MORE HEAT THAN LIGHT

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While many parts of the northern hemisphere were experiencing an unprecedented heatwave last week, the heat was somewhat taken out of global trade tensions after a meeting between US President Donald Trump and his European Union (EU) counterpart Jean-Claude Junker. Tensions between the US and EU had been building since May when the Trump administration imposed tariffs on foreign steel and aluminium imports, including those from Europe, to which the EU retaliated with tariffs on American goods. Now the two leaders agreed to work towards "zero tariffs" on trade in industrial goods. However, the threat of tariffs on cars unfortunately remains. And of course Europe only represents one front in Trump's trade war. Tensions are still simmering between the US and China.

What has the impact of the trade fights been so far, apart from stock market volatility? At the conclusion of the European Central Bank's interest rate meeting - where policy was left unchanged – its president Mario Draghi noted that the direct tariffs implemented thus far on Eurozone exports to the US had a "limited" effect. US economic growth jumped in the second quarter to the fastest quarterly rate since 2014. Strong growth in consumer spending was responsible for more than half the 4.1% quarter gain, but net exports also contributed one percentage point. Here too there was some distortion from the trade tensions, due to a surge in soybean exports before Chinese tariffs kicked in.

US listed companies have to report earnings on a quarterly basis. While this has arguably led to short-termism on the part of management and investors, it does provide a timely update in terms of what is happening on the ground. In reporting earnings, many companies are noting the uncertainty created by tariffs, but so far the impact on the bottom line has been limited to companies that are heavily reliant on steel and aluminium, and have already faced higher input costs. The Big Three US automakers are the prime example. US-based appliance manufacturer Whirlpool is another. It initially benefited from a tariff on washing machine imports to the US – which it lobbied the government for - but this protection from foreign imports has been more than offset by the impact of higher steel and aluminium input prices. Companies are also reporting measures to lessen the impact of tariffs, including shifting production around. Most trade today is in intermediate goods, i.e. inputs, and not in finished goods. For instance, in car components, not in the finished, showroom-ready vehicles. Tariffs were more effective in days gone by when most trade was in finished goods. This also complicates any calculation on the economic impact of trade wars. There are just too many moving parts, including currencies. The trade debates are generating more heat than light, in other words.

STATUS UPDATE

Nonetheless, the Thomson Reuters consensus earnings forecast for S&P500 companies is for 21.4% growth in the second quarter compared to a year ago. Of the 150 S&P500 companies to have reported so far, a record 86% had exceeded Wall Street's expectations and the index inched closer to the January all-time high. So far therefore, trade issues have not derailed the profit train yet. Amazon was an example of a company that completely shattered expectations, reporting a quarterly profit of $2.5billion. On the other hand, the notable miss on analysts' expectations was Facebook. While the company continues to post astonishing growth, too much good news was clearly priced in. Technology shares have been the standout performers on the US market this year and investors have been prepared to pay up for the growth prospects. The New York Stock Exchange FANG+ index (including Facebook, Apple, Amazon, Netflix, Google and others) has outperformed the S&P500 by 28% over the past year, even after Facebook's slump.

The big difference between today's tech boom and the late 1990s is that most of these companies actually do generate high levels of cash and are not just pure blue sky bets. However, Facebook's slump is a reminder to not bet the farm on a single growth story, no matter how compelling and exciting. We saw the same with Bitcoin (down 50% year-to-date). The coming years will see a lot of hype around machine learning, artificial intelligence and 3D printing, among the drivers of the so-called fourth industrial revolution. While transformative, these technologies are unlikely to make money for investors who overpay and don't diversify.

YUAN FOR THE MONEY

Locally, the heat is off the rand somewhat, and it strengthened to below R13.20 to the dollar. While some attributed this to the news that China would be investing $14.7 billion in our economy (in unspecified areas), the strengthening of the local currency probably has more to do with Chinese spending in its own economy. Authorities in Beijing have announced modest monetary and fiscal stimulus measures over the past few days and more monetary stimulus is expected. This seems to have lifted emerging market currencies. The Chinese yuan has lost around 7% against the dollar since mid-April, as concerns grew that the trade tensions with the US would add to the moderate slowdown in economic activity against the backdrop of a rather sharp decline in credit growth. It is yet another illustration of the futility of tariffs as a trade tool, since the yuan's decline will almost compensate Chinese exporters for higher tariffs.

It is also notable that the yuan's slide has not nearly had the same disruptive impact as in late 2015, when a small 2% depreciation sent shock waves through global markets. The world economy is in a much healthier space.

