INTEGRAL
Asset Management

The Outlook

June 2024

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US macro-outlook and implications for equities and bonds.

In its **Equities and The Perfect Macro Landing** (15 May) research report, **Alpine Macro** believes that any US equity consolidation will be benign on the back of dovish Fed rhetoric and an encouraging profit outlook. At the negative extreme, at the 1 May post-FOMC press conference, Fed chair Jerome Powell said "*I think it's unlikely that the next policy rate move will be a hike. I'd say it's unlikely*." Alpine Macro believes that "*the Fed's message is that interest rates are too high and cuts are a matter of when, not if*".

Alpine Macro contends that "*the inflation outlook is a critical input for Fed policy and, therefore, equity and bond strategy. Inflation may well be sticky for another couple of months, but there are encouraging signs for labour and shelter inflation looking 6 to 12 months out*".

Alpine Macro adds that "*even a small increase in unemployment will bring down wage inflation and that the likelihood of slower wage growth and job creation increases our conviction that shelter inflation will drop in the coming months*". But economists are never without an 'on the other hand' word of caution – "*needless to say, this benign inflation forecast could turn out to be overly complacent, after three consecutive CPI monthly upside inflation surprises. A geopolitically driven oil price spike well above the $129/barrel level hit soon after Russia invaded Ukraine would be worrisome*". Alpine Macro expects "*Fed rate cuts and lower inflation to bring down bond yields by late 2024/2025*".

Global growth rebalancing.

Alpine Macro says, "*that manufacturing survey readings are improving, both in the US and for the world as a whole, and that Chinese growth indicators are rising and the domestic equity market is well off its lows*".

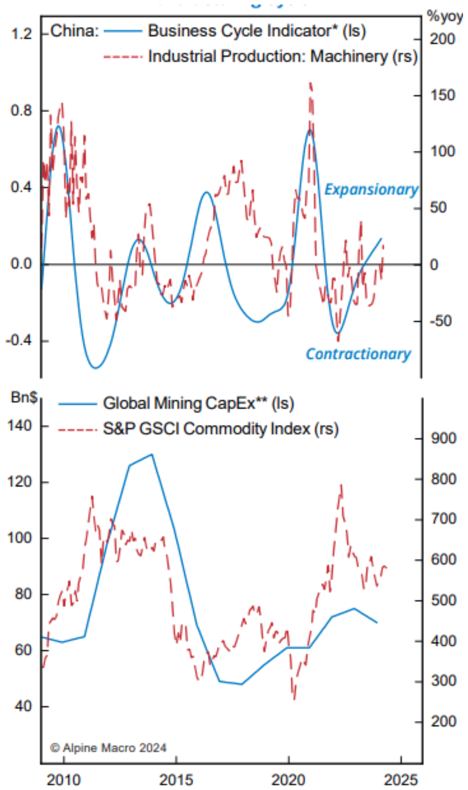
Alpine Macro questions whether "*the recovery in growth outside the US will lead to inflation. Not likely. The improvement is from a low starting point after multi-year deflationary shocks in both Europe and China. Goods inflation should stay subdued with both Chinese export and producer prices contracting, nominal GDP flat over the past year and the current account in surplus*".

Alpine Macro notes that "*the dollar and commodity prices have been positively correlated since the second half of 2021, an extremely rare combination. But it does fit with our view that interest rates will decline faster and by more in parts of the rest of the world than in the U.S*".

The China/commodity angle.

Over the past year, the Chinese economy has suffered under the housing crisis, mounting debt, worsening geopolitics, and trade tensions. Alpine Macro says that "*Beijing's latest bazooka program to stabilize the housing market and stimulate demand is a boon for the global industrial complex. The programs should boost China's fixed asset investment and industrial production, which have already been trending up.*

Indicators specific to construction, including excavator sales, also appear to be inflecting higher. Bringing China online is another boost for Emerging Markets, which have the highest level of PMI (52) since 2021. At a minimum, the fiscal floor under property developers removes a downside risk to industrial demand. Industrial industries including Building Products, Electrical Equipment, Machinery, and Construction have high degrees of revenue exposure to China and connected markets as evidenced in the top panel of the chart below".



