MARKET MATTERS
27 AUGUST – 31 AUGUST 2018

OLD MUTUAL MULTI-MANAGERS

TIME TO CRY FOR ARGENTINA

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Argentinians did not have much time to enjoy their recent victory over the Springboks in Mendoza. The country's beleaguered currency, the peso, slumped to a new record low of 37 to the US dollar. This despite the central bank hiking short-term rates to the asphyxiating level of 60%. The Argentinean government requested that the International Monetary Fund (IMF) accelerates payment of the record $50 billion bail-out. But rather than comfort markets, it had the opposite effect.

The market has seemingly lost faith in Argentina's promise to gradually close the budget deficit (i.e. gradually reduce the amount it has to borrow every year). The only way to do so is to aggressively cut spending and raise taxes. This will not only make them deeply unpopular, and risk derailing the government's other reform efforts, but will also further cripple the economy. But the lack of a domestic capital market means that Argentina is at the mercy of global investors and the IMF, and therefore not only cruelly exposed to swings in its exchange rate, but to the vicious cycle of currency weakness further undermining its credit worthiness.

OTHER CURRENCIES SELL OFF

Other emerging market currencies sold off in sympathy, especially the Turkish lira, but also the rand, which fell to R14.68. This means that the local currency lost 11% during the month of August. This was in line with the Brazilian real and the Russian rouble, but worse than the Indian rupee's 4% decline (though the rupee fell to a record low against the greenback). The lira, in contrast, slumped 37% and the peso by a similar amount. While there has been a spill-over from Turkey and Argentina to other emerging markets, it is still not a full-blown contagion. Markets are seemingly still drawing a distinction between countries that are in deep trouble and those that are merely vulnerable.

POSITIVE DEVELOPMENTS

All this has been happening against the backdrop of three emerging market-unfriendly global developments in recent months: US interest rate hikes and a stronger dollar, trade disputes and a cooling of China's economic growth rate. But there have been some positive developments on all three fronts over the past few days.

On the first issue, an important speech by US Federal Reserve Chair Jerome Powell at the annual Jackson Hole central banking conference confirmed that the current approach of gradually raising interest rates would continue. He highlighted an awareness that there are risks to both raising rates too slowly and too quickly. Raising rates too slowly could lead to an economy overheating, while doing it too quickly could prematurely tip the economy into recession. The Fed's preferred inflation measure, the personal consumption expenditure price index, rose 2.3% year-on-year (2% excluding food and fuel), and therefore close to the inflation target. Growth is strong and unemployment low, but Powell noted that there is no sign of overheating. He also emphasised that he will be guided by incoming economic data, and not rely on vague theoretical concepts. Following such a pragmatic approach reduces the risk of monetary policy overkill. Though emerging market currencies were weaker, the dollar has lost its upward momentum against the euro and other major currencies. The trade-weighted dollar index rose 8% between mid-April and mid-August, but has given back about 2% since then.

On the second issue, trade, there was a positive development in the form of an agreement between US president Donald Trump and his Mexican counterpart, potentially saving the North American Free Trade Agreement (Nafta, though the name will change if Trump has his way). Canada, the third Nafta member, still has to agree. While there are still many details to be ironed out, it provides hope that Trump is amenable to a trade deal despite his continued bluster, and it provides Chinese leaders with a template on how to approach talks. It does, though, illustrate Trump's preference for bilateral deals between two countries, rather than to work in a multi-lateral framework such as the World Trade Organisation, which he has threatened to pull out from.

On the third issue, China's official purchasing managers' indices rose for both services and manufacturing in August. After July's steep decline, this provides some comfort that the world's number two economy is still growing at a solid clip, even though its growth rate should slow down over time. Regulators in China have recently urged banks to boost lending into flagging sectors of the economy.

Despite this uncertain global macro backdrop, the US equity market has moved higher, with the benchmark S&P 500 breaching 2 900 points for the first time on the way to a 3% return in August. Locally, the JSE finally enjoyed some upward momentum until interrupted by news of MTN's latest Nigerian setback. The Central Bank of Nigeria wants MTN to return dividends taken out of the country between 2007 and 2015, illegally in its opinion. The FTSE/JSE All Share Index even closed above 60 000 points for the first time since early January, but ended the week 58 668, up 2.2% for the month. MTN's share price in contrast fell to a nine-year low. Its weight in FTSE/JSE All Share Index is around 2%, and 4% in the FTSE/JSE Capped SWIX.

