the country. Ramaphosa has asked for four months to review the report, so immediate changes are unlikely.

Despite SA GDP growth of 1.9% for the quarter to end March, the economy remains stuck in its longest downward cycle since WWII. Policy paralysis, weak business sentiment and turbulent socio-economic conditions continue to hamper fixed investment spending, as evidenced by stage six loadshedding for the first time since 2019, on the back of unlawful and unprotected labour action. It is not just Eskom: the latest Green Drop report shows that half of South Africa's sewage treatment works are failing, with more than a third of the country's municipalities in a critical state. The World Economic Forum's recently released Travel and Tourism Development Index placed SA in the bottom half, at 68th out of 117. While SA scored well in important categories (13th in natural resources, 21st in non-leisure resources such as medical travel, 26th in cultural resources), it was ranked 112th in safety and security.

Transnet became the most recent state-owned fiscal monster, with Moody's citing insufficient resources to repay a bond maturing next month and placing the company on review for a downgrade. With the momentum adding up against SA's beleaguered SOEs, it is hoped that Eskom will set an example. The UK, US, Germany, France and the EU are plotting SA's path out of coal-powered loadshedding via an $8.5-billion climate finance deal. As local state-owned entities die a slow, inefficient death, initiatives such as the Just Energy Transition Partnership (JETP) and the Renewable Energy Independent Power Producer Procurement Programme (REIPPPP) show that SA power generation can be diplomatically outsourced.

By Iain Anderson
Head of Investments

Outlook and positioning

June's shifts in economic conditions, particularly around the US inflation vs recession narrative, have driven volatility in global financial markets. The regular Sygnals reader will remember that Sygnia was well aligned with these changes. Generally, we expect volatility to remain heightened, and we continue to find value in more defensive plays such as value, healthcare and self-recovery stories, and we anticipate that this trend will continue as global inflation remains elevated. We continue underweight SA equity in favour of emerging markets and remain neutral developed market equity. In terms of technology, we prefer China over the US, at least until inflation peaks, giving US small-cap tech some breathing room. While the US sways between monetary policy and more intervention, China is lining up a compelling case for the next business cycle's bullishness. We anticipate a rotation in growth from the US to Asia, where government support and a post-Covid dividend is attractive.

Surging energy prices remain a risk. Türkiye has dropped its opposition to Finland's and Sweden's membership in NATO, which could further fan Russian aggression and worsen the situation for Europe. A reduction in Russian gas has left Germany exposed, making them dependent on their European partners. A sustained rise in energy prices could make central bankers nervous enough to push the global economy into a recession, though we think central banks will choose higher inflation over recessions. Of course, this could still lead to recessions, particularly in Europe, which remains very vulnerable in this situation.

Key indicators

		1 mo.	*3 mos.*	*6 mos.*	*1 yr.*	*2 yrs.*	*3 yrs.*	*5 yrs.*	*10 yrs.*
J203T	**FTSE/JSE All Share Index**	-8.0%	-11.7%	-8.3%	4.7%	14.4%	8.2%	8.7%	10.5%
J200T	**FTSE/JSE Top 40 Index**	-8.1%	-11.8%	-8.5%	4.6%	13.4%	8.6%	9.3%	10.7%
J210T	**FTSE/JSE Resources 10 Index**	-17.2%	-21.9%	-7.7%	8.5%	18.0%	15.9%	21.7%	7.3%
J211T	**FTSE/JSE Industrials 25 index**	1.6%	-2.6%	-16.1%	-7.2%	4.3%	5.2%	4.2%	11.7%
J212T	**FTSE/JSE Financials 15 Index**	-13.6%	-15.6%	1.4%	16.9%	24.9%	-0.6%	4.9%	8.9%
J403T	**FTSE/JSE SWIX Index**	-7.4%	-10.6%	-5.5%	2.8%	11.9%	5.6%	5.9%	9.3%
J433T	**FTSE/JSE Capped SWIX Index**	-7.5%	-10.6%	-4.6%	6.9%	16.8%	6.8%	5.9%	9.1%
J303T	**FTSE/JSE CAPI Index**	-7.8%	-11.4%	-7.1%	6.8%	17.2%	9.0%	8.9%	10.6%
J253T	**FTSE/JSE SA Listed Property Index**	-10.3%	-11.6%	-12.7%	0.2%	12.0%	-9.0%	-7.3%	2.7%
ALBI	**JSE All Bond Composite Index**	-3.1%	-3.7%	-1.9%	1.3%	7.3%	5.8%	7.8%	7.2%
STeFI	**STeFI Index**	0.4%	1.2%	2.2%	4.2%	4.1%	5.0%	5.9%	6.1%
	MSCI World Index in SA Rands	-4.0%	-6.0%	-18.4%	-1.7%	6.0%	12.6%	12.7%	17.4%
	Rand/US Dollar Exchange Rate	5.1%	12.1%	2.6%	14.7%	-2.9%	5.2%	4.6%	7.2%
	Rand/Euro Exchange Rate	2.6%	5.3%	-5.6%	1.1%	-6.3%	2.3%	2.8%	5.2%
	Rand/Pound Exchange Rate	1.3%	3.4%	-8.0%	0.9%	-3.7%	3.6%	3.2%	4.5%
	Headline CPI	0.7%	2.3%	3.7%	6.5%	5.8%	4.6%	4.5%	5.1%
	PPI	1.8%	6.2%	9.0%	14.7%	11.0%	7.4%	6.6%	6.1%