The Monthly Bulletin

SygniaSygnals

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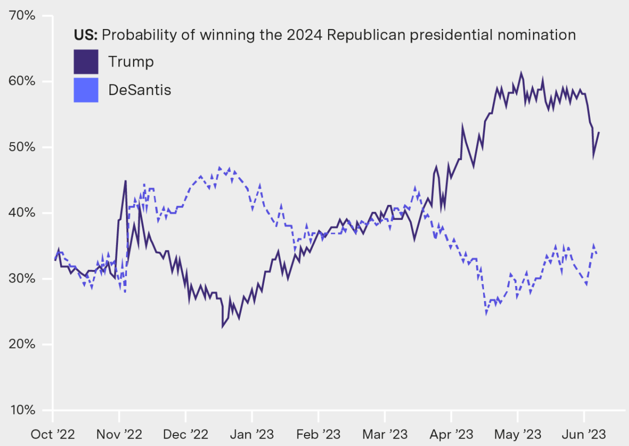
By Kyle Hulett
Head of Investments

Market review

Markets performed well in June, buoyed by the raising of the US debt ceiling, falling energy prices and resilient economic growth. However, this resilience will lead to higher inflation for longer and a longer pause in interest rate hikes by the Federal Reserve (the Fed). It is therefore important to focus on what global policymakers do, rather than on what they say. The Fed maintained a hawkish tone but did not raise rates in June. On the other side of the world, China's official policy of prioritising economic growth was reflected in yet another rate cut and further fiscal stimulus, causing the market to rally briefly. However, the market is not yet convinced there is sufficient stimulus to promote robust reflation.

While global energy prices have fallen, the current Ukrainian counteroffensive unfortunately aggravates geopolitical risk. If significant territorial shifts occur and Russia loses major ground, Russia may intensify its military pressure and further cut commodity exports; the Wagner group’s brief push towards Moscow increased this risk. While the push was abruptly halted, it has exposed deep flaws in Putin’s regime, calling his invasion of Ukraine into doubt and weakening his authority over the Russian state.

Chart 1: Trump remains the Republican favourite



Source: BCA

Meanwhile, risks between the US and China are “stabilising” but could escalate again as next year’s US presidential elections draw nearer. Despite facing multiple legal troubles, former President Donald Trump continues to dominate the political landscape. Trump enjoys a unique advantage in the Republican Party due to his strong personal following. If the GOP were to nominate another candidate, Trump could run as a third-party candidate and split the Republican vote, effectively handing the election to the Democrats.

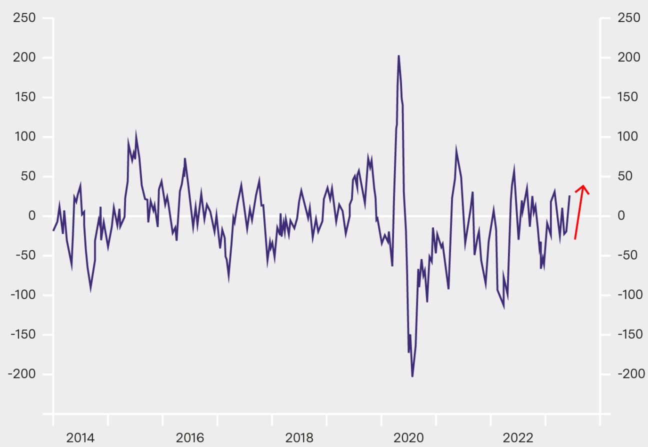
As a result, it is likely that the Republican Party will stick with Trump until he is either exonerated or convicted. For now, Trump leads the pack for the Republican nomination, with Florida Governor Ron DeSantis a distant second.

Japan – a bright outlook with strong monetary stimulus

- **Japan's economic future looks bright due to the Bank of Japan's robust monetary stimuli.**
- **There is potential for a revaluation in Japanese equities, leading to higher economic growth, corporate earnings and valuations compared to other developed markets.**

The Bank of Japan kept its policy rate untouched at -0.1% and made no changes to its yield curve control program. While there has been a pickup in economic activity, inflation has eased. Economic surprises are stronger in Japan than in the G10. We are bullish on Japan and believe that Japanese equities offer attractive value. Like China, Japan is reopening from lockdowns later than other developed markets, suggesting there is still room for growth normalisation. In addition, the normalising inflation will boost real wages, asset values and pricing power. The yen is weak and likely to strengthen, and Japanese equities are trading at a significant discount to their global peers. More importantly, there are a number of catalysts for rerating in Japanese equities.

