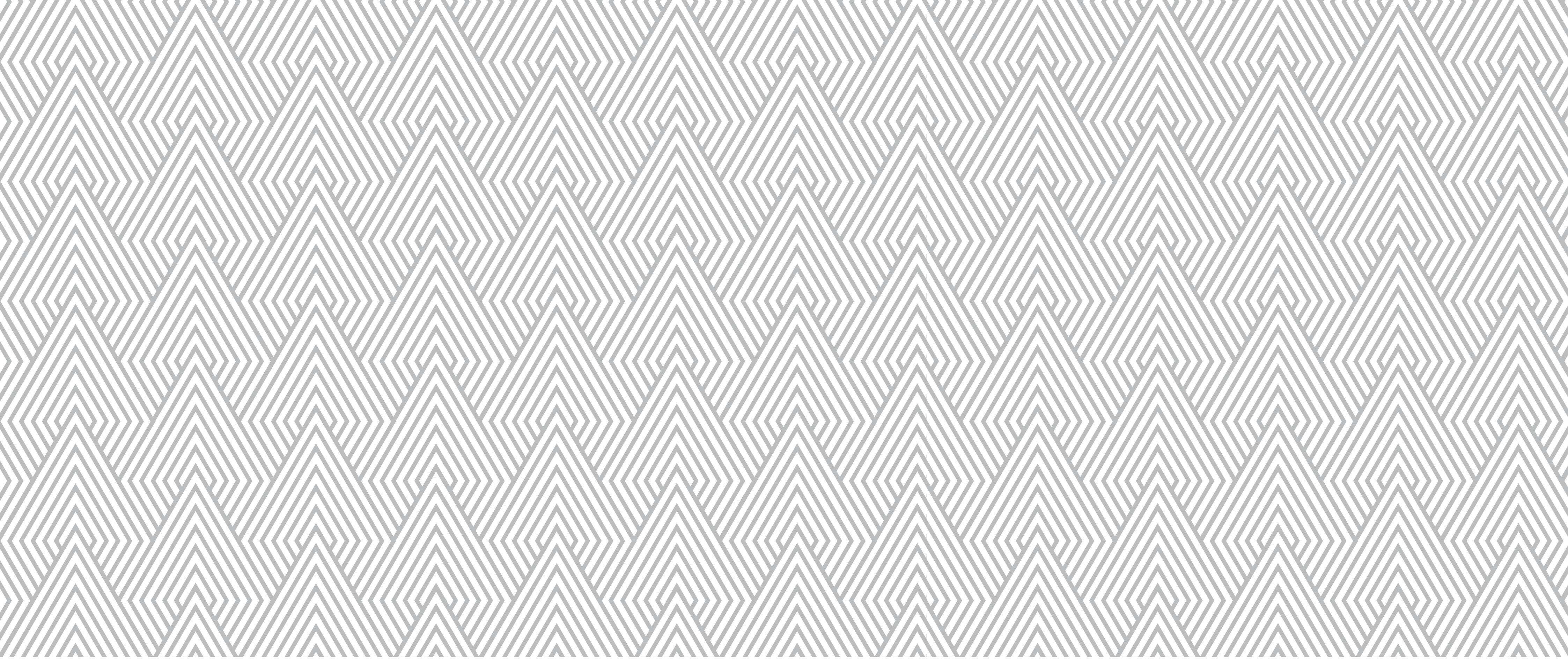

# Market Commentary

*November 2019*

RisCura

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# Here are this month's highlights:

South African assets struggled in November, underperforming global peers. Sentiment regarding trade talks swung between optimism and concern: A 'Phase One' trade deal seemed imminent after China promised improved policing of Intellectual Property Rights but appeared to be at risk after US President Donald Trump provoked Beijing's displeasure by supporting pro-democracy protests in Hong Kong. Risk-on, however, remained the prevalent sentiment and November was a particularly good month for developed market equities.

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# Cash

South African cash was one of the better performing asset classes for November, generating a 55 basis points (bps) return. South African inflation fell to an eight-year low in October, registering 3.7%. Lower transport costs, as well as a slight drop in food and non-alcoholic beverage prices, were the main contributors.

*The South African Reserve Bank (SARB) elected to leave the repo rate at 6.5% after its November meeting.*

The SARB has indicated that its medium-term inflation outlook is largely unchanged and that headline CPI inflation is expected to peak at 5.3% in the first quarter of 2021.

