OVERBERG MARKET REPORT

Monday 15th April 2019

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- There are many things that are wrong in South Africa. The media typically covers bad news and ignores good news. Bad news sells, unfortunately. But there are also many things that are right in South Africa. There are smart investors who had the vision to see that South Africa has lots to offer. We look at four investors from abroad who could have invested anywhere in the world, yet they saw potential in SA.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- Business confidence for March 2019, as measured by the South African Chamber of Commerce and Industry Business Confidence Index (SACCI BCI), dropped to 91.8 down 1.6 index points from 93.4 in February. Year-on Year the business confidence is down 6.8 points from 97.6 in March 2018. The month-on-month decline in business confidence can largely be attributed to a weakening exchange rate, fuel price increase, increasing electricity tariffs, load-shedding and slowing manufacturing production. Six of the thirteen sub-indices of the BCI improved on their February readings, four declined and three remained unchanged. The declining business confidence is an indication of the challenging and uncertain economic and political environment businesses are operating in. The upcoming elections (8 May) further add to this uncertainty, as the direction of the economy and certainty over various policies will only be known after the elections.

- Mining production in February declined 1.5% month-on-month, as platinum group metals (PGM) output contracted by 6%, while gold output declined by 1.6%. Year-on year mining production for February 2019 decreased by 7.5%. The decline was mainly caused by a drop in the mining output of diamonds (-43.8%), gold (-20.6%) and iron ore (-20.7%). The largest positive contributor to total mining production was platinum group metals with a production increase of 17.8% year-on-year in February.

- Manufacturing production in February declined by 1.8% month-on-month, seasonally adjusted. Despite the monthly decline, production was up by 0.6% on an annual basis. The monthly drop comes mostly on the back of an 18% month-on-month decline in the output of petrol and other fuel products. On an annual basis, the food and beverages as well as petrol and fuel subsectors made the largest positive contributions to growth.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Werner Erasmus

- Consumer Price Index (CPI) for March 2019: Due Wednesday, 17th April at 10h00. CPI is expected to increase to 4.6%, up from its February reading of 4.4%. The expected increase is still well within the SARB CPI target range of 3%-6%.

- Retail sales for February 2019: Due Wednesday, 17th April at 13h00. Retail sales for February is expected to increase by 0.9% month-on-month. This is 0.6% lower than the retail sale growth of 1.5% recorded in January 2019. Year-on-year retail sales growth is expected to slow to 0.6%, down 0.6% from its February 2018 growth rate of 1.2%.

GLOBAL

Contributed by Nick Downing

- In its bi-annual World Economic Outlook, the IMF cut its forecast for global GDP growth in 2019 from 3.7% to 3.3%, citing "trade tensions and tariff hikes between the US and China, a decline in business confidence, a tightening of financial conditions, and higher policy uncertainty across many economies." The IMF predicted a slowdown in 70% of the global economy. However, there was hope that growth would recover on aggregate in 2020 to 3.6%, helped by the U-turn in central bank monetary policy and signs of progress in US/China trade talks. Central bankers and finance ministers at the spring IMF meeting voiced optimism over a recovery in the pace of growth. In its Financial Stability Report, the IMF while hailing an improvement in the stability of household and financial sector balance sheets since the 2008/09 global financial crisis, cautioned that corporate debt is at elevated levels in two-thirds of the world economy. In its long-term projections, the IMF signalled that emerging market economies would fare better than developed economies. While GDP growth in the US and Eurozone is projected to fall between 2018 and 2024 from 2.9% to 1.6% and from 1.8% to 1.4%, respectively, across emerging markets GDP growth is projected to improve from 4.5% to 4.9% over the same period.

NORTH AMERICA

Contributed by Nick Downing

- Consumer price inflation (CPI) accelerated sharply in March from 1.5% to 1.9% year-on-year pushed higher by a 0.4% month-on-month increase. However, the move is almost entirely due to higher oil prices. Core CPI, which excludes oil and food prices due to their short-term volatility, subsided from 2.1% to 2.0% on the year, which should be enough to keep the Fed on its current path of keeping interest rates unchanged. Several core CPI components reflected a disinflationary trend. Apparel prices fell a massive 1.9% on the month, its biggest decline on record, while airfares dropped 0.6% and the prices of second-hand cars and trucks fell 0.4%. Producer price inflation (PPI) exhibited the same oil-induced upward pressure at the headline level but a subdued pattern at the core level. Headline PPI increased by a sizeable 0.6% on the month pushed higher by a 16% surge in gasoline prices, the strongest monthly increase since August 2009, lifting the year-on-year measure to 2.2%. However, core PPI excluding energy, food and volatile trade services subsided to 2.0%.

