Market Commentary

November 2022

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US CPI Inflation surprises to the downside, catalysing a risk-on rally

Federal Reserve likely to slow pace of interest rate increase going forward

Global market themes

November was a strong month as the majority of markets posted gains, thanks to a variety of positive developments. This was primarily a function of lower-than-expected US CPI inflation data and remarks by Federal Reserve Chairman Jerome Powell indicating that the bank may start slowing its pace of short-term interest rate increases after its December meeting. Investor speculation that China would partially unwind its current "Dynamic zero-Covid" policy was also a contributing factor. Both developed and emerging market equities performed strongly, the latter group benefitting the most from the changing market narratives. The MSCI EM Index returned 14.8% and the MSCI World Index gained 7.0%. The softening seen in annual US CPI inflation data bolstered global bond performance, with aggregate indices such as the Barclays Bloomberg Global Bond Index rising by 4.7% or more. Government bond yields in the US and across the European Union fell over the month. Increased risk appetite returned to bonds too, with the JP Morgan EM Bond Index gaining 6.6% as the US Dollar weakened in November. In aggregate, commodities posted losses in November, with the S&P Goldman Sachs Commodities Index closing 1.7% lower. This was mainly due to falling energy prices, likely a reflection of slowing global economic growth. Industrial metals and agricultural commodities also showed falling prices over the month.

Inflation, US CPI in particular, remains the dominant market theme in 2022.

November data released in the middle of the month surprised by coming in at 7.7% relative to the consensus figure of 8.0%. A 0.3% difference may not seem like much, but markets appear to have read this as the peak in annual US CPI, and that this metric will most likely continue trending lower in coming months. This in turn implies that the US central bank is now likely closer to the end of its interest rate hiking cycle, which means that both inflation and short-term interest rates moving forward pose less uncertainty for markets broadly. This CPI print and the US central bank chairman's comments (providing guidance that the pace of rate hikes is likely to slow to 50 basis points per meeting from the December meeting onwards) were clear catalysts for higher asset prices in November.

Economic data out of the US continues to indicate a slowdown. Manufacturing Purchasing Managers' Index (PMI) data (survey data which proxies the domestic business cycle) fell into contractionary territory this month, printing at 47.6 versus 50.6 the previous month – the 50-index level is the line between economic expansion and contraction. Persistent inflation and an uncertain short- to medium-term outlook were the prevailing factors cited as the causes of falling output and declines in new orders – subcomponents of the PMI data. On the employment front, monthly non-farm payroll data showed a better-than-expected gain of 263 000 new jobs. While monthly job growth has trended down over the year, from the 500 000 level in January, the US economy remains strong from a labour market perspective. This is important as it's a primary input into monetary policy. The Federal Reserve is concerned that a consistently strong labour market may lead to rising wage inflation, which in turn feeds into and sustains higher levels of overall CPI inflation over time.

As of the end of November, fixed income markets are expecting the Federal Funds Rate to peak at 5% by May 2023, implying another 1% – 1.25% of rate increases between December and May.

Forward-looking growth metrics continue to point towards a recession in Europe. Composite PMI data for October (composite here referring to data from both manufacturing and services businesses) continued to show economic contraction, printing

China reopening narrative boosts global risk appetite

Economic growth continues to slow in Europe and the United Kingdom

at an index reading of 47.3. The survey data did note an easing of inflationary pressures faced by businesses as costs borne by these firms rose at the slowest pace in 14 months. EU officials have cut their growth forecasts for 2023, with calendar year growth estimated to slow to a meagre 0.3% from this year's estimate of 3.2%. Reasons cited include energy price pressures, consumers' weakened spending power and a weaker external trading environment. CPI inflation remains in the double digits, with the estimated November print showing a 10% year-on-year increase across the EU. This is down from October's 10.6%, with some market participants calling last month's print the peak for this cycle. Warmer autumn weather across the region has meant lower-than-anticipated energy demand, allaying concerns about shortages, even though energy prices remain the biggest driver of higher inflation.

