Our Weekly Paid Newsletter

Richard Cluver Predicts

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

Volume: 37 - Issue: 36

20 September 2024

The event a weary world has waited four long years to occur happened this week when the US Federal Reserve finally announced an interest rate cut which will positively affect the lives of virtually everyone on Planet Earth.

That US Federal Reserve Chairman Jay Powell opted to give us a half rather than the expected quarter percent reduction is further good news for everyone with a household mortgage or hire-purchase debt. And of course it is music in the ears of millions of pensioners everywhere who got themselves locked into property mutuals when they so dramatically unwound between mid-2016 and the final Covid Crash of 2020. But many fear that it is a signal that the US economy is in worse shape than most imagine!

But momentarily let us return to the impact upon property mutuals. Using high levels of gearing, the property mutuals were a sitting duck when borrowing costs started to soar taking shares like Hyprop from a peak value of R139.30 in July 2016 to a low of R15.70 in April 2020, they represented one of the greatest value destruction events of the past decade. And for those of you with understanding of the boom and bust nature of the interest rate cycle, Hyprop, Growthpoint and a handful of others with well-founded portfolios, that 2020 low was a great entry point because, by the time I signalled a time to gamble late last year the shares had already trebled to R33.50 and then fallen back to R25.54.

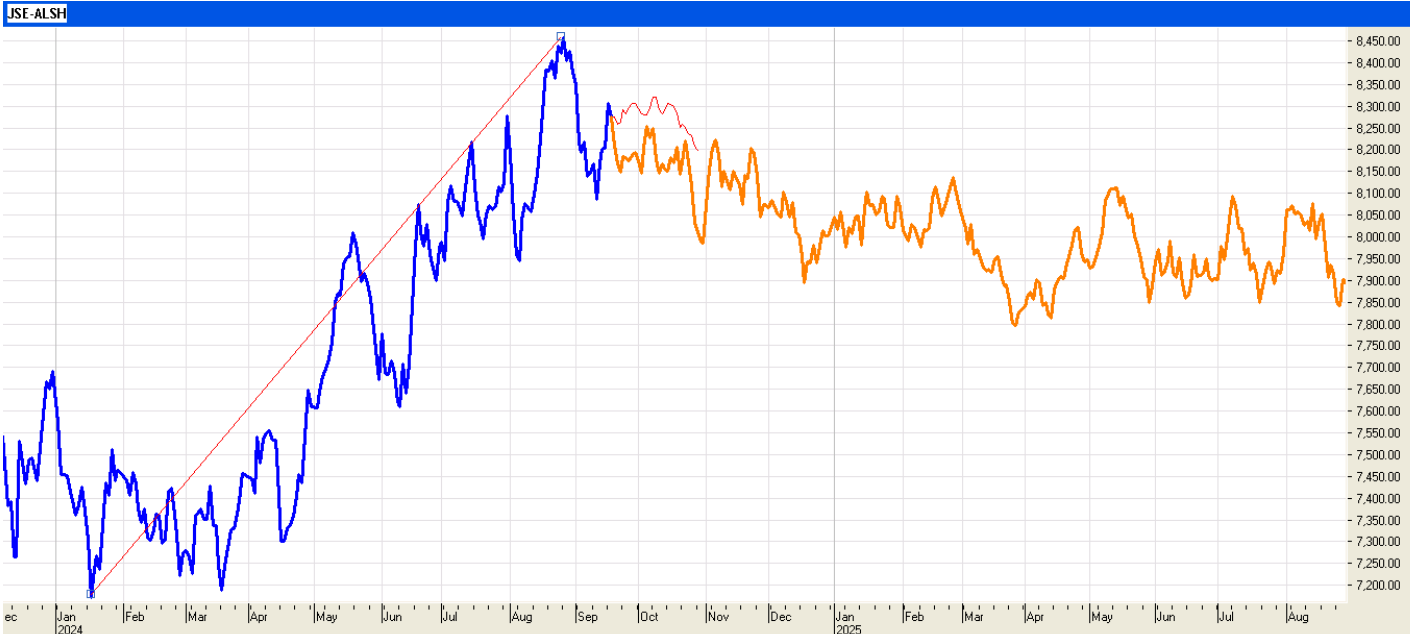
Sensing a light at the end of the tunnel I bought them for the Prospects Portfolio at R29.72 in early January and sat back watching them climb to R42 this week when I sold them. Normally I would have hung on because I think they still have a long way to go as interest rates unwind across the world over the next 12 months or so. However I was in the process of re-calibrating the portfolio to the requirements of our new ShareFinder algorithm which is based on the premise of a smaller high-growth share selection.

Of course the gains are by no means confined to a few property shares. Indeed the biggest gainers are likely to be retailers whose sales have been heavily impacted by the dramatic decline in disposable income of the average citizen worldwide. Recently in one of my columns I illustrated, for example, the change in mortgage costs of a typical South African suburban home which had risen from a monthly R16 030 to R26 908 between 2020 when mortgage rates began soaring from seven percent to a current 11.75 percent.

