Our Weekly Paid Newsletter

Richard Cluver Predicts

In our 35th year of service to the investing public of South Africa

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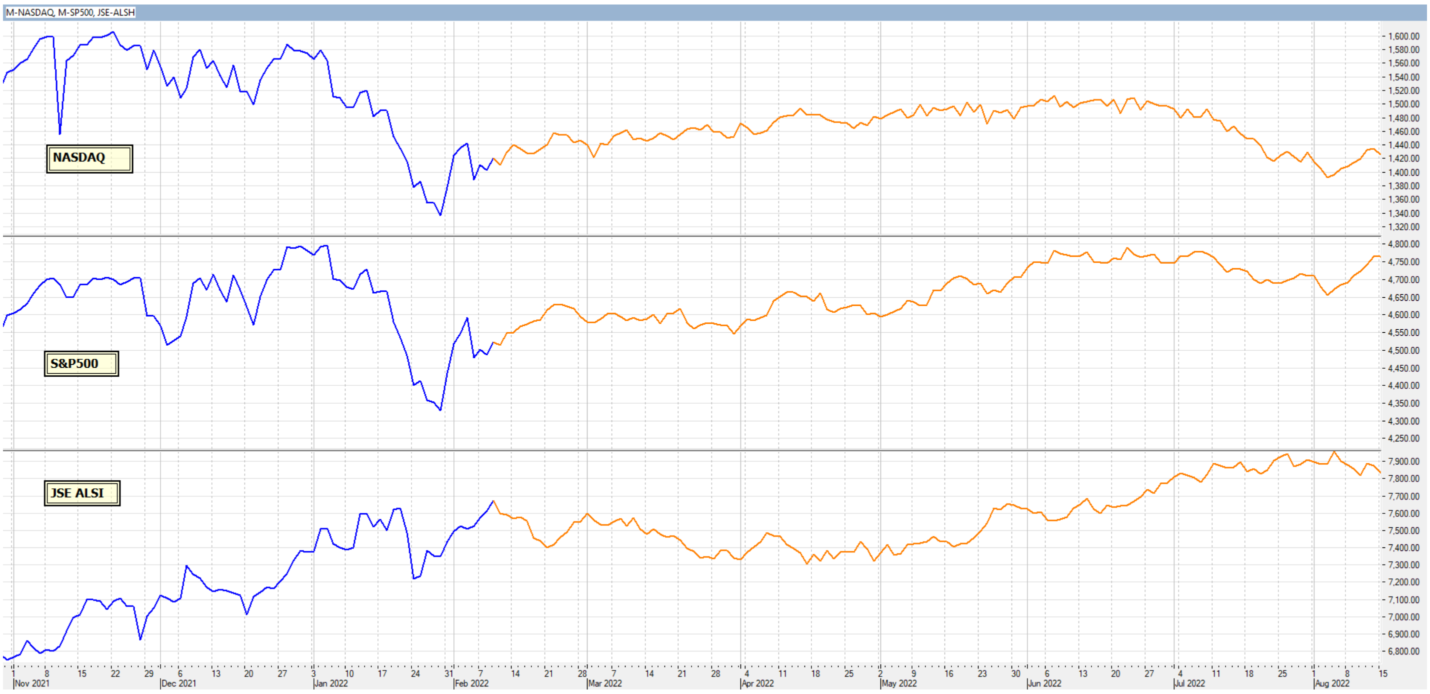
A strange thing is happening with the JSE! Can it be that it has disconnected from overseas markets as it continues to race ahead to ever new highs at a time when major markets are seriously signaling that the end of the longest-ever bull market might be in sight?

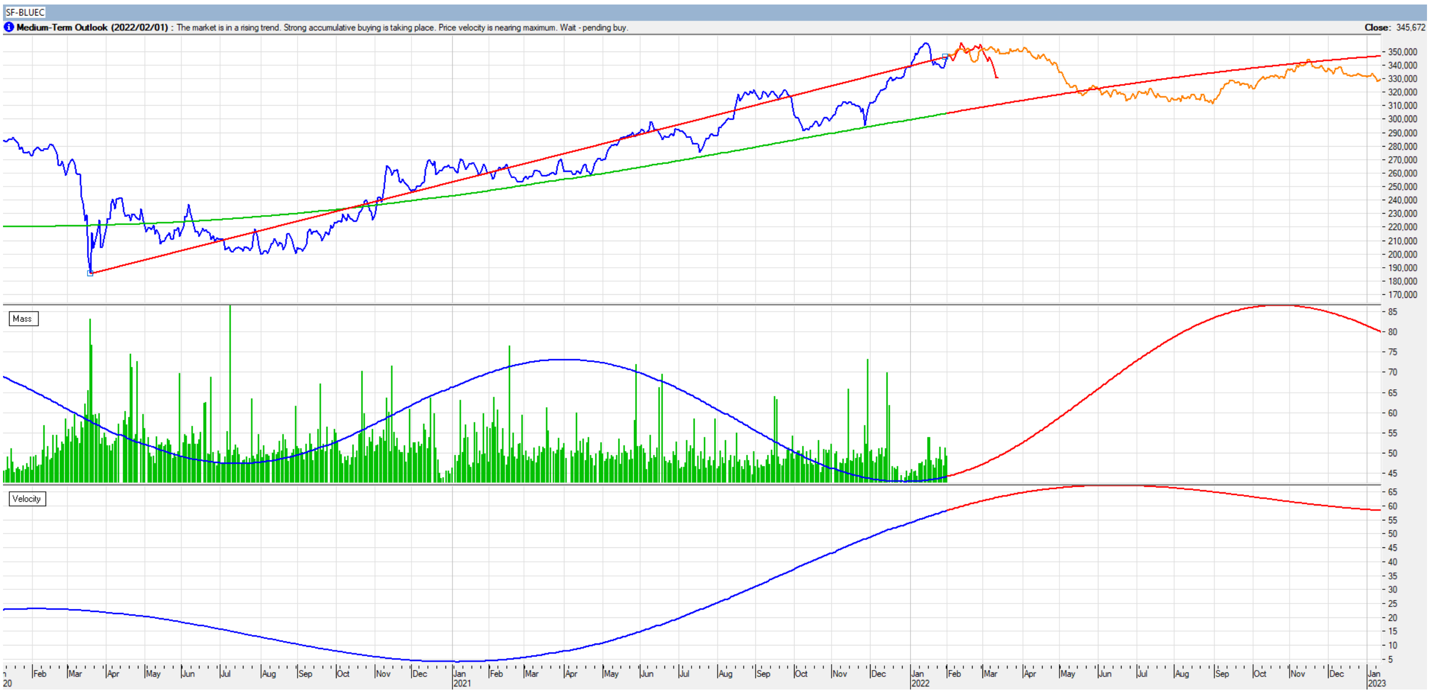
Noting that Wall Street's Nasdaq (which houses many of the tech counters which have been making most of the running for years) was down 11.6 percent from its November 22 peak until it began a modest recovery on January 31, and that the world's biggest market indicator, New York's S&P500 Index was down 9.74 percent from a January 5 peak, the third graph in the composite below makes it clear that the JSE has just continued running.



