Trendline

Third Quarter 2019

Outlook

Navigating markets through Q3 proved a perilous exercise with markets experiencing further volatility following Q2's roller coaster ride. The quarter started off on a positive note as the US–China trade war seemed to find stable footing with trade talks back on track and no new tariff increases from either side. Unfortunately, this did not persist for long as August saw the US impose an additional 10% tariff increase to which China retaliated by allowing its currency to depreciate down to its lowest level in over a decade. This mitigated the intended impact of the US tariff increase to an extent by making Chinese exports to the US more affordable.

Global geopolitical tension remained elevated over the quarter with the US–Europe trade war taking off along with mass uncertainty regarding a potential of a no deal Brexit. While an increasing amount of central banks have adopted a dovish approach to interest rates in order to stimulate growth, the effects of the global risk off environment which ensued could not be completely mitigated. To date, the price tag for the global trade war uncertainty exceeds 600 billion Dollars, more than double the direct impact of the tariff increases.

Developed markets fared better with the MSCI World closing the quarter up 0.53% (USD) whilst emerging markets sold off sharply (-4.25%) as a risk off sentiment prevailed. As markets digested renewed trade war rhetoric between the US and China, a slowdown in Germany as well as the potential impeachment of US president Trump. Global bond markets posted 0.85% (USD) over the quarter as investors sought the security of safe havens in the uncertain environment despite the US Fed cutting rates and the ECB advising of a stimulus package which included the lowering of a key interest rate, as well as 20 billion Euros worth of monthly bond purchases.

Global

US

The US economy grew by 2% in Q2, considerably slower than in Q1, as the effects of their trade wars become more evident with weak business confidence being a major detractor.

The manufacturing sector recorded its lowest reading in over a decade and a second consecutive month of contraction registered at 47.8 in September. This comes after August marked an end to a thirty five month long period of expansion, which averaged 56.6 points.

The detraction was largely due to poor export orders stemming from weak global demand. Q3 saw the FED cut rates for the first time in ten years, in an effort to stimulate US economic growth amid the global economic slowdown.

The disastrous impact of the US-China trade war will pale in comparison to the potential impact from a US-Europe trade war for US firms with foreign affiliate earnings, as the US exports over three times as much to the Euro Zone than it does to China.

Eurozone

Germany has continued to struggle over the quarter with the IMK index which gauges the health of an economy, assigning a 60% probability of a recession in the foreseeable future. Germany's PMI fell below its expected level of 45 points in both August and September, speaking to the dire state of the manufacturing sector.

In line with peers, the Euro-Zone has reduced its GDP growth forecast to 1.1%, on the back of the global economic slowdown, along with uncertainty arising from the US-Europe trade conflict. To aid in stimulating growth, the ECB (European Central Bank) cut interest rates by 10 basis points to -0.5% and have relaunched their bond repurchase programme.

UK

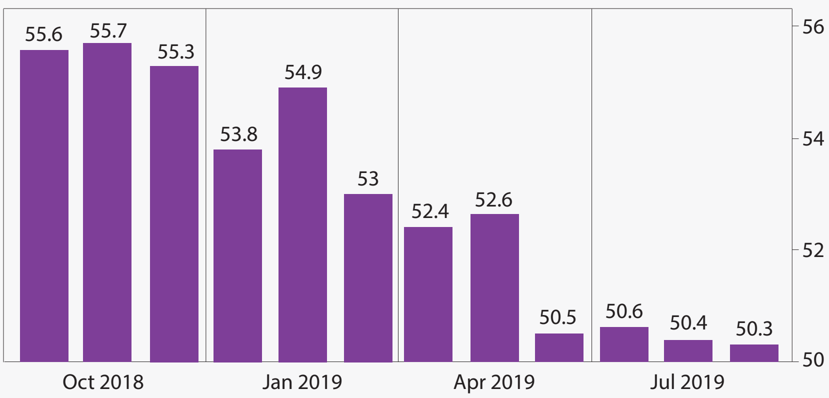
July marked the election of Boris Johnson as the new prime minister of the UK. While many expected Johnson to bring much needed certainty to the Brexit negotiations, this was not the case. After many failed attempts to find a resolution acceptable to both sides, Johnson remains confident that come 31 October, the UK will leave the Euro zone with a deal in place. The UK recorded a -0.2% GDP contraction for Q2 2019 further fueling fears of a technical recession in Q3 2019. The FTSE All-Share was flat for the quarter delivering 0.12%.