*Alpine Macro proprietary model
**Top 40 mining companies; source: PwC analysis

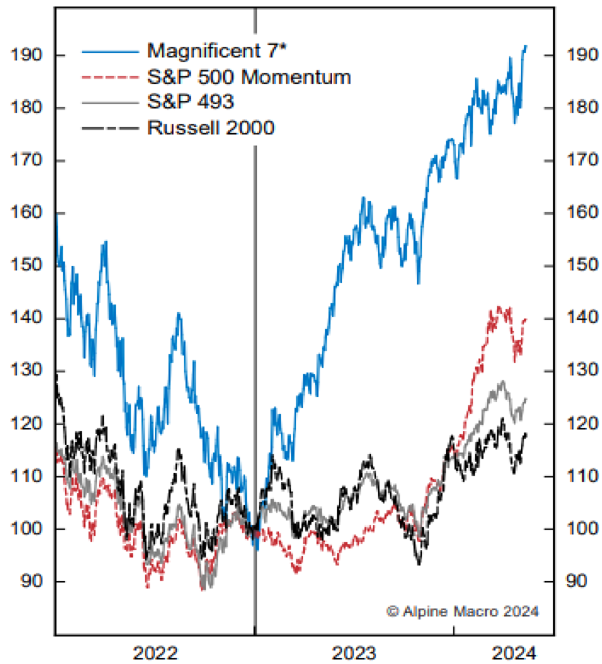
Alpine Macro notes that "*the strength in the commodity complex, with the Bloomberg Industrial Metals Index up 16% YTD, comes at a time of considerable dollar strength relative to a weak Euro and Yuan. This commodity spike may suggest that a supply crunch of some magnitude is behind the price gain. The bottom panel of the previous chart shows the global mining sector has suffered a sustained period of under-investment and capacity reduction.*

With the world economy continuing to strengthen and commodity prices rising, investment in the mining sector will rise. The reoccurring pattern in the mining sector is that surging investment into the sector almost always follows major commodity spikes, which, in turn, are the consequence of under-investment in the previous cycle.

All signs seem to suggest that we are on the cusp of another major investment cycle, which should be bullish for Industrials. The Chinese stock market likes the news, with the real estate sector jumping nearly 30%".

Equities and the perfect macro landing.

The following chart shows that "*the equity uptrend has been concentrated in a handful of mega-cap tech and pharma stocks. The "S&P 493", which excludes the Magnificent 7 big tech ("Mag 7"), and the small-cap Russell 2000 Index are both up about 20% since the beginning of 2023, while the Mag 7 have nearly doubled*". Alpine Macro says that "*at a minimum, poor breadth, high concentration, and sustained price appreciation point to the need for a pullback*".



*Meta, Apple, Amazon, Microsoft, Google, Nvidia and Tesla
Note: All series are rebased to Jan 2023 = 100

US market ignores headwinds.

In a world ravaged by geopolitical fragmentation, Alpine Macro and many other economic commentators seem to brush aside the geopolitical tensions including two costly wars with no end in sight (Biden is now to allow Ukraine weapons to strike inside Russia). The uncertainties around the November election (Trump has been found guilty on 34 counts), the Green Energy Transition, extreme weather events, the massive AI energy requirements, US/China trade tensions, deglobalization disruptions, and associated costs are also ignored.

Closer to home, US markets continue to ignore repeated warnings from Jamie Dimon, CEO of JP Morgan, of a potential recession and higher rates. His latest warning, on Wednesday this week, was that "*private credit could spark turmoil amongst retail investors if the opaque sector of financial markets weakens*".

US equities and the JSE ALSI in dollars.

Year-to-date (YTD), the S&P 500 and the Nasdaq are, respectively, up 10.2% and 9.8%, whereas gold is up 13.7%, and the JSE ALSI is down 2.9% in dollars and up 0.4% in rands. Communication Services (+19.7%), Information Technology (+16.9%), and Banks (+13.2%) lead the major sub-indices YTD ranking.

US major equity indices (ranked by 2024 YTD performance)

US Equity Indices	Latest	2024 YTD
Communication Services	295	19.7%
Information technology	3,972	16.9%
Banks	398	13.2%
Insurance	723	13.2%
Utilities	361	12.3%
Nasdaq	18,539	10.2%
S&P 500	5,235	9.8%
Financials	682	8.8%
Energy	691	7.9%
Industrials	1,031	6.9%
Consumer Staples	812	6.6%
Materials	569	5.5%
Healthcare	1,648	3.6%
Russell 2000	3,035	1.8%
DJI	38,111	1.1%
Consumer Discretionary	1,421	0.2%
JSE ALSI in dollars	4,086	-2.9%
Real Estate	234	-7.1%

Source: Refinitiv - excludes dividends

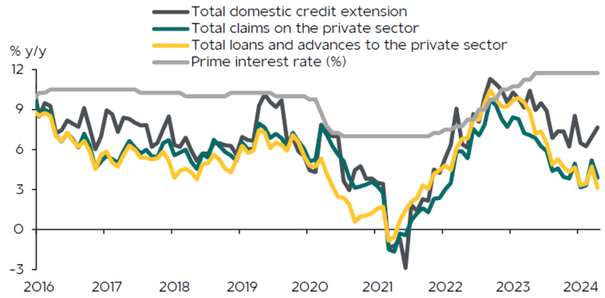
On the downside, Consumer Discretionary is up 0.2%, and Real Estate is down 7.1%. With such massive exposure to interest rates, this is a red flag. The gold price, although it generates no yield, has played the defensive role that we had expected.

