

February 2020

Line of THOUGHT

ECONOMIC AND MARKET OVERVIEW

Global

January saw the world's political and business leaders convene in the Swiss town of Davos under the banner of the World Economic Forum (WEF). The theme of the 2020 meeting was "Stakeholders for a Cohesive and Sustainable World", and even attracted US President Donald Trump.

It was not only his opinions expressed at the WEF that made headlines though. President Trump authorized a drone strike near the Baghdad International Airport which targeted and killed Iranian major general Qasem Soleimani of the Islamic Revolutionary Guard Corps. He also signed a trade agreement between the United States and China, and is the subject of an impeachment trial back home. There is no doubt that the run-up to the US Presidential election will contain a lot of fireworks that may drive short-term sentiment in markets.

On a more fundamental level the International Monetary Fund's latest World Economic Outlook (published in January 2020) expects global economic growth to be around 3.3% per annum in 2020 and 2021, respectively. This report was published before the coronavirus outbreak in China and actual growth could end up being somewhat lower if the illness turns into a pandemic.

The growth rate has been revised downward from their October 2019 report and reflects negative surprises to economic activity in a few emerging market economies, notably India, which led to a reassessment of growth prospects over the next two years. In a few cases, this reassessment also reflects the impact of increased social unrest. On the positive side, market sentiment has been boosted by tentative signs that manufacturing activity and global trade are bottoming out, a broad-based shift toward accommodative monetary policy, intermittent favorable news on US-China trade negotiations, and the (at least theoretical) conclusion of Brexit, leading to some retreat from the risk-off environment that had set in a few months ago.

Against this backdrop, a recent report from Macro Research Board Global notes that economic activity is slowly firming, but is not likely to be sufficiently strong as to unnerve government bond markets over the next few months. They expect that a calm bond market, in turn, will be supportive of equity and credit markets, although some markets and sectors are probably becoming too aggressive in terms of discounting the coming upturn in corporate profits. Nevertheless, the macro backdrop is sufficiently positive, and likely to remain so, to suggest that no worse than a digestion phase or mild correction will be necessary to better align equity prices with the slow-moving uptrend in earnings.

The current market cycle (which started in 2009 at the bottom of the Global Financial Crisis) is now the longest on (modern) record. It's important to note, though, that cycles don't die of old age, but of a significant change in economic fundamentals. The latter has not transpired (yet). Add to that that one "should not fight the Fed(eral Reserve Bank)" and global developed markets could continue to be led by market performance in the United States.

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South Africa

The South African Reserve Bank's Monetary Policy Committee's (MPC) first meeting for 2020 brought some relief to the South African consumer when Governor Lesetja Kganyago announced a reduction of 0.25% in the repurchase rate.

This decision was reached in a unanimous vote. Their Quarterly Projection Model (QPM) indicates another rate cut of 0.25% in the fourth quarter of 2020, but many economists are calling for much deeper and earlier cuts in order to kickstart South Africa's ailing economy.

In his statement the governor notes that the outlook for the local economy remains fragile and business confidence remains weak. Inflation is under control by most measures so it should not be a cause for concern when further rate cuts are considered. The MPC assesses the risks to economic growth to be to the downside. Escalation in global trade tensions, geo-political risks, further domestic supply constraints and/or sustained higher oil prices could generate headwinds to growth. They further stated that public sector financing needs have risen, thereby increasing risk premiums and pushing borrowing costs for the broader economy higher. Implementation of prudent macroeconomic policies and structural reforms that lower costs and increase investment, potential growth and job creation, remains urgent.

The headline consumer price index (CPI) increased from a year on year rate of 3.6% in November to 4.0% in December to record the lowest average calendar year inflation since 2005. The somewhat higher inflation was a result of the faster increase in the prices of transport and food. Nevertheless, inflation is expected to increase going into 2020 due to higher food and energy prices. While weak demand should result in a shallow inflation upcycle, key risks are a drought-induced food price increase, higher electricity prices and a weaker rand.

