

# INVESTMENT NOTE

24 JUNE 2024

## THE NEW NEW DAWN

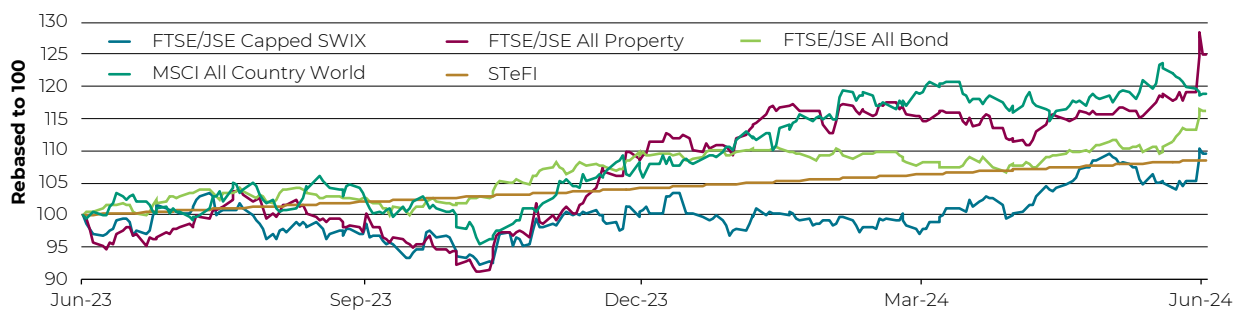


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OLD MUTUAL WEALTH  
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South African investors finally have something to cheer about, and local assets rallied strongly last week. The newly inaugurated Government of National Unity under President Cyril Ramaphosa is not going to solve all or even most of the country's problems, but it can address a handful of big blockages that hinder economic growth. It has also placed adherence to the Constitution at the centre of its agreement, as well as professionalising the public service. Can it boost that intangible ingredient of economic activity that John Maynard Keynes, the great British economist, called "animal spirits"? In other words, the willingness of investors and entrepreneurs to risk capital in search of better returns.

**CHART 1: SOUTH AFRICAN ASSET CLASSES IN RAND OVER 12 MONTHS**



Source: LSEG Datastream

We've already seen the positive impact of private sector participation on electricity supply, three months have passed without loadshedding. This doesn't mean loadshedding is gone for good, but it is unlikely to return to anything near the dire levels we saw in 2022 and 2023. The fact that some parts of the country still experience outages is because of municipal problems, not a nationwide shortage of electricity.



WEALTH

There is progress at Transnet too, and encouragingly, its current leadership is aligned with government policy to boost private sector participation. The penny seems to have dropped in the past two or three years that if government

includes, rather than excludes, the private sector in infrastructure provision, there is both better infrastructure, and considerable investment spending.

## FALSE DAWNS

Of course, there have been false dawns before. The period of “Ramaphoria” when Jacob Zuma was replaced as state president by Cyril Ramaphosa in 2018 did not last very long, despite Ramaphosa’s flowery rhetoric of a “New Dawn” and “Thuma Mina” (send me). This is partly because global market conditions turned unfavourable (by the end of 2018, markets everywhere were slumping) and partly because Ramaphosa struggled to get a grip on his divided party. After all, he won the ANC leadership race with a slim margin during the previous December.

But the biggest reason is probably because the depth of destruction during the Zuma era was much worse than

most people initially realised, with key institutions from SARS to the NPA gutted while SOEs were saddled with unsustainable debt and riddled with corruption. Cleaning up this mess took time, and met considerable resistance, and unfortunately, there was collateral damage. For instance, the emphasis on improved maintenance at Eskom after 2018 meant that loadshedding was ironically worse under Ramaphosa than under Zuma, hobbling the economy. The Covid pandemic also set the country back many years. While one can argue whether it was handled well or not, it would have devastated the economy either way.

