



Richard Cluver Predicts

In our 30th year of service to the investing public of South Africa



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I am back from a long trip that took me to Australia and New Zealand, but more properly saw us calling by ship at most of the principal cities in both countries together with a side trip to Tasmania and that very special city of Hobart where the Sidney to Hobart yacht race had just ended.

In the process we twice weathered a Force 9 gale, sailed to 47 degrees South when we rounded the Southern tip of New Zealand (the Arctic begins at latitude 66.5) came close to Maori culture which, like Australia's Aboriginals and our own San people enabled a harmony with nature with which our own know-it-all society has yet to form even a dim understanding.

More importantly so far as my readers are concerned, I got to discuss the economies of those far off countries which are probably more interlinked with China than they are with the West. New Zealand, the often forgotten nation of just 5-million people whose principal northern airport at Auckland is nearly on the same latitude as Cape Town (Auckland lat 36 South Cape Town 33 South) is blessed with low international debt, low population density, abundant water, high education levels and above all scenic magnificence and a warm friendly people. It is where I would urge my grandchildren to make their home. I will write more about all of this in a forthcoming issue of The Investor.

Back here in the real world, however, economic events look to be at a turning point with ShareFinder's projections for Wall Street signaling that the time for a share market down-turn has arrived. Surprisingly, however, I have watched those projections change in recent months from a very sharp and protracted fall to a much more modest decline which is in keeping with a marked improvement in global perceptions.

Quite the best summary of the global outlook was published this week by Investec whose John Wyn-Evans is their Head of Investment Strategy at Investec Wealth & Investment UK.

There is broad agreement that global growth is the strongest since 2010 and still accelerating. It also appears to be relatively evenly distributed. There is less consensus about the second order effects of that growth, especially what will happen to inflation, and that will probably be the most important factor for investors.

According to consensus data from Bloomberg, the median forecast for Global GDP growth in 2018 is currently 3.7%, a small tick up from the 3.6% forecast for 2017. The 2018 forecast is up from 3.4% at the start of 2017, and the upgrades really started to come through during the summer. All major economies are feeling the benefit. The US growth forecast has accelerated from 2.3% to 2.6%; Europe from 1.6% to 2.2%; Japan from 1% to 1.3%; China from 6.3% to 6.5%. Only the UK (1.3%), has failed to join

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the party, although at least the worst fears of a Brexit-related collapse have not been met. So, what's going on?

I would contend that there are three major factors behind this uptick in growth. The first, and possibly easiest to see, is the rebound in commodity prices and global trade. Although commodity prices bottomed out as far back as the first quarter of 2016, they really only started to accelerate again in the second half of 2017, driven by a combination of increasing demand and constrained supply. Investment in commodity production capacity collapsed along with prices and just the absence of that negative effect shows through as a recovery in growth. Global trade is closely aligned with the trend of commodity prices.

Second is the passage of time since the Great Financial Crisis (GFC). The further we move away from that event, the more the scars heal, both psychological (investors) and financial (banks). Following the Tech Bust, the GFC and the euro zone crisis, many an investor's mindset had reached the point where "crisis" was becoming "business as usual". The memory of pain is slowly fading. Indeed "FOMO" (fear of missing out) is in the ascendant. The wounds of the financial sector have been repaired by surgery. Banks have recapitalised by raising equity and shedding assets, and are now generally profitable and in a better position to lend. Households are also in better health as they have been less dependent upon credit at the same time as household assets (house prices, investments) have risen.

Finally (and I acknowledge this is not an exhaustive list) China has been a beacon of stability. We thought this would be the case ahead of the Party Congress in October, as the leadership would want to show itself in the best possible light at what is the biggest political event in a five-year cycle. If anything, we were further impressed by China's commitment to maintain stability. Very simply, the country's leaders have an agenda that promises to give it a much bigger role in the world, economically and politically. They know they have a better chance of achieving their ambitions with a more stable economy.

So what's the problem with all this growth? The fear is that too much "boom" will lead to a "bust". Busts don't usually materialise out of thin air. And old market saying has it that economic expansions and bull markets don't die of old age – they are murdered by the Fed (Federal Reserve Bank). Indeed, looking at US stock market data going back to the 1920s, we find that only twice have US equities suffered a bear market – a fall of 20% or more – without a recession. These were in 1963, when the main reason seems to have been fear of nuclear war during the Bay of Pigs affair, and in 1987 when the stock market crash was fuelled by the use of "portfolio insurance" products. Slightly worryingly, both of those periods have a possible equivalent today. The tensions on the Korean Peninsula are well documented, although mercifully slightly less worrisome than they have been. Then there is the proliferation of computer-driven trading strategies, "short volatility" products and huge growth in Exchange Traded Funds to contend with. Quite how these will act during a period of greater market stress is the subject of some debate, but there is a definitely a concern that they will exacerbate any downward momentum.