Admittedly, ShareFinder's orange projections suggest a better two-month outlook for US markets than it sees for the JSE. Furthermore, the projections suggest that US markets will continue rising from here on forward at something like twice the local growth rate.

Indeed, the Nasdaq has achieved twice the growth the JSE managed over the past 13 months, and so the present interim strength does not stand for much unless you compare the universal gloom with which most South Africans view our economy with the positive optimism that prevails in the US right now. Are we being too pessimistic?

Even more surprising is my second graph composite which tracks JSE Blue Chip shares which have been rising at compound 39.5 percent since the March 2020 market bottom. That is only a tad less than the 44 percent compound average growth rate of the S&P500 over the same period. Furthermore, if you consider the various indicators forecasting the outlook for local Blue Chips, only ShareFinder's future projection system is negative from now until the end of August:



Noting that trading volumes of the Blue Chips have been rising at a startling compound average annualized rate of 650 percent, one might almost be tempted to argue that the JSE is being overwhelmed by an optimism twice that of the wave of pessimism which overcame us during the opening months of 2020.

All things are relative of course so it is useful to note that South African Blue Chips stand at an earnings yield of 10.6 percent while their Wall Street equivalents stand at only 3.6 percent which, simply stated, means local shares are priced at a third of the value of their Wall Street equivalent.

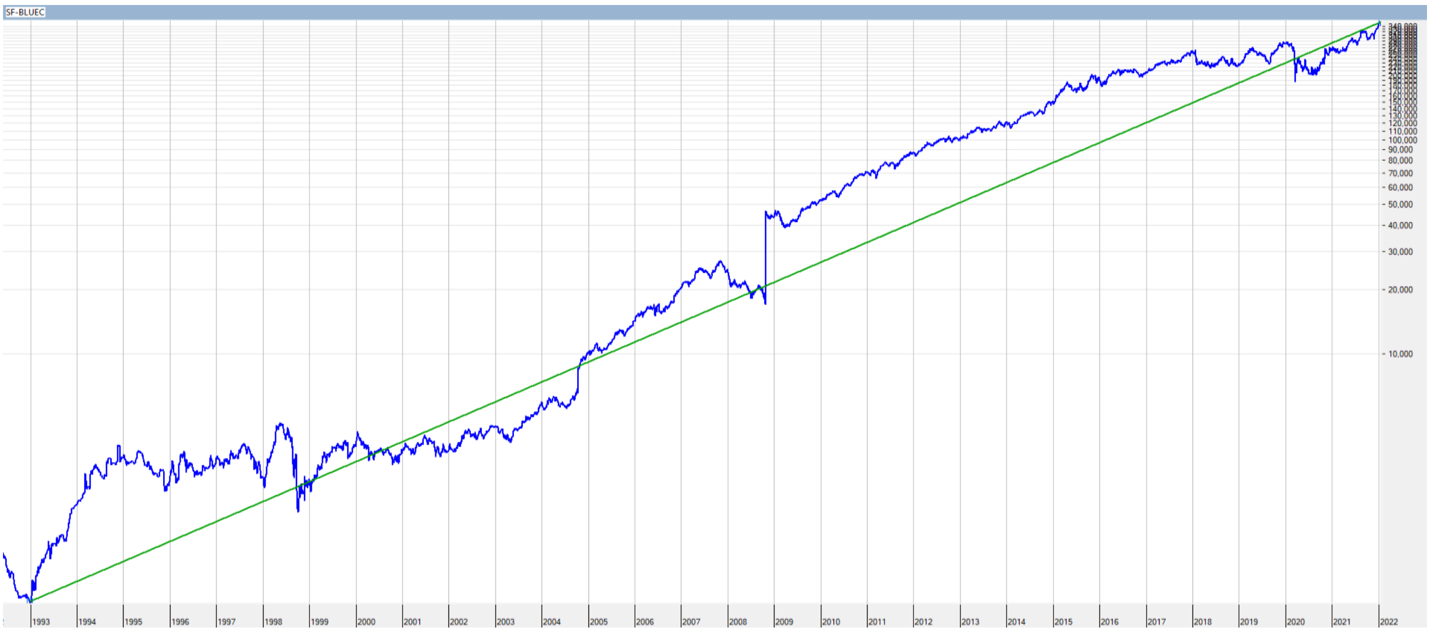
They offer a ten-year average dividend growth rate of 32.99 percent compared with Wall Street's 11.77 percent which supports the above view that the best SA shares offer three times better value than their US equivalent.

