BREXIT BUNGLES AND OIL STUMBLES

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Another eventful week and we are closer to the end of what has been a dreadful year for local investors. Locally, headlines were dominated by the decision of the parliamentary constitutional review committee to proceed with an amendment to explicitly allow for land expropriation without compensation (EWC). This was expected and therefore largely ignored by the markets. The big question instead is under which circumstances EWC will be applied.

LEAVING IS THE HARDEST THING TO DO

Two items hogged global news headlines over the past week; but only one has real significance for South Africa. The events of course were the further decline in the oil price and the shambles that is Brexit. UK Prime Minister Theresa May managed to get her Cabinet to agree to a draft agreement that would cover the UK's relationship with the European Union (EU) after leaving on 29 March.

However, within a day key Cabinet ministers – including the Brexit minister – resigned in protest. It is now unclear whether a parliamentary vote later this month will endorse her deal. If it doesn't, it could lead to a combination of a leadership tussle within the Conservative Party, fresh elections, the formation of a new government, a second referendum, further negotiations with the EU, or simply a 'hard' Brexit, i.e. crashing out of the EU without a guiding framework. Either way, it is a recipe for political intrigue and market uncertainty.

What are the broader implications? The UK economy is large (the world's number five at market exchange rates) but substantially smaller than the European trading bloc it is (or is not) leaving and much less important for the global economy and markets than the US and China. The Brexit chaos is likely to weigh on the UK economy but markets are probably already pricing in a negative outcome. This is unlike June 2016, when the market was shocked at the unexpected referendum outcome that gave rise to this situation in the first place. Any progress towards the deal will be a positive surprise.

CRUDE BUT EFFECTIVE

Of bigger importance is the slump in the oil price, with Brent crude down 20% from its recent early October peak of $85 per barrel. The oil price ran up on concerns of a supply shortfall due to the imposition of sanctions on Iran, among other reasons. But traders now come to the opposite conclusion: there is enough oil to meet global demand heading into 2019. Encouraged by the higher prices, US oil supply has surged to a record of almost 12 million barrels per day, eclipsing Saudi Arabian and Russian production. Meanwhile, the oil producers' cartel, OPEC, has cut its own forecast for global growth for next year from 3.6% to 3.5%, implying a softening of demand.

What are the implications of a lower oil price? When the oil price slumped from more than $100 per barrel in 2014 to $29 in early January 2016, it boosted global economic growth by much less than was widely expected. One reason was credit and equity market stress linked to oil producing companies. Oil producing countries, particularly Russia and Brazil, fell into recession. The magnitude of the oil price decline is much smaller now, and therefore share and bond price declines are also muted. Unlike early 2016, there is no talk of widespread bankruptcies among producers.

However, the lower oil price will help importing countries and companies that rely heavily on transportation. Two such importers are Japan and Germany, the world's number three and four economies. Both reported negative growth rates for the third quarter though there were one-off factors in both cases. Japan suffered from a destructive typhoon, while German vehicle manufacturing was interrupted as companies retooled factories to comply with new European emission standards. In contrast, the US grew by 3.5% in the third quarter. The US economy is still solid and less dependent on the global economy than China, Japan or Germany. Exports are only 12% of US GDP but 16% for Japan, 20% for China and more than 40% for Germany. The latter is clearly the most exposed to a slowdown outside its borders, and of course any escalation of US President Trump's trade wars.

PETROL PRICE REPRIEVE

The lower oil price is clearly good news for South Africa since we import most of our petroleum needs and it is indeed the single largest item in our import bill. The average over-recovery on the petrol price of R1.59 per litre points to a price cut of similar magnitude early next month, just in time for the festive season. It should reduce one source of persistent negativity from the past few months.

Another source has been the technical recession in the first half. New data from Stats SA released over the past two weeks suggest not only that the third quarter should be positive, and therefore ending the technical recession of two consecutive negative quarters, but that second quarter growth could be revised up. Manufacturing, electricity and mining output numbers are all better than initially estimated, implying that the country possibly was never in a technical recession to begin with. Third quarter gross domestic product data will be released on 4 December.

