CITADEL
WEALTH MANAGEMENT

ECONOMICS & FINANCIAL MARKETS

WHERE ARE WE AND WERE ARE WE HEADING TO?

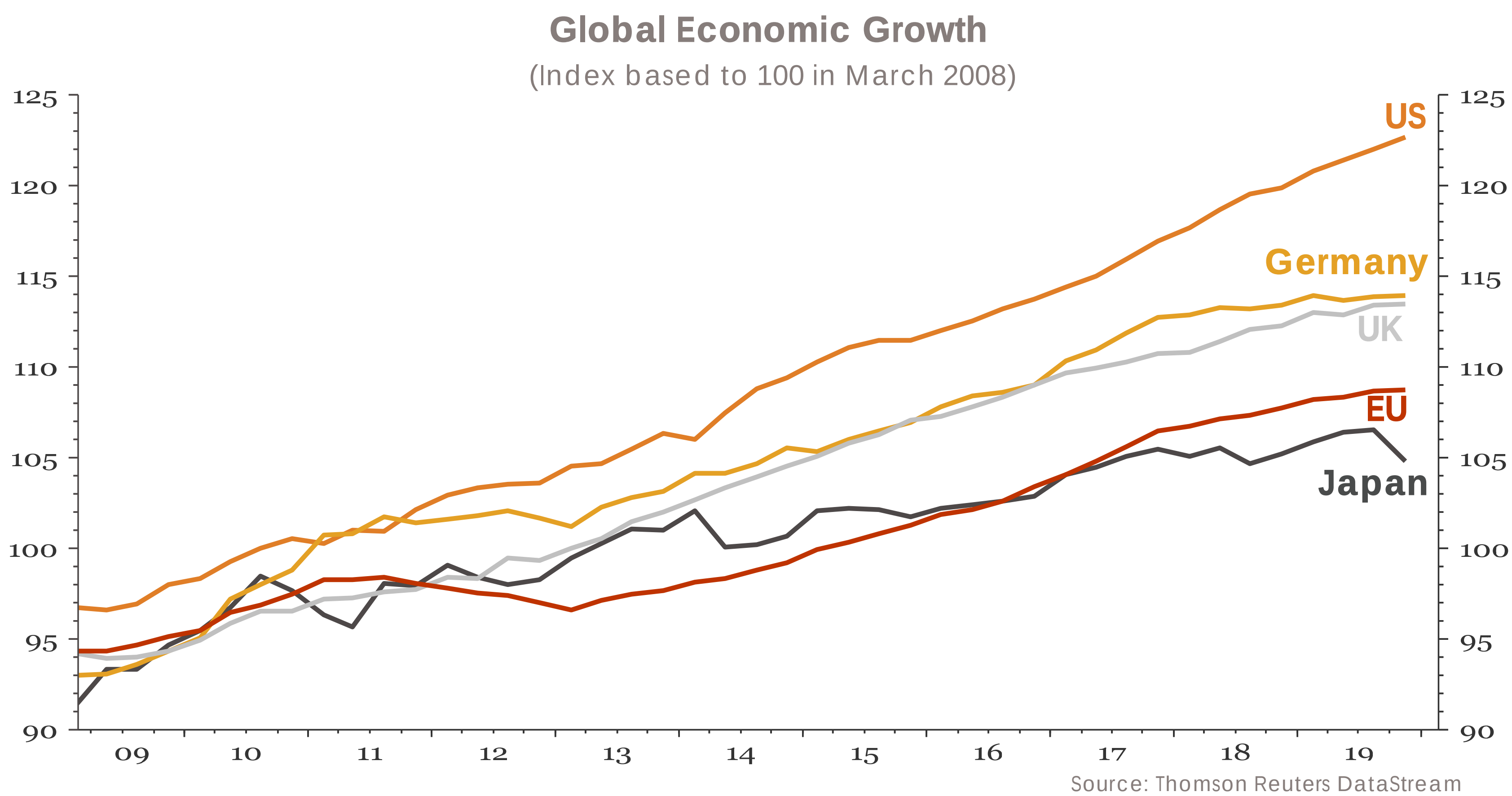
3 MARCH 2020

YOLANDA NAUDÉ
INVESTMENT STRATEGIST & PORTFOLIO MANAGER

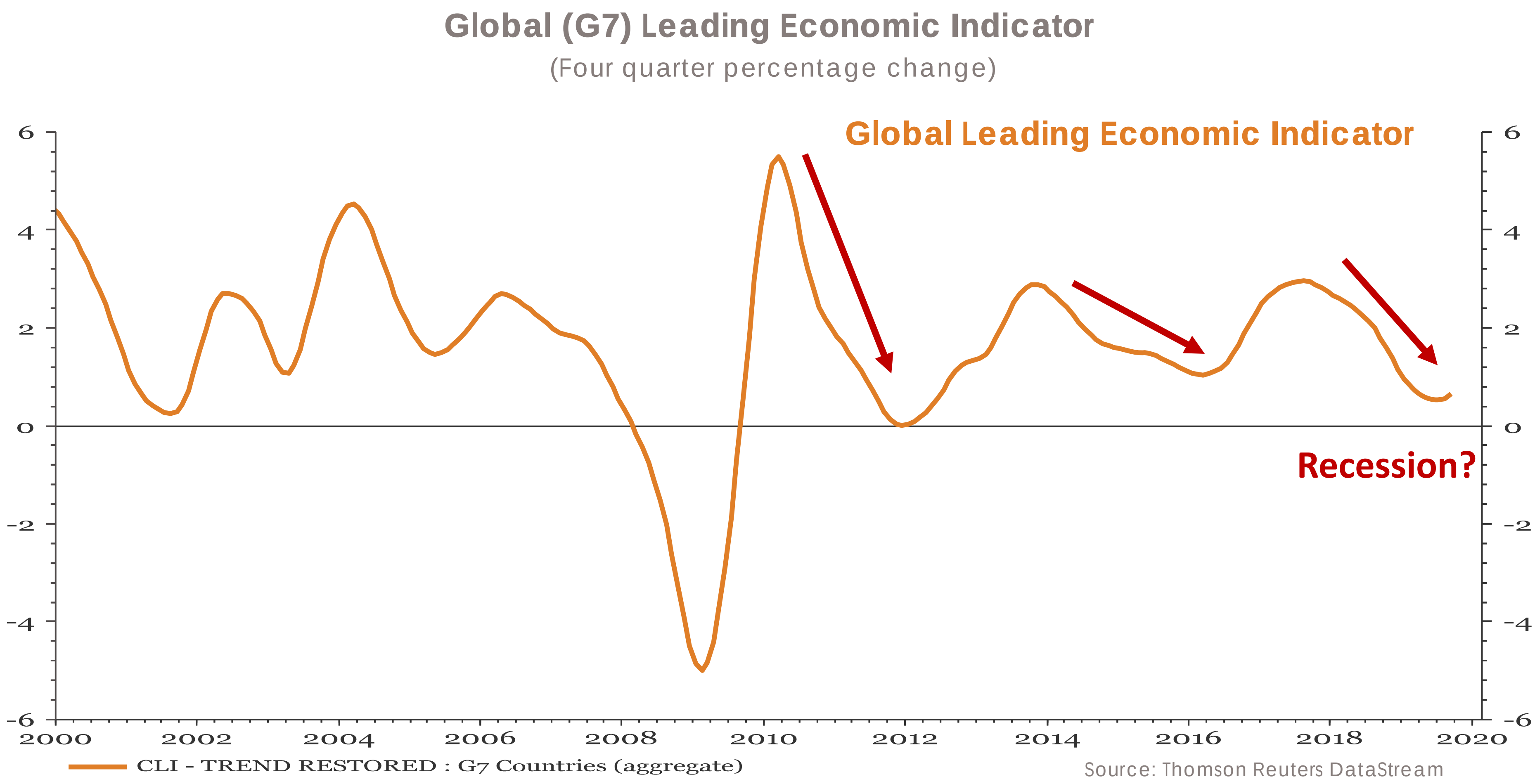
CITADEL
WEALTH MANAGEMENT

OUR CURRENT VIEW ON THE GLOBAL ECONOMY

THE GLOBAL ECONOMIC **RECOVERY CONTINUES**



BUT MOMENTUM HAS **SLOWED**



RECESSION SCORECARD : MARCH 2020

Yield Curve

Unemployment

Leading Indicator

Consumer Confidence/Consumption

Household Debt

Debt Servicing Cost

