HEADLINES, DEADLINES AND RED LINES

Dave Mohr and Izak Odendaal, Old Mutual Multi-Managers

Geopolitical events are in the spotlight again, as the summit between US President Donald Trump and North Korean leader Kim Jong-Un failed to deliver an agreement and tensions between India and Pakistan over the disputed Kashmir region escalated. However, these types of incidents tend to have limited impact on global markets, barring the outbreak of a full-on war involving major powers.

TRADE TENSIONS DEFUSING

It is a different form of geopolitics – trade policy disagreements – that has weighed on markets over the past year. However, the promise of a resolution in trade negotiations between the US and China has supported the 2019 rebound in global equities. Last week, President Donald Trump claimed "substantial" progress, and agreed to postpone the 1 March deadline when tariffs on $200 billion of Chinese imports were set to jump from 10% to 25%. Trump is expected to meet face-to-face with President Xi to sign the agreement. For most of the past year, the risk of an all-out trade war between the world's two largest economies weighed on investor sentiment, following a series of tit-for-tat tariff increases.

The Americans have four broad concerns with the way China conducts business. Firstly, China has a massive bilateral trade surplus with the US, meaning it exports more to the US than it imports from the US. It has been blamed for job losses in US manufacturing, and Trump sees this as evidence of the US "losing" to China, even though importing a lot also indicates a strong economy with healthy demand.

The second accusation is that China offers excessive protection for its domestic firms against foreign competition, while the US seeks a more level playing field.

Thirdly, China is accused of forcing foreign companies operating there to share technology with local partners. In some cases, there has been blatant copying and disregard for intellectual property rights.

The final concern relates to the rise of China as a leader in next generation technologies such as 5G internet and artificial intelligence under the label of its 'China 2025' industrial policy plan. The China hawks in the White House view this last area as their biggest concern as it threatens US dominance. However, with the US economy cooling somewhat, a volatile stock market and political pressure ratcheting up, it is expected that Trump will push for a deal with China that addresses some of the shorter-term issues, take the political win, and defer the tough long-term strategic battle.

Markets cheered the better news on the trade front. The US benchmark S&P 500 gained 3.2% in February, lifting the return for the first two months to a strong 11.5%. However, it has only barely recovered last year's losses, and the 12-month return is 4.7%. Similarly, European equities returned 4.1% in February and 11% in the first two months of the year in euro. The Japanese Nikkei 225 returned a somewhat more subdued 6.9% in 2019 so far in yen. Emerging market equities lagged developed markets in February, but the return for the year to date is not too far behind. The MSCI Emerging Markets Equity Index returned 0.2% in February in US dollars and 9% year-to-date. Over 12 months, the index is still in the red, with a -9.5% return. The MSCI All Country World Index, comprising developed and emerging markets, returned 2.7% in February, but is slightly negative over the past 12 months.

CARS CAN GO IN REVERSE

Unfortunately, an end to the US-China trade tensions is not necessarily the end of global trade concerns. The US Commerce Department is finalising an investigation into whether imports of vehicles poses a national security risk to the US. As ridiculous as it sounds, the Trump administration last year slapped tariffs on steel and aluminium imports from allies like Canada on national security grounds. A tariff increase on vehicle imports would be massively negative for Europe, and Germany in particular, given its sizable automotive sector.

Globally, car sales have already peaked and come under pressure. This is a contributor to the weakness in global manufacturing that we've witnessed in recent months. The February Manufacturing Purchasing Managers' Index (PMI) fell below the 50 points neutral level for the Eurozone and Japan, and the latest January PMI for China was also negative. The US PMI is still in positive territory, but is also weaker. While manufacturing and trade in manufactured goods is under pressure globally, consumer spending should hold up. In all the major developed economies, unemployment is low or declining and wage growth is slowly rising. At the same time inflation is still low, with the recent oil price weakness putting further downward pressure on price increases.

BREXIT CHAOS CONTINUES

While some of Trump's accusations against Chinese trade policies have merit, they also reflect a different worldview to the one that prevailed in recent decades, namely that greater global integration creates prosperity for all participants. In Trump's mind, if somebody is winning, someone else has to be losing. The reality is more complex: globalisation lifted millions out of poverty and saw massive growth in the world economy, reducing inequality between nations. But within countries like the US and UK, many were left behind, and inequality rose. Technological advances had a similar impact. Looking for scapegoats, many populist politicians pointed to immigration. This brings us to Brexit, the British withdrawal from the European Union (EU).

Last week saw shifting positions as the clock ticks towards the exit date of 29 March. UK Prime Minister Theresa May will put her unpopular exit agreement with the EU to a parliamentary vote this week. For the first time, she has indicated that she is open to seeking a postponement of the exit date to allow for further negotiations. However, it is not clear what good more time will do. The more interesting development is that the leader of the opposition Labour Party, Jeremy Corbyn, has for the first time agreed to back a second referendum, crossing what had been a red line for him. Nobody yet knows how this will play out.

