October 2021

Sygnals

The Monthly Bulletin by Sygnia

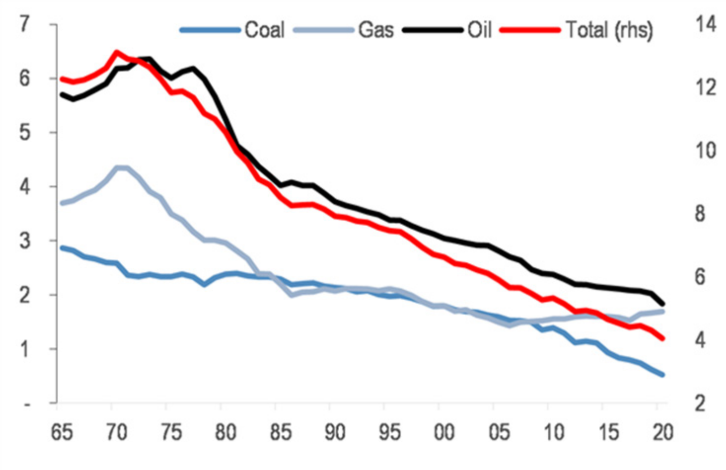
Market review: September correction

The IMF has cut its global growth forecasts and raised inflation forecasts, never a good combination. Supply-chain disruptions and rapidly rising energy costs are providing upside risks to inflation and downside risks to growth. Energy is currently at the centre of the perfect storm. We do not believe that the current price of energy will have a significant negative impact on the economy, but it will cause further volatility. China's electricity consumption is at peak levels due to global demand for goods as Covid restricts services spend. China banned Australian coal imports following a diplomatic fall out, even as flooding and air pollution targets have reduced China's coal production. China has stepped up its purchases of natural gas from Russia, who in turn has taken advantage of Europe's natural gas shortage (due to lower wind-driven electricity and a cold snap in autumn that has seen increased demand for heating) to negotiate the approval of Nord Stream 2, so most of the supply/demand imbalance is short term. The pipeline has gained more prominence as Europe faces a gas-supply crunch that sent prices to record levels last month.

The peak in coal and natural gas prices could reflect the future for oil. Certainly, there is some upside to oil, but coal and natural gas will most likely come down after the pre-winter panic buying. Even if oil rises to $100 a barrel, some rebalancing and rotations will be required, but the global economy will survive. The most likely outcome of the current energy crisis is increased production at higher energy prices, which would stabilise the global economy and energy infrastructure but also temporarily slow down the energy transition. For example, China has instructed 170 coal mines to expand capacity, the US rig count has risen from low levels and solar polysilicon prices have reached their highest level in a decade on the back of Chinese factory shutdowns. Oil supply remains well managed, and US shale is likely to come online and meet demand as it grows.

In addition, work-from-home (WFH) is a new reality, as are electric and hydrogen vehicles. The world is also less energy intensive than it used to be. Natural gas, oil and coal consumption only represent 2% of GDP in the EU – the lowest level since 1999. Similarly, the US generates three times more output for every joule of energy consumed than it did in 1970. While the current energy price surge is painful for many, the effective tax on the overall economy remains manageable, particularly as central banks are likely to look through energy price spikes. Inflation remains key to the global outlook.

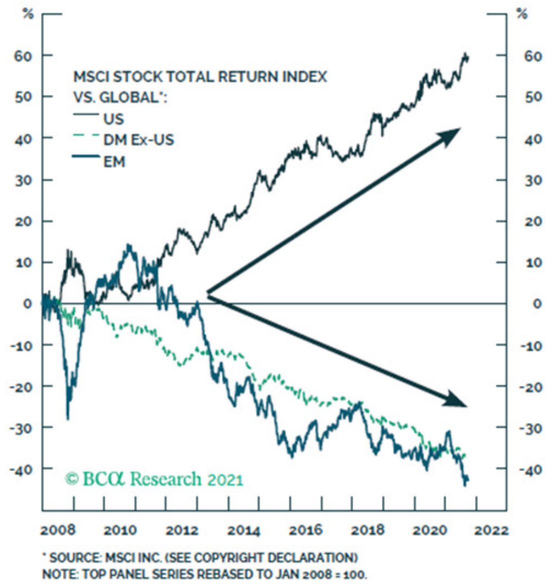
Chart 1: US Energy consumption (in exajoules) divided by USD trillion of real GDP.
Source: JP Morgan



