SYGNALS

JUNE 2015

KEY INDICATORS

		1 MONTH	3 MONTHS	6 MONTHS	1 YEAR	2 YEARS	3 YEARS	5 YEARS
J203T	FTSE/JSE All Share Index	-0.8%	-0.2%	5.6%	4.8%	17.9%	19.0%	18.0%
J200T	FTSE/JSE Top 40 Index	-0.2%	0.7%	6.4%	3.4%	18.2%	19.4%	18.0%
J210T	FTSE/JSE Resources 20 Index	-6.6%	-4.6%	-4.8%	-28.7%	-0.5%	-2.8%	0.0%
J211T	FTSE/JSE Industrials 25 index	0.9%	2.0%	8.1%	14.7%	23.3%	30.4%	29.2%
J212T	FTSE/JSE Financials 15 Index	-0.5%	-2.7%	7.6%	18.1%	26.4%	24.5%	22.7%
J403T	FTSE/JSE SWIX Index	0.6%	-0.1%	6.7%	10.2%	20.5%	20.6%	19.9%
J303T	FTSE/JSE CAPI Index	-0.8%	-0.2%	5.6%	4.9%	18.0%	19.0%	18.2%
J253T	SA Listed Property Index	-0.4%	-6.2%	6.6%	27.0%	16.0%	18.6%	20.5%
ALBI	BEASSA All Bond Index	-0.2%	-1.4%	1.6%	8.2%	6.8%	6.6%	9.1%
STeFI	STeFI Index	0.5%	1.6%	3.1%	6.3%	5.8%	5.7%	5.8%
	MSCI World Index in SA Rands	-2.2%	0.6%	9.1%	16.1%	24.6%	30.7%	24.0%
	Rand/US Dollar Exchange Rate	0.1%	0.3%	6.3%	14.5%	11.0%	14.3%	9.7%
	Rand/Euro Exchange Rate	1.4%	3.0%	-3.3%	-7.0%	2.7%	9.4%	7.6%
	Headline CPI	0.3%	2.6%	2.9%	4.6%	5.6%	5.6%	5.4%
	PPI	0.8%	3.4%	2.4%	3.6%	6.1%	5.7%	6.4%

"Men are so naive, and so much dominated by immediate needs, that a skillful deceiver always finds plenty of people who will let themselves be deceived."

Niccolò Machiavelli, the 16th-century political realist, quoted with reference to Greek Prime Minister Alexis Tsipras who was elected on the back of plethora of unrealistic populist pledges.

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SYGNIA
THE SUM OF ALL THINGS

MARKET OVERVIEW

The global stock market roller-coaster continued as speculation about the timing of the US Federal Reserve's interest rate increases took second place to the eurozone flirting with the possibility of Greece defaulting on its IMF debt obligations and potentially exiting the euro.

With the eurozone's portion of Greece's €245 billion bail-out deal due to expire on 30th June, (the same day Athens had to pay back €1.6 billion in loans to the IMF, a payment it was not able to make without a new transfer of aid), time to reach a deal started running short. Unfortunately, Greece and its creditors, the ECB, the IMF and the EC, remained deadlocked over how much austerity the country would accept. The left-wing government of Prime Minister Alexis Tsipras focussed on raising new revenues from corporate taxes and employers' social-security contributions. The creditors, on the other hand, wanted to see cuts in pensions and military spending, as well as increases in sales taxes.

Apart from its June commitments, Greece faces €6 billion of treasury bills and bonds maturing in July. In a last minute bid to avert a crisis, the creditors offered Greece €15 billion in funding until November if Tsipras agreed to their conditions. Tsipras responded by calling for a 5th July referendum so that the Greeks can decide whether or not to accept the terms of the proposed deal. He made it clear that he would campaign for a "no" vote, arguing, perhaps naively, that this is merely another step in the negotiation of better bail-out terms. This was followed by the closure of all banks until after the referendum in a bid to prevent the banking system from collapsing under the strain of withdrawals. Cash withdrawals for Greeks have been limited to €60 a day. The move stunned the Greeks, baffled the creditors and put the country on a path to exit from the euro. In addition, it guaranteed that the bail-out agreement between Greece and its creditors would expire on 30th June and that Greece would default on its IMF repayment. A plea from Greece for a one month extension of the former was rejected. The two events have no immediate consequences for Greece, but they up the ante. If this was not enough, hours before the deadline expired, Athens announced that it will seek a new two-year bail-out programme which would run alongside the debt restructuring.