Coming on the back of the fact that the South African Rand was one of only four emerging-markets **not** to have weakened against the dollar last year despite the prospect of capital flight when the US Federal Reserve starts rolling back its stimulus, it is important to remember that foreign investors hold about 30 percent of South African government debt which makes the country particularly vulnerable to a selloff.

However, to date there has been no sign of the Rand weakening. To the contrary, my next graph illustrates how the Rand has gained steadily in strength since the start of this year when it stood at R16.16 to the US Dollar. Since then it has been gaining at a compound annual average rate of 23.6 percent with ShareFinder projecting that it is likely to reach R14.5 by the end of June. Should it manage that, the light-green trend line suggests that strengthening will have occurred at a compound annual average rate of 17.2 percent.

So where does that put my long-term strategy which has been to accumulate cash ahead of buying opportunities ahead? Well I remain content to hold onto considerable reserves of cash in my overseas portfolios because I find it incomprehensible that the long-term bull run can endure in the face of central banks everywhere beginning to raise interest rates and their ending of the Covid 19 era of financial accommodation as they begin a strategy of warding off the now steeply-rising rates of monetary inflation that they were responsible for.

I think, however, that South Africa might be an exceptional situation simply because investor pessimism has been overdone. In that sense, I think my last graph is quite instructive. It plots on a log scale the entire course of JSE Blue Chips during the era of the ANC Government during which, as the green trend line makes clear, they have delivered average annual growth of 23.9 percent and on average delivered a dividend growth rate of 33 percent annually.



By that test alone they have remarkably rewarded investors and, as the difference between dividend growth and share price growth underscores, they have some significant catching up to do if only the ANC can deliver on Cyril Ramaphosa's eternally optimistic promises.

Team Ramaphosa knows that the very future of the ANC depends upon how they acquit themselves between now and 2024. Most South Africans have all but given up hope that they can turn the ship of state around, but the graph indicates that, notwithstanding their perceived incompetence, our private sector has nevertheless retained its excellence. Given an enabling environment over the next few years there is clearly some remarkable potential remaining!

Imagine if Cyril were to ditch his "party unity" strategy and go for economic growth. We could be unstoppable!

The month ahead:

New York's SP500: I correctly predicted the weakness would be over last Friday and I still expect the recovery to last until the third week of February when I expect another month-long retraction.

Nasdaq: I correctly argued that the retraction was now over ahead of volatile gains until early June.

London's Footsie: I correctly predicted the present recovery was a short-term thing in a longer-term declining trend which I believe is about to resume until early April when I expect a two-month recovery before things head south again.

Germany's Dax: I correctly predicted a brief recovery within a volatile decline which I expect to last the whole year. Now I see a few days of losses followed by gains until early March and then down again to May.

France's Cac 40: I correctly predicted a yo-yo somewhat downward trend for most of the year. I also correctly expected brief weakness until the second week of March ahead of a month of gains and then further declines.

Hong Kong's Hangsen: I correctly predicted gains until mid-May followed by a two-month decline followed by a protracted recovery.

Japan's Nikkei: I correctly predicted a continued decline until late April when a sharp recovery appears likely.

Australia's All Ordinaries: I correctly predicted a brief recovery which I expected to last until late February before the decline resumes for most of the year.

JSE Top 40 Index: I wrongly predicted weakness which I expected to last until late May when a longish rally appeared likely. However I believe the prediction was merely premature and likely to start almost immediately.

ShareFinder JSE Blue Chip Index: I correctly predicted weakness to the end of January ahead of another last rally which might well end today ahead of declines until late August.

Rand/Dollar: I correctly predicted a recovery which I still see lasting until the end of June.

Rand/Euro: I correctly predicted weakness until early March ahead of gains from then until late October.

BUSINESS MAVERICK

SONA BY (DEPRESSING) NUMBERS

What the hard data reveals about the true state of the nation (spoiler alert: not good at all)

By Tim Cohen

Small lakes of ink have been used in writing about the political challenges that face President Cyril Ramaphosa at his fifth State of the Nation Address (Sona) on Thursday. But what is his factual position? What does the data show? What are the numerical challenges that he faces? Here are some of the key numbers.

Theories about the direction in which South Africa should go or will go or have gone are as plentiful as Eskom's load shedding. But what are the facts?

Fortunately, they are at hand because some of the most well-known figures in development economics, led by Ricardo Hausmann, have just published a paper on the South African economy over the past decade through the United Nations University World Institute for Development Economics Research.

