Truffle Asset Management

Economic Commentary
January 2023

Chinese consumers back on the street

Following 2-3 years of sustained and strict pandemic-led lockdown, the Chinese consumer is out and eagerly spending accumulated savings on goods and services. Against a "new" backdrop of pro-growth economic policy and more business-friendly regulation, Chinese PMI statistics, mobility data and spend on services are showing notable improvements. This underpinned the strong January gains in Chinese shares and global consumer goods companies, including Richemont in South Africa.

Consumer-led growth in China is typically good for Emerging Markets (EM), and South Africa has benefitted from global moves to invest in EM baskets.

China's sudden reopening is yet to show evidence of increasing capital expenditure; however, commodity prices for metals such as iron ore and copper have already run hard alongside their respective miners.

US valuations overlooking recession risk

January was once again characterised by a buoyant US labour market providing the US Fed limited reason to ease monetary policy and pivot from rate hiking in 2023. In addition to higher rates, banks are also tightening lending standards. We think there is an increased risk of recession from here, although this risk is not reflected in current share prices, with the S&P500 now trading on approximately 18.4X PE.

US unemployment levels at 3.4% have reached 53-year lows. However, rapidly declining growth in temporary payroll data, a leading indicator for employment numbers, is signalling unemployment is set to rise. Rising unemployment typically continues for an extended period and results in a recession.

From an equity market perspective, earnings momentum appears to be falling, and downgrades to earnings expectations for 2023 EPS continue at about 2% per month, driving an even higher S&P valuation.

South Africa is running on reserve and China stimulus

Loadshedding-related challenges continue to weaken the local economy. The unavoidable business spend on short term energy solutions to sustain operations during stage 4 and higher levels continues to weigh on many sectors, particularly retail and manufacturing. Short-term earnings forecasts are unclear, given the uncertainty of whether and when the power crisis will be resolved. Corporate SA is stepping up to the challenge while Government appears to have several options available when it comes to re-powering SA. The willingness to implement a solution remains imperative to any meaningful improvement in the economic outlook.

Despite the fundamental challenges of doing business in SA, and a weaker consumer, China's reopening supported SA as a commodity-rich country. Continued demand for commodities which is essential for South Africa's terms of trade and fiscal health, will depend on further fixed capital investment from China. Stronger fiscal and trade balances, in turn, support domestic interest rates and Rand value. A significant lift in tourism as travel normalises to pre-pandemic levels is an added, although less material, positive for our economic growth.

SA equities continue to offer value relative to history and other EM markets. However, the uncertain outlook for domestically exposed corporates means incorporating higher margins of safety in our valuations and a preference for businesses less exposed to the higher cost impact of extended loadshedding.

Outlook

January has provided little clarity on how global economies will shape in 2023. Much still depends on the outcomes of many variables, including a potential US recession, sustainability of Chinese growth and capital investment, European energy demand and, importantly, the path of monetary policy by Central Banks. The uncertain macro environment continues to fuel financial market uncertainty.

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Morningstar Award was awarded to Truffle Asset Management (Pty) Ltd on 23 March 2022. Details available on request..

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