The UK economy is showing clear signs of recession. The latest monthly growth data for September showed the UK economy contracting by 0.6% relative to expectations of a 0.4% decline. Third-quarter growth data also confirms the contraction. The services sector in particular remains under pressure from the rising cost of living that households are facing, along with recent and impending strike action. CPI inflation continues to accelerate, with the October number coming in at 11.1% – a full 1% increase on an annualised basis from the previous month. The main culprits here remain accelerating food and energy price increases.

Despite government support on energy costs, the average utility bill increased by 27% year on year to October.

These inflation figures give the Bank of England greater impetus to remain steadfast in raising rates. The bank added 75 basis points to its key reference rates at the beginning of the month, bringing the rate to 3%.

In China, the economy continues to face headwinds as fresh Covid outbreaks, and the resultant lockdowns, led to widespread protests across the country. Manufacturing activity for November came in marginally better than expected, with PMI data printing a reading of 49.4 versus the previous month's 49.2 print. However, this was the fourth consecutive month of contractionary prints, indicating growth remains subdued due to the ongoing battle with Covid. Chinese authorities did roll out some measures to support growth: the People's Bank of China lowered selected reserve requirement ratios thereby freeing up capacity for banks to lend to selected economic sectors. Authorities also eased measures in the property sector during the month. They removed restrictions on equity financing for listed property companies thus providing a boon for property shares. This sector was up approximately 70% in November alone as a result.

Politically, the breakout of protests against Covid restrictions looks to have pushed authorities to begin softening their zero-Covid policy stance.

It's too early to tell how this will play out as there has been no guidance as to when the world's second-largest economy will reopen fully. Progress thus far has been incremental. Despite this, markets look to have gotten ahead of themselves on the narrative that an end to zero-Covid is imminent, catalysing the strong performance seen in Chinese equities: the CSI 300 Index returned 13.1% in November.

All returns above are in USD.

South African market themes

Risk appetite returns, catalysing a strong month for equities

Annual inflation remains elevated, trending sideways in the mid-7% range

Manufacturing activity appears resilient to ongoing loadshedding

Thanks to the major themes in global markets – softer US CPI inflation, lower rate increases in the US and the Chinese reopening narrative – local equities performed strongly in November. The All Share Index gained 12.3% while the SWIX rose by 10.0%. This strength was concentrated in large capitalisation shares. The Mid-Cap and Small-Cap indices returned pedestrian gains of 2.9% and 2.4%, respectively. In terms of sectors, Resources led the way gaining 16.0%, with Industrial counters collectively adding 14.0% and Financials bringing up the rear with a modest 1.4% gain. The Rand strengthened by 6.2% against the US Dollar, closing the month at the R17.20 level. This strength was due to US Dollar weakness, driven by the factors mentioned above. Fixed income assets also saw increased buying appetite, with the All Bond Index adding 3.9% as the desire for increased exposure to EM debt returned more generally. The Composite Inflation-Linked Index posted a marginal gain of 0.6%. Listed property, per the All Property Index, added 5.8%.

There have been no material changes on the economic front as the country continues to deal with ongoing loadshedding, curtailing general economic activity, and an uncertain outlook due to both internal and external forces. Annual mining production declined by 4.5% in September marking the eighth consecutive monthly decline in this series. September manufacturing production meanwhile surprised to the upside, printing an annual 2.9% expansion versus expectations of a 2.4% contraction. This encouragingly implies that the sector has found the means to cope with the chronic power outages, at least in the short to medium term. More forward-looking manufacturing PMI data points to a marginal increase in activity and sentiment across the factory floors in SA, with the latest print coming in at 52.6 versus a reading of 50 the previous month. This was the highest reading since May of this year, which reflects improvements in overall business activity and specifically in new orders.

All returns above are in ZAR.

Inflation continues to run hot. Annualised CPI accelerated to 7.6% to the end of October, a 0.4% month-on-month increase, worse than consensus expectation of 0.2%. Annual CPI looks to be trending sideways in the mid-7% range since the July peak print of 7.8%. Food price increases have been the consistent primary driver here, with the latest increase of 12.3% year on year.