## GNU DAWN

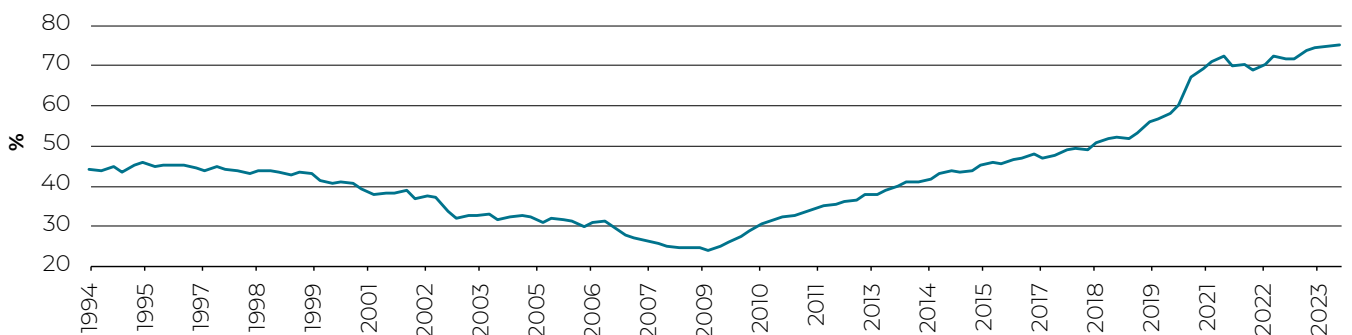
The 2024 New Dawn is different in that key reforms are already underway as noted earlier. The new government just needs to keep its foot on the accelerator, and not hit the brakes. But no one should be unrealistic. If everything was easy, it would have been done by now. And there will be disagreements along the way. Indeed, as of Monday morning, tough negotiations over Cabinet positions were still ongoing. It might be too much to expect the GNU to serve out a full five-year term, but a lot can be achieved in 24 months to cement key reforms.

The trickiest area will probably be fiscal consolidation. South Africa cannot afford not to stabilise a debt-to-GDP ratio that has almost doubled in the past decade and results in

20 cents of every rand collected by SARS going to interest payments.

It is relatively easy for the various coalition partners to agree on feel-good economic reforms that lead to private investment and photo opportunities for hard hat-wearing politicians. It is much more difficult to commit to being disciplined with state money when each party has its own spending priorities. As a start, the aspiration of a slimmed-down value-for-money cabinet will probably be shelved to accommodate ministers from several parties in sufficient numbers. For similar reasons, the bloated state bureaucracy might not shrink.

**CHART 2: SOUTH AFRICA DEBT-TO-GDP RATIO**



Source: LSEG Datastream

Encouragingly, the agreement between member parties includes fiscal discipline as a key principle. But that is not the end of the matter, rather the starting point. Fiscal

consolidation will really be the litmus test for the GNU and its commitment to doing what’s best for the country’s long-term interests, including a few unpopular things. As ratings

agency S&P Global noted: “The election outcome is broadly favourable for the economic and fiscal outlook, compared with the alternatives. Nevertheless, we expect the government

will face an uphill battle to revive growth and maintain fiscal discipline, while navigating the new realities of coalition politics.”

## VIRTUOUS CIRCLES

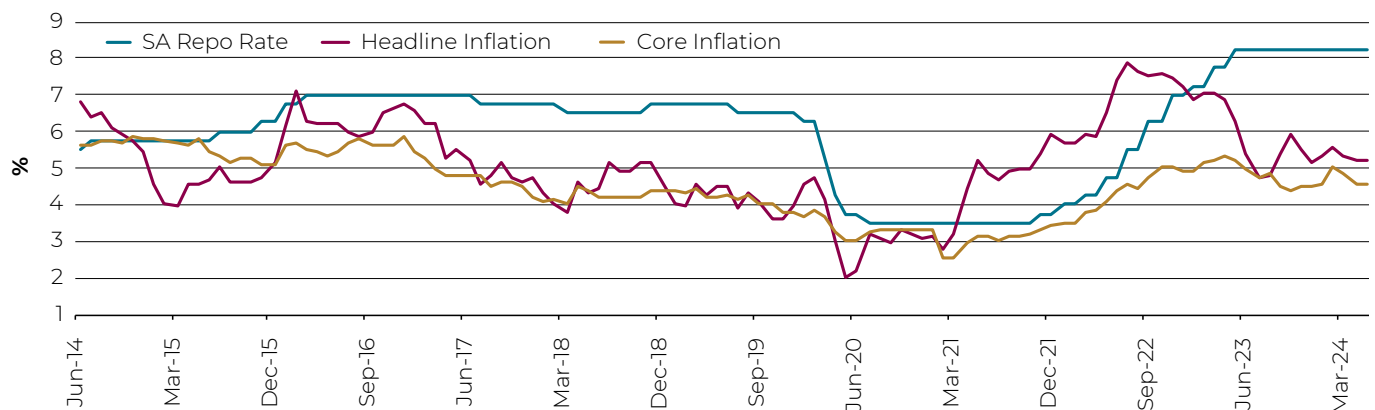
For investors, it is important to realise the potential feedback loops at play. In a situation like South Africa’s, small improvements can lead to big change over time. It is often the case that people overestimate the short-term implications of an event like the formation of the GNU, and underestimate the long-term consequences.