WHY DIVERSIFICATION MATTERS

A large decline in the share price of a large company obviously catches the eye and causes concern, but this is the reality of investing in shares. Of the 168 members of the All Share Index, 35 have fallen more than 20% over the past year, and a further 21 declined by between 10% and 19%. Yet the overall index has posted a positive return over the past year. Any individual share carries a lot of risk, but this is diluted and diminished in a diversified portfolio. At a balanced fund level of course, the risk of something going wrong in an individual company is further reduced by the inclusion of global shares and fixed income assets.

FISCAL RISKS CONTAINED

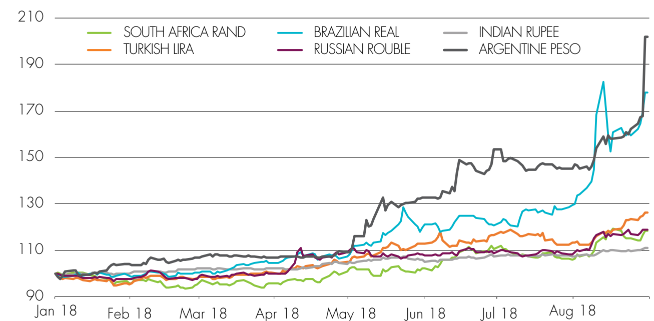
Finally, what about the risk of South Africa facing an Argentinian-style fiscal crisis? Ratings agency S&P Global noted this week that unlike Turkey, which it recently cut deeper into junk status, South Africa's current rating was unlikely to change, due to moderately faster expected economic growth, a steady outlook for government debt and the expectation that government would gradually implement economic and social reforms.

Budget data for the first four months of the current fiscal year (which started in April) shows a R123 billion deficit. The good news is that this cumulative deficit is R5 billion smaller than for the same four months last year. Also encouraging is that revenue growth is outpacing spending growth year-over-year with revenue growth of 11.6% against expenditure growth of 7.3%. This is also broadly in line with budgeted growth in revenue and spending.

However, there are some substantial deviations from target within the tax revenue category. Revenue from the fuel levy is growing faster than budgeted (10% year-on-year), something that few motorists will be happy about, especially given that another petrol price hike is in the works in September. Revenue from customs duty is also growing much faster than planned. The three biggest tax items are personal income tax, VAT and company tax. All three are slightly lagging growth targets, but in the case of company tax, it is lagging a target that was very low to begin with (6%). This points to the weak business environment.

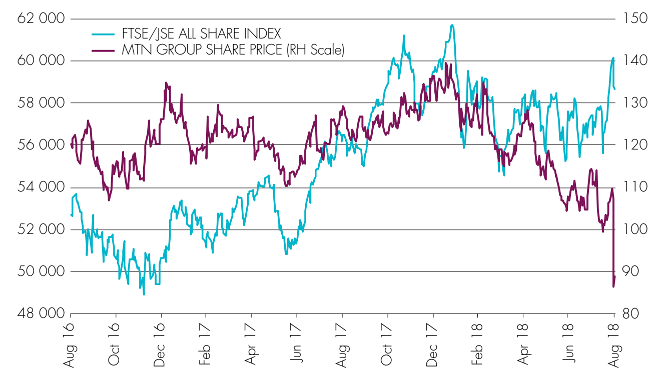
The upcoming October mini-Budget provides the Finance Minister with an opportunity to fine-tune revenue and spending estimates. Unfortunately, it is likely that he will have to project a larger deficit than the 3.6% estimate from the February Budget. A number of unplanned spending items have crept up, including further bail-out requests from State Owned Enterprises, and a wage agreement beyond what was budgeted for. But at least there is some progress on fiscal consolidation. Importantly, there is also virtually no risk that the South African government will not be able to fund itself in the bond market. Most borrowing (90%) is locally, and in the local market. Although foreigners have dumped South African bonds at a record pace since April (more than R80 billion), and government bond yields have increased in that time, they are still within the broad trading range of the past two years. In the case of the benchmark 10-year bond, the latest yield of 9% is higher than earlier this year, but below the 2017 high of 9.4%. As foreigners have sold, locals seem to have been happy to buy. And why not at such attractive yields?