Market reaction to the changing news was negative, but far from a panic, in what has been attributed to "headline fatigue" and investors becoming conditioned to the idea of Greece leaving the euro. It also helped that the ECB signalled that it would take additional steps if needed to calm financial markets from any contagion fears. The best tool it can deploy quickly would, of course, be large-scale bond purchases under the QE programme as the ECB is not tied to a fixed schedule of purchases.

This complacency may well underestimate the future. A "no" vote in the referendum would be treated by much of Europe as the end of the five-year effort to save Greece from bankruptcy and the Grexit. Such an exit would bring about a deep recession, a dramatic decline in income levels, an exponential rise in unemployment and a collapse of all that the Greek economy has achieved over the years of its EU membership. If Greeks vote "yes" then the government will most likely have to resign, and the country will either have to hold fresh elections or rule by coalition.

The key lever rests in the hands of the ECB and its emergency liquidity assistance which became the only source of funding for the Greek banks in February, after the ECB said it would no longer accept Greek government debt as collateral for its standard bank lending operations. The ECB has extended nearly €89 billion in emergency loans to the Greek banks since, as domestic deposits fell from €179 billion in September 2014 to €139 billion at the end of May, reflecting €40 billion in withdrawals. The banks' reliance on central bank funding rose from €42.6 billion to €116 billion over the same period. The ECB could have halted the party earlier, but it has consciously resisted any moves that would have pre-empted political decisions. At month-end, however, the ECB froze the ceiling for emergency liquidity assistance at €89 billion.

The uncertainty around Greece led to a spike in the bond yields of "peripheral" eurozone countries, such as Spain, Italy and Portugal.

Outside of Greece, the eurozone continued to show signs of a recovery, with manufacturing activity growing more rapidly than expected in May and the Markit/HSBC manufacturing PMI rising to 52.2. Export numbers also look healthier. Most significantly, consumer prices rose for the first time in six months, a significant victory for the ECB in its campaign to avert a slide into deflation. The 0.3% year-on-year rebound was a combination of higher oil prices and strengthening consumer demand. The ECB lifted its inflation forecast for 2015 to 0.3%, up from 0% in March, and recommitted to keeping quantitative easing running until September 2016, despite the fact that rising expectations for eurozone economic growth have sparked an ongoing sell-off in bonds.

The strong US dollar continued to drag down growth in the US, with clear signs that the US economy has down-shifted after a period of rapid growth in 2014. Industrial production and orders for durable goods declined, while consumer sentiment fluctuated between a six-month low in May and a recovery in June. On the other hand, manufacturing activity and construction data came in better-than-expected. Private-sector employment as measured by the ADP survey also picked up, although the official unemployment rate rose to 5.5%. Consumer prices recorded their largest increase in more than two years in May as gasoline prices surged, with the CPI rising by 0.4%, leaving the year-on-year figure flat after a 0.2% decline in April.

The US Fed left interest rates unchanged and cut is economic growth forecast from 2.5% this year to 1.9%, with the chairwoman, Janet Yellen, emphasising the importance of the pace and trajectory of the interest rate hikes, rather than the timing of the initial hike. Yellen indicated that no decision has been made on raising rates this year as the timing will depend on the economy. Both the IMF and the World Bank have called on the US to hold off on raising rates until next year, arguing that moving too soon could stall the economy.

China continued to slow down with their consumer price index slipping by 0.2% in May from the month before, bringing annual inflation to 1.2%. Manufacturing activity continued to deteriorate despite government measures to support the economy, with the HSBC/Markit Manufacturing PMI coming in at 49.2 in May, a third month of below 50 index levels. Flash June figures remained in the contraction territory. Exports slipped by 2.5% year on year, while imports tumbled by 17.6%. Only the services sector showed some life.

To add to the concerns, the Chinese stock market, which has more than doubled over the past 12 months, lost over 17% of its value in June as China's central bank quietly drained money from the country's financial system to prevent the market overheating. The central bank responded by announcing a quarter-point interest rate cut coupled with the relaxation of banks' reserve requirements; a combination of measures last seen in 2008. In addition, the government lowered stamp duties on stock purchases and stated that the state's pension fund could be allowed to invest up to 30% of its assets in securities. The Chinese stock market has been in a frenzy since the central bank commenced cutting interest rates in November 2014. Much of the freed up cash found its way into stocks. After an initial hiccup post the announcement, stocks seemed to recover from their lows.

