MAKING SENSE OF SHIFTS AND SWINGS

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Financial market activity is often dominated by particular themes or narratives. Sometimes these storylines are created after the fact to explain random market movements, but they are often based in reality. Towards the end of 2017, the dominant theme was 'synchronised global growth'. Though this narrative appears to have taken a backseat to worries over a trade war between the US and China, global growth is still pretty solid. The International Monetary Fund's (IMF) latest set of forecasts, released ahead of its annual gathering in Washington, expects real global growth of 3.9% this year and next year, up from 3.7% in 2017 at the fastest pace since the initial post-crisis bounce in 2011.

The IMF is by no means the most accurate forecasting agency, and economic forecasting is indeed inherently prone to errors, particularly around turning points in the economic cycle. Put differently, it is easy to extrapolate current trends into the future, but hard to know when those trends bend or even end. What is significant about the IMF is that between 2011 and 2016 it consistently downgraded forecasts; now it is upgrading. With decent global economic growth – not spectacular but better than over the previous few years – companies grow profits, especially since wage growth, the main input cost for most firms, is still muted in the developed world despite low unemployment. This is visible in the results companies are currently reporting, while US-based companies are reporting strong earnings under the new lower corporate tax rate for the first time.

The thing with market narratives is that you shouldn't accept them without question as the world is always changing. The latest economic numbers from Europe have been unexpectedly soft, and while this could possibly be explained by particularly wintry spring weather, it is a development worth watching. At the same time, the growth disappointments of recent years have led to a mindset of focusing on what could go wrong, rather than on what could go right.

OIL'S NOT WELL WITH THE WORLD

From time to time, geopolitical conflicts also become a dominant narrative, even if they have been simmering in the background for a long time. President Trump has been tweeting since day one in office, but his comments now cause consternation, while they were largely ignored last year. The Syrian civil war has been raging since 2011, without really hitting investors' radar screens, but US airstrikes put the devastated country front and centre.

The Syrian conflict is increasingly seen as a proxy war between the West and Saudi Arabia on the one side, and Russia and Iran on the other. Syria was never a major oil producer, but Saudi, Iran and Russia are. Some prominent Russian companies were also hit by US sanctions recently, but not its major oil producers. On the other hand, the distinct possibility of reintroduction of sanctions on Iran could see its oil exports curtailed significantly. In a large liquid (no pun intended) market such as the one for oil futures, many factors drive the price: stronger global growth should result in demand increasing. The output cuts agreed on by OPEC and Russia have been unusually successful in curtailing supply. (Historically, there has been a significant degree of cheating on output quotas when the price starts to rise.) Oil production in the US (not a party to the production cutbacks) continues to set new records, which should put downward pressure on prices. But geopolitical risk is clearly also a driver of the oil price after being largely absent since the 2014 price collapse. This helped to push the price of Brent crude oil to a four-year high above $70 per barrel last week.

The collapse in oil prices in 2014 and 2015 did not quite result in the expected boost to global growth as the negative impact of reduced investment spending and equity and credit market stress related to oil producers almost offset the positive benefits to consumers. We can expect the impact of higher prices to be similarly mixed, crimping consumer spending and resulting in marginally higher headline inflation, while spurring investment spending.

IMPACT ON SOUTH AFRICA

For South Africa, the impact of the higher oil price is twofold (although it greatly depends on the rand-dollar exchange rate). Firstly, it is likely to increase the total import bill, potentially tipping the trade balance towards deficit. Secondly, it puts upward pressure on inflation. Petrol has a 4.5% direct weight in the CPI basket. The bigger concern is the second round impact of higher petrol prices, when companies pass on input cost increases to consumers. But they can only do that when the economy is strong enough to not risk losing market share to competitors. Recent evidence clearly shows that local companies would rather absorb input cost increases (electricity, fuel and wages) and limit selling price increases.