Chart 2: Strong economic surprises in Japan relative to the G10



Source: BCA

The Tokyo Stock Exchange has announced several reforms aimed at improving corporate governance and shareholder returns. Japanese companies are also taking action to improve shareholder returns, with a third of Japanese companies with stocks trading below book value announcing measures to narrow their discounts in the market.

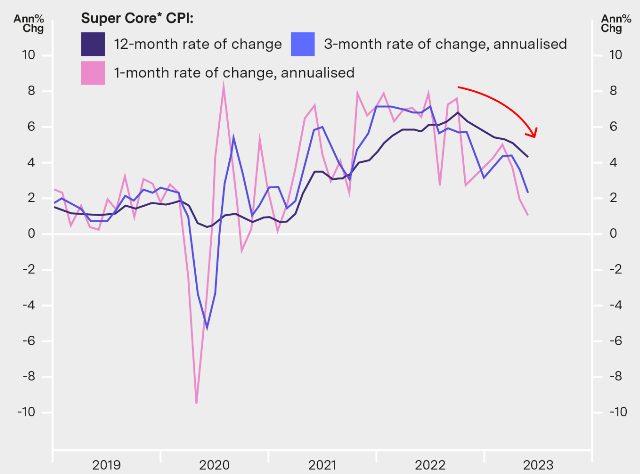
Japan is also benefitting from various government-led structural reforms aimed at making Japan a more attractive place to do business. Overall this could lead to higher Japanese economic growth, corporate earnings and valuations relative to other developed markets.

US – Fed pauses as soft landing in place

- **Indicators suggest a slowdown despite US economic resilience, with jobless claims at their highest since October 2021.**
- **Amid economic uncertainties and expectations of decreased inflation, there is a likely rotation from AI stocks to sectors more sensitive to economic growth.**

The US economy has proven to be more resilient than expected, but leading economic indicators still point to a slowdown ahead. Monetary policy is already restrictive and employment is weakening, with jobless claims surging to their highest level since October 2021. The US consumer price index for May also came in lower than expected. However, core inflation rose to its highest level since August 2008, driven by Shelter and Used Vehicle prices, both of which are expected to fall dramatically in the coming months.

Chart 3: US super core inflation is rolling over



Excludes Food, Energy, Shelter and Used Vehicles.
Source: BCA

This allowed the Fed to pause for the first time in ten meetings, but as expected they maintained their hawkish tone and raised the dot plot to forecast another two hikes this year. Fed Chair Jerome Powell refrained from commenting on whether a hike would come as soon as the July Federal Open Market Committee meeting, however, and emphasised that it would be a “live meeting”.

US stock market breadth remains very low, and we expect it to rotate out of AI stocks into more economic growth-sensitive sectors as concerns of a US recession recede. AI stocks have been outperforming the market year to date but are vulnerable to a short-term reversal.

By Marius Kuyler
Investment Analyst

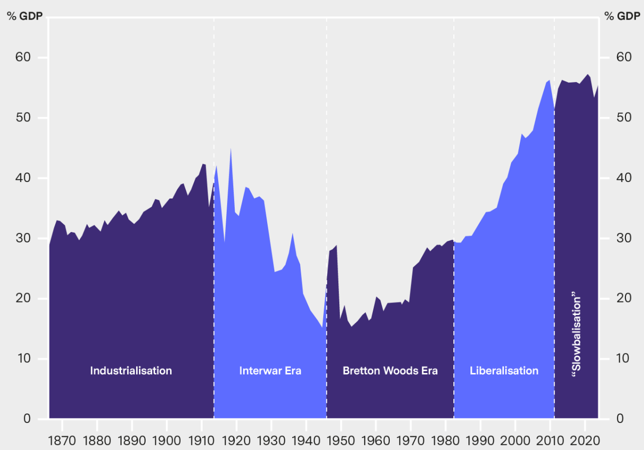
Emerging markets – the rise of the Global South

