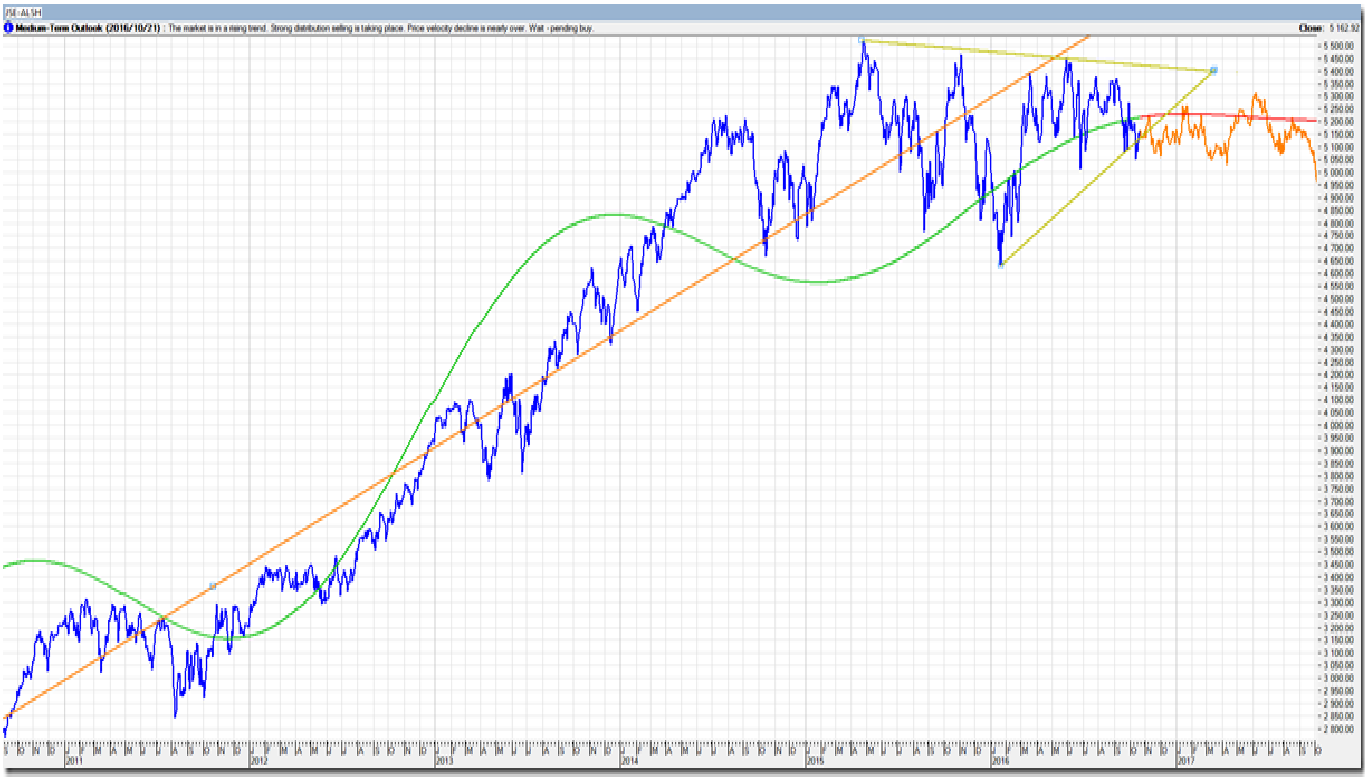
Could the bull market end by nigh?

The way ahead for share market investors has been troubling enough coping with a stagnant South African economy and the impact of Zupta machinations that have sent the Rand reeling. But now there is a fresh problem looming; the likely end of the longest-running bull market of modern history.

If you care to examine the graph immediately below depicting the JSE All Share Index it is quite clear that the share market peaked way back in April last year and each successive high thereafter has been a little lower than the previous one as highlighted by the yellow upper trend line that I have drawn onto the chart. That is a clear sign that the market is trending downwards. In fact that upper trend line is falling at a very modest annual rate of two percent which can hardly be described as a severe threat. However, if you factor in an inflation rate averaging around six percent then the decline in real terms does become significant. Add in the fact that one can also draw in a lower trend line which creates a pennant formation that reaches its apex in mid-March next year, and you can see that something significant is happening.

