Richard Cluver Predicts

In our 29th year of service to the investing public of South Africa

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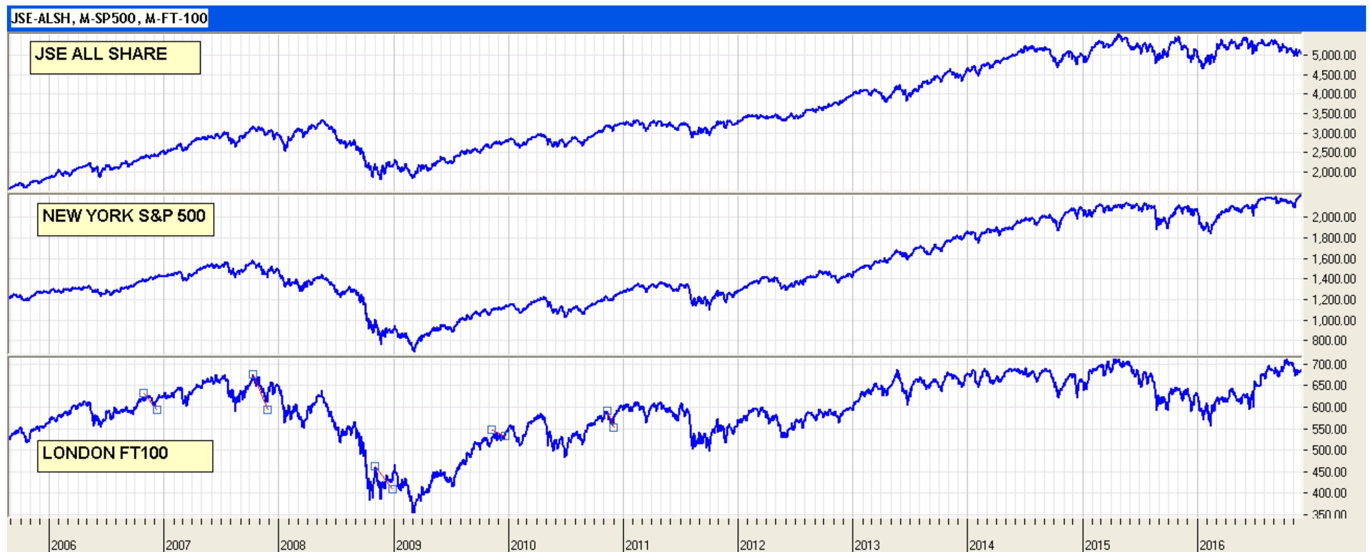
News from the markets is seldom good news these days. But that fact should not depress seasoned investors because this is normal for this time of year. Rather see it as a short-term buying opportunity.

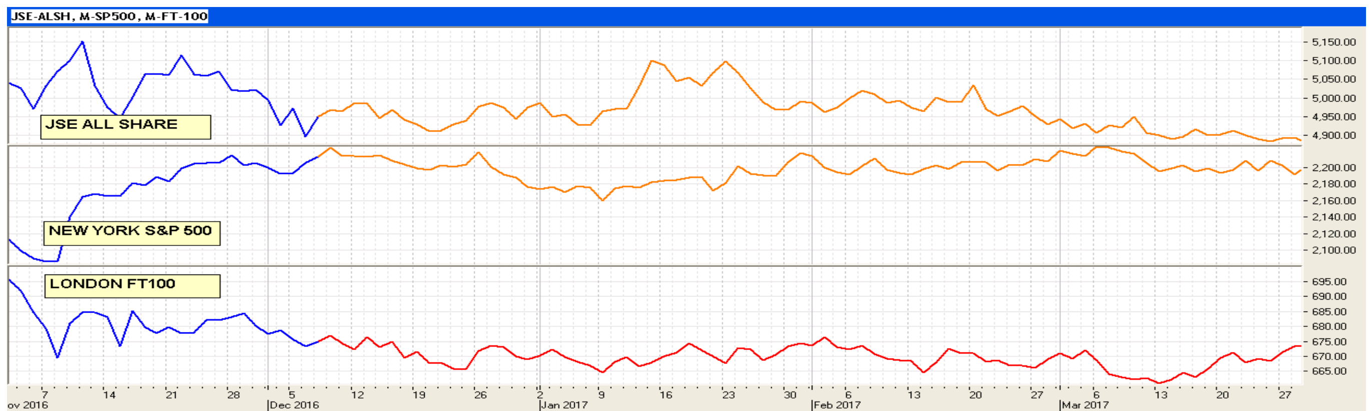
If you care to carefully examine the graph composite below, you will note that in respect of both New York and London, and to a slightly lesser extent, the JSE, markets normally decline at this time of year as brokers and investors clear their desks for the anticipated leisure of the Festive Season.



New York experienced a down-turn in eight of the past ten years. London experienced downturns every year at this time, while the JSE has declined in eight of the past ten.

More importantly, the JSE has recovered, usually quite strongly, in the first three months of each new year. New York has recovered in eight out of the past ten and London has recovered strongly in ten out of ten past years.

