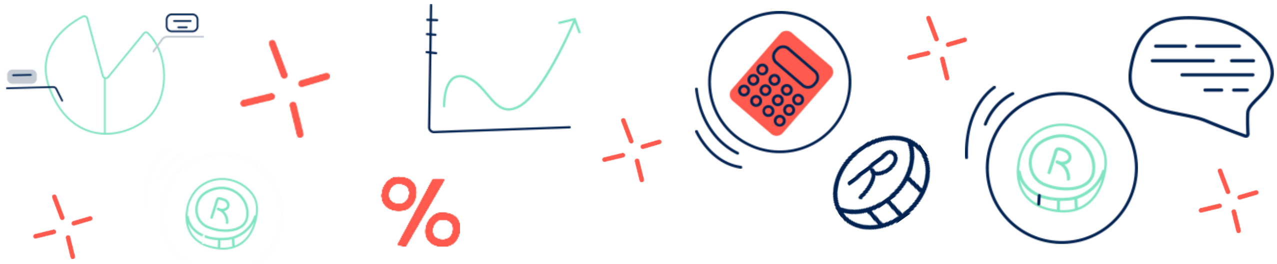

What we are watching

Global markets once again waited eagerly for new data prints to come through in May to guide potential turning points in the economic cycle. May proved to be a weak month for equity markets with most global indices, including the JSE ALSI, posting negative returns.

This month we highlight some of the key indicators that we are watching and why these matter.

Is the US feeling the pressure of tighter policy?

Interest rate hikes have stretched well beyond original expectations at the beginning of the cycle with the US Fed raising rates once again in May by 25bps - taking the US rate to 5.25%, the highest since 2007. The US Fed also has a watchful eye on data and their current narrative indicates that next time around they are more likely to pause rate hikes and apply a wait-and-see approach.

We are also closely watching for:

- Falling US inflation data and a slowing of GDP growth. Core inflation remained stubborn in May (marginally down) with services inflation making up a sizeable portion. Wage inflation is still running high at over 4% even though unemployment has ticked up to 3.7%. US growth held its ground with data for Q1 proving higher than market expectations which rewarded the USD, (and hurt an already fragile ZAR). However, signs of a slowdown continue to emerge. PMI data is showing both manufacturing and services sectors coming under pressure with manufacturing remaining in contractionary territory.
- Knock-on effects of the US mini-banking crisis on the property sector. Tighter credit conditions imposed by banks and higher rates are also limiting funding in the US and will place pressure on companies with geared balance sheets.

Why these matter: A measurable slowdown in the US will impact the S&P 500, and given the US represents 60% of world markets, the rest of the world will come under pressure.

Is there more life in the Chinese cyclical recovery?

The markets responded with enthusiasm when China came back to the economic playing field at the end of 2022. The cyclical recovery was potentially weaker than expectations with recent data suggesting a cooling. Historically Chinese policy has stimulated property growth following market downturns however not this time around. The latest Purchasing Managers Index (PMI) survey showed continued weak construction, but manufacturing output ticked up and the services sector is still showing gains.

In China we are watching:

- (And expecting) second-round effects from the reopening due to higher consumer spend. Youth unemployment remains an issue in China and further consumer-led growth may help to alleviate these employment pressures.
- Further property market support to drive fixed investment growth. Recent data has indicated there may be appetite from Chinese policymakers to provide some stimulus into the market.

Chinese geopolitical and structural issues do however remain and while company valuations are reasonable, these risks could dampen Chinese growth going forward.

Why this matters: Further Chinese consumer recovery will be supportive of EM's and consumer exposed shares such as Tencent will benefit. Potential property or fixed investment stimulus would benefit SA commodities; however, the likelihood of such stimulus remains uncertain.

SA: Have we reached the darkest hour?

Market and consumer pessimism appeared to reach a 2023 low point in May as further load-shedding, SA's perceived partnership with Russia and a free-falling currency dragged on sentiment. The ZAR: USD reached a record low of 19.85 on 25 May.

Markets are pricing in bad news with company valuations at historic lows while recent company reporting (including PnP and Tiger Brands) has laid bare the very real costs of loadshedding and an increasingly constrained consumer. Credit loss ratios at the banks are also rising, reflecting the poor state of the SA economy.

Small positive shifts in the direction of current challenging trends are all that is needed to improve SA's outlook and economic data. Top of our SA watchlist right now:

- A firm indication that loadshedding will begin to taper (and ultimately end). SA's government is starting to provide a clearer picture on the electricity outlook. An energy plan crafted and owned by the Presidency and the new Electricity Minister indicates the possibility that loadshedding could reduce by 2-3 stages into the new year. Furthermore, while private companies are under cost pressure, plans for alternative sources of energy will also come to fruition within the next 18 months.
- Geopolitical tensions continue to run high and South Africa's reported alliance with Russia significantly marred foreign sentiment over May, raising the level of economic fragility. Fortunately, more recent news flow evidencing a more neutral stance has provided some relief for the Rand.
- A positive shift in the leadership of SA is critical for business confidence and foreign investor sentiment. News reports indicate that SA Government is now more willing to work with business leaders to address the economic and Eskom crises as well as the significant challenges of crime and corruption.

Why this matters: SA valuations may be low however the unlock of value in company share prices is heavily dependent on data. It is important as we add SA stocks to our portfolio that we continually focus on potential value vs a value trap.

Investing in current market conditions requires patience. At the end of May our portfolios are defensively positioned, as we watch carefully for fundamental data shifts that will open up good opportunities to deploy capital into riskier assets.

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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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