PATIENT POWELL

Of course geopolitics is not the only source of market uncertainty, as investors have fretted over the future path of monetary policy over the past year. Several central banks, most notably the US Federal Reserve (Fed), have called time on interest rate hikes, for now at least. The fear that the Fed would overdo interest rate hikes and the pace at which it was shrinking its holdings of bonds was a big contributor to market volatility. Fed Chairman Jerome Powell's testimony to Congress last week reiterated his newfound patient stance. He also noted that he didn't believe rising wages would cause inflation. Though the US economy is still healthy, inflation is muted (especially with the lower oil price). At the same time growth is slowing in Europe and China. Powell also noted the potential uncertainty caused by Brexit and the trade war. Recent comments from other Fed officials also indicate that it is closer to the end of shrinking its balance sheet (also known as quantitative tightening) than was previously thought. Just as the impact of quantitative easing – the purchases of bonds by the Fed – was probably overstated, so was the impact of quantitative tightening. But it was a source of concern for many investors, who will be happy to see it end soon.

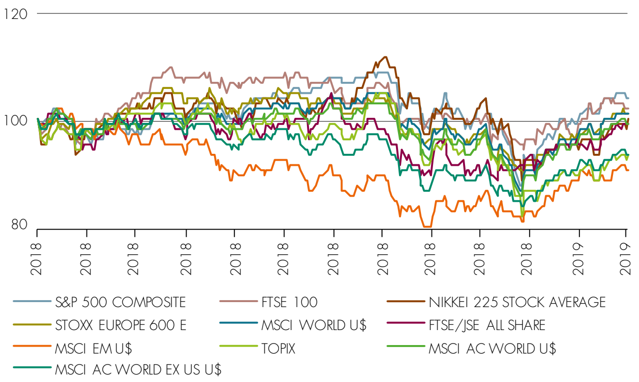
With interest rate expectations shifting across major economies, particularly for the US Fed, the dollar has lost some of its upward momentum. This helped emerging market currencies, and the rand surged 7% against the dollar in January. However, it pulled back 5% in February to end the month at R14.06/$. Over the past 12 months, the rand is 19% weaker against the dollar. Currency weakness therefore supported rand returns from global markets over this period.

Local equities followed global markets higher in February. The FTSE/JSE All Share Index returned 3.4% in February and 6.3% so far in 2019. The one-year number remains negative at -0.9%. Our preferred, less concentrated benchmark, the FTSE/JSE Capped SWIX Index, gained 1.23% in the month. Its -6.2% 12-month return also lags the All Share Index, largely due to a lower exposure to Anglo American and BHP. The general mining index, where these diversified heavyweights sit, gained 9.9% in February, taking the one year-return to 40%.

VALUATION SUPPORTS MARKETS

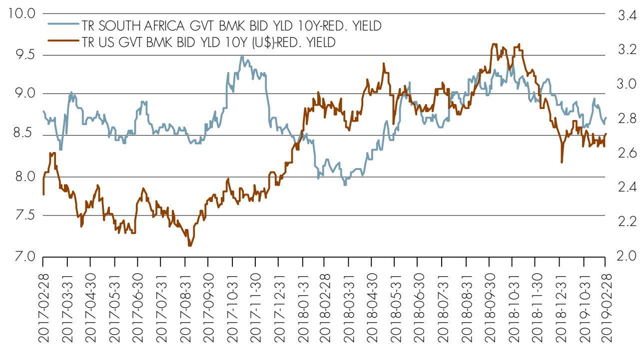
Global equity markets have been off to a flying start in the first two months of 2019. Many commentators have questioned whether this is sustainable as it is unusual to see such an upward surge in share prices when global economic growth has cooled. At any rate, markets never move in a straight line. However, remember that markets are forward-looking and sensing an improvement as the pressure of rising interest rates and trade tensions abate. Importantly, there is still a valuation cushion as share prices fell much faster at the end of 2018 than the deterioration in the profitability of companies. Valuations on global markets are still close to seven-year lows. After all, no one can predict the future. The best approach is to build a portfolio of diversified assets that are reasonably priced and hold them for long periods of time, preferably ignoring headlines on geopolitics and other market noise.