The standard observation of technical analysts of such formations is that the market will break out of the pennant with significant force sometime before the apex is reached. So please note that last week as the news broke about the National Prosecuting Authority prosecution of Finance Minister Pravin Gordhan, the All Share Index did break down through the lower trend line. Happily it recovered again. But do note ShareFinder's normally very accurate projection of the future trend of the market which suggests that there will be another downward break on or about November 10 and, if ShareFinder is correct the average trend thereafter will be continually downwards.

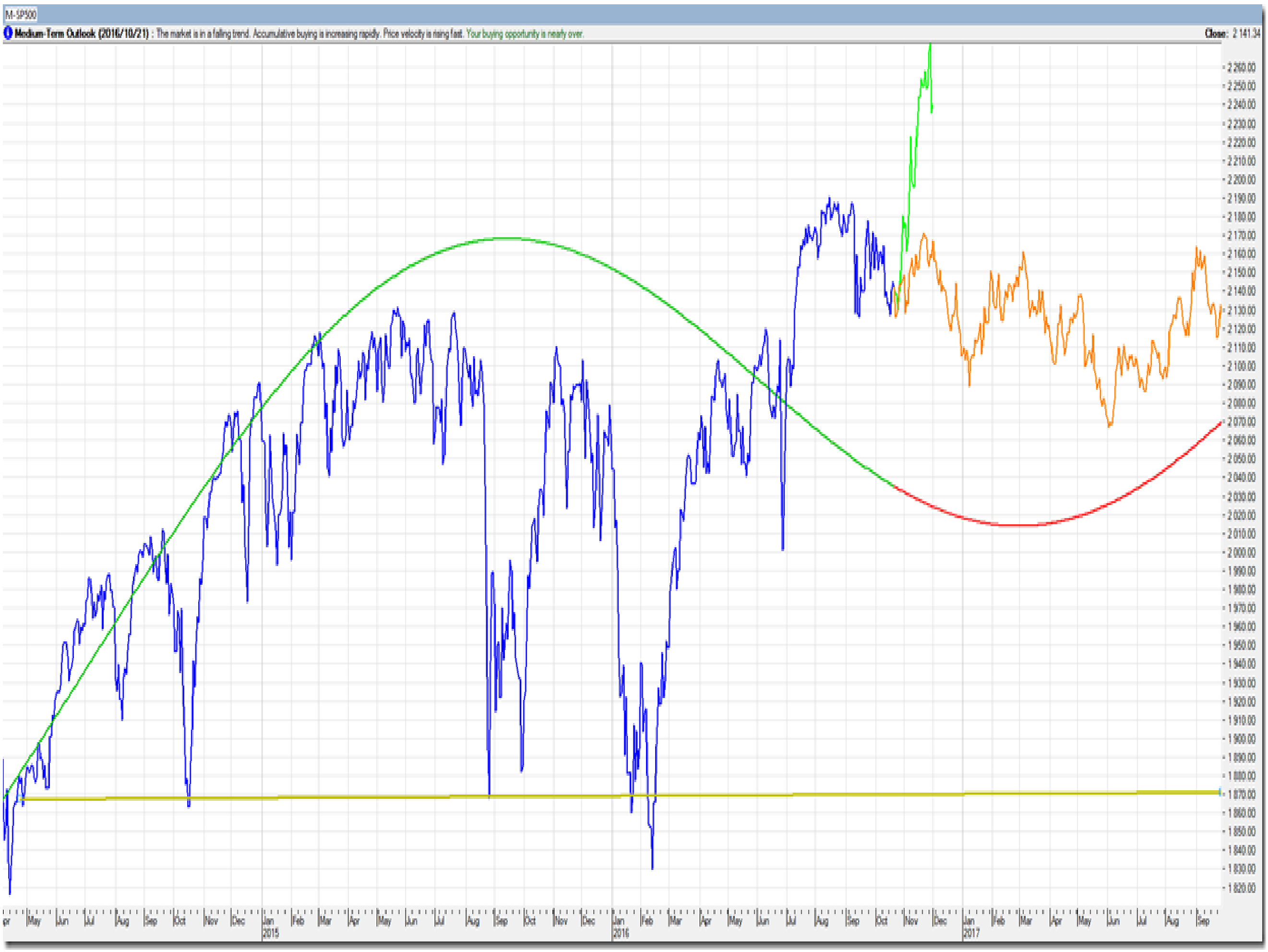
Note alsi te smoothly-curving long-term cycle sine wave which is the most accurate portend we have of long-term market movement, usuall signalling some six months in advance the probability of a cyclic market decline. At the point that this indicator changes from green to red, one can see that the line is still rising but is depicted as likely to peak in December leading one to conclude that around June next year we should see the onset of a major bear market. ShareFinder's medium-term projection meanwhile suggests that the Alsi will make its last peak on or about June 7 next year before beginning as series of precipitous falls.