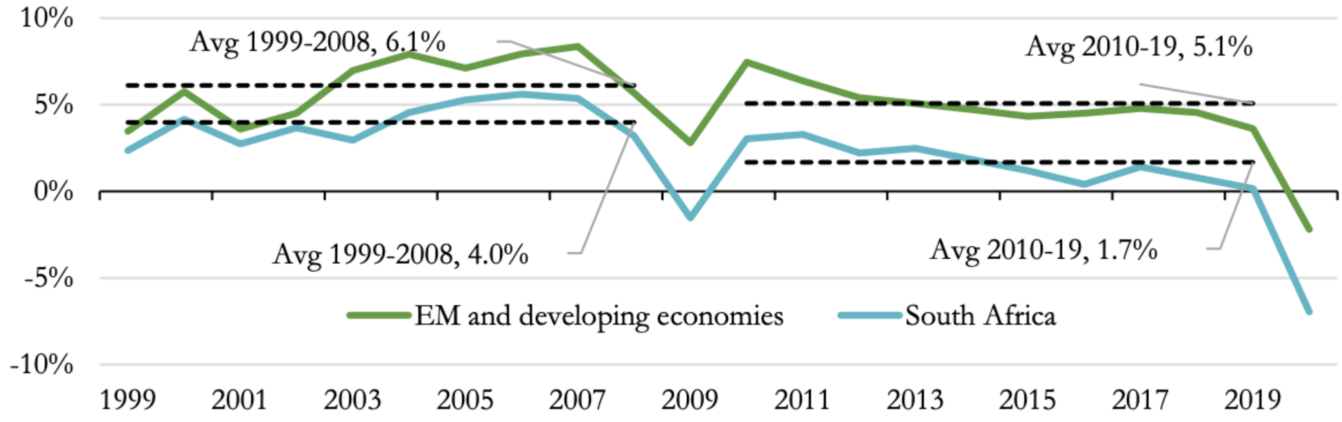
We all know the general picture is bad, but prepare to be really depressed. The research is aimed at discovering the reasons why SA grew barely at all for a decade and it poses three possibilities:

1. An external story — the end of the country's growth and the fiscal consequences of the end of the commodity supercycle.
2. A macro story — SA's debt build-up and macroeconomic failures.
3. A microeconomic story — the persistent loss in productivity in the economy and the investment slowdown triggered by microeconomic policies.

But let's leave that for another day and focus on what actually happened, in detail, in data.

The big picture is clearly bad, but it's worth noting that even before the financial crisis, South Africa was underperforming on the average global developing country growth rate. After the financial crisis, the country's position declined, and the gap between SA and the developing world universe got larger.

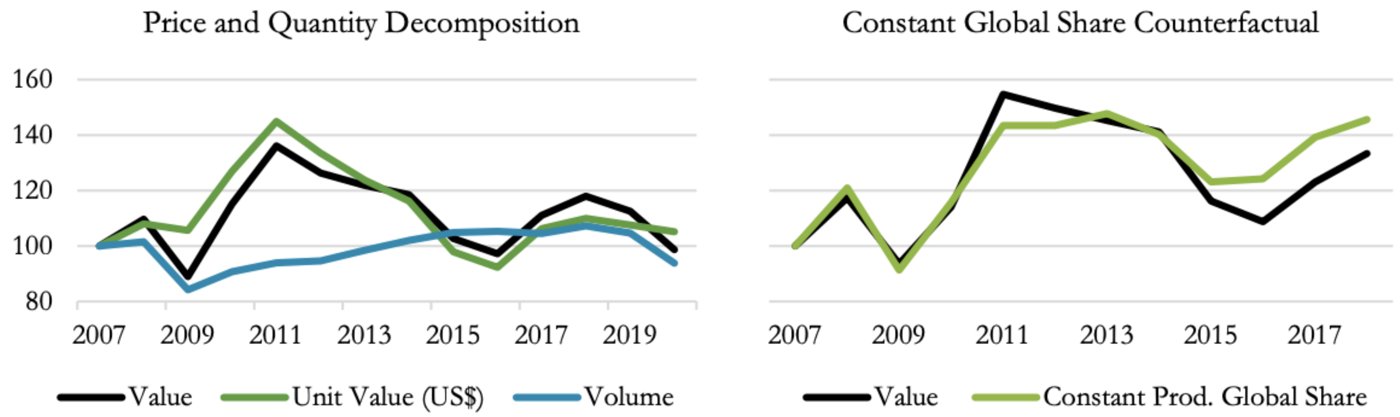
Figure 1: Real gross domestic product growth: annual percentage growth



Source: IMF data.

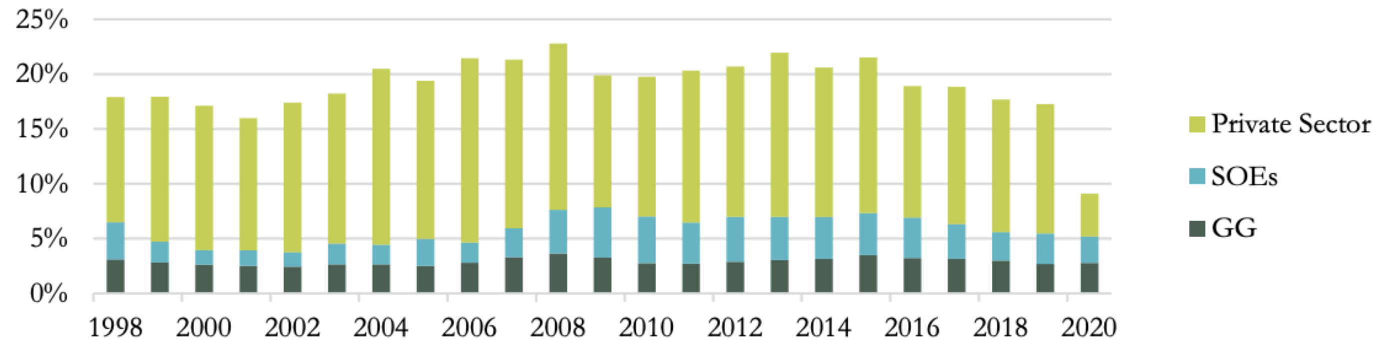
Superficially, the problem was not exports, which were flat in volume and value over the period. But this view is deceptive because relative to the rest of the world, SA was falling behind.

