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WEEKLY REPORT

OVERBERG MARKET REPORT

Tuesday 28th September 2021

IN THIS WEEK'S BOTTOM LINE

Contributed by Gielie Fourie

- Valuations on the JSE are currently very low. The JSE seldom trades at these low values. We look at current valuations. Read more in the Bottom Line.

SOUTH AFRICA ECONOMIC REVIEW

Contributed by Werner Erasmus

- The composite leading business cycle indicator in South Africa fell by 2.5% from a month earlier in July of 2021, following a revised 4.4 % drop in the previous month. Nine of the ten available component time series decreased, while one increased. The leading indicator leads economic activity by around six months and provides insight into expected future economic and business conditions. The largest detractors were decelerations in the six-month smoothed growth rate of job advertisement space and the number of new passenger vehicles sold. The positive contributor was the increase in the number of residential building plans approved. Although better than expected GDP growth is forecast for 2021, fixed investment in South Africa remains low which will have a negative impact on sustained economic growth. This combined with the July events and the Covid-19 pandemic is likely to have a lasting effect on investor confidence and job creation, hampering a recovery in labour-intensive sectors hardest hit by the lockdowns. Policy settings in advanced economies remain accommodative, although the spread of the Delta variant, higher global inflation, and uncertainty about the normalisation path for interest rates continue to cause financial market turmoil and capital flow volatility.

- Consumer inflation, as measured by the consumer price index (CPI), came in at 4.9% year-on-year in August, up from 4.6% recorded in July. This was in line with the consensus and marks the fourth consecutive month that inflation was above 4.5% (the midpoint of the SARB's target). The main contributors to the 4.9% annual inflation rate were food and non-alcoholic beverages (up 6.9%), housing and utilities (up 3.8%), transport (9.9%) and miscellaneous goods and services (up 4.2%). Core inflation increased to 3.1% year-on-year though in contrast, the consensus forecast had been for it to remain unchanged at 3%. The SARB's latest inflation forecasts indicate no significant change in the inflation outlook. Forecasts for the headline inflation rate in 2021 were revised up, from 4.3% year-on-year to 4.4%, and remained unchanged at 4.2% in 2022 and 4.5% in 2023. The SARB noted that the risks to the short-term inflation outlook are assessed to the upside. Rapid global producer price and food price inflation have surprised to the upside in recent months and could do so again. Oil prices have become more volatile in recent weeks and could rise beyond expectations. Electricity and other administered prices also continue to present short-term risks. In the medium to long term, a weaker currency, higher domestic import tariffs, and escalating wage demands present further longer-term upside risks to the inflation forecast.

- The South African Reserve Bank (SARB) kept the repo rate unchanged at 3.50% with the prime lending rate remaining at 7%. The latest Monetary Policy Committee (MPC) meeting was the seventh consecutive meeting at which monetary policy settings have been left unchanged, following 275bp of cumulative cuts since the onset of the coronavirus crisis. With the inflation outlook and inflation expectations well anchored around the SARB's midpoint of 4.5% policymakers are expected to be in no rush to increase rates. However, the SARB's Quarterly Projection Model (QPM) indicates an increase of 25 basis points in the fourth quarter of 2021 and further increases in each quarter of 2022 and 2023. On the economic growth front, the SARB expects the economy to grow by an upwardly revised 5.3% this year (up from 4.2%), 1.7% in 2022, (down from 2.3%) and by 1.8% in 2023 (down from 2.4%). Overall, and after revisions, the risks to the medium-term domestic growth outlook are assessed to be balanced, as most of the bounce back from the recovery is now in the past. Looking ahead, economic and financial conditions are expected to remain volatile for the foreseeable future. On the positive side, the SARB governor highlighted that, relative to the US Fed taper tantrum episode in 2013, South Africa was now better prepared for the start of monetary policy normalisation in the US. The implication was that the SARB does not necessarily have to slavishly follow developments in the US. SARB governor, Lesetja Kganyago mentioned South Africa's large current account surplus, domestic fiscal consolidation, and lower inflation (relative to 2013) as key factors that should help SA weather the expected rise in US interest rates.

SOUTH AFRICA: THE WEEK AHEAD

Contributed by Ingrid Breed

- Interest Rate Decision, due Thursday 23 September. The South African Reserve Bank's Monetary Policy Committee is not expected to move interest rates from their current near-five decade low given the unstable economic recovery and contained consumer inflation. Interest rates are expected to normalise in 2022 from the current low of 7% prime overdraft rate and the 3.5% repo interest rate.