Excluding Tesla, the top 6 stocks now account for over 30% of the S&P 500, with Nvidia leading the way up 123% YTD. Despite a very positive outlook, this narrow breadth and concentration is the reason Alpine Macro points to the need for a pullback.

South African economics.

RMB Markets report that government spending surged to R168.6bn in April reflecting typical early-year spending patterns. However, this is a stark reminder that an unmanageable deficit will haunt the new government.

On the credit front, total extensions in South Africa grew by 7.1% in April, driven by a 35.5% and 3.9% increase in government and private sector extensions. Underlying the private sector credit extensions were: households (+3.4%), instalment sales (+8.1%), leasing finance (+6.3%), mortgages subdued at +3%, and other loans at +1.8%. RMB Markets "*anticipates that credit extension will remain subdued due to the high-interest rate environment, which is dampening demand for new credit across the private sector. Additional uncertainty stemming from global geopolitics is likely contributing to subdued business investment and related demand for credit*".



Sources: SARB and RMB Markets (data as at May 2024)

In April the PPI rose, respectively, by 5.1% (y/y) and by 0.5% (m/m), driven by a wide range of raw material, food, beverage, machinery, and equipment cost increases. On Thursday, the SARB left the repo rate unchanged at a 15-year high of 8.25% with the Governor, Lesetja Kganyago, stressing "*continued concerns about near-term inflation risks even as El* Niño-*related inflation food shocks dissipate*".

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South African 2024 national election.

With a 58.6% voter turnout and just over 50% of votes counted at a national level by mid-day Friday, the IEC Results Portal results are summarised below. The top 4 parties have secured 85.1% of the national vote and the Patriotic Alliance (4%), Inkatha FP (2%), and Vryheidsfront Plus (1.85%) take the total to 93%.

The original +70% ANC 1994 vote has been whittled down to 60%, spread amongst the ANC, MK, and the EFF, with the DA well ahead in second place.

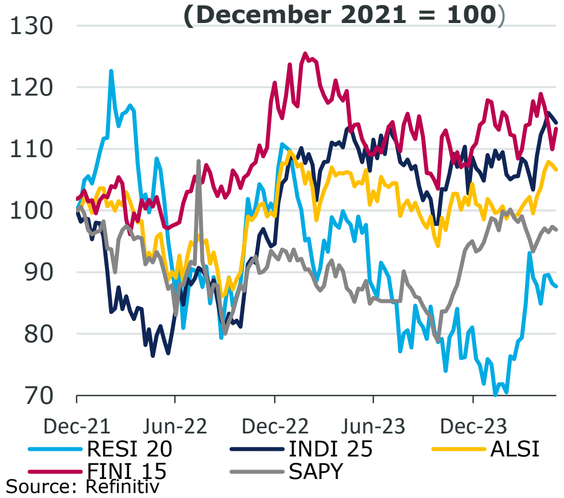
Of the three most populous provinces:

- ✓ The Gauteng coalition threatens to be messy,
- ✓ The DA looks likely to avoid a coalition in the Western Cape, and
- ✓ KZN will be dominated by MK.

2024 National Elections					
Province	**Population**	**ANC**	**DA**	**EFF**	**MK**
Gauteng	15,628	33.2%	29.4%	12.9%	9.9%
KZN	12,808	18.7%	10.1%	2.4%	44.5%
Western Cape	7,743	18.8%	54.6%	4.6%	0.7%
Eastern Cape	7,353	65.0%	14.2%	9.5%	1.3%
Limpopo	6,822	71.3%	9.5%	11.7%	1.0%
Mpumalanga	5,361	52.5%	11.0%	12.1%	17.1%
North West	3,853	63.0%	10.0%	16.5%	1.6%
Free State	3,000	53.0%	21.8%	11.8%	3.0%
Northern Cape	1,399	46.4%	24.6%	10.6%	0.8%
National	**63,967**	**42.8%**	**23.4%**	**10.8%**	**8.1%**
Source: StatsSA					

At a national level, the ANC will have to form a coalition. There is no doubt managing the country is going to be doubly difficult as the EFF and MK, emboldened by their combined near-20% of the national vote, look to enforce their anti-business policies that include the nationalization of banks, insurance, and mining companies, plans to place land under state control and to scrap parts of the constitution.

ALSI and major JSE indices (December 2021 = 100)



Source: Refinitiv

Local equities started the year under severe pressure and have been saved by gold shares and Tencent (Naspers). YTD the RESI 20 (+7.5%), the INDI 25 (3.9%), the ALSI (+0.4%), and the SAPY (+1.1%) are all in positive territory, whereas the FINI 15 (-7.8%) remains in negative territory.

The poor 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 the Mag 7 equities are looking risky. Gold in rands is at a record high, up 21.6% in 2023 and up a further 16.4% YTD. There will be much focus on the make-up of the new government as policy could go either way.

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