Headline inflation, measured by the year-on-year change in the consumer price index, unexpectedly declined to 3.8% in March, the lowest level since February 2011. The petrol price declined in March, and year-on-year petrol inflation declined to 2.9%. However, the 72 cents per litre hike (including fuel and RAF levy adjustments) should see April's reported petrol inflation rising to 9%. The current under-recovery on the petrol price is 45 cents per litre, and a similar-sized price increase can be expected in May. Since inflation is a year-on-year growth rate, the base can play a significant role. The petrol price fell in June and July last year, setting an unfavourable base. It increased again towards the end of the year.

Core inflation, which excludes volatile food, fuel and energy prices was 4.1% in March. This is the better indication of underlying price pressures and shows companies' limited ability to pass on input costs. Despite the higher oil price, the overall outlook for inflation is still positive and it is expected to remain well below 6% for the next two years.

Muted inflation in turn has implications for consumer spending and monetary policy. With household income growth around 7%, lower inflation results in increased real income. Since South Africans don't save much, real income gains translate directly into real spending growth. StatsSA data last week showed real retail sales growth of 4% year-on-year.

On the monetary policy front, lower inflation should translate into lower interest rates, but it will depend on the Reserve Bank's interpretation. While inflation has fallen below 4%, and is expected to remain below 6%, it is likely to drift back up above the 4.5% midpoint of the South African Reserve Bank's (SARB's) target range. In its recent Monetary Policy Review publication, the SARB noted that it had taken "the strategic decision to anchor inflation expectations" around the midpoint, moving away from the perception that the upper bound of the range is the de facto target. Although the SARB does not set its own inflation target – it is set by the government – it has full autonomy in how it goes about achieving it. The immediate implication is that the bar for further rate cuts is much higher.

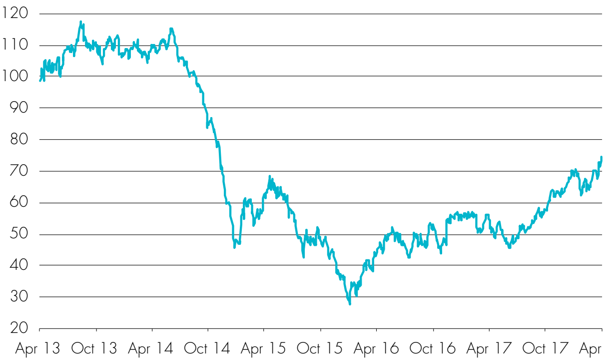
BEWARE SCARE STORIES

Considering all the above, there is clearly a lot for investors to think about, and a number of (sometimes competing) narratives to digest. The key is to remain level-headed and not overreact to anything you read or hear. While April has been a much better month than February and March, year-to-date returns from risk assets are still flat to negative. Local fixed income has performed well, in contrast, highlighting the importance of diversification. It is worth remembering that while nominal returns have been under pressure, the decline in inflation means the real return from a diversified portfolio is still positive.

CHART 1: GLOBAL GROWTH WITH FORECAST, US DOLLAR PURCHASING POWER PARITY BASIS.