- The halt in the Fed's interest rate hiking cycle is largely responsible for powering US and global equity markets higher since the start of the year, with the S&P 500 index enjoying its strongest first quarter since 1998. Minutes from the Fed's policy meeting on 19-20th March reveal that "A majority of participants expected that the evolution of the economic outlook and risks to the outlook would likely warrant leaving the target range unchanged for the remainder of the year." The minutes cited concern over the global slowdown and domestically some weakness in housing activity, business investment spending and consumer spending. Although forecasting a resumption in domestic demand in the second half of the year, the Fed cautioned that longer-term consumer and business inflation expectations were falling. The Fed minutes indicated that the central bank would slow the $40 billion per month contraction (quantitative tightening) of its $3.9 trillion balance sheet from May onwards and by October end it altogether. The increasingly "dovish" tilt in the Fed's policy statements led economists to revise their interest rate outlook. A Wall Street economists' survey showed the majority of respondents forecast no change in the fed funds rate in 2019 while a third predict a rate cut in 2020.

- The University of Michigan US consumer sentiment index fell in March for the first time in three months from 98.4 to 96.9. The forward-looking consumer expectations index also fell from 88.8 to 85.8 while the gauge of current economic conditions increased slightly from 113.3 to 114.2. While all three consumer confidence measures are lower than they were a year ago, attributed to the fading impact of tax cuts implemented in 2017, consumer confidence is still elevated by historical standards. According to Richard Curtin, the survey's chief economist, "What has been of increasing importance to consumers are rising nominal incomes, and low inflation, producing strong gains in inflation adjusted incomes." Household expectations of future inflation over the next year fell from 2.5% to 2.4% and over five to ten years fell from 2.5% to 2.3%. The combination of low inflation, strong jobs growth, robust wage growth and an increasingly "dovish" Fed should keep consumer confidence at lofty levels over the foreseeable future.

- Initial jobless benefit claims fell below the key 200,000 mark, dropping from 204,000 to 196,000 in the past week, its lowest since October 1969. The population is significantly higher now than 50 years ago making the data even more impressive. On the other hand, the Department of Labour's monthly Job Openings and Labour Turnover (JOLT) report shows job openings fell sharply in February from 7.6 million to 7.1 million its lowest since March 2018. Although sending conflicting signals on the health of the labour market, the February JOLT report may have been affected by the 35-day partial government shutdown in much the same way that the shock February non-farm payroll report was affected. Non-farm payrolls subsequently rebounded in March indicating that the February numbers were a once-off aberration. Moreover, despite the significant drop in job openings they are still higher by around 900,000 than the total number of unemployed, a sign of a healthy labour market.

CHINA

Contributed by Nick Downing

- Local governments issued bonds worth a total of 1.2 trillion yuan in the first quarter, equivalent to around $180 billion. The fast-tracking of local government bond issuance signals a growing urgency to stimulate the economy through infrastructure spending. Local governments normally refrain from issuing bonds until much later in the year. Bond proceeds are used primarily for large-scale construction projects. Moody's forecasts total local government bond issuance will exceed 2018 levels by around 70% in 2019. At the same time authorities have deregulated the bond market making it easier and more attractive for retail investors to purchase local government bonds.

- Inflation accelerated at both consumer and producer levels adding to evidence of a recovery in China's economic prospects. Consumer price inflation (CPI) increased from 1.5% year-on-year in February to 2.3% in March, helped by a 4.1% rise in food price inflation. Producer price inflation gained from a slender 0.1% to 0.4% on the year. At the CPI level, closely watched pork prices gained 5.1% on the year while fresh vegetable price surged by 16.2%. However, there was evidence of a broader-based gain in CPI components. Nonetheless, CPI remains some distance from the People's Bank of China (PBOC) 3% target, which suggests further monetary stimulus is likely. The PBOC, which has increased its Reserve Requirement Ratio five times in the current easing cycle has yet to cut its benchmark interest rate, a move which is likely over the course of the year to build momentum in the nascent recovery.

- China's trade surplus with the rest of the world increased from $4.1 billion in February to $32.6 billion in March. However, the surge is explained by a continued decline in imports rather than a meaningful recovery in export volumes. Exports increased in March by 14.2% year-on-year partly recouping the 20.7% drop in February, although the gain could be attributed to the seasonal impact of the Lunar New Year holiday. More importantly, imports fell for a fourth straight month, declining by 7.6% on the year after falling 5.2% in February. Exports to the US increased by just 3.7% while imports fell 25.8%. The overall data suggests continued weakness across both global demand and domestic demand in China.