CHART 1: GLOBAL EQUITIES, REBASED TO 100



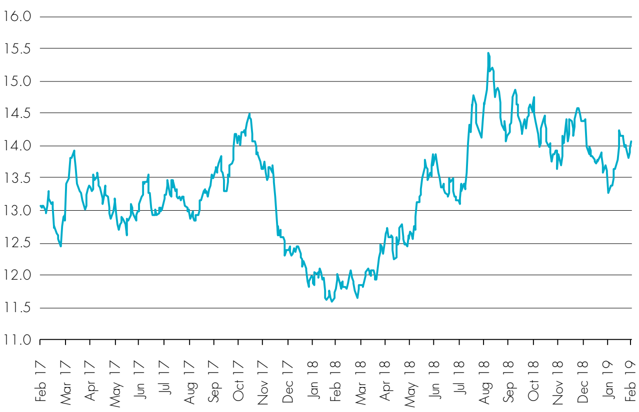
Source: Refinitiv

CHART 2: SA AND US 10-YEAR GOVERNMENT BOND YIELDS, %



Source: Refinitiv

CHART 3: RAND-DOLLAR EXCHANGE RATE



Source: Refinitiv

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 086.0	0.43%	2.86%	10.72%	-1.51%
United States	S&P 500	US$	2 784.0	0.32%	2.96%	11.05%	2.58%
Europe	MSCI Europe	US$	1 632.0	0.93%	3.10%	9.83%	-8.21%
Britain	FTSE 100	US$	9 383.0	0.42%	2.70%	9.30%	-5.72%
Germany	DAX	US$	1 232.0	0.98%	1.65%	1.61%	-14.03%
Japan	Nikkei 225	US$	192.0	-0.96%	1.68%	2.37%	-7.18%
Emerging Markets	MSCI Emerging Markets	US$	1 051.0	0.00%	0.10%	8.80%	-12.05%
Brazil	MSCI Brazil	US$	2 167.0	-1.95%	-5.29%	11.47%	-5.66%
China	MSCI China	US$	80.9	1.15%	3.44%	14.89%	-13.17%
India	MSCI India	US$	546.0	0.89%	-0.18%	-2.15%	-7.30%
South Africa	MSCI South Africa	US$	472.0	0.21%	-5.41%	6.07%	-23.87%

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	56 002.0	0.93%	3.41%	6.19%	-3.98%
All Share	All Share (Total Return)	Rand	8 218.0	0.95%	3.42%	6.31%	-0.89%
TOP 40/Large Caps	Top 40	Rand	7 265.0	0.93%	3.56%	6.38%	-0.34%
Mid Caps	Mid Cap	Rand	16 039.0	0.65%	2.28%	4.67%	-5.30%
Small Companies	Small Cap	Rand	17 826.0	0.32%	-2.71%	-0.72%	-15.26%
Resources	Resource 20	Rand	2 990.1	0.20%	8.04%	11.06%	32.66%
Industrials	Industrial 25	Rand	13 052.0	1.71%	4.10%	5.13%	-10.71%
Financials	Financial 15	Rand	9 734.0	0.22%	-2.05%	4.57%	-2.34%
Listed Property	SA Listed Property	Rand	1 896.0	-1.75%	-5.72%	2.99%	-5.20%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	483.4	0.00%	-0.58%	0.94%	-0.57%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	Index Value	Week	Month-to-date	Year-to-date	1 Year
All Bond	BESA ALBI	Rand	648.7	1.08%	-0.44%	2.45%	4.21%
Government Bonds	BESA GOVI	Rand	642.2	1.11%	-0.48%	2.48%	3.63%
Corporate Bonds	SB JSE Credit Indices	Rand	102.8	0.39%	-0.19%	0.93%	-20.36%
Inflation Linked Bonds	BESA CILI	Rand	256.7	-0.03%	-0.38%	1.27%	1.85%
Cash	STEFI Composite	Rand	415.6	0.14%	0.55%	1.16%	7.26%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	66.4	-0.75%	8.89%	23.00%	2.18%
Gold	Gold Spot	US$	1 324.0	-0.90%	0.30%	3.36%	0.46%
Platinum	Platinum Spot	US$	872.0	5.95%	6.60%	9.96%	-11.02%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	14.09	-0.47%	-5.96%	1.88%	-16.30%
ZAR/Pound	ZAR/GBP	Rand	18.68	-2.09%	-7.07%	-1.93%	-13.12%
ZAR/Euro	ZAR/EUR	Rand	16.02	-0.80%	-5.29%	2.83%	-10.16%
Dollar/Euro	USD/EUR	US$	1.14	-0.88%	0.44%	0.61%	7.02%
Dollar/Pound	USD/GBP	US$	1.33	-1.70%	-1.22%	-3.48%	4.06%
Dollar/Yen	USD/JPY	US$	0.01	0.60%	2.32%	1.63%	4.40%

Source: I-Net, figures as at 1 March 2019

ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Fourth quarter GDP growth
- Markit Purchasing Managers' Index

US

- Non-farm payrolls and unemployment

EUROPE

- Retail sales
- European Central Bank interest rate decision

CHINA

- Caixin Composite Purchasing Managers' Index
- Trade balance

JAPAN

- Household spending

HELPLINE +27 21 524 4430 | **FACSIMILE** +27 21 441 1199 | **EMAIL** ommmclientquery@ommm.co.za | **INTERNET** www.ommultimanagers.co.za