momentum
investments

The Macro Research Desk

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Economic and market snapshot for November 2016

Global economic developments

United States (US)

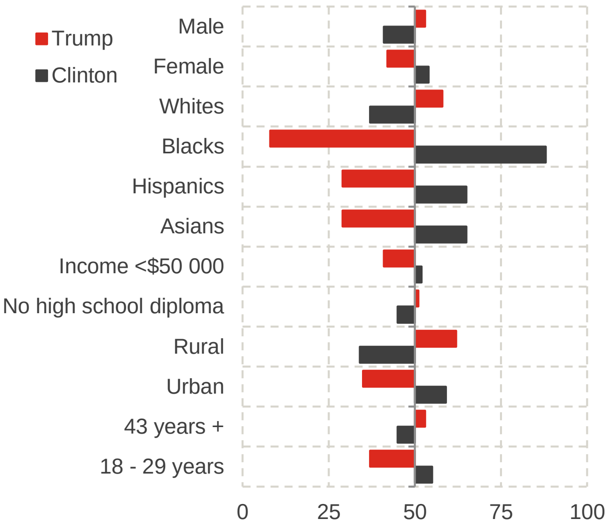
Populists hail Trump's victory in the US presidential election as discontent over incumbent political establishments grows

Trump's populist campaign targeting foreign policies, institutions and political elites appealed to a large number of American voters in key states, revealing a deep and widespread anti-establishment attitude.

Trump tapped into an overlooked demographic, namely the white working class. His call to protect American jobs likely appealed to those voters, where between 2007 and 2014, the median income of white males without college degrees fell by 14%. Notwithstanding negative comments about Mexicans, Trump fared marginally better among Blacks and Hispanics than Republican frontrunner, Romney, in 2012. Meanwhile, Clinton did not achieve as large a share of these core Democratic groups as President Obama did in 2012.

Divisions within the electorate by gender, race and education were evident in an analysis of national exit poll data conducted by Edison Research (see chart 1).

Chart 1: US election voter breakdown (% of voters)



Source: Edison Research (numbers will not add up to 100 in all cases, as not all questions were answered and other candidate votes were counted)

Despite young adults (aged 18 to 29 years) preferring Clinton over Trump by a wide margin (55% versus 37%), Clinton received a lower share of the vote for this age cohort than Obama received in 2008 and 2012.

Although Trump comfortably won the Electoral College votes, Clinton narrowly won the popular vote, symbolising a sharply polarised political divide. According to the Pew Research Centre poll, 58% of Republicans and 55% of Democrats had a very unfavourable view of the opposing party in 2016. This proportion has risen considerably from 32% and 37%, respectively, in 2008.

At this stage, Trump's economic policy stance is far from clear and may prove to be more pragmatic relative to radical campaign rhetoric, given the reality of a separation of powers, the influence of his eventual appointed cabinet, as well as congressional fiscal hawks, who may push back on seemingly bold fiscal plans.

Eurozone

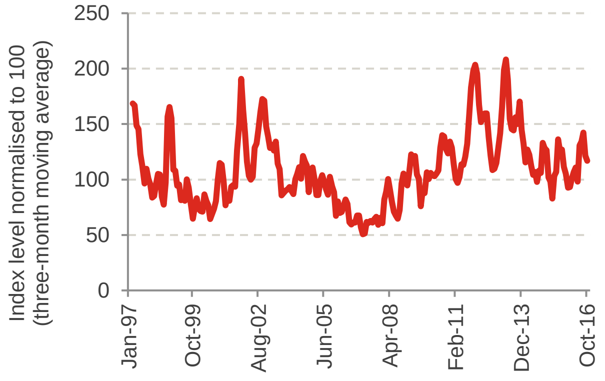
Italy's constitutional referendum could trigger additional political shockwaves in the global economy

Currently, laws have to be passed by both chambers (Senate and the Chamber of Deputies), resulting in a more-or-less equal separation of powers in Italy, which has led to many political gridlocks in the past.

Earlier this year, the Italian parliament voted to change this by limiting the Senate's involvement in law-making. This vote aimed to improve the stability of the Italian political system by streamlining decision-making to allow for faster progress on economic reforms.

The majority vote was, however, too small and did not reach the two-thirds majority required to be passed as legislation. Consequently, the matter is up for a public vote on 4 December.

Chart 2: Policy uncertainty in Italy has risen for the year to date



Source: Economic Policy Uncertainty

Prime Minister Renzi had previously pledged that he would step down in the likelihood of a 'no' win (i.e. a vote against the proposed changes to the constitution), but he has since backtracked. Even so, the political situation could become turbulent (see chart 2) even if he remains in office, as his party would likely lose support in the event of a negative outcome on the referendum vote. Italy's anti-establishment party, the Five-Star Movement, is seen to be a likely beneficiary in this scenario, which could fuel the rise in populism that has triumphed in the US (Trump victory) and the United Kingdom (Britons opting out of the European Union) so far this year.