The thing about share market collapses is the there is almost always a trigger event and so, while it might have been evident to almost everyone for some considerable time that the market as a whole is overpriced and in need of a correction, it takes something seismic to create an avalanche effect. Given the market reaction to the sacking of Mr Gordhan's predecessor – that is ignoring the "weekend special" – the thinly disguised move by the prosecuting authority to provide President Zuma with an excuse to sack Gordhan understandably creates such a pretext. So it was very interesting that as supporters of Mr Gordhan came out in their numbers to expose the move for the sham that it was, the market quickly retraced. However the retracement was fairly modest. It is as if investors have adopted a wait and see attitude. Another sharp decline is therefore extremely probable if Zuma were to act against Gordhan.

Meanwhile there are at least half a dozen other permutations of shocks that could send the market plunging, from a downward rating of our sovereign debt rating to further dramatic events as Jacob Zuma plays out his end game. Yet another would be a collapse of the US market, and there could be an equal number of events that have not been foreseen at all.

So let us turn to Wall Street to see if there are any signs of an impending decline in that market. As my graph below makes clear, Wall Street's widest measure of the market, the S&P500 Index obviously peaked in mid-August and has been heading downwards since then. Here a very interesting phenomenon is evident in ShareFinder's opposing stories with a (light green) short-term sharp upward spike being projected but not expected to outlast November. Presumably such a burst of confidence would be the result of Hilary Clinton winning the presidency. However, the red medium-term projection suggests a much more modest market honeymoon for Clinton before the reality of her tax proposals sink in for the US public. In any event ShareFinder's medium and long-term projections suggest that the market could fall steadily until early June with my yellow trend line suggesting the next support level. If the market were to fall as far as that first support point then the cost to US investors would be around 17 percent of their capital: a catastrophic enough event. But that would very likely be just the first of a series of unpleasant events for the market. And there are many support lines below that one if investors were to lose their cool.



Recognising the truth of the old adage that when Wall Street gets a cold the rest of the world develops Pneumonia, te JSE could not escape the consequences of a US share market decline of that magnitude and, you can be sure, that the local impact would be far more severe than that of Wall Street.

Three possible SA Themes

by Cees Bruggemans and Prof Willie Esterhuyse

SA politics and her economy face three major options in the weeks, months (years?) ahead. None of them palatable but presumably realistic, but varying

in intensity from the mild to the extreme. Which of these futures await us?

There is the option of continuing (for the time being, until the 2017 leadership contest) with our present unstable condition, in which the Zuma

regime has all the cards (buttons to push), yet refrains from a cabinet reshuffle and dumping of finance minister Gordhan (thus not proceeding to

final complete state capture). It is a scenario in which Zuma has the power but could be uneasy about what is arraigned against him inside his party,

not particular visible on the outside, but strong enough to protect Treasury and the disciplines some of us cherish.

Alternatively, the Zuma regime feels strong enough to reshape politics in a way that suits its ends, starting with a cabinet reshuffle shortly which

dumps finance minister Gordhan and finally replaces him with something more pliable, giving full access to national taxing and borrowing resources.

Following such full state capture, the SARB would probably be an afterthought, waiting for senior members' contracts to run out, not unlike with the

public protector, and replace them with successors who will know how to run a monetary policy in the extended Zuma Era.

The third option is the extreme one and co-opts the young rabble-rousers (a term borrowed from Galbraith about those opposing the established order)

driving the unrest at leading universities, so far successfully shutting some down, and still intensifying the conflict with greater government

authority.