US Freedom Score downgraded

US five-year inflation break-evens are now at their highest in 20 years, at 2.9%, in line with what the Fed is now calling "transitory for longer" inflation, as rising energy prices take over from inflation driven by supply shortages. Peak inflation is behind, even though it may take a while to subside. Goods inflation will ease in 2022, and energy price pressures will abate. Most importantly, the Fed will not panic. Tapering will start this year, but interest rates hikes will not be rushed. The US has been the sole winner in the equity market race of the past decade (Chart 2) on the back of a strong dollar and technology shares. Tesla joined the trillion-dollar club, but its price-to-earnings multiple is nearly ten times its already expensive trillion-dollar peers (Amazon, Apple, Microsoft and Alphabet). We remain concerned about the next decade in the US: over the past 10 years, the US aggregate Freedom in the World score declined by 11 points, from 94 to 83, placing it among the 25 countries that suffered the largest declines in this period. The decline was a result of political corruption, lack of government transparency and punitive immigration policies. According to JP Morgan, equity returns are about 5% p.a. lower over a 10-year period after a country is downgraded than they would be in markets where the country has been upgraded. We remain overweight Europe and Japan.

Chart 2: US a lone star driven by tech and the dollar.
Source: BCA



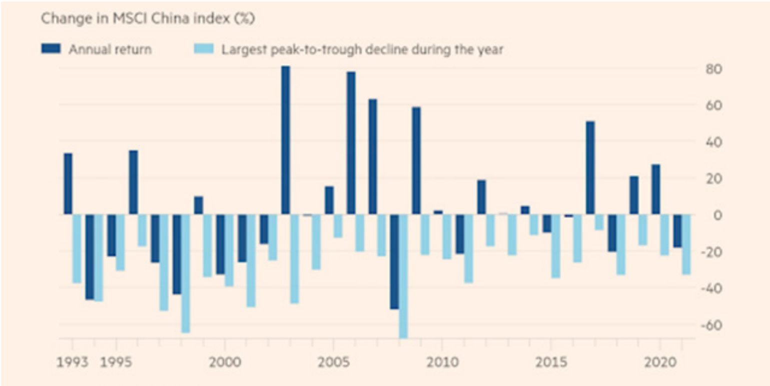
China: Growth slows but volatility is rewarded

China's economy expanded 4.9% in the third quarter, down from 7.9% in the previous quarter, as the property slump and energy crisis impacted demand. Chinese new home prices fell on a month-on-month basis in September for the first time since April 2015. Given that efforts to contain the real estate sector's leverage and home price inflation are structural in nature, Beijing is unlikely to significantly relax the regulatory crackdown. Households in China are highly exposed to property values, with housing representing more than 50% of their total asset values.

While we do not expect a hard landing in China, it will be a soft recovery. Chart 3 shows that high volatility in China's stock market is not unusual, with bear markets happening in most years, so buying into China (and emerging markets) must be timed appropriately. Already, Alibaba Group Holding Ltd's stock has turned from the biggest loser to the top gainer on Hong Kong's stock benchmark and the Hang Seng Properties Index has rallied more than 18% from its more than five-year low in September.

Chart 3: : Bear markets in China happen most years and are not a cause for concern.