- SACCI Business Confidence Index, due Wednesday 29 September. The South African Chamber of Commerce and Industry (SACCI) business confidence index (BCI) is expected to have recovered slightly to 95 in August from 93.2 in July. This small improvement is anticipated as

August was not negatively influenced by the looting that occurred during July, nor as heavily impacted by lockdown restrictions. Moreover, the focused attention on the vaccination process during August is anticipated to have brought a further sense of normality to the economic environment.

- Private Sector Credit Extension, due Thursday 30 September. Private sector credit extension is expected to have increased 1% year-on-year in August up from a 0.61% year-on-year increase in the previous month. This rise in credit extended is likely to be driven by households' demand for credit as the moderate improvement in economic activity continues to decrease credit demand from distressed companies.

- Producer Price Index, due Thursday 30 September. Producer inflation, as measured by the Producer Price Index (PPI), is expected to have increased 7.2% year-on-year and 0.5% month-on-month in August from 7.1% and 0.7% in July. Producer inflation is anticipated to remain high as producers continue to experience rising cost pressures resulting from higher petrol and diesel prices.

- Balance of Trade, due Thursday 30 September. The trade surplus is expected to have widened in August as exporters' conditions normalised after being negatively influenced by the civil unrest in July. The consensus forecast is expecting a R45 billion surplus in August up from the R37 billion surplus in the previous month.

- ABSA Purchasing Managers' Index, due Friday 1 October. Manufacturing activity, as measured by the ABSA Purchasing Managers' Index (PMI), is anticipated to have remained in expansionary territory during September, albeit declining from the previous month. The PMI is expected to have declined to 55.3 in September from 57.9 in August as it normalises from the rebound seen in August following the record single-month decline in July which resulted from the civil unrest.

- Total New Vehicle Sales, due Friday 1 October. The domestic automotive industry has likely continued to benefit from the strong rebound in global economic activity and favourable trading conditions abroad during September. Car sales are expected to have increased 12% year-on-year in September from 24.6% in August, with the large increase in August resulting from the low 2020 base and the rebound in car sales after July sales were restrained due to the civil unrest.

GLOBAL

Contributed by Nick Downing

- In its latest quarterly report, the Organisation for Economic Cooperation and Development (OECD) reduced its global GDP growth forecast for 2021 while simultaneously lifting its inflation forecast. The chief culprit is the spread of the Covid Delta variant and its continued impact on supply chains, especially in the Far East and emerging economies, which have experienced lower vaccination rates. However, for 2022 the OECD lifted its GDP growth forecast and saw inflation reducing. The Delta variant is expected to delay business and consumer expenditure but not cancel it out altogether, while inflation should ebb as supply chains recover. The report maintains that inflationary pressures are temporary but cautioned against the risk of second round inflationary effects if businesses implement price increases and households demand higher wages. The global GDP growth forecast for 2021 was reduced from 5.8% to 5.7% and for 2022 lifted from 4.4% to 4.5%. The US forecast was reduced from 6.9% to 6% for 2021 and raised from 3.6% to 3.9% in 2022. The OECD forecasts the average inflation rate among G20 economies will accelerate to a year-on-year rate of 4.5% in the fourth quarter 2021, subsiding to 3.5% by the end of 2022 but cautioned that "sizeable uncertainty remains" around this forecast. The US inflation rate is projected to ease from 3.6% to 2.9% between 2021 and 2022. Lastly, the OECD report said central banks in wealthy nations should begin setting out their exit strategies from pandemic era monetary stimulus, since their economies had fully recovered. In the past week, the Federal Reserve and Bank of England both signalled exits from their asset purchase programmes, while Norway's central bank became the first major western economy to lift interest rates. The Norges Bank lifted its benchmark interest rate from zero to 0.25% and indicated a further rate hike in December. The end appears in sight for the global surge in pandemic liquidity relief.