- **The global economy is witnessing a new era of globalisation, with China as a central player and countries like India, Indonesia and Brazil able to capitalise by maintaining strategic independence from China.**
- **The unipolar world dominated by the US has given rise to multipolar phenomena caused by shifts in global alliances.**

> “Countries are tired of the dollar being weaponised by the United States and are looking for – and finding – alternatives. The great splintering of global trade is underway, and countries that can play both sides will benefit.”

Global trade is not falling, it has simply moved South: Huawei phones are popular across Africa, and Chinese brands are displacing Peugeot and Ford in Latin America. Not only is trade shifting, but it is moving away from dollar pricing: Saudi Arabia and China have set up a joint oil futures exchange, bypassing the New York Mercantile Exchange; Brazil and China have agreed to settle trade in their local currencies; India and Malaysia have signed an agreement to use the rupee in cross-border business; and even France, a US ally, is starting to use the yuan. China and France signed cooperation agreements on aviation, space research and nuclear power. Countries are tired of the dollar being weaponised by the United States and are looking for – and finding – alternatives. The great splintering of global trade is underway, and countries that can play both sides will benefit.

Chart 4: Globalisation remains high by historical standards



*Sum of exports and imports as percent of GDP; Sample composition changes over time
Source: Alpine Macro

India, Indonesia and Brazil are well-positioned to do so, as they can tap into the growth of the Global South while maintaining strategic independence from China. This is a new era of globalisation, of Southern trade with China at its centre.

The “death of globalisation” and the “death of dollarisation” are similarly exaggerated, as both processes will be slow, steady and complex. Cold War 2.0 will significantly diverge from the past to the extent that Russia and China are different animals. From 1945 to 1989 the world grew increasingly polarised as the People’s Republic of China and the Soviet Union split due to doctrinal divergences. China normalised relations with America through reforms under Mao Zedong in the 1970s and through its embrace of the US’ globalisation, and the period from 1989 to 2008 represented a unipolar world of US hegemony. However, the current era has ushered in a quasi-multipolar world, in which alliances are nuanced and complex. US excellence is hard to oppose and likely to persist.

No single country can truly rival US strategic positioning, but alliances like BRICS, while unfit to dethrone the US, can make it bleed. A slight loss of grip on power courtesy of China, coupled with domestic political disunity, has made the US vulnerable to intermittent challenges. Emerging markets are individualising, and in a quasi-multipolar world alliances like BRICS are powerful enough to drive their own ideologies and organisations and can intermittently flourish during times of US disunity. In a divided US, foreign policy (on almost everything except China) suffers whiplash each time the party in power changes. A Trump presidency would likely result in less military support for Ukraine and could push Zelensky to the negotiation table. Regardless, the tailwinds for multipolar phenomena remain strong, and the outcome of more distributed power would make countries like Indonesia, South Africa, Turkey and Saudi Arabia swing states. However if any of these countries aligns too closely with China or the US, they could lose out entirely. A delicate geopolitical balancing act is in play.

SA – hanging in there, but NHI poses new risk

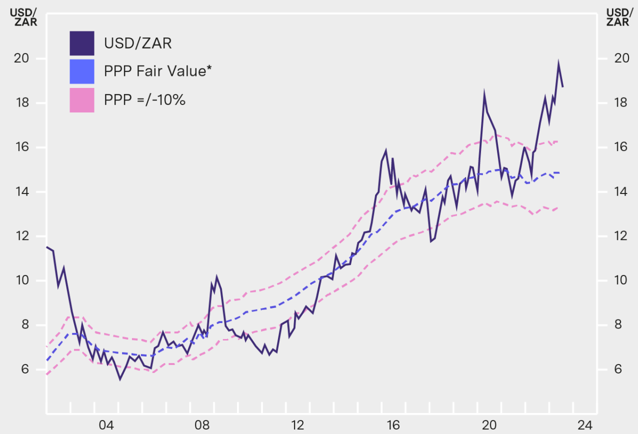
- **South Africa is facing a complex economic landscape, with both positive growth indicators and mounting pressure from the US and IMF.**
- **The recently passed National Health Insurance bill, intended to establish universal healthcare, introduces the new risk of a state healthcare monopoly.**

