INTEGRAL Asset Management

The Outlook

October 2024

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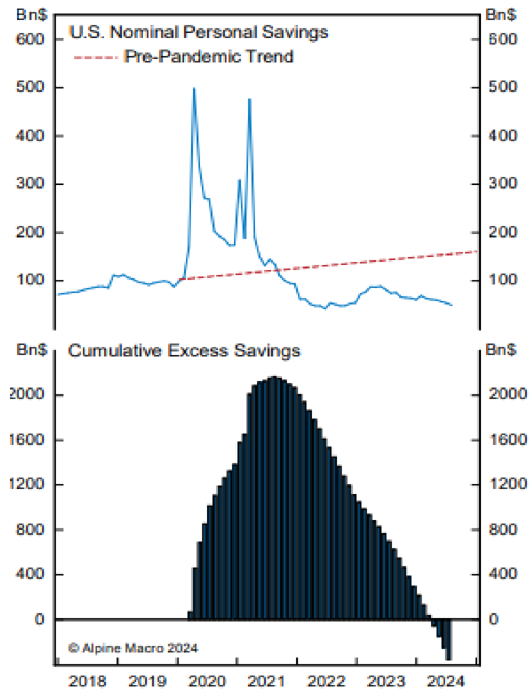
Alpine Macro – tailwinds have faded.

In its 13 September research report, **Consumer slowdown: signposts to monitor**, Alpine Macro believes that "*Tailwinds that benefited the US consumer in 2023 have since gone into a holding pattern or present mild headwinds. Nevertheless, the risk of a severe recession remains low because there are no major headwinds:*

- ✓ *Depleted household savings mountain,*
- ✓ *The job market is easing,*
- ✓ *Revenge services spending is well advanced, and*
- ✓ *Productivity gains continue.*

Alpine Macro shows that the savings buildup from the pandemic subsidies is gone and that "*the consumer has already boosted spending faster than income growth by 160bps since the savings rate peaked 16 months ago*" – see chart alongside. However, household balance sheets are healthy, with consumer wealth being boosted by the sharp rise in housing and financial market prices over the past year.

On the job market front, a range of labour data statistics shows that "*employment will slow*", but there is "*no sign of a falloff in services spending, with both the ISM and S&P Global services PMI readings above 50*".



Downward revisions in employment imply that businesses are "*largely benefitting from rising labour productivity, with real personal disposable income up only 1.1% over the past year. Still, businesses will not be under pressure to slash headcounts with unit labour costs barely rising*".

Alpine Macro adds that *"The reduced exposure of consumer debt to Fed rate hikes also reduces the odds of a major spending retrenchment".* Their research shows that 57% of household mortgages are fixed at rates below 4% and 76% at below 5%. The drawback here is that many homeowners are loath to sell their homes and upgrade at higher interest rates. This has strangled liquidity across the US housing market and forced prices higher.

The bottom line from Alpine Macro is that "*Consumer spending may well slow, but in an orderly manner that is consistent with a perfect landing*".

Alpine Macro – why this time will be different.

Alpine Macro's view of a perfect US landing depends on how the economy and consumer responds to a Fed tightening cycle. They have identified **the dependence of global producers on US consumers as a major unappreciated risk**. Four signposts will provide warning signs that the US consumer is more vulnerable than expected. The signs are:

- ✓ That real private demand compares favourably with previous recessions,
- ✓ That the labour market does not worsen - layoffs and job openings stand at 7.7m and 1.7m, respectively.
- ✓ No undue further tightening in the supply of bank credit, and
- ✓ No-mean reversion in house prices which would put pressure on household savings.

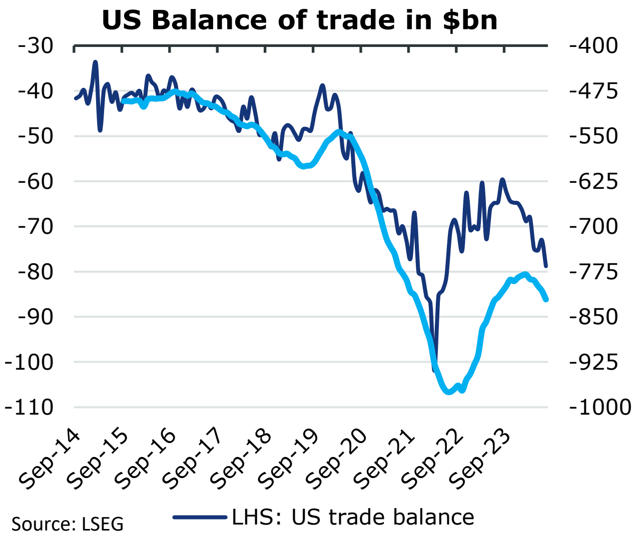
The chart alongside shows that the US trade deficit increased from a rolling 12-month average of around \$490bn in late 2015 and peaked at \$975bn in July 2022. The deficit is currently around \$820bn, derived from exports of \$3.14bn and imports of \$3.96bn.

