SYGNALS

NOVEMBER 2015

KEY INDICATORS

		1 MONTH	3 MONTHS	6 MONTHS	1 YEAR	2 YEARS	3 YEARS	5 YEARS
J203T	FTSE/JSE All Share Index	-3.9%	4.4%	0.5%	6.8%	10.5%	14.1%	14.7%
J200T	FTSE/JSE Top 40 Index	-3.9%	5.7%	1.9%	8.2%	10.8%	14.4%	14.9%
J210T	FTSE/JSE Resources 20 Index	-22.5%	-26.1%	-36.4%	-38.5%	-25.1%	-16.5%	-10.1%
J211T	FTSE/JSE Industrials 25 index	-1.0%	12.8%	10.2%	19.3%	20.1%	24.9%	26.4%
J212T	FTSE/JSE Financials 15 Index	-4.0%	0.8%	-0.5%	7.9%	19.0%	20.7%	20.6%
J403T	FTSE/JSE SWIX Index	-2.7%	3.3%	0.6%	7.0%	12.9%	15.8%	16.3%
J303T	FTSE/JSE CAPI Index	-3.9%	4.4%	0.5%	6.8%	10.6%	14.2%	14.9%
J253T	SA Listed Property Index	-0.5%	2.4%	7.5%	16.3%	21.3%	16.6%	19.0%
ALBI	JSE All Bond Composite Index	-1.0%	0.2%	1.2%	1.3%	7.1%	5.3%	7.9%
STeFI	STeFI Index	0.5%	1.6%	3.2%	6.4%	6.1%	5.8%	5.8%
	MSCI World Index in SA Rands	4.0%	12.5%	14.0%	29.8%	24.0%	30.4%	26.2%
	Rand/US Dollar Exchange Rate	4.5%	8.8%	18.7%	30.7%	19.2%	17.5%	15.3%
	Rand/Euro Exchange Rate	0.0%	2.2%	13.9%	10.3%	4.9%	9.6%	10.5%
	Headline CPI	0.3%	0.3%	2.0%	4.7%	5.3%	5.4%	5.5%
	PPI	0.9%	1.3%	2.6%	4.2%	5.4%	5.7%	6.6%

"The circumstances are unprecedented. The gauntlet thrown down to Russia is unprecedented. So naturally the reaction is in line with this threat."

Dmitry Peskov, Russian President Vladimir Putin's spokesman, in explaining a decree imposing a raft of punitive economic sanctions against Turkey

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SYGNIA
THE SUM OF ALL THINGS

MARKET OVERVIEW

November brought a slew of disheartening news, including new frontiers for terror with an attack on Paris and a shut-down of Brussels, numerical confirmation of slowing global economic growth, a further collapse in commodity prices and, closer to home, financial woes at SAA, MTN and Lonmin. Despite all of that, the most meaningful consideration for investors remained the rising certainty that the US Federal Reserve will increase interest rates in December.

The expectations of an imminent US interest rate hike strengthened the US dollar, a negative for commodities and the rand which hovered between R14.15/US$ and R14.50/US$ through November.

Heedless of global woes the US economy continued to grow at a moderate pace, supporting the argument for a hike. October was the best month for job creation this year, with the official unemployment rate dropping to 5.0%, regarded as "full employment". More encouragingly, wage growth numbers showed some acceleration. The third quarter GDP growth number was revised upwards to an annualised 2.1%. There were, however, some weak spots, including manufacturing activity which hit a two-and-a-half year low in October buffeted by a strong US dollar, and consumer spending which barely rose from its September level as households took advantage of rising incomes to boost savings rather than spending. Inflation came in at 0.2% year-on-year, far from the 2% targeted by the US Fed.

