



INVESTMENT NOTE

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STILL STICKING THE LANDING



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For those needing an escape from the financial market turmoil of the past few weeks, the Olympic Games in Paris offered a welcome distraction. As usual, gymnastics was one of the most popular sports at the Games, with gymnasts delivering incredible feats of strength, flexibility and grace. They not only need to do their floor, beam or bar routines with precision and flair, but must also “stick the landing”. After tumbling and turning through the air, a gymnast must neatly land with both feet perfectly still. It takes incredible skill and balance to do so.

LANDING SOFTLY

Despite the August market spasm, we still appear to be on track for a soft landing in the US. There are signs of strain in certain sectors of the economy, but also signs of ongoing resilience. The US consumer seems more cautious, especially lower income consumers. Several companies have reported slowing sales, and where companies are doing well, it is often because consumers are trading down. Case in point is giant

For investors, the number one question is still whether the US Federal Reserve can stick the landing, a “soft” landing to be precise. A soft landing means that economic growth slows without contracting meaningfully (i.e. falling into recession), while inflation also cools, creating enough room for the Fed to cut interest rates from elevated levels, thereby sustaining the expansion.

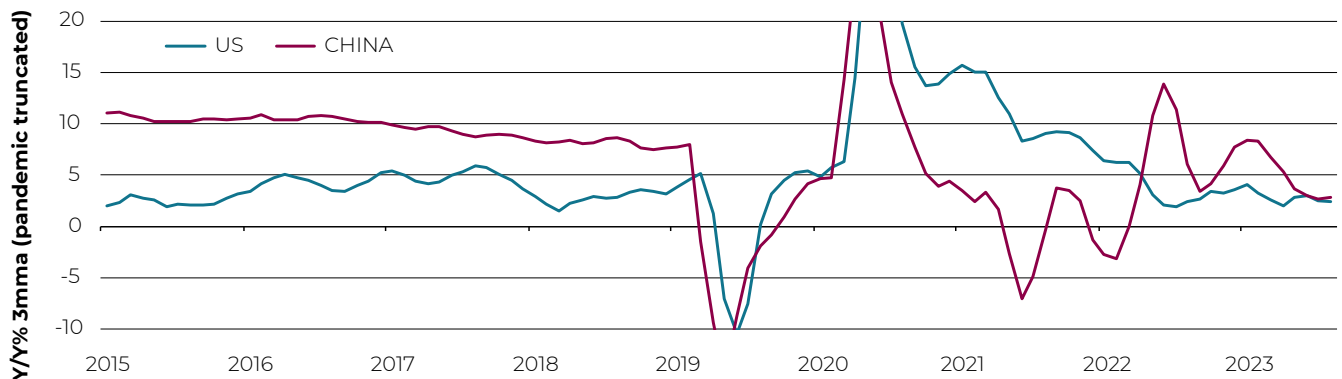
Soft landings are rare, and most of the Fed’s interest rate hiking cycles since World War II have ended in hard landings. If Fed Chair Jerome Powell sticks this landing, he’ll deserve a gold medal.

retailer Walmart, which posted solid top-line and bottom-line growth for the second quarter. It noted that customers were more discerning but did not notice any “incremental fraying of consumer health”. The official retail sales data for July was also much stronger than expected, though growth has slowed from a heady pace in 2021 and 2022.



WEALTH

CHART 1: ANNUAL GROWTH IN NOMINAL RETAIL SALES



Source: LSEG Datastream

Part of the reason behind softer sales is because some companies were overzealous with price increases. In an environment where demand was strong, supply chains stretched, and commodity prices high, it was possible for companies to raise their prices markedly without pushback from consumers. In other words, when prices were rising everywhere, consumers didn't rebel if your company also raised its prices. Some called this "greedflation" or profit-led inflation.

But what was the case between 2021 and early 2023 is not the case now. Companies can no longer rely on higher prices to drive top-line growth and therefore profitability,

quite the contrary. To use Walmart as example again, it intends to cut prices across 7 500 product lines to remain competitive and grow sales volumes.