One example: Over the past decade, South Africa has experienced the unfortunate situation where weaker economic growth has led to higher interest rates, instead of lower interest rates as would be the case in most countries. Subpar economic growth means tax revenues are insufficient to match government spending, leading to a deteriorating creditworthiness of the government which is reflected in elevated bond yields. These fears also put downward pressure on the rand. The big fear of the Reserve Bank is that it could lead to a disorderly currency blow-out. As a result, it has kept interest rates higher than what domestic economic conditions would warrant if there were no fiscal worries.

If faster economic growth can be achieved, it will make it easier to get government debt levels under control. If government borrows less, there are two important benefits. Firstly, it spends less on interest payments down the line, which either frees it up to spend a bit more elsewhere or allows it to pay down debt even quicker. Secondly, the more markets gain confidence that it is successfully tackling debt levels, the less it will charge for lending to the government, in other words, bond yields will decline.

Moreover, improved supply-side performance (notably electricity and logistics) will not only facilitate faster economic growth over time, but can also limit upward price pressures, for instance, if companies don’t have to pass on the cost of running diesel generators. An improved inflation outlook means the Reserve Bank can reduce short-term interest rates relative to a scenario where loadshedding was still a regular occurrence. Lower rates, in turn, support economic growth.

**CHART 3: SOUTH AFRICA INFLATION AND INTEREST RATES**



Source: LSEG Datastream

In other words, while the country has been stuck in all sorts of vicious cycles, at last there is now an opportunity to turn

some into virtuous cycles, though it will still require patience and determination.

## SMALL

Nothing happens in isolation, however. South Africa is a small corner of the global market, and therefore global market conditions will be important in determining returns from local asset classes.

On the equity side, South African shares are only 3.5% of the MSCI Emerging Markets Index and therefore less than 0.5% of the MSCI All Country World Index, a common global

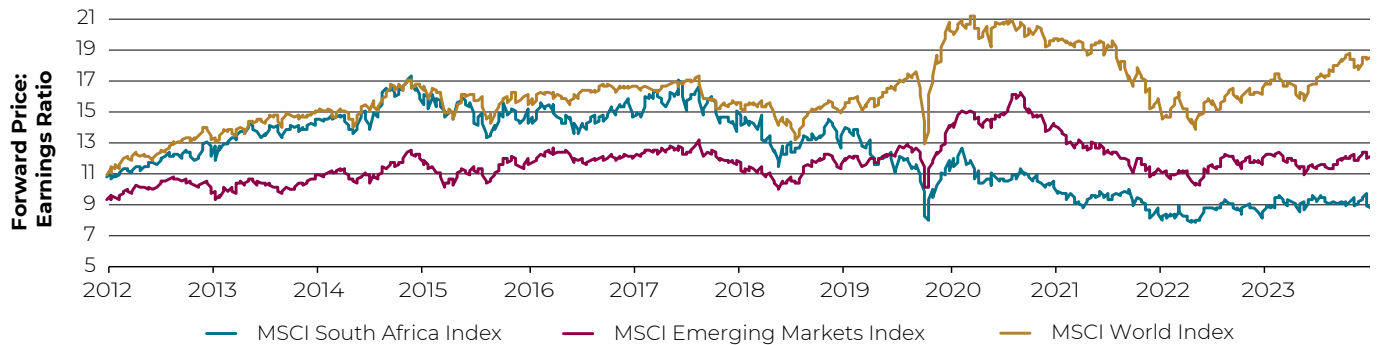
equity benchmark. This fact alone argues against going overboard with domestic allocation. A diversified portfolio should still have sufficient global exposure.

