Our Weekly Paid Newsletter

Richard Cluver Predicts

In our 37th year of service to the investing public of South Africa

Volume: 37 - Issue: 3

19 January 2024

At the start of 2023 I wrote words to the effect that the year ahead looked like one of the most challenging in my entire experience as an investor – and that included the time when bombs were going off in our streets in the 1980s. But this year looks even more challenging!

Let's start with the fact that US futures fell back this week alongside global stocks, as investors reacted to fresh pushback from central bankers over near-term rate cuts. And Chinese shares sank to the lowest in nearly five years after a raft of weak economic data.

Just the fact that 64 countries go to the polls this year – the biggest such event in modern history - means that much of the news we hear will not be grounded in truth. South Africans will for example have to take with a huge pinch of salt utterances like those of EFF leader Julius Malema's claim that his party intends expropriating (without compensation) all the luxury properties in Umhlanga for the benefit of his comrades.

Then there is the matter of the ANC attempting to look like the good guys in taking Israel to the International Court of Justice which, read with its pro-Putin stance in the Ukraine, surely also represents a costly dig at the USA which further risks our privilege of SA exports entering the USA duty-free, not to mention the US subsidies which keep South Africa's AIDS immunisation campaign running!

On an international level, the entire Middle East looks like being drawn into conflict. Last week the circle of aggression widened when Britain and the US launched missiles into the Yemen. Then on Monday Iran's Revolutionary Guards launched ballistic missiles at what it said was a spy base for Israel's intelligence agency Mossad in northern Iraq, and at "anti-Iran terror groups" in Syria. Then, in the latest escalation of hostilities which risks spiralling into a much wider Arab World regional conflict, Iran launched missiles into Pakistan. It's a mess with likely global consequences!

On the investment front, my daily breakfast reading is the Financial Mail whose reliable analyses of JSE companies has been a valued resource for most of my life. So for those of you who have not already read it, I have to comment that its' last Thursday edition summarising the poor performance of its past "Top Picks" and the outlook for 2024 is only recommended reading if you want to start your day bowed in pessimism.

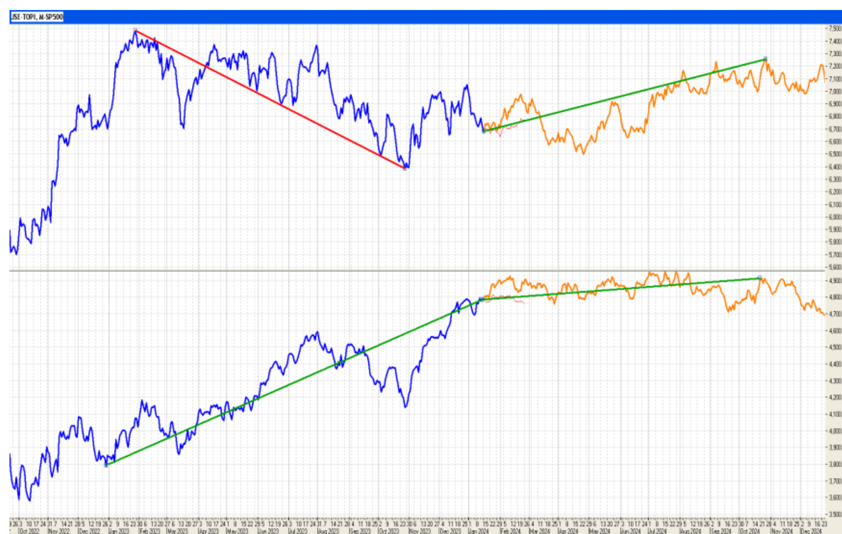
And then there's Jacob Zuma's new MK party adding to the coming conflagration. According to The Daily Maverick, *Zakhele Ndlovu, a senior political lecturer at the University of KwaZulu-Natal, said the party would be lucky to get more than 5% of votes in the province and very little elsewhere. He said uMkhonto Wesizwe was perceived as Zuma's "stokvel" dominated by Zulus and people unhappy about how the current ANC leadership had treated them.*

"The MK party has not shown us anything other than being a Zuma show. Zuma is trying his best to show how popular he remains in KZN. He seems to tap into his support among those who benefitted materially when he was the president of the country. So, what we are seeing here is the politics of patronage on full display. My guess is that these tenderpreneurs are longing for the return of the glory days when tenders came in handy.