This is an opportunity, as we have seen to date, for government to send in its heavy brigades to suppress the unrest. The committee to address these

issues includes the entire security cluster and and now belatedly also the finance minister. The bottom line is the opportunity to eventually repress

all this unrest through a State of Emergency, in the process prolong the period in power of those already established there, potentially indefinitely.

This may sound a most unlikely outcome, but remains a possibility.

Certainly the youngsters rebelling at universities aren't something of a passing fad. Those at the centre of this revolt keep moving the goalposts. By

now we should understand they are looking for a fundamental change in society, but apparently not realising that instead of getting their transforming

revolution, they are creating an opportunity for the squatting patronage elite to extend their political control, potentially indefinitely.

Obviously, if we were shortly to end up in this last scenario (State of Emergency), it would thereafter follow naturally that scenario two (full

capture of the state’s core institutions by replacing finance minister, Treasury minions and senior SARB members) could then follow effortlessly.

For by then, no amount of internal ANC opposition will presumably be feared or able to achieve much in preventing it.

The country apparently likes to think it is in scenario one (unstable political environment eventually giving way to something better…), many fear

the second scenario (full Zuma state capture shortly) but the country is probably still in total denial about the third scenario (co-opting the

revolting youth by way of State of Emergency repression, in the process opening the way to indefinite political control, thereafter effecting full

state capture, relaxing and enjoying the spoils).

None of these themes and their potential outcomes are welcome scenarios. They all carry costs, typical so far of the Zuma era, but with a rising tab

as the more extreme alternatives to Zuma retirement and Zuma patronage era ending come into focus. Yet one has to give recognition where recognition is due. Evidence of extreme shrewdness taken to very long ends, often stealthily offered, but always

with very costly outcomes.

To think that the ANC can somehow resist such shrewdness is asking much, as it is mostly the older, sidelined generation that sees the dangers. And it

hasn't got the numbers to really press the issue? As to whether future elections can do so, the 2017 leadership election or the 2019 national

elections, it isn't yet at this stage fully convincing. The Zuma regime knows its innate strengths (in the rural areas) and will probably not drop

below 50% political support.

And even if it were to do so (minimally), there are splinters to be co-opted to restore a majority, and when all else fails, the EFF if at a price.

Yet more fundamentally, it has increasingly come to the fore that the historic compromise that constituted the 1994 Rainbow agreement wasn't

necessarily the final word on this issue. Over two decades later, the larger population isn't satisfied with what that compromise achieved.

It is of course the wrong conclusion. If the ANC had followed recommended policies these past two decades it would have given the country breakout

growth, we would find ourselves today with a much more transformed society probably satisfying many more people’s aspirations than currently the

case. But this didn't happen, the ANC ultimately caused its own demise, and with it the perceived failure of 1994 compromise, as the rising

expectations of the greater population simply haven't been met, and a scapegoat easily found in what is now perceived as an inadequate compromise,

though real failure residing elsewhere.

The likelihood of fundamental upsets and a return to the political centre look very challenging, to the point of possibly not being achieved. It has

to be shown that such leadership can be elected within the year and make a fundamental difference. But the possibility of a breakthrough to a much

less palatable regime than even so far suffered this decade remains feasible, going by current straws in the wind.

And thus we await the chess masters to move their pieces.

SA growth & inflation

by Cees Bruggemans

It is an odd couple, SA growth & inflation. The one distinctly down next year, the other really not going anywhere except at the decimal-point level,

provided we stay lucky (never a given). And SARB in the role of the unwilling bride…

The 3Q16 is going to be unimpressive growth-wise after an explosive catchup in the 2Q16 being mostly a base period recovery effect. Looking through

it, the 2Q16 wasn't all that impressive. Only a depressed base helped. But this is no longer the case in the 3Q16. Firstly, mining, manufacturing and retail in July-August are down on the comparative period of 2Q16,

suggesting a modest decline in the quarter’s output. And motor trade and the building trades.

But the year-on-year comparisons also are mediocre, indicative that growth barely scrapes along. Still, the economy is advancing, however slowly it

may be. It suggests ruling out recession (two successive quarters of GDP decline). Instead this sideways shuffle.