JAPAN

Contributed by Carel la Cock

- The International Monetary Fund's (IMF) World Economic Outlook (WEO) has downgraded its projection for economic growth in Japan for 2019 from 1.1% down to 1.0% and kept unchanged the 2020 outlook at 0.5%. Although disappointing, the outlook is still an improvement on the 0.9% forecast made in October. The WEO stated that "This revision mainly reflects additional fiscal support this year, including measures to mitigate the effects of the planned consumption tax rate increase (to 10% from 8%) in October 2019". The IMF further advised that "In Japan, sustained monetary accommodation will be necessary to lift inflation expectations and progress toward the central bank's (inflation) target. Fiscal policy should be geared toward ensuring long-term fiscal sustainability while protecting growth. The coupling of the planned October increase in the consumption tax rate with fiscal measures to support near-term activity is welcome." Core inflation is predicted to rise to 1.4% by the end of 2020 and then moderate to 1.3% over the medium term. Bank of Japan (BoJ) Governor, Haruhiko Kuroda, corroborated the message from the IMF and said that it will take some time to get to the 2% target and that it is important for the BoJ to "maintain the current powerful easy policy". He further highlighted that Japan's economy will keep expanding moderately driven by domestic demand and moderate growth in global economies in part thanks to stimulus in China. On balance, Japan will most likely experience a moderate expansion over the medium term, but the planned hike in consumption tax in October remains a key risk to growth.

EUROPE

Contributed by Carel la Cock

- Last week The European Central Bank (ECB) kept both its refinancing rate unchanged at 0% and its deposit rate at -0.4%, a move which was widely anticipated. Mr Mario Draghi, the ECB president, stressed that the bank is ready to use all measures at its disposal if growth in the economy and price inflation remain subdued. It has opened the door for potentially more extensive stimulus measures. Rates are likely to remain unchanged for the remainder of the year and markets only expect rates to change by mid-2020. Furthermore, the ECB also announced another round of targeted longer-term refinancing operations (TLTRO III) for issuance in September, running until March 2021. Thus far the cheap financing, aimed at spurring on large commercial banks to increase lending to companies and households and thereby stimulating the economy, has had little effect. The problem is not the supply, but rather the demand for credit, despite very low interest rates. The most recent ECB lending survey showed that the increase in demand for loans in the last quarter was 0% quarter on quarter, compared to 9% at the end of 2018. Households and businesses already indebted do not want to increase their leverage in these uncertain times. With interest rates at record lows and cheap credit not moving the needle, the ECB is fast running out of options to re-ignite growth in the region.

UNITED KINGDOM

Contributed by Carel la Cock

- Prime Minister Theresa May has successfully extended the deadline for Britain to leave Europe to the end of October, a date traditionally reserved for Halloween, and journalists have not missed the opportunity to draw the parallels with the current Brexit nightmare. The move has been widely seen as positive as it gives negotiators more time to finalise a Brexit deal and prevents an unintended “no-deal” exit. However, some of the pro-Brexit communities in the British midlands have called for any type of exit rather than the current limbo they find themselves in. The problem is that there currently is still no majority view on a single course of action. Thus far talks between Mrs May’s Conservative party and the Labour Party of Mr Corbyn, have borne little fruit. At the heart of it, Labour wants to remain in a permanent customs union with Europe whereas many Conservatives are in favour of a cleaner divorce from the Union. Talks are set to continue over the remainder of April and Mrs May will be hoping to come to some agreement ahead of the 22nd May European Parliamentary Elections in order to avoid participation.

