

January 2020

Line of THOUGHT

ECONOMIC AND MARKET OVERVIEW

Global

Throughout 2019, the global economic backdrop, while seemingly strong, has kept investors on edge. Tantalum Capital attributes this to both the length of the current economic expansion as well as the belief and knowledge that the expansion has been fueled by unsustainably low interest rates amidst rising socio- and geo-political tensions.

Fiscal constraints imposed after the 2008/2009 global financial crisis have systematically been dismantled in many key economies. Labour markets in the United States and Europe showed signs of peak health, levels which usually signal that inflationary wage pressures are imminent. Commodity prices have also continued their rally, which would usually raise the prices of goods and fuel the forecast for consequent cost-push inflation. When coupled with a pending trade war between the two large economic superpowers of the United States and China, where tariff imposition should also inevitably lead to greater goods price inflation, market participants have fretted all year that asset prices could and should reflect more risk. They should also de-rate in line with the deterioration in new growth capacity and a more hawkish policy stance. Despite a briefly inverted US Treasury yield curve mid-year, this did not happen. Investors rather stayed in the trade, supporting the prices of known growth assets (equities in particular) boosting cyclical stocks in many cases and even supporting stuttering economies like South Africa, where attractive yield remains on offer.

In their December market commentary the team from Tantalum argued that economic expansions do not die of old age, but typically end suddenly due to policy mistakes and pent-up imbalances in specific areas of the global economy. In the current cycle the booming, doomed imbalances are not that easily identifiable. The known “suspects” like US housing, sovereign debt in Europe and Japan, and Chinese bank lending appear to have found their own supporters and policy enablers. This merely kicked the economic growth can down the road.

The most significant and pressing other risk to global growth is not of an economic nature, but rather socio- and geo-political in nature, with a rapidly polarizing world order developing. Within countries and across continents global political tension has arguably not been higher since the Cold War. This reality should claim some level of risk discount in asset prices, as the tension can readily manifest itself in fiscal and economic policy missteps and misallocation of capital and spending.

As an alternative to this consensus view TS Lombard, a global macro research house, holds the view that positive surprises could set the scene in 2020. 2019 didn't go the way the consensus expected. After a shock selloff in equities, GDP growth in most economies deteriorated unexpectedly sharply and inflation dipped lower, in contrast to what a hawkish consensus had anticipated. Central banks arguably provided the biggest surprise in 2019, shifting their 'reaction function' in a way few analysts had anticipated. The authorities ditched their traditional inflation models and reacted aggressively in an effort to keep the decade-long global expansion going. The consensus for 2020 is that these efforts will prove successful (sort of), with growth a tiny bit higher, inflation steady and monetary policy on hold. Given the recent ceasefire in the US-China trade war, plus Fed “liquidity” support, TS Lombard argues that market confidence (and asset prices) could bounce more sharply than the consensus expects. The question is whether this improvement in sentiment will also materially boost global growth and lift inflation – this is the scenario nobody seems to be talking about for 2020.

...improvement in sentiment will also materially boost global growth and lift inflation – this is the scenario nobody seems to be talking about for 2020

January 2020

Line of THOUGHT

South Africa

In South Africa, the economic situation remains tense. Renewed power generation problems at Eskom in December stemmed growing optimism over the appointment of their new CEO and the decisive action to deal with the ailing SAA.

Business and consumer confidence has been at such a low ebb for such a long time that the market has been looking for early signs of a turnaround in both Eskom's and the country's fortune. Interestingly, the rand has held firm all year, and rallied even more in December. The price of South African bonds followed suit as yields continued to fall. This provided another indication that the global search for yield remains high, and that the absolute interest rates on offer in rand are attractive versus the entire emerging market and developed market bond universe, despite the negative ratings outlook in place.

