INTEGRAL Asset Management

The Outlook

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How to listen when markets speak.

In a recent publication "How to Listen When Markets Speak: Risks, Myths, and Investment Opportunities in a Radically Reshaped Economy" authors Lawrence McDonald and James Robinson focus on understanding the signals and trends in the economy to be able to identify risks, and dispel myths, and to capitalise on investment opportunities in a significantly transformed economic landscape.

From Wall Street to the White House, the fantasy of an eventual "return to normal" is still alive and well, nurtured by dangerously outdated theories. But the economic world as we know it—and the rules that govern it—are over. In the coming decade, we'll witness sustained inflation, a series of sovereign and corporate debt crises, and a thundering of capital out of financial assets into hard assets. Few are prepared.

McDonald, founder of the economic research platform The Bear Traps Report, got a real-world education in market risk , as a Lehman Brothers VP, when he watched the firm ignore the warning signs before its collapse. His analysis led him to identify twenty-one indicators for gauging the health of an economy and detecting early signals of opportunity and danger. In How to Listen When Markets Speak, McDonald unveils his unique predictive models, connecting surprising dots between past, present, and future and outlining actionable trading ideas for staying a beat ahead of the markets. Readers will learn:

- ✓ How disastrous Fed policy will collide with an increasingly fragmented geopolitical landscape to keep US inflation near 3-5% for the next decade,
- ✓ How growing demand for oil and gas, underinvestment in urgently needed energy infrastructure, and cozy Russia–Saudi Arabia relations will lift the base price of energy to historic levels,
- ✓ Why hard assets and rare minerals like lithium and cobalt will outperform growth stocks, US treasuries, and overcrowded passive investment strategies—and how to detect bearish and bullish trends in advance,
- ✓ How passive investing and the vehicles intended to democratize finance have fuelled bubbles and ideological skew by large market participants, leaving millions of 401(k)s and IRAs at risk,
- ✓ Why America will likely lose its position as a global superpower and holder of the world's premier reserve currency and may be forced to slash Social Security, Medicare, and military spending.

Rather than merely doomsaying, How to Listen When Markets Speak equips readers to make sense of our current moment, resist reactionary narratives and baseless analysis, and pounce on a new investing playbook. When markets speak, it pays to listen. *(The sources of the above review of the book are attributable to Amazon and the WSJ).*

Our analysis of global opportunities and dangers aligns closely with those of McDonald and Robinson. Until wars and geopolitical tensions are resolved, and the US elections are behind us, we will remain defensively positioned, but attentive to how the new world order unravels. The "*investment opportunities in a significantly transformed economic landscape and a new investing playbook*" that the authors refer to will be born out of a transition to a cleaner, greener, and more sustainable world. Energy security will remain a major focus and the changing new world order will be driven by AI/tech.

2024 is not just an election year, it's perhaps the election year.

Resolving the current geopolitical tensions and putting the necessary strategy in place to set the new world order on the right track will require competent politicians with vision, strategy, and the ability to fully involve the private sector. We need to return to the rule of law and not rule by law.

In The Devil's Dictionary, Ambrose Bierce described politics as *a means of livelihood affected by the more degraded portion of our criminal class*, alternatively as *the conduct of public affairs for their private advantage*".

Time magazine recently reported that "*Globally, more voters than ever in history will head to the polls as at least 64 countries (plus the European Union)—representing a combined 49% of the people in the world—are meant to hold national elections, the results of which, for many, will prove consequential for years to come".*

The US and our election matter most to us. Ahead of the US November elections, people are anxious, and bitter divisions between Biden and Trump supporters are tending towards violence on both sides of the fence. So much for the appellation, United States.

Meanwhile, US markets are ignoring the fact that the two aged presumptive candidates have not yet nominated running mates. With the US involved in two wars, confrontations in the South China Sea, and a trade war with China, this raises the level of uncertainty a notch or two. The US capital markets remain oblivious to the uncertainties and risks.

A New World order with lots of opportunities.

The changing New World order that McDonald talks about has been predicted by many others and refers to the significant maintenance backlog in global infrastructure, the demand for a Green Energy Transition (GET), and the unstoppable wave of AI/tech projects. Where will all the minerals come from?

