MARKET COMMENTARY

QUARTER 1, 2024

INN8 INVEST

RECORD HIGH FOR STOCK MARKETS

AMID RATE CUT HOPES

After an up-and-down start to the year on the back of the market pricing-in aggressive rate cuts in the world's largest economy – as many as six interest-rate cuts – global equity markets continued their strong performance with many ending the quarter at all-time highs.

The consensus view is that interest rates have peaked in major developed countries, but markets have had to dial back expectations on when central banks will kick off the rate-cutting cycle this year. The major central banks kept their key interest rates unchanged, except for the Bank of Japan. It set its policy interest rate in a range of 0%-0.1%, up from -0.1% – this is the first time the nominal rate has been positive since 2016. The Swiss National Bank made a surprising move, cutting its interest rates by 25 bps to 1.50%, prompted by a significantly lower inflation forecast.

Central banks give the greenlight

Central bankers are now grappling with **HOW** soon and **HOW** far they should lower rates. They have reiterated their commitment to maintaining high interest rates to achieve their respective inflation targets.

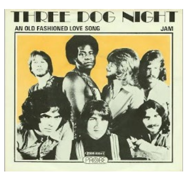
Policymakers in the US maintained their outlook for three cuts in 2024 and moved toward slowing the pace of reducing their bond holdings, which suggests they are not alarmed by the recent rebound in price pressures. Markets are now pricing in a year-end 2024 Fed funds rate of 4.54% vs the current range of 5.25% to 5.5%. Andrew Bailey, Governor of the Bank of England, said interest rate cuts are "on the way" as inflation falls.

> "The normalisation of global inflation will be the primary driver of rate cuts rather than a late-cycle collapse in economic growth." - Paul Carr and Adam Furlan, Ninety One

Global growth, especially in the US, has been resilient and the growth outlook remains strong. The Fed revised their GDP growth estimate for 2024 substantially from 1.4% to 2.1%, however, the timing of the first rate cut in the US remains uncertain and will be data dependent as the US Fed keeps a close eye on inflation and growth numbers.

GLOBAL MARKETS

Top of the charts...week in week out



Wall Street's major stock indices – the S&P 500, Dow Jones, and Nasdaq – achieved all-time highs in the first quarter, a hot streak of weekly gains last seen in 1971 when Three Dog Night's "Joy to the World" topped the Billboard Hot 100.

On the other side of the globe, we witnessed a similar milestone, with Japan's Nikkei 225 Index at a new record high, surpassing levels last reached in 1989. It therefore comes as no surprise to also see the MSCI AC World Index at a new record high – up 8.2% YTD and 23.2% for the 12-months ended March 2024.

INN8 INVEST

A dovish Fed and the AI boom keep driving the US market. The S&P 500 gained a further 10.6% in Q1 2024. A reassuring economic outlook is also encouraging investors to look beyond technology stocks, with the financials, industrials and energy sectors also outperforming the S&P 500 YTD.

After the 'Magnificent Seven' posted huge gains in 2023, performance among them has diverged more this year, giving investors more reason to look at the rest of the market. Nvidia's share price jumped another 82% this year. Meta surged 37% after the tech behemoth reported its biggest quarterly sales increase in two years and initiated its first-ever dividend. Microsoft gained 12% for the quarter. On the other side of the ledger, Apple, Alphabet and Tesla lost 11%, 8% and 30%, respectively. Tesla is the worst-performing stock in the S&P 500 this year.

At the end of Q1, the 10 biggest companies made up just less than one-third of the total market value of the S&P 500. The top three – Microsoft, Apple and Nvidia – account for 17.9% of the total. This is not the first time the US stock market has been highly concentrated in a few large companies. In the boom years of the 1950s, the 10 biggest companies, which included AT&T, DuPont, and General Motors (GM), regularly exceeded 30% of the value of all US stocks. In July 1955, GM amounted to 6.8% of the value of the entire US stock market according to the Center for Research in Security Prices at the University of Chicago.

Poster child…Nvidia

Nvidia's market capitalisation surpassed $2 trillion during the quarter, just 180 trading days after hitting the $1 trillion mark. The chip maker – now the world's third most valuable company – also unveiled its latest AI systems during the kick-off of its annual developers conference in March.

