23 March 2022

Outlook for the day

The overnight traction in US markets, a marginally improved trading tone in early morning US futures trading and workmanlike momentum in the Asian Pacific region will allow the JSE to deliver further marginal improvement even though very short-term technical metrics are currently a touch stretched. The upside for domestic equities will however face a tailwind in the form of the modestly improved Rand. Despite the likelihood of further marginal improvements current levels do not offer favourable entry points at which to engage the market with available evidence indicating that some circumspection and patience is appropriate.

- More pressure on Russia
- Easing tariffs on British steel and aluminium
- Helping struggling U.K. families
- The China Eastern Airlines crash.

Here's what people are talking about.

New Sanctions

President Joe Biden and allies meeting Thursday in Brussels are expected to announce both new sanctions against Russia and fresh measures designed to keep the Kremlin from sidestepping existing economic penalties. The moves are expected to cap an intense day of diplomacy that will see Biden attend an emergency NATO summit, a meeting of the Group of 7, and a session of the European Council. The U.S. and partners are also expected to announce new action aimed at "enhancing European energy security and reducing Europe's dependence on Russian gas."

Can Europe wean itself off Russian fossil fuels?

Lots of circular talk but little action yet as Europe wrestles with the fact that Russia provides more than 40% of the EU's gas and coal imports and more than a quarter of its crude oil imports. The ECB estimates that cessation of Russian energy imports would cut 1.4% off eurozone GDP reducing growth to 2.3%. Professor Gerald Mangott, of Innsbruck University, says Russia earns 23% of state income from taxing oil exports but only 8% from gas. He thinks Europe will cut of the oil supply from Russia but not the gas. He thinks the Russians might cut off the gas anyway. Zelensky has urged Berlin to sever economic links with Russia "which just uses you to finance the war". FT.

Cleveland Fed President Mester proposes front loading rate hikes

In a speech at John Carroll University, Cleveland Fed President Loretta Mester (voter) suggested it would be appropriate to lift the fed funds rate up to its longer-run level, which she estimates to be about 2.5%, and to follow with further rate increases next year. Noted her trajectory is somewhat steeper than the median path in the March SEP, preferring to front-load some of the increases to place policy in a better position to adjust if the economy evolves differently than expected.

References: PMK Investment committee, exchange4 free, Momentum Investment consulting, Momentum securities, RMB Global markets Swissquote, eToro, Currency Partners

Suggested that rate hikes could be accelerated or slowed in the middle of the year depending on inflation momentum. On balance sheet run-off, added context that size of assets held is much larger than during the Great Recession, hence adding justification for a faster reduction (building on prior comments). One benefit is alleviation of yield curve distortions by removing downward pressure in the long end. Also acknowledged implications of the unfolding situation in Ukraine for the medium-term economic outlook in the US will also be a consideration in determining the appropriate timing and pace of monetary policy actions.

Some doubts on whether flattening yield curves signals recession

Bond yield backup continues as markets price in more aggressive, front-loaded Fed tightening cycle. Flattening yield curves also fuelling concerns about potential recession signalling amid risk of Fed tightening too aggressively and triggering a downturn (WSJ). However, this is not a view shared widely on Wall Street with some noting lower yields at the long end may just reflect Fed messaging rates need to temporarily rise above neutral level. That could lead to rate cuts down the track, as is being predicted in Eurodollar futures market, but necessarily a recession. Some point to additional forces influencing flatter yield curves, including demand for longer dated Treasuries from pension funds and overseas investors. Firms also note continued steepness in parts of the curves considered to be more reliable recession indicators.

US to unveil more Russia sanctions in Brussels

Bloomberg cited National Security Adviser Sullivan's press conference, indicating President Biden's meetings in Brussels expected to yield new sanctions against Russia and fresh measures designed to prevent circumvention of existing penalties. Story noted Biden's busy schedule including emergency NATO summit, G7, and European Council. They are also expected to announce new action aimed at "enhancing European energy security and reducing Europe's dependence on Russian gas," though there were no details yet. Leaders will also discuss how to respond if China aids Moscow to bolster Russia's military or subvert economic sanctions. Following earlier claims by US officials that they believed the Russians had requested assistance from Beijing, Sullivan told US had not seen the provision of military equipment to Russia since Biden and Xi spoke last week.