Figure 2: Exports of goods and services



Investment held steady for the first few years after the financial crisis, but then steadily declined.

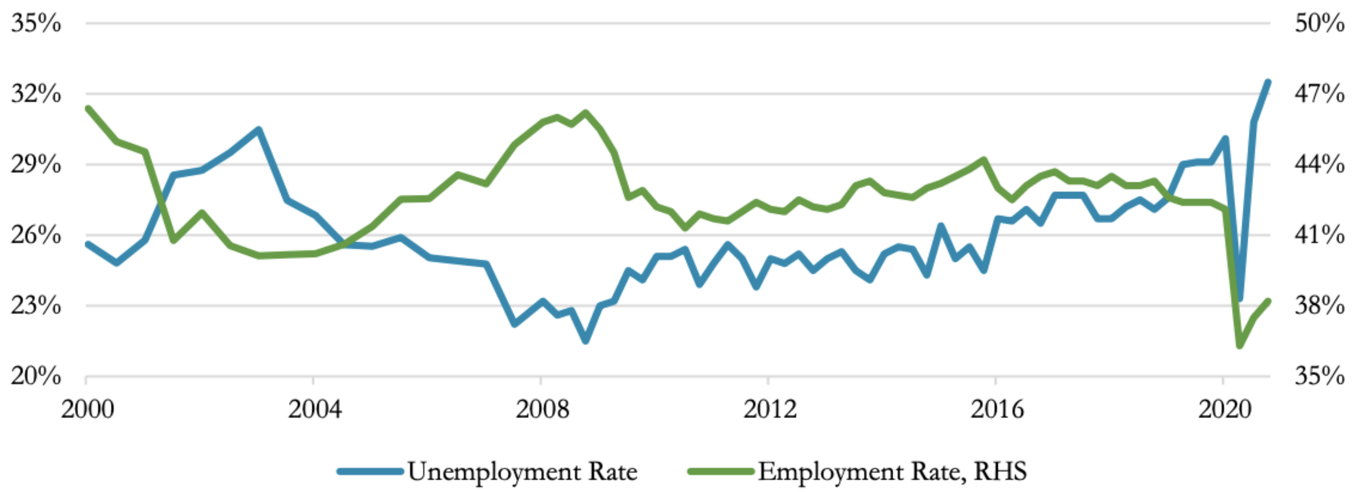
Figure 3: Investment by sector, percentage of GDP



Source: authors' illustration using SARB data.

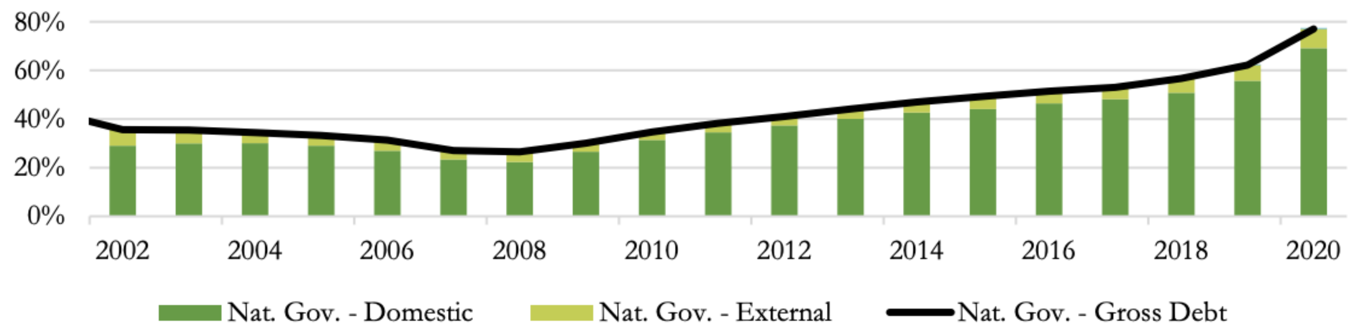
The real shocker was what happened to the unemployment rate and its converse, the employment rate. In its slightly laconic way, the report says: "[South Africa's] labour market indicators have deteriorated notably in the last decade and are amongst the worst in the world."

Figure 4: Employment and Unemployment Rate



And here is one of the big culprits: the government just continued to spend more and more. But what is worse, even though it was spending more, the investment portion of that expenditure got smaller and smaller. If you want to know why SA's roads are full of potholes and the traffic lights don't work, this is where you see it.