The rand was aided by some much-needed positive economic news last month. The economy grew more than expected in the first quarter of 2023 and the current account deficit also improved, while manufacturing output rose by 3.4% on an annual basis in April. Inflation rose less than expected, to 6.3%. In addition, government is trying to backtrack on some of the mistakes of last month that saw the currency slip into freefall. Unfortunately, South Africa still faces pressure from the US to move the upcoming African Growth and Opportunity Act (AGOA) summit away from, and it is at risk of losing its AGOA status altogether. The International Monetary Fund (IMF) has warned that South Africa needs to reform its state-owned enterprises to achieve energy security, create jobs and reduce poverty and inequality. The IMF has also said that private investment is held back by low levels of competition, high labour costs, infrastructure deficiencies and an unfavourable business environment.

But just as the IMF said we need more private investment, a new risk arose. Parliament passed the “revolutionary” National Health Insurance (NHI) bill, paving the way for universal healthcare. While the intention is noble, execution is key. In its current form, blended funding is not an option, meaning the NHI will basically turn healthcare into a state monopoly – precisely the issue that led to state capture and load shedding. Health Minister Joe Phaala has confirmed that the NHI will be implemented in stages over the next three to four years. Professor Benjamin Smart of the University of Johannesburg says that success is hard to achieve even in a country with high GDP growth, low unemployment and a trustworthy government – the UK’s National Health Service, for example, has a waiting list of over 7 million people.

Prof. Smart believes the NHI will drive doctors and taxpayers abroad and worsen the situation. The South African Medical association has rejected the NHI Bill in its current form. Chairperson Dr Mvuyisi Mzukwa said that the “NHI Bill in its current form sets up the healthcare system for failure at the expense of further deterioration of the health and wellbeing of all who live in the country." Trade union Solidarity similarly believes that government is incapable of managing the governance, infrastructure and staff shortages of the current healthcare system. Business Leadership South Africa CEO Busi Mavuso said the government is ignoring the successful public-private partnerships that developed during the Covid-19 pandemic. Mavuso pointed to the Affordable Care Act (Obamacare) in the US as a viable alternative to NHI.

Chart 5: The rand appreciated over the month from very cheap levels



*BCA purchasing power parity model based on relative price rations of adjusted CPI baskets.
Source: BCA

Peter Attard Montalto, managing director at Intellidex, estimates that the NHI would cost the country as much as R460 billion a year, but a Money Bill – the financing plan, which must come from National Treasury – has yet to be published. Solidarity is taking the fight to the constitutional court, so legal challenges may stall the process until the bill can be modified to become more workable and open to a blended funding method.

As the Department of Health set the scene for NHI implementation, the high court in Pretoria rescinded Acting Judge Thembi Bokako’s judgement of June last year that found that the "certificate of needs” is not constitutional. The certificate of need provisions in the National Health Act apply to facilities ranging from JSE-listed hospital groups to single GP practices.

This means that individuals and companies would have to apply for permission to set up a location – and worse, the certificate is only valid for five years providing no long-term certainty for investment. The new finding is likely to deter new healthcare professionals from entering the industry.

The rand remains exceptionally cheap, but risk in South Africa remains high, particularly as elections approach.