But the main focus for any murder enquiry will have to be the central banks. They have the power to raise the cost of funds and to withdraw liquidity from the market. The main reason for taking this action will be if they detect an overheating of the economy – something that will become visible in wage and (ultimately) consumer price inflation. This is where the economics community fails to find a consensus. Inflation has been notable by its absence in recent years (with the standout exception of the UK, where sterling's devaluation has led to sharp price rises). Economists are split into two camps. The Inflationist believe that it is only a matter of time before the historical relationship between monetary growth, economic growth, wages and inflation reasserts itself. They believe that the post-GFC period of stagnant growth is purely cyclical. On the other side are the Deflationists, who believe that ageing, shrinking populations and the implacable march of technology will continue to dampen wage and price pressures. We remain agnostic. Being wed to one philosophy can be very painful if it turns out to be the wrong one. We, like central banks, will

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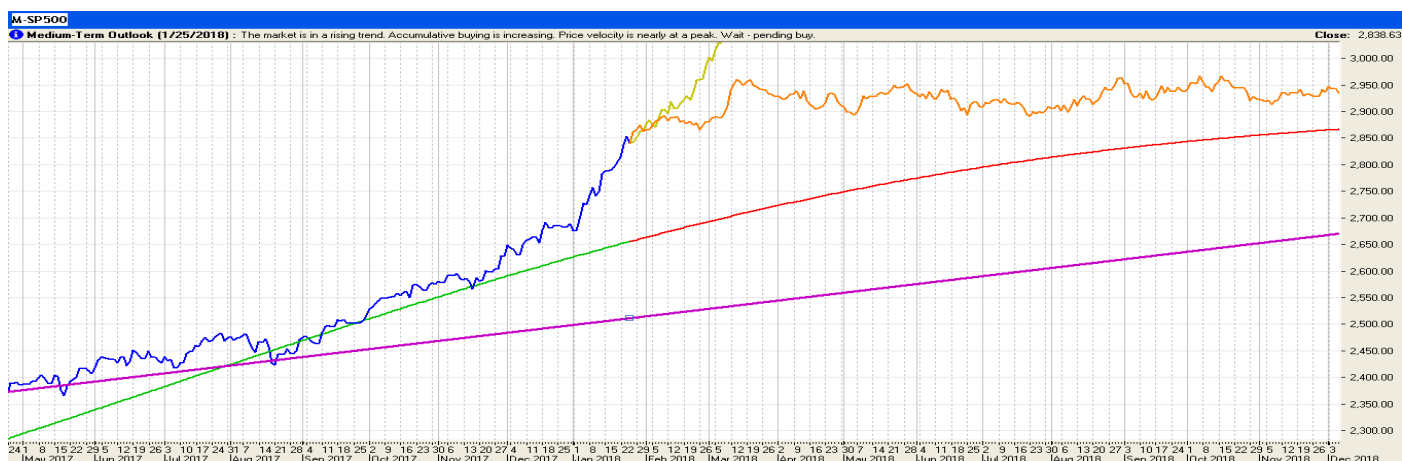
have to judge the data as it develops.

***John Wyn-Evans is Head of Investment Strategy at Investec Wealth & Investment UK. The Weekly Digest is an Investec Wealth & Investment UK publication**

Turning to the markets this week, the critical one, of course, is always New York's S&P500 Index which sets the tone for the whole world, so consider the graph below which depicts the past nine months of performance, noting in particular the purple line which defines the long-term trend. This trend line defines the entire history of Wall Street's longest-running Bull market which has been defined by the US Federal Reserve's money-printing strategy. That line has been rising at 9.5 percent compound at a time when, until very recently, the US economy was virtually stagnant.

It represents, in fact, the triumph of optimism over realism. Moreover, the fact that the blue day-to-day trace of the graph has pulled significantly away from the trend line as it surges into the stratosphere, is final proof of the feeding frenzy that is gripping market speculators.

It is a bubble that just has to burst and, ShareFinder projects that the first serious tremor will occur sometime between March 7 and 14. That is when the yellow short-term projection line tops and the red medium-term line turns downwards. ShareFinder suggest that this correction will last until the last few days of July before resuming its upward trend until mid-October.



Meanwhile, the inflation adjusted price earnings ratio of the New York stock exchange continues to inch higher, standing today at 48.59 compared with its highest ever level of 56 immediately ahead of the Dot Com bubble bursting in 2000 which precipitated the biggest crash in recent market history. Yet a survey of Wall Street traders suggests that they have never been as bullish.

Clearly we are riding for a fall – as some analysts have predicted – for the mother of all bear markets.”



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The next month:

New York's SP500: I wrongly predicted a January retraction. Now I don't expect it until March.

London's Footsie: I correctly predicted a brief up-tick which could continue, but with much volatility, into the first week of January and that from there on in it would be down all the way! That decline is under way.

JSE Industrial Index: I correctly predicted gains into mid-January. Now I see them lasting until mid-February.

Top 40 Index: I correctly predicted things would run up until the middle of January and, if Cyril got the nod it would continue up. Now I see further gains until February 14.

ShareFinder Blue Chip Index: I correctly predicted a recovery into January and now I see it continuing until mid-February.

Gold shares: I correctly predicted a short-term decline followed by gains which I now see running out of steam between now and mid-February.

Gold Bullion: I correctly predicted the beginning of a decline followed by a fairly sustained recovery which I now see running out of steam between February 7 and 13.

The Rand: I correctly predicted fresh gains in the New Year and they seem set fair to continue for most of this year touching R10.92 to the Dollar by next Christmas.

The Predicts accuracy rate on a running average basis over the past 643 weeks has been 84.39%. For the past 12 months it has been 91.07%.

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