Figure 7: National government debt level, valued at face value: percentage of GDP

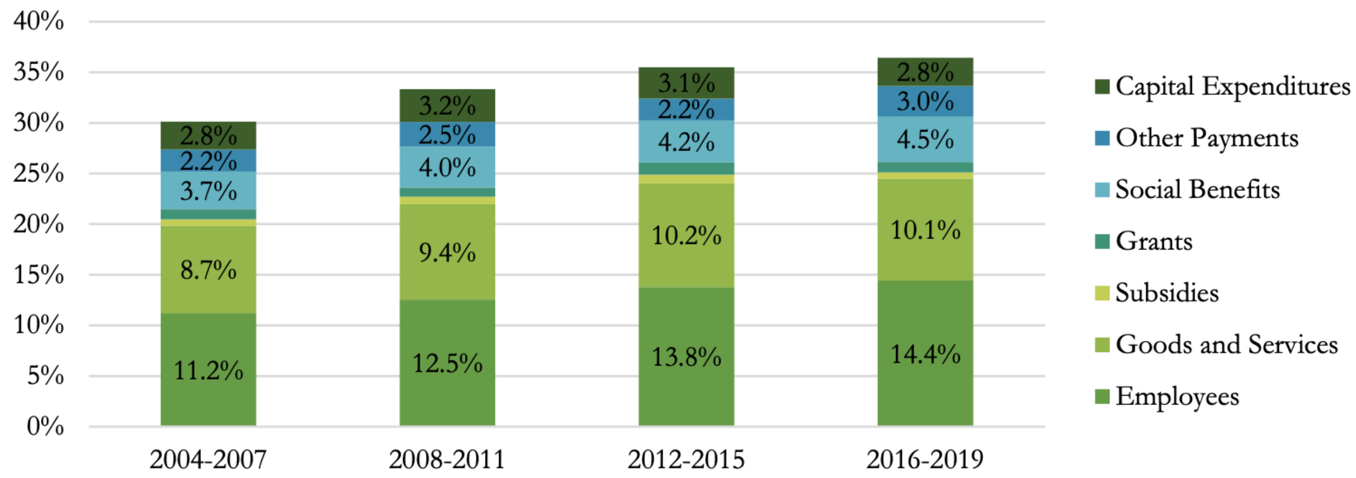


Source: authors' illustration using SARB data.

And what happens when you spend more than you take in? Your debt increases. And so it turned out in South Africa: the country's government debt burden rose from just 27% of GDP in 2008 to 62% in 2019, an increase of 35 percentage points in 11 years. It's now sitting at around R4.2-trillion, and South Africa is spending about R303-billion annually just to service the debt, a little below R1-billion per day — and this, as the research points out, is despite the Treasury frantically pushing the debt out to reduce immediate payments.

How was this money spent? This graph shows how the spending patterns changed over time, with payments for government employees and grants increasing, squeezing out investment spending.

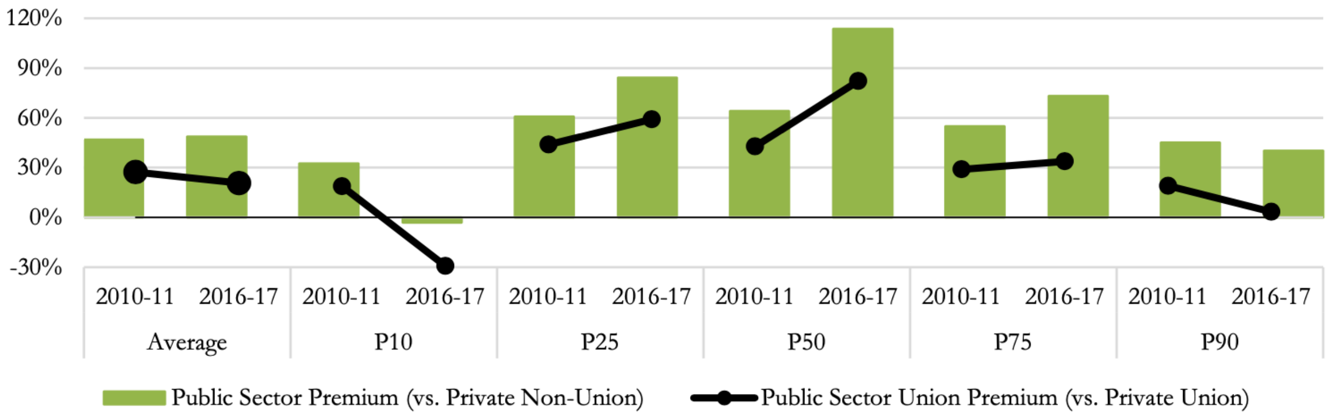
Figure 9: General government primary expenditures: percentage of GDP, period average



Source: authors' illustration using SARB data.