The SARB's 2019 GDP growth forecast was lowered, and it continues to see downside risks. These include global factors such as escalating global trade tensions, geo-political risks, and sustained higher oil prices. Local conditions also remain subdued, with domestic supply constraints, infrastructure bottlenecks, labour unrest and rising public sector financing needs cited. After S&P and Moody's imposed negative outlooks on the country's credit rating, analysts predict that there is less room for manoeuvre and the market is only pricing in a 50% probability of one interest rate cut over the next 12 months.

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# Bonds

South African bond markets were subdued during November. The ALBI posted a 20 bps return, and Inflation Linked Bonds (ILBs) dipped solidly into the red. In local currency terms, South African bonds were ahead of global peers, as the BarCap GABI lost 3.46% in ZAR (-0.76% in USD). SA bonds continue to offer attractive real yields in SA terms, but foreign investors remain net sellers for the year-to-date. In November, however, there was renewed interest from foreign investors. The last weekly government bond auction saw demand surge as investors stocked up on some of the most attractive emerging market (EM) bond yields on offer.

*South African bonds were under pressure this year due to the negative outlook from ratings agencies, and the uncertainties regarding the country's fiscal woes.*

Simultaneously, developed market central banks have implemented accommodative monetary policy measures, with the number of government bonds (e.g. Bunds) dipping into negative territory. South African government bond yields are therefore trading at extremely attractive levels, bettered only by Turkey, Nigeria and Lebanon amongst EM peers. In addition, supply is likely to dry up in December (Treasury stops issuing bonds after the 17th) and getting in at these levels has proven hard to resist.

*Global fixed income markets have had something of a banner year, which some analysts attribute to a safety rotation play against the backdrop of growing trade and geopolitical tension.*

This is illustrated by fixed income-based exchange traded fund growth, which saw a record USD 130 billion in inflows as at mid-November. During November, as investor sentiment was buoyed by positive news on the trade front, the safety rotation play lost some of its impetus. The riskier side of the capital structure, including corporate and high yield bonds, outperformed global government bonds. Developed market government bond yields rose in November: T-bill yields increased by 9 bps and UK 10-year Gilt yields were 7 bps higher. Peripheral European players, Italy and Spain, saw yields tick up 31 bps and 18 bps, respectively. German and French 10-year yields rose 5 bps each but remained in negative territory (at -0.36 and -0.05% respectively). EM government bond markets declined during the month, with currencies weakening against the dollar.

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# Equity

Domestic equity markets had a disappointing November: the All Share declined by 1.8% and the SWIX gave up 1.5%, significantly underperforming global counterparts.

South African investors saw little to cheer about on the economic and political fronts. The euphoria of winning the 2019 Rugby World Cup was soon diminished by dour company news regarding State Owned Entities (SOE). SAA was the subject of industrial action, as workers downed tools from 15-22 November. The strike cost the airline an estimated R50 million a day.

> *During the month, President Cyril Ramaphosa assented to the Special Appropriation Act, which makes provision for Eskom to receive an additional R59 billion out of the National Revenue Fund over the next two years.*

This has not, however, kept the lights on, as the SOE unexpectedly implemented rolling blackouts again in the first week of December. StatsSA announced that the economy had contracted by 0.6% in the third quarter, with the struggling mining sector one of the biggest negative contributors to GDP (falling 6.1%).

International finance institutions such as the IMF and World Bank have repeated downgraded forecasts for South Africa's economic growth and the SARB did the same in mid-November. The forecast was lowered further to 0.5%. The IHS Markit South Africa Composite PMI, unsurprisingly, declined for the seventh consecutive month, the sharpest decline since July. Consumer confidence remained at a two-year low, with household budgets constrained even as the country readied itself for a Black Friday spending-spree.

Industrial stocks led losses on a sectoral basis, losing 2.6% during the month. Resources and Financials, also ended in the red. Amongst resource companies, gold miners Harmony and Anglogold were substantially lower, losing 13% and 17% during the month, while diversified miner BHP Billiton realised a modest gain. Platinum miners stood out from the slump, as they traded mostly firmer due to improved platinum group metal prices. Northam Platinum closed just under 5% higher, and Anglo American Platinum was 7.5% higher.