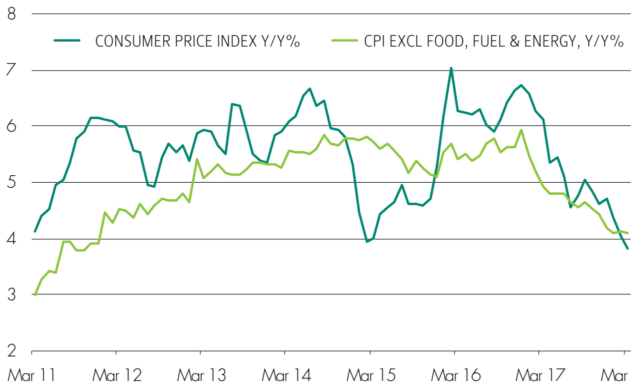
Source: International Monetary Fund

CHART 2: BRENT CRUDE OIL US DOLLAR PER BARREL



Source: Thomson Reuters Datastream

CHART 3: SOUTH AFRICAN HEADLINE AND CORE CONSUMER INFLATION



Source: StatSA

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 116.0	1.29%	2.37%	0.62%	14.56%
United States	S&P 500	US$	2 670.0	0.53%	1.02%	-0.15%	13.33%
Europe	MSCI Europe	US$	1 813.0	1.00%	3.54%	0.89%	15.92%
Britain	FTSE 100	US$	10 315.0	-0.29%	4.32%	-0.83%	13.20%
Germany	DAX	US$	1 454.0	0.41%	3.12%	-2.43%	23.22%
Japan	Nikkei 225	US$	205.9	1.51%	2.00%	1.91%	22.77%
Emerging Markets	MSCI Emerging Markets	US$	1 184.0	1.20%	1.11%	2.25%	23.59%
Brazil	MSCI Brazil	US$	2 205.0	2.32%	-1.96%	9.00%	21.29%
China	MSCI China	US$	90.7	0.21%	0.63%	2.46%	35.56%
India	MSCI India	US$	587.6	-0.09%	3.82%	-3.83%	13.00%
South Africa	MSCI South Africa	US$	591.0	3.50%	2.60%	-2.31%	20.12%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	57 582.0	1.80%	3.80%	-3.23%	9.69%
All Share	All Share (Total Return)	Rand	8 278.0	1.86%	4.18%	-2.04%	12.93%
TOP 40/Large Caps	Top 40	Rand	7 286.0	1.80%	4.43%	-2.18%	14.16%
Mid Caps	Mid Cap	Rand	16 851.0	3.23%	3.01%	-0.73%	6.26%
Small Companies	Small Cap	Rand	20 922.0	-0.02%	0.81%	-0.48%	0.86%
Resources	Resource 20	Rand	2 389.9	2.35%	7.38%	4.54%	19.59%
Industrials	Industrial 25	Rand	14 326.0	1.55%	3.85%	-5.23%	8.68%
Financials	Financial 15	Rand	9 940.0	2.69%	3.52%	2.40%	28.41%
Listed Property	SA Listed Property	Rand	2 123.1	2.58%	7.17%	-13.84%	0.33%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	973.2	-0.27%	-0.46%	2.65%	6.84%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY					
All Bond	BESA ALBI	Rand	636.0	0.37%	0.13%	8.23%	14.86%
Government Bonds	BESA GOVI	Rand	632.4	0.36%	0.13%	7.86%	14.54%
Corporate Bonds	SB JSE Credit Indices	Rand	119.7	-1.23%	-3.18%	-5.12%	-16.37%
Inflation Linked Bonds	BESA CILI	Rand	257.0	-1.64%	-2.29%	1.74%	3.89%
Cash	STEFI Composite	Rand	391.3	0.13%	0.41%	2.19%	7.44%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	73.7	1.56%	6.75%	9.94%	38.98%
Gold	Gold Spot	US$	1 336.0	-0.74%	0.83%	3.01%	4.21%
Platinum	Platinum Spot	US$	925.0	-0.32%	-0.54%	-0.54%	-5.52%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	12.10	-0.19%	-2.31%	2.29%	8.49%
ZAR/Pound	ZAR/GBP	Rand	16.95	1.47%	-2.01%	-1.24%	-0.77%
ZAR/Euro	ZAR/EUR	Rand	14.87	0.20%	-1.89%	-0.07%	-5.38%
Dollar/Euro	USD/EUR	US$	1.23	0.00%	0.16%	-2.36%	-13.01%
Dollar/Pound	USD/GBP	US$	1.40	1.72%	0.01%	-3.56%	-8.56%
Dollar/Yen	USD/JPY	US$	0.01	0.25%	1.28%	-4.47%	-2.06%

Source: I-Net, figures as at 20 April 2018

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ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Producer inflation

US

- Flash Markit Purchasing Managers' Index
- House prices
- Durable goods orders
- First quarter GDP growth

EUROPE

- European Central Bank monetary policy decision
- Eurozone Flash Markit Purchasing Managers' Index
- Eurozone economic sentiment indices

JAPAN

- Bank of Japan monetary policy decision
- Flash Markit Purchasing Managers' Index

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