Asia

Asian markets were certainly not spared with the impact of the global slowdown creating large volatility in their markets. The quarter saw the Yen rally as investors sought safe havens amid the risk off sentiment. Economic data coming out of Japan was mixed as retail sales rebounded 4.3% in August after contracting 2.3% in July while its economic growth for Q2 came in at only 0.3%. During the quarter the Bank of Japan's Tankan index capturing big manufacturing sentiment fell to a 6 year low.

China's PMI rose back into expansionary territory in July and August despite weak global demand. Notwithstanding, China's economy slowed to 6.2% in Q2 2019, its weakest level in 27 years as the trade war took its toll. Further weakening China's outlook, Hong Kong's economy continues to stagnate with no relief in sight from the strain of the unrelenting anti-government protests.

US manufacturing PMI



Source: Trading Economics

Local

SA

The quarter saw a nation on fire as the unrest amongst SA citizens and foreign nationals sparked intense violence and looting. This further escalated the wildfire engulfing our local economic growth prospects.

The International Monetary Fund and Moodys rating agency has revised their GDP growth forecast for SA downward to 0.7% for 2019. Moodys is the only rating agency that has kept SA sovereign credit rating at investment grade, with a rating review due on 1 November 2019.

As widely expected, the SA Reserve Bank kept its rates unchanged despite a flagging economy and a lower than expected inflation print in July. Expectations are that the central bank will follow global peers in cutting rates at its November meeting.

Manufacturing activity returned to contractionary territory in August as economic activity remained constrained. The Absa purchasing managers' index (PMI) in the manufacturing sector declined to 45.7 index points in August from a three-year high of 52.1 in July. This index measures the health of the manufacturing sector and a score below 50 points indicates contraction. SA's manufacturing sector accounts for about 13% of GDP. This can be largely attributed to the dire state of SA's power utility provider, Eskom.

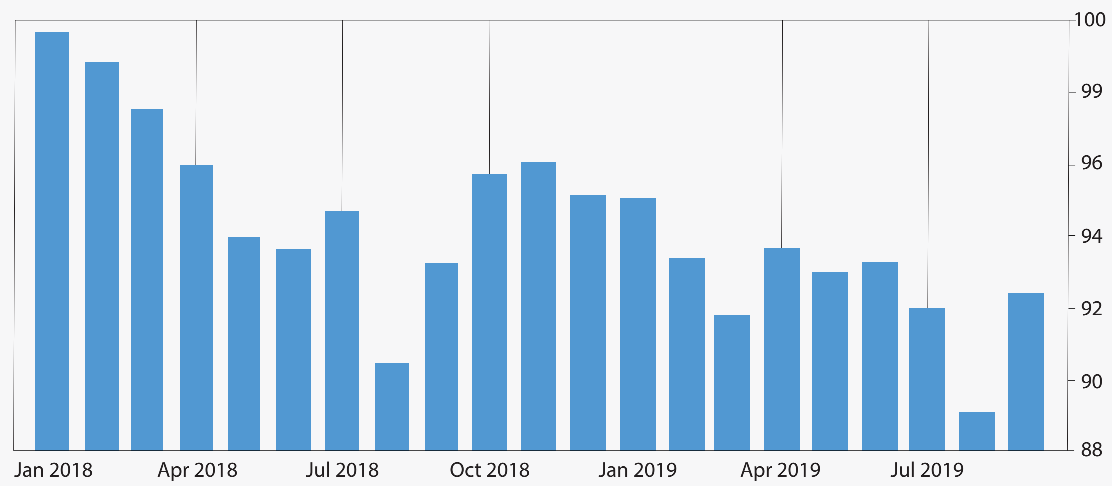
Data from Statistics South Africa showed South Africa's headline consumer inflation came in at 4.3% year on year in August up from 4% year on year the previous month. Producer Price Index for final manufactured goods increased 0.3% to 4.5% in August 2019 year on year.

The FTSE/JSE All Share followed its emerging market peers lower, closing down -4.57% (ZAR) led by losses in Resources (-7.33%), Financials (-7.67%) and Industrials (-2.54%).

The All Bond Index ended up 0.78% while its inflation linked counterpart ended up 0.12% over the quarter. Property followed the decline in EM growth assets, falling -4.44% while cash returned 1.80%. The Rand weakened closing at R15.16 to the US Dollar.

The South African Chamber of Commerce and Industry (SACCI) business confidence index fell to a 34 year low at 89.1 in August before recovering to 92.4 points in September. The slump was mainly driven by poor export volumes and a deteriorating Rand strength relative to the US Dollar.

SACCI Business Confidence Index



Source: Trade Economics

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