> *Index heavyweight Naspers and spin-off Prosus lost ground and Financial heavyweights Firstrand and Standard Bank were substantially softer.*

British American Tobacco registered a strong performance in November, as the company kept its earnings forecasts unchanged, despite predicting lower sales growth from the new product categories. Vaping and e-cigarettes are likely to come under pressure as health concerns and a US regulatory crackdown weigh on next-generation product revenue.

As the year draws to a close and the economic calendar quietens down, investors and international ratings agencies will be keeping a watchful eye on the developments around South African SOEs. They are regarded as the biggest risk to South Africa's sovereign credit rating and analysts are predicting that a rating downgrade around February/March 2020 is a distinct possibility.

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# Property

Local listed property markets did relatively well during November. The SAPY registered an 81 bps gain, and the ALPI (with greater offshore exposure) closed near the flatline. The residential market remained strong, with consumers, particularly in the lower priced bands and including first-time buyers, demonstrating a sound appetite for home purchases and financial institutions remaining willing to lend. New developments are still being brought to market in the residential and mixed-use segments, which indicate developers' ongoing confidence in the consistently resilient residential market.

*Meanwhile, the retail sector continues to struggle, with vacancy rates ticking up even as the festive shopping season kicks off.*

Some listed REITs, such as Vukile, have managed to report positive results. Vukile recently announced that it would become an exclusively shopping centre-focused property counter. This comes after it announced an empowerment deal that would see the sale of its last remaining non-retail property to a new unlisted property fund. The new fund will be managed by a new joint venture between a black women-owned and -managed property group and Vukile. This further attests to the listed property sector's track record in leading empowerment.

Five South African REITS – Arrowhead Properties, Redefine Properties Growthpoint, Equites and Rebosis Property Fund – were named amongst the 'Top Empowerment Companies of 2019' in this year's The Empowerment Report. Amongst the top REITs, reporting seasons concluded with some better than expected results. The sector, however, saw mixed news on the dividend front. Rebosis chose not to pay a dividend in its latest reporting seasons.

*It became the first local REIT not to pay out a dividend since the capital structure legislation came into effect in 2013.*

The firm indicated that it is likely to retain its REIT status and has also indicated that a potential merger with Delta Property Fund is back on the table. Markets greeted the news as positive, and Rebosis was the best performing fund for November (with a 23% jump). Indeed, analysts predict that more M&A (merger and acquisition activity) is likely to be driving share prices in the sector in the first half of 2020. Accelerate Property Fund reported that its dividend per share (DPS) declined by 41% for the half-year ending September 2019, and struggled in November, generating a -16% return. Nonetheless, the majority of the sector is still backed by substantial dividend yields. South African property is therefore offering good value, although investors need to take a long-term view and expect short-run volatility.

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The FTSE EPRA/NAREIT posted a -1.14% loss for November 2019 in USD. Amongst the regions, European property stocks provided the month's best returns. Asia lagged, as China-US tension and Hong Kong protests spilled over into investor sentiment. Prospects, however, remain sound, particularly in the prevailing low rate environment. In a low yield and declining economic growth environment, real yield-generating assets remain attractive. In the US and elsewhere, rental rates are likely to increase further, as demand outstrips supply.

Globally, banks have tightened lending standards, labour costs and material costs rose and supply has not increased dramatically. This has resulted in rental tension. An interesting additional factor is that many of the leases negotiated at the time of the Global Financial Crisis are coming up for renewal. Many of these leases were escalating at very low rates, in line with low inflation. They are therefore likely to rebase to market level, resulting in noticeable organic rental growth in the retail and residential markets. Some sectors also continue to enjoy tailwinds from global structural changes.

> *Investors, therefore, need to remain selective, and look at country and sector specifics in their allocation.*

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# International Markets

November was a particularly good month for developed global equity markets. The MSCI World closed 2.8% higher, while EM indices were more subdued. African markets tracked their developed market peers and beat other EM regions, as the MSCI EFM Africa ex-SA gained 1.31% in USD. In the weeks ahead, investors will focus intently on the topic of trade, as that is regarded as the factor that may make or break the rally at year-end.