How to get growth up beyond 1% next year is a challenge, bearing in mind that on the demand side of the economy the public sector is constrained (we

may assume budget-wise?).

The household sector is similarly constrained. For job growth was earlier this year still positive year-on-year, but we could easily encounter a

falloff in 2H16. Credit growth is constrained to low single-digits, partly through higher rates but most effective through tightened regulatory

strictures of the most demanding kind, for motor deals, housing mortgages, retail credit, ordinary credit access.

And business suffers the deepest blues, going by confidence indices, their strategic plans all seem offshore, and local fixed investment commitments

minimal (except in energy and computing).

Yet not all is lost. There is the presumption of a more normal agricultural year (and it has started to rain in the summer rainfall region, if so far

not very impressively). After the deep output falls of the past year, there potentially awaits a rebound these next two years (recovery tends to take

time).

Global commodity demand seems to be stabilizing (implying some upside?). Electricity supply has improved and with it stability, with possibly some

heavy electricity users coming back into the game (difficult to read). These two sources may be most uncertain. Households could benefit from an inflation reversal, shortly still to peak (rising to 6.1% in August, not as high as expected, and still to rise in

coming months, but not as high as SARB only recently still expected at 6.7%), and thereafter plunging in the course of next year, with food inflation

especially year-on-year expected to be coming off.

If there is no drought continuation into 2017, political SA risk doesn't suddenly rears its head sinking the Rand and the US economy stays meek & the

Fed cool in its minimal rate rising, SA inflation next year could easily reach 5% (as opposed to reaching high single digits).

Such an inflation falloff will likely boost real income gains of households, with these the most pronounced among lower incomes due to the food

impact. That could imply a retail and consumption recovery, even if not a very strong one. But enough to reinforce the decimal-point GDP growth

recovery to 1% or better.

That doesn't suggest recession shortly. Instead, we will probably keep skimming the zero growth line, with some slight upward potential into next

year, assuming nothing big & bad sinks us. And this at a time inflation subsides anew into the 3%-6% target zone, and could actually sink quite low before stabilising near 5%.

Would this tempt the SARB into rate cutting?

SARB has shown todate a near pathological anxiety about global risk surprises adversely affecting our foreign capital flows, badly hitting the Rand

and this feeding through into higher inflation, with our semi-rigid pricing framework potentially worsening the inflation effects.

In addition, we continue to have a labour force making substantial wage and benefits demands, certainly in elite Union corners, but projected from

there much wider through institutional arrangements.

And our political environment remains uncertain, potentially giving way to patronage networks, inviting expansionary fiscal policies and generally

implying less discipline, potentially fanning inflation. And this also jeopardizing our credit rating and the demands by foreign creditors on what risk premiums we pay, and the pressure put on our financial

system?

So SARB has much to worry about even if short-term inflation were to fall away. A reason to allow real interest rates to rise some more (reducing our external capital flow exposure as global yield considerations change?). This continues to deny the potential for rate cuts. And this before

considering the SARB Governor's New York sentiments in early October of remaining on a rising rate trajectory (but also raising the issue of whether

he was playing to his audience?).

Comments since then focus on the bar being high for rate cuts (despite imminent inflation collapse) but this merely highlights how risk anxiety

remains front and centre in SARB calculations. Minimal growth lift, considerable inflation falloff, a stagnating SARB rate policy. And a volatile Rand (not discussed but still thrown in the hat in

the 13-16:$ range) in 2017. It could of course have been considerably worse (thinking recession, even higher inflation peaking, Rand at new lows, SARB

unforgiving with rate increases).

But if new crises don't derail us, the better prospect could prevail. Of course, we say this every year, and 2017 still appearing rather

challenging…

Trans-Atlantic Viewpoint: The Reinvention of the Democratic and Republican Parties

by George Friedman

The election is far from over, and given the pattern of this election, nothing can be taken for granted. So while at the moment Hillary Clinton appears to be winning, two weeks remain. Nevertheless, whoever wins the election, certain massive shifts in the party structure of the United States have become visible and need to be considered.