The alternative is for companies to cut costs to protect margins, including laying off staff. The problem is that, while it may be rational for an individual firm to cut jobs to reduce costs, if many firms do so, the widespread job losses would put severe strain on consumer spending. The net result would be a recession where everybody loses. This remains the main route through which a hard landing might still materialise. So far, however, layoffs are well within the usual range.

COOLING INFLATION

If companies are not able to raise prices with gusto anymore, it also implies that the inflation threat has mostly passed. Yes, fuel prices can still spike if a full-blown war between Israel and Iran breaks out. And yes, shipping channels are vulnerable to disruptions. But if companies cannot pass on these costs to customers, the so-called second round impact will be muted. Similarly, the ongoing decline in wage growth

suggests that the labour market is not going to be the source of upside inflation risks as much as the Fed feared not that long ago.

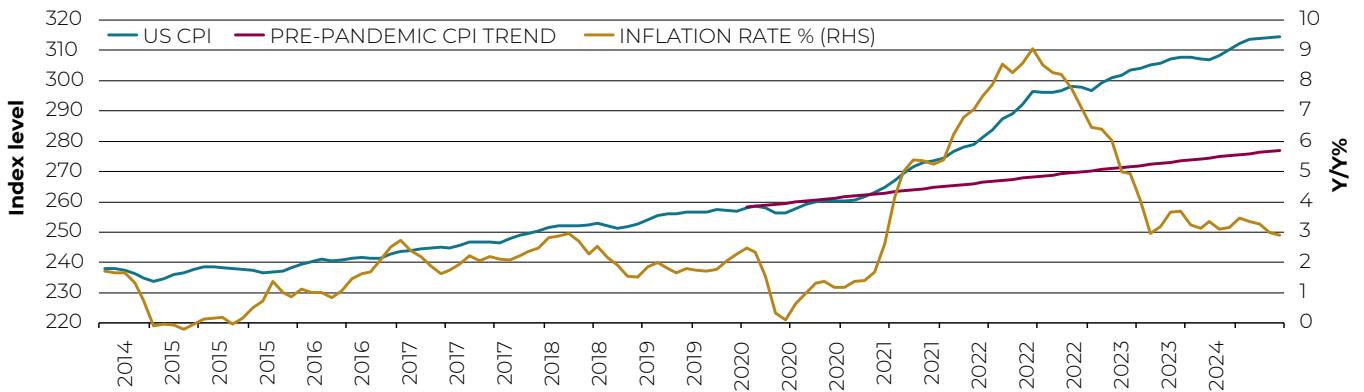
It means, however, that what investors gain in terms of lower inflation (and ultimately, lower interest rates), they could lose on company profitability.

GREEN LIGHT

Looking at the data, US consumer inflation fell below 3% for the first time since early 2021, coming in at 2.9% year-on-year in July. Granted, this is still above the Fed's 2% target, and core inflation is still 3.2% thanks to sticky rental inflation, but the decline from a peak of 9% in mid-2022 has been remarkably painless. When inflation was hovering near this

peak, the argument was made, not unreasonably, that only a recession could bring it back to 2% by destroying the pricing power of firms and the wage bargaining power of workers. Instead, we've had an ongoing expansion and unemployment hovering near record low levels (though it has ticked up somewhat of late).

CHART 2: US CONSUMER PRICE INDEX



Source: LSEG Datastream

Despite this remarkable turn of events, many Americans feel bleak about the state of the economy according to survey data. It is worth remembering that most people don't care about the change in the price level (i.e. the inflation rate) but where the price level is. While the inflation rate is the same as in early 2021, the price level is 20% higher. It is also about 14% higher than if the pre-Covid trend remained in place. This cost-of-living shock will likely still be an election issue come November, even if the inflation rate continues declining.

Importantly, from the Fed's point of view, consumers' expectation of future inflation remains roughly where it was before the pandemic. People mostly see this jump in the price level as a one-off event, not one that will be sustained year after year. The Fed therefore has a green light to start cutting interest rates at its policy meeting next month. The only question is by how much. The more resilient the economy, the fewer the Fed will cut over the next few months. Rates will fall much less in a soft landing scenario than if a hard landing occurred.

