SYGNALS

AUGUST 2015

KEY INDICATORS

		1 MONTH	3 MONTHS	6 MONTHS	1 YEAR	2 YEARS	3 YEARS	5 YEARS
J203T	FTSE/JSE All Share Index	-3.6%	-3.8%	-4.5%	1.1%	12.2%	15.6%	16.4%
J200T	FTSE/JSE Top 40 Index	-4.3%	-3.6%	-4.1%	0.2%	11.6%	15.9%	16.3%
J210T	FTSE/JSE Resources 20 Index	-0.2%	-14.0%	-19.6%	-33.8%	-11.7%	-4.6%	-1.5%
J211T	FTSE/JSE Industrials 25 index	-4.6%	-2.3%	-1.7%	10.7%	18.2%	24.1%	26.2%
J212T	FTSE/JSE Financials 15 Index	-4.0%	-1.3%	-1.2%	15.8%	24.9%	22.1%	20.9%
J403T	FTSE/JSE SWIX Index	-3.1%	-2.6%	-3.2%	4.5%	15.5%	17.0%	17.9%
J303T	FTSE/JSE CAPI Index	-3.6%	-3.8%	-4.5%	1.2%	12.3%	15.7%	16.5%
J253T	SA Listed Property Index	0.2%	5.0%	1.4%	27.5%	23.8%	15.3%	19.5%
ALBI	BEASSA All Bond Index	0.1%	1.0%	-0.8%	5.4%	8.5%	5.7%	7.9%
STeFI	STeFI Index	0.5%	1.6%	3.2%	6.3%	6.0%	5.7%	5.8%
	MSCI World Index in SA Rands	-2.1%	1.4%	6.8%	19.3%	22.5%	29.3%	24.9%
	Rand/US Dollar Exchange Rate	4.9%	9.2%	13.8%	24.5%	13.7%	16.5%	12.5%
	Rand/Euro Exchange Rate	6.9%	11.5%	14.0%	6.3%	4.7%	12.1%	9.7%
	Headline CPI	1.0%	1.8%	4.8%	5.0%	5.7%	5.9%	5.6%
	PPI	0.2%	1.3%	4.3%	3.3%	5.6%	6.0%	5.4%

"There is definitely less confidence, a lot less confidence about how inflation works."

James Bullard, President of the Federal Reserve Bank of St. Louis,
at the gathering of central bankers at Jackson Hole, Wyoming, August 2015

MARKET OVERVIEW

Global markets tumbled in August on the prospects of imminent interest rate increases in the US, and the continuing structural slowdown in China. Emerging markets, and in particular commodity producers like South Africa, bore the brunt of the sell-off which culminated in a market crash on the 24th and 25th of August. However, the two-day plunge was followed by a sharp recovery which erased most of the losses as China flooded the market with liquidity and the US appeared to remain on a sound economic footing.

The month started with increasing doubt being cast on China's assertion of GDP growth in the second quarter at an annualised 7% and waning confidence in the Chinese government's ability to manage the economy. This came after China's efforts to rekindle growth, (which have included four interest rate cuts since November 2014, reserve rate cuts, tax breaks and accelerated infrastructure spending), have shown little effect and especially after its ill-advised intervention in the equity markets in July.

Concerns were solidified after the People's Bank of China orchestrated a 2% decline in the yuan's official exchange rate, a move designed to make China's exports more competitive. The PBOC sets the mid-point of the trading range in the yuan against the US dollar on a daily basis and allows the currency to trade within a 2% band. The steep depreciation that followed forced the PBOC to intervene again, spending US$40 billion of China's roughly US$3.6 trillion in foreign exchange reserves in propping up the currency. This has come on top of the estimated US$145 billion the Chinese government has spent on supporting the nation's stock markets.

The devaluation triggered a sharp multi-day sell-off of Chinese stocks which erased all gains for the year. It also triggered more broad-based panic about the weakness of the economy as the preliminary Caixin China Manufacturing PMI, a gauge of nationwide manufacturing activity, fell to a six-and-a-half year low in August, at 47.1.