Wage Growth

Monetary Conditions

Trade

Market/Earnings/Valuations

+/- 50%

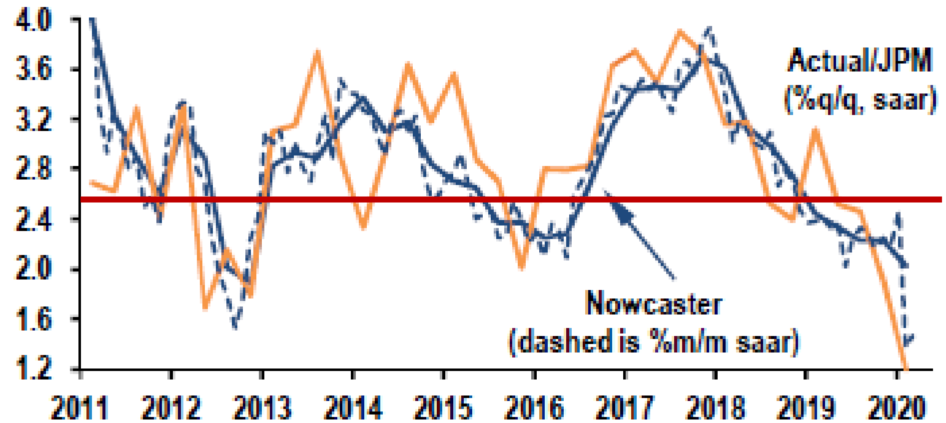
CORONAVIRUS IMPACT…

To delay, not derail the muted global economic recovery?

Q1 '20 ar
estimates:
US 1.5%
Europe 0.3%
China -3.5%
World -0.1%

Figure 2: Global real GDP

%q/q, saar; J.P. Morgan projection and Nowcaster thru 1Q20

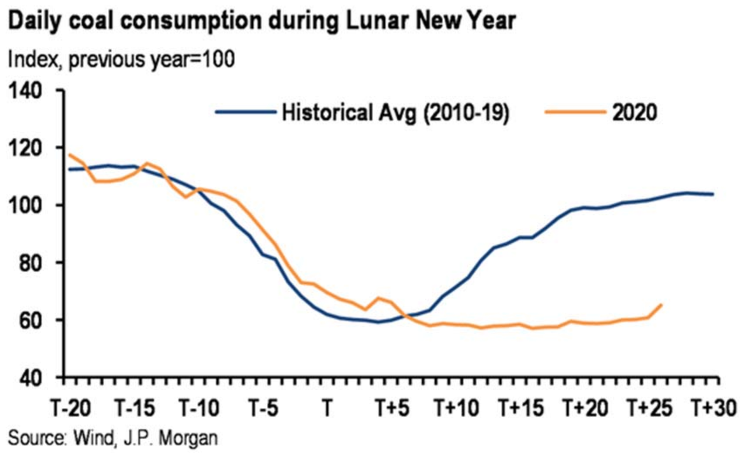


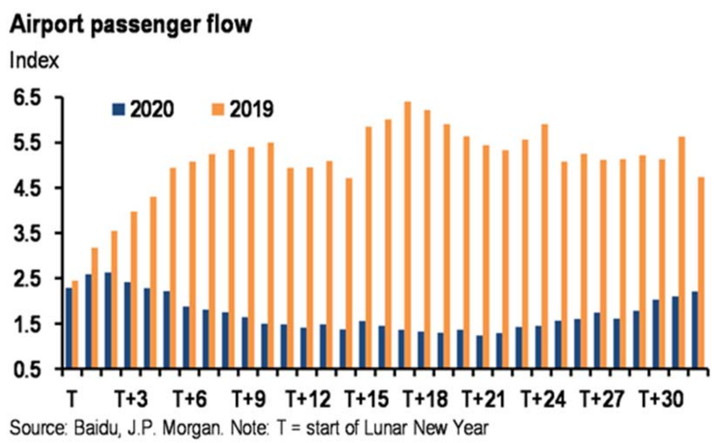
Source:J.P.Morgan

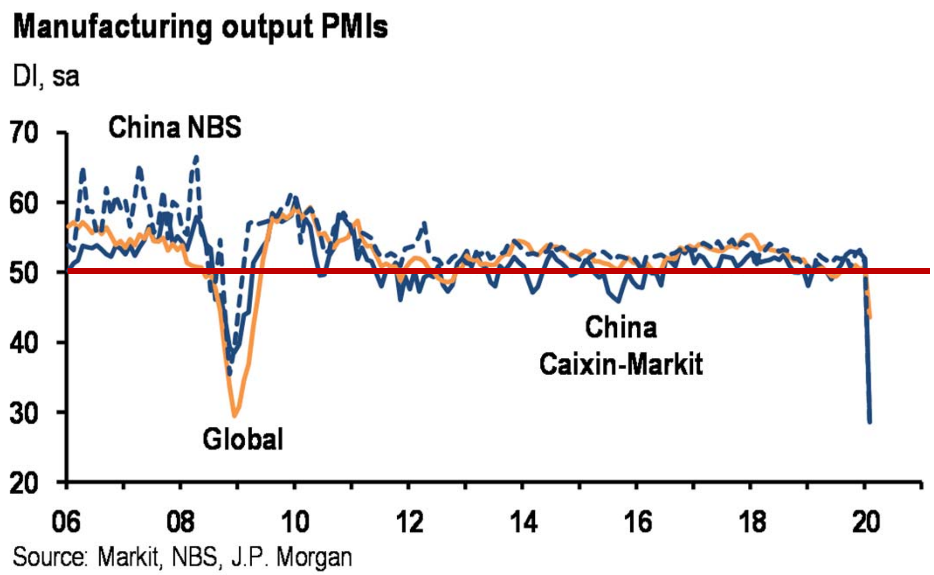
Source: JPM Global Data Watch, 21 Feb 2020, p7