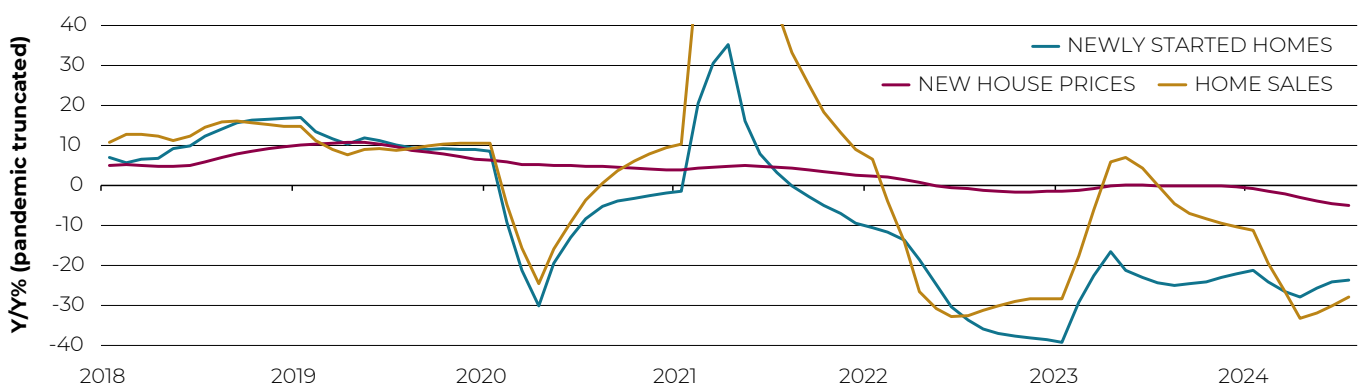
A DIFFERENT PICTURE

In China, the world's number two economy, a very different growth, inflation and policy picture is emerging. The economy has been trading water by its own standards. Most other countries would be happy with 4% to 5% GDP growth, but not China. Many business models were based on ongoing rapid growth. For instance, headline annual growth in retail sales was only 2.7% in July in nominal terms, compared to an average of around 10% in the years before the pandemic. The point is not that 2.7% is a terrible number; it isn't. But imagine how many shopping malls were built on the assumption of continued double-digit sales growth. And

how many steel mills operated on the assumption that more and more shopping malls would be built? How much of all of this was underpinned by debt which must now be serviced with reduced incomes? In other words, while this is not a hard landing as traditionally defined, it will feel a lot like it to many Chinese households and business owners.

One of the main reasons for this dramatic slowdown is the popping of the property bubble which has negatively impacted household wealth and confidence and evaporated about a quarter of housing market activity compared to last year. The property implosion shows little sign of stabilising.

CHART 3: CHINA HOUSING ACTIVITY



Source: LSEG Datastream

Given this, the government response remains muted from the perspective of outsiders used to seeing policymakers throw the kitchen sink at economic problems. Authorities remain focused on supporting higher-value manufacturing, instead of propping up household demand. There is no appetite for deploying a “big bazooka” stimulus plan as was done in the past.

