SYGNALS

JANUARY 2015

KEY INDICATORS

		1 MONTH	3 MONTHS	6 MONTHS	1 YEAR	2 YEARS	3 YEARS	5 YEARS
J203T	FTSE/JSE All Share Index	3.1%	3.4%	1.3%	17.1%	16.0%	18.5%	17.3%
J200T	FTSE/JSE Top 40 Index	2.6%	1.9%	-0.9%	14.5%	15.1%	17.8%	16.7%
J210T	FTSE/JSE Resources 20 Index	0.4%	-10.8%	-28.5%	-19.3%	-8.1%	-5.9%	0.2%
J211T	FTSE/JSE Industrials 25 index	3.2%	6.3%	10.9%	27.2%	27.1%	32.6%	28.4%
J212T	FTSE/JSE Financials 15 Index	4.6%	7.9%	14.2%	43.9%	24.3%	27.5%	21.6%
J403T	FTSE/JSE SWIX Index	4.0%	4.9%	5.9%	24.2%	19.5%	21.4%	19.3%
J303T	FTSE/JSE CAPI Index	3.1%	3.5%	1.5%	17.3%	16.1%	18.6%	17.6%
J253T	SA Listed Property Index	7.4%	11.6%	25.5%	46.4%	20.8%	24.1%	23.2%
ALBI	BEASSA All Bond Index	6.5%	7.4%	12.3%	21.2%	8.6%	10.3%	11.3%
STeFI	STeFI Index	0.5%	1.6%	3.1%	6.0%	5.6%	5.6%	5.8%
	MSCI World Index in SA Rands	-0.3%	4.0%	7.2%	12.0%	27.0%	29.0%	20.5%
	Rand/US Dollar Exchange Rate	1.6%	5.5%	8.7%	4.7%	13.9%	14.3%	8.8%
	Rand/Euro Exchange Rate	-6.1%	-4.9%	-8.3%	-12.4%	3.8%	8.8%	4.5%
	Headline CPI	-0.2%	0.0%	1.2%	5.3%	5.4%	5.5%	5.2%
	PPI	-0.2%	0.1%	0.7%	5.8%	6.1%	5.9%	6.7%

"The Greeks have the right to elect whoever they want; we have the right to no longer finance Greek debt. The Greeks must now pay the consequences and cannot saddle German taxpayers with them."

Hans-Peter Friedrich, a senior member of German Chancellor Merkel's conservative bloc

finsolnet

SYGNIA
THE SUM OF ALL THINGS

MARKET OVERVIEW

The global economy began 2015 on a fragile note, with weakening manufacturing activity in China and the eurozone, a collapsing ruble threatening Russia's financial stability, political change in Greece resurrecting the spectre of the country exiting the euro, and commodities in free-fall on the back of a falling oil price and a strong US dollar.

The falling oil price has translated into lower inflation in most parts of the world, including the eurozone where in December inflation slipped to -0.2%, piling pressure on the ECB to introduce further quantitative easing (QE) measures. Inflation is likely to fall below 2.0% in all the G7 countries in 2015, the first time that has happened since before the Second World War.

The lower oil price has also triggered a fully-fledged currency crisis in Russia where the ruble fell by 40% relative to the US dollar in 2014.

In stark contrast, the US has once again reasserted its position as the engine of world growth. Its third quarter GDP growth number was revised up to an annualised 5.0%, the highest level since 2003, the unemployment rate dropped to 5.6% in December and inflation fell to a nine-month low of 1.4% relative to a year earlier. The economy added 2.95 million new jobs last year, the best record since 1999. Unfortunately, wage growth remains disappointing. Other economic data for December was mixed with weaker than expected construction, manufacturing activity; factory orders and retails sales data. The mixed economic signals, falling inflation and a stronger US dollar all point to the likelihood of US interest rates remaining low for longer.

Domestically, the rand fell to a six-year low against the US dollar, a victim of global events and weak domestic economic fundamentals, including the impact of electricity cuts. On a positive note South Africa avoided the widely expected credit rating downgrades by Fitch and S&P in December, although both agencies expressed concerns about growth.

Mid-month brought a sharp sell-off in stocks after the World Bank downgraded growth forecasts and US retail sales disappointed. The World Bank now expects global growth to average 3.0% in 2015 from its earlier forecast of 3.4% despite the lower oil price. The news triggered a bout of safe-haven buying, with the 10-year Treasury bond trading at a yield of -1.71%, a two-year low, and the gold price starting an advance which culminated in the best month for the metal price in a year.