NORTH AMERICA

Contributed by Nick Downing

- Financial markets have been waiting with bated breath for the Federal Reserve to begin normalising its monetary policy. In its firmest signal yet that the Fed would begin reversing its pandemic stimulus programme, chairman Jay Powell said: "My own view is that the substantial further progress test is all but met." Powell indicated the reduction (taper) of the $120 billion per month asset purchase proramme would be announced at the next policy meeting on 2-3rd November and that the taper would be completed by mid-2022. This would be a faster taper than in 2013 but Powell said: "The economy's much further along than it was when we tapered in 2013." He also indicated that the policy fed funds interest rate would not be lifted until the taper was complete and asset purchases fully ended. Compared with its most recent forecasts made in June the Fed upped its inflation projections and simultaneously reduced its GDP growth projections. The year-on-year forecast for Its preferred inflation measure, the core personal consumption index, was raised for end 2021 and 2022 from 3% to 3.7% and from 2.1% to 2.3%. At the same time, the GDP growth forecast for 2021 was reduced from 7% to 5.9%, dropping in 2022 to 3.8%. Of the 18 policy makers in the Federal Open Market Committee (FOMC), 9 now expect a lift-off in the fed funds rate in 2022, up from 7 in June. According to the FOMC's "Dot Plot" three rate hikes are now expected by end 2023 compared with just two in June, while three more rate hikes are expected in 2024, which would result in a fed funds rate of 1.8%. The overall tenor of the Fed policy signal indicated a growing unease over inflationary pressures. While the Fed maintained that the inflationary spike is temporary, it conceded that inflation is rising faster and remaining elevated for longer than previously expected.

- Economic survey data sank in September, spelling out a soft patch in economic activity. The IHS Markit composite purchasing managers' index (PMI), measuring activity across both services and manufacturing sectors, fell from 55.4 to 54.5, still above the expansionary 50-level but its lowest since September 2020. The drop is attributed to the Covid Delta variant, in particular its effect on supply chains and the supply of components from the Far East. The manufacturing PMI slipped from 61.1 to 60.5 while the services PMI, which covers two-thirds of the economy, fell more sharply from 55.1 to 54.4 its lowest since July 2020. There were some bright spots in the data, with survey respondents tending to look past the temporary impact of the Delta variant. Optimism among services businesses increased to a 3-month high and among the manufacturing PMI sub-indices, hiring and new orders indices bucked the downward trend. Nonetheless, the overall PMI data points to a significant slowdown in US GDP growth in the third quarter (Q3) compared with the 6.6% quarter-on-quarter annualised growth achieved in Q2. The data is consistent with a Q3 growth rate of 3-4%, representing a significant albeit temporary loss in momentum.

CHINA

Contributed by Nick Downing

- An increasing number of business sectors are falling victim as Beijing continues its regulatory crusade in the pursuit of "common prosperity." The latest regulation, implemented in the past week, prevents overseas cryptocurrency exchanges from dealing with residents in China. This follows the ban earlier in the year on domestic institutions and comes ahead of the planned launch of a digital yuan in 2022, to coincide with the hosting of the Winter Olympics. Beijing has exploited the window of opportunity offered by its strong economic rebound from the pandemic in 2020 to implement an array of new regulations, affecting property developers, e-commerce, gaming, online tutoring and now crypto investing, but some economists believe the window of opportunity is now closing due to a loss in economic momentum. This may spell good news for anxious investors if it means authorities will begin to step back and instead of thwarting economic growth through their regulatory zeal, turn instead to stimulating growth through fiscal and monetary policy.

- While it is generally accepted that the China Evergrande Group will default on its debt obligations it is unlikely that the event will be China's "Lehman moment" when the US investment bank was allowed to fail, marking the start of the Global Financial Crisis in 2008. Rating agency S&P Global believes China's authorities will seek an "orderly debt restructuring that maximises the value of its substantial assets." In some regions, local governments have already assumed control of Evergrande's sales revenue to protect homebuyers' interests and enable the continuation of construction projects. Evergrande bond and share investors will likely incur maximum losses but it is anticipated that Beijing, which has the necessary resources, will seek to protect the tens of thousands of home buyers and household investors in Evergrande's wealth management products. China's real estate market is characterised by economic primacy, accounting for a massive 74% of household wealth and 30% of GDP. While the government is intent on gradually letting air out of the real estate bubble, it will be anxious to avoid a systemic shock.