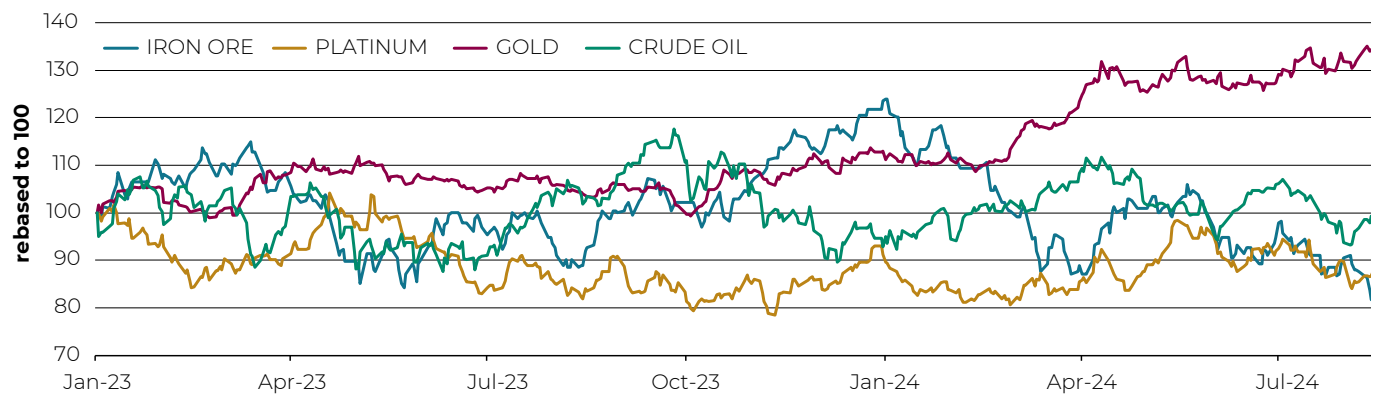
Since inflation is like a thermometer for an economy, it remains unsurprisingly low. Consumer inflation is less than 1%, while producer prices are still falling.

The People’s Bank of China has only lowered interest rates modestly this year. Since inflation is low, real interest rates remain relatively high despite the cuts. The People’s Bank

is clearly not only focused on economic growth outcomes, but also financial stability. Cutting rates too much could weaken the currency, while it is seemingly worried that falling bond yields could undermine banks. It is a tricky balancing act, but it is also hard to imagine that the direction for both policy and market-based interest rates is anywhere but down. And if Beijing is serious about achieving its 5% growth target, it will have to step up stimulus measures.

For now, however, the challenged economic growth outlook in China has put pressure on commodity prices, notably iron ore. Even the oil price has barely reacted to new geopolitical risks. Gold has been the outlier, trading near new record highs as Fed rate cuts loom.

CHART 4: COMMODITY PRICES IN US\$



Source: LSEG Datastream

Commodity prices are cyclical and will recover at some point. There are likely longer-term tailwinds from the green transition and rising global infrastructure spending. Even the AI boom is as much a commodity story as a computing one, since large data centres must be built, wired with copper, and powered with immense amounts of electricity.

Nonetheless, South Africa, cannot sit around and wait for the next commodity boom. It needs to improve economic growth internally by making it easier to do business. And when the commodity cycle does eventually turn, the country must be ready, and not miss out again due to stifling mining regulations and inadequate infrastructure. If it doesn’t, unemployment is not going to decline much from the staggering 33.5% reported by Stats SA last week.

The correct metaphor for the local growth, inflation and policy picture is not one of a landing, but rather a case of light at the end of a long, dark tunnel. The backward-looking economic data remains muted, though last week there

was a positive surprise on retail sales growth (which is now well ahead of China’s).

It is the forward-looking expectations that are much improved. The economy’s biggest constraint, unreliable electricity, has eased to a remarkable degree. Another constraint, high interest rates, will also start easing soon. Things are also improving in the logistics arena, but much still needs to be done. Encouragingly, Nedbank’s Capital Expenditure Tracker for the first half of the year has already noted a big jump in the announcement of public and private projects compared to last year. These projects will be completed over a few years, so the economic impact is not immediate, but it does point to improved confidence and a better medium-term economic outlook.

In the meantime, even though China is struggling, a US soft landing would be good news for South Africa. It implies less financial market volatility and hence a more stable and firmer rand and lower interest rates.

FINAL WORDS

It is too soon to say if the recent market slump was a short-lived blip, or the start of something bigger. For now, it seems to have been a temporary correction, since it looks like the US will stick a soft landing. However, uncertainty will likely linger since many trusty economic relationships that historically used to predict recessions seem not to work in the aftermath of the pandemic. Nonetheless, equity markets have recovered most of the losses, and in the case of the local market, is back near all-time highs. This is a reminder that there are two types of fees market-linked investors

must pay. The first is the direct cost of the fund or ETF they invest in, the administration and management fees and so on. The second is psychological, the cost to your emotional wellbeing from sitting through periods of market stress. There are ways to minimise both types of costs. In the case of the latter, you can simply look at your portfolio less often. If you look at your portfolio monthly instead of daily, you will probably be none the wiser that there was real volatility and deep fear on markets not long ago.