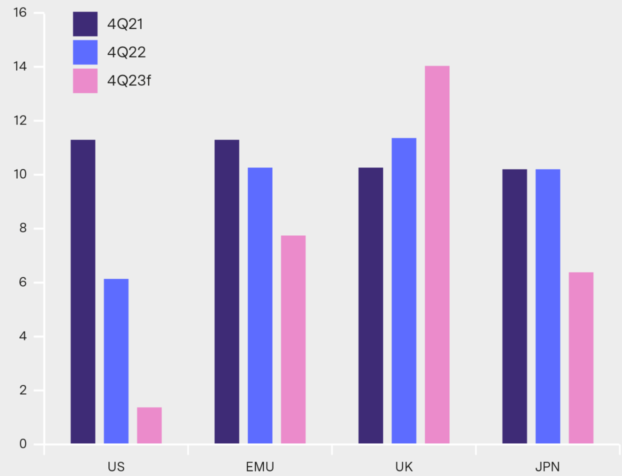
By Iain Anderson
Head of Investments

Outlook

Investor sentiment has surged to its highest level since late 2021, as evidenced by the CNN risk appetite indicator, which is sitting in extreme-greed territory. This suggests that equities are due for a correction, but a deep correction is not expected. The short-term outlook is dominated by two risks: China's policy support and the Fed's rhetoric on inflation. Further negative news on either of these fronts could be a catalyst for a pullback in equity markets. However, there are reasons to believe that should a US recession occur, it will be a shallow one. First, there are no major imbalances or debt build-ups in corporates or individuals. Second, high cash balances have put a floor under household wealth. Third, the US regional banking system remains contained. Fourth, inflation is continuing to fall.

BCA estimate that with inflation below 4%, real earnings will turn positive and a US earnings rebound in 2H is likely. And in China, small steps are already being made to increase policy support. Absent a major escalation in geopolitical risk in the Ukraine or elsewhere, earnings should continue to grow this year, supporting equities. However, the lagged impacts of higher interest rates could take their toll next year.

Chart 6: Excess household saving, G4



Source: JPMorgan

Key indicators

		1 mo.	*3 mos.*	*6 mos.*	*1 yr.*	*2 yrs.*	*3 yrs.*	*5 yrs.*	*10 yrs.*
J203T	**FTSE/JSE All Share Index**	1.4%	0.7%	5.9%	19.6%	11.9%	16.1%	9.6%	10.3%
J200T	**FTSE/JSE Top 40 Index**	1.1%	0.9%	7.2%	22.2%	13.1%	16.3%	10.3%	10.8%
J210T	**FTSE/JSE Resources 10 Index**	-8.2%	-6.4%	-10.5%	2.9%	5.7%	12.8%	13.7%	8.4%
J211T	**FTSE/JSE Industrials 25 index**	3.7%	3.7%	18.7%	36.8%	12.7%	14.1%	9.1%	11.0%
J212T	**FTSE/JSE Financials 15 Index**	11.4%	6.0%	6.4%	15.6%	16.2%	21.7%	4.7%	8.4%
J403T	**FTSE/JSE SWIX Index**	4.0%	1.2%	3.9%	14.0%	8.3%	12.6%	6.3%	8.7%
J433T	**FTSE/JSE Capped SWIX Index**	3.8%	1.2%	3.6%	13.5%	10.2%	15.7%	6.9%	8.5%
J303T	**FTSE/JSE CAPI Index**	2.1%	0.6%	4.9%	18.1%	12.3%	17.5%	9.9%	10.3%
J253T	**FTSE/JSE SA Listed Property Index**	0.9%	0.7%	-4.4%	10.0%	5.0%	11.3%	-3.5%	1.5%
ALBI	**JSE All Bond Composite Index**	4.6%	-1.5%	1.8%	8.2%	4.7%	7.6%	7.4%	7.4%
STeFI	**STeFI Index**	0.6%	1.9%	3.7%	6.7%	5.4%	4.9%	5.8%	6.2%
	MSCI World Index in SA Rands	1.1%	13.7%	27.8%	36.7%	15.9%	15.3%	16.3%	16.8%
	Rand/US Dollar Exchange Rate	-4.7%	6.5%	11.0%	15.3%	15.0%	2.8%	6.6%	6.7%
	Rand/Euro Exchange Rate	-2.4%	6.9%	13.5%	20.3%	10.3%	1.8%	5.2%	4.8%
	Rand/Pound Exchange Rate	-2.2%	9.5%	17.3%	20.7%	10.3%	3.8%	5.8%	4.8%
	Headline CPI	0.2%	1.6%	2.6%	6.3%	6.4%	6.0%	4.9%	5.2%
	PPI	0.6%	1.6%	1.7%	7.3%	11.0%	9.8%	7.1%	6.4%