There is as yet no detail on when and where the $14.7 billion will be spent and by which Chinese companies or state agencies. Nor how much will be in the form of loans, and who will be responsible for servicing it. At the current exchange rate, it amounts to around R190 billion, compared to total fixed investment by the public and private sectors of around R890 billion in 2017. So not a game changer, but every rand helps.

A further sign of somewhat-improved sentiment towards emerging markets has been the broad rise in share indices. After relentlessly declining over the past few months, the MSCI Emerging Markets Index is up 2.7% so far in July.

The local market lags the MSCI Emerging Markets Index by about 10% this year in common currency terms. In fact, the JSE is one of the worst-performing major markets in the world this year when measured in dollars. The weakness on the local market has been concentrated in a few areas: precious metals mining, tobacco, and a cluster of sectors exposed to the local economy (financials, retail, general industrials). The precious metals miners have been hammered by low dollar gold and platinum prices (the diversified general miners have done much better). The global tobacco giants, including BAT, the one listed on the JSE, have come under pressure as people smoke fewer cigarettes and penetration of the new e-cigarette market is lower than expected. For the locally-focused companies, soft economic growth in the first half of the year has weighed heavily.

The South African economy should improve in the coming quarters, supported by a backdrop of strong global growth (trade spats notwithstanding) and consumer spending lifted by real income growth. An improvement in business confidence and rising fixed investment should also help, but this will take time. Clearly the expectation of a quick turnaround at the start was unfortunately misplaced and it is now an uphill climb.

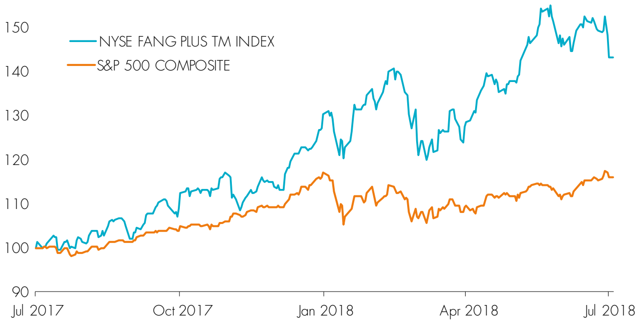
DISINFLATIONARY PRESSURES

Turkey was a notable exception to the gains among emerging market currencies. With inflation running at 17%, the central bank was expected to implement another steep rate hike last week. When it didn't, presumably under pressure from President Erdogan, the lira sold off to fresh record lows. South Africa has neither an inflation problem, nor an overly dovish central bank.

Though weaker since the start of the year, the rand is more or less trading at the same level as a year ago and therefore limits any upward pressure on inflation. In fact, the latest StatsSA import price data shows a 6.7% decline in the year to end May, while import prices excluding petroleum were 9% lower. Disinflationary forces are therefore still at work, to the benefit of consumers, despite the oil price jump over the past few months. Unfortunately export prices are also 4% lower compared to a year ago and this puts downward pressure on the revenues of exporters. The poor performance of exports in turn explains a large part of the weakness in the economy in the first half of the year.

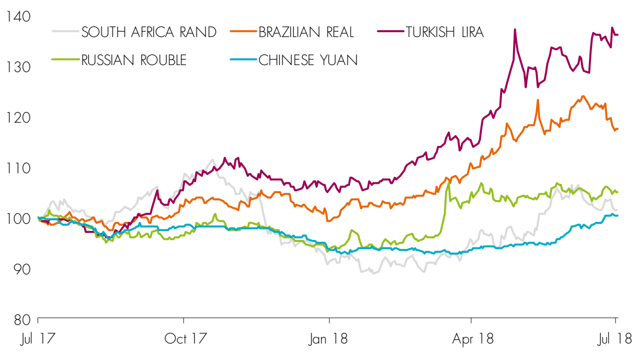
In summary, there is a lot going on, but that is always the case. None of the events of the past week fundamentally change the outlook for the global or local economy or markets. Recent returns have been disappointing but there is no reason to expect this to be a permanent feature. Like a heat wave, disappointing market returns can persist for an uncomfortably long time, but it does not last forever.