Source: www.boredpanda.com

CORONAVIRUS IMPACT...IS REAL







Source: JPM Global Data Watch, JPM daily economic briefing mails, 2 March 2020

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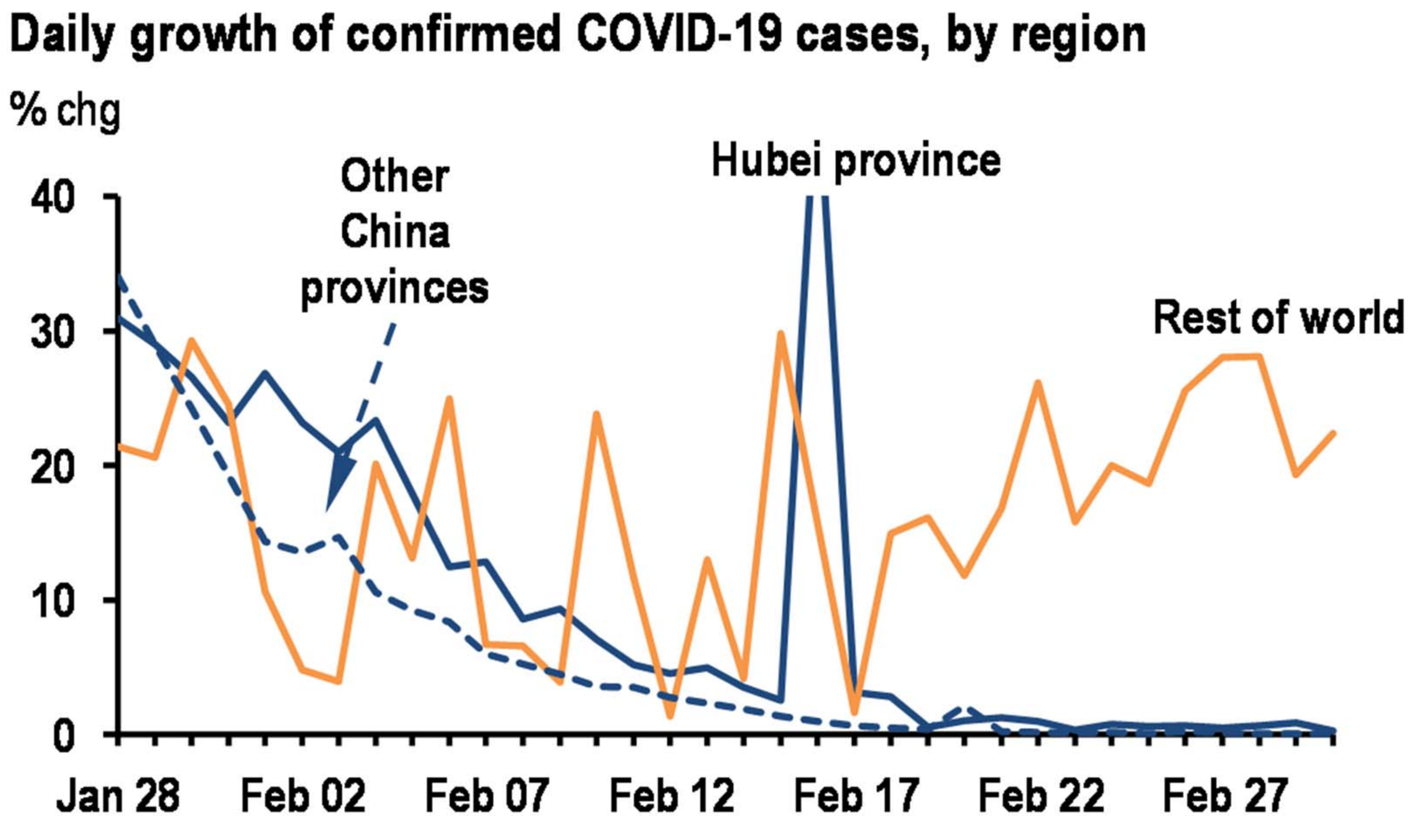


Source: WHO, J.P. Morgan. Note: Definitional change for Hubei on Feb 16.

Source: JPM Global Data Watch, JPM daily economic briefing mails, 2 March 2020

CHINA'S **ECONOMIC** **STIMULUS** **RESPONSE** THUS FAR IN 2020

"This is a crisis and it is also a major test"

China's President, 25 Feb 2020

Monetary:

-injecting **liquidity** into the fin system

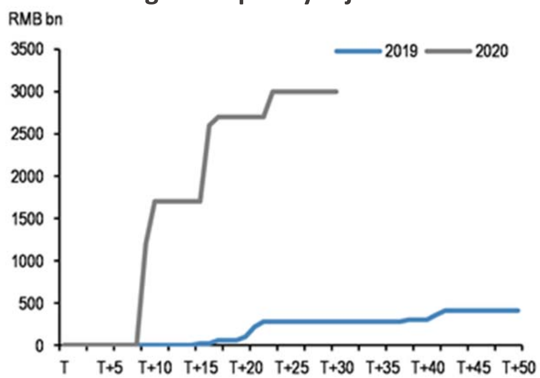
-various **interest rate cuts**

-tolerance for **non-performing loans**

-50% interest rate **subsidies** for certain companies

-loan repayment **extensions**

Cumulative gross liquidity injection since LNY



Source: JPMorgan, 25 Feb 2020

Fiscal:

-**cutting taxes** for SMEs

-temp **waiving of rent pay** (private SMEs)

-special local gov bond issuance

-real estate co: **delaying tax payments**

-**reduce corporate burden** (delay in fee, electricity, water & gas cost payments)

-**VAT deductions** for COVID-19 prevention related business activities

-temporarily **waiving social security collection** (pension, unemployment, and employment injury) for companies

-increasing **government expenditure**

Other:

-**funding/subsidies** for farmers

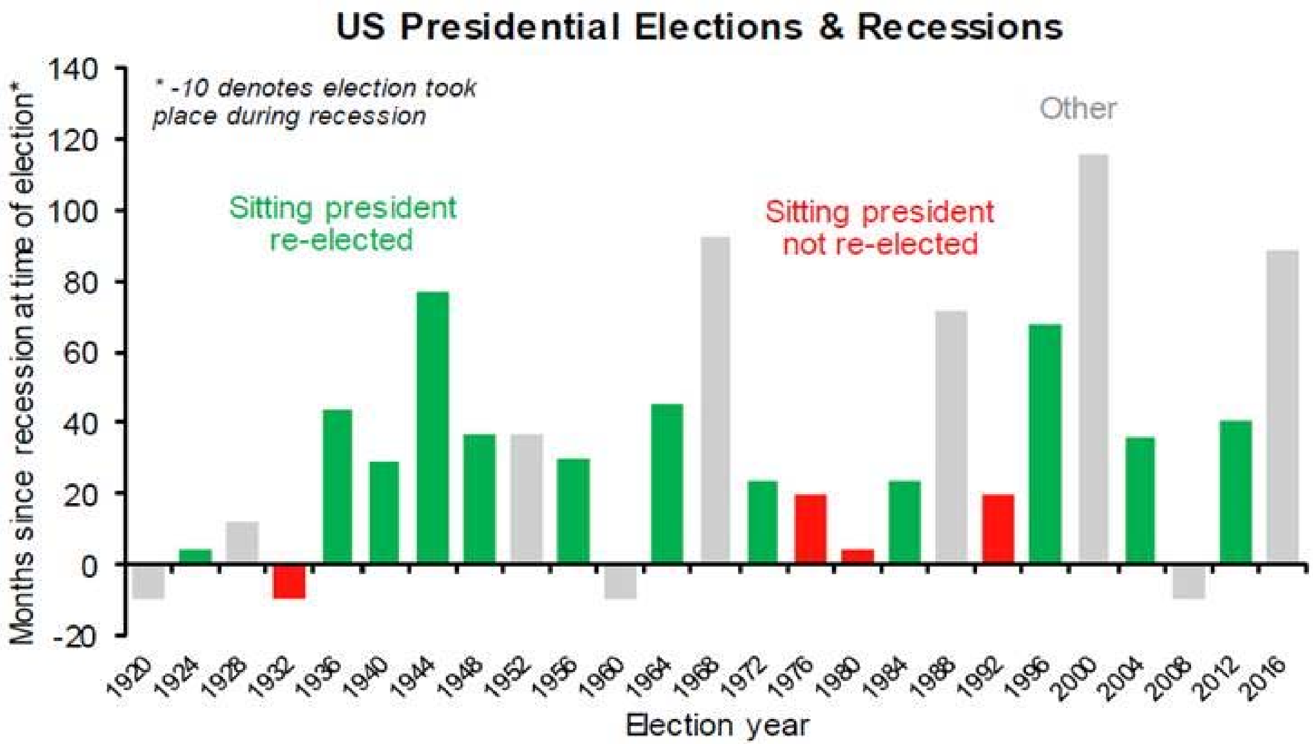
-**government support** for factory openings

-accelerating the implementation of **new projects**

-**delay the implementation** of vehicle emission standards VI

THE NOVEMBER 2020 **U.S. ELECTION**

Fig 3 Only four presidents have failed to gain a second term in the past 100 years, with a weak economy a key swing factor



Source: NBER, US National Archives, Macquarie Macro Strategy

<u>Democrat candidates:</u>

Bernie: leftist/socialist
Biden: moderate
Buttigieg: moderate
Bloomberg: falling behind
E.Warren: capitalist but

SUMMARY **ECONOMIC** VIEW

U.S.A GDP: 1.6% - 2.0%

- 2020 should get to capacity growth – headwinds include manufacturing and trade, tailwinds include consumer and monetary policy
- Inflation not dead, positive wage growth, credit demand and job market.
- Fed should continue with monetary support
- TRUMP risk – geopolitical tension, further protectionism
- Growth disappointment likely going into 2021 as consumer gets under pressure

CHINA: GDP: 5% - 5.5% (?)

- Economic slowdown continues, should dip below 6% this year despite stimulation
- Credit dynamics should be manageable given government policy
- Government will continue with targeted support
- As US closing down through protectionism, China is opening up more to become bigger global player

EUROPE: GDP: 1.2%-1.5%

- Less Brexit uncertainty and PMI's bottoming out should support sentiment and economic activity
- Job market recovery continues with wages up Political challenges remain – rise of populism – US trade tariffs on EU
- ECB in full support mode

JAPAN: GDP: <1%

- Slowing down again
- With inflation set to remain well below the 2% target, policy tightening remains a long way off

Emerging Markets GDP: 4.0%-4.5%

- Should keep premium growth over DM.
- China/India supporting growth premium to developed markets.
- Structural issues remain with reform needed is most countries.
- Social and political risk

SOUTH AFRICA GDP: <1%

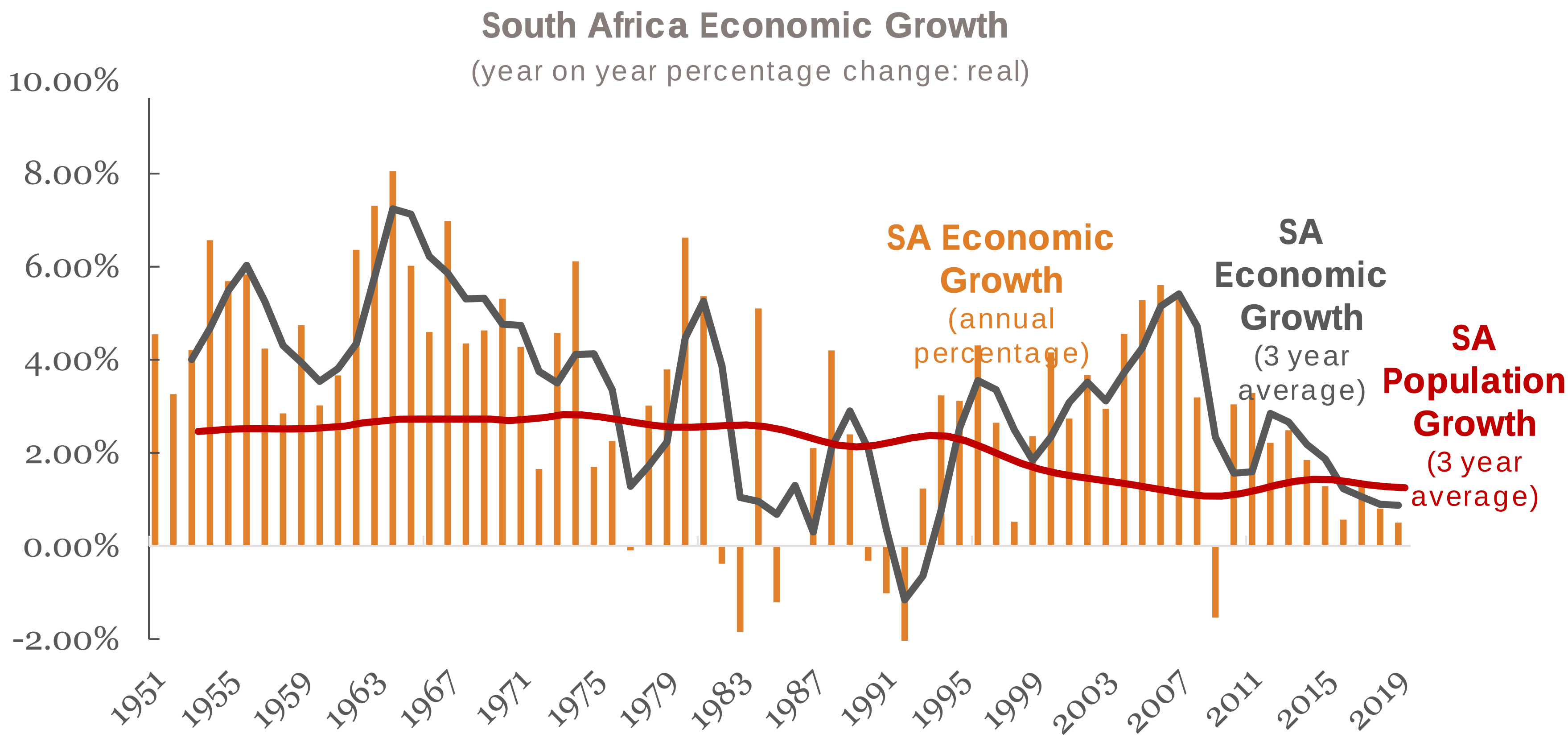
- All focus on economic plan and reforms
- Feb budget not enough to avoid a Moody downgrade?
- Consumers and business confidence at decades low
- Inflation and growth expectations suggest SARB can afford to cut again
- Next 12 months are vital to get reforms on the way and stabilise SOE's financial position.

