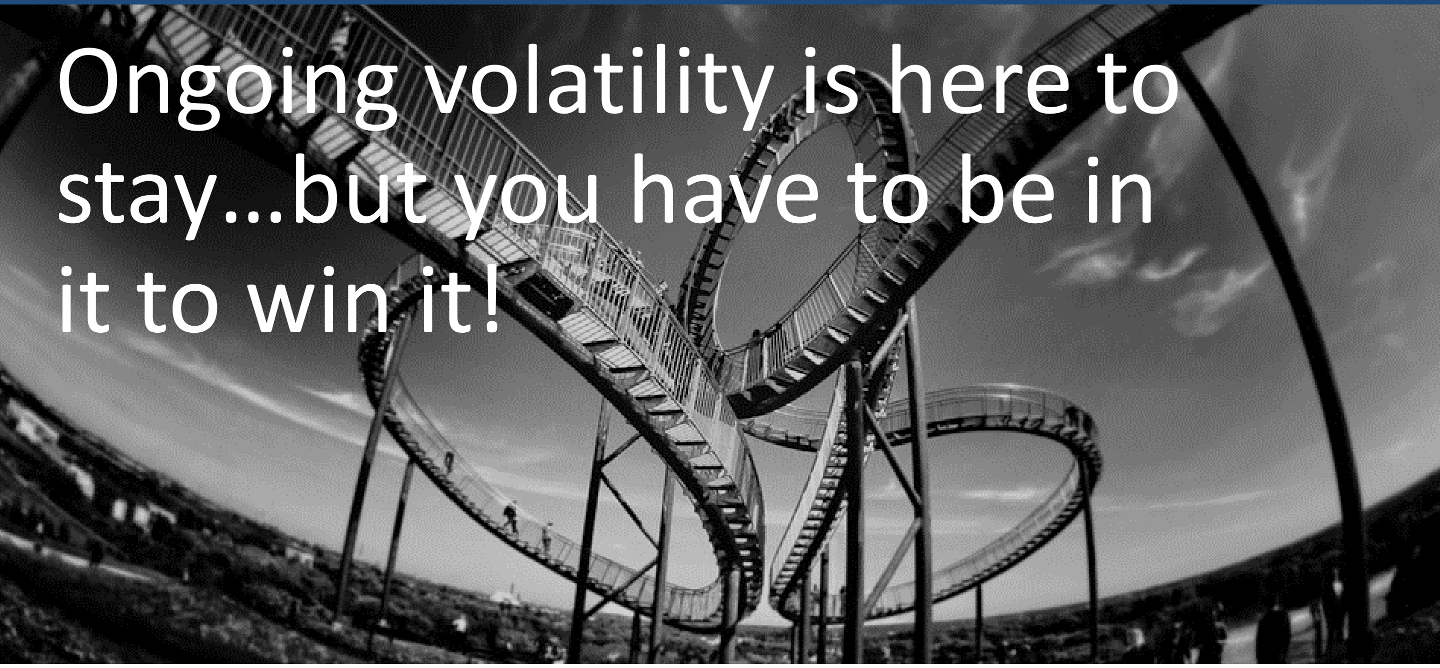
Ongoing volatility is here to stay…but you have to be in it to win it!



During a recent scenario planning session, we identified a number of specific near-term concerns, both at home and abroad, and potential catalysts that could address the uncertainty in market associated with them. In no particular order, these were:

- An SA election outcome and subsequent actions to improve economic policy and address State-Owned Enterprises' (SOEs) financial conditions;
- A deal between the US and China to end the trade war;
- A definitive outcome to the UK and EU's Brexit negotiations;
- Improving SA, emerging market and developed market corporate earnings;
- An end to of the FED's rate normalization cycle.

There are many more factors that can and will influence capital market behavior, but these catalysts and their outcomes remain important to provide global and local SA investors with much needed confidence to invest capital into risk assets or to remain invested. Now let's deal with the progress (or lack thereof!) in these factors.

Global readers, excuse me for focusing on SA election matters first:

The solid ANC victory with Cyril Ramaphosa as the leader and President has been well received by markets to date and since Friday last week we have identified foreign purchases of SA banks and retail stocks, while the latest government bond auction received bids of ZAR18.325bn, when Treasury only offered its usual ZAR3.3bn. This does not mean that the longer-term outlook is improving, but rather that investors are giving Ramaphosa a chance. We will learn of his intentions soon as he needs to appoint a new – and hopefully much smaller - cabinet and provide investors with more certainty by demonstrating his commitments in terms of governance, expenditure and economic policy. The Minister of Energy, Jeff Radebe, has already told the power regulator, NERSA, to issue licence applications from business to generate power and feed it into the national grid. This is a breakthrough in terms of rhetoric and actions to improve productivity and generate a wider national power grid. Many SA asset classes (the ZAR, bonds and domestically-focused stocks) are undervalued in our view and any major improvement in local business confidence, economic policies and tough calls to address SOE's longevity, should see these asset classes rally. Only if the global catalysts play ball, however!

Continued overleaf

The US/China trade talks took a new turn over the past week or two, as the US implemented more stringent tariffs and China retaliated by announcing its own measures on US goods from 1 June, all of which took place before the latest round of talks were due to go ahead. A game of chicken or is this just the early exchanges in a long-term power struggle between the two largest economies in the world? We do not know the answer, but what we do know is that it creates further uncertainty in capital markets and the consequences can lead to lower economic growth for both the US and China, higher inflation and potentially a US recession in the next 12-18 months. Rumours are aplenty and one includes rhetoric that Trump cannot afford an economic collapse in the US due to these actions (in terms of getting re-elected as President). Therefore, he needs to first 'create' the uncertainty and volatility to, in the end, get the Fed to cut rates, make a deal with China and be the 'economic' hero of 'hopefully' a positive outcome for the US. A dangerous game indeed and enough reason for us to be more cautious in our portfolios.

On Brexit we cannot spend too much time, suffice it to say that *any* outcome is preferable to the current state of play…

Where to in terms of corporate earnings? Margins are under pressure for SA domestically-focused companies and unemployment numbers are increasing dramatically, with over 90,000 employees having lost their jobs in the SA financial services industry lately! Any positive reforms, as mentioned, can turn this tide but it will take time to heal the wounds of the past. In the US more than 70% of US companies reported improved earnings relative to expectations in the last round of quarterly announcements. US corporate earnings are slowing but still growing. In Europe and Asia earnings results are mixed but are not falling off a cliff.

In summary, in the short-term we can expect to have more answers than questions on SA political intent, economic policy and its consequences. From a global perspective, it is anyone's guess when the US /China and Brexit negotiations come to an end. Any conclusion to one or more of these matters will provide markets with more certainty to deal with the direction of trade in capital markets.

In terms of exposure to risk assets in SA or global capital markets under these conditions? Markets behave in a forward-looking manner and re-act quickly to new, positive information: 'One must be in it, to win it' so to speak…

To time markets remains impossible.

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