Gold ended the month down 1% at below US$1 174/oz on surprisingly little risk aversion. Oil, meanwhile, remained range-bound through the month, at around US$62 a barrel as China's oil imports dropped sharply, the OECD kept its production targets unchanged and the Greek crisis raised concerns about demand for petroleum in Europe.

The OECD lowered its global growth forecasts to 3.1% for this year and 3.8% in 2016, as lower investment and "transitory" weakness in the US economy weighed on the recovery.

360 DEGREES ROUND THE WORLD

UK: The UK economy is back on track with inflation edging up by 0.1% in May compared with a year ago and unemployment at a low of 5.5% in April. An improving labour market is underpinning consumer spending. However, S&P's warned that the UK is in danger of losing its AAA rating while it downgraded its outlook on the UK's rating to "negative" on the back of political risks posed by the 2017 referendum on EU membership. It is the only one of the big three credit agencies that still gives the UK a top tier credit rating.

TURKEY: The lira slumped to an all-time low after President Recep Tayyip Erdogan's AKP party lost its decade-long majority in parliament, leaving the country bitterly polarised and without a clear government.

GERMANY: Whilst the growth number for the first quarter disappointed at 0.3%, latest economic data points to an upturn. The unemployment rate remained at 6.4%, the lowest level since German reunification.

RUSSIA: The World Bank expects the Russian economy to shrink by 2.7% this year and return to growth of 0.7% in 2016. Russia has been savaged by the fall in oil prices and Western sanctions imposed over the conflict in Ukraine. The EU extended the sanctions until the end of January 2016 so it can determine if the Kremlin will comply with February's Minsk cease-fire plan. The EU tied the easing of the sanctions to a complete implementation of the cease-fire agreement, including handing back of control of Ukraine's eastern border to Kiev.

GREECE: It is not a surprise that pension reform is a key demand by creditors. Wages and pensions account for 80% of government spending, with pensions amounting to 16% of GDP. The retirement age in Greece is very lenient (men: 62, women: 60), while arduous professions, including bakers and hairdressers, are eligible for more generous benefits.

SOUTH KOREA: The Bank of Korea lowered its key interest rate to a low of 1.5%, the fourth reduction in 12 months, as it warned that the spread of Middle East Respiratory Syndrome (MERS) poses an imminent threat to consumption.

CHINA: Global stock-index compiler MSCI Inc. chose not to add Chinese domestic stocks to its widely tracked Emerging Markets Index until important issues related to market accessibility have been resolved. The MSCI Emerging Markets Index is tracked by roughly $1.7 trillion in assets worldwide.

INDIA: The Reserve Bank of India cut interest rates for the third time this year to 7.25% to help boost growth in Asia's third largest economy. The economy grew by 7.5% year-on-year in the first quarter, outstripping China, the world's second largest economy.

AFRICA: Five sub-Saharan African central banks have bucked a global trend by increasing borrowing costs this year to ward off inflation and defend their currencies. In June, Uganda's central bank raised its benchmark rate by 1.0% for the second time this year, while Namibia raised its repurchase rate by 0.25%. Kenya, Angola and Ghana have also tightened monetary policy this year. Brazil is the only major emerging market outside of Africa to have increased rates in 2015. The benchmark lending rate stands at 22% in Ghana, 13% in Uganda, 10% in Kenya, 9.25% in Angola, 6.5% in Namibia and 5.75% in South Africa.

SOUTH AFRICA

It appears there is no end to bad headlines. Chaos at Eskom, a lack of any visible investigation into the FIFA scandal, further disruptions in the National Assembly and the granting of safe passage to the Sudanese President Omar al-Bashir in the wake of the AU summit did little to endear the country to foreign investors. The rand acted as a barometer of global sentiment, weakening to over R12.60/US dollar inter-month, before strengthening as the US dollar retreated. It ended the month at R12.17/US dollar.

The economy continued to show weakness, with few signs of a recovery in the second quarter. In May, Sacci's business confidence index plummeted to its lowest level since September 1999 on falling exports, manufacturing and mining production numbers.