Japan

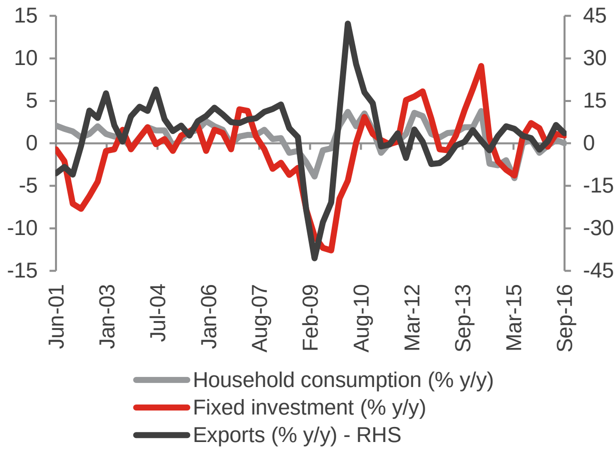
Export-reliant economic recovery at risk from weak domestic demand

Economic activity expanded for a third consecutive quarter by an annualised 2.2% in the third quarter of 2016, exceeding market expectations for a shallower rise.

Private consumption inched only 0.1% higher year-on-year for the third quarter of the year, as muted annual wage increases provided little support to household spend (see chart 3).

Spending by businesses remained relatively flat in response to low potential growth and sluggish momentum in economic reform.

Chart 3: Japanese GDP breakdown



Source: Bloomberg, Momentum Investments

Net exports (exports less imports) contributed 0.5% to real gross domestic product (GDP) growth, thanks to falling imports triggered by an earlier appreciation in the yen and a dip in international oil prices. Although Trump's election victory has led to a slump in the yen, which could extend the country's export-reliant economic recovery, the currency could face strengthening pressure in an environment of rising risk-off sentiment.

Moreover, Trump's vow to introduce a 45% tariff on all imports from China (unless it unwinds generous subsidies to key manufacturing industries) could hurt Japanese trade, even if protectionist measures are directed at China. According to the International Monetary Fund, a 1% decline in Chinese real GDP growth could shave a quarter of a percent of growth off Japanese GDP.

As such, the positive surprise in Japanese GDP should be viewed with caution. Bank of Japan Governor Kuroda acknowledges that "risks to both economic activity and prices are skewed to the downside". He maintained his commitment to further easing, should the economy lose momentum in reaching its 2% inflation target, which has been pushed back for the fourth time since Kuroda took office in 2013.

Emerging markets (EMs)

'Trumpenomics' raises the risk of a rise in protectionism, a reduction in capital flows and increased financial vulnerabilities

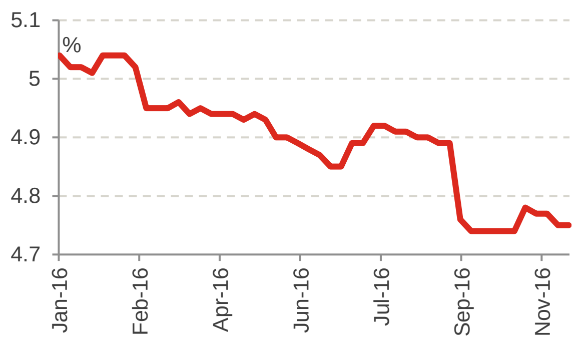
A Trump presidency increases downside risks for the anticipated EM economic recovery (see chart 4). Protectionist comments made in the election campaign raise the risk of lower global trade activity, which could have a dampening effect on growth in EMs geared to world trade.

Trump's spending plans could also prove to be inflationary, which has led markets to price in a higher US interest rate profile. EMs with large dollar-denominated debt burdens (including key economies in Emerging Asia) are vulnerable to a more rapid rise in US policy rates and the dollar.

Furthermore, economies with large current account deficits reliant on external funding (typically net commodity-exporting countries), could face increasingly challenging conditions for foreign capital funding.

While it is yet to be seen whether Trump's campaign rhetoric materialises into a stronger fiscal impulse in the US (spurring inflation and raising the prospect of higher US interest rates) and renegotiated trade deals, EM currencies (particularly those belonging to countries exposed to a larger foreign ownership of government bonds) have sold off in reaction to potential downside risks to EM assets under a Trump presidency.