FAR EAST AND EMERGING MARKETS

Contributed by Carel la Cock

- The International Monetary Fund (IMF) has warned that emerging markets (EM) have become more vulnerable to a sudden market crash due to the rise in passive index-driven investments. In the past decade assets benchmarked against EM bond indices have quadrupled to $800bn with another $1.9tn tracking the MSCI EM indices, according to the IMF. Roughly 70% of global investors’ geographic allocation decisions are based on benchmark weightings. The effect is that investments in specific EM countries tend to be more volatile because global investors focus on issues that affect EMs as a whole rather than country specific issues. For instance, US monetary policy and the relative strength of the dollar might have a bigger effect on an EM stock market than the outcome of elections. There is a direct correlation between the US Volatility index (Vix), which is the market’s expected risk in the S&P 500 index, and invested assets in EM. Research by the IMF shows that in the last 9 years a one standard deviation rise in the Vix has on average led to a 2% drop in invested assets from benchmark tracking investors. Thus, when investors expect more risk in the S&P 500 index, they reduce their investments in EM. The IMF warns “A large share of benchmark-driven investments in total portfolio flows could increase the risk of excessive inflows or outflows unrelated to countries' economic fundamentals and could, in some cases, have destabilising effects". The lesson for investors in the South African market is that short-term outflows from the local markets are much more likely to come from changes in global investors' risk appetite for emerging markets as a whole, than as a result of our own political issues.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 10.75	58405
JSE Fini 15	+ 2.99	16870
JSE Indi 25	+ 13.01	71972
JSE Resi 20	+ 16.90	47983
R/$	+ 2.85	13.96
R/€	+ 4.41	15.77
R/£	+ 0.43	18.25
S&P 500	+ 15.98	2907
Nikkei	+ 9.27	21870
Hang Seng	+ 17.27	29909
FTSE 100	+ 10.54	7437
DAX	+ 13.65	11999
CAC 40	+ 16.32	5502
MSCI Emerging	+ 12.78	1089
MSCI World	+ 14.62	2159
Gold	+ 0.75	1290
Platinum	+ 11.98	888
Brent oil	+ 31.30	71.48

BOTTOM LINE

Contributed by Gielie Fourie

- The G20: South Africa is a member of the G20 group of countries, an international forum for governments and central bank governors. In this group we are one of the worst performers – in about every economic activity we are close to the bottom. It begs the question: Should SA really be part of the G20? Fortunately, there is good news as well. Unfortunately, it does not make the headlines. Bad news hits the headlines daily. We have social unrest all over the country. We have grand corruption. Most SOE's like Eskom, SAA, Denel and the SABC are financial disasters. They are destroying wealth, they are destroying jobs. There are many things that are wrong in South Africa. The media typically covers bad news and ignores good news. Bad news sells, unfortunately. But there are also many things that are right in South Africa. There are smart investors who had the vision to see that South Africa has lots to offer.

- We look at four investors from abroad who could have invested anywhere in the world, yet they saw potential in SA. There are several international entrepreneurs from abroad who have quietly, and under the radar, invested in South Africa. Let us look at four billionaires, from the eldest to the youngest, who invested in SA. Two are British, and two are Indian. They started several years ago, they invested billions, and there is no sign that they are leaving.

- Laurence Graff (OBE) (80) is a self-made British billionaire. He made his fortune in the diamond business. In 2003, Laurence Graff bought the Delaire wine estate from John Platter and duly converted it into an ultra-luxury wine farm with luxury lodges and a world-class restaurant to match. The Delaire Graff restaurant is perhaps the most expensive restaurant in the Western Cape.

- Sir Richard Branson (68) is another self-made British billionaire. He is the serial entrepreneur and business magnate who founded the Virgin Group. Richard Branson bought the Mont Rochelle wine estate and hotel in Franschhoek. Mont Rochelle offers the very best accommodation in the Franschhoek Valley. Branson also owns the Ulusaba Private Game Reserve in the Sabi Sands Reserve bordering the Kruger National Park.

- Prem Watsa (68) is a self-made Canadian billionaire. As a young man he left India with eight Rupees in his pocket and headed for Canada. Strictly following the investment strategies of Warren Buffett, he built Fairfax Insurance. He turned his eight Rupees into billions of Dollars. Fairfax is valued at around $10 billion. He owns 50% of Fairfax. Prem Watsa bought big stakes in Afgri, an agricultural and financial services company, in Zurich SA, an insurance company, and in Consolidated Infrastructure Group, a JSE listed construction company. He also made an unsuccessful bid to acquire cement company PPC.

- Analjit (Bas) Singh (65). Like Prem Watsa, he is from India and like Watsa he made his fortune in insurance. After visiting the FIFA Soccer World Cup in 2010, Analjit Singh invested a reported R1 billion in the Leeu Collection in Franschhoek, comprising several wine farms, a micro-brewery, guesthouses, spas, hotels and restaurants, including the award-winning Le Quartier Francais hotel and restaurant. The Leeu collection is now an international hotel group, having bought two luxury hotels in England and Italy. And it all started in Franschhoek!

- 2020: These four billionaires had one thing in common – they had vision. Where most people saw problems, they saw opportunities. They are the kind of people who will never waste a crisis. They are visionaries who can see the invisible and achieve the impossible! Their investments are Fixed Direct Investments, rather than investments in shares on the JSE. They cannot liquidate their investments overnight and take their money out of the country. In the process they created wealth; they created thousands of jobs. They are visionaries. If we can attract more visionaries with 20/20 vision, we could, by 2020, become a proud and respected member of the G20 group of countries. Yes, indeed, despite the bad news, there are pockets of good news as well.