FIVE REASONS TO BE OPTIMISTIC IN 2019

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Last year was a tough year politically, economically and of course for financial markets. Although 2018 started on a high, the mood quickly soured. 'Ramaphoria' brought optimism around South African politics, but policy uncertainty flared up again with the debate around land expropriation without compensation. The first VAT increase in two decades was announced in February. September saw the economy in a technical recession. This just before petrol prices reached a new record level in October. The medium-term budget then surprised the market with news of a R20 billion shortfall in tax revenue due to SARS's bungling of VAT refunds. On top of all this, adding insult to injury, the Reserve Bank hiked rates in November.

As can be expected, markets fell sharply towards the end of the year. Global equities dropped by almost 13% in the final quarter to end the year 9% down in dollars. The local market lost 10% in the three-month period between September and November and the JSE All Share Index ended the year down 8%. This was the first negative calendar year return since 2008.

So why should we be optimistic in 2019?

1. Reduced political uncertainty

South Africa is on the path to cleaner and more competent governance and rational policy-making. For the first time in a decade, it seems we have a president and finance minister, both respected by investors and business leaders, in the same canoe, rowing in the same direction, and rowing in the right direction. Reforms and policy interventions to date support this view and should raise business confidence over time, but a lot of work remains to be done.

Although the pace of change is too slow for many people's liking, President Ramaphosa has been busy. The following key changes have been implemented so far:

- Cabinet changes, particularly the key Finance Minister position
- Commissions of inquiry into State Capture, the South African Revenue Services (SARS) and the Public Investment Corporation (PIC)
- New boards at Eskom, Transnet and Denel
- Reworked Mining Charter finalised
- New National Director of Public Prosecutions
- Investment and Jobs summits signal openness to work with business

The political scene is likely to be noisy in the run-up to the election (to be held around April or May). But once the elections are over, the pace of reforms will probably speed up. Of course no one has a magic wand to fix all our problems and one should be realistic. But as they say, every journey starts with the first step. At any rate, the political turmoil in the US, where the government shut down for almost a month, and the shambolic Brexit process in the UK, remind us that South Africa is not the only country where politics can be uncertain.

2. Oil scare has faded

The oil price rose at the start of 2018, first steadily then ominously. By September, the Brent crude oil price had broken through $80 per barrel and some analysts warned that oil prices could hit $100 a barrel. Worryingly from a local perspective, the rand also weakened as the year progressed, trading above R14 per dollar at the start of the fourth quarter. As a result, the local petrol price hit a record of R17 per litre in October.

The high oil price, however, spurred on US shale oil production, and total American output hit a new record on the way to becoming the world's largest supplier of oil. The combination of record US output, concerns over global demand growth and the market sell-off then saw the oil price slump during the fourth quarter, ending the year at $53 a barrel. Though it has picked up somewhat in January, at these levels it still translates into relief for motorists, milder inflation, less upward pressure on interest rates and a narrower current account deficit. Petrol prices were cut by R3 per litre in December and January.

3. Inflation outlook is still subdued

Apart from the benefit of the lower oil price, the overall inflation outlook is still positive, meaning it should remain within the Reserve Bank's 3% to 6% target range in the coming years. The rand has strengthened below R14 to the dollar again, which should keep a lid on imported price inflation. But more broadly speaking, the tough competitive environment for companies is putting downward pressure on those prices that are subject to market competition and influenced by demand. Companies are reluctant to raise prices, even when their input costs rise, because they worry about losing market share. The only prices that are rising rapidly are those set by the various levels of government (such as electricity tariffs and municipal rates). This should give the Reserve Bank reason to pause on its hiking cycle, after the somewhat surprising November interest rate hike.

4. Economic growth set to improve off a low base

South Africa suffered a surprise technical recession - two consecutive negative quarters - in the first half of 2018 but this ended with a positive third quarter. Economic growth should gradually increase in 2019 and beyond as long as the global economy remains on a sound footing. Though global growth has certainly cooled from early 2018 rates, it is still positive and in line with its long-term average. As we've seen recently, it is entirely possible for South Africa to miss out on a global boom, but it does not work the other way round: we have no hope of strong domestic growth if the global economy splutters.

Locally, consumer spending can increase from 2018's subdued levels supported by real income gains and modest credit expansion. Business fixed investment spending has been depressed for several years and there is significant scope for improvement. This is not just to expand capacity but simply to replace and repair existing machinery, equipment, software and old buildings. The key is improved confidence, as management teams invest when they see a future of rising sales and where there is sufficient certainty that the rules of the game won't change.

The consensus forecast for 2019 is growth of 1.6% which is low compared to the rest of the world, but will amount to roughly double last year's growth rate. The benefit of a low base is that even small changes can be significant.

5. Markets offering value

Meanwhile, after last year's sell-off, equities are also much more attractively priced, and the prospective return outlook has improved even as historic returns have deteriorated. Share prices fell, but the earnings ability of global companies remains intact (even if somewhat less than previously thought), while it should improve for local companies. One of the reasons the local economy has struggled so much is that local companies have relentlessly cut fat out of their operations. The slightest recovery in sales growth can translate into big jumps in profitability. The other reason the local economy has struggled is because real interest rates are high. This is bad news for borrowers but good news for investors in fixed interest.

Keep calm and carry on in 2019

The future is always uncertain and no one has a crystal ball. The one prediction that can be made with confidence at the start of the year is that there will be surprises. That is why diversification is so important. The other important thing is not to panic after a period of weak returns. Now is a good time to remember legendary American investor Howard Mark's two rules for investing. His first rule is that most things on markets are cyclical. The second rule is that some of the greatest opportunities for making or losing money come when other people forget the first rule. The cycle will turn; we just need to be patient.

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