Chart 4: EM 2017 GDP consensus forecast



Source: Bloomberg, Momentum Investments

Local economic developments

Political instability is a shared concern for Fitch and Moody's

Fitch Ratings lowered its outlook on SA's long-term sovereign debt rating to negative from stable, but kept the rating intact at BBB-. Moody's, which rates SA one notch higher than Standard and Poor's (S&P) Global Ratings or Fitch at Baa2, left the rating (and the negative outlook on the rating) unchanged.

A common concern voiced by both ratings agencies was the current state of political affairs in SA. SA's potential growth profile and overall governance could be negatively affected by political infighting, distracting policymakers from adhering to sound fiscal management and maintaining a healthy investment climate through the implementation of growth-enhancing policy initiatives. Despite Fitch suggesting (in its December 2015 ratings review) that SA ranked higher than its peers on the World Bank Governance Indicator, it noted that recent political tensions may not be adequately addressed in the most recent results for 2015.

Fitch highlighted that SA's real GDP per capita is estimated at US$5,140 in 2016, which ranks significantly lower than its peer group (US$9,188). The failure of SA growth to outperform population growth has been a key concern of S&P. In a recent presentation, S&P showed that SA's real GDP per capita had declined since 2012 (see chart 5) and was markedly lower than many others in its peer group.

Potential growth remains muted and real GDP per capita growth will likely struggle to outpace population growth in SA in the next three years. Low economic growth continues to constrain SA's economic assessment and rising political tensions are accentuating vulnerabilities. Consequently, SA is, in Momentum Investments' view, not yet out of the woods regarding the foreign rating and, as such, the company sees a higher-than-even chance of a foreign rating downgrade by S&P to sub-investment grade by June 2017.

Chart 5: SA's real GDP per capita over time

Source: S&P, Momentum Investments

Financial market performance

Global markets

Global equities lifted 0.8% in November 2016, bolstered by a 1.4% recovery in developed market (DM) equities, while US dollar strength weighed heavily on EM equities for the same period.

Within DM equities, the S&P 500 Index was one of the clear outperformers in November 2016, surging 3.7%. Gains were spurred by optimism that economic policies supported by Trump, including proposals to increase military and infrastructure spend, would stimulate economic growth in the US. Japanese stocks also extended their winning streak, following the US election outcome, as renewed US-dollar strength and an uptick in global bond yields boosted Japanese exporters and banking stocks.

Meanwhile, the Eurostoxx 50 Index tracked sideways for the corresponding period, as political risks resurfaced in the run up to the 4 December referendum on constitutional reform in Italy.

EM equities tumbled following Trump's victory, in line with fears that Trump will follow through on campaign rhetoric against free trade. The MSCI Latin America Index was the biggest loser in November 2016, collapsing more than 15% by mid-month before recovering marginally into month end. The MSCI Europe, Middle East and Africa (EMEA) Index plummeted 4.9%, followed by a 3.3% dip in the MSCI Asia Index for November 2016.

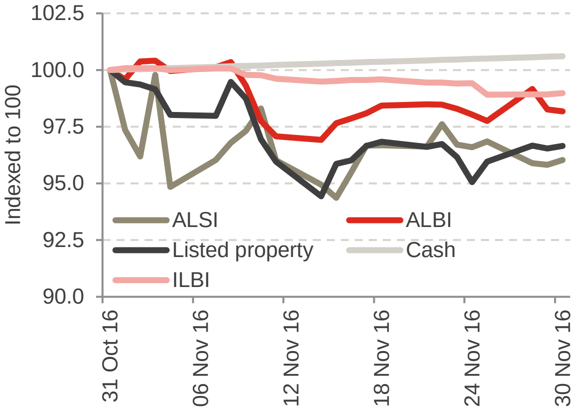
Local markets

Despite intra-month volatility, the FTSE/JSE All-Share Index ended the month only 0.6% weaker. The FTSE/JSE Resources Index gained the most, following a strengthening in commodity prices. The index increased 6.1% for November 2016, followed by a 0.3% gain in the FTSE/JSE Financials Index. The FTSE/JSE Industrials Index lost 3.7% for the same period.

The FTSE/JSE Mid-cap Index lost 2.2% for November 2016, while losses in the FTSE/JSE Small-cap Index were capped at 0.5%.

SA ten-year government bonds sold off by 46 basis points in the immediate aftermath of the US election results and has since only partially retraced the initial sharp move higher. The FTSE/JSE Listed Property Index declined by 3.3% for November, followed by a 1.8% decrease in the Inflation-linked Bond Index (ILBI). SA cash gained 0.6% for the same period.