Local economic data releases continue to point to a weak economy that is teetering on the brink of a recession. Whether the economy grew just over or under zero during the last quarter of 2019 will determine whether it is in a technical recession or not. Whatever the outcome, growth is low with an unlikely meaningful recovery in 2020. With much of the bad news seemingly priced into companies with a South African focus, any positive surprise should reward investors exposed to these shares.

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Market Performance

Visio Capital reports that concerns around the impact of the Coronavirus on global economic growth drove investors to safe haven assets such as gold (up 4.2%) and global government bonds (up 1.3%, both in US Dollars) in January. Crude oil had its biggest monthly decline in over a year (-12%) as the extent of the pandemic and its likely influence on economic activity in China and around the globe started to become more apparent. The upside is that the price of fuel in South Africa will again be lower in February.

Domestic equities were out of favour losing 1.7% in the month. The weak rand, however, propped up some index heavy-weights (British American Tobacco up 10.3% and Naspers up 7.4%), helping the All Share Index outperform its emerging market peers and masking some large losses of retail and bank shares. The five largest banks (including Capitec) gave up at least 6% during the month, while Sasol paid the price for the significant reduction in the oil price as its share price declined by a little over 21%.

In the local market nominal bonds were the best performing asset class (up 1.2%), benefiting from the surprise repo rate cut and despite a weak currency, suggesting that investors do not expect the currency depreciation to have a material impact on inflation. This is also evident by another poor month for inflation linked bonds. The Rand gave up all of its 2019 gains (and then some) as it ended the month around 7% weaker.

South African Multi-Asset High Equity Funds delivered an average of 9.2% to investors during the last 12 months with their low equity counterparts delivering 8.5%.

MARKET INDICES ¹	31 January 2020		
(All returns in Rand)	3 months	12 months	5 years
SA equities (JSE All Share Index)	-0.3%	7.1%	5.0%
SA property (S&P SA Reit Index)	-4.8%	-14.7%	-0.1%
SA bonds (SA All Bond Index)	3.3%	8.5%	6.7%
SA cash (STeFI)	1.8%	7.3%	7.2%
Global developed equities (MSCI World Index)	4.9%	33.8%	15.3%
Emerging market equities (MSCI Emerging Market Index)	1.9%	17.8%	10.3%
Global bonds (Bloomberg Barclays Global Aggregate)	0.7%	20.5%	8.0%
Rand/dollar ²	-0.4%	13.0%	5.2%
Rand/sterling	1.4%	13.3%	2.5%
Rand/euro	-1.1%	9.2%	4.8%
Average South African Multi-Asset High Equity Fund	1.3%	9.2%	5.0%
Average South African Multi-Asset Low Equity Fund	1.4%	8.5%	5.9%

1. Source: Factset

2. A negative number means fewer rands are being paid per US dollar, so it implies a strengthening of the rand.

Line of THOUGHT

...being right is much harder than being outrageous

Commentary – Much ado about nothing

“I never think of the future — it comes soon enough.”