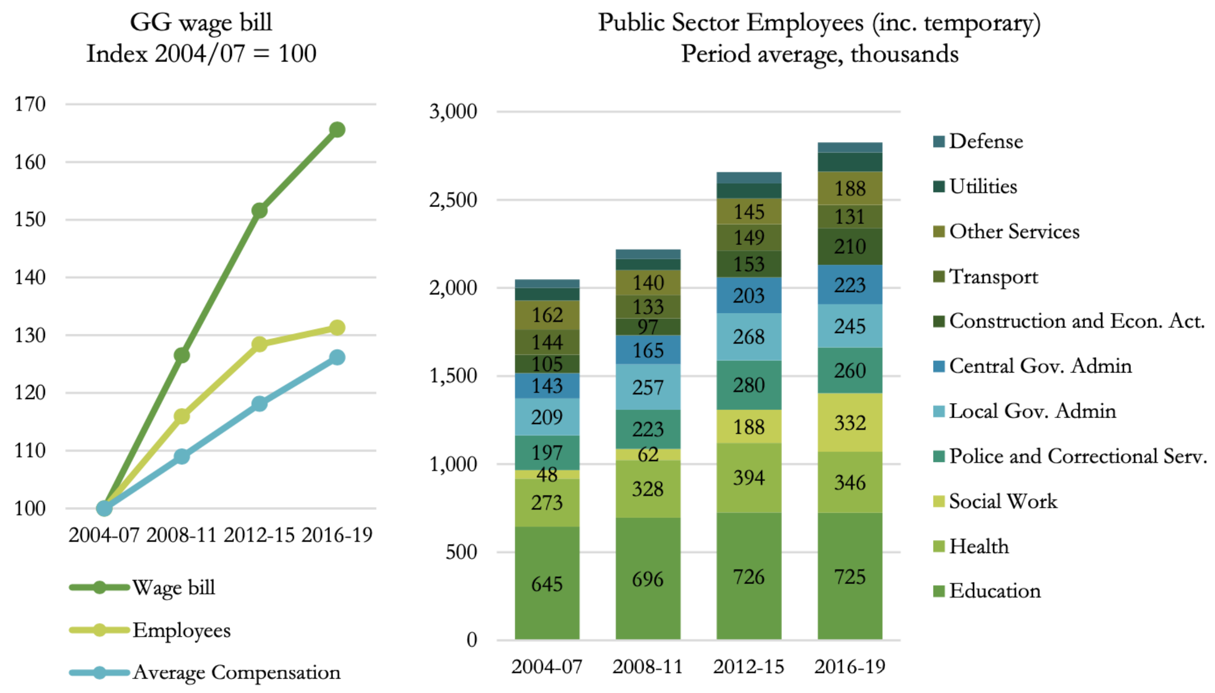
The result is particularly weird — government salaries in all but the lowest and highest categories gradually outpacing private sector salaries, to the extent that now state employees in the 50th percentile get paid 110% more than their private-sector counterparts.

Figure 11: Public sector wage premium: premium relative to non-union formal private workers, controlling by worker characteristics



In addition, the total number of employees jumps too, with the result that the total salary bill shoots up by 70%. And who are these new employees? Not teachers and not so much health workers and police — the sectors that really need them — but people employed in the social work, transport, central government administration.

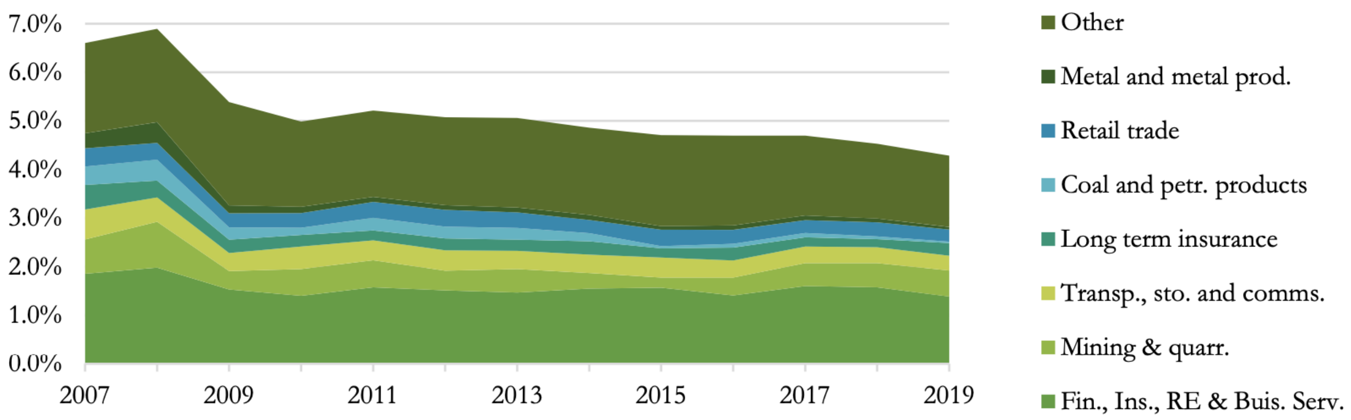
Figure 10: Public sector wage bill



Source: authors' elaboration based on SARB, Post-Apartheid Labour Market Survey (Statistics South Africa) data.

Tax rates stay more or less the same, other than a big increase in VAT in 2018 and personal tax in 2017. But it's interesting to note that the corporate take, what SARS managed to bring in, slides from 2011. Which sector? All of them.

Figure 16: CIT by economic sector, % of GDP



Source: authors' illustration using SARS data.

Why did this all happen? One reason is the consistent overestimation of growth and of inflation. This graph is complicated but it shows what the expectations were compared with how things turned out. Every year growth was expected to rise, but instead, it fell.