Consumer inflation rose to 4.6% year-on-year in May, a marginal uptick from April. The Reserve Bank has warned that further rand weakness, an expected increase in electricity tariffs, which was subsequently rejected by NERSA, and higher wage settlements could worsen the inflation outlook. The Bank's current forecast is for inflation to average 4.9% this year, 6.1% next year and 5.7% in 2017, with a peak outside the 3% to 6% target band at about 6.8% in the first quarter of next year. The Reserve Bank has repeatedly warned of imminent interest rate increases.

On a more positive note, retail sales increased by a more-than-expected 3.4% year-on-year in April, while private sector credit extension grew by a stronger-than-expected 9.4%. The Kagiso manufacturing PMI rose to 50.8 from 45.4 in April on improving economic prospects in Europe, a key export market for South Africa.

The government concluded a three-year deal to increase public sector wages by 7% in the first year, with further increases in housing subsidies and medical aid. The next sector to face wage negotiations is gold mining. South African gold producers, already battling a low gold price and power outages, are now gearing up for wage talks and the BEE definition of "once empowered always empowered". NUM and AMCU, representing more than 80% of the country's gold workers, are demanding as much as double current wages.

Surprisingly, both Fitch and S&P's affirmed South Africa's sovereign credit ratings at investment grade with Fitch maintaining a negative outlook, and S&P's stable. The rating agencies quoted quick conclusion of the public sector wage negotiations, government's fiscal consolidation and expectations for the budget deficit to narrow and for the economy to improve by 2017 as positives.

South Africa continued its slide down the charts of world competitiveness rankings, falling from 45th position in 2010 to 53rd last year and 56th in 2015 out of the 144 countries included in the World Economic Forum's Global Competitiveness Index. Labour market inefficiencies and a weak education system were highlighted as major pull-backs.

ODDS AND ENDS

MINING UNDER ATTACK

According to the PwC annual survey, Mine 2015, the market capitalisation of the world's 40 biggest mining companies amounted to US$791 billion at the end of 2014, the same level it was at a decade ago. Market cap has halved in just four years as a consequence of declining commodity prices. Barely any of the top 40 companies had a South African connection, with BHP Billiton having unbundled its South African interests, along with some in Australia and South America, into a separately listed company.

CRITICISE NASPERS AT YOUR PERIL

Global e-commerce reached US$1.3 trillion last year, with China at the forefront of growth as a consequence of the rapid growth in the usage of smartphones in the country. An estimated 461 million Chinese consumers, a third of the population, shop online, up from 46 million in 2007 when e-commerce started gaining momentum. China's e-commerce market grew 49% last year to 11% of all retail sales, after gains in the prior three years of 59%, 51%, and 70%, respectively. China overtook the US as the world's biggest e-commerce market in 2013.

The closest South African investors can come to accessing the Chinese e-commerce phenomenon is through Naspers, which holds a 34% stake in Tencent, a Chinese internet company with a market capitalisation of US$139 billion. Tencent was founded in 1998 and is one of China's largest and most used internet service portals with nearly a billion active users. Simplistically, Tencent offers the functionality of Facebook, Amazon, Twitter and Uber rolled into one.

WAS IT WORTH IT?

Greek Prime Minister Alexis Tsipras was elected to office in January 2015 on the back of myriad promises, including negotiations to write off Greece's debt, an end to austerity through a boost to government spending, the rehiring of workers laid off by previous governments and protection for Greek bank depositors. His ability to meet these pledges depended on extracting concessions and more money from the country's creditors. Neither outcome happened.

Five months down the line, with the economy in tatters, Tsipras's campaign of brinkmanship is coming to a sad end. Whatever deal is struck, it will be a poor cousin of what was on the table just five months ago. The fastest growing economy in the eurozone in the second half of 2014 is now back in recession. A budget surplus before interest costs that was predicted to hit 2.6% of GDP this year is now heading for a deficit and €40 billion of deposits have been withdrawn from the banking system. Greece has also lost whatever goodwill still existed towards it.

The broader consequences are that the debate about whether the euro can deliver benefits for all its members, and whether the decision to join the euro is reversible, is gaining momentum. The rise of new, more radical parties in Europe poses a huge challenge to the political will that has sustained the euro even through times of crises.

DISCLOSURE

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