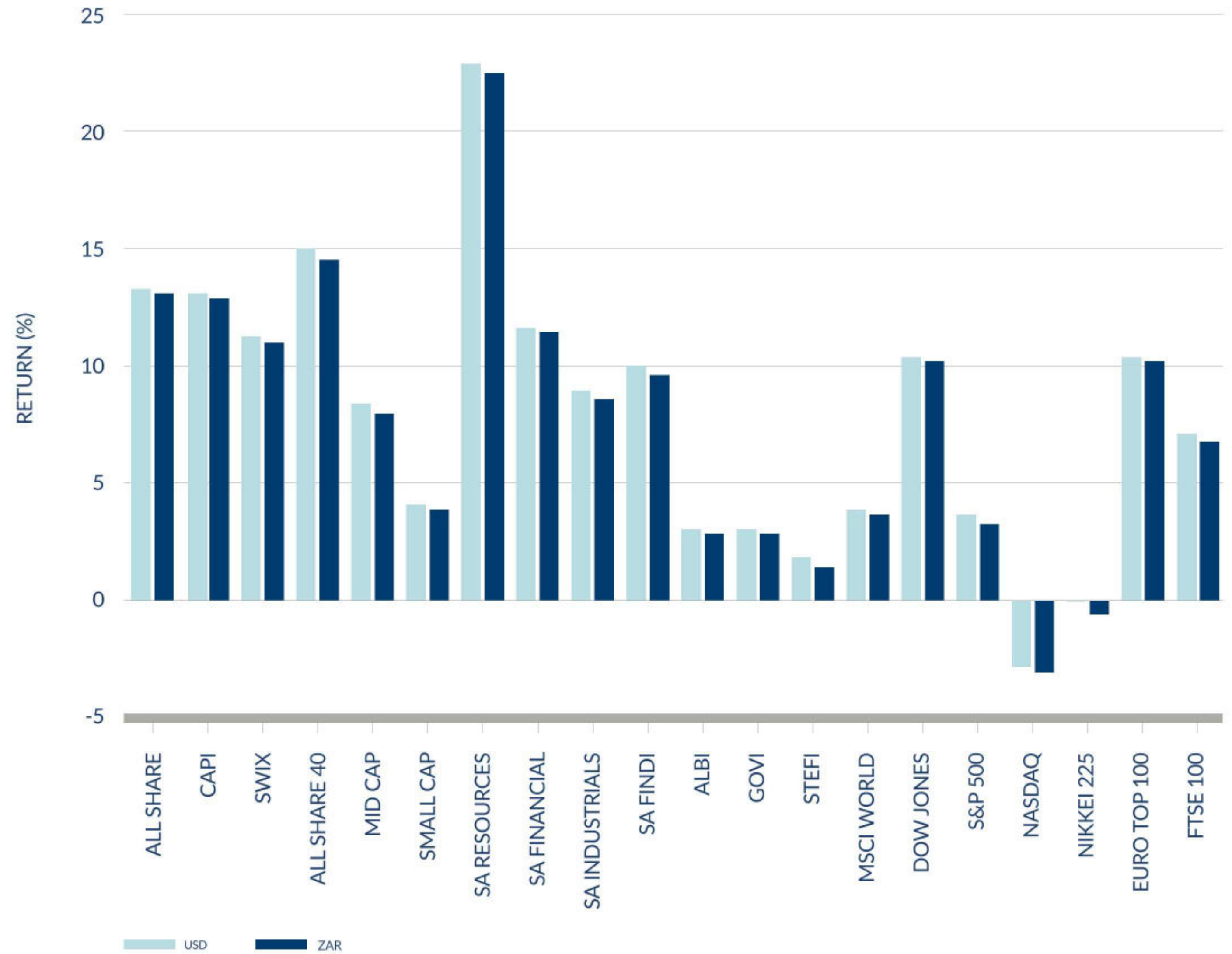
An expected further petrol price increase in December, due to Rand weakness as global oil prices have cooled dramatically since the first quarter, will add further pressure to already strained household incomes.

With the prime lending rate now at 10.25%, following a 75 basis point increase in the repo-rate last month, consumers and businesses face the growing headwind of higher debt-servicing costs, which is unlikely to subside in the short to medium term as SA Reserve Bank Governor Lesetja Kganyago hinted at more rate hikes in 2023.

