Truffle Asset Management

Economic Commentary
April 2023

Are we reaching the tipping point?

Global equity markets gained in April supported by resilient global economic data - despite continued stress in the banking sector, stubborn inflation, and uncertainty around the economic outlook. PMI data for US, EU and UK showed a higher-than-expected increase in economic activity. However, this was more services related than manufacturing-driven.

US recession risk over the near term has reduced, partly because of continued consumer resilience. We expect the lagged impact of 5% consecutive rate increases and a tightening in credit conditions to drive a slowdown in the US economy. Core inflation flattened across most of the major developed economies (helped by lower energy costs). We, therefore, expect another 25bps rate hike in the UK and Europe in Q2, while any further change in US rates is dependent on the Fed's reading of new economic data and inflation reports.

DM equity markets still resilient

Challenges in the US regional banking sector continued, and market participants remain apprehensive about further casualties of persistently high interest rates. Discussions around expanding the existing deposit insurance scheme will be beneficial for sentiment and the stabilisation of deposit flows. As noted previously – the resulting impact of bank's tightening credit is a significant risk to corporate growth. Furthermore, Corporates are yet to report a change in earnings because of persistently higher borrowing costs and taxes. On this basis US valuations continue to look expensive.

Europe maintained resilient economic growth with a Q1 reported growth of 0.1%, while inflation remains high, changing little from the previous month. Similarly in the UK, core inflation was relatively unchanged with wages data strong. This supports market expectations of another rate hike from the Bank of England in May. Across UK and Europe, energy stocks performed well while the technology sector in Europe came under pressure following a drop in demand for semi-conductors. Assets across Europe are offering reasonable value, benefitting from lower energy prices and a China re-opening.

Geopolitical tensions resulted in weak performance for Emerging Markets, particularly China with potentially new restrictions from the US on foreign direct investment. Despite the Q1 GDP surprise, manufacturing PMIs dropped again in April, pointing to an uneven recovery as services' recovery remains on track. A service-led recovery is typically far less supportive for SA exports.

SA challenges deepen

The SA macro-environment continues to worsen with the return to Stage 6 power cuts and ongoing rail and port constraints. The SARB's latest policy review estimates that loadshedding will reduce GDP growth by 2% in 2023 and add 1% to CPI. Persistent load-shedding, with likely increases into winter, poses further challenges for many businesses and consumers. However, our base case for the next 18-24 months indicates an improvement to the electricity issues as additional private sector supply is created.

Fears of CPI remaining elevated increase the likelihood that the SARB will raise interest rates again in May; however, this is potentially the last hike in the cycle. Expectations for rate cuts have been pushed out to early 2024.

SA's currency has come under significant pressure, with the ZAR down by 3% against the USD in April. YTD, the ZAR has now depreciated by 6.9% against the USD.

SA's fiscal risks are a further concern and require close monitoring. The potential of a higher-than-expected budget deficit increases as mining profits pull back with the impact of a global slowdown on commodity prices and exports capped by logistical and electricity constraints. Public indebtedness will continue to worsen under such a scenario, leading to continued pressure on the ZAR.

Corporate valuations are at historical lows suggesting the market is currently pricing in negative domestic earnings revisions and the high level of SA-specific risk.

Outlook: desynchronising growth

The risk of a US recession remains as indicators continue to signal an imminent slowdown. We are still of the view that valuations are too high and therefore expect underperformance of the S&P index going forward. Global markets are still adjusting to higher interest rates – we have seen casualties in the banking sector and expect sectors such as private equity and real estate to follow. China's reopening is gathering momentum which will benefit other geographies however geopolitical tensions add risk. South Africa faces strong headwinds with significant risk of further decline.

Despite continued market uncertainty, we remain focused on identifying appropriate investment opportunities across all funds while staying committed to our investment philosophy and process.

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