DOMESTIC ECONOMIC OUTLOOK

DOMESTIC ECONOMY: **STRUCTURAL IMPEDIMENTS**

- Low quality of **education** → lacking **skillset** → weak **productivity** growth
- + weak local & foreign private sector **fixed investment growth + structural challenges + policy uncertainty**
- = Economic growth **per capita < population growth**

POPULATION GROWTH IS FASTER THAN ECONOMIC GROWTH



Source: Penn World Table, Citadel Asset Management

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- = Economic growth **per capita < population growth**
- High and rising **unemployment** → rising **crime levels** (...emigration etc) **& social unrest**
- **+ Weak SOEs** → poor service delivery & **bailouts**
- = Growing **fiscal deficit** (& debt) → **no room** for counter-cyclical support

SA'S **2020 BUDGET : ALL THUMBS UP?**

Source: news24, 26 Feb 2020

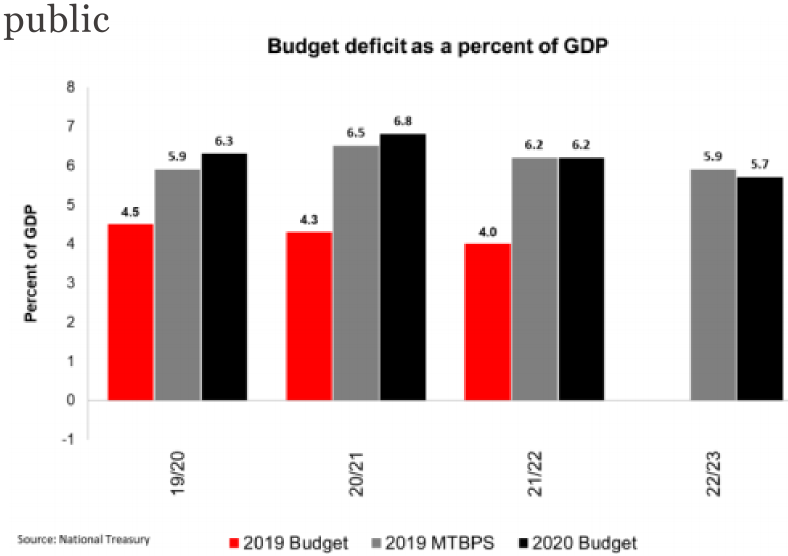
SA'S 2020 BUDGET: ALL THUMBS UP?

INCOME SIDE:

- **no** major tax increases
- in fact: effective **income tax cuts**
  (bracket adjustment > inflation)
  (rebate adjustments > inflation)
- **vital opportunity was missed** to build in a financial cushion with the potential to offset challenges arising from the public sector wage bill negotiations.

EXPENDITURE SIDE (over next 3 years):

- cut civil servant **wage bill** by R160bn
  (R38bn in 2020/21: not agreed yet...)
- cut R100bn in grants for **provinces and municipalities**...counterproductive



SA'S 2020 BUDGET: OUR VIEW

Positives:

- more **realistic** economic growth forecasts
- willingness to take on the massive **wage bill** drain
- continued support for **inflation targeting and an independent SARB**
- a notable focus on cutting **wasteful** expenditure
- addressing the severe **youth unemployment** problem
- wage freeze/cuts = **deflationary**. more interest cuts by SARB?

Concerns:

- bold and a **high-risk** move by the finance minister
- **e.v.e.r.y.t.h.i.n.g** riding on government's ability to negotiate **wage freezes with the unions**

DOMESTIC ECONOMY: **WEAKEST LINKS**

WEF Global Competitiveness Index component	2019 South Africa's rank out of 141 countries (141=worst)	2019 Best performing country/countries
Cooperation in labour-employer relations	139	Singapore
Homicide rate per 100 000 population	135	Multiple countries
Flexibility of wage determination	134	Estonia
Hiring and firing practices	129	Hong Kong SAR
Time to start a business	129	New Zealand
Organized crime	128	Finland
Digital skills among active population	126	Finland
Ease of hiring foreign labour	123	Albania
Reliability of police services	121	Finland
Healthy life expectancy	117	Multiple countries

Source: World Economic Forum, The Global Competitiveness Report, 2019, p534-537

SA'S 2020 BUDGET: OUR VIEW

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Concerns:

- bold and a **high-risk** move by the finance minister
- **everything** riding on government's ability to negotiate **wage freezes**
- **debt-to-GDP** number will not alter notably over the medium-term framework **(one wrong move** and the ratio will increase)
- the R60 billion set aside for **Eskom and SAA** hurts
- **Sovereign Wealth Fund** and a **State Bank**: Why? To placate political agendas? Unrealistic given the current fiscal state!

2020 BUDGET: IMPACT ON THE COUNTRY'S CREDIT RATING?

- needed R150bn in **expenditure cuts** over 3 years: got R160bn
- unlikely that **Moody's** will tip **a reform-minded** government over the edge
- if **wage** bill not cut by October, and **economic growth** not picking up, then the risk of a **Moody's downgrade** remains very much on the table
- But what about **Fitch & S&P?**

FITCH RATINGS: SOUTH AFRICA BUDGET HIGHLIGHTS SCALE OF FISCAL DETERIORATION

Fitch Ratings-London-26 February 2020: South Africa's 2020 Budget highlights the severe deterioration underway in public finances and the long-term policy challenge of stabilising government debt, Fitch Ratings says. Fiscal metrics worsened moderately compared with the Medium-Term Budget Policy Statement (MTPBS) in October, despite the announcement of significant expenditure cuts. Moreover, these consolidation measures rely heavily on hoped-for moderation in public sector wages, which might not materialise, adding further risks to South Africa's deficit and debt trajectories.