The so-called critical minerals are the cornerstone of the coming New World order. We are talking about a paradigm shift with significant implications for energy transition minerals. But what makes these metals so indispensable?

It is all about metal intensity per MW of energy. The table below, sourced from CDA, IEA 2021, is slightly outdated but makes the point. Clean energy systems, on average, require vast amounts of minerals to build.

	Offshore wind	Onshore wind	Solar PV
Copper	8,000 kg/MW	2,900 kg/MW	2,822 kg/MW
Zinc	5,500 kg/MW	5,500 kg/MW	30 kg/MW
Manganese	790 kg/MW	780 kg/MW	-
Chromium	525 kg/MW	470 kg/MW	-
Nickel	240 kg/MW	404 kg/MW	1 kg/MW
Rare Earths	239 kg/MW	14 kg/MW	-
Molybdenum	109 kg/MW	99 kg/MW	-
Silicon	-	-	3,948 kg/MW
Others	6 kg/MW	-	32 kg/MW

Clean energy systems differ profoundly from those fuelled by traditional hydrocarbon resources. The International Energy Agency (IEA) estimates that "*a typical electric car requires six times the mineral inputs of a conventional car and an onshore wind plant requires nine times more mineral resources than a gas-fired plant. Furthermore, since 2010 the average amount of minerals needed for a new unit of power generation capacity has increased by 50% as the share of renewables in new investment has risen".*

The IEA's Sustainable Development Scenario forecasts that "*the energy sector demand will account for over 40% of copper and rare earth consumption, for 60-70% of nickel and cobalt, and almost 90% of lithium*".

A conflict of interest and a call to action.

In its 24 April 2024 report Conflict of Interest – the Cost of Investing in a High-Interest Rate Era, Wood Mackenzie (WM) says that "transitioning *to a net zero global economy is a monumental investment challenge. Meeting the challenge, already an outside bet, will have to happen against a less favourable monetary backdrop than the world has been used to since 2009*.

WM adds that "*the 'zero era' for interest rates has come to an end. The monetary environment over the next couple of decades is likely to remain much tighter than it was in the period from 2009 to 2022. In major economies, nominal and real interest rates could be as much as two percentage points higher, on average, than in the 'zero era'. Companies, investors, and policymakers should brace themselves: tougher financial conditions could persist for some time to come.*

WM calls for "*policymakers to act swiftly to offset the interest-rate headwinds. Governments must remove obstacles such as slow permitting and project approval and offer clear, consistent, and sustained incentives that support nascent low-carbon technologies. Strengthening global carbon markets, maximizing subsidy efficiency, and mobilizing green finance are also essential".*

US election - up to the marginal independent vote.

In its Bond Risks and Equity Rotation report (15 April 2024) Alpine Macro says "*Our baseline scenario calls for 10-year Treasury yields to form a volatile double top at 5%. Still, a decline in yields could take time to play out, with the Fed on hold awaiting clear signs of declining inflation".*

Alpine Macro's view is now in line with our view that inflation would not easily fall to the Fed's target of 2% and that a 5% yield at the short end of the yield curve was the better alternative. The geopolitical and global economic landscape continues to threaten business.

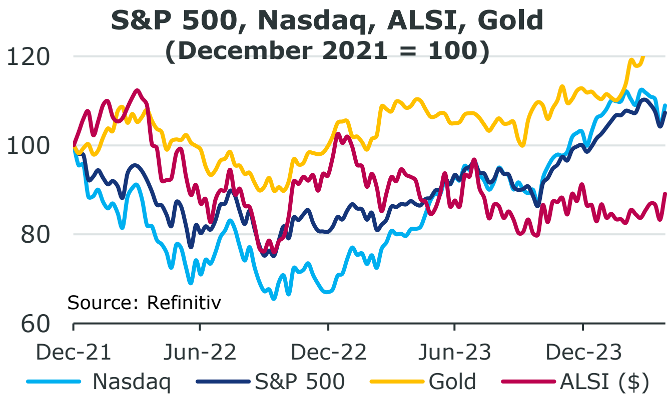
US voters don't appear to be in love with either the Democrats or the Republicans. Assuming both Biden and Trump get to contest the November elections, it will be the marginal independent voters (25-30% of the electorate) that elect the next US president. A 2% swing at the margin might be all that is necessary to determine the way forward.