It should thus be no surprise that the JSE has underperformed on global markets over the past 12 months and, although I have pointed out several times to readers that the usually very reliable ShareFinder AI-

powered projections have sensed a quite powerful recovery for the JSE in coming months, the political omens are really not that promising, both for the JSE and for markets everywhere.

In the graph composite on the right I have compared the JSE Top 50 Index with its US equivalent, the S&P 500 which makes it unsurprisingly clear that while our market fell at a compound annualised average rate of minus 19.1 percent during 2023, Wall street rose by a compound annualised average of 24.8 percent.



ShareFinder continues to be optimistic about the year ahead as is clear from the green trend line in the upper graph which measures out at an annualized 11.1 percent compared with an annualized 3.4 percent for the S&P500 in the lower graph:

Now, during 2023, the US economy was running on a record 3.5 percent unemployment rate compared with a historic average of 5.7 percent. That is an utopian figure when one considers our own "Official" rate of 32.6 percent and a youth unemployment rate of 60.7 percent. But then ours is reputedly the worst in the world - at least in countries capable of measuring these things- having risen by 57 percent from a rate of 20.83 percent when the ANC took over government in 1994.

So the comparative slow-down in Wall Street share prices projected for 2024 might surprise some who have ignored the huge impact of borrowing rate increases. Currently, as my next graph illustrates, US 30-year long bond yields are back at their average lows of the 2003 to 2011 years which encompassed the period of "Black Monday" and the Sub Prime share market crisis. Thereafter, however, they fell - because the US Federal Reserve was printing money at an unprecedented rate – to a 2 percent low in 2019 and, once Covid bit and central banks, fearing another Great Depression, printed money on such a scale that 30-year T Bonds fell to an all time low of 0.96 percent in March 2020.

Inevitably the overhang of such monetary stimulation inevitably ignited monetary inflation and, as the graph illustrates, by October 23 last year yields rose all the way to 5.11 percent. That was a 532.29 percent gain and so it drew speculative money out of the share market which, like the afterflow of a tsunami, neatly explains why Wall Street shares did so well in 2023 as speculators bid into the future economic recovery of the US.

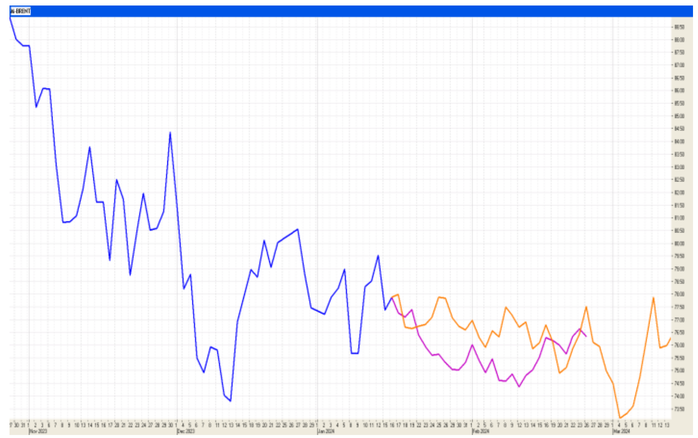
So what is important for share market investors everywhere is what has been happening lately. Accordingly I have blown up the right-hand side of that T Bond graph to show you what has been happening lately and what ShareFinder believes the future holds:

Note the now quite strong up-tick in yields from a December low of 3.95 percent to a current 4.22 percent and rising. ShareFinder thinks the yield will continue rising until February 7, to around 4.44 percent, before resuming its down-trend for the rest of the year. But that objective is very likely to change somewhat in the coming weeks if tensions in the Middle East and China continue hotting-up....and as the world considers the growing possibility of Donald Trump becoming the next US President!

The supply-chain problems which Covid ignited, and which were a major secondary cause of the post-Covid monetary inflation, could well come back to haunt us this year if tensions continue rising in the Middle East. Thus it is important to recognise that a major contributory cause of the recently diminishing inflation problem has been a steadily-declining fuel price. If you consider the graph below of Brent crude oil prices, you can see how supply-chain problems in the Covid era drove crude oil from a 25-year average of 75 dollars a barrel to $124

Note my green median price line of the past decade and the fact that ShareFinder's price projection on the graph above currently expects Brent crude to reach those levels from late May if the world military and supply chain issues remain unchanged.