In a January 2020 investment note Fairtree Capital observed that South Africa's growth rate has stagnated over the last decade. This structural decline can mostly be explained by a loss in productivity. The economy is in desperate need of both economic and political reforms. During the first fourteen months of President Ramaphosa's term his focus has been on uniting factions within the ruling party (ANC) and strengthening his power base to win the national election held in May last year. He has been successful but one could argue that it has come at the expense of driving a much needed and urgent reform phase. Ramaphosa now holds clear power across most government and provincial structures and his recent actions (placing South African Airways in business rescue status and more recently, PRASA under administration) have been a move in the right direction to demonstrate his willingness to drive reform. Eskom, the country's electricity utility company, remains a significant challenge for South Africa and a clear solution is still not evident. Fairtree reasons that the country is now in a political reform phase with movement being gradual and incremental. What is key is that the President has reinforced instrumental parts of government, namely the revenue services (SARS), the national prosecuting authority (NPA) and South Africa's investigative and intelligence arm (Hawks). Constructively, and in Fairtree's view very positively, President Ramaphosa has achieved much in the early phases of his term in office.

...the country is now in a political reform phase with movement being gradual and incremental

Global equities and bonds recorded their best calendar year performance...

Market Performance

Global markets ended the year strongly as economic data was supportive and trade tensions have eased, according to a recent Visio Capital report. Global equities and bonds recorded their best calendar year performance since 2013 and 2014, respectively. The strong year-on-year performance was driven by easier monetary policy by key central banks and despite slower economic growth in the major economies. Global equities delivered a little over 27% for the year (nearly 24% when measured in rands) while global bonds ended 6.8% higher (measured in USD).

South African equities performed better than global equity markets in December but remained a laggard for the year, underperforming both developed and emerging markets as local economic growth stagnated. Bonds, on the other hand, outperformed their global counterparts (supported by a strengthening rand in December) despite a significant deterioration of the fiscal outlook and a high likelihood of a Moody's rating downgrade in the first half of 2020. Most of the return on local bonds came from its high running yield. Of the 10.3% that SA bonds returned only 0.9% was a result of capital appreciation and the balance (9.4%) from yield. Property stocks continued to underperform the broad South African equity market – the South African Listed Property Index added only 1.9% for the year.

Multi-asset portfolios enjoyed a much better year as high equity portfolios (on average) delivered 9.8% to investors, at least 5% ahead of the annual inflation number. The mean conservative (low equity) portfolio ended the 12 months to end December 8.8% higher (net of fees). In both instances the returns on these type of portfolios beat the performance of cash as measured by the Short-Term Fixed Interest (STeFI) Composite index which gained 7.3% for the year.

MARKET INDICES ¹ (All returns in Rand)	31 December 2019		
	3 months	12 months	5 years
SA equities (JSE All Share Index)	4.6%	12.0%	6.0%
SA property (S&P SA Reit Index)	0.7%	-2.2%	2.4%
SA bonds (SA All Bond Index)	1.7%	10.3%	7.7%
SA cash (STeFI)	1.7%	7.3%	7.2%
Global developed equities (MSCI World Index)	0.2%	24.8%	13.6%
Emerging market equities (MSCI Emerging Market Index)	3.2%	15.6%	10.1%
Global bonds (Bloomberg Barclays Global Aggregate)	-7.3%	3.9%	6.3%
Rand/dollar ²	-7.8%	-2.8%	3.9%
Rand/sterling	-0.9%	1.1%	0.5%
Rand/euro	-5.0%	-4.5%	2.3%
Average South African Multi-Asset High Equity Fund	2.5%	9.8%	5.0%
Average South African Multi-Asset Low Equity Fund	1.5%	8.8%	6.1%

1. Source: Factset

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

*...artificial
intelligence...
reckons Mr.
Trump will
lose*

Commentary – What lies ahead in 2020?

Twenty-twenty has a lovely ring to it. Not only is it the start of a new decade, but it's also a symbol of perfect vision. According to the Chinese zodiac (which has a cycle of 12 years) this is the year of the rat – the traditional start of the cycle. The last time this rodent featured in was in 2008 and South Africans will be excused for associating it with the smell of one too. Given that we're a diverse and hardy nation who subscribes to #ImStaying (depending on how much rest you got over the holiday season...), let's put that smell behind us and envisage the year ahead. According to the Economist¹ there are (at least) a dozen highlights to look out for in 2020. Just remember that economists are no better than weather forecasters at getting it right...

