Truffle Asset Management

# Economic Commentary
July 2023

## Positive sentiment amidst record heat

July proved to be one of the hottest months on record in the Northern Hemisphere, with climate change and rising temperatures becoming a reality as heatwaves and wildfires spread across some regions. It was also a month of rising global equity markets, with emerging equity markets outperforming Developed Markets for the first time this year. Lower inflation figures coupled with better economic growth data drove investor confidence. And more specifically, raised the potential for a softer landing for the US economy.

### US outlook

The US Fed met market expectations in July, raising interest rates another 25bps to 5.5%, the highest since 2007. The Fed's narrative remained unchanged, and the door remains open for further increases or maintaining rates at these levels, particularly as core inflation remains sticky.

The market responded positively to a significant decline in year-on-year US inflation (the June CPI print), expecting the peak of the rate hiking cycle with a softer landing in sight when it comes to slowing economic growth.

Employment data remained buoyant and economic growth resilient, driving continued positive sentiment and another solid monthly performance from the S&P 500, which is now up 20% year-to-date.

While the impact of sustained higher interest rates may be less severe than originally expected, a slowdown of the US economy into 2024 would weigh on corporate earnings momentum. US stock valuations remain elevated at current levels, and there remains a risk of meaningful de-rating when the US does start to slow down.

### Chinese consumers need a boost

Economic activity in China remained sluggish through the second quarter and into July. Chinese consumers remain scarred from the pandemic era given a lack of direct fiscal stimulus during economic lockdowns compared to the US and Europe. Now into a post-recession cycle, stimulus policy is needed to garner consumer confidence and economic momentum.

The recent Politburo meeting indicated the implementation of policy support designed to drive confidence and a cyclical recovery, a positive for China growth.  Immediate policy action would benefit consumers, while over the medium-term private sector and infrastructure would receive support. Long-term initiatives are designed to invigorate capital markets.

Positive policy news helped Chinese equity markets in July. While unlikely to experience post-pandemic boom growth, the Chinese economy should start to incrementally benefit from stimulus into the fourth quarter of this year.

Chinese consumer recovery will be supportive of EM's and Chinese consumer exposed shares.

## Is South Africa set for stronger second half?

Easing of loadshedding and the increased privatisation of power supply, continue to improve overall sentiment in South Africa supporting strong equity market performance in July. The Rand also benefitted from a weaker USD and improved EM sentiment.

While longer term challenges and uncertainties remain, potential improvements over the short-term are supported by:

- Privatisation of infrastructure and co-operation between public and private sectors: SA Government has shown increased willingness to work with business leaders to address the economic and Eskom crises as well as the significant challenges of crime and corruption. Recent news of potential partnerships for infrastructure development is also positive.
- Resilient South Africans: SA corporates and consumers are increasingly finding alternative power sources and at lower costs to remain sustainable.
- Peaking of interest rate hikes: An already stretched consumer will welcome an end to rising rates and a potential reduction as we head into 2024. Inflation will need to stay within the target range.

Opportunities should be balanced with the risk of South Africa's fiscal fragility and internal political tensions as we near elections. Stock valuations are at significant lows signally some good buying opportunities, however it's important to protect portfolios from downside risk and consider the impact of various challenging scenarios and any value traps.

Looking ahead into August, patience is required as we "wait and see" how economies continue to respond to 18 months of tight policy in developed markets and whether China can indeed stimulate growth in an increasingly desynchronized global market. .

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

Contact

# Get in touch with us

**Telephone numbers**
Johannesburg Office: +27 (0)11 325 0030
Cape Town Office: +27 (0)21 007 0532

**Email addresses**
General queries: info@truffle.co.za
Institutional services: institutional@truffle.co.za