

INVESTMENT NOTE

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STORM CLOUDS, SILVER LININGS



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Storm clouds are building over the Middle East as the long-feared escalation of the conflict there arrived in recent days. The latest round of a decades-old conflict started a year ago with Hamas' October 7 attack in the south of Israel. Israeli armed forces responded by bombing and invading Gaza and, in the past few days, turned its attention to Iran-backed Hezbollah to the north in Lebanon, killing several of its top leaders. Iran's response was to rain almost 200 ballistic missiles down on sites in Israel, though damage was limited.

The next stage of the conflict is not yet known. There is likely to be an Israeli counterstrike, backed by the US, but will it be a largely symbolic affair as earlier in the year, or will it be a genuine attempt to destroy Iranian military or industrial capacity? How does Iran respond then? With its economy already under severe pressure, can it afford a further escalation?

This is a volatile situation that has implications far and wide, including the US election that takes place in a month's time. However, the sad reality is that, despite the tens of thousands of people, mostly Palestinian civilians, who have already been killed in the past year, the main reason investors care more about this conflict than others, such as wars in Sudan or Myanmar, is because of oil. The region's bond and equity markets are insignificant in the global context, but it remains the source of about a quarter of the world's oil. Iran is a major oil producer in its own right, and if Israel attacks Iranian facilities, its output could be reduced. However, Iran can also disrupt the global oil market by impairing maritime traffic in the Strait of Hormuz, a vital chokepoint through which most Middle Eastern oil is transported.



WEALTH

SPIKE

Unsurprisingly, oil prices spiked over the past week, reflecting the increased concerns of supply disruptions. However, at \$78 per barrel, the price of Brent crude is well within the broad trading range of the past three years.

Before the missile strikes, the oil outlook was rather bearish, with reports that Saudi Arabia was considering abandoning the OPEC production cuts it agreed on and focusing on gaining market share rather than maintaining a target price. This would basically mean starting a price war and could send prices even lower.

CHART 1: BRENT CRUDE OIL, DOLLARS PER BARREL



Source: LSEG Datastream

OPEC and Russia (known as OPEC+) implemented a series of production cuts since 2022 amounting to around 5 million barrels per day, or 5% of global demand, in order to support prices. Unwinding this could theoretically replace Iran's total output of 3 million barrels per day if the cartel feared that oil markets would become destabilised, but the price jumps would need to be significant. It also means, however, that the oil price has largely been propped up by voluntary production limits. In a truly free market, oil prices would be lower by now.

Prices would also generally be more volatile, since at lower prices some producers would go out of business, eventually leading to higher prices. In that sense, OPEC has played an

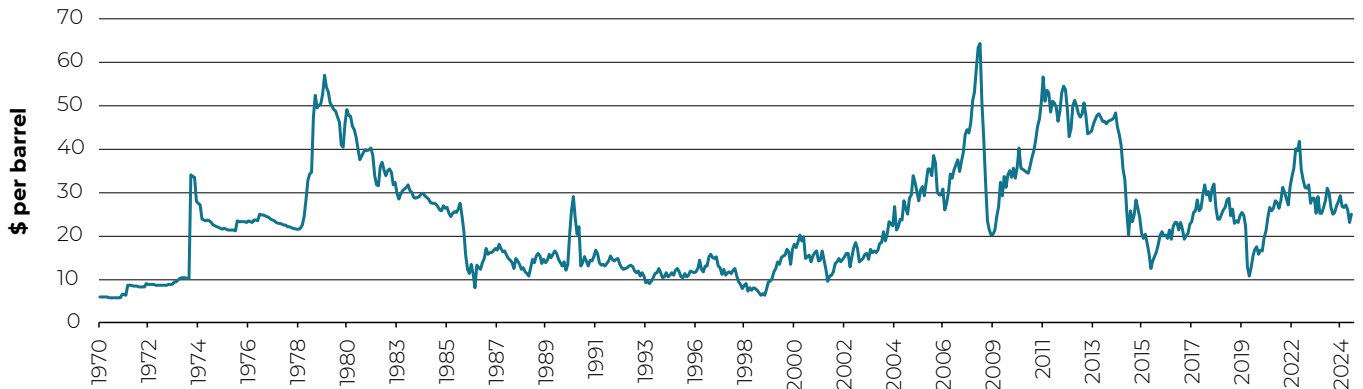
important role in stabilising global oil prices, but of course it has largely aimed to do so at levels that suit its members, not consumers.