The run to safety continued after the Swiss National Bank surprised markets by removing the 1.20 Swiss franc/euro trading cap. The cap was introduced to shield the Swiss economy from the sovereign debt crisis, but has become too expensive to defend in the face of ECB's planned QE programme. The Swiss franc soared 28% against the euro on the news, back to where it was before the peg was introduced.

Within days of the move the ECB finally launched its QE programme, announcing €1.1 trillion in new purchases of government bonds in monthly instalments of €60 billion per month until September 2016, with the aim of reaching the targeted 2% rate of inflation. The programme will be run decentrally, with national central banks of the eurozone members conducting most of the purchases.

Markets soared in response, with bond yields falling and the euro weakening to an 11-year low against the US dollar.

The trend reversed temporarily after the Greek leftist anti-austerity Syriza party, a fierce opponent of Greece's bail-out deal with the EU and the IMF, swept to power in the 25 January elections. Alexis Tsipras, Syriza's maverick leader, while pledging to keep Greece in the eurozone, set himself an immediate task of reversing wrenching austerity policies such as privatisation and wage cuts, restoring growth and negotiating with European leaders to reduce Greece's debt burden of €240 billion bail-out funds.

The European Commission immediately made it clear that although Greece could be given more time to repay its debts, it should not expect those debts to be cut, while the IMF indicated that it expected Greece to honour the reform pledges it made as part of its bail-out plan.

Syriza has become the first anti-austerity party to take power in a eurozone country, sending a warning to the rest of Europe, where continuing economic weakness has stirred a populist backlash.

It is important to note that despite the unpopularity of austerity policies, the previous government oversaw Greece exiting a six-year recession, achieving a budget surplus before interest payments, and reducing youth unemployment from 60% to about 49% last year.

The market's initial dismay over Syriza's electoral victory faded relatively quickly. Unlike at the height of the debt crisis in 2011 and 2012, European banks now have limited exposure to Greece, and policymakers have set out safety nets to deal with renewed contagion.

Perhaps the biggest question is what the Syriza victory will mean for Greek bonds in light of the ECB's QE plan. A buy-up of Greek bonds would bring substantial relief to the new government's borrowing costs. However, the ECB has already indicated that there will be special conditions attached to the purchase of Greek bonds.

The US Federal Reserve painted a bullish view of the US economy after its first policy meeting of 2015, which was interpreted as putting it on course to raise interest rates by mid-2015.

Oil resumed its decline as US crude production increased, the IMF lowered its forecasts for global economic growth to 3.5% in 2015 and 3.7% in 2016 and China reported GDP growth of an annualised 7.3% in the fourth quarter of 2014 and 7.4% for the year as a whole, missing the government's target of 7.5%. The last time China's GDP growth fell below 7.5% was in 1990 after the Tiananmen Square massacre. The oil price did spike briefly on the news of the death of King Abdullah of Saudi Arabia, the biggest producer within OPEC. However, his successors, Crown Prince Salman bin Abdulaziz, moved quickly to assuage fears of an unstable transition and any policy change in the world's largest oil exporter. At month end oil prices dipped to a six-year low on data showing fresh additions to record-high US oil inventories.

The end of the month saw a strong surge in global equity markets spurred by stronger than expected earnings reports from Wall Street, including Apple which reported the best quarterly results since its inception on phenomenal sales of the new iPhone.

2015 is likely to bring more volatility. The lower oil and food prices, strong growth in the US, the ECB's QE programme and record low interest rates create a positive environment for most asset classes during the first half of the year. Even geopolitical shocks to the system, such as Greece exiting the euro, have been largely factored in. However, the slowdown in China, the risk of deflation and the feeble global economic growth mean that the medium to longer term outlook remains extremely uncertain, demanding caution and diversification.

360 DEGREES ROUND THE WORLD

UK: The UK received a nasty reminder that it cannot escape the general weakness in the eurozone as its HSBC/Markit manufacturing PMI fell to a three-month low in December (52.5) on stagnating overseas orders. Inflation fell to 0.5% year-on-year, its lowest level since 2002, forcing Governor Mark Carney to write the Bank of England's first open letter explaining why prices are rising too slowly. The Bank of England's mandate is to maintain inflation at 2.0%.