Clearly, as borrowing rates fall there will be a lot more disposable income flowing back into the economy. And with most manufacturers reporting significant spare capacity, there are likely to be some very profitable gains by both commerce and industry before the need for costly capital investment kicks in. The share market has, of course, been anticipating this for some time with the JSE All Share Index up 18 percent since mid-January.

Indeed, it might well have over-anticipated the benefits because ShareFinder is projecting a steady overall decline from here on until the end of next March as illustrated in the following graph:

Published by ShareFinder International
http://www.sharefinderpro.com
richard@rcis.co.za



There are, furthermore, some serious question marks over Chairman Powell's assertion that the Fed has inflation well under control. One of the most conspicuous events in the minutes after the interest rate cut was announced was a huge spike in the gold price taking it up 35 dollars to $2 600 an ounce. The increase was on top of a steep climb at a compound annualised rate of 28 percent since last November as illustrated in my graph on the right:

Of course the spike was not an isolated event. The first significant spike came in early March, when prices surged to $2,160 per troy ounce, up 8% from the previous record of $2,135 in December 2023. By April, the price of gold had broken another record, and it did so again in May and again in August. Gold's price then continued its upward trajectory, landing at yet another all-time high of $2,584.09 per ounce this week ahead of yesterday's further leap.

While this price performance would be impressive for any asset class — gold's price is up 25% since January 1 while the average stock market return is about 10% per year — it's particularly notable for gold. After all, gold is traditionally seen as a long-term investment rather than a high-growth opportunity. Commentators have argued that a lowering of interest rates logically lowers the holding cost of the metal and facilitates investment, but that does not explain why the metal price has risen 57 percent since last November at a time when the world has been through the highest interest rates in decades.

So who is buying Gold? According to **The International Banker** China's central bank bolstered its gold purchases by a hefty 30 percent in 2023. Central banks led by China purchased 1,037 metric

tonnes of gold last year, with the Peoples Bank of China buying more gold than all other central banks combined. This buying intensity continued well into 2024, with net purchases of 290 tonnes recorded in the first quarter (Q1) of 2024—the fourth strongest quarter of purchases since the buying streak began in 2022—with China again leading the way.

Indeed, the first quarter's acquisitions were around 36 percent higher than the quarterly pace of around 213 tonnes implied by J.P. Morgan Research's annual estimates of 850 tonnes for 2024. "The 70-tonne increase in net purchases versus the fourth quarter of 2023 is also despite a 5 percent quarter-on-quarter increase in the average price of gold," the bank's research division wrote on July 15, while the WGC also recorded a 29-tonne boost in China's net gold purchases for the first half of 2024, which raised its total holdings by 1.3 percent.

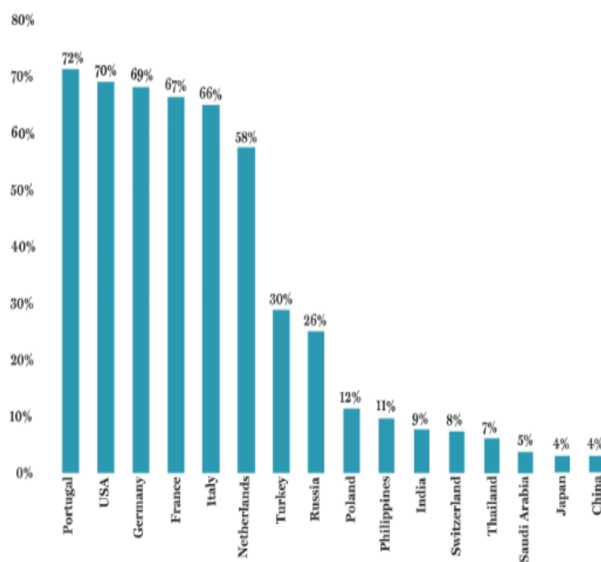
Significantly, bearing in mind the rising tensions between China and the West, its gold buying is thought to be part of a determined effort to replace its US dollar reserve holdings with bullion. This is being carried out against a grim backdrop of rising tensions with the US, including an escalating trade war and US-led sanctions against China and Russia, all triggering a dramatic deterioration in relations between the economic superpowers.

In response, China has been aggressively selling off its holdings of US Treasury securities as it seeks to effectively substitute its massive quantities of dollar reserves with more gold. While early 2022 saw China sitting on more than $1 trillion of US Treasuries, those holdings had dwindled to $768.30 billion by May 2024, as per official US government figures.

"The main motivation of the PBOC is to be less dependent on the US dollar and—in an extreme case—to be less susceptible to US sanctions," Julius Baer analyst Carsten Menke recently told **Reuters**. Menke said he expected China's desire to diversify its reserves to persist, as "the geopolitical tensions between China and the United States are unlikely to disappear any time soon, independent of the outcome of the US presidential elections".