Source: FT



South Africa: Unemployment rises to decade highs as Ease of Doing Business drops

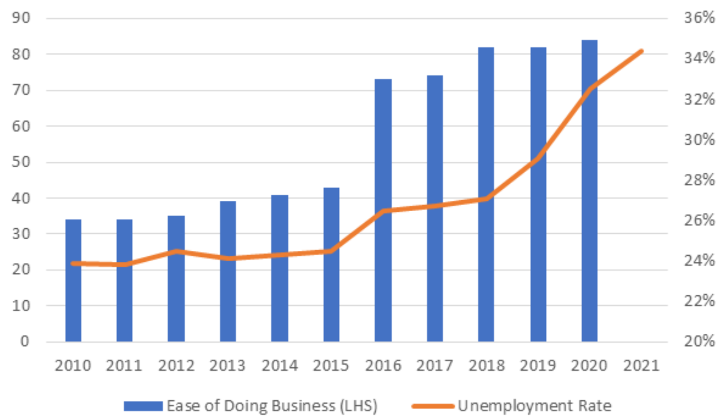
South Africa has dropped to 84th place out of 190 countries, down from 34th place in 2010, in the World Bank's Ease of Doing Business index. This is mostly driven by Eskom's load shedding and Transnet's transport delays. The government unveiled a pipeline of 55 new infrastructure projects valued at about R595 billion that will create an estimated 538 500 employment opportunities. President Cyril Ramaphosa says government recognises that the current policy and legal framework for public infrastructure is not really workable, with many overlapping institutional roles and poor accountability.

In the year ahead, Infrastructure SA is expected to propose amendments to the Infrastructure Development Act, but the proof will again be in the execution, which has been lacking to date. GDP per capita is a proxy for average living standards, and South Africa's has been flat over the last 15 years (in rands, let alone dollars), placing the country second to last after India.

The OECD recommends labour reforms to improve living standards but does expect significant gains in South Africa over the next 40 years. Yesterday's municipal elections will give an indication of how patient voters are when it comes to non-delivery of services.

Chart 4: South Africa's Ease of Doing Business score worsens.

Source: World Bank



Key indicators

		1 mo.	*3 mos.*	*6 mos.*	*1 yr.*	*2 yrs.*	*3 yrs.*	*5 yrs.*	*10 yrs.*
J203T	**FTSE/JSE All Share Index**	5.2%	0.1%	3.3%	36.0%	13.2%	12.6%	9.5%	11.1%
J200T	**FTSE/JSE Top 40 Index**	5.3%	-0.9%	2.1%	33.4%	13.9%	13.4%	10.2%	11.0%
J210T	**FTSE/JSE Resources 10 Index**	8.4%	-6.7%	-3.9%	42.9%	22.7%	20.9%	20.3%	5.8%
J211T	**FTSE/JSE Industrials 25 index**	6.8%	0.1%	2.6%	21.1%	13.8%	13.6%	7.7%	14.0%
J212T	**FTSE/JSE Financials 15 Index**	-3.8%	10.0%	15.3%	53.4%	-2.2%	0.3%	3.9%	10.2%
J403T	**FTSE/JSE SWIX Index**	2.8%	1.7%	1.8%	29.4%	9.7%	9.7%	6.6%	10.4%
J433T	**FTSE/JSE Capped SWIX Index**	2.7%	3.3%	5.8%	39.8%	10.8%	9.1%	6.1%	10.1%
J303T	**FTSE/JSE CAPI Index**	4.9%	0.8%	5.5%	41.8%	14.1%	12.4%	9.4%	11.1%
J253T	**FTSE/JSE SA Listed Property Index**	-1.7%	4.8%	4.6%	65.9%	-10.4%	-6.8%	-6.1%	5.0%
ALBI	**JSE All Bond Composite Index**	-0.5%	-0.9%	4.7%	10.9%	7.9%	9.5%	8.3%	7.9%
STeFI	**STeFI Index**	0.3%	0.9%	1.9%	3.7%	4.8%	5.6%	6.4%	6.2%
	MSCI World Index in SA Rands	6.8%	7.9%	14.0%	31.4%	21.4%	19.3%	18.3%	19.7%
	Rand/US Dollar Exchange Rate	1.0%	3.9%	4.8%	-6.5%	0.3%	1.0%	2.5%	6.7%
	Rand/Euro Exchange Rate	0.9%	1.4%	0.7%	-7.1%	2.2%	1.7%	3.5%	4.8%
	Rand/Pound Exchange Rate	2.7%	2.4%	3.7%	-0.8%	3.2%	3.4%	4.8%	5.0%
	Headline CPI	0.2%	1.7%	2.8%	5.0%	4.0%	4.0%	4.4%	5.0%
	PPI	0.9%	2.4%	4.3%	7.8%	5.2%	4.8%	5.2%	5.3%