So what does ShareFinder predict will happen to these three markets this January? Well, not surprisingly the programme's artificial intelligence projections suggest that all three will recover from approximately January 6 to 9th. However, all three markets are projected to perform only very modestly into the first Quarter with the JSE trending steadily downwards from January 23 onwards.



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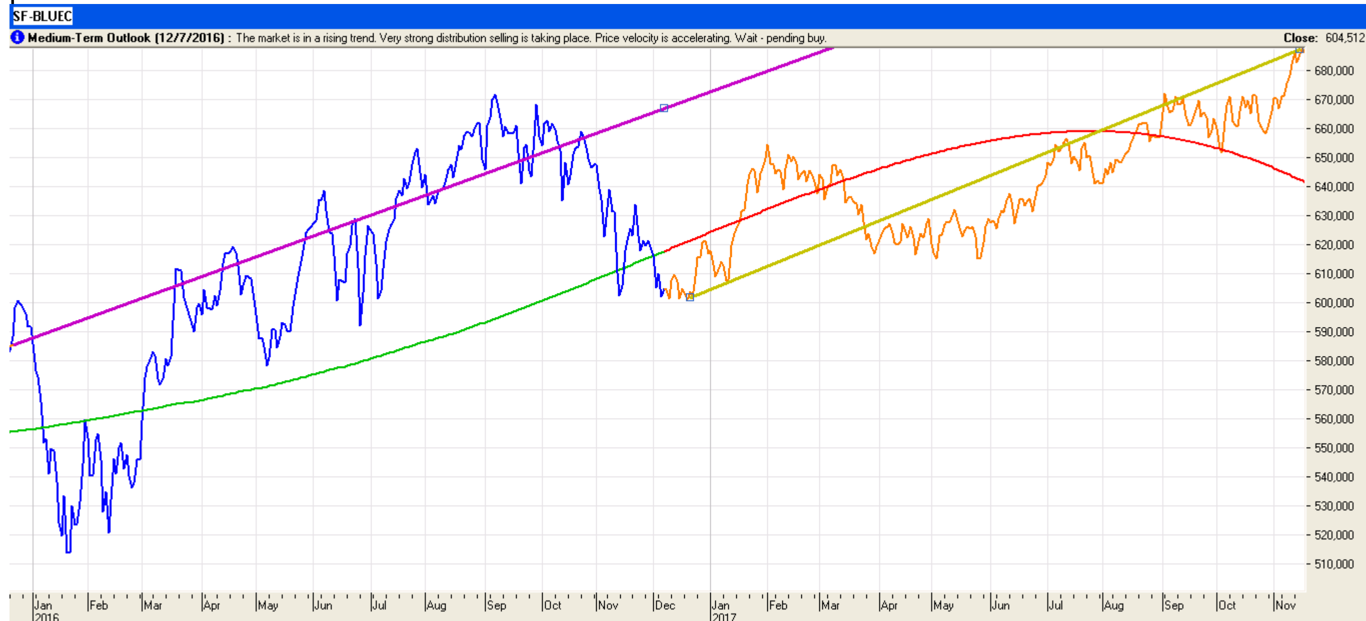
http://www.rcis.co.za
richard@rcis.co.za

Happily, ShareFinder's projections for Blue Chip shares is somewhat better with the probability that market recovery will begin earlier than usual this year and rise in parallel with their ultra long-term trend as traced by the mauve trend line signaling what has happened hitherto and the yellow line signaling what is likely in the future with Blue Chips suggesting gains at an annualized rate of better than 16 percent.



And for the start of the year, ShareFinder sees the resources sector continuing its recovery until March end before going into reverse until mid-August and then resuming their upward trajectory.

Of course all of these forecasts could well be undone if, as some pundits predict, our President in his wisdom decides on another Cabinet reshuffle during the festive season.

The next month:

New York's SP500: The decline I have been anticipating for the past fortnight again failed to materialise and I now foresee the recovery continuing until Tuesday before weakness finally sets in.

London's Footsie: I correctly predicted weakness ahead. Now I see a brief recovery followed by declines from late today.

JSE Industrial Index: I wrongly predicted a recovery until the end of the month followed by a decline until mid-December. The sector continued to fall and is now likely to continue down for the rest of December.

Top 40 Index: I correctly predicted a decline. Now I see a volatile recovery until just before Christmas when weakness again is likely.

The ShareFinder Blue Chip Index: I correctly a predicted a modest and brief recovery followed by a December decline which I continue to expect.

Golds: I correctly predicted the decline would extend well into December and I see no reason to change that view.

The Rand: I correctly predicted a continuing recovery which I expected to continue until mid-December. Now I see weakness beginning in the middle of the week for the rest of December.