Deglobalizing and US tariffs are adding pressure to **China's econom**y already plagued by the housing crisis. The contracting current and capital account surpluses are putting the Chinese currency under pressure (-7% since early 2023) and this is impacting the global economy. Ahead of the third plenary session in July where economic direction is set for the next 5-10 years, this week China's Politburo *"highlighted "the ferocity of international competition and risks lurking in key areas of the economy"* – SCMP.

Not only are changes taking place within Western free markets but also within the greater financial system where extreme weather events, skewed demographics, higher inflation, debt, and interest rates have added to the geopolitical uncertainties. Easier said than done, but now is the time to buy cheap currencies and not cheap companies.

US equities and the JSE ALSI in dollars.

Year-to-date (YTD) the S&P 500 and the Nasdaq are, respectively, up 6.9% and 5.3%, whereas gold is up 13.3%, and the JSE ALSI has fallen by 0.7% in dollars and 2.3% in rands. Communication Services up 17.1%, have been joined by Energy (+14.3%) and Banks (+12.3%) at the top of the major sub-indices YTD ranking. Of the eleven S&P sub-indices only Real estate (-9.1%) is down YTD. With such massive exposure to interest rates, this is a red flag. The gold price, although it generates no yield, has played the defensive role that we had expected.



South Africa and the new world order.

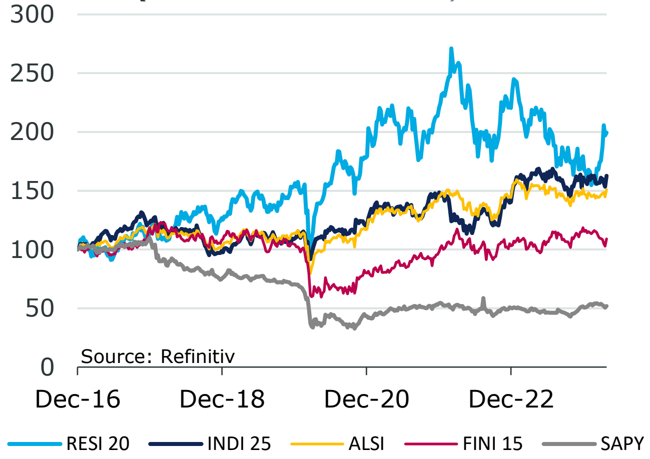
In a Daily Friend article on 24 April 2024, Jonathan Katzenellenborgen notes that "*the post-Cold War world has been divided into three groups: the West, those that stand against the West, and the Neutrals. The West consists of the US and its allies. Those who stand most forcefully against the West are China, Russia, Iran, and North Korea. Those who claim neutrality are countries that include South Africa, Brazil, India, Vietnam, and most African countries".*

Katzenellenbogen continues*, "In this world order, South Africa is treading in dangerous waters. Most of our economic ties are with the West, although China is our single largest export market. So far, we have gained little from our close relations with China, Russia, and Iran. Trade and investment flows are now increasingly determined by considerations of national security and therefore 'whose side you're on'. South Africa could soon find itself out on a limb, with little international influence".*

Western governments continue to provide generous incentives for businesses to invest in clean energy and as outlined above, insane volumes of critical minerals will be required for decades. A neutral SADEC declaring political neutrality, holding hands, and enacting investor-friendly policies could be the perfect foil for global geopolitical tensions and be a source of the required critical minerals. It might also encourage the South African diaspora to come home. South Africans – "To sleep perchance to dream" – Hamlet.

Local equities have started the year under severe pressure, saved only by gold shares and Tencent (Naspers). The RESI 20 (10.3%), The INDI 25 (1.1%), and the SAPY (1%) are up YTD, whereas the ALSI (-0.7%) and FINI 15 (-7.7%), are in negative territory.

ALSI and major JSE indices (December 2016 = 100)



The negative performance of the ALSI in dollars and rands highlights how tough it has been for investors seeking the safety of a diversified or balanced investment portfolio.

On a positive note, cash and US and other bonds are yielding attractive, equity-like yields just as equities are looking risky. Gold in rands is at a record high, up 21.6% in 2023 and up a further 16.8% YTD. As such we remain cautious and positioned to capitalize on opportunities as the market presents them to us.

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