My focus, in general, is on the broad geopolitical forces shaping and reshaping the world. Politics (or which individual has what job) is of little interest to me. But in this case, there are two reasons to be interested in the American election. First, this is the United States, and shifts in the behavior of the US affect geopolitics globally. Second, this election (regardless of who wins) has revealed some profound changes in the underlying dynamics of American politics.

The New Deal Kicks Off a New Era

The frame for thinking about this issue lies with the two major political parties. I want to begin with the Democrats because it is the party that has undergone the most profound change, and the party in which change is least discussed.

The framework of the Democratic Party was set in the New Deal. It was a coalition of Southern whites, Northeastern industrial workers, and African Americans. There were other elements, but this was the core. It was an unlikely coalition. In dominating the American South, it included white supremacists and African Americans in the same coalition, and then threw Catholic and Jewish Northeastern and Midwestern urbanites into the mix.

The foundation of this coalition was poverty. The Civil War had ended 67 years before the New Deal, and the South remained impoverished compared to the rest of the country. The ethnic Northern industrial class (many of whom were just a generation or two away from immigration) had been devastated by the Great Depression, as had African Americans who had migrated north since the Civil War.

The Democratic Party won the election of 1932 because it cast itself against the economic and social disruption of the Depression. It created a coalition of those who had been most affected by the Depression and the Civil War.

The Republican coalition was focused on small businesses, small towns, the more prosperous farmers, professionals, and the upper class. It was the party of the previous generation, in terms of both wealth and culture. It retained the Republican disdain for the South, dating back to slavery, and felt unease regarding both the waves of Eastern and Southern European immigrants and massive industrial urbanization. This was in many ways the coalition that had ruled the country since the Civil War. But its power had been broken by the Depression.

The Republicans argued that the Depression was caused by the irresponsible consumption and lifestyle of the 1920s and that the solution was a dose of austerity. The Democrats' view was that this was a systemic failure of capitalism that could only be corrected by state intervention.

Goldwater Crashes the Party

The two coalitions lasted until 1964 when Barry Goldwater took the South away from the Democrats. Goldwater was crushed in the election, but the coalition shift he heralded reshaped American politics.

While the Democrats retained Northeastern ethnic workers and a growing black voting bloc, the Republicans retained the wealthy, the professionals, farmers, and a shrinking small town base. But the shift of Southern Democrats to the Republicans is what elected Richard Nixon, Ronald Reagan, and the Bushes. Since 1932, the party coalitions had remained stable, with the exception of the white South revolting against integration, which the Democrats championed. This shift to the Republicans resulted in 28 years of Republican presidents in the 48 years between 1968 and 2016.

In those years, a new section of the population emerged: the suburbanites. This group was relatively well-to-do and tended to be better educated. The suburbs were founded by the VA loans to World War II veterans and the interstate highway system that made the land around cities accessible. The pre-World War II suburbs were Republican, but this shifted as the Depression-WWII generation moved in. Then their children, the Baby Boomers, moved on, and what had been a stable coalition became far more unpredictable.

The Boomers had a general tendency to be socially liberal and, over time, more economically conservative. They were better off and so were drawn toward the Republicans. But this group had been forged in the 1960s, and their social perspective was far more flexible.

Increasingly, the Republicans sought to hold and expand their coalition with two strategies. One was the need for tax cuts. The other was the culture wars: opposing abortion and gay marriage, supporting prayer in schools, and the like. During this time, the Democrats remained wedded to the New Deal strategy. Then they added abortion rights, gay rights, and opposition to prayer in schools to their strategy. Cultural issues became at least the equal of economic issues (which had been the center of the New Deal Democrats).

The white South remained attached to the Republicans. African Americans remained attached to the Democrats. The children of the ethnic industrial workers were split. They now lived in the suburbs, and the suburbs were divided by a majority that was socially liberal and a large minority that was socially conservative. Both of these groups shared a general tendency to be economically conservative.

The Divide Becomes Cultural

The issue became increasingly about social mores, with an accelerating movement to normalize what had been considered deviant behavior. The children of the Boomers, the Millennials, were strikingly like their parents. They had their own cool name, they thought they were completely unlike their parents, and they tended to reinforce their parent's views.

The country remained rooted in a culture war, while there was a general consensus over more conservative economics. But beneath the surface, a massive shift was taking place.