While the US Fed is poised for tightening, the ECB is readying for more stimulus in response to a visible slowdown in the eurozone, where the third quarter GDP number came in at 0.3% quarter-on-quarter and 1.6% year-on-year, down from 0.4% in the prior quarter, as exports weakened. The slowdown was most pronounced in Germany, the export powerhouse, followed by Italy, Greece, Finland and Estonia. Portugal's economy stagnated, while, surprisingly, France's economy expanded. The European Commission forecasts that GDP in the 19-nation eurozone will grow by 1.6% this year and 1.8% in 2016, while GDP in the 28-member European Union will expand by 1.9% and 2.0% respectively. October, however, brought some better economic news with stronger manufacturing activity and inflation turning positive at 0.1% year-on-year. Markit's manufacturing PMI rose to 52.3 from 52.0 in September.

The ECB warned that inflation dynamics have weakened and that a "sustained normalisation" of inflation could take longer to achieve than previously thought. The central bank repeatedly assured investors that it will consider more quantitative easing, whether through the expansion of the existing programme or via interest rate cuts, at its December meeting.

Moving onto China, economic data flow continued to disappoint, highlighting the fact that the world's second-biggest economy remains under pressure. Industrial production in October came in weaker than expected despite six interest-rate cuts and hundreds of approved infrastructure projects aimed at spurring growth. The Caixin manufacturing PMI improved to 48.3 but remained below the key 50 level. Exports fell for the fourth consecutive month, while weak domestic demand continued to punish imports. China's trade surplus widened to US$61.64 billion from US$60.3 billion in September. The Chinese consumer, on the other hand, albeit only accounting for 40% of the domestic economy, appears to be weathering the storm better than the economy's traditional growth engines such as manufacturing. Retail sales in October increased by 11% from a year earlier as sentiment improved on the back of a recovery in the stock markets which entered a bull market, a surprising milestone after a volatile summer. The Shanghai Composite index has gained over 20% since August.

Worryingly, China seems to be readying to cut its official five-year economic growth target as President Xi Jinping warned that the economy faces domestic and global uncertainties. He also warned that a minimum of 6.5% growth is needed to realise Beijing's goals of doubling per capita income and the size of China's economy between 2010 and 2020, dual objectives set as part of the 100th anniversary of the Communist Party in China.

Stock markets had a volatile November as the expectations that the US Fed will officially end the low interest rate cycle by raising rates in December overshadowed all other considerations. The resultant strength of the US dollar, combined with a global glut in supply and prospects of slower growth globally, but particularly in China, sent commodity prices tumbling to multi-year lows. Gold, silver and platinum fell to their lowest levels in six years as outflows from exchange-traded funds backed by the metals, (always a good barometer), intensified.

We believe that the sooner the US Fed raises interest rates, the better. Once the first symbolic move is out of the way, investors can re-focus on US Fed chair Janet Yellen's repeated emphasis that the path of rate increases over the next few years would be slower than during previous cycles because the pace of expansion has been unusually weak. Therefore we expect a rebound in the markets after an initial shock reaction, followed by a period of stability and a marginal recovery in the battered rand. Despite the fact that the resources sector seems to have been severely oversold, the short term prospects for commodities remain underwhelming. Diversification of risk remains a key consideration in all our strategies.

360 DEGREES ROUND THE WORLD

GERMANY: The European Commission expects that Germany's expanding refugee population will lift the nation's economy by boosting spending in the short term and expanding the labour market in the years ahead. GDP is expected to get a 0.1% boost in 2015, 0.4% next year, 0.6% in 2017 and 0.7% in the three years after that.

GREECE: The Greek economy contracted by 0.5% quarter-on-quarter in the third quarter, the first official indicator of the turmoil wreaked by the leftist government in June. Stronger revenues from tourism and increased spending by households worried that they may lose their deposits at the country's collapsing banks may have helped to lift the number. The EC expects Greece to remain in a recession in 2015 and 2016, with GDP contracting by 1.4% and 1.3%, respectively. The EC's previous forecasts made in May had expected Greece to grow by 0.5% in 2015 and by 2.9% in 2016.