Global equity investors have long held underweight positions to South Africa in their emerging market portfolios, generally preferring faster-growing Asian countries. South African equities trade at a discount to emerging markets and has

room to re-rate relative to its peers. The same can be said about the rand: it underperformed other commodity-producing emerging markets for most of the past three

years, but now has room to make up some ground on a relative basis.

**CHART 4: SA, DEVELOPED AND EMERGING MARKET EQUITY VALUATIONS**



Source: LSEG Datastream

But the peer group itself trades at a discount to global markets. The next leg is that global investors need to fall in love with emerging markets as a group again, closing the discount. This is a harder case to make, since China is experiencing a structural downshift and is still the largest EM (India is on the rise, but not yet large enough to compensate). The phenomenal performance of the US tech megacaps is another factor, as the AI boom builds, as is the strong dollar of the past decade.

A US Federal Reserve cutting cycle has historically done wonders for emerging markets. While the Fed itself has been dialling back its rate-cutting expectations, most recently in its latest “dot plot” summary of economic projections, the case has been building for it to start a gradual easing cycle before long.

After a string of worrying inflation data releases in the first quarter, the latest numbers have been better. Data can be

noisy from month to month, and one should be careful of extrapolating too much, but there is enough evidence of a softening of inflation in the labour market, while inflation expectations remain anchored. The Fed itself views rates as “restrictive” meaning that they are constricting economic activity, especially weighing on small businesses and low-income households.

The Fed does not need inflation to be at 2% to start cutting rates, it just needs to have a visible path down to 2%. While rates are still unlikely to fall to pre-pandemic levels, a reduction from current elevated levels could ease upward pressure on a strong dollar. A somewhat softer dollar (a big dollar bear market is unlikely to stem from rate cuts alone, but rather from increasingly dysfunctional US domestic politics) can give the rand a further boost.

## DARKEST BEFORE DAWN

The old saying of not counting chickens before they hatch remains applicable, but we are looking at a promising flock. There is a broader lesson here, beyond the current moment in South African politics. When investments are cheap, people are tempted to wait until there is a clear catalyst that will unlock the value. In reality, the catalyst is usually

unpredictable. It means that a valuation-based investment process requires persistence. Just when South African investors grew tired of hearing about being patient, we seemingly have a pro-growth GNU that was not the consensus view ahead of the election. Unpredictable things often happen. Sometimes they have positive results.

## EQUITIES - GLOBAL

| DESCRIPTION      | INDEX                 | CURRENCY | INDEX VALUE | WEEK   | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR  |
|------------------|-----------------------|----------|-------------|--------|---------------|--------------|---------|
| Global           | MSCI World            | US\$     | 3 508.0     | 0.46%  | 1.83%         | 10.70%       | 19.81%  |
| United States    | S&P 500               | US\$     | 5 465.0     | 0.61%  | 3.54%         | 14.57%       | 25.17%  |
| Europe           | MSCI Europe           | US\$     | 2 104.0     | 0.72%  | -2.00%        | 4.16%        | 9.87%   |
| Britain          | FTSE 100              | US\$     | 10 413.0    | 0.75%  | -1.25%        | 5.76%        | 7.90%   |
| Germany          | DAX                   | US\$     | 1 674.0     | 0.36%  | -3.46%        | 5.49%        | 8.07%   |
| Japan            | Nikkei 225            | US\$     | 241.5       | -2.08% | -1.32%        | 1.77%        | 2.05%   |
| Emerging Markets | MSCI Emerging Markets | US\$     | 1 087.0     | 0.93%  | 3.62%         | 6.15%        | 8.27%   |
| Brazil           | MSCI Brazil           | US\$     | 1 404.0     | -0.21% | -4.81%        | -22.00%      | -16.97% |
| China            | MSCI China            | US\$     | 58.7        | -0.64% | -0.49%        | 5.73%        | -3.71%  |
| India            | MSCI India            | US\$     | 1 052.2     | -0.24% | 4.80%         | 14.12%       | 32.52%  |
| South Africa     | MSCI South Africa     | US\$     | 435.0       | 7.41%  | 11.25%        | 4.82%        | 8.21%   |