But let us expand the latest part of that graph in order to highlight that from December 13 the price of crude spiked upwards quite sharply because of supply issues resulting from Houti rebel rocket attacks on Western shipping in the Red Sea which has resulted in fuel tankers being re-routed around the Cape.



While the price trend has resumed its downward trend since Christmas -when seasonal consumption is usually low - it has lately begun tracking upwards once more.

So fragile inflation consequences might easily reverse upwards as the world considers this week's latest developments which included Iran (likely by now a nuclear armed state) opening an offensive against Pakistan.

Meanwhile, the inflation numbers of 13 out of 16 G20 nations monitored by Trading Economics INCREASED in December meaning that the inflation problem is by no means beaten. In the light of this it is important to note a Deloitte analysis which notes that, " *In North America and Europe, core inflation is currently running close to 4%, although it has been declining. In Japan, which long had low or no inflation, core inflation is running close to 3%. In large emerging economies, inflation is even higher. In India, for example, inflation exceeds 6%. Moreover, some of these economies, like China, suffer from slow economic growth. Yet China alone is experiencing deflation.*

Why is this important? First, deflation is an indication that there is either weak demand or excess supply in the economy. The fact that producer prices have consistently fallen since October 2022 is evidence that there is excess supply. Indeed, producer prices were down 2.7% in December versus a year earlier. Weak consumer spending and private sector investment are evidence of weak demand. Thus, it is most likely both factors that have contributed to deflation.

Second, declining prices have an impact on economic activity. They lead to higher real (inflation-adjusted) borrowing costs, thereby hurting credit market activity. They increase the real value of debts, making them more difficult to service. The result could be increased defaults and bankruptcies. This was a problem that Japan faced in the 1990s. In addition, declining prices discourage consumers from spending, less they miss out on a bargain. Declining prices also discourage business investment for fear that the return on investments will decline. Thus, on balance, deflation is a bad thing. Plus, it could be a bad thing for the rest of the world if China attempts to offload excess goods on the rest of the world at low prices. This is what the EU has suggested that China is doing.

What can be done? If the cause of deflation is weak demand, then the solution is to boost demand through monetary and/or fiscal stimulus. Indeed, the Chinese authorities have eased borrowing conditions and boosted public investment. Still, they are reluctant to go all-in. Excessive monetary stimulus risks depressing the value of the currency. Excessive fiscal stimulus would lead to added government debt at a time when local governments face fiscal problems.

It is a complex web of global events through which we have to maneuver in the months ahead. But then who ever said that life was simple? Meanwhile I direct readers to the attached column by economist Natale Labia. It is an important view on the changing international role of China.

The month ahead:

New York's SP500: I correctly predicted continuing gains until late December followed by a dip which began on December 29. Now a recovery has begun and is likely to last until February 12 ahead of a decline until late March.

Nasdaq: I correctly predicted a post-Christmas dip of shorter duration than I had expected. The recovery that is now under way is likely to last until the first week of February when a three-month decline appears likely the first phase of a year-long declining trend.

London's Footsie: I correctly predicted a very cruel January which is now well and truly under way and likely to last until February 7. Thereafter I see a brief but very volatile recovery until August and then down-hill for the rest of the year.

France's Cac 40: I correctly predicted a decline starting immediately in the New Year and lasting all of 2024. The first down-hill phase should last until April followed by gains until the end of August, but overall it is likely to be a losing market.

Hong Kong's Hangsen: I correctly predicted the long-term decline since last January. Happily it will soon be over with a long recovery likely to begin in the new week and run upwards at least until the end of May.

Japan's Nikkei: I correctly predicted declines which have begun on time and I expect them to last until mid-May followed by a long recovery.

Australia's All Ordinaries: I correctly predicted the start of losses until late-March. Thereafter I see gains until the end of June and then another decline until September.

JSE Top 40 Index: I correctly predicted losses until the end of January followed by a recovery until February 22 then losses to April 25 and then a volatile recovery to the end of October.

ShareFinder JSE Blue Chip Index: I correctly expected a brief post-Christmas retreat which ended sooner than I expected. Now I see a few further days of losses until the latest by February 7 followed by gains to the end of September.

Rand/Dollar: I did not expect this week's weakness but then volatility in the short-term is a heightened consequence of the times we are living in. Overall, however, I continue to expect the trend to be one of recovery albeit amid considerable short-term volatility.