JAPAN

Contributed by Carel la Cock

- Japan's private sector business activity marked a further decline in September, although at a softer pace than August, aided by the much larger services sector registering a slower decline. The Jibun Bank Flash Japan Services Business Activity Index improved from 42.9 in August to 47.4 in September. New business inflows in the services sector marked a twentieth straight monthly decline, impacted by an extension to lockdown measures in fighting the latest wave of covid-19 infections. Respondents from the services sector saw light at the end of the tunnel and job creation expanded for a second month. Positive sentiment for business activity in the next twelve months was underpinned by a belief that further vaccinations will lead to improved demand. Manufacturing remained in good health during September albeit at a reduced level while experiencing a contraction in both output and new orders. The latest Jibun Bank Flash Japan Manufacturing Purchasing Manager's Index (PMI) reading of 51.2 for September was marginally down from the 52.7 final reading in August, indicating a mild improvement in operating conditions while the Output Index showed a contraction (48.1) compared to an expansion (51.0) in August (50 marks the neutral level). Input price pressures continued during September with many respondents indicating that rising costs of raw materials, transport and labour added to higher factory gate prices. Optimism for the year ahead remained resilient and encouraged employers to increase staff levels.

EUROPE

Contributed by Carel la Cock

- Germans went to the ballot boxes on Sunday to elect a new chancellor as the 16-year reign of Angela Merkel came to an end. Merkel's party, the Christian Democrats (CDU) and its Bavarian sister party, CSU, slumped to their worst election performance, gaining a paltry 24.1% of the votes, down 8.9% from 2017. Armin Laschet, CDU/CSU's chancellor candidate, will now seek to form a coalition government in what could be Germany's first three party coalition. Olaf Scholz, candidate for the Social Democrats (SPD), pulled off a stunning victory on Sunday, claiming 25.7% of the vote, 5.2% more than in 2017. However, the Greens who took 14.8% of the vote, an improvement of 5.8%, and the FDP who garnered 11.5% are likely kingmakers with only three options in forming a coalition government. Firstly, there is an SPD, Greens and FDP coalition with a 56.6% majority. Secondly, a CDU/CSU, Greens and FDP option that will have a 55.2% majority and lastly an SPD and CDU/CSU government with 54.7% majority. Despite coming in second, Laschet is confident that he would be able to form a coalition government with the Greens and the FDP since their policies are more aligned compared to Scholz's centre-left SPD. However, Scholz contends that he has a clear mandate from the German people to form a new government and has political momentum on his side. In earlier polls, voters indicated that Scholz, a former vice-chancellor and finance minister, is the preferred candidate to take up the reins from Merkel. Voters see him as the most likely candidate to continue with the economic policies in place. However, some analysts argue that Germany needs a chancellor that can take bold decisions and implement the change needed to keep Germany competitive in an ever-changing world. While Merkel is lauded for making correct decisions on some of the difficult issues that faced Germany and the EU during her leadership, she has been criticised for not transforming Germany to keep up with the times. Much needed investment will have to be authorised by the new government, a task that will be ever more difficult with a three-party coalition.

UNITED KINGDOM

Contributed by Carel la Cock

- The Bank of England (BoE) has kept its benchmark rate at 0.1% despite raising concerns that inflation will hit 4% by the end of this year and stay at that level well into 2022. However, the monetary policy committee (MPC) stressed that there was no immediate need to hike rates and that inflation will revert to the 2% target in the second half of next year. It noted that recent price rises have strengthened the case for tightening monetary policy in the next few years and at the same time has discarded its previous guidance that it would not start hiking rates until the economy has recovered sufficiently from the pandemic. The MPC will scrutinise employment levels after furlough schemes end this month which will be an important factor in future rate decisions. Voting unanimously to keep rates unchanged was a departure from previous meetings when comments from members showed discord within the committee. The MPC was however divided on the continuation of its asset purchase programme that will run its course until the end of the year, resulting in £895bn assets purchased. BoE governor, Andrew Bailey, explained that the 4% inflation peak will endure for longer if the energy price cap was adjusted materially higher in April, despite global price pressures easing by next year. He conceded that the risk of higher inflation for longer could lead to the expectation of persistent higher inflation which may lead to a self-fulfilling inflation spiral. Following the announcement, markets priced-in the first interest rate hike in February next year with a low probability of a hike this year.