It included the first official details of the company's Blackwell GPU architecture, named after David Blackwell, the first African American member of the National Academy of Sciences. This will succeed its popular H100 systems that have become the workhorse of generative AI workloads. Nvidia is claiming it will enable up to 30 times greater inference performance and consume 25 times less energy for massive AI models.

China… foreign investors remain watchful

The CSI 300 Index gained 3% for the first quarter of the year, after Chinese policymakers stepped up their efforts to support the economy and sliding markets. The measures have included:

- Unleashing more long-term cash for banks – the central bank lowered the reserve requirement ratio, which is the amount of cash lenders must keep in reserve.
- Tightening rules on the lending of shares for short selling.
- An abrupt bout of state-backed ETF buying. According to estimates by UBS Group AG, China has poured more than $57 billion into onshore shares this year in a bid to prop up the market; and lastly
- Broadened access to loans for property developers to boost the beleaguered housing market. In the latest sign of distress in the real estate sector, troubled property giant, Country Garden Holdings, announced that it will miss its annual reporting deadline and needs more time to assess its financial situation.

Foreign investors remain wary of the Chinese government, which has clamped down on private enterprise. This together with weakness in the property sector, a drop in demand for China's exports, as well as high debt levels have weighed on the Chinese stock market – the MSCI China TR Index lost 18% in US dollar terms over the past 12 months.

Japan…stock market surpassed the 40 000 level

Japanese stocks reached levels that have not been seen for 34 years, with the Nikkei 225 Index gaining another 21% this year. This performance was mainly driven by gains in technology shares. There are also fundamental reasons why investors are bullish on Japan:

- The government's push to improve corporate governance has boosted dividends and buybacks.
- Activist investors are increasingly throwing around their weight and Japanese companies are more willing to listen.
- Warren Buffett's endorsement, through his big investment in Japanese trading companies, gave sentiment another push.
- As with most stock markets around the world, the Japanese market is benefitting from the end of the US Fed rate-hiking cycle.

New paradigm... positive interest rates after 17 years

The Bank of Japan (BoJ) finally ended an eight-year experiment to escape deflation. The 'war' against deflation began in earnest in 2013 under then-prime minister, Shinzo Abe – 'Abenomics' combined generous government spending and central bank monetary easing. Japan's long experience has challenged the first claim, putting Japan's 'lost decades' of stagnation and deflation behind it. Now, unwinding its policies will test the second.

To date, markets have taken Japan's first interest-rate hike since 2007 in stride, as the yield differential remains wide with other major economies. The yen hit its weakest level against the dollar in 34 years, with traders citing the BoJ's promise to keep conditions accommodative as a sign there will not be rapid tightening ahead. Also, moving too quickly could also see a flight of capital from elsewhere into Japan by investors seeking higher returns, potentially destabilising financial markets.

Nevertheless, one of the biggest questions is what happens to that big ball of money stored overseas in assets including US government bonds. Japanese investors, for example, hold around $1.1 trillion of US Treasury bonds, making them the largest foreign owner. Japan's foreign-portfolio investments stood at the equivalent of $4.2 trillion at the end of 2023. A large percentage of that comes from Japanese pension funds and insurers, who would suddenly have more attractive options at home.

Gradual interest rate increases in Japan probably will not change investment flows much in the short term, but it could be a different story down the road if the shift back to positive rates proves sustainable. If that starts to change, the effects will be felt nearly everywhere, sooner or later. Years of 'cheap' money encouraged an enormous carry trade in which investors could borrow yen to fund investments elsewhere.

Unwinding these trades as the BoJ normalises policy could reshape financial markets around the world.

Rate cuts delayed ... 'setback' for global bonds

Global bonds dropped this year as Fed Chair Jerome Powell led major peers in pushing back strongly against market bets that central banks would start cutting interest rates as early as March. The rout accelerated after data showed US inflation in February was stronger than expected – CPI rose 3.2% in February.

The 10-year US Treasury yield finished the quarter at 4.19% after starting the year at 3.86%, with the Bloomberg Global Aggregate TR Index down 2% YTD.