Rand/Euro: I correctly predicted brief weakness which I still expect to last until January 26 followed by gains until mid-March and then a further sustained phase of weakness.

The Predicts accuracy rate on a running average basis since January 2001 has been 87.12 percent. For the past 12 months it has been 91.85 percent.

Why the China growth story is over

By Natale Labia

This analysis first appeared in The Daily Maverick

No matter what President Xi Jinping and other China acolytes might argue is the economic narrative, the fundamentals paint a different picture. All too often the narrative around a series of stylised economic 'facts' become detached from the facts themselves.

Nowhere is this more pervasive than in China. While it is broadly accepted that China's growth is not as rapid as it was back during the breakneck pace of economic progress between 1990 and 2020, the narrative remains that despite a few short-term speed bumps, China is still on course to either catch up with or indeed surpass the US as the world's pre-eminent economic power.

Debt, deflation and demographics

The facts, detached from the commonly accepted narrative, tell the opposite story. As Ruchir Sharma, the chair of Rockefeller International, has written: "In a historic turn, China's rise as an economic superpower is reversing." The story of its growth and transformation is one of the past half-century, not the next half-century. Debt, deflation and demographics are crippling it.

There can be no doubting the phenomenal transformation that has occurred. After opening itself to the world in the 1980s under Deng Xiaoping, China's share of global GDP rose almost 10 times from an inconsequential 1.8% to 18.4% in 2021. A rounding error became a global powerhouse.

Since then, however, China has simply not been able to keep up. Since 2022 its share of global GDP has shrunk, materially, to barely 17%. According to Sharma, this is the biggest drop since the 1960s.

Interestingly this data comes from Beijing itself, in the form of official nominal GDP data, meaning that Chinese authorities must be all too aware of the malaise. They are, however, not adjusted for inflation, which calls into question the official stance that real GDP has indeed been expanding consistently at more than 5% per annum. Most economic estimates register real long-term potential growth at no more than 2.5%. Has Beijing been doctoring inflation statistics to make the real growth figures look overly robust?

Read more in Daily Maverick: Can Xi Jinping resurrect the China growth story?

The reasons behind this structural slowdown are clear. First, the demographic tailwind of the Lewis Theory of an untapped reserve army of labour entering the workforce in the 1980s and 1990s has already turned into a handbrake. The one-child policy resulted in a demographic time bomb of a rapidly ageing population and a shrinking population of workers that will have to carry the cost of this tidal wave of retirees. The ongoing baby bust in China has already lowered its share of the world working-age population from a peak of 24% to 19%, and it is expected to fall further to 10% over the next 35 years. With a shrinking share of the world's workers, a smaller share of growth is almost certain.

Second is the drop in productivity. Sharply higher debt, an increasingly more interventionist government and bloated state-owned enterprises have all dampened labour productivity growth. This has almost halved from 9.9% in 2010 to 5.5%, according to the IMF. China is simply not the open, agile and innovative economy it once was.

Third, it is now one of the very few countries in the world experiencing deflation. This is tremendously challenging for a country like China which is accumulating debt eye-wateringly fast. During times of deflation, prices and wages fall, but the value of debt does not, raising the burden of repayments. With deflation continuing to eat into profits, companies cut wage growth, creating a vicious "debt deflation doom loop" of ever-weaker aggregate demand and deflationary pressures.

Waning economic superpowers struggling to reinvent themselves are the most dangerous and least predictable.

Finally, the debt-fuelled property crash goes from bad to horrifying. More than half of the country's massive developers have defaulted and house prices are in freefall. Analysts warn that the housing sector crisis poses a huge risk to the economy, chilling construction activity, cutting household wealth and damping consumer confidence. "The Chinese economy won't get back on track until the housing market recovers," says Hang Seng Bank chief economist Dan Wang.

Investors have seen the writing on the wall. About $12-billion of foreign direct investment was cancelled in the third quarter alone, while Chinese investors are making outward investments at a record pace, according to the *FT*.

Geopolitical consequences

Since 1990 China's growth in share of global GDP came mostly at the expense of Europe and Japan. In the past two years they have held steady. China, instead, has fallen behind the US and other emerging markets, specifically Mexico, Indonesia, India, Poland and Brazil.