Importantly, if this is indeed the reason, China's gold purchases are only beginning. The graphic on the right clearly illustrates that in sharp contrast with the role of gold in the reserves of the world's leading nations standing normally at more than two thirds of their total central bank reserves, China gold holdings total just four percent:

Figure 1: Gold as a Percentage of Total Reserve Holdings Across Select Central Bank



Source: World Gold Council | IMF | J.P. Morgan Commodities Research

So the question that investors need to asking themselves today is whether China's actions are simply that of wishing to be rid of its dollar reliance or, is it being more prescient given the issue I have so often written about; the alarming rise in government debt throughout the West.

Given the uncertainty of the forthcoming US election with neither candidate offering any clear idea of how their respective administrations might deal with a debt problem whose servicing costs now

©2024 ShareFinder International

consume 40 cents of every tax dollar collected, there is a very real concern that if concerted efforts are not soon started to pay back the money, a US default becomes probable within the decade!

And of course the US, whose debt to GDP ratio stood at 123 percent at the end of 2023, is just one of many severely indebted nations, some, as the table on the right details, with impossibly greater levels which together clearly threaten the long-term stability of the global monetary system.

Economy by Gross Debt	% of GDP (2023)
Japan	255%
Greece	168%
Singapore	168%
Italy	144%
United States*	123%
France	110%
Portugal	108%
Spain	107%
Canada*	106%
Belgium	106%
G7 Average	**128%**

Now it is true that some respected economists tend to pour scorn on the idea that a "Great Reset" could soon occur, the reality is that there has been no let up to date in US borrowing.

Created by the US Congress in 1917, the debt limit, or ceiling, sets the maximum amount of outstanding federal debt the US Government can incur. The Treasury Department reached its debt ceiling of $31.4 trillion in January 2023, and after months of debate, lawmakers voted in June of that year to suspend the ceiling until January 2025.

Meanwhile the US government has run a deficit averaging nearly $1 trillion every year since 2001, meaning it spends that much more money than it receives in taxes and other revenue. To make up the difference, it has to borrow to continue to finance payments that Congress has already authorized. As of June 2023, the total national debt stands at more than $32 trillion.

The debate over the debt ceiling has caused economists to consider the once unthinkable prospect of a US default — that is Washington declaring that it can no longer pay its debts. Goldman Sachs economists have estimated that a breach of the debt ceiling would immediately halt about one-tenth of US economic activity. According to centre-left think tank Third Way, a breach that leads to default could cause the loss of three million jobs, add $130,000 to the cost of an average thirty-year mortgage, and raise interest rates enough to increase the national debt by $850 billion. In addition, higher interest rates could divert future taxpayer money away from federal investments in such areas as infrastructure, education, and health care.

A US default could wreak havoc on global financial markets. The creditworthiness of US treasury securities has long bolstered demand for US dollars, contributing to their value and status as the world's reserve currency. Any hit to confidence in the US economy, whether from default or the uncertainty surrounding it, could cause investors to sell US treasury bonds and potentially weaken the dollar.

A default of choice would diminish the dollar's appeal as a global currency for payments and finance. Since over half of the world's foreign currency reserves are held in U.S. dollars, a sudden decrease in the currency's value could ripple through the market for treasuries as the value of these reserves drops. As heavily-indebted lower-income countries struggle to make interest payments on their sovereign debts, diminished value of foreign currency reserves could threaten to tip some emerging economies into debt or political crises.

In the circumstances it is hardly surprising that Gold, as the most fundamental store of wealth, is rising in price. Clearly a US debt Default Would Cause Global Economic Chaos. So who can blame China for trying to build up its reserves?

So how can the ordinary person cushion themselves against such an event? My own research has constantly shown that well-chosen Blue Chip shares are as good as gold!

The month ahead:

New York's SP500: I correctly predicted the gains would continue. Now I see weakness until October 9 ahead of a final upsurge until the end of October ahead of a protracted decline until the end of April.

Nasdaq: I correctly predicted the gains would continue. I last week saw the peak on the 23rd ahead of a week-long dip preceding the next short-term upsurge to the end of October. Now I am extending it to the 25th and the bottom of the dip to October 9. But the end of October will likely mark the start of a long decline to mid-year!

London's Footsie: I also correctly predicted the start of a lengthy decline that should last to mid-December.

France's Cac 40: I correctly predicted declines which I now see extending to early-January.

HongKong's Hangsen: The brief retraction I predicted is over and now it is a long surge to a peak at the end of November ahead of a long New Year decline.

Japan's Nikkei: I correctly saw weakness from early September until month-end followed by gains which I expect to be over by the start of October ahead of a long decline into the New Year.

Australia's All Ordinaries: I correctly saw the start of losses which I now see extending all the way to next February.

JSE Top 40 Index: I correctly warned of impending volatile weakness lasting well into the New Year.

ShareFinder JSE Blue Chip Index: I correctly saw gains which I now see lasting until the second week of October followed by losses until year--end.

Rand/Dollar: I correctly predicted a wobble of weakness lasting to month-end within a long-term series of gains well into the New Year.

Rand/Euro: I wrongly predicted weakness would begin this week and now I see today as the likely start lasting into the first week of October. Overall, however, I see gain well into the New Year.

The Predicts accuracy rate on a running average basis since January 2001 has been 87.36 percent. For the past 12 months it has been 94.86 percent.