Fitch Ratings Limited email, 26 Feb 2020

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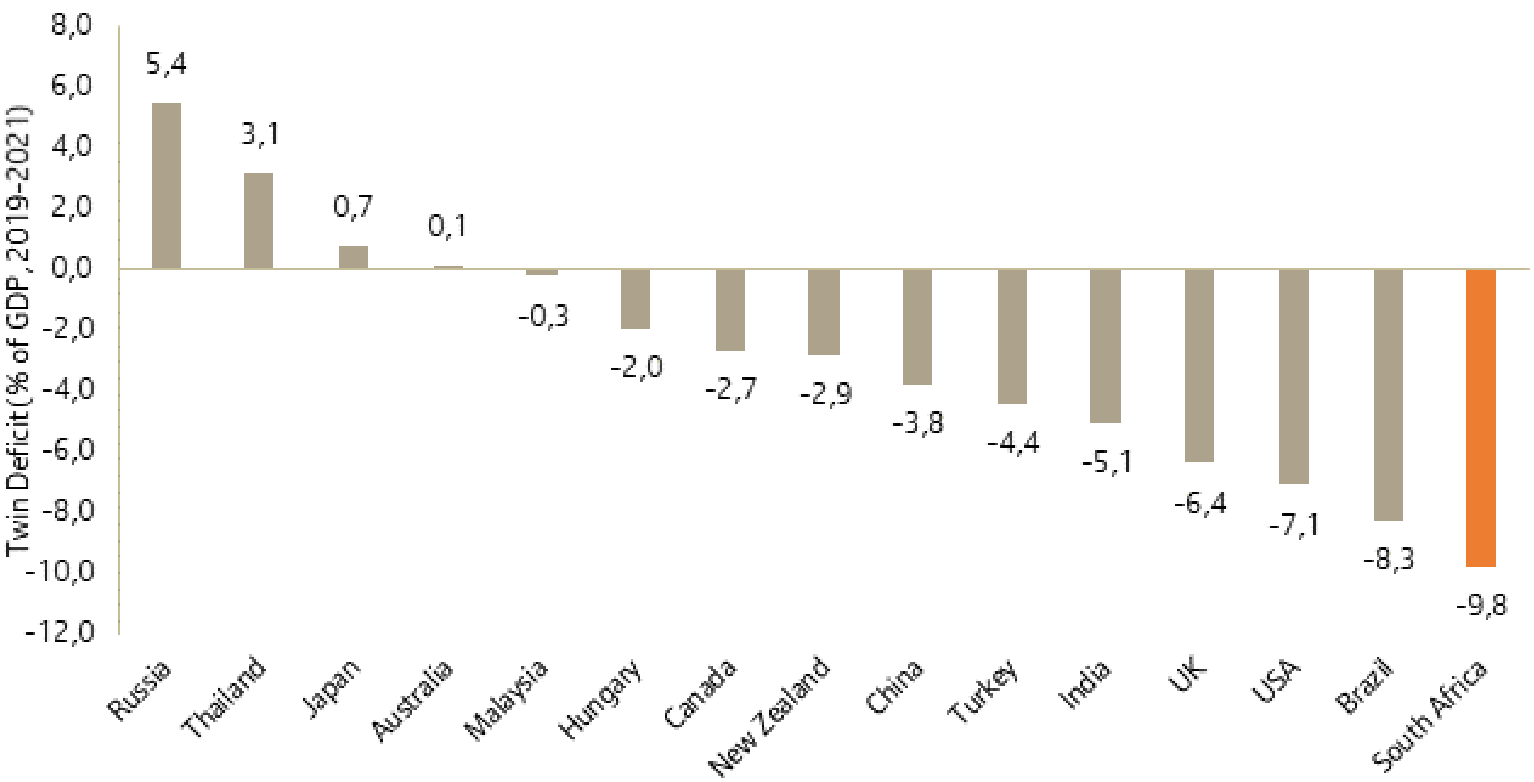
- = Growing **fiscal** deficit (& debt) → no room for counter-cyclical support
- + **Current account deficit** financed by volatile flows, not FDI
- = **Twin deficit risks**

THE **TWIN DEFICIT** CHALLENGE



Source: Std Bank, SA Daily, 3 Feb 2020

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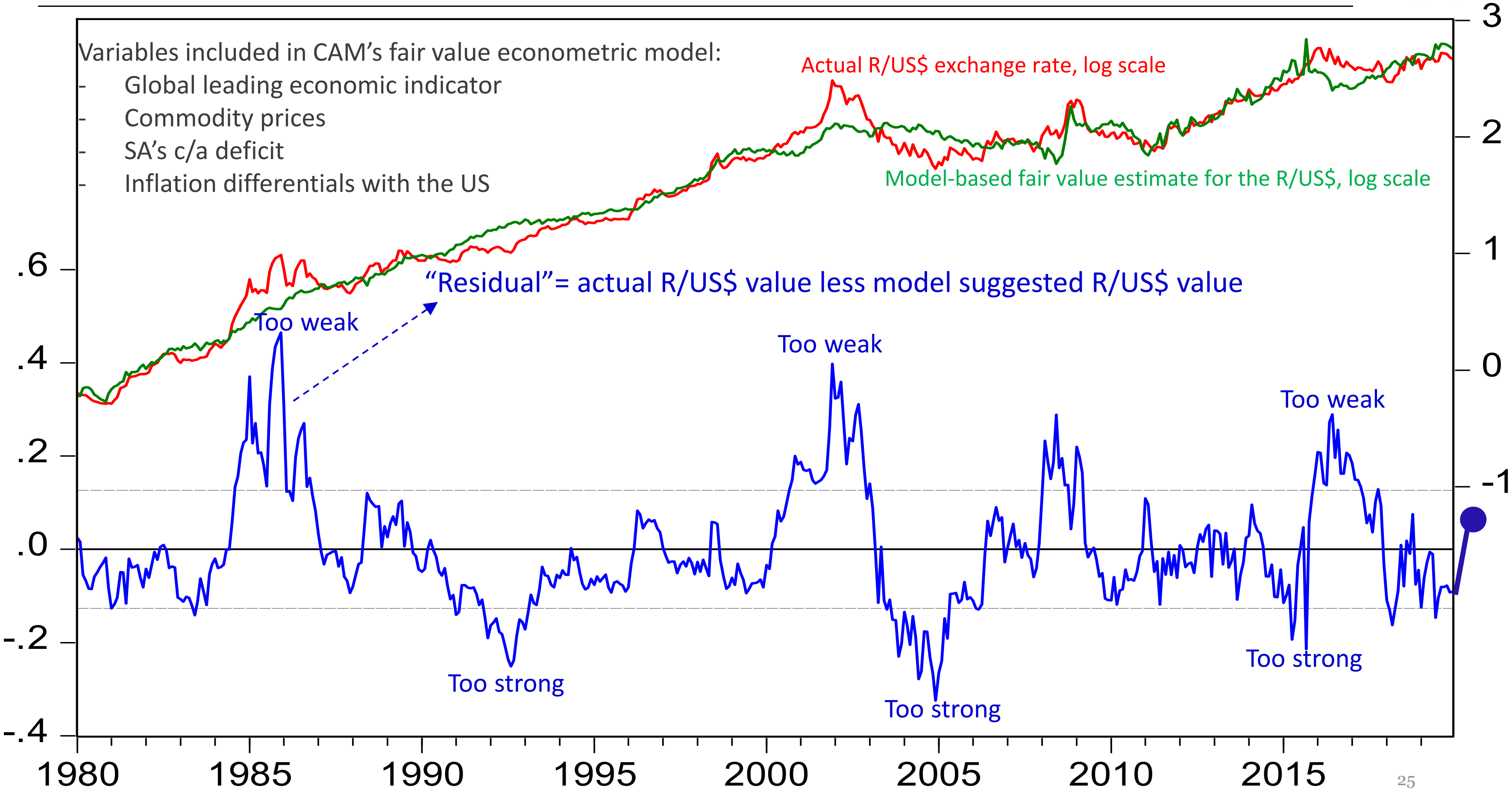
- + Current account deficit financed by volatile flows, not FDI
- = Twin deficit risks
- → downward (weaker) pressure on the **currency** → **inflation**↑ → **interest rates**↑