FRANCE: With the Eiffel Tower, the Louvre and many tourist attractions shuttered, the terrorist attack on Paris, the second this year, risks chilling France's nascent economic recovery. France's economy remains anaemic, although the GDP growth rate rose to 0.3% quarter-on-quarter in the third quarter. French President Francois Hollande called on the US and Russia to join forces to destroy ISIS and announced a wave of measures to combat terrorism in France.

UK: The Bank of England indicated that it is in no hurry to increase interest rates as it does not expect inflation to reach its 2% target for another two years, given lower commodity prices and a strong pound.

FINLAND: Finland has emerged as the eurozone's worst performing economy, contracting by 0.6% quarter-on-quarter in the third quarter, more than Greece. Finland's problems stem from a collapse in demand from neighbouring trade giant Russia, a highly uncompetitive labour market, and the decline of its most successful company, Nokia. The country is also grappling with chronic ageing and has one of the highest rates of government spending in Europe.

MYANMAR: Five years after Aung San Suu Kyi was freed from house arrest, her National League for Democracy party won victory in national elections, the strongest challenge to military dominance in over half a century. The victory completes her transformation from an icon of democratic struggle against a military regime that branded her a traitor and kept her under house arrest for 20 years, to a political leader responsible for governing a nation of 51 million people, which is trying to catch up from lost decades of underdevelopment and isolation. The NLD will be able to elect the next president, although Suu Kyi is barred from contesting the presidency by the military imposed constitution because she has foreign-born children.

One-quarter of the seats in parliament remain reserved for unelected military generals which gives them veto power over constitutional changes. The real question is what kind of a bargain Suu Kyi will be able to strike with the military to share power. The military has ruled Myanmar since 1962 while allowing a transition to a nominally civilian government five years ago. Suu Kyi has said that she will pick a presidential candidate amenable to her party and will be “above the president” calling the shots.

JAPAN: Asia’s second-biggest economy fell back into recession, contracting by an annualised 0.8% in the third quarter after GDP shrank by 0.7% over the previous three months. Prime Minister Shinzo Abe responded by instructing his cabinet to compile an extra budget for the current fiscal year which will include support for rural areas hit by the Trans-Pacific Partnership Free-Trade deal and cash pay-outs to low-income groups to spur private consumption. The size of the “extra budget” has not been finalised, but is expected to exceed US$25 billion.

ZAMBIA: The Bank of Zambia raised its benchmark lending rate by a record 3% to 15.5% to rein in 14.3% inflation after the currency of Africa’s second-biggest copper producer lost almost half its value this year. Low copper prices, a ballooning budget deficit and lack of electricity mean that the economy is expected grow at its slowest pace in 17 years. Copper accounts for 70% of Zambia’s exports.

DRC: The DRC’s government lowered its 2015 economic growth forecast to 7.7% from an earlier prediction of 8.4% due to weak commodity prices and lower mining output. The economy of Africa's largest copper producer grew by 9.5% in 2014.

NIGERIA: Nigeria's central bank cut its benchmark interest rate by 2% to 11.0% for the first time in six years in an effort to stimulate growth in Africa's biggest economy.

SOUTH AFRICA

There was no shortage of bad news in South Africa which is waiting for credit rating updates due in the first week of December. MTN continued its battle against the US$5.2 billion fine imposed on it in Nigeria, Lonmin and SAA flirted with bankruptcy and Anglo American shares fell by 25%. The economy continued to battle drought, while the rand collapsed to new lows against the US dollar.

Activity in the manufacturing sector continued to deteriorate with the Barclays manufacturing PMI dropping further to 48.1 in October from 49.9 index points in September. The index has been stuck below the 50 level for three consecutive months, as the manufacturing sector struggles to grow in the face of weak demand. The manufacturing sector makes up 12% of the South African economy.

Consumer inflation came in at a surprisingly benign 4.7% year-on-year in October, lagging in reflecting the effect of the weak rand. Producer price inflation, at 4.2%, came in above market expectations. Both figures are expected to increase significantly in response to the currency weakness and rising food prices. The Reserve Bank, in a clear desire to stay ahead of the US Fed’s interest rate cycle, increased the repo rate by 0.25% for the second time this year to 6.25%, taking the prime lending rate to 9.75%.