Listening to President Xi Jinping and other China acolytes, one would never believe these realities. But no matter what they might argue is the economic narrative, the fundamentals paint a different picture.

Read more in Daily Maverick: Hello, China: In the run-up to 2024, Ramaphosa & Co come out swinging, challenging our basic constitutional rights

It is perhaps too soon to argue that the age of Chinese and American bipolarity is giving way to multipolarity. However, as shown by the example of the USSR, waning economic superpowers struggling to reinvent themselves are the most dangerous and least predictable.

While a couple of years of data is perhaps too little to form any secular conclusions, the trendlines are clear. China's moment has passed. Rather than a Thucydides trap of a grand overtaking of the US, the story of the rest of the 21st century will be how these two hegemons manage their own respective declines. **DM**

Natale Labia is a partner and chief economist of a global investment firm, he writes in his personal capacity.

JUSTICE MALALA: Why Zuma still spooks the ANC

There's a nifty little quote in John Wayne's 1965 movie, *In Harm's Way*, that ANC leaders might like to read twice and then reflect upon. It says: "Indecision is a virus that can run through an army and destroy its will to win. Or even to survive."

Since Jacob Zuma launched his new party on December 16, stealing the ANC guerrilla army's name, logo, songs and even history, the party has been standing by silently. Zuma has insulted its leaders, claimed he is still a member of the party and its national executive committee (NEC), organised against it, and vowed to topple it. The response from the ANC has been fear, infighting, indecision and silence. The party's leaders have been at each other's throats about how to respond to Zuma, with national chair Gwede Mantashe lambasting secretary-general Fikile Mbalula for confessing that the party broke the law to protect its former leader over corruption charges in the building of his Nkandla palace.

Zuma has been running circles around the ANC, stealing the limelight and rebuilding his RET faction outside the party. He has accused President Cyril Ramaphosa, his successor, of destroying the party and of being corrupt. Ramaphosa has been like a rabbit caught in headlights, silent and wide-eyed, giving neither direction nor leadership to his confused flock.

Things are going so well for Zuma that he has now openly broached the subject of becoming president again. At the weekend he told a gathering of the Nazareth Baptist Church in KwaZulu-Natal: "I was quickly removed before the end of my term as president because I was trying to change people's lives, but their behaviour has made me want to come [back]. I want to return to change our situation."

A spirited response from the ANC highlighting the "nine wasted years" under Zuma would have been in order here, but the party has been in hiding even though this was the organisation that fired him, and has now confessed to protecting him from corruption charges. Instead, there has been silence from ANC leaders. Even the party's allies have wondered what is going on. On Saturday, SACP general secretary Solly Mapaila bluntly told the ANC to act: "I don't know why the NEC is dilly-dallying about this. He [Zuma] can't be allowed to divide a liberation movement as old as the ANC."

Mapaila should save himself the stress of advising the ANC. The truth is that it is Ramaphosa and his close allies in the party who have mollycoddled, protected and appeased Zuma for years while the rest of us called for action against him. When Zuma was accused of raping his own comrade's daughter, the ANC built a ring of support around him. When he destroyed institutions such as the Scorpions, they enabled him. When he brought in the Guptas, they aided and abetted him. When he dodged his arms deal corruption trial, they sang for him.

Over the past six years, the ANC sprang Zuma from jail (he apparently suffers from a "terminal illness", but I have not seen a healthier 81-year-old in my life), then changed the law to allow him out, and then did sweet nothing to send his close allies involved in state capture to jail. Zuma is the fruit of the ANC. The party raised him, fed him and protected him at every turn, and is still afraid to tell him off.

Zuma will now destroy the ANC. Over the next few months, ANC leaders will continue to coddle the man, try to make nice with him because they fear him, refuse to draw the line on his dangerous utterances (he claimed our elections are rigged, an outright lie that can have devastating consequences), and allow support for him to grow. Ramaphosa and the ANC have fed this monster, and if they do not act to expose him now, he will eat them up.

Many ANC members are already confused by their leaders' silence, while Zuma acolytes are claiming victory on social media and

elsewhere. ANC members' morale is low and being sapped daily. Their leaders have, for the past month, failed to reassure them.

If Ramaphosa and his party continue in this manner, Zuma will become an electoral and societal force again — and this will be the end of the ANC. Though some might say that's not such a bad thing.