GERMANY: Germany's economy grew at the fastest pace in three years and posted a third consecutive fiscal surplus in 2014. GDP rose by 1.5%, compared with a 0.1% gain in 2013, its best year since 2011. However, inflation turned negative in January, falling by 0.5% year-on-year and boosting demand for the safety of bonds. Germany's 30-year yield fell below 1.0% and the five-year yields dropped below zero for the first time in history.

RUSSIA: The plight of Russia was best reflected in the dearth of Russians on the ski-slopes of Europe's exclusive ski resorts in December. The central bank's efforts to defend the ruble have led to its foreign reserves dropping to their lowest level since the global financial crisis as US$133.3 billion left the country in 2014. With its options narrowing, the central bank announced it will unseal its US$88 billion Reserve Fund and raise interest rates as the next step. Fitch cut Russia's credit rating to BBB minus, one notch above junk, while S&P's lowered Russia's long-term foreign currency rating to a junk grade of BB+.

ITALY: Italy's jobless rate fell to 12.9% in December from a record high of 13.3% in the prior two months, in a possible indication of some economic recovery driven by a lower euro and dropping oil prices. Prime Minister Matteo Renzi is pushing through reforms aimed at simplifying the labour market, the public administration and the justice system.

LITHUANIA: Lithuania became the 19th member of the eurozone, with effect from the start of the year.

CHINA: The 2014 GDP growth of 7.4% disappointed investors. As export demand reduces and the real estate sector cools, China has been looking to consumers to help pick up the slack. Consumer spending, which makes up for 36% of the GDP, has been increasing at a decent pace. However, this is a fight against a widely entrenched savings culture. The average Chinese household saves as much as 40% of its income, in comparison to USA's 5.2% and Japan's 1.8%.

What really matters is that 2014 provided the template for what China's economy is likely to look like in the next decade. This includes an economy less reliant on export-led manufacturing, slower growth in commodity consumption and imports and a smaller role for government stimulus spending.

JAPAN: The Bank of Japan has once again cut its inflation forecast from 1.7% to 1.0% for the year beginning in April, and from 2.2% to 2.1% for the year thereafter. At the same time, the government approved a record budget for the next fiscal year to support the economy. There are some signs that the economy is improving (e.g. falling unemployment), but Tokyo's attempts to overcome deflation with cheap central bank money appears to be failing. Weak consumer demand adds to the problem, with wages remaining largely stagnant throughout 2014.

INDIA / TURKEY: Both countries' central banks were the first to cut their benchmark interest rates in response to the lower oil price.

SOUTH AFRICA

Electricity shortages frayed nerves as Eskom announced rolling black-outs due to lack of capacity and maintenance problems, issues which it says could last for three years. Given Eskom's abysmal track record of time projections, with both power stations, Medupi and Kusile, already three years behind schedule, now is the time to invest in a generator and a gas stove, and figure out the logistics of regular diesel refuelling. More seriously, the move is likely to deter investments and detract from economic growth in 2015, wiping out any benefits of the lower oil price on growth. The electricity crisis competed for headlines with the uncomfortable news of a resurgence of violence against foreigners in the townships.

Unsurprisingly, the IMF cut its forecast for South Africa's economic growth this year to 2.1% from its earlier 2.3%, the third consecutive cut in 12 months. The growth outlook for 2016 was cut to 2.5% from 2.8%.

Economic signals are pointing to further weakness in the first quarter, with private sector credit demand coming in flat between October and November, and retail sales disappointing. The Kagiso PMI, which gauges activity in the manufacturing sector, fell to 50.2 in December from 53.3 in November.

The price of petrol, on the other hand, dropped to its lowest level since August 2012, providing much-needed relief to consumers. This, combined with lower food prices, drove inflation down to 5.3% year-on-year in December and producer price inflation to 5.8%.

This has not been sufficient for the Reserve Bank, which left interest rates unchanged at 5.75% and has not visibly abandoned a hiking cycle. Although indicating that interest rates may stay unchanged for the better part of this year, it made it clear that a weaker rand and looming US interest rate increases pose a significant risk to future inflation. The Reserve Bank expects inflation to average 3.8%, reaching a low of 3.5% in the second quarter, and GDP growth to come in at 2.2%, down from an earlier forecast of 2.5%.

The ECB's QE announcement resulted in the JSE breaching the 50 000-point level once again, while the rand strengthened against the euro. We expect the rand to stay relatively stable during 2015 at the current levels, bar unexpected shocks such as Greece leaving the EU or further instability in Russia.

And finally, SAA is out of the woods for now with a R6.5 billion government guarantee enabling it to publish its long-delayed financial results.