*US stocks closed out their best performing month since June. Technology was the best performing sector, and the Nasdaq gained 4.5% in November.*

Biotech was also a top performer. Earnings season came to a close, with 80% of companies beating estimates for the quarter. The energy and materials sectors delivered the weakest numbers. US macroeconomic data was mostly positive. GDP grew at a moderate 2.1% in the third quarter, slightly beating market expectations.

The IHS Markit US Manufacturing Purchasing Managers Index (PMI) rose to 52.2 in November, indicating the sharpest rate of expansion in the factory sector since April. The composite index also ticked nicely higher. Measures of consumer confidence improved, despite political noise regarding the impeachment of US President Donald Trump and the ongoing see-sawing about the Chinese 'Phase One' trade deal. The US jobs report showed that 128 000 jobs were added in October, the labour force participation rate increased and average hourly earnings rose 3% from a year earlier.

*The fourth quarter is expected to be fairly healthy, given solid job growth and consumer spending during the holiday shopping season.*

In the UK, the FTSE100 gained 1.81% in local currency terms, as the country looks ahead to a 12 December general election. The strong performance from British equities comes despite lacklustre economic readings. The UK unemployment rate remained fairly stable, but the number of employed persons dropped by 58 000 as Brexit uncertainty took its toll on the job market. An interesting feature of the current statistics is that the number of male employees increased, but was offset by a 93 000 drop in female employment. This may reflect the alarming rate of High Street store closures, traditionally a sector dominated by women. The data also shows pay growth dipped in the three months to September. In keeping with these trends, retail spending was weak before Black Friday. Despite heavy discounting by High Street and online retailers, the latest data for October showed retail volumes at their weakest since April 2019.

*In Europe, the Stoxx All Europe gained nearly 3%. Eurozone macroeconomic data was mostly positive.*

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Measures of consumer confidence improved, with respondents more confident regarding the general economy and their own future financial situation. The unemployment rate remained low, and retail sales ticked up in a number of key economies. Preliminary estimates of the Composite PMI, however, painted a slightly more gloomy picture, as the reading showed a weaker-than-expected expansion. New orders dropped for the third consecutive month, and the job creation rate eased for the fifth consecutive month to its lowest since 2015.

Overall business sentiment remains subdued, against the backdrop of geopolitical uncertainty, trade wars, Brexit, climate change and auto tariffs. A positive note, however, was the marked improvement in German macroeconomic data. The European powerhouse avoided a technical recession in the third quarter, the composite PMI ticked up, the Ifo Business Climate Index rose and the ZEW Indicator of Economic Sentiment jumped to its highest level since May. Consumer confidence measures improved and unemployment rate remained at a 39-year low.

*Italy and Spain also saw improvements in measures of business confidence, although consumers in the peripheral Eurozone economies were less than sanguine about their economic prospects.*

On a sectoral basis, cyclical parts of the market outperformed the traditionally more defensive sectors. Information technology, industrials, healthcare and materials made the biggest gains. Utilities, consumer staples and communication services were laggards.

Japanese markets ended the month in the green, with the Nikkei rising 1.61% in local currency terms. The International Monetary Fund trimmed Japan's fiscal 2019 GDP growth forecast to 0.8% due to the global economic slowdown, and the knock-on impact of the trade wars. The body noted, however, that the economy had been resilient despite the decline in export demand.

*Japan's higher consumption tax, effective as of October 2019, is regarded as a positive step to reduce the massive public debt and the cost of supporting an aging demographic.*

The impact showed, however, in the latest retail sales data for October 2019, with sales dipping 14.4%. Expectations are that the numbers will improve drastically for November, given that measures of consumer confidence improved during that time. The Japanese Composite PMI also showed a modest improvement. Overall, Prime Minister Shinzo Abe's economic policies have succeeded in lowering deflation risk, reducing the fiscal deficit and keeping investor sentiment broadly positive, in spite of global headwinds.

Chinese equities were mixed during November. The MSCI China index registered a 1.78% gain, while China A Onshore shares ticked nearly 1% lower. Investor sentiment was largely guided by developments in the trade talks between the US and China. There were signs during the month of an imminent 'Phase One' trade deal, which would see either a delay in the implementation of additional tariffs, set for 15 December, or a scaling back of existing tariffs. China's commitment to stronger policing of Intellectual Property Rights, long a bone of contention between the two countries, buoyed investor sentiment at mid-month.