R/US$ **FAIR VALUE ESTIMATE**: +/- R15/US$



Source: Citadel Asset Management (CAM)


LAND REFORM:
- Restitution
- Redistribution
"Do not jeopardise property rights in any way" Fin Min Mboweni, Aug '19
"Land grabs will not be allowed" President Ramaphosa, 20 Feb '20
Five circumstances where expropriation without compensation could be allowed.
• Abandoned property
• Property owned by state-owned enterprises (like Prasa/Eskom/Transnet)
• Land held for purely speculative purposes
• Land into which the government has already invested more than its worth
• Land occupied by labour tenants

Source: google, https://boksburgadvertiser.co.za

NATIONAL HEALTH INSURANCE (NHI)

"We will implement it in an **incremental** fashion and aim to **cover the whole country by 2025**."

"We are clear that **the pace and the scale** at which we implement the NHI will **be determined by the means at our disposal**."

President Ramaphosa, SONA 2020 debate & weekly email (24 Feb 2020) from the desk of the President

DOMESTIC ECONOMY: **THE POSITIVES**

- Deep capital markets & highly developed **financial system**
- Impressive **services sector**
- A **flexible** exchange rate
- **A credible** (inflation targeting) and **strong SARB**
- **Low foreign currency debt** liabilities
- Access to **foreign capital**, if needed (BRICS $10bn & China $4.3bn)

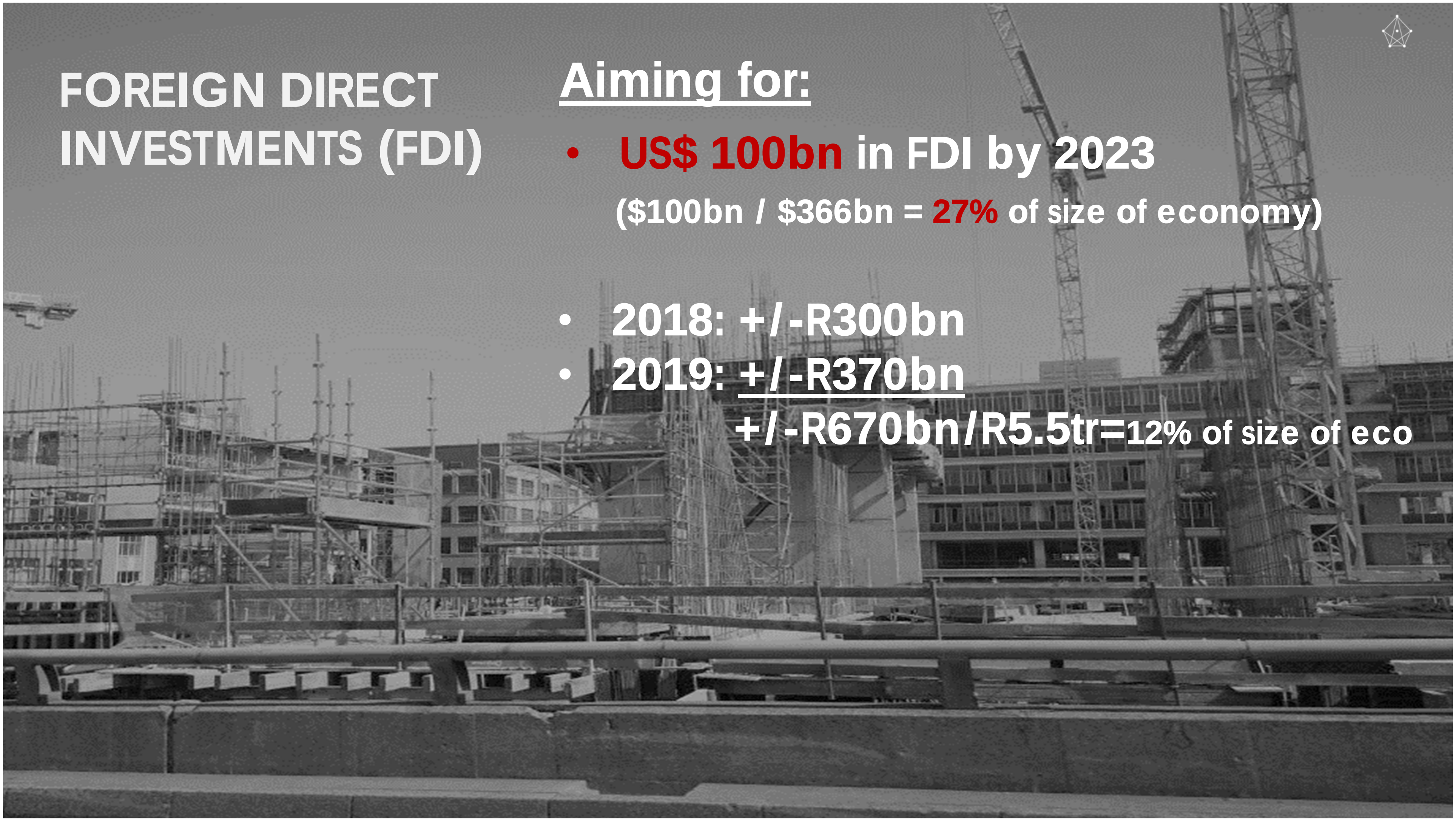
DOMESTIC ECONOMY: **STRONGEST LINKS**

WEF Global Competitiveness Index component	2019 South Africa's rank out of 141 countries (1=best)	2019 Best performing country/countries
Budget transparency	1	South Arica
Stock market capitalisation as % of the size of the economy	2	Multiple countries
Insurance premium volume as % of the size of the economy	3	Multiple countries
Road connectivity	7	Multiple countries
Mobile cellular telephone subscriptions per 100 population	10	Multiple countries
Conflict of interest regulation	12	Kenya
Energy efficiency regulation	15	Italy
Internal labour mobility	18	USA
Renewable energy regulation	21	Germany
Diversity of the workforce	28	Singapore
Freedom of the press	28	Norway
Soundness of banks	29	Finland