Russian troops in Ukraine facing difficulties on multiple fronts

Little change on the ground in Ukraine, Pentagon assessed Russia's combat power has fallen below 90% of its original force, as its military is beset with communication, logistics and fuel challenges (NY Times, FT). Noted Ukrainian forces pushing to retake territory in some places, including near Kherson which is under Russian control. Comes as Russia intensifies bombing of strategically importance city of Mariupol that links Russian-controlled parts of eastern Ukraine with territories Moscow has already captured. Ceasefire talks continue but no indications of progress towards a near term solution. While Western intelligence services believe fighting is largely at a stalemate, concerns have been raised about Russia possibly resorting to chemical or biological weapons. Kremlin spokesman Peskov also warned Russia would consider using nuclear weapons if it felt it was facing a "an existential threat."

Deglobalization trends are accelerating

Ukraine war and pandemic accelerating deglobalization trends that were prevalent even before Covid. NY Times discussed how countries are seeking to reduce economic interdependence and strengthen resiliency. Soaring costs and supply chain disruptions have led companies to reorganize how they obtain goods while increased sensitivity to human rights abuses and authoritarianism prompting western officials and executives to rethink business dealings with China. Conversely, non-US allies wary of their own economic ties to America may be pulled into Russia and China's orbit. Result would be a splintering into economic blocs where countries align more on ideological grounds. While this will create long-term uncertainty, near-term outcome may be one where world experiences slower growth, goods shortages, and inflationary pressures.

Growth outperformed value today, but both factors were higher

Most FANMAG names were up 2%+. Autos were strong, led by EVs/batteries (with TSLA-US a notable gainer). Banks, particularly the money centres, rallied against the higher-yield backdrop (10Y yield up more than 20bp this week alone). Credit cards, life insurers were strong as well. Airlines largely erased Monday's slide. Apparel group was stronger led by NKE-US on its report. Tech space was largely up, especially software and hardware names. China tech had another strong session after pausing Monday. Many meme stocks had a good session amid high retail activity. Biotech, A&D (BA-US rebound), entertainment, media, asset managers, specialty retailers, restaurants, travel/tourism, beverages were among the other areas higher. Energy was the only sector decliner today, though downside was limited. E&Ps, oil services fared worst. Larger-cap pharma was a weaker spot in healthcare. Precious-metals miners followed the underlying assets lower. Industrial metals were largely lower as well. Homebuilders were mostly down on rates.

Oil off yesterday's highs with EU leaders split on Russian oil sanctions

Oil came a bit off yesterday's highs after reports EU foreign ministers were split over whether to sanction Russia's energy sector (Reuters). Consensus would be required to implement sanctions, but Germany and the Netherlands concerned bloc is too dependent on Russian oil. However, an EU diplomat voiced hope EU will have found enough alternative sources by June to consider an oil embargo (and US may be working on joint efforts to reduce Russia dependence, see Reuters). Analysts continue to flag upside risk to oil prices. RBC sees no immediate offramp to war in Ukraine, saying market has so far given Putin the benefit of the doubt on willingness to negotiate. Bank of America also told US is set for periodic price spikes given tight inventories and limited production growth, which could set up an increased risk of short squeezes as WTI moves toward expiry every month (CNBC).

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Easing Tariffs

The U.S. and U.K. reached a deal to ease tariffs on British steel and aluminium, resolving a longstanding irritant as the nation's work to strengthen trade and integration. The deal will allow 500,000 metric tons of steel annually to be imported duty free, with higher amounts subject to tariffs, starting June 1, the Commerce Department said. The U.K. will end retaliatory tariffs on more than $500 million worth of U.S. exports, including distilled spirits, agriculture products and consumer goods.

Stand by Britons

Rishi Sunak plans to help British families struggling with a surge in energy prices and the cost of living, adding to 21 billion pounds of measures already announced, in his Spring Statement on Wednesday. The U.K. Chancellor of the Exchequer will also say Britain's response to Russia's invasion of Ukraine includes "strengthening our economy here at home."

Speed of Sound

The China Eastern Airlines jet that crashed Monday was traveling at close to the speed of sound in the moments before it slammed into a hillside, according to a Bloomberg News review of flight-track data. Such an impact may complicate the task for investigators because it can obliterate evidence and, in rare cases, damage a plane's data and voice recorders that are designed to withstand most crashes.

