Market and Model Update

Waypoint Asset Management | September 2023

Introduction

We have just completed another quarter and are now approaching the culmination of 2023. Due to persistent inflation, central banks worldwide are working to reduce the pricing pressures. In this discussion, we will examine how global markets responded during the third quarter of 2023.

The US

The positive outlook that characterized the second quarter of 2023, creating a favourable environment for riskier assets, faded in the subsequent three months. Investors had initially anticipated a slowing of fiscal tightening, and a possible halt by the end of the year. However, due to consistently high inflation, robust employment, and economic growth that remained "above-trend, expectations have been adjusted for the likelihood of the Federal Reserve increasing interest rates in November and maintaining them through 2024.

This shift resulted in Treasury yields reaching their highest levels since 2007, which became hard to overlook for those holding stocks and other speculative assets. Yields on the 10-year Treasury benchmark rose by 75 basis points, marking the most significant quarterly increase in a year. Beyond falling bond prices, the surge in yields also affected the stock market by providing competition for equities and raising borrowing costs for both businesses and households.

The S&P 500 extended its decline, retreating by more than 6% from its peak at the end of July. In September alone, the index experienced a 4.8% drop, coinciding with the 10-year Treasury yield reaching a level not observed in over fifteen years, momentarily touching 4.7% before easing to 4.5%. The United States is expected to confront ongoing challenges related to persistent inflationary pressures and a tightening monetary policy.

South Africa

In August, South African stocks began a downward trend that has continued throughout the quarter, tracking global markets. As a result, the All-Share Index concluded the quarter with a decrease of 3.5%. However, it's worth noting that the index has managed to maintain a positive trajectory for the year, with an overall year-to-date gain of 2.2%.

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The country's fiscal challenges are primarily rooted in declining revenue collection rather than excessive spending. Sluggish economic growth, lower commodity prices, and decreased exports of coal and iron ore due to infrastructural deficiencies have all contributed to South Africa's fiscal dilemma. Much attention is now focused on the upcoming mini-budget, set to be announced on November 1st. There is much anticipation for insight into how current issues issue will be addressed, whether through increased taxes or reduced spending.

The South African Reserve Bank's most recent bulletin does little to ignite enthusiasm, though it does offer some positive titbits. During the second quarter of 2023, the bank emphasized that there was a significant increase in real gross fixed capital formation. This was due to a significant increase in capital spending by the private sector. However, a decrease in capital investment by the public sector slightly offset this positive trend.

Additionally, in the second quarter of 2023, household debt as a percentage of disposable income increased to 62.5%. The situation is worsening because of higher debt servicing costs caused by the cumulative 475 basis point increase in the prime lending rate since November 2021.

Despite a risk-averse sentiment and heightened demand for the US dollar, the rand finished the quarter just -1.2% lower against the Greenback. This resulted in muted gains for investors holding rand-hedged assets, such as Richemont, BAT, Sasol, and Anglo Platinum.

UK & Europe

The economic situation in both the UK and Europe continues to paint a grim picture. For the United Kingdom, the Office for National Statistics predicts a meagre 0.2% increase in GDP for the third quarter. While this estimate is still better than that of various European countries like France and Germany, it is lower than the estimates for the United States, Canada, Japan, and Italy.

Persistently high inflation and a tight labour market have compelled the Bank of England, which has raised interest rates fourteen times since December 2021, to maintain interest rates at a 15-year high of 5.25%. Understandably, consumers, concerned about the impact of inflation, have scaled back their spending. In the second quarter, the household saving ratio increased to 9.1% from 7.9% in the preceding quarter.

In Europe, the economic outlook is even more dismal. Economic activity in the EU during the first half of 2023 remained subdued, largely due to elevated consumer prices for most goods and services, which have taken a toll on domestic demand. Consequently, GDP growth is anticipated to stagnate in the third quarter of 2023 and remain subdued for the fourth, reflecting weak performance in the manufacturing and services sectors. This is despite declining energy prices and an exceptionally robust labour market, characterized by record-low unemployment rates, continued employment growth, and rising wages.