KEY MARKET INDICATORS (YEAR TO DATE % AND LEVEL)

JSE All Share	+ 8.06	64197
JSE Fini 15	+ 18.13	14246
JSE Indi 25	+ 6.41	82890
JSE Resi 20	+ 0.29	57743
USD/ZAR	+ 1.80	14.96
EUR/ZAR	- 2.52	17.51
GBR/ZAR	+ 2.11	20.52
S&P 500	+ 18.29	4443
Nikkei	+ 9.83	30141
Hang Seng	- 9.80	24561
Shanghai	+ 3.70	3601
FTSE 100	+ 9.33	7063
Gold	- 7.75	1751
Platinum	- 7.90	987
Brent oil	+ 54.70	80.14

BOTTOM LINE

Contributed by Gielie Fourie

- The valuation of shares on the Johannesburg Stock Exchange (JSE) is currently very low. The JSE seldom trades at these low values. Our shares are low when we compare them to the valuations of some global markets, but they are also low when measured against proven metrics. Investors might rightfully say that considering our country's poor economic performance it is no surprise that our shares are so cheap. But we have several companies, like our mines and many industrial companies, that trade internationally, and they are also cheap.

- PRICE EARNINGS RATIOS: To start with, we can look at the Price Earnings (PE) ratios of shares listed on the JSE. A low PE ratio indicates that shares are cheap. The PE ratio on Thursday was a low 11.56. The lowest PE ratio during the past five years was 9.43 recorded last year on 19 March 2020, just before the Covid-19 lockdown was introduced on 27 March. The average PE ratio for the last five years is 14.13. The current PE ratio must increase by 22.2% to reach the average PE ratio. To reach the maximum PE ratio of 23.34 recorded during the last five years, the PE ratio must increase by 102%. This indicates that we can expect some upside for shares to return to the average PE ratio of around 14. Every time the PE ratio dipped below one standard deviation from the mean, it rebounded sharply. See the graph below.

- PRICE to BOOK RATIOS: Another metric is to compare the price of a share with its book value - the P:B ratio. A low P:B ratio indicates that shares are cheap. The current P:B ratio is 1.8666. During the past 25 years the lowest P:B ratio of 1.1696 was recorded on 30 Sep 1998 - the highest P:B ratio of 3.0654 was recorded on 30 Mar 2007 – the average P:B ratio was

2.0915. The P:B ratio must increase by 12% to reach the average P:B recorded over the last 25 years. The P:B ratios support the evidence shown by the PE ratios that the market is cheap and that there is upside potential on the JSE.

- BLENDED MULTIPLIER: The blended multiplier (BM) is a metric developed by Benjamin Graham, Warren Buffett's mentor. The BM is simply calculated by multiplying the PE ratio with the P:B ratio. The PE ratio connects to the Income Statement (Earnings), while the P:B ratio connects to the Balance Sheet (Book Value). Graham preferred the BM to be below 25. The current BM of the JSE is 21.58 (11.56 x 1.8666). The BM also supports the view that there is upside potential on the JSE.

- EARNINGS YIELD: The earnings yield (EY) of shares is another important metric to consider. Over the last five years the highest EY recorded was 10.61 (indicating shares were cheap), the lowest was 4.28% (indicating shares were expensive), and the average EY was 7.07%. The current EY is 8.65%. This is even higher than current Capital Market rates of 7.48% for 3 – 5-year bonds. It confirms the upside potential for shares.

- DIVIDEND YIELD. All the above metrics are supported by a juicy dividend yield (DY). A high DY indicates that shares are cheap. The current DY on the JSE is 4.05%. Over the past 25 years the highest DY recorded was 4.8051% on 31 March 2020. The lowest was 1.7231% on 31 Dec 1999. The average DY over 25 years was 2.8993%. Like all the other metrics the current high DY supports the potential upside for the JSE. (Source: Bloomberg. Index used: JSE All Share.)

- S&P 500: Comparing these metrics with the S&P 500 confirms that the JSE is undervalued. For the S&P 500 the current DY is 1.28%, the current EY is 2.88% and the current PE ratio is a high 34.70%. These are signs of an expensive market. The S&P is at an all-time high - these figures confirm it. Some of the reasons why the S&P 500 is so high are the ultra-high valuations of technology stocks, very low interest rates (negative real interest rates) and the effect of Quantitative Easing (QE) of $120 billion per month. QE has the effect of inflating asset prices, including share values on the markets. When QE stops, and tapering starts, it will remove the inflationary effect of QE on asset prices.

- It is not often that shares on the JSE trade at these low levels. On all metrics shares are undervalued. There is considerable upside potential. If you are interested in investing, do not try it at home. You are welcome to contact one of our friendly and qualified financial consultants. They are waiting for your call. Consultations are free.