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*Toward month-end, however, President Trump sparked the ire of Beijing by signing a bill supporting the pro-democracy Hong Kong protesters.*

The gesture complicated the bilateral trade talks, and fuelled investor jitters. Mixed economic data also exerted pressure on Chinese equity markets. Industrial profits fell in October for the third consecutive month and retail sales disappointed relative to expectations. Consumer confidence measures, on the other hand, improved. This is in spite of rising consumer inflation, which was driven by soaring pork prices.

On the manufacturing front, the official NBS Manufacturing PMI rose into expansionary territory for the first time since April and the Caixin China General Manufacturing PMI edged up to a near three-year high. The service sector, however, dipped to its weakest pace of growth since February. Nonetheless, market watchers took the data as a sign that the Chinese economy remains on a robust, albeit moderating, growth path.

Elsewhere in emerging Asia, Taiwanese equities registered gains, with growth in the semiconductor industry boosting the local market. Indian stock markets posted a 1.66% gain, buoyed by better than expected quarterly corporate earnings and the expectation of further tax reforms. The Philippines, Malaysia and Indonesia were amongst the poorest performing emerging bourses.

*With no resolution in sight, regional growth will continue to suffer as the protests in Hong Kong escalate in intensity.*

Big company news included the secondary listing of Chinese giant Alibaba on the Hong Kong Stock Exchange. Latin American markets were mixed. Argentina posted the biggest gain amongst EM, returns in Brazil were muted and the smaller markets were weak as political unrest spread from Chile to Colombia. Toward month-end, the central banks of Brazil and Chile intervened in currency markets, as the real and peso hit record lows. The rapid depreciation in Latin American currencies prompted President Trump to level allegations of competitive devaluations, sparking concern that the US would hit Brazil and Argentina with metal tariffs.

Within Emerging Europe and the Middle East (EMEA), performance was mixed. Weakness in Poland's market was exacerbated by the 2.4% depreciation of the Polish Zloty. Turkey did well, on an improved economic outlook and some easing of the Syrian tension. Russian equities gained 1.43% in local currency terms. Russian stock markets have performed particularly well for the year-to-date, with the RTS Index the best performing stock market globally. Global investors are taking note of Russia's better debt dynamics and an equity dividend yield close to historic highs. Russian companies have increased their dividend pay-outs this year, especially for firms in which the Russian government is a majority shareholder. This market has therefore become increasingly attractive to traditional value investors.

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*Stocks have also benefited from a pause in the implementation of new US and EU sanctions, and from strong corporate earnings.*

Big company news in EMEA was the approval of the Initial Public Offering of Saudi Aramco by Saudi Arabia. The company is the world's biggest oil company, and its most profitable too. The state oil company's IPO, which comprises an offer of a 1.5% stake, came seven weeks after crippling attacks on its oil facilities. The Saudi index, after swinging between gains and losses as investors initially digested the news, closed the month in the green. The USD 25 billion listing is expected in mid-December 2019.

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# Currencies & Commodities

The GSCI commodities index closed modestly lower, as Precious Metals were noticeably softer. Gold, silver and platinum lost their lustre. Iron Ore was also lower on concerns regarding slowing Chinese demand. The energy sub-index gained ground.

*Oil prices retraced at month-end, as OPEC initially confirmed that its members would maintain the status quo and signalled that deeper supply cuts were not on the cards.*

But, analysts expect that Saudi Arabia, the de facto leader of the bloc, will push its partners to tighten compliance, and may even cut its own output even more than required. The rationale is that the kingdom wants to keep a lid on supply in 2020, in the hope that it will result in a good price for the IPO of Saudi Aramco early in December. Iraq's oil minister Thamer Ghadban at month-end told reporters that OPEC and its allies outside the cartel (OPEC +) would consider cutting supply further by about 400 000 barrels.

Black gold consequently closed 1.4.% higher. Copper prices were ticking up, as ongoing civil unrest in Chile, the world's biggest copper producer, curtailed supply.

*Currency markets were relatively stable, with the US dollar regaining ascendency.*

The US Dollar Index was 95 bps higher for the month. Sterling stabilised during November as the risk of a no-deal Brexit declined. To the relief of holidaymakers visiting Europe, the British Pound ended the month at Euro 1.17, a modest improvement on the previous month. The yen continued to depreciate against the USD, a boon to export-oriented firms, although month-end saw safe-haven buying. EM currencies were mostly lower against the USD, with the Brazilian real's 5.2 % depreciation one of the most marked. The rand proved quite resilient. The local unit gained 2.8% on a month-on-month basis against the dollar and Sterling, and notched a 4% appreciation against a softer Euro.