CHART 1: EMERGING MARKET CURRENCIES AGAINST THE US DOLLAR INDEXED TO 100



Source: Thomson Reuters Datastream

CHART 2: FTSE/JSE ALL SHARE INDEX AND THE MTN SHARE PRICE



Source: Thomson Reuters Datastream

CHART 3: SOUTH AFRICAN 10-YEAR GOVERNMENT BOND YIELD

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$	2 182.0	0.93%	1.35%	3.76%	11.33%
United States	S&P 500	US$	2 902.0	0.94%	3.05%	8.53%	17.39%
Europe	MSCI Europe	US$	1 723.0	0.76%	-1.99%	-4.12%	0.88%
Britain	FTSE 100	US$	9 632.0	-1.07%	-5.30%	-7.39%	0.36%
Germany	DAX	US$	1 373.0	-0.15%	-3.04%	-2.91%	3.08%
Japan	Nikkei 225	US$	205.8	1.31%	2.07%	1.85%	15.11%
Emerging Markets	MSCI Emerging Markets	US$	1 058.0	0.76%	-2.67%	-8.64%	-2.76%
Brazil	MSCI Brazil	US$	1 589.0	-2.09%	-13.64%	-21.45%	-20.47%
China	MSCI China	US$	81.0	1.24%	-2.98%	-8.44%	-0.67%
India	MSCI India	US$	601.3	0.03%	0.88%	-1.60%	5.67%
South Africa	MSCI South Africa	US$	476.0	-4.80%	-10.19%	-21.32%	-11.52%

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	58 668.0	-0.22%	2.15%	-1.41%	3.80%
All Share	All Share (Total Return)	Rand	8 480.0	-0.16%	2.34%	0.36%	6.88%
TOP 40/Large Caps	Top 40	Rand	7 564.0	-0.47%	2.42%	1.56%	7.95%
Mid Caps	Mid Cap	Rand	15 494.0	1.25%	1.48%	-8.72%	-3.35%
Small Companies	Small Cap	Rand	19 714.0	0.68%	1.23%	-6.22%	-2.77%
Resources	Resource 20	Rand	2 824.5	3.96%	5.77%	23.55%	26.80%
Industrials	Industrial 25	Rand	14 496.0	-3.02%	2.06%	-4.10%	0.33%
Financials	Financial 15	Rand	9 529.0	1.55%	-0.26%	-1.83%	14.26%
Listed Property	SA Listed Property	Rand	1 969.0	0.50%	2.13%	-20.09%	-12.41%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	936.6	-0.05%	-0.30%	-1.21%	-2.26%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	614.4	-0.34%	-1.87%	4.55%	8.00%
Government Bonds	BESA GOVI	Rand	609.4	-0.36%	-2.03%	3.93%	7.34%
Corporate Bonds	SB JSE Credit Indices	Rand	115.3	-0.13%	0.07%	-8.60%	-15.90%
Inflation Linked Bonds	BESA CILI	Rand	251.4	0.14%	-0.21%	-0.47%	1.60%
Cash	STEFI Composite	Rand	401.4	0.13%	0.59%	4.81%	7.29%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	77.6	2.58%	4.86%	15.82%	46.42%
Gold	Gold Spot	US$	1 202.0	-0.33%	-1.31%	-7.32%	-9.08%
Platinum	Platinum Spot	US$	785.0	-0.38%	-4.85%	-15.59%	-21.42%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	14.68	-3.03%	-9.60%	-15.70%	-11.40%
ZAR/Pound	ZAR/GBP	Rand	19.03	-3.73%	-8.46%	-12.03%	-11.67%
ZAR/Euro	ZAR/EUR	Rand	17.04	-2.74%	-8.91%	-12.78%	-9.14%
Dollar/Euro	USD/EUR	US$	1.16	0.00%	0.78%	3.53%	2.59%
Dollar/Pound	USD/GBP	US$	1.30	-0.85%	1.09%	4.17%	-0.46%
Dollar/Yen	USD/JPY	US$	0.01	-0.14%	-0.68%	-1.38%	1.11%

Source: I-Net, figures as at 31 August 2018

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ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Second quarter GDP growth
- Second quarter current account balance
- Absa Manufacturing Purchasing Managers' Index
- Standard Bank Purchasing Managers' Index
- New vehicle sales
- Mining production

US

- ISM manufacturing and services indices
- New vehicle sales
- Trade balance
- Unemployment rate and non-farm payrolls

EUROPE

- Eurozone retail sales

CHINA

- Caixin Purchasing Managers' Index
- Foreign exchange reserves

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