Global markets tumbled, with emerging markets and their currencies bearing the brunt of the sell-off on the prospect of slackening demand for commodities from China. The rand briefly touched the R14 to the US dollar level before recovering, while the US crude oil price fell below US$40 a barrel. The gold price rebounded by over 7% from a five-and-a-half-year low of US$1 077 an ounce reached in late July on safe haven buying.

Two days into the panic the PBOC finally stepped in, cutting interest rates by 0.25% to 4.6% for the one year lending rate and 1.75% for the one year deposit rate, thereby reducing bank-reserve requirements by 0.5%. This effectively added US$106 billion to the Chinese economy. Positive economic data from the US, including a much better than expected second quarter GDP growth figure, also helped to improved sentiment. Markets surged, recovering much of the earlier losses, and emerging markets' currencies strengthened and the oil price recovered by 10%. The tail-end of the month brought another rout of negativity as the US Fed reinforced its commitment to raising interest rates before the end of the year.

Stock markets' wildest week in years has rattled confidence and has highlighted just how incredibly nervous investors have become. On the other hand, the quick recovery points to the fact that most investors believe that equities remain their best investment option. Unfortunately, as the factors that led to the correction remain in play, we expect current market conditions and volatility levels to prevail for the rest of 2015.

In Europe, the ECB continued to buy bonds as part of its quantitative easing policy as economic growth lost some momentum, with second quarter GDP growth coming in 0.3% quarter-on-quarter and 1.2% year-on-year. The slowdown in China, a major export market, and lingering concerns about Greece, continue to weigh down sentiment. Although China makes up a limited percentage of its exports, the eurozone's hope has been to export its way out of trouble by increasing the competitiveness of its exports through lower wages and a weaker euro. This strategy may well need to be reviewed going forward. On the positive side, the eurozone's factory activity grew faster than expected in July with the Markit Manufacturing PMI coming in at

52.4, comfortably above the 50 level that separates growth from contraction. Inflation held steady at 0.2% year-on-year, the same pace as in June.

After a sluggish start in the first quarter, the US economy expanded by an annualised 3.7% in the second quarter. Most economic indicators were positive, with improvements in retail sales numbers, durable goods orders, unemployment and the housing market. Unemployment came in at 5.3% for July, close to the 5% level usually associated with “full employment”. On the negative side, falling unemployment has put little pressure on wages, suggesting that the economy is operating below normal capacity. Furthermore, there is a concern that the numbers are artificial in that many discouraged workers have simply dropped out of the job search or are working part-time, with the labour force participation rate of 62.6% at a multi-decade low. Other signs of intermittent recovery include consumer sentiment which pulled back from the five-month high it hit in June and the growth in manufacturing where the ISM manufacturing index fell to 52.7% in July. Consumer prices rose by 0.3% in July from a year earlier, well below the US Federal Reserve’s 2% goal. Despite that, leading into August, the US Fed seemed poised to raise interest rates at its September meeting. This decision may well need to be delayed.

360 DEGREES ROUND THE WORLD

UK: Economic data continued to signal a recovery albeit at a slower pace. The CPI rose by 0.1% year-on-year in July after slipping to zero in June and manufacturing growth picked up. However, the services sector growth eased and the unemployment rate edged up to 5.6% in a sign that the economy has lost some momentum at the start of the third quarter. The Bank of England kept interest rates unchanged.

RUSSIA: Russia’s economy shrank by 4.6% in the second quarter from a year earlier, the most since 2009, on the back of its worsening currency crisis. The ruble fell to the lowest level since February as oil traded below US$40 a barrel. Oil and natural gas account for half the nation’s budget revenue.

TURKEY: Turkish President Recep Tayyip Erdogan called snap parliamentary elections two months after voters deprived his AKP party of an outright parliamentary majority. Although the president is meant to remain non-partisan, Erdogan campaigned heavily for AKP in the June elections hoping that a majority win would enable him to amend the constitution to expand his powers and solidify his increasingly Islam-oriented authoritarian rule. After failing to do so, the AKP delayed the formation of a coalition government until the mandated 45-day deadline for forming a new government has passed. This allowed Erdogan to call a second election.