It is becoming increasingly difficult to play this stabilising role since OPEC's share of global output has declined from around 55% in the 1970s to 30% today. Some countries have left the cartel, while other non-members have emerged as new major producers, notably Brazil and Guyana. Importantly, the US is the world's largest oil producer these days thanks to fracking, reducing OPEC's grip on oil markets. It also means the US economy is even less exposed to oil price volatility today than it was in the past.

NOT THE 70S SHOW

In other words, while oil prices could still move even higher, it seems unlikely that prices would spike back to \$130 as was the case in the wake of the Russian invasion of Ukraine. Certainly, a repeat of the 1970s oil shocks, sparked by the Yom Kippur War in 1973 and the Iranian Revolution in 1979, is highly doubtful. Oil prices rose tenfold in real terms between 1970 and 1980, devastating a global economy that was much more dependent on oil than is the case today, and contributing to persistently elevated inflation. As chart

2 shows, the inflation-adjusted price of oil today is in line with its long-term average and therefore does not pose much of a risk at current levels. The 1990 spike following Iraq's invasion of neighbouring Kuwait and subsequent war with the US is clearly visible, as is the 2022 increase in the wake of the Russian invasion of Ukraine. In contrast, last year's October 7 attack and Israel's various retaliations barely show up.

CHART 2: BRENT CRUDE OIL PRICE ADJUSTED FOR US INFLATION

Source: LSEG Datastream

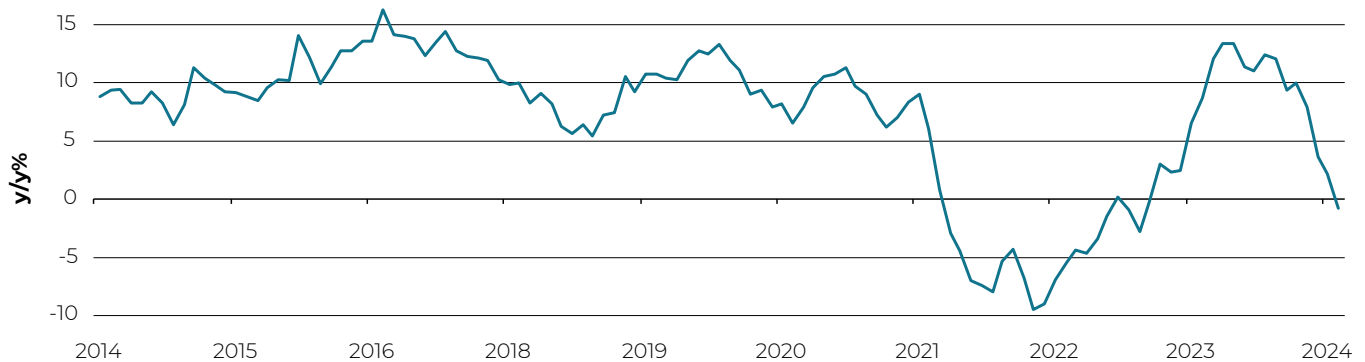
It should also be noted that at \$78 per barrel, oil prices are still 8% below levels from a year ago. At these levels, oil is still detracting from headline inflation rates, not adding to them, though this can change as time goes on. The same is true in South Africa, where the rand price of oil is still 18%

lower than a year ago. The big question, as always, is not the direct impact on inflation rates but the "second round" impact where companies pass on higher input costs to customers. This is what central banks will be looking out for and responding to.

CHINA WEAKNESS

One of the reasons behind the softer oil price before the Iranian missile strike is that Chinese demand has disappointed this year. Rather than staging an anticipated recovery, China's economy has been sluggish, limiting oil demand.

Electric vehicle adoption is also ahead of other parts of the world, as home-grown brands are increasingly taking market share.

CHART 3: CHINA CRUDE OIL IMPORT VOLUMES, GROWTH OF 12-MONTH SUM

Source: LSEG Datastream

The announcement of several policy interventions by Chinese authorities in recent days is therefore noteworthy. If they take root, it could improve the oil demand picture somewhat.