US top 5 exports and imports by country - 2023

Country	Mexico	China	Canada	Germany	Japan
Imports	16%	15%	14%	5,3%	4,9%
Country	**Canada**	**Mexico**	**China**	**Netherlands**	**Germany**
Exports	18%	16%	7,5%	4,2%	3,9%

Mexico's figures are misleading as increasingly China is routing trade through Mexico. The important point that Alpine Macros makes is that "*there is a tight correlation between the US trade deficit and the combined trade surpluses of China and the euro area*".

Alpine Macro says that the US deficits are partly a result of "*a US spending boom, uncompetitive US tradeable goods/competitive global trade goods and a lack of confidence or willingness to spend among consumers abroad".* **Either way, the world depends on the US consumer not to falter.**



These vast trade numbers are thanks to almost four decades of globalization. The safety and sustainability of the global supply chains are now at great risk due to unprecedented geopolitical tensions, and heightening conflict in Ukraine and the Middle East. A recent WEF survey found that "*geopolitics worries banks more than inflation*".

To boot, the US elections are 36 days away and a Trump or Harris victory will likely add more pressure on US/China trade. All good reason to be a bit cautious.

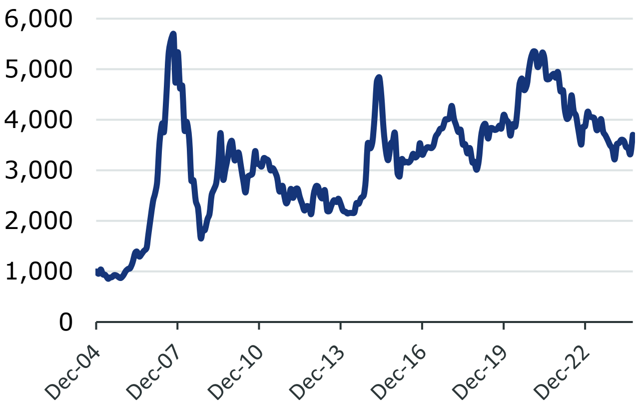
China – directs fiscal firepower at itself.

Eventually the Chinese authorities have announced its long-awaited, stimulus package. However, the statement from the extraordinary Politburo meeting this week raised a red flag and shed some light on +1,100 financial and securities executives who have left their positions since August.

The Politburo said, "*We need to establish a strong benchmark for selecting and employing people, conscientiously implement the 'three exemptions,' and support those who take responsibility and get things done*". The statement left no doubt about the leadership's intentions. Those who demonstrate "*the courage to take responsibility and innovate,*" in Xi Jinping's words, will be rewarded, with exemptions, a "*responsibility and punishment*" waiver for those acting on policy guidance.

The stimulus measures announced by the PBOC included rate cuts, property loans for unsold homes, equity buyback facilities, and the bailing out of local banks and bolstering of state banks. The measures suggest deep-rooted concerns about local debt, the real estate bubble, the LGFV/shadow banking repayment crisis, and underscores Xi Jinping's desire for a firm control over the economy.

Shanghai Shenzhen CSI 300 Index

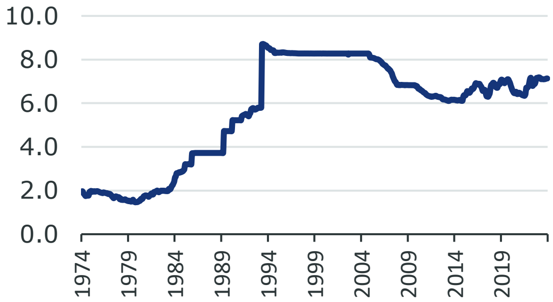


4% and 76% below

Prior to this week's announcement the CSI 300 had grown annually by 6% since 2004. The market was over-joyed with the measures announced and off a low base (PE 10x), the CSI 300 rose 15.7% over the week.

Not for a discussion this time around, but the red flag is the heightened pressure on the structure of **the Chinese monetary policy** which started in 1994 when **the Chinese the yuan was fixed to the US dollar**. The ability of the authorities to control the price and the quantity of money AND manage the currency is becoming increasingly unsustainable.

Yuan:USD
(a managed currency)



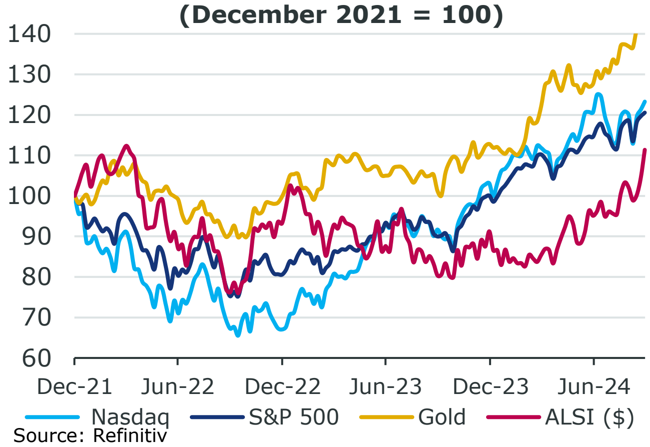
China is the second largest economy in the world and the largest trader. **Any significant change to the structure of its Monetary Policy will significantly impact the global financial system**. Watch this space!

