Are markets souring?

Last week, Willie delved into a few interesting trends across markets – the Magnificent Seven, the "Granolas", and the surge in commodity prices. Those trends remain in place. But after a stellar start to the year – US and European markets were up over 10% in Q1 - markets have cooled in April. As always, we ask why and whether this signals a change in trend or is merely a healthy correction?

Michael Porter

Markets started 2024 in an ebullient mood, underpinned by the momentum generated in Q4 last year and the propsect of falling interest rates combined with solid economic growth. What was not to like? Furthermore, the Magnificent seven – as articulated by Willie last week – continued to shine as AI grabbed all the headlines. Consequently, US markets rallied by 10% in Q1. European markets fared even better, rising a solid 12% over the quarter. The UK (+3%) was the outlier by a wide margin.

The second quarter has started on a more sombre note. US markets have lost half of those gains, with the tech shares coming under more pressure. The Nasdaq Composite Index is not far from where it started the year. So why the change of trend? Is this a healthy correction, or the start of something more worrying?

As we have so often noted, the ultimate mover of markets is interest rates. After all, interest rates are the price of money. In late 2023, a steady decline in global inflation fuelled optimism that rates would be falling by March. In January, we argued that such a timeframe was unrealistic and that markets had got ahead of themselves. But the optimism continued, buoyed by further hype around AI, and solid economic data.

In our opinion, markets have "sobered up" over the past few weeks, for a few key reasons:

1. US economic data continues to surprise positively. Fears of a US slowdown has so far been exaggerated. We discussed in the Money Morsel that we risked entering a period where "good news was bad news and vice versa!" You might think that strong economic data is good news – and it is. Ultimately a solid economy is required to generate profit and dividend growth. But the bad news is that it eases the pressure to cut interest rates prematurely.
2. This was ultimately confirmed by the Chairman of the Federal Reserve earlier this month. Having held the line for months that the cutting cyle was on track to start in June, Jerome Powell finally admitted that data was too strong and inflation too sticky. The first cut is now only anticipated in August and September. If we must highlight one major risk for the remainder of this year, its that interest rates don't fall at all. That is not our base case, but we have to acknowledge it as a risk.
3. It is also worth bearing in mind that the closer we get to the end of the year, the less likely the Federal Reserve is going to act. That is because of US elections in November. Similar to our own Reserve Bank, the Federal Reserve would not want to be seen to be favouring any one candidate over another. Cutting rates a month before the elections could easily be misinterpreted.
4. I have focused mainly on the US, because ultimately US policy sits at the centre of the financial world. But in contrast to the US, European and UK officials are singing a different tune. They are suggesting rate cuts by the middle of this year. This is causing currency volatility, and

SPEED READ

- **Globally, markets started 2024 on the front foot, buoyed by the prospect of declining rates and stronger economic growth.**
- **That optimism has been tempered as the timing of US rate cuts gets pushed further and further out and geopolitical events rear their head again.**
- **Markets are in a tug-of-war between solid economic growth on the one hand, and higher interest rates on the other. The current reporting season will shed light on which side has the upper hand.**
- **Locally, it is unsurprising that investors are taking a cautious approach ahead of next month's election. This despite reduced loadshedding, solid earnings growth and a commodity upswing. That offers opportunities.**

a stronger dollar, at least for the moment.

5. Coming back to inflation, one of the reasons why inflation hasn't fallen as fast as expected is the rise, once again, of geopolitical tensions. Thankfully, at the time of writing, tension between Iran and Israel had simmered down. But the region is on tenterhooks, and so too, are markets. Petrol prices in the US are up 14% this year. In SA, petrol is 8% higher. At least we are not alone in our suffering. A regional conflict, and the impact on oil prices, remains another wildcard for markets. The longer they stay elevated, the slower inflation will fall.

These global jitters have also fed through to the local mood, and have been compounded by pre-election nerves. Whilst our inflation rate is stable and trending marginally lower, the SARB will be hard-pressed to cut local interest rates if global central banks are holding tight. That implies that the benefit of lower interest rates will only manifest itself in our economy in 2025, later than previously expected.

Yet its not all doom and gloom. Globally, growth is accelerating, as Willie highlighted last week. Manufacturing is expanding for the first time in 18 months, and the implications of AI on downstream industries is starting to become a talking point. The result is a rally in commodity prices. Furthermore, we have now had no loadshedding for 28 consecutive days – the longest period of constant power since Q1 2022. Whilst we agree that it smacks of electioneering, there is still a benefit to the economy as a whole, and it buys time until new private sector generation comes on stream. Having traveled recently to the northern Cape on holiday, I have seen first-hand the proliferation of new solar generation. The energy revolution is well underway.

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As all investors are aware, markets never go up in straight lines. There is a constant ebb and flow that mirrors rising optimism and pessimism. Globally, the near-term trend will be set by company results over the next few weeks, which we expect to be broadly positive. Locally, markets are likely to tread water until the elections – thankfully now only about a month away. Despite the uncertainty, we believe the weakness is overdone. SA is once again trading at record lows against our peer group. That always provides opportunities for those able to block out the noise.

CORRECTION*:*

Two weeks ago, Robin erroneously quoted our magnificent UFC Championship fighter as Dricus Van Heerden, when in fact he is Dricus Du Plessis. Apologies for the error. If you missed his brutal championship win or his interview where he criticized the SA Government, both are available on YouTube.

Blue skies are emerging over the world economy.

By the time of our next Insight seminar, our election will be out of the way. We will take the opportunity to review market performance for the first five months of the year, and look ahead to what the second half might hold.

Please note that we will be hosting both a morning and evening presentation in Cape Town. The venues will be communicated once finalised.

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Topic:	Taking Stock: Mid Year Update
Natal Midlands	
Date:	20 June, 2024
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	11 June, 2024
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	13 June, 2024
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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