CHART 1: HIGH-FLYING TECHNOLOGY SHARES VERSUS S&P500



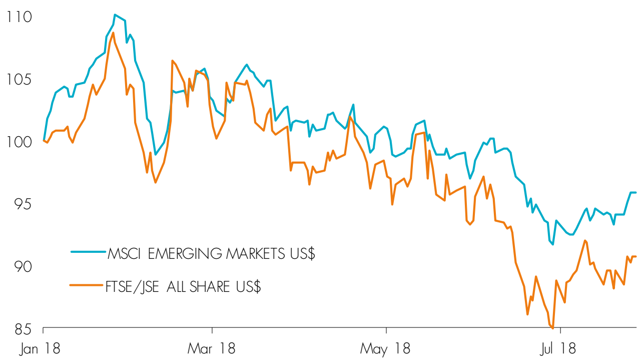
Source: Thomson Reuters Datastream

CHART 2: EMERGING MARKET CURRENCIES AGAINST THE US DOLLAR



Source: Thomson Reuters Datastream

CHART 3: EMERGING MARKET AND SOUTH AFRICAN EQUITIES IN US DOLLARS



Source: Thomson Reuters Datastream

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 162.0	1.08%	3.49%	2.81%	10.08%
United States	S&P 500	US$	2 819.0	0.61%	3.72%	5.42%	13.76%
Europe	MSCI Europe	US$	1 747.0	0.81%	2.58%	-2.78%	1.98%
Britain	FTSE 100	US$	10 090.0	0.07%	0.03%	-2.99%	3.68%
Germany	DAX	US$	1 418.0	1.65%	4.42%	0.34%	7.26%
Japan	Nikkei 225	US$	204.6	0.45%	1.51%	1.24%	13.20%
Emerging Markets	MSCI Emerging Markets	US$	1 089.0	1.78%	1.78%	-5.96%	1.87%
Brazil	MSCI Brazil	US$	1 857.0	2.43%	12.75%	-8.21%	0.43%
China	MSCI China	US$	85.4	2.07%	-0.89%	-3.45%	9.74%
India	MSCI India	US$	584.1	2.20%	4.12%	-4.40%	2.48%
South Africa	MSCI South Africa	US$	520.0	0.97%	2.97%	-14.05%	-0.57%

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	57 162.0	0.30%	-0.78%	-3.94%	4.14%
All Share	All Share (Total Return)	Rand	8 247.0	0.34%	-0.71%	-2.40%	7.31%
TOP 40/Large Caps	Top 40	Rand	7 358.0	0.48%	-0.69%	-1.21%	8.38%
Mid Caps	Mid Cap	Rand	15 065.0	-0.53%	-0.81%	-11.25%	-1.41%
Small Companies	Small Cap	Rand	19 448.0	-1.44%	-1.88%	-7.49%	-1.94%
Resources	Resource 20	Rand	2 633.4	3.04%	-2.80%	15.19%	26.66%
Industrials	Industrial 25	Rand	14 312.0	-1.17%	-1.46%	-5.32%	1.17%
Financials	Financial 15	Rand	9 350.0	2.14%	4.28%	-3.68%	15.33%
Listed Property	SA Listed Property	Rand	1 902.9	-0.75%	-1.76%	-22.77%	-14.48%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	939.4	0.13%	0.06%	-0.92%	0.71%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	625.6	1.22%	2.37%	6.46%	10.59%
Government Bonds	BESA GOVI	Rand	621.6	1.27%	2.48%	6.02%	10.07%
Corporate Bonds	SB JSE Credit Indices	Rand	115.2	0.47%	1.16%	-8.67%	-16.20%
Inflation Linked Bonds	BESA CILI	Rand	251.3	0.48%	0.04%	-0.50%	1.83%
Cash	STEFI Composite	Rand	398.7	0.13%	0.53%	4.12%	7.32%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	74.4	1.77%	-5.87%	10.99%	45.80%
Gold	Gold Spot	US$	1 224.0	-0.65%	-2.31%	-5.63%	-2.78%
Platinum	Platinum Spot	US$	829.0	0.24%	-2.47%	-10.86%	-10.28%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.18	1.67%	4.19%	-6.07%	-1.37%
ZAR/Pound	ZAR/GBP	Rand	17.27	1.97%	4.98%	-3.07%	-1.56%
ZAR/Euro	ZAR/EUR	Rand	15.37	2.24%	4.39%	-3.29%	-1.07%
Dollar/Euro	USD/EUR	US$	1.17	0.00%	-0.17%	2.65%	0.00%
Dollar/Pound	USD/GBP	US$	1.31	0.22%	0.75%	3.04%	-0.02%
Dollar/Yen	USD/JPY	US$	0.01	-0.39%	0.31%	-1.45%	-0.08%

Source: I-Net, figures as at 27 July 2018

ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Trade balance
- Credit growth
- Absa Manufacturing Purchasing Managers' Index
- New vehicle sales
- Unemployment rate

US

- Employment Cost Index
- Personal income, consumption and inflation
- House prices
- ISM Manufacturing Index
- Nonfarm payrolls and unemployment

EUROPE

- Eurozone Consumer Confidence
- Eurozone Business Confidence
- Eurozone second quarter GDP growth
- Bank of England interest rate decision
- Eurozone retail sales

JAPAN

- Bank of Japan interest rate decision

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