MARKET MATTERS
4 FEBRUARY – 8 FEBRUARY 2019

OLD MUTUAL MULTI-MANAGERS

THE STATE OF THE RAND

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A year ago, on the eve of President Ramaphosa's first State of the Nation Address (SONA), the rand was trading at R11.56 per US dollar. Last week, the exchange rate was R13.60 per dollar before the big speech. This is not far from where it was two years ago when Jacob Zuma delivered what was to be his final SONA. This should make a point many often miss: markets don't care nearly as much about who the president is and what he (or she) says as you might think.

GLOBAL FACTORS, NOT LOCAL

The bigger drivers of the rand are global not local commodity prices and investor sentiment towards emerging markets. Usually, when people refer to 'the rand', they refer to the rand-US dollar exchange rate. It is one of the top 20 most actively traded currency pairs in the world, according to the Bank for International Settlements, which puts it ahead of other countries with larger economies. Due to its liquidity, it's often used as a proxy for other, less freely tradable emerging market currencies by investors. Therefore, our local currency is usually at the top or the bottom of the ranking tables of best or worst performing currencies. Last year it was close to the bottom and a few weeks into 2019 it's close to the top.

Supporting the rand and other emerging market currencies this year has been the pivot in the interest rate policy of the US Federal Reserve (Fed). Expectations of rising US interest rates attracted capital from the rest of the world, strengthening the dollar and weakening other currencies. With the Fed now seemingly on pause, the dollar's upward momentum has stalled too.

Sentiment to emerging markets can be gauged by credit default swap (CDS) spreads. These are essentially insurance contracts against the risk of a bond not getting repaid and, as with all insurance premiums, rise with perceived risk. South Africa's CDS spreads widened during 2018 in line with our peer group, but have narrowed again this year. Currently, the market is pricing Brazil as a lower risk than South Africa, despite the fact that our credit rating is one notch higher. The market seems to be pricing in an upgrade for Brazil or downgrade for South Africa. The enthusiasm for Brazil is based on the reform promises of new President Jair Bolsanaro, especially the reform of the burdensome public pension system. The market rates Bolsanaro's chances of successful reform as higher than Ramaphosa's, which doesn't seem right,as Ramaphosa's party controls the legislature, while Bolsanaro's doesn't.

BREAKING UP IS HARD TO DO

Nonetheless, this was one of the more consequential SONAs in recent years, with a strong focus on reviving the domestic economy, making it easier to do business and tackling corruption. Of particular interest from a market point of view was the announcement that Eskom would be unbundled into separate distribution, transmission and generation entities. This is not a new proposal, as it was first mooted by the government 20 years ago. Together with cost reductions, it marks a first step on the long road to financial sustainability. A failure to implement these reforms, characterised by President Ramaphosa as 'painful', risks crippling not only Eskom, but also the economy as a whole. The big question of how much financial support Eskom will get from the state to manage its debt burden will be revealed at next week's Budget Speech. This, more than any other item, will dominate Finance Minister Mboweni's address.

The challenge is always to turn talk into action, and past SONAs have fallen flat on this score. What is notably different this time is the extent to which government and business are talking to one another. Last week Ramaphosa also became the first sitting president to address the annual Mining Indaba, which along with other recent summits at least demonstrates an intent to work with the private sector.

COMMODITY PRICES

The rand has also benefited from firmer commodity prices this year. This might seem surprising given that commodity prices in general are vulnerable to any slowdown in global growth. However, each commodity has its own supply and demand dynamics. The main four commodities produced in South Africa, according to StatsSA numbers, are coal (24% of the total), platinum group metals (23%), gold (16%) and iron ore (12%).

Gold has found some support with the shift in the US interest rate stance and is above $1300/oz for the first time in a year. Within the platinum group metals (PGM) basket, platinum and palladium had divergent fortunes, as the former is largely linked to production of diesel vehicles, which have fallen out of favour with consumers. The palladium price overtook platinum in late 2017 and has surged ahead this year. StatsSA does not split platinum and palladium production, but based on company reports, the total PGM basked is about two-thirds platinum and one-third palladium. This total basket price has gained in recent months.

The iron ore price plunged from a level of above $140 per tonne in 2013 to a low of $40 dollars in early 2016. This brutal collapse weighed not only on mining activity and jobs, but also on the share prices of Anglo American (through its holding in Kumba) and BHP, the JSE's mining heavyweights. The iron ore price jumped from $65 to $95 since December following the tragic collapse of a tailings dam at a Brazilian iron ore mine. Production has been halted there and at similar mines operated by Vale, the world's largest producer, elsewhere in the country.