Chart 6: Local asset class returns



Source: Bloomberg, Momentum Investments

The rand sold off around 7% against the US dollar in a shock market reaction, following Trump's victory, but strengthened later in the month, partly due to Moody's and Fitch's decision to leave SA's credit ratings unchanged. The rand experienced renewed weakness at month-end, following dashed expectations that the incumbent president may leave office after three-day discussions were held by the National Executive Committee (NEC) of the African National Congress (ANC).

Indices summary for November 2016

Equity indices	One month	Three months	One year	Three years	Five years	Ten years
FTSE/JSE All-Share Index (ALSI)	-0.55%	-3.94%	-0.10%	6.86%	12.20%	10.85%
FTSE/JSE Shareholder Weighted Index (SWIX)	-2.35%	-5.94%	-0.86%	8.12%	13.42%	11.76%
FTSE/JSE All Share Top 40 Index	-0.55%	-4.72%	-3.20%	5.89%	11.48%	10.25%
FTSE/JSE Mid Cap Index	-2.15%	-1.99%	16.87%	10.95%	14.86%	13.88%
FTSE/JSE Small Cap Index	0.48%	0.23%	8.39%	11.55%	18.44%	13.48%
FTSE/JSE Resources Index	6.11%	7.07%	33.87%	-8.72%	-5.88%	0.28%
FTSE/JSE Financials Index	0.28%	0.80%	-4.56%	11.36%	17.70%	11.08%
FTSE/JSE Industrials Index	-3.65%	-9.71%	-8.47%	8.65%	18.19%	16.34%
FTSE/JSE Research Affiliates Fundamental Indices 40 Index (RAFI)	2.79%	3.33%	15.35%	6.53%	11.02%	11.00%
FTSE/JSE Research Affiliates Fundamental Indices All Share Index	3.30%	4.64%	16.50%	6.60%	11.02%	10.57%
FTSE/JSE SA Listed Property Index (SAPY)	-3.34%	-1.80%	-0.76%	13.45%	16.81%	15.61%
Interest-bearing indices						
BEASSA All Bond Index (ALBI)	-1.83%	1.75%	6.08%	6.74%	7.18%	7.96%
BEASSA All Bond Index 1-3 years (ALBI)	0.15%	2.01%	7.62%	6.70%	6.57%	7.83%
Barclays BEASSA SA Government ILB Index	-1.02%	0.14%	4.71%	7.47%	8.56%	9.53%
Short-term Fixed Interest Composite Index (SteFI)	0.61%	1.88%	7.33%	6.52%	6.06%	7.32%
Commodities						
NewGold Exchange-Traded Fund	-3.90%	-14.33%	7.97%	8.69%	3.14%	12.95%
Gold price (in rands)	-4.82%	-13.55%	7.65%	9.19%	2.68%	13.51%
Platinum Exchange-Traded Fund	-2.69%	-16.61%	7.75%	-3.19%		
Platinum price (in rands)	-2.80%	-16.89%	7.11%	-2.41%	-1.76%	1.17%
Currency movements						
Rand/euro movements	0.71%	-9.21%	-2.19%	2.46%	6.43%	4.58%
Rand/dollar movements	4.03%	-4.58%	-2.70%	11.33%	11.62%	6.94%
Inflation index						
Consumer Price Index (CPI)			6.36%	5.64%	5.61%	6.22%
Global indices						
MSCI World Index (All Countries)	-3.30%	-2.69%	-1.10%	13.65%	19.38%	8.92%
MSCI Developed Markets Index	-3.35%	-3.23%	-1.15%	14.66%	21.34%	10.35%
MSCI Emerging Markets Index	-2.79%	0.80%	6.78%	7.83%	11.90%	
Global Property Research (GPR) 250 REIT Index	-9.81%	-15.34%	0.57%	31.90%	36.50%	16.91%
MSCI Africa Index	-2.62%	-6.11%	-3.96%	4.23%	9.33%	
Citigroup World Government Bond Index	-5.15%	-4.80%	4.06%	10.58%	11.53%	9.77%
Three-month US dollar LIBOR rate	-1.70%	-2.52%	-1.63%	10.87%	12.25%	7.57%
Three-month Euro LIBOR rate	-4.45%	-4.76%	-3.31%	2.79%	6.22%	

Important notes

1. Sources: Momentum Investments (Pty) Ltd, INET BFA, www.msci.com, www.yieldbook.com, www.ft.com.
2. Returns for periods exceeding one year are annualised.
3. The return for Consumer Price Index (CPI) is to the end of the previous month. Due to the reweighting of the CPI from January 2009, this number reflects a compound of month-on-month CPI returns. The historical numbers used are the official month-on-month numbers based on a composite of the previous inflation series (calculations before January 2009) and the revised inflation series (calculations after January 2009).
4. The MSCI World index (All Countries) returns are adjusted to correspond with global investment prices received.
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