US equities and the JSE ALSI in dollars.

The big event of the month was the 50bps rate cut by the Fed. This was an 'off to the races' moment for the market, believing that inflation will soon become yesterday's concern and that lower rates are needed to support the labour market. The 10 minus 2-year yield curve has normalized and as indicated by Alpine Macro above, many are forecasting a soft or perfect landing for the US economy. With more rate cuts all but guaranteed, this is bullish for both stocks and bonds.

Year-to-date (YTD), the S&P 500 and Nasdaq are up, respectively, 20.8% and 19.2%. But the big winner is still gold, up 27.7%. The JSE ALSI is up 19.2% in dollars and 12.6% in rands. Of the sub-indices, Information Technology (+28.9%), Insurance (+27.9%), and Utilities/Communication Services (+26.9%), lead the YTD ranking. This is a potent performance under any circumstance, but to be noted, all in the shadow of a rampant gold price.

S&P 500, Nasdaq, ALSI, Gold
(December 2021 = 100)



Source: Refinitiv

South Africa – the GNU rekindles hope.

Following the announcement of the Government of National Unity (GNU) the press was awash with positive headlines – "South Africa to benefit from GNU growth", GNU triggers a wave of investment", and "GNU working to build an inclusive economy".

After a recent visit to China, President Ramaphosa spoke encouragingly about the "*potential for greater cooperation, investment and trade between South Africa and China with emphasis on low-carbon, climate-resilient economic growth*". But his comments, "*the current approach to world peace is unjust, unfair, and unsustainable*" at last week's UN Security Council meeting in New York were less business orientated. Adding that "*sustainable development can only be achieved when it is being driven by inclusive, responsive and agile multilateral institutions*". In turn, he said "*This means that bodies like the United Nations and financial institutions like the International Monetary Fund need to be fundamentally reformed*".

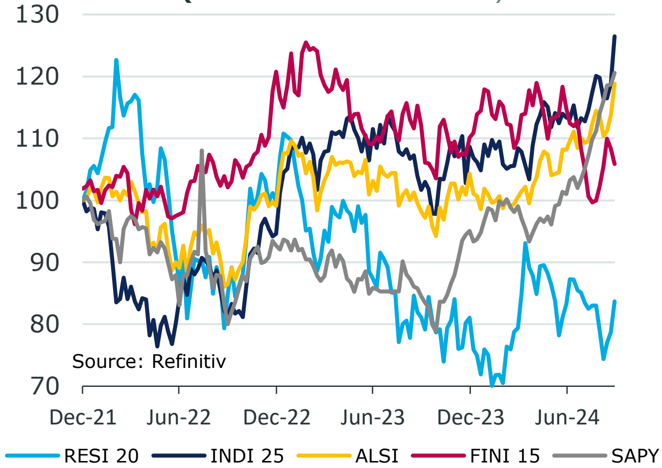
Such rhetoric is part of the US/China tensions and the G7/BRICS+ divide. The local economy would be far better served if all this political energy was directed at freeing up our competent private sector to fix the past failures. That said, the launch of Phase II of the Government/Business partnership with about 350 projects on the table is very good news.

The rand and the JSE.

Rand:dollar & rand:dollar index (DXY)

Daily and weekly moves in the rand can be emotionally draining. To put the recent moves in perspective, the US dollar index (DXY) has fallen by 11.5% since its 21-year low of 114 in September 2022, whilst the rand is virtually unchanged. The rand, however, has not been without its own cycle of volatility and is up 9.5% on its all-time low of R19.81 in May 2023.

ALSI and major JSE indices (December 2021 = 100)



The SAPY (+25.7%) leads the JSE performance YTD, followed by the FINI 15 (+18.8%), the INDI 25 (+15.5%), the ALSI (+12.7%), and the RESI 20 (+0.54%). The high US valuations have deflected attention abroad and the wars have narrowed the field for investors. Yet foreigners remain unsure of investing in South Africa, preferring to wait and see. Post the elections locals have aggressively bought up SA Inc. stocks whilst the stronger rand and weak China/Euro economies have seen resource stocks being sold off.

We remain cognisant of escalations in the two wars, the US election uncertainty, a weak and politically tense western Europe, and the Chinese Monetary Policy challenges outlined above. The new highs in the gold price are also telling us something.

Bruce Williamson
Mining analyst

Keith McLachlan
Chief Investment Officer

Danilo Pagani
Chief Executive Officer

Dave Eliot
Executive Chairman

Integral Asset Management (Pty) Ltd is an authorized Financial Services Provider **FSP Number** 46545 **Registration Number** 2015/393458/07 | **Directors** Dave Eliot (Executive Chairman), Danilo Pagani (CEO), Bruce Williamson (Mining Analyst), Keith McLachlan (CIO) Block B, The Offices of Hyde Park, 1 Strouthos Road, Hyde Park, 2196 | P O Box 934, Northlands, 2116 +27 87 985 0104 | info@integralasset.co.za