So far, the oil market has not reacted much to the imposition of sanctions on Venezuela by the US. Venezuela has the biggest reserves of any country, but production has halved in recent years due to the mismanagement and politicisation of the state-owned oil company. The announced 'major' oil and gas discovery off the Southern Cape coast is estimated at 1 billion barrels, while Venezuela's proven reserves are 300 billion barrels.

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It is too soon to gauge how South Africa's 'Brulpadda' discovery will impact the economy and the rand, because it is still fairly early in the exploration stage. But it sounds promising for a country that imports most of its petroleum needs. Customs data shows imports of mineral products (mostly oil) at R233 billion last year. It is unlikely to lead to lower fuel prices, since even locally produced petroleum would be sold at prevailing global prices (as is the case with Sasol's output).

POUND POUNDED AND EURO TO ZERO

There are a number of currency pairs that include the rand. Apart from the rand-dollar, the most important are the rand-euro and rand-sterling exchange rates. Since an exchange rate is basically a ratio of two prices, it has two moving parts. Developments affecting either economy can influence it. For instance, sterling has been impacted by the evolving Brexit drama. The less likely the UK is to crash out of the European Union without a transitional agreement in place (a so-called 'hard' Brexit), the better the pound has done. This in turn has largely been a function of Conservative Party internal politics, and hence unstable.

Unlike most other currencies, the euro is shared by a number of countries and always vulnerable to unravelling if a member state should leave. While the UK is leaving the European Union, it thankfully was never part of the single currency, so there is no need to redenominate contracts, debts and bank accounts into a new currency. It would be a different matter if, say, Italy left.

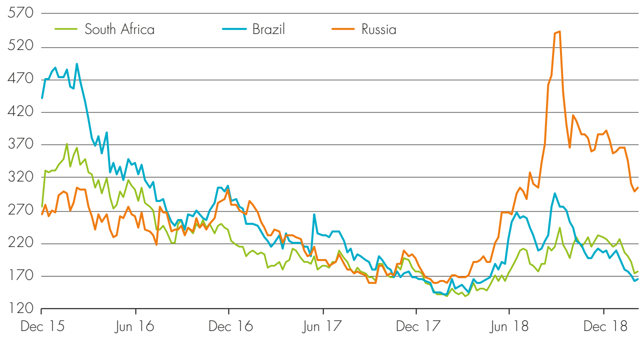
Italy is back in technical recession after two consecutive negative quarters and its real income per head is lower than a decade ago. Moreover, it has a populist coalition government in place. But with more debt (denominated in euros) than any other country in Europe, its exit would cause chaos, especially as Italian banks are the biggest holders of that debt.

RANDS AND SENSE

Finally, how should investors think about the rand's moves? Firstly, the rand has historically been a large inflation driver, but not by as much as generally thought. A stronger rand will typically lower inflation and take pressure off interest rates. It therefore supports bonds and other assets sensitive to interest rates. Secondly, the JSE is dominated by global companies that should in theory benefit from a weaker rand, but it doesn't automatically happen in practice. Last year, the rand weakened 16%, but non-resource rand hedges performed poorly for company or sector specific issues. This year, the JSE is positive despite a stronger rand.

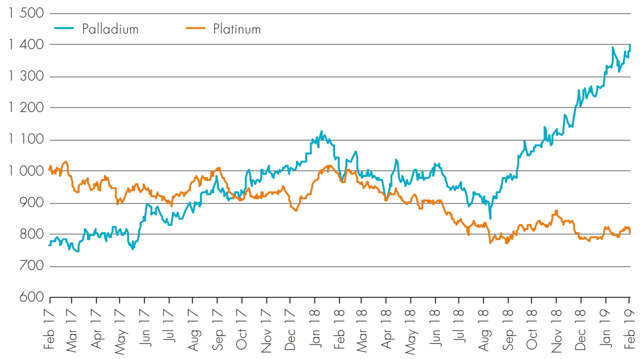
Finally, the direct offshore component of any portfolio should benefit from a weaker rand, all else being equal, but clearly the currency can introduce short-term volatility. There are a lot of moving parts pushing and pulling the currency, and whether it strengthens or weakens from here will largely depend on global factors and much less on the noisy lead-up to the general election on 8 May and its aftermath.