ODDS AND ENDS

LET'S NOT LOSE SIGHT OF EBOLA

Johnson & Johnson has started clinical trials of its experimental Ebola vaccine, making it the third such treatment to enter the human testing phase. The Ebola death toll stands at 8 429. Two other experimental vaccines, from GlaxoSmithKline and rival NewLink and Merck, are already in clinical development.

TIME TO GET ENGAGED?

According to the WWW International Diamond Consultants diamond prices suffered their biggest quarterly decline in more than two years as banks tightened credit to the industry, forcing traders, cutters and polishers to sell more inventory. Rough diamond prices fell 6.9% in the last three months of 2014, the steepest drop since the second quarter of 2012.

LOW OIL PRICE NOT ENOUGH TO DEFEND WORLD GROWTH

The World Bank cut its forecast for 2015 global growth to 3.0%, despite an improving US economy and lower fuel prices. It reduced its projections for the euro area and Japan, citing lingering effects from the financial crisis and “structural bottlenecks” and cut its forecast for China, saying the world’s second-biggest economy is undergoing a “managed slowdown”. The 19-nation euro area is projected to grow by 1.1% in 2015, China by 7.1%, Japan by 1.2% and the US by 3.2%. Projections for emerging economies have all been broadly cut back, with the outlook for oil exporters Russia, Nigeria and Saudi Arabia worsening the most.

The IMF followed, cutting its forecasts for global growth to 3.5% and calling for the continuation of accommodative monetary policies and structural reform.

AN ALTERNATIVE VIEW ON THE ECB’S QE

The ECB’s QE has faced strong criticism for coming too late to have more than a marginal effect. Since the global financial crisis Western economies have relied heavily on their central banks to come up with growth strategies. The tools at their disposal are limited to controlling the money supply and the levels of interest rates. The concern is that slashing of interest rates to zero and floods of newly printed money have had little impact on consumer demand and true economic growth since the global financial crisis. With everyone printing money, the race for the most competitive currency devaluation has become a zero sum game that intuitively is likely to end badly.

UNDERSTANDING DEFLATION

On the surface falling prices are good for consumers. However, entrenched deflation is not. Once deflation becomes an expectation, consumers and corporates tend to defer spending on the hope of getting a better deal in future. Given that consumer spending forms a large part of the economy, a slowdown in consumption immediately translates into lower growth. This, in turn, translates into lower profits, lower salary increases and fewer jobs being created. This, of course, immediately affects consumer spending – a vicious cycle of lower inflation, lower spending, lower profits and so on. On the liability side, debt levels remain the same as borrowers struggle to repay debt. Should consumers start defaulting on debt the situation could worsen. The typical antidote is lower interest rates. However, in the current environment, that remedy has been exhausted, hence the printing of money.

DISCLOSURE

The information and opinions contained in this document are of a general nature and are not intended to address the circumstances of a particular individual or entity. Sygnia does not act as advisor or in a fiduciary capacity towards the recipient(s).

Whilst reasonable care was taken in ensuring that the information contained in this document is accurate, Sygnia does not warrant its accuracy, correctness or completeness and accepts no liability in respect of any damages and/or loss suffered as a result of reliance on the information in this document. Sygnia does not undertake to update, modify or amend the information on a frequent basis or to advise any person if any information provided in this document is found to be inaccurate or subsequently becomes inaccurate.

No one should act on the information contained in this document without having obtained appropriate and professional investment, legal, tax and such other relevant advice as may be required in each instance.

The figures and values are calculated by FTSE International Limited (‘FTSE’) in conjunction with the JSE Limited (‘JSE’) in accordance with standard criteria. Figures and values quoted are the proprietary information of FTSE and the JSE. All copyright subsisting in the Figures and values vests in FTSE and the JSE jointly. The data was obtained from I-Net Bridge.

SYGNIA ASSET MANAGEMENT (PTY) LTD Registration No. 2003/009329/07
Directors: M. Budge | N. Giles | C. Leetjer | S. Mkhwanazi | S. Peile | M. Wierzycka
CAPE TOWN 7th Floor The Foundry Cardiff Street Green Point 8001 T +21 446 4940 F +21 446 4950
JOHANNESBURG Unit 40 6th Floor Katherine & West Building West Street Sandton 2196 T +10 595 0550 F 0862 065 173
www.sygnia.co.za | info@sygnia.co.za | Sygnia Asset Management is a licensed Financial Services Provider (FSP 873)