LOCAL MARKETS

Lack of structural reform is haunting us

History has shown that structural reforms can take a long time to bear fruit and can manifest in higher growth and more jobs. We desperately need structural reform. In contrast to the major developed markets that are mainly confronted with disinflation for now, we unfortunately have more to worry about. Our big challenge is stagflation i.e. **LOW** growth, **HIGH** Inflation and **HIGH** unemployment. To get ourselves out of this low-growth trap, South Africa needs to address the deep, structural constraints that will lift output in sectors such as mining, agriculture, manufacturing, and services (to name a few) and improve the ability of those sectors to generate jobs.

LOW growth	Economic growth in 2023 was only 0.6%, compared with 1.9% in 2022. The IMF downgraded its economic growth forecasts for SA, warning that logistical challenges are constraining activity. The economy will likely grow a meager 1% this year, although the Reserve Bank is forecasting a slightly higher rate of 1.2%. This is well short of the growth rate required to overcome the stagflation challenge.
HIGH inflation	The Monetary Policy Committee (MPC) kept interest rates on hold at 8.25% for the fifth time in a row, signalling a delayed start to an anticipated cutting cycle, with inflation risks still skewed to the upside. Inflation tilted further upwards to 5.6% in February, from 5.3% in January.

HIGH unemployemnt	Unemployment, which according to the expanded definition includes people who were available for work but not seeking a job, stood at 41.1% at the end of December 2023. The jobless rate may continue to rise as weaker commodity prices, energy shortages and logistics constraints on the freight-rail system take their toll on the profits of mining companies. Amplats has opened discussions with labour unions that may affect 3 700 jobs and Sibanye has already cut 2 600 employees.

Budget…the 'bracket creep' catch

The 2024 Budget revealed ongoing fiscal challenges as revenue collection falls short of expectations, while public sector wage demands, and rising debt service costs worsen expenditure. To address fiscal pressures and support debt stabilisation, the Budget proposed net tax revenue increases, primarily through non-inflationary adjustments to personal income tax brackets.

Without adjustments for inflation, taxpayers might find themselves effectively paying more tax due to 'bracket creep,' where inflationary salary increases push them into higher tax brackets without a real increase in purchasing power, putting more pressure on taxpayers.

Disappointing start to the year…equity market down

The JSE All Share Index lost 2.3% in Q1. Numerous events resulted in the overall market underperforming, from a raft of disappointing earnings announcements and trading updates to the decision by the SARB to keep interest rates higher-for-longer.

Financials were the main drag, losing 6% in Q1, led by banking and insurance shares. Standard Bank and FirstRand lost 11% and 16% respectively, followed by Old Mutual which lost 10%.

Notwithstanding an uptick in the price of Platinum Group Metals (PMG) in March, the underlying performance in the mining sector remains weak. **Resource** shares lost almost 2% in Q1 and are down 9% over the past 12 months. The four biggest PGM producers – Sibanye Stillwater, Anglo American Platinum, Impala Platinum Holdings and Northam Platinum – released sobering earnings reports during the past quarter. Ongoing structural domestic issues including weak sentiment, policy uncertainty, logistics issues and recurring rolling blackouts continue to weigh on the sector. Sasol dropped 21%, with disappointing results including the news that it would need to slash its dividend.

Financials -6% ↓

Resources -2% ↓

Industrials 1% ↑

Industrials managed to grind-out a small positive return, gaining almost 1%. This was led by British American Tobacco (BAT) which gained almost 7% after the decision to commence with a $2 billion buyback program after selling part of its stake in India's ITC. BAT has been under pressure to return more cash to shareholders. Unfortunately, retail stocks plummeted on the back of the depressed local consumer environment with retail sales volumes contracting by 2.2% YoY in January. Spar (-25%), Woolworths (-18%) and Pick n Pay (-20%) were a drag on the sector. In addition, paper and packaging company Mondi Plc lost 16% after agreeing to buy DS Smith Plc for £5.1 billion (R119 billion) in a deal that would create one of the world's largest manufacturers of packaging.

The JSE All Property Index gained 3.5% YTD. Valuations in the market appear attractive and positive rental reversions together with better-than-expected earnings could see a re-rating in the sector. The JSE All Bond Index fell 1.8%, as yields crept slightly higher during Q1. Money market assets, as measured by the STeFI Composite Index, delivered a respectable 2% for the quarter.

Albert Louw
INN8 Invest

INN8.CO.ZA