## EQUITIES - SOUTH AFRICA (TOTAL RETURN 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     | 79 768.0    | 3.52% | 3.99%         | 3.74%        | 5.47%  |
| All Share                | All Share (Total Return)   | Rand     | 14 330.0    | 3.57% | 4.07%         | 5.74%        | 9.72%  |
| JSE Capped SWIX          | Capped SWIX (Total Return) | Rand     | 35 070.6    | 3.63% | 4.14%         | 5.69%        | 10.65% |
| TOP 40/Large Caps        | Top 40                     | Rand     | 12 954.0    | 3.34% | 3.44%         | 5.23%        | 7.66%  |
| Mid Caps                 | Mid Cap                    | Rand     | 23 219.0    | 5.61% | 7.33%         | 6.58%        | 17.33% |
| Small Companies          | Small Cap                  | Rand     | 36 109.0    | 5.21% | 7.47%         | 10.56%       | 20.25% |
| Resources                | Resource 20                | Rand     | 4 938.5     | 3.61% | -6.18%        | 1.58%        | -7.08% |
| Industrials              | Industrial 25              | Rand     | 23 561.0    | 1.44% | 1.99%         | 6.12%        | 9.03%  |
| Financials               | Financial 15               | Rand     | 14 166.0    | 6.12% | 15.49%        | 9.72%        | 25.24% |
| Listed Property          | SA Listed Property         | Rand     | 2 041.2     | 2.14% | 5.93%         | 9.51%        | 23.34% |

## FIXED INTEREST - GLOBAL

| DESCRIPTION  | INDEX | CURRENCY | INDEX VALUE | WEEK   | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|--|-------|----------|-------------|--------|---------------|--------------|--------|
| IBOXX Global Government S&P Overall (USD Unhedged) |       | US\$     | 74.2        | -0.45% | 0.28%         | -5.39%       | -4.01% |

## FIXED INTEREST - SOUTH AFRICA

| DESCRIPTION            | INDEX           | CURRENCY | INDEX VALUE | WEEK  | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|------------------------|-----------------|----------|-------------|-------|---------------|--------------|--------|
| All Bond               | BESA ALBI       | Rand     | 1 004.1     | 3.22% | 6.39%         | 6.77%        | 16.23% |
| Government Bonds       | BESA GOVI       | Rand     | 989.1       | 3.22% | 6.39%         | 6.71%        | 16.16% |
| Inflation Linked Bonds | BESA CILI       | Rand     | 356.7       | 0.95% | 2.96%         | 2.14%        | 8.36%  |
| Cash                   | STEFI Composite | Rand     | 570.0       | 0.16% | 0.47%         | 4.01%        | 8.54%  |

## COMMODITIES

| DESCRIPTION     | INDEX           | CURRENCY | INDEX VALUE | WEEK  | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|-----------------|-----------------|----------|-------------|-------|---------------|--------------|--------|
| Brent Crude Oil | Brent Crude ICE | US\$     | 85.2        | 3.17% | 5.23%         | 10.70%       | 10.70% |
| Gold            | Gold Spot       | US\$     | 2 322.0     | 0.30% | -0.21%        | 12.55%       | 20.00% |
| Platinum        | Platinum Spot   | US\$     | 996.0       | 4.18% | -4.60%        | 0.91%        | 5.62%  |

## CURRENCIES

| DESCRIPTION  | INDEX   | CURRENCY | INDEX VALUE | WEEK  | MONTH-TO-DATE | YEAR-TO-DATE | 1 YEAR |
|--------------|---------|----------|-------------|-------|---------------|--------------|--------|
| ZAR/Dollar   | ZAR/USD | Rand     | 17.96       | 2.15% | 4.57%         | 1.87%        | 1.98%  |
| ZAR/Pound    | ZAR/GBP | Rand     | 22.71       | 2.60% | 5.46%         | 2.60%        | 2.95%  |
| ZAR/Euro     | ZAR/EUR | Rand     | 19.21       | 2.33% | 6.08%         | 5.14%        | 4.72%  |
| Dollar/Euro  | USD/EUR | US\$     | 1.07        | 0.00% | 1.40%         | 3.18%        | 2.80%  |
| Dollar/Pound | USD/GBP | US\$     | 1.26        | 0.36% | 0.47%         | 0.47%        | 1.26%  |
| Dollar/Yen   | USD/JPY | US\$     | 0.01        | 1.55% | 1.63%         | 13.33%       | 12.64% |

Source: I-Net, figures as at 21 June 2024

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