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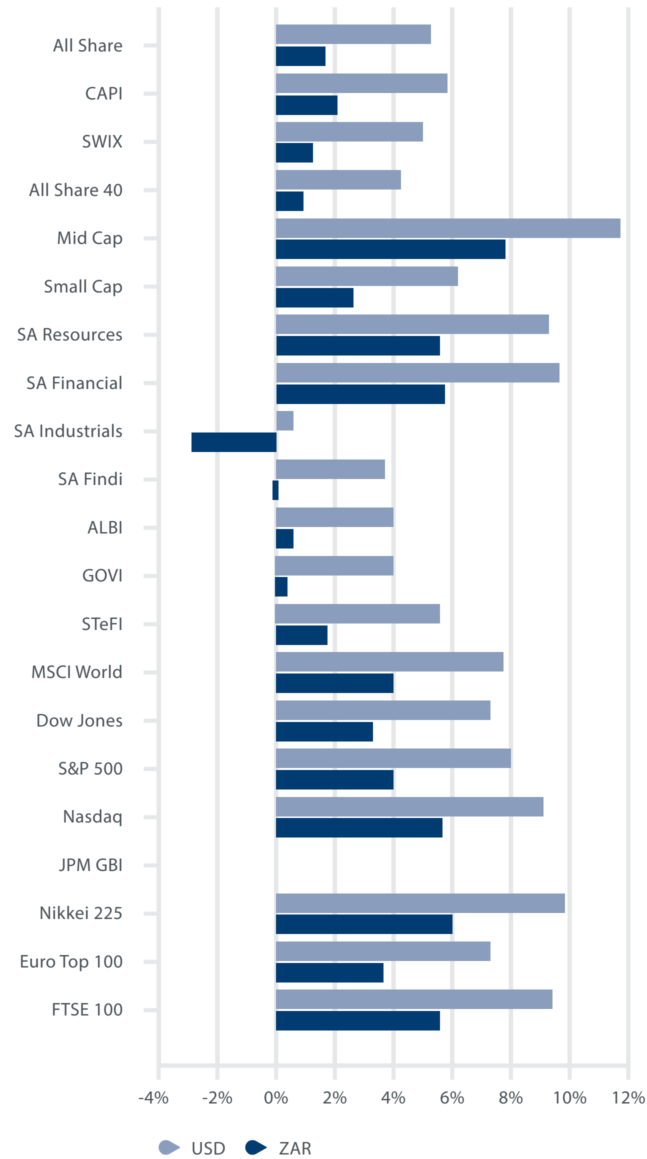
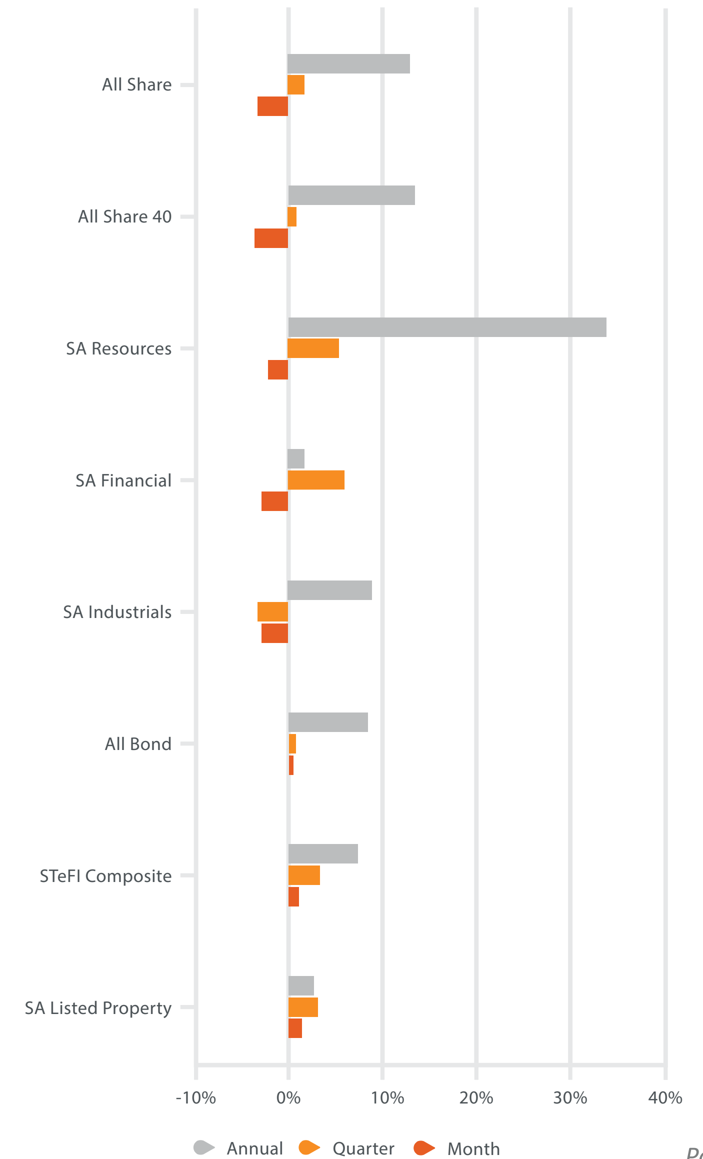
## World Market Indices Performance

