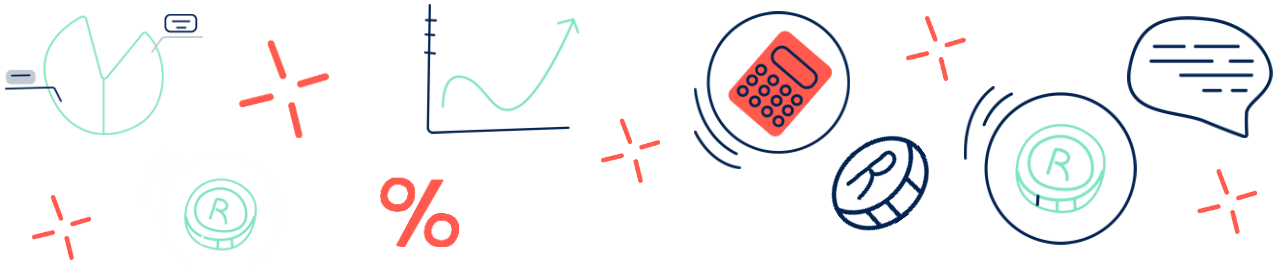
Truffle Asset Management

Economic Commentary
November 2023



Markets in good spirits

Falling inflation data signalled a peak in interest rate hikes across developed markets in November, lifting spirits ahead of the holidays and driving a market turnaround. MSCI World was up 9.3% for the month reversing losses in previous months. Whether policymakers will implement rate cuts anytime soon remains uncertain as wage inflation remains elevated. This will continue to be balanced against a general slowing of economic activity across most developed countries.

China's economy rebalancing

The IMF growth forecast for China was recently revised down to only 4% for 2024 as the Chinese economy realigns away from an excessive reliance on property to focus on growing consumption. A sovereign debt downgrade by Moody's also highlights the need to reduce the dependence on debt-fuelled stimulus. These factors could temper the extent of any significant cyclical upswing in Chinese growth and, coupled with a somewhat capricious government policy, the outlook for China remains uncertain. The potential for cyclical recovery remains, but appropriate valuations for the Chinese "new normal" are still in flux. We acknowledge the related market volatility over the short term and have placed downside protection on Chinese exposures in our portfolios.

US slowly slowing

The US economy's continued resilience is coming into question, with several signs that the economy is finally slowing. The GDPnow forecast for Q4 is down to 1,2%, from a previous estimate of 2,4%. Whilst labour market conditions remain robust, consumers are clearly feeling some pressure, as seen by lower volumes in the housing market. Slowing credit extensions and money supply, as well as a reduction in business capital spend, are also signalling that economic activity will slow down.

We have highlighted throughout the year that US valuations are elevated. Against a weakening backdrop, the S&P 500 valuation remains high with a PE ratio of 19, well above the historical average.

The 5-year breakeven inflation rate has fallen to 2% from a 2022 high of 3.6%, and although US bond yields have fallen 0.75% from a peak of 5%, markets are discounting limited cuts of just over 1.5% over the next two years. Given expected equity returns at 3.5% and real rates of 2%, the depressed Equity Risk Premium of 1.5% means we still prefer US debt to equity.

SA logistics crisis is taking its toll

SA CPI for October came in higher than expected at 5.9% year-on-year, driven by food and transport costs. Core inflation at 4.4% is still within the target band, and the falling oil price should support a lower rate going forward. Unfortunately, Q3 GDP declined by 0.2% quarter on quarter as Transnet issues hit a new low, triggering well-documented logistics challenges across the country.

South African equity markets appeared immune to local challenges and rallied in line with global counterparts as the ALSI rose 8.3% over the month. SA's 10-year bond followed the US bond market rally, declining by approximately 70bps. SA rates are expected to come down from here, with the market pricing a relatively slow decline of 1% over the next two years.

As South Africa gears up for elections in 2024, economic growth remains heavily dependent on the restoration of Transnet. Positively, SA Treasury provided financial support issuing a guarantee facility that enables Transnet to raise new debt with banks or settle existing debt obligations. Operationally, passing the turnaround plan in Parliament and announcing new Transnet management is key to future success.

A new report issued by the Financial Action Task Force (FATF) in November brought further positive news for South Africa, showing the progress in efforts to be removed from the global watchdog's dirty money watchlist. A formal review and a re-rating deemed South Africa to be "fully or largely compliant" in 35 of FATF's 40 recommendations, including five of the watchdog's six core recommendations. A potential formal removal from the "grey list" will support ease of business going forward.

With 2023 drawing to a close, the country remains heavily hamstrung by poor and weakening infrastructure, particularly logistics and power. Globally, developed economies are expected to slow down in 2024; however, uncertainty remains as to exactly how slow and how low.

Our portfolios are defensively positioned with investments in select businesses that display higher margins of safety and strong cashflow yields during uncertain times.

As we come close to the end of another busy year, Truffle would like to thank you for your ongoing support. We wish you and your loved ones a wonderful festive season ahead.

Iain Power
Chief Investment Officer

Summer Holidays

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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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