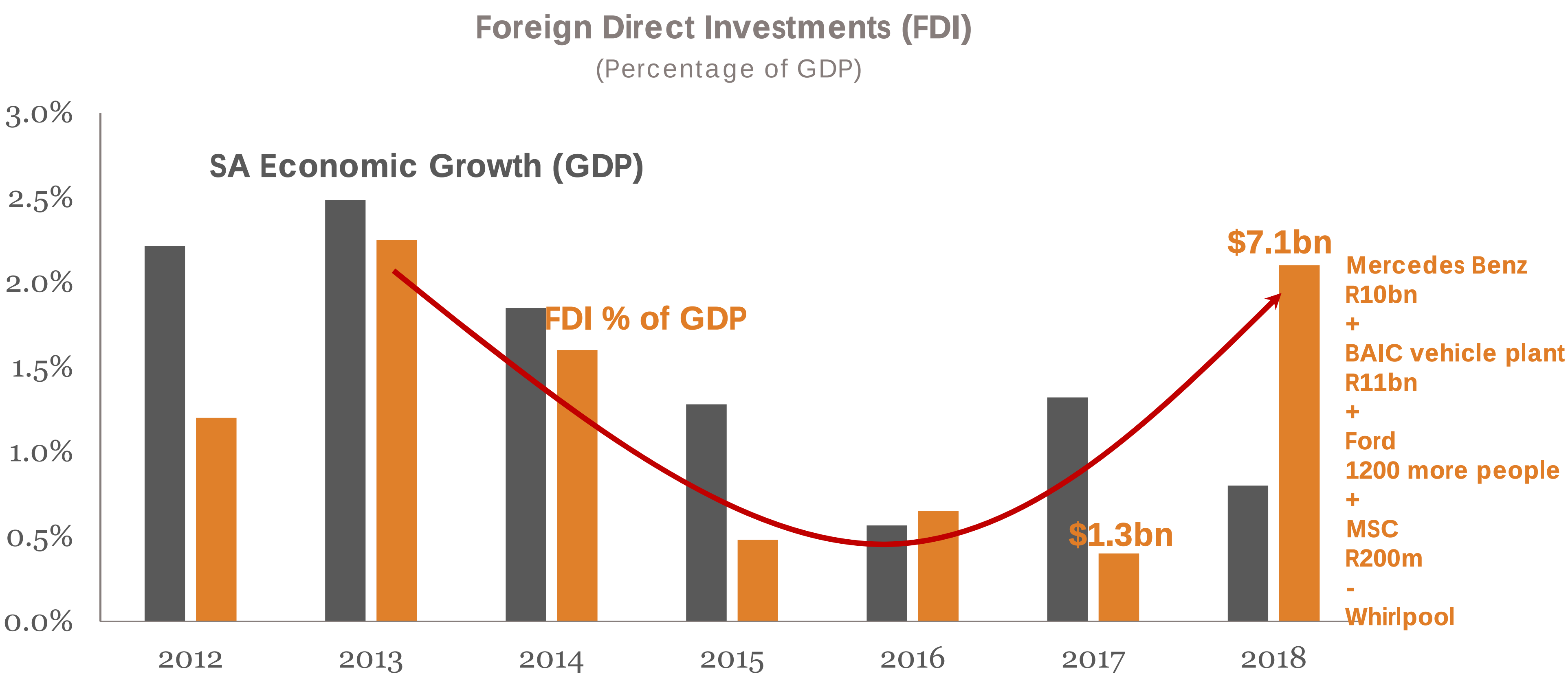
Source: World Economic Forum, The Global Competitiveness Report, 2019, p534-537

PROGRESS THUS FAR IN TERMS OF **STRUCTURAL REFORM** ISSUES:

- **SARS** is being rebuilt under Edward Kieswetter
- Some further clarity on **mining regulation** (Integrated Resource Plan)
- **Visa restrictions** eased for tourists
- Some positive movement on **broadband spectrum**
- Some (welcome!) **deregulation of the energy industry** to reduce reliance on Eskom
- **Ease of doing business** improving a bit (water licenses (90 days vs 5 years) & company registrations within one day)
- +/- R2.8bn **state capture waste recovered** thus far


FOREIGN DIRECT INVESTMENTS (FDI)
Aiming for:
• US$ 100bn in FDI by 2023
($100bn / $366bn = 27% of size of economy)
• 2018: +/-R300bn
• 2019: +/-R370bn
+/-R670bn/R5.5tr=12% of size of eco

FIRST **GREEN SHOOT** APPEARING: **FDI**



Source: FTI, World Bank, BER, Citadel Asset Management

WHAT DOES THIS MEAN FOR YOUR **INVESTMENTS**?

WHERE TO INVEST TO **PROTECT** AND **GROW** YOUR WEALTH

CITADEL ASSET VALUATION SIGNALS

	Below Neutral		Neutral Outlook	Above Neutral	
Local Assets					
SA Cash	○	○	●	○	○
SA Bonds	○	● (red)	○	○	○
SA Preference Shares	○	○	●	○	○
SA Hedge FoF	○	○	●	○	○
SA Protected Equity	○	○	●	○	○
SA Listed Property	○	○	●	○	○
SA Equities CAPPED	○	● (red)	○	○	○
SA Equities	○	● (red)	○	○	○
Global Assets					
US Cash	○	● (red)	○	○	○
US Gov Bonds	○	● (red)	○	○	○
US Corporates	○	● (red)	○	○	○
US HY Bonds	○	● (red)	○	○	○
US Protected Equity	○	○	●	○	○
Global Hedge FoF	○	○	●	○	○
Global Property	○	● (red)	○	○	○
Global Equity	○	● (red)	○	○	○

Views shown reflect the signals from Citadel Asset Management's asset valuation models and are based on each asset class's **3-5 year expected return.**

The model's expected return is compared to what investors historically expected from these asset classes.

As example: a **Neutral Outlook** will be roughly:

- 1% real return for Cash,
- 3% real for Government Bonds,
- 5% real for listed Property and
- 6% real for Equity

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CITADEL
WEALTH MANAGEMENT

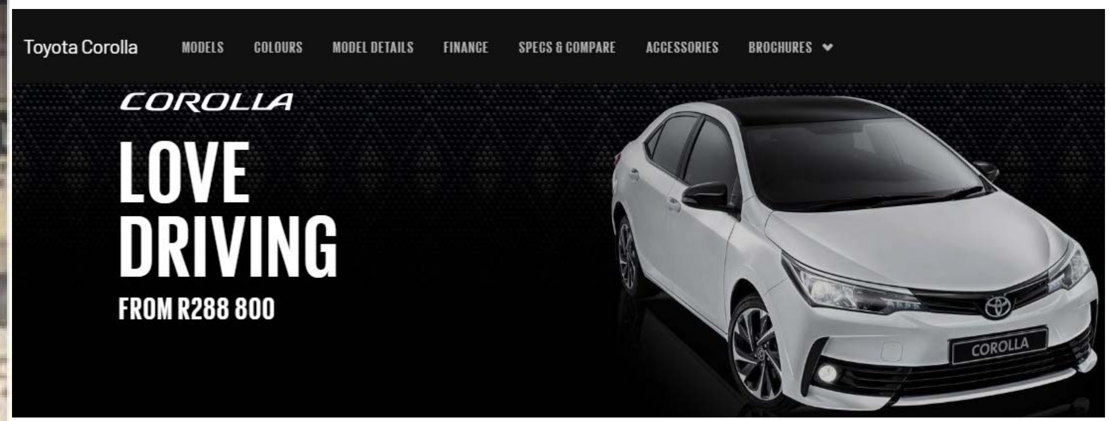
WHY IS THIS IMPORTANT?

TO MANAGE THESE **INVESTMENT RISKS**

AN INDIVIDUAL'S MAIN INVESTMENT **RISKS: 1) INFLATION**

Image by Julie Bang © Investopedia 2019

AN INDIVIDUAL'S MAIN INVESTMENT **