But even though growth is positive, it is slow. September's retail sales data shows spending at shops increased only 0.7% from a year ago in real terms. Nominal sales growth, in other words the revenue growth that retailers generated, was only 2.9%. Retail inflation has been around 2% since the start of the year. Headline consumer inflation has been higher because it includes the price of services, housing and fuel. But even with record petrol prices and the VAT hike in the numbers, consumer inflation in September was below 5%. The tough economic environment means local companies do not have pricing power, and face margin pressure.

THE RAND HEDGES THAT WEREN'T

And yet, the JSE's weak returns in 2018 cannot be primarily linked to the tough domestic economy. This brings us to perhaps the most disappointing aspect of investments this year: the poor performance of the JSE's non-resource rand hedges despite the rand losing 15% against the dollar since January.

With the slump in the oil price, and the slightly firmer rand, Sasol's share price has predictably declined and is down by almost 10% this month. But unfortunately it is not the worst performing major share on the JSE. British American Tobacco declined almost 20% this month after US authorities announced an intention to ban menthol cigarettes. Its 2018 losses are twice as much.

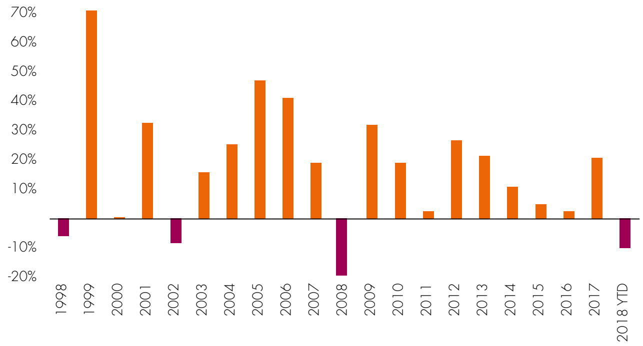
The big industrial rand-hedges on the JSE have fared almost as poorly, for reasons unrelated to the macro-economy. Naspers is the biggest share on the local market and its value is largely determined by its stake in Tencent. Tencent's Hong Kong share price is down 30% over the past year. Richemont's Zurich share price is down 25%. MTN faces a huge fine for allegedly contravening Nigerian regulations and its price has plunged 40%. Aspen's strategy of growth through acquisitions left it with high debt levels making investors very uncomfortable. The weak rand could not offset any of these losses.

We are therefore on track for only the fourth negative calendar year for the FTSE/JSE All Share Index in the past 20 years (chart 2). This year the JSE has lagged other markets, including other emerging markets, by quite some distance when measured in dollars. The previous three occurred against the backdrop of global sell-offs: the 2008 financial crisis, the 2002 post-dotcom bear market and the 1998 East Asian crisis. Every subsequent year saw a decent bounce. The other point to remember is that over the whole 20-year period, South African equities delivered 15% average annual returns, but no single year delivered that. Returns are lumpy, with great years interspersed with poor ones. To benefit from the former, one unfortunately has to sit through most of the latter