On the political front, a panel of independent investigators reported that President Cyril Ramaphosa may have broken his oath of office amid the investigation into a robbery at his Phala Phala farm.

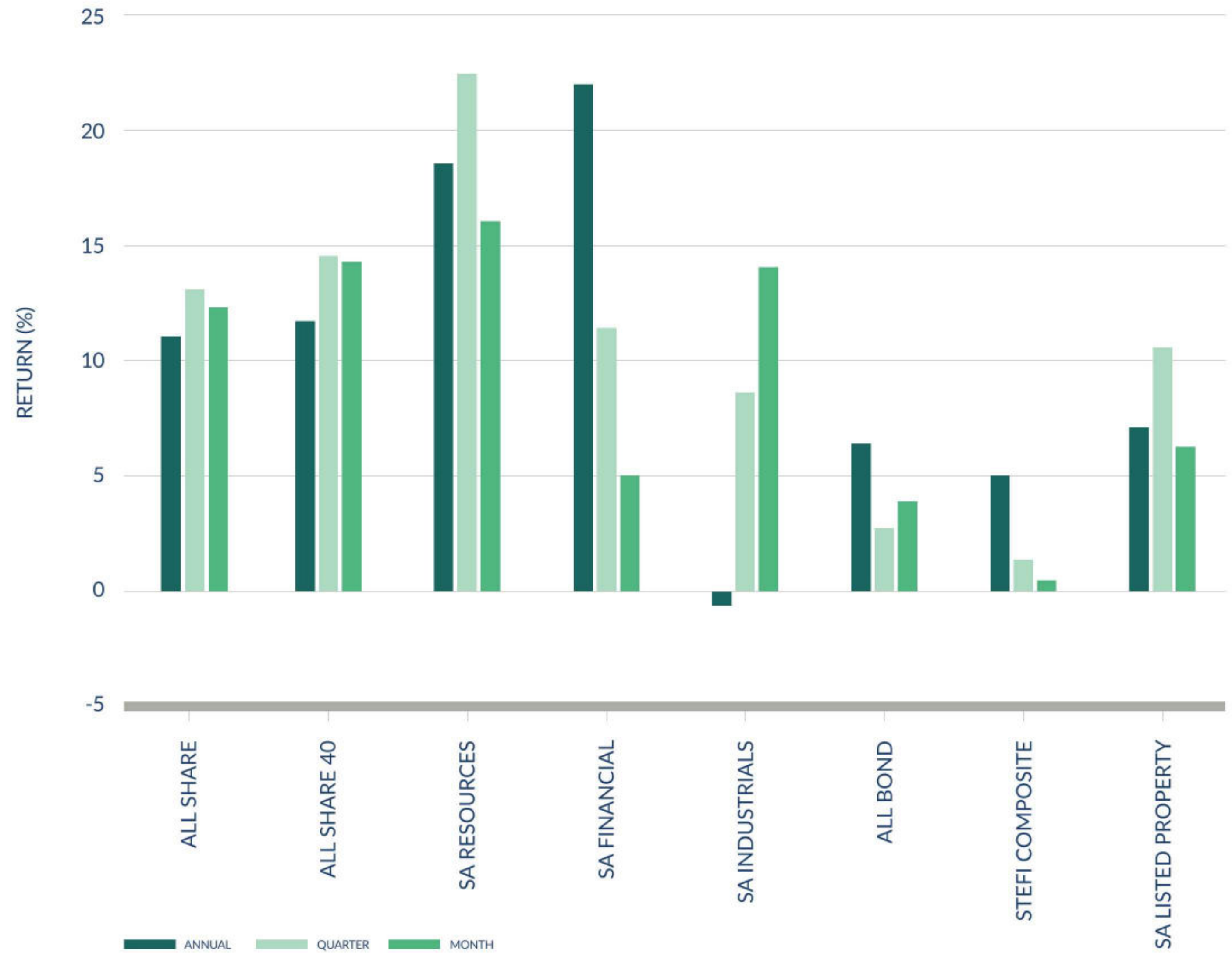
World Market Indices Performance

QUARTERLY RETURN OF MAJOR INDICES



Local Market Indices Performance

RETURNS OF THE FTSE/JSE SECTORS AND INDICES



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