GREECE: The Greek stock market plunged by 22% after trading resumed following a five-week halt. Most economic indicators were dire with manufacturing activity plunging to the lowest level in 16 years. Ironically, the Greek economy actually grew by 0.8% year-on-year in the second quarter just before the stand-off with its creditors. Prime Minister Alex Tsipras and his seven-month-old administration resigned in a bid to trigger an election that would return him to power with a new mandate. In the meantime, the Syriza party continued to disintegrate with 20% of its members leaving to form a left-wing Popular Unity party, and a number of senior figures indicating that they would not stand for election.

UKRAINE: Ukraine’s central bank became the 39th monetary authority to ease policy this year, cutting interest rates to 27% to support flagging growth. Ukraine also reached a deal to restructure its US$19 billion of debt, with creditors agreeing to a 20% haircut. This is a vital step towards the unlocking of emergency aid for an economy badly affected by the Russia-backed insurgency in the eastern part of the country.

JAPAN: Japan's economy contracted by an annualised 1.6% in the second quarter on weak exports and consumer spending. The slowdown comes after the country’s GDP grew by 4.5% in the first quarter.

INDIA: Moody's lowered its growth forecast for India to 7.0% for 2015 as below-normal rainfall offset higher government spending. Rainfall over the monsoon season of June to August has been 10% lower than the average.

BRAZIL: Brazil's economy has officially entered a recession on the back of declining export revenues driven by a fall in commodity prices. The economy contracted 1.9% year-on-year in the second quarter, after shrinking 0.7% in the first quarter.

MALAYSIA: The Malaysian currency, the ringgit, spiralled weaker after Swiss authorities opened a criminal probe into the relationship between "suspicious transactions" in the country's banking sector and a troubled state investment fund, 1Malaysia Development Berhad. The ringgit is down almost 22% against the US dollar so far this year.

THAILAND: Thailand's economic growth decelerated in the second quarter to 2.8% year-on-year on weak investment and consumer spending. The government lowered its growth forecast for 2015 to a range of 2.7% to 3.2% as the bomb attack in Bangkok is expected to affect tourist numbers.

ZIMBABWE: Zimbabwe's government has cut its 2015 growth forecast from 3.2% to 1.5% after a slump in farm production due to drought. The central bank also capped lending rates at 18% in a move to reform the banking sector. Lending rates have risen as high as 30% in the recent past, stifling corporate borrowing.

ZAMBIA: In comparison to South Africa, Zambia has been suffering power failures of up to ten hours a day, creating chaos at petrol stations and severely hampering the already embattled copper mining industry. Copper accounts for 80% of all export receipts.

SOUTH AFRICA

In step with other emerging markets' currencies the rand plunged to levels last seen in 2001, closing at R13.27 relative to the US dollar for the month. The Reserve Bank warned that the economy faces turbulent times as the prospect of US interest rate increases and a slowdown in China complicate domestic policy. In a continuation of bad news, Public Enterprises Minister Lynne Brown confirmed that Eskom will continue to impose power cuts for the next 18 months as the company struggles with capacity shortages. Brown also expressed concerns about Eskom's financial sustainability and the reliability of its ageing power plants. The only bright light has been that unit 6 at the Medupi power station has eventually come online. The unit has added 794MW to the national power grid.

On the economic front, second quarter GDP contracted by a seasonally-adjusted and annualised rate of 1.3% compared with 1.3% growth in the first quarter. The Markit Standard Bank Manufacturing PMI fell to 48.9 in July, the second successive month below the 50 level. Total credit extension in July came in at 9.9% year-on-year, up from 9.1% in June. Consumer price inflation rose to 5.0% in July, up from the 4.7% registered in June, signalling more interest rate hikes in the near future. The World Bank cut its 2015 growth forecast for South Africa to 2.0% this year and next, warning that risks to these low growth outcomes were firmly to the downside.