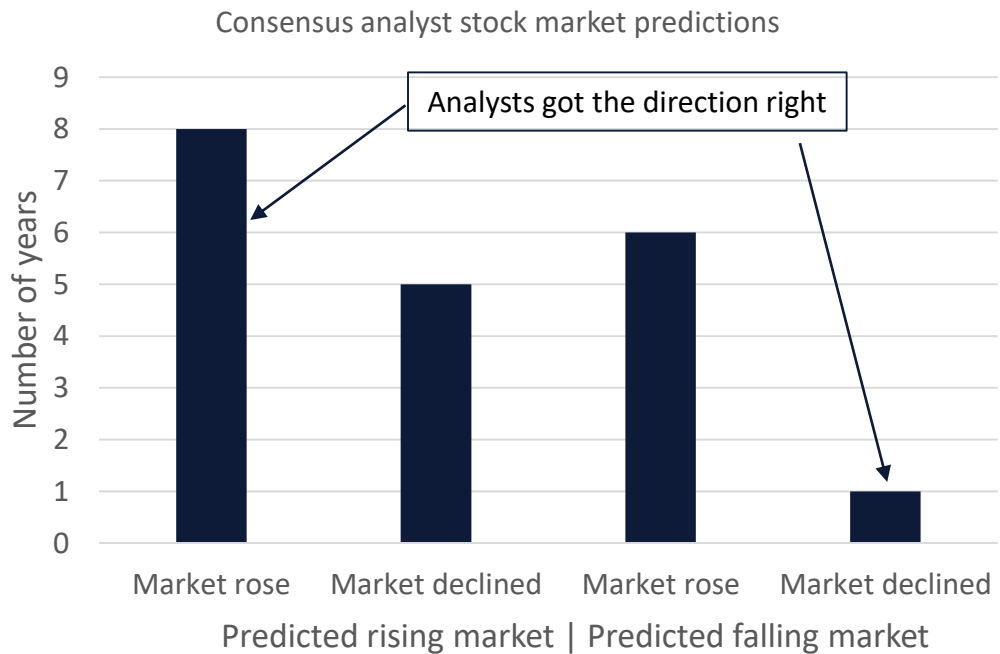
Albert Einstein

It's the start of the year and strategists and economists have announced their forecasts for 2020. Like every year, there'll be plenty of mainstream predictions telling us everything (certainly in South Africa) is going to tick over at the current pedestrian pace. There will, however, be a few that are so outrageous in their optimism or pessimism that they really grab the headlines.

For investors, however, being right matters more than grabbing headlines. And being right is much harder than being outrageous.

In his forthcoming book (7 Mistakes Every Investor Makes (And How to Avoid Them)), Joachim Klement, CFA examines the S&P 500 return forecasts of investment professionals over the last 20 years. In 13 of those years, beginning-of-the-year predictions were off by more than 10 percentage points. Often, they didn't even correctly call the stock market's direction.

The following chart shows how often the annual consensus prediction anticipated the stock market would rise or fall, and the resulting direction it actually went over the next 12 months. Only in nine of the 20 years did the consensus get it right:



Line of THOUGHT

...that there is a simple way to outperform even the consensus forecast of a crowd of experts

*Commentary – Much ado about nothing (continued)
“Forecasts usually tell us more of the forecaster than of the future.”
- Warren Buffett*

This analysis is based on the *consensus* of analyst forecasts. New research by Ritong Qu, Allan Timmermann and Yinchu Zhu shows that the consensus forecast of individual economists beats even that of the most skilled single economist. As a result, investors should rely on the wisdom of the crowd and follow the expert consensus forecast rather than any individual prediction. This is a fairly well known and well published conclusion.

What you probably didn't know, because the research was only published in German and hence never made the headlines in the English-speaking press, is that there is a simple way to outperform even the consensus forecast of a crowd of experts.

Oliver Hein and Markus Spiwoks analyzed more than 150,000 stock market, interest rate, and exchange-rate forecasts compiled by the German ZEW Institute between 1995 and 2004. These forecasts sought to predict six international stock markets and the interest rates in these markets, as well as the major exchange rates, for the next three and 12 months. Here, again, the consensus typically beat almost all individual predictions. But Hein and Spiwoks found that the consensus was more highly correlated with where stock markets and interest rates were at the time of the prediction than the time the prediction aimed to forecast. In a sense, the experts seem to start with the current situation and then try to guess in which direction the markets will move.

The ability of “expert” market forecasters is so poor that investors are better off assuming that nothing will change at all. In fact, predicting that stock markets will be right where they are today a year from now not only tends to be more accurate than even the most skilled individual forecast, but also more accurate than the consensus forecast.

So when it comes to end-of-year forecasts, economists and analysts should avoid making them and investors should avoid listening to them. It's far better to focus on much longer term trends such as equities beating cash hands-down over almost all rolling ten-year periods.

Nevertheless, it is that time of the year. So where will stock markets be at year-end 2020? We're guessing exactly where they are today. Chances are we'll be less wrong than all the other expert forecasts, consensus or otherwise.

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