The People's Bank of China cut the reserve requirement ratio for banks by 50 basis points, freeing up room for more lending. It also reduced mortgage rates for homeowners,

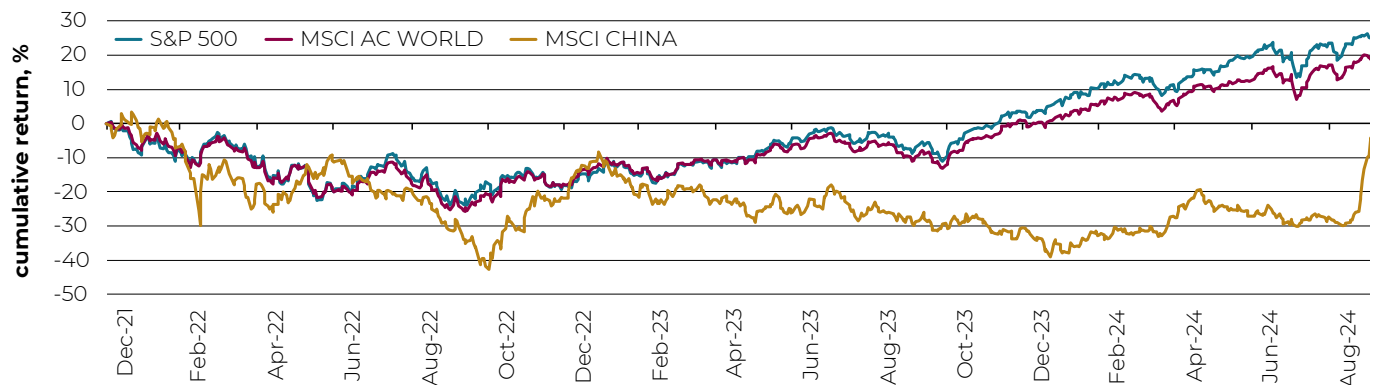
and lowered its policy interest rate a bit. These steps will help on the margin, but China's main problem is not that rates are too high or that credit is unavailable. It is that the property market implosion has shattered confidence among households for whom real estate is their main store of wealth and left the economy missing a key growth engine.

FAST AND FURIOUS

Most notably, the central bank injected liquidity into the financial sector, including setting up a facility that asset managers, insurers and banks can borrow from to buy equities. Listed companies can also borrow money to buy back their own undervalued shares. The response of the

equity market was fast and furious, as chart 4 shows. Remarkably though, while the 2024 losses were wiped out by the 25% jump, the 2022 and 2023 losses have yet to be recouped.

CHART 4: EQUITY INDICES IN DOLLARS



Source: LSEG Datastream

It is also not clear if higher share prices are enough to boost consumer confidence, since equity ownership is low. It might help a bit, but a bigger policy intervention is needed to stabilise the property sector by completing sold but unfinished flats and to deal with the massive overhang of completed but unsold units. Local governments who can no longer rely on land sales as a source of income also need support, while expanding the safety net for households is probably necessary for them to reduce high levels of precautionary savings.

Following an unscheduled meeting, the Politburo made unspecified promises that it will mobilise fiscal resources to ensure the world's number two economy can still meet its 5% growth target. For the first time, it appears that Beijing

is prepared to tackle the economic malaise at its source, but details are lacking. If it is the case that authorities are going to be much more forceful and increase stimulus measures in the months ahead, it could stabilise the declining growth outlook and support Chinese markets.

The timing is probably down to two factors. Firstly, apart from export growth, Chinese economic data has continued to disappoint. Annual core inflation fell to only 0.3% in August, while producer inflation remains negative. Youth unemployment climbed to 18.8%, the highest level in a year as per the refined definition. Retail sales is only growing by 2% a year in nominal terms. Secondly, the start of a US interest rate cutting cycle creates room for policy makers elsewhere to be more forceful.

POSITIVE BACKDROP

It means that there is now a strong easing bias among policymakers in the world's major economies, with Japan being the exception. And while economic activity is soft in China and Germany among these large economies, it seems to be holding up elsewhere. Friday's US labour market data showed surprising strength in the world's largest economy with 254,000 jobs created in September, and a slight decline in the unemployment rate to 4.1%. Recession fears have therefore been premature. This is a positive macro backdrop for financial markets, provided the geopolitical environment does not deteriorate much further.

Historically, most regional geopolitical incidents have been bumps in the road, rather than fundamentally altering the direction of travel for markets. There have been notable exceptions like the 1970s as discussed above, however, and it is these "tail risks" that will keep investors on edge. Another source of uncertainty is the US election, which remains balanced on a knife-edge. Again, US elections have not

historically mattered all that much for markets beyond short-term noise, but this time one of the candidates (Donald Trump) is promising massive tariff increases that could disrupt global trade, more specifically trade with China. There is also the possibility that election results won't be finalised quickly, leading to a drawn-out period of uncertainty.