CHART 1: BRENT CRUDE OIL $ PER BARREL

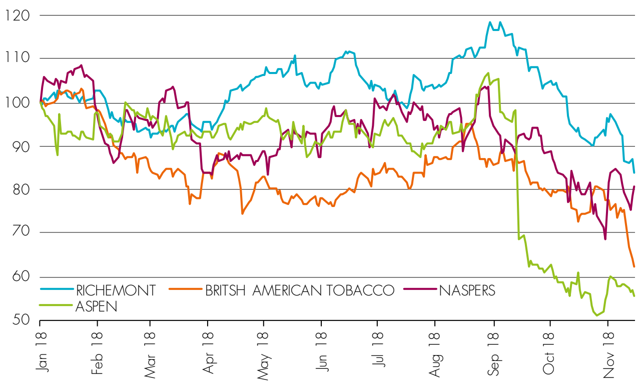
Source: Thomson Reuters Datastream

CHART 2: FTSE/JSE ALL SHARE TOTAL ANNUAL RETURNS, %



Source: Thomson Reuters Datastream

CHART 3: MAJOR RAND HEDGES ON THE JSE IN 2018, INDEXED TO 100



Source: Thomson Reuters Datastream

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 026.0	-1.79%	0.20%	-3.66%	-0.49%
United States	S&P 500	US$	2 736.0	-1.62%	0.88%	2.32%	5.80%
Europe	MSCI Europe	US$	1 564.0	-2.13%	-0.82%	-12.97%	-10.22%
Britain	FTSE 100	US$	9 002.0	-2.35%	-1.09%	-13.45%	-7.67%
Germany	DAX	US$	1 225.0	-0.97%	-0.08%	-10.47%	-14.10%
Japan	Nikkei 225	US$	192.2	-1.71%	-0.96%	-4.90%	-2.31%
Emerging Markets	MSCI Emerging Markets	US$	981.0	0.51%	2.62%	-15.28%	-12.80%
Brazil	MSCI Brazil	US$	1 967.0	-0.41%	-3.44%	-2.77%	0.46%
China	MSCI China	US$	73.5	2.78%	5.24%	-16.93%	-16.61%
India	MSCI India	US$	530.7	0.60%	4.68%	-13.14%	-7.54%
South Africa	MSCI South Africa	US$	440.0	-1.35%	6.80%	-27.27%	-15.71%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	52 096.0	-2.25%	-0.56%	-12.45%	-12.52%
All Share	All Share (Total Return)	Rand	7 617.0	-2.23%	-0.54%	-9.86%	-9.76%
TOP 40/Large Caps	Top 40	Rand	6 687.0	-2.21%	-0.59%	-10.22%	-11.51%
Mid Caps	Mid Cap	Rand	15 021.0	-2.37%	-0.09%	-11.51%	-3.07%
Small Companies	Small Cap	Rand	18 816.0	-1.77%	0.50%	-10.49%	-6.54%
Resources	Resource 20	Rand	2 604.9	-2.00%	-4.01%	13.94%	10.21%
Industrials	Industrial 25	Rand	12 129.0	-2.42%	-0.60%	-19.76%	-23.68%
Financials	Financial 15	Rand	9 276.0	-2.10%	3.49%	-4.44%	9.53%
Listed Property	SA Listed Property	Rand	1 884.6	-4.94%	-0.02%	-23.51%	-19.84%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	917.4	0.00%	0.00%	-3.24%	-2.15%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY					
All Bond	BESA ALBI	Rand	620.4	0.66%	2.43%	5.57%	11.97%
Government Bonds	BESA GOVI	Rand	614.0	0.67%	2.48%	4.71%	11.14%
Corporate Bonds	SB JSE Credit Indices	Rand	115.5	0.36%	0.79%	-8.46%	-12.92%
Inflation Linked Bonds	BESA CILI	Rand	251.6	-0.96%	-1.13%	-0.40%	3.25%
Cash	STEFI Composite	Rand	407.3	0.13%	0.31%	6.36%	7.25%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	67.0	-3.76%	-10.65%	0.01%	9.85%
Gold	Gold Spot	US$	1 221.0	0.99%	0.49%	-5.86%	-4.53%
Platinum	Platinum Spot	US$	842.0	-0.94%	1.08%	-9.46%	-9.75%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.97	2.48%	5.74%	-11.40%	1.19%
ZAR/Pound	ZAR/GBP	Rand	17.94	3.62%	5.18%	-6.69%	4.07%
ZAR/Euro	ZAR/EUR	Rand	15.96	2.16%	4.67%	-6.92%	4.42%
Dollar/Euro	USD/EUR	US$	1.14	-0.88%	-0.79%	5.35%	3.51%
Dollar/Pound	USD/GBP	US$	1.28	1.10%	-0.26%	5.19%	2.85%
Dollar/Yen	USD/JPY	US$	0.01	-0.87%	-0.14%	0.15%	-0.71%

Source: I-Net, figures as at 16 November 2018

ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Consumer inflation
- SA Reserve Bank Monetary Policy Committee meeting

US

- Building permits and housing starts
- Durable goods orders
- Flash Markit Purchasing Managers' Index

EUROPE

- Eurozone current account balance
- Flash Markit Purchasing Managers' Indices

JAPAN

- Inflation
- Flash Markit Purchasing Managers' Index

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