CHART 1: 5-YEAR US$ CREDIT DEFAULT SWAPS



Source: Thomson Reuters Datastream

CHART 2: PLATINUM AND PALLADIUM PRICES. US$/OUNCE



Source: Thomson Reuters Datastream

CHART 3: RAND-US DOLLAR EXCHANGE RATE

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$	2 021.0	-0.44%	-0.35%	7.27%	-1.17%
United States	S&P 500	US$	2 708.0	0.04%	0.15%	8.02%	4.92%
Europe	MSCI Europe	US$	1 561.0	-1.58%	-1.39%	5.05%	-11.36%
Britain	FTSE 100	US$	9 152.0	-0.34%	0.18%	6.60%	-8.27%
Germany	DAX	US$	1 167.0	-3.63%	-3.71%	-3.75%	-19.52%
Japan	Nikkei 225	US$	185.3	-2.39%	-1.89%	-1.23%	-7.96%
Emerging Markets	MSCI Emerging Markets	US$	1 036.0	-1.33%	-1.33%	7.25%	-10.92%
Brazil	MSCI Brazil	US$	2 189.0	-4.62%	-4.33%	12.60%	-0.05%
China	MSCI China	US$	78.1	-0.47%	-0.15%	10.89%	-13.03%
India	MSCI India	US$	551.2	0.17%	0.76%	-1.22%	-8.29%
South Africa	MSCI South Africa	US$	470.0	-4.47%	-5.81%	5.62%	-18.54%

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	53 244.0	-1.27%	-1.69%	0.96%	-5.99%
All Share	All Share (Total Return)	Rand	7 813.0	-1.26%	-1.67%	1.07%	-2.96%
TOP 40/Large Caps	Top 40	Rand	6 875.0	-1.46%	-2.00%	0.67%	-2.94%
Mid Caps	Mid Cap	Rand	15 512.0	-1.51%	-1.08%	1.23%	-5.21%
Small Companies	Small Cap	Rand	18 193.0	-0.47%	-0.70%	1.33%	-10.99%
Resources	Resource 20	Rand	2 748.0	-1.15%	-0.71%	2.07%	23.36%
Industrials	Industrial 25	Rand	12 293.0	-0.92%	-1.95%	-0.98%	-12.91%
Financials	Financial 15	Rand	9 574.0	-3.19%	-3.66%	2.85%	0.65%
Listed Property	SA Listed Property	Rand	1 996.8	-0.27%	-0.71%	8.46%	-7.90%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	483.9	-0.23%	-0.48%	1.03%	-0.16%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	Index Value	Week	Month-to-date	Year-to-date	1 Year
All Bond	BESA ALBI	Rand	650.8	-0.05%	-0.12%	2.78%	7.98%
Government Bonds	BESA GOVI	Rand	644.5	-0.05%	-0.11%	2.86%	7.21%
Corporate Bonds	SB JSE Credit Indices	Rand	102.4	-0.57%	-0.63%	0.49%	-19.95%
Inflation Linked Bonds	BESA CILI	Rand	258.2	0.09%	0.22%	1.88%	4.41%
Cash	STEFI Composite	Rand	414.0	0.14%	0.16%	0.76%	7.25%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	62.1	-1.19%	1.75%	14.94%	-4.51%
Gold	Gold Spot	US$	1 314.0	-0.38%	-0.45%	2.58%	0.31%
Platinum	Platinum Spot	US$	800.0	-2.56%	-2.20%	0.88%	-17.86%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.61	-2.21%	-2.67%	5.43%	-10.58%
ZAR/Pound	ZAR/GBP	Rand	17.64	-1.25%	-1.59%	3.85%	-4.02%
ZAR/Euro	ZAR/EUR	Rand	15.43	-1.13%	-1.71%	6.71%	-3.40%
Dollar/Euro	USD/EUR	US$	1.13	1.77%	1.33%	1.50%	7.96%
Dollar/Pound	USD/GBP	US$	1.29	1.07%	1.21%	-1.10%	7.39%
Dollar/Yen	USD/JPY	US$	0.01	0.21%	0.82%	0.14%	0.92%

Source: I-Net, figures as at 8 February 2019

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ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Quarterly labour force survey
- Manufacturing and mining output
- Retail sales

US

- Job openings
- Inflation
- Retail sales
- Industrial production
- Consumer confidence

EUROPE

- UK Q4 GDP growth
- Eurozone industrial production

CHINA

- Vehicle sales
- Trade Balance
- New loans
- Inflation

JAPAN

- Q4 GDP growth

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