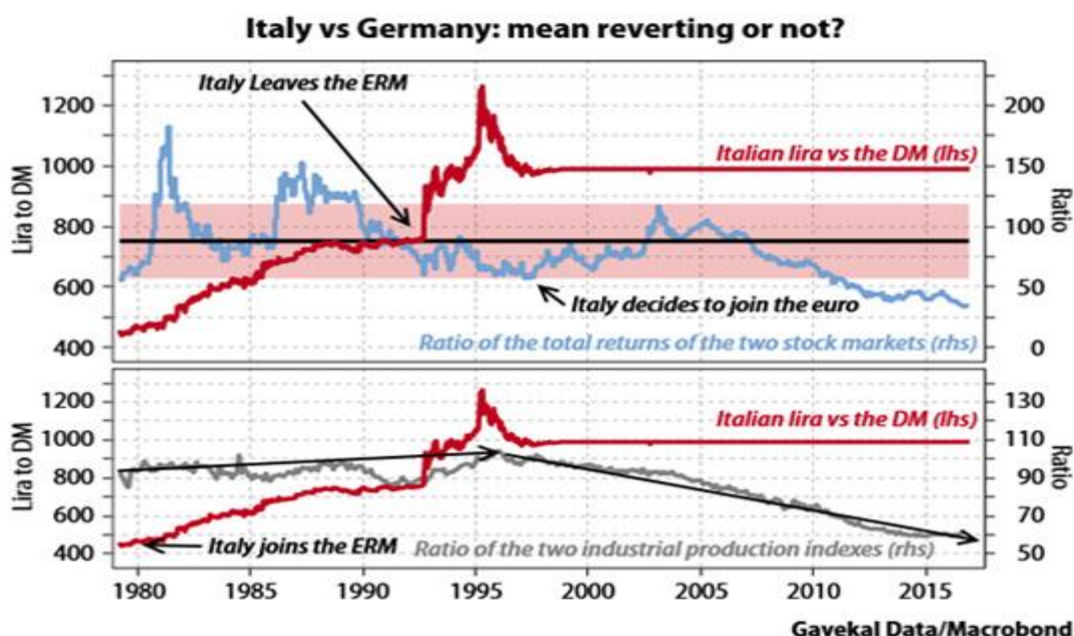
The Predicts accuracy rate on a running average basis over the past 608 weeks has been 83.95%. For the past 12 months it has been 89.64%.

Richard Cluver

Putting the Boot into Italy

By Charles Gave

Matteo Renzi has joined a long line of Italian prime ministers who failed to "reform" their country. This is another way of saying that he could not wave a magic wand and make Italy competitive with Germany. The grim reality is that no Italian leader stood a chance of changing their country once the fateful decision was made to peg its currency to Germany's. At the time of the euro's launch in 1999, I argued that the risk profile of Italy would change from being an economy where there was a high probability of many currency devaluations to the certain probability of eventual bankruptcy. Sadly, that moment is not so far away.



The chart above tells the story of Italy's recent economic history in two parts, namely, (i) March 1979 to March 1999, and (ii) March 1999 to the present. Italy joined the Exchange Rate Mechanism in 1979 at 443 lira per deutschemark, yet by 1990 frequent devaluations meant that rate had slid to about 750 lira.

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richard@rcis.co.za

By the early 1990s, the Bundesbank was overseeing a newly unified German monetary system and in order to fight inflation it had driven real interest rates to 7%. By September 1992 the stresses on the system caused the UK, Sweden and Italy to exit the ERM, which meant another huge currency devaluation, pushing the lira as low as 1250 against the deutschemark, but delivering a huge tourist boom to boot.

Still, from 1979 to 1998 Italian industrial production outpaced that of Germany by more than 10%, while Italian equities outperformed German equivalents by 16% (this indicates that Italian firms were earning a higher return on invested capital than those in Germany).

Then came the euro. By 2003 it was clear that Italy was uncompetitive and subsequently, Italian equities have underperformed German equities by -65%, reversing the previous half century's pattern when Italian equities outperformed on a total return basis. Similarly, since 2003 Italian factory output has lagged Germany's by 40%.

The diagnosis is simply that Italy has become woefully uncompetitive, and as a result, is not solvent. This much is clear from the perilous state of its banking system, which is always the outcome when banks lend to firms that have been rendered uncompetitive by some reckless central banker. Short of imposing Greek-style slavery on Italy, there is not much hope of solving the problem, but I rather doubt that the Italian electorate will be as patient as its neighbors across the Ionian sea.

As such, the relationship between Italy and Germany is radically different from that in the 1945-99 era when a natural return toward equilibrium was achieved through exchange rates adjustments. The only possibility on the current trajectory is that the Italian and German economies keep diverging, which is why a "normal" resolution cannot be achieved.

Hence, an Italian sovereign default of some variety is now a near certainty. While a central bank can address a liquidity problem, it cannot fix a solvency issue, especially one as large as Italy's. The only remedial action that can now be taken is to throw good money after bad, which is exactly what I expect Mario Draghi to do, especially as he played such a key facilitators' role in getting Italy into the euro system in the first place. Such actions – possibly to be announced at the European Central Bank's policy setting meeting – can of course merely postpone the day of reckoning, but will solve absolutely nothing.

The rational approach for investors is to shun Italian financial assets such as bank equities or government bonds until such time as exchange rates are once again market determined prices. This has to be the most well-telegraphed, and now inevitable, national bankruptcy that I have seen in my 45-year career. There is no reason to be dragged under the steam roller as there are many other markets and assets to play in.