Nike beats, talks China improvement

Nike beat on fiscal Q3 EPS with help from better sales and GM expansion. Reiterated guidance for +MSD sales growth in FY22, while outlook for GM and SG&A looked better. No formal guidance yet for FY23 due to macro uncertainty though management said it should be a strong year. Street takeaways focused on comments about market demand significantly exceeding available inventory supply, production levels in Vietnam returning to pre-closure levels and expectations for sequential improvement in China in fiscal Q4 following a better than feared performance in Q3. Also, some positive commentary surrounding GM tailwind from full-price sell-throughs and limited markdowns, along with update on wholesaler strategy (which has helped Foot Locker). However, company did note that NA transit times worsened in Q3 and are now more than six weeks longer than pre-pandemic levels and two weeks longer than in the year-earlier period.

Financials higher with rates

Financials outperformed on Tuesday amid some scrutiny surrounding the inability of the space to keep up with the latest move higher in rates (The Market Ear). Atlantic Equities flagged recent overhang from concerns about a meaningful slowdown in ECM and DCM activity. However, firm pointed out that weakness in DCM seems to be benefitting banks' C&I loan growth and the updated dot plot suggests a much more aggressive pace of rate increases, a dynamic that will benefit the more rate-sensitive banks. Firm reiterated overweight ratings on BofA, Morgan Stanley and

Wells Fargo. BofA said today that it remains overweight financials. Firm noted that despite concerns about a war, curve inversions and volatility that has weighed heavily on M&A and IPO activity, sector should still find support from record low leverage and earnings volatility, along with underweight positioning by funds despite the strong 2021 performance.

Chinese regulators tell some of country's US-listed firms to prepare for more audit disclosures

China ADRs higher on Tuesday. Along with upsized (from $15B to $25B) buyback authorization from Alibaba, some focus on a Reuters report that Chinese regulators have asked some of the country's firms with US listings, including Alibaba, Baidu, JD.com and Weibo, to prepare for more audit disclosures. Report said move comes as Chinese regulators considering a proposal to allow US counterparts to examine audit working papers of some Chinese firms that do not gather sensitive data. Follows FT report that said Beijing planning concession on disclosure of audit information to address delisting threat facing more than $2T of shares in US-listed Chinese companies. Also follows comments from State Council last week that Beijing would take measures to support the economy and financial markets. Reassuring comments were made around several issues that have weighed heavily on sentiment, including overseas listings, the tech crackdown and property market risks.

South Africa

Muted hopes for tomorrow's investment conference

The President will have spectrum and some other positives to talk about but, as usual, the media is full of questions as to how much of the investments pledged will be genuinely new or would have happened anyway. Hilary Joffe says presidential economic advisor Trudi Makhaya counts a turnaround in mining investment as one of the successes of the president's drive but of course there has been a commodities boom and the Mineral Council points out that there would be a great deal more if the government cleared the huge backlog of mining and prospecting rights applications and approved the R60bn of renewable energy projects. BD.

Claire Bisseker quotes the late Michael Spicer as saying the problem was not just the labour laws and BEE "but the whole intrusive, intensive regulatory environment that has grown up over the last 20 years." BD. Yet again, behind that, is the failure to appreciate, on the part on many of our legislators and bureaucrats, that new jobs require new or existing employers who either must risk their own money or persuade others to do so. More constructive attitudes from organised labour would also work miracles.

Chaos in Mangaung Metro

Early yesterday morning an unruly crowd prevented workers from entering the Metro building (the "Glass Palace") which has been the scene of meetings where ANC members openly gesticulated at each other and one faction repeatedly voted with the opposition against the party. Deputy President David Mabuza has also been spending time there but the DA caucus leader, Johan Pretorius, said "everything is falling apart for the ANC, from the infrastructure to the alliances". A parliamentary committee of the department of cooperative government and traditional affairs would visit Bloemfontein on Friday to determine whether it should be placed under administration. Netwerk24.

Exchange rate

Latest Rates	Spot	Move
USD/ZAR	14.81	v
GBP/ZAR	19.67	v
EUR/ZAR	16.34	v
CHF/ZAR	15.85	v

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Coming Up

- European stocks are set to gain after Asian stocks advanced amid a rally in Chinese tech shares.
- Asian tech will be at the forefront today as Tencent and China Mobile report earnings.
- There's another chance for Federal Reserve Chair Jerome Powell to deliver his message on quashing inflation as he speaks at a BIS panel, along with U.K. Bank of England Governor Andrew Bailey. U.K. inflation data hits on the same day as Rishi Sunak's Spring Statement on the U.K. budget.
- Elsewhere, the U.S. reports new home sales.

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