1. **It's judgment time.**

That is doubly true for President Donald Trump: first in Congress with the Democrats' drive to remove him from office (the Republican controlled Senate will save him), then in a febrile election in November. It will be ugly; the artificial intelligence we consulted reckons Mr. Trump will lose. Britain's reckoning with Brexit will leave the country divided, damaged and diminished.

2. **Economies wrestle with negativity**

Banks, especially in Europe, will battle with negative interest rates. America will flirt with recession – but don't be surprised if disaster fails to strike, and markets revive.

3. **China highlights positivity**

It will claim to have met its target of achieving "moderate prosperity" by 2020. Other countries will have to work out how to position themselves, in trade and technology, between a Chinese sphere of influence and an American one.

4. **Sport has a jumbo year**

The Tokyo Olympics will draw a huge global audience. The Euro 2020 football championship will be spread across 12 countries. Cricket hopes for a smashing success in Australia with the T20 World Cup – and in England and Wales with a new, even shorter format called The Hundred.

5. **Worries about nuclear weapons proliferate**

The five-yearly review of the Nuclear Non-Proliferation Treaty will be a fraught affair, 75 years after the bombing of Hiroshima and Nagasaki. Fears of a new arms race will grow as nuclear arms-control agreements fray.

6. **Sustainability is all the rage**

At least, talking about it is. In Kunming countries will discuss biodiversity. In Glasgow they will make pledges on carbon emissions. Business leaders will vow to support sustainable capitalism – as long as shareholders let them.

7. **The Gulf welcomes the world**

Dubai hopes its World Expo will have a lasting impact. More awkwardly, Saudi Arabia hosts the G20 summit.

January 2020

Line of THOUGHT

...It's
also... **50**
years since
the Beatles
broke up

Commentary – What lies ahead in 2020? (continued)

8. **Multiple missions head to Mars**
America, Europe, China and the UAE all send probes.
9. **Technology has both highs and lows.**
The highs include flying taxis, electric supercars and personalised medicine; the lows involve tech giants bracing themselves for more regulation, taxation and critical scrutiny. Instagram will find itself in the spotlight of controversy in this American-election cycle.
10. **Big anniversaries resonate, especially Beethoven's 250th.**
It's also 500 years since Raphael's death, 400 since the Mayflower sailed to America, 300 since the South Sea Bubble burst, 200 since the birth of Florence Nightingale (the World Health Organisation has designated 2020 the Year of the Nurse), 100 since Prohibition, 75 since the founding of the United Nations and - while their fans gently weep – 50 years since the Beatles broke up.
11. **A torrent of entertainment comes on stream.**
Television's streaming wars intensify, and streaming opens new vistas for gamers too. But James Bond fans will head to old-fashioned cinemas for the 25th film in the franchise. And a grand new national museum in Cairo will show that physical presence still matters.
12. **It's the decade of...the "yold", or the young old, as sprightly baby-boomers hit 65.**
For the first time, the world will have more people aged over 30 than under. The 2020s promise to be a bad decade for African dynasties, a disruptive one for countries facing separatist pressures and an exciting one for plant geneticists, who in ten years' time aim to be drawing down carbon dioxide from the atmosphere at a global scale.

There are many uncertainties that lie ahead, but what is beyond doubt is that 2020 will be an interesting year. Buckle up – time waits for no one.

The information and opinions contained in this document are recorded and expressed in good faith and in reliance on sources believed to be credible. No representation, warranty, undertaking or guarantee of whatever nature is given on the accuracy and/or completeness of such information or the correctness of such opinions. Analytics will have no liability of whatever nature and however arising in respect of any claim, damages, loss or expenses suffered directly or indirectly by the investor acting on the information contained in this document. Furthermore, due to the fact that Analytics does not act as your financial advisor, we have not conducted a financial needs analysis and will rely on the needs analysis conducted by your financial advisor. We recommend that you take particular care to consider whether any information contained in this document is appropriate given your objectives, financial situation and particular needs in view of the fact that there may be limitations on the appropriateness of the advice provided. No guarantee of investment performance or capital protection should be inferred from any of the information contained in this document. Portfolio Analytics (Pty) Ltd and Portfolio Analytics Consulting are authorised financial services providers. Analytics (Pty) Ltd is an Authorised Financial Services Provider. FSP No. 631