In September, the European Central Bank raised its key interest rate to a record high of 4%. This was the tenth time in fourteen months that the bank had increased the rate to curb inflation. However, the bank has indicated that this hike is likely to be the final one. Despite this, the battle against inflation is far from over. It is expected to take two years for the bank to reach its 2% inflation target, during which economic growth is projected to cool further.

China

Mainland China's economic growth is facing several challenges, and the impact of recent monetary stimulus remains uncertain at this stage.

Over the past three months, the country's weak economy has shown little signs of improvement. The ongoing slump in the property market and the government's reluctance to implement effective spending measures are the main obstacles. As a result, Standard & Poor's has revised its real GDP growth projections for 2023 and 2024 downwards to 5.0% and 4.6% respectively.

These challenges have also triggered a sell-off in China's domestic stocks, continuing the trend observed in the second quarter. In the upcoming weeks, China's ruling Communist Party is scheduled to convene its Third Plenum, a once-every-five-years meeting that focuses on the long-term aspects of the economy. Investors will be keenly watching for any indications that bolder measures will be taken, as China's economic growth has positive implications for South Africa's commodity-driven economy.

Commodities

Brent crude ended the quarter almost 30% higher, supported by Saudi Arabian oil cuts, and more recently the news that Saudi Arabia and Russia will cut oil production until at least the end of the year. Oil prices are expected to increase for the remainder of the year as global inventories drop.

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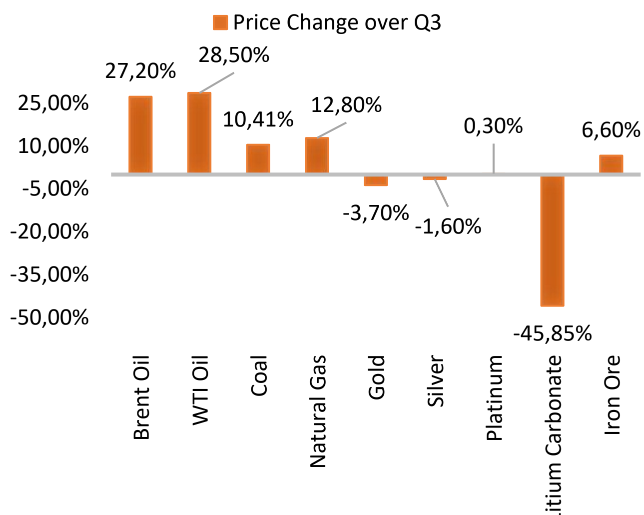
During the last quarter, natural gas prices rose, particularly in Europe, where they went up by 12.8%. This increase followed three consecutive quarterly declines. On the other hand, gold prices experienced a decline of 3.7%, dropping to $1 856.3. The drop in gold prices was attributed to a strong US dollar and Treasury yields that rose amid the expectation of higher interest rates for an extended period, reducing the attractiveness of the precious metal.



Platinum, industrial, and other precious metals were broadly negative or even over the quarter, weighed down by rising Treasury yields and a weaker global growth outlook. One of the biggest losers for the quarter was Lithium which shed 45.85%, thereafter pricing at levels last seen in August 2021. The aforementioned headwinds to the Chinese economy have led to reduced consumer spending and a decline in the demand for electric cars.

Conclusion

Global economies are still struggling to find their footing amid the aftermath of intense contractionary monetary policies. Despite slow growth, markets have shown a strong recovery since the downfall of 2022.

During our Q3 Investment Committee meeting we decided to increase our offshore equity positions to take advantage of recent global market pullbacks. Additionally, this galvanizes portfolios against continued ZAR currency depreciation.

We are closely monitoring the global macro environment and adjusting our portfolios accordingly while keeping in mind the importance of our clients' investment horizons.

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