The foundation of the New Deal coalition was that the Democratic Party was the party of the workers and the Republican Party was the party of the upper-middle class. But the culture wars had cut the Democrats' ties to blue collar workers without college degrees. This class also tended to be the most socially conservative. This was true not only in the South—where it was intense—but broadly around the country. Opposition to social evolution was present in all classes but most heavily in this class.

The Democrats had already willingly given up Southern conservatives. Now, given the culture wars, they were prepared to give up social conservatives everywhere. The problem though was that the social conservatives were to a large extent the non-college-educated workers that had once been the core of the New Deal coalition.

President Barack Obama sought, not entirely successfully, to keep this group in the coalition. Then, Hillary Clinton decided to use them to discredit Donald Trump. She painted Trump (and he painted himself) as the spokesman for those who were not college educated, white, socially conservative workers. Clinton understood that this group was not simply no longer favored by the Democratic Party—it was repulsive to the Democratic Party.

There is a constant argument that soon the United States will cease to be a predominantly white country, and that this group is increasingly irrelevant. A reasonable argument, it is posed in such a way as to create both a sense of desperate embattlement among white workers (particularly male) and a sense of loathing toward this group in the rest of the country.

There are two baskets. One is the "deplorables" who should have been expelled from the Democratic Party back in 1964 with the South. The second is the impoverished and hopeless. But the key here is that Clinton did not try to split Trump's hold over this second group, as Lyndon Johnson or Harry Truman would have. Rather, she treated them as alien and unimportant.

The Democrats basically gave up this core constituency of the New Deal—the white, undereducated working class, committed to strict social values. Clinton's calculation was that the price of retaining them was to accept strict social values. If she did that, she would lose heavily with the Democrats' new base… the socially liberal in all classes.

Look at this another way. Since 1932, American politics were driven by economic issues. Now, they are driven by social issues. From the Democrats' point of view, the working class was on the wrong side of these social issues, so Clinton gave up on them.

The Future of the Parties

The Democrats created chaos in their base, but in an orderly fashion. The Republicans created it in a disorderly way. Trump drew the white working class to him and engaged in what proved to be the losing side of the social values debate. While he had support in other classes, he did not own them as he owned white, non-college-educated workers. The Republican Party lost the culture wars in 2016: they added the white working class (as Reagan had in part) but united them on social issues that simply didn't have the votes.

The issue, at present, is this: What is the Democratic Party about now, if it has already won on gay rights, abortion, and prayer in schools? What is the reason to vote Democrat in 2020? If there is a recession and 2020 is a tough economic year, what is the coalition that will flock to the Democratic Party?

The major political battles on the cultural issues have been won. And while the battle may continue, a massive reversal on these issues would require a massive reversal in the political structure of the United States. The issue at this point is the fate of those earning below the median income. These are the people in the second basket of Trump supporters… and the former core of the Democratic Party. But because of the Democrats' shift on cultural issues, they are now more aligned with the classes who earn above the median income. If they focus on those below, they must shift their cultural views. If they focus on those above, they alienate their old base.

If the Republicans now have the South and the white working class, what do they do with it once the culture wars subside? Both parties tossed out historical coalitions to fight the culture wars. When they are done, there is no clear hold the Democrats have on any group for primarily economic reasons—the Democrats' old foundation. The Republicans actually have more currency there now. But these groups and the traditional Republican base don't live well with each other.

It is tempting to say that the Republicans are a permanent opposition party now, but that would be wrong. For the moment, they have the possibility of owning the emerging challenge in the US—the ability of the middle class (and those below) to afford a decent standard of living. This was one of Reagan's issues, and Trump resurrected it. The question is what the Republicans will do with the issue.

Nevertheless, I will argue that when we look back at this year, the Republicans will have lost the election, but they have been handed an opportunity to build a new coalition. The US may or may not find that whites are a minority, but it is not clear that all non-whites have common interests. Franklin Roosevelt had white urban workers. And Nixon offended white suburbanites. The Republicans' acquisition of white non-college educated males, plus the South, is not trivial. This is a vital but not sufficient base. And we will see that when hard times come, as they always do.

Tying this base together with a winning coalition will not be easy, as it challenges what the Republican Party has become for the last generation. But then, Trump has ended that phase of Republican history.