Monthly return of major indices




## Local Market Indices Performance

Returns of the FTSE/JSE sectors and indices



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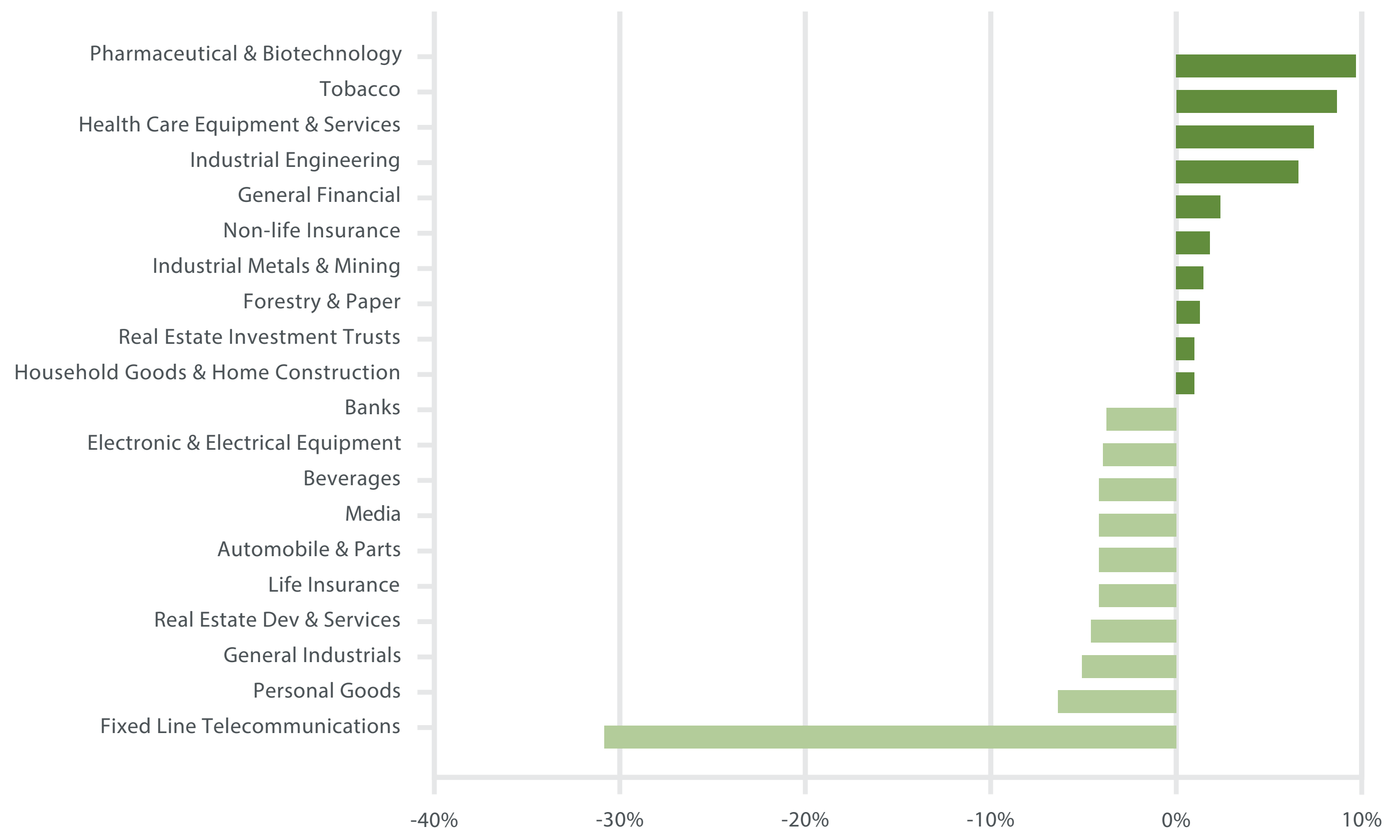
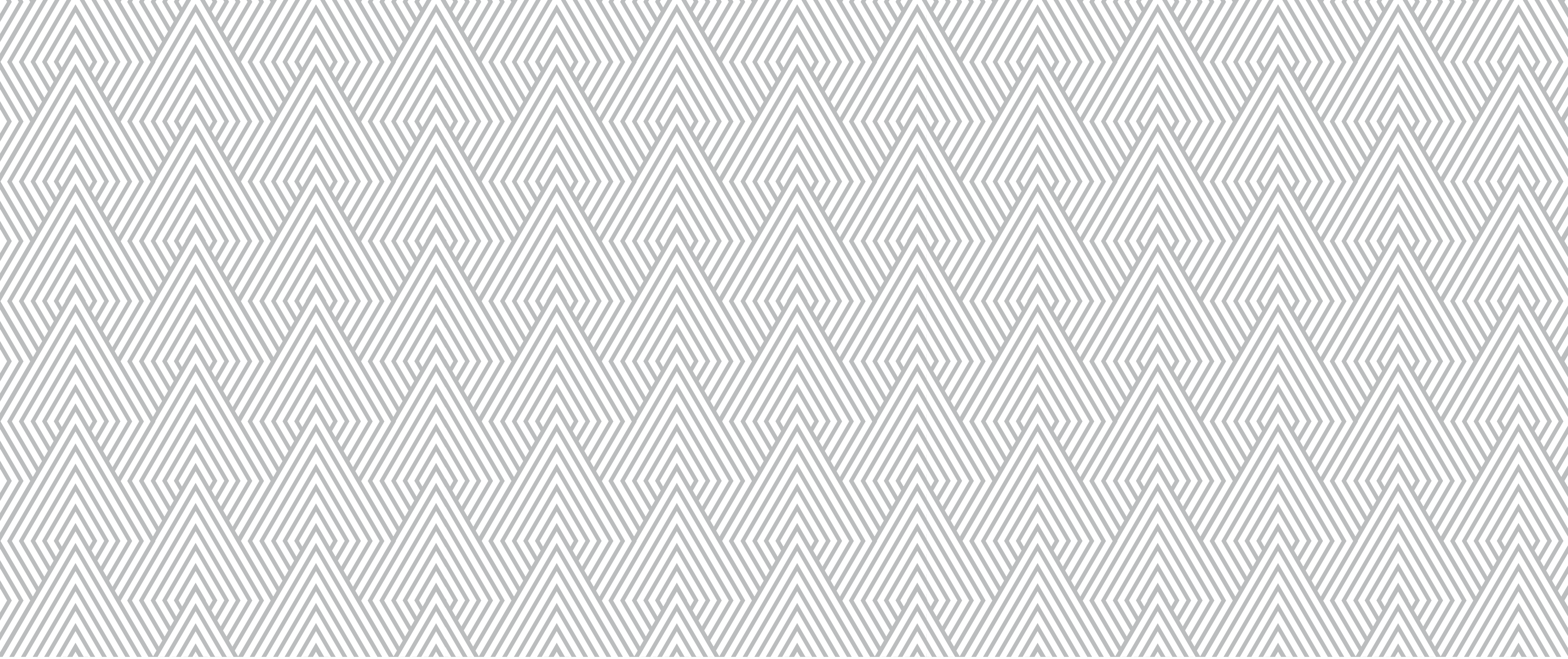
## Monthly Industry Performance





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