In a shadow of things to come, the composite leading business cycle indicator fell for the eighth consecutive month in September. The seasonally adjusted indicator provides a guideline for economic activity and growth for at least six months ahead.

South Africa's economy avoided a technical recession by growing at a seasonally adjusted and annualised 0.7% in the third quarter, after contracting by 1.3% in the second quarter. Although fewer power outages helped manufacturing, the slow pace of growth was blamed on persistent weakness in global commodity prices, lower demand, drought and a slowdown in China. The same factors threaten growth next year.

On the retirement fund reform side, the Taxation Laws Amendment Bill has been formally adopted, paving the way for the introduction of compulsory annuitisation of two-thirds of provident fund benefits on retirement as from 1 March 2016.

ODDS AND ENDS

RUSSIA IN NO MOOD TO PLAY NICE

Russian President Vladimir Putin signed a decree introducing an array of sanctions against Turkey in response to the downing of a Russian bomber on the Syrian border, after the plane strayed into Turkish airspace. This is the first time a NATO member has shot down a Russian aircraft since 1952. Turkish leaders fruitlessly sought to calm tensions with gestures of goodwill. The sanctions include a ban on Russian tours to Turkey and on charter flights between the two countries, as well as tighter control on Turkish trucking and shipping companies. The measures are to remain in place indefinitely.

VW'S WOES CONTINUE

Shares in Volkswagen AG plunged again after the car maker said its emissions-testing scandal had widened beyond what was previously disclosed; now encompassing a broader set of infractions that could affect about 800 000 more cars and cost the company at least an extra US$2 billion. The German auto maker admitted that it understated the level of carbon-dioxide emissions of the additional cars when providing information to regulators. Some of these cars were gasoline-powered, moving the violations beyond the company's diesel fleet for the first time. Since the first disclosures in September, VW has reshuffled top management and suspended senior executives in charge of engine development.

DEMOGRAPHICS LOOM ON THE HORIZON

Demographics are one of the worst threats facing the developed nations. According to the United Nations' projections the world's most advanced economies will reach a critical milestone in 2016. For the first time since 1950, their combined working-age population will decline, and by 2050 it will shrink by 5%. The ranks of workers will also fall in key emerging markets, such as China and Russia. At the same time the share of these countries' populations over 65 will skyrocket. Japan is already in the danger zone. One in four Japanese is 65 or older, compared with 15% in the US. There are now just 1.6 working-age Japanese supporting each senior or child under 15. By 2050, there will be just one working-age Japanese for every senior or child.

CHINESE BUYERS TARGET US HOMES

Chinese investors are flooding into the US property market, upending the traditional dynamics of buying and selling and affecting both the affordability and availability of housing, particularly in large cities. In 2015 Chinese represented the largest group of overseas home buyers in the US. And while Chinese purchases make up a small percentage of overall sales, they have had a disproportionate impact on the market for more expensive properties. One in 14 homes sold for more than US$1 million was sold to a Chinese investor. On average, buyers from China, including the mainland, Taiwan and Hong Kong, pay US$831 800 for a US home, more than three times as much as Americans spend.

BIG FUTURE FOR THE YUAN

The IMF included China's yuan in its reserve currency basket as from 1 October 2016. The yuan will constitute 10.9% weighting in the basket, the US dollar 41.7%, the euro 30.9%, the Japanese yen 8.3% and the British pound 8.1%. The value of the currency basket determines the value of Special Drawing Rights, an international reserve asset created by the IMF to supplement the existing official reserves of member countries. The SDR serves as the unit of account of the IMF. The move confers a measure of international legitimacy to China's currency at a point when the Chinese government is trying to liberalise its rigidly controlled financial system. The move has also been seen as an incentive for China to continue to reform.

DISCLOSURE

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