The government introduced a 10% import tariff on steel to aid the industry which has been battered by cheap steel imports from China which have flooded the market. The World Trade Organisation allows countries to raise tariffs by up to 10% to protect local industries. In another pre-emptive move, the mining industry, unions and the government have committed to a broad plan to reduce future job losses by delaying lay-offs, selling of distressed mining assets instead of closing them, and looking at ways of streamlining the legal process which employers must follow to cut jobs. Even President Jacob Zuma stepped into the fray by appealing to business and labour to work together to save jobs in a "sick" economy.

ODDS AND ENDS

EL NIÑO IS BACK….

El Niño, which has brought dry weather to parts of Asia and Africa, including KwaZulu Natal, since April this year, is expected to persist well into 2016. El Niño occurs when ocean surface warming develops in the equatorial regions of the Pacific, along with a weakening of the easterly trade winds. These periods of higher than normal temperature anomalies last between nine months and two years. El Niño typically affects weather patterns by baking Asia and Africa, altering rainfall across South America and bringing cooler summers to North America. This is the first El Niño effect since 2010.

…AND SO IS THE ZIM DOLLAR

Zimbabwe tiptoed back into producing its own currency six years after runaway inflation led to the 100-trillion-Zimbabwe dollar bill and the eventual decommissioning of Zimbabwe dollars. Since then, consumers have had to use US dollars for larger purchases and South African rand coins for smaller ones. As the relative value of the US dollar and the SA rand widened the work-around became a problem. In response, Zimbabwe started minting a small amount of gold and silver-coloured coins in denominations equivalent to US pennies, nickels, dimes and quarters. Zimbabweans are slowly coming around to using the dollar-backed "bond coins" which were minted in South Africa and are backed by a US$50 million bond.

CAN CENTRAL BANKS REALLY TAME INFLATION?

The annual meeting of central bankers at Jackson Hole in Wyoming has come out with a new conundrum; they are no longer sure that they understand how inflation works.

Inflation did not fall as much as expected during the financial crisis, when the economy faltered and unemployment soared, and it has not bounced back as predicted when the economy recovered and unemployment fell. Inflation is lower than the targeted 2% throughout the developed world, despite exceptionally low interest rates and other quantitative easing measures.

If inflation does not behave as expected, and the link between unemployment and inflation is broken, as it appears to be, the central banks' ability to manage inflation using interest rates is greatly compromised.

Some behavioural trends noted at the Jackson Hole meeting included the notion that private companies do not behave as expected in a crisis and do not drop their prices despite a fall in demand. A decline in oil prices and a rising value of the US dollar were also cited as a challenge to the notion of inflation forecasts. The debate was particularly relevant given that the US Fed is largely planning to increase interest rates to avoid overheating the economy.

OBAMA'S SWAN SONG

US President Barack Obama's nuclear deal with Iran looks more and more like a long-term lame duck as news agencies reported that Iran will be allowed to use its own inspectors at the secret Parchin nuclear site under a side agreement reached with the International Atomic Energy Agency. Parchin, a military complex, has long been suspected of being the home of Iran's nuclear-weapons and ballistic-missile development. The US has said that any deal requires Iran to agree on an inspections protocol with the IAEA by the end of this year. For obvious reasons self-inspection was not on the table.

WHAT IS HAPPENING TO OIL PRICES

Global oil prices continue to suffer on the back of oversupply. Record production from OPEC, expectations of Iranian oil coming online and a slowdown in China have all contributed to a glut of supply. In addition, oil producers in the US have proven to be extremely resilient, pumping crude at record levels despite months of spending cuts, thanks to new efficiencies in drilling technology. An unexpected oil price rally in the second quarter also allowed some companies to lock in profitable prices for next year and add new drilling rigs. As much as low oil prices are good for South Africa's inflation, they are posing a deflationary threat to the developed world, while destabilising oil exporters such as Russia and Nigeria.

DISCLOSURE