In the end, however, the mundane, day-to-day business of companies growing profits for the benefit of shareholders is what will keep investment markets ticking over. This will continue regardless – with the question just being whether investors are too optimistic in their expectations, which seems to be the case in the US, judging by a market trading at 21 times forward earnings, or still too pessimistic, which might be the case in South Africa. Given that these things are impossible to know with certainty, diversification is always prudent, especially in this messy and stormy world we find ourselves in.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 698.0	-0.78%	-0.67%	16.69%	31.55%
United States	S&P 500	US\$	5 751.0	0.23%	-0.19%	20.57%	34.87%
Europe	MSCI Europe	US\$	2 170.0	-3.60%	-2.52%	7.43%	22.67%
Britain	FTSE 100	US\$	10 868.0	-2.33%	-1.36%	10.38%	20.81%
Germany	DAX	US\$	1 823.0	-3.24%	-2.25%	11.90%	30.77%
Japan	Nikkei 225	US\$	259.8	-7.23%	-1.59%	9.49%	26.92%
Emerging Markets	MSCI Emerging Markets	US\$	1 179.0	0.34%	0.68%	15.14%	27.05%
Brazil	MSCI Brazil	US\$	1 483.0	-1.46%	-0.40%	-17.61%	1.02%
China	MSCI China	US\$	75.1	11.53%	7.27%	35.32%	33.94%
India	MSCI India	US\$	1 110.2	-4.64%	-3.30%	20.41%	35.22%
South Africa	MSCI South Africa	US\$	485.0	-3.58%	-1.22%	16.87%	38.18%

EQUITIES - SOUTH AFRICA (TOTAL RETURN UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	86 332.0	-1.42%	-0.25%	12.28%	22.34%
All Share	All Share (Total Return)	Rand	15 679.0	-1.36%	-0.18%	15.70%	26.81%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	38 373.3	-1.40%	-0.21%	15.65%	28.12%
TOP 40/Large Caps	Top 40	Rand	14 071.0	-1.50%	-0.25%	14.31%	24.83%
Mid Caps	Mid Cap	Rand	25 450.0	-1.24%	-0.35%	16.82%	32.81%
Small Companies	Small Cap	Rand	41 180.0	-1.26%	-0.44%	26.08%	39.79%
Resources	Resource 20	Rand	5 108.4	-0.17%	1.86%	5.08%	10.60%
Industrials	Industrial 25	Rand	26 091.0	-1.07%	-0.29%	17.51%	26.35%
Financials	Financial 15	Rand	15 755.0	-2.93%	-1.51%	22.03%	39.15%
Listed Property	SA Listed Property	Rand	2 379.6	-2.45%	-1.83%	27.66%	50.13%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
IBOXX Global Government S&P Overall (USD Unhedged)		US\$	77.5	-2.08%	-1.87%	-1.14%	7.35%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 074.6	-2.28%	-2.12%	14.27%	24.92%
Government Bonds	BESA GOVI	Rand	1 057.8	-2.26%	-2.10%	14.11%	24.78%
Inflation Linked Bonds	BESA CILI	Rand	372.1	-0.31%	-0.39%	6.54%	12.96%
Cash	STEFI Composite	Rand	583.5	0.15%	0.09%	6.47%	8.54%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	78.1	8.43%	8.40%	1.36%	-9.24%
Gold	Gold Spot	US\$	2 653.0	-0.19%	0.04%	28.60%	45.53%
Platinum	Platinum Spot	US\$	988.0	-1.30%	-0.30%	0.10%	14.22%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	17.49	-2.10%	-1.26%	4.65%	10.59%
ZAR/Pound	ZAR/GBP	Rand	22.96	-0.30%	0.61%	1.48%	2.22%
ZAR/Euro	ZAR/EUR	Rand	19.19	-0.40%	0.22%	5.28%	5.85%
Dollar/Euro	USD/EUR	US\$	1.10	1.82%	1.27%	0.36%	-4.55%
Dollar/Pound	USD/GBP	US\$	1.31	1.88%	2.10%	-3.24%	-7.81%
Dollar/Yen	USD/JPY	US\$	0.01	4.57%	3.54%	5.44%	-0.28%

Source: I-Net, figures as at 4 October 2024

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WEALTH

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