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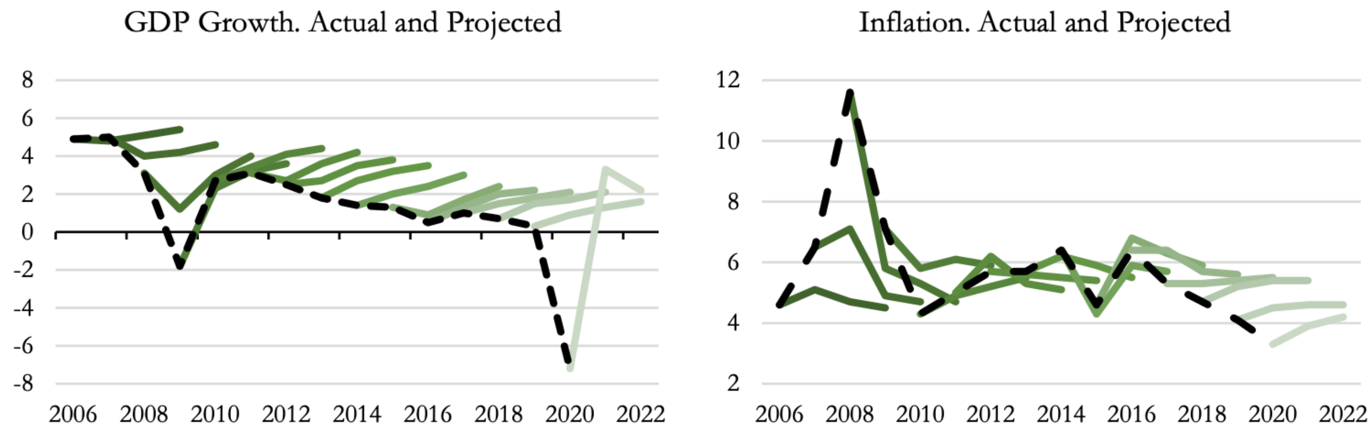
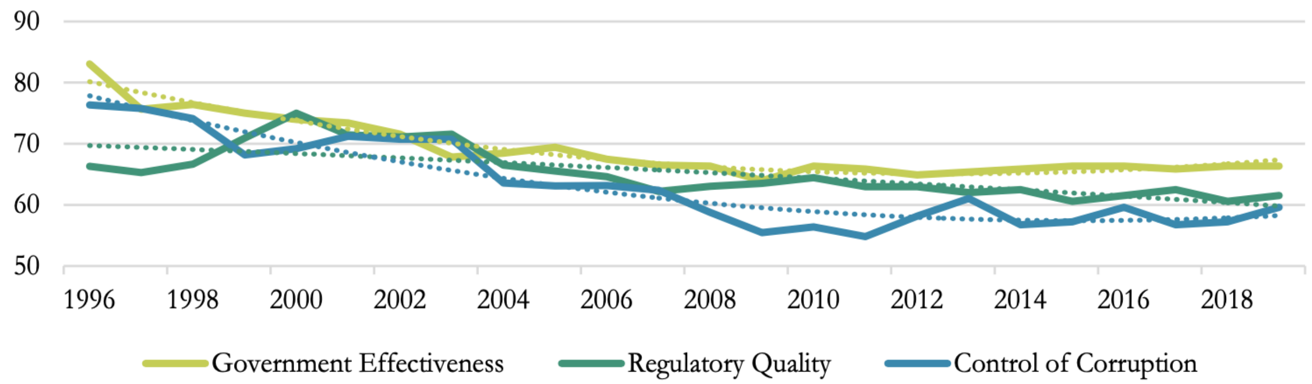
http://www.sharefinderpro.com
richard@rcis.co.za

Figure 18: Budget forecast and execution errors



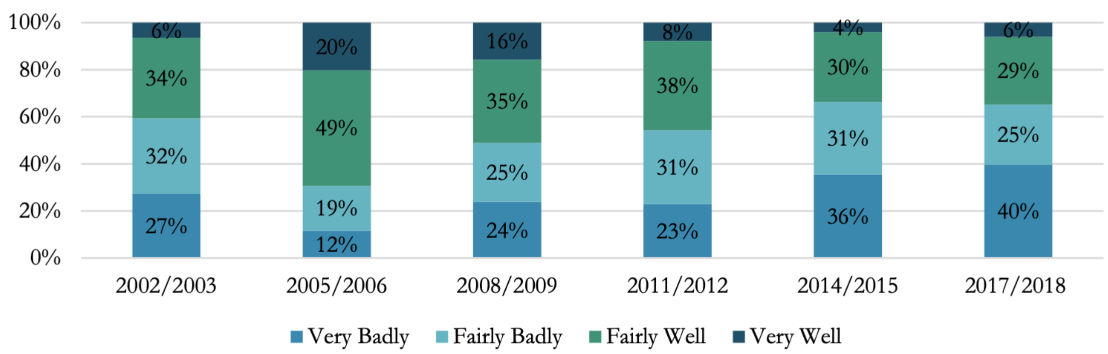
All of this happened during a period when the quality of governance declined. Remember all those promises of a "capable state"? Turns out they were porky pies.

Figure 22: World Governance Indicators, percentile rank



And as night follows day, the public perceptions of governance declined too, but what is remarkable about this graph is by how much. From 2005, the perception that the government was doing "very badly" was confined to just 12% of the population. It is now 40% of the population.

Figure 23: Public perception of the government's handling of the economy, share of respondents



Source: authors' illustration using Afrobarometer data.

So where does this leave us all on the eve of Ramaphosa's Sona? Ever since US President Ronald Reagan introduced the phrase "The State of the Union is strong," in his State of the Union speech, US presidents have repeated it every year. If Ramaphosa were to be honest, he would start by saying, "The state of the union is weak." The numbers show it. **DM/BM**