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US\$	3 584.0	4.55%	0.34%	13.10%	22.49%
United States	S&P 500	US\$	5 554.0	4.42%	0.58%	16.44%	26.11%
Europe	MSCI Europe	US\$	2 145.0	3.77%	0.28%	6.19%	13.01%
Britain	FTSE 100	US\$	10 758.0	3.60%	0.00%	9.26%	14.86%
Germany	DAX	US\$	1 740.0	4.57%	0.64%	9.86%	14.47%
Japan	Nikkei 225	US\$	257.9	9.04%	-1.08%	8.67%	18.80%
Emerging Markets	MSCI Emerging Markets	US\$	1 094.0	4.59%	0.83%	6.84%	12.09%
Brazil	MSCI Brazil	US\$	1 539.0	6.58%	8.00%	-14.50%	-1.03%
China	MSCI China	US\$	56.7	2.49%	1.14%	2.27%	-4.75%
India	MSCI India	US\$	1 091.1	1.85%	-2.14%	18.34%	34.87%
South Africa	MSCI South Africa	US\$	460.0	6.48%	2.45%	10.84%	18.25%

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	82 824.0	2.58%	0.07%	7.71%	10.56%
All Share	All Share (Total Return)	Rand	14 915.0	2.66%	0.15%	10.06%	14.81%
JSE Capped SWIX	Capped SWIX (Total Return)	Rand	36 531.0	2.68%	0.04%	10.09%	15.28%
TOP 40/Large Caps	Top 40	Rand	13 483.0	2.74%	0.12%	9.53%	13.08%
Mid Caps	Mid Cap	Rand	24 083.0	2.76%	-0.45%	10.54%	19.64%
Small Companies	Small Cap	Rand	38 104.0	2.16%	0.99%	16.67%	24.28%
Resources	Resource 20	Rand	5 074.2	0.96%	-5.28%	4.37%	7.07%
Industrials	Industrial 25	Rand	24 342.0	2.51%	1.97%	9.63%	9.64%
Financials	Financial 15	Rand	15 061.0	4.42%	1.98%	16.65%	26.21%
Listed Property	SA Listed Property	Rand	2 222.7	2.45%	4.30%	19.24%	29.98%

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\$	77.3	0.53%	1.70%	-1.48%	2.95%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	1 044.6	0.97%	1.18%	11.08%	17.84%
Government Bonds	BESA GOVI	Rand	1 028.8	0.95%	1.17%	10.99%	17.74%
Inflation Linked Bonds	BESA CILI	Rand	366.5	0.54%	1.01%	4.93%	9.87%
Cash	STEFI Composite	Rand	577.2	0.18%	0.36%	5.32%	8.56%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US\$	79.7	0.66%	-1.63%	3.48%	-4.00%
Gold	Gold Spot	US\$	2 508.0	4.63%	3.76%	21.57%	31.72%
Platinum	Platinum Spot	US\$	956.0	3.13%	-1.54%	-3.14%	8.39%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	17.91	2.59%	1.59%	2.20%	7.06%
ZAR/Pound	ZAR/GBP	Rand	23.12	1.34%	1.25%	0.78%	5.58%
ZAR/Euro	ZAR/EUR	Rand	19.70	1.77%	-0.05%	2.54%	5.83%
Dollar/Euro	USD/EUR	US\$	1.10	-0.91%	-1.55%	0.36%	-0.91%
Dollar/Pound	USD/GBP	US\$	1.29	-1.51%	-0.34%	-1.89%	-1.89%
Dollar/Yen	USD/JPY	US\$	0.01	0.22%	-1.59%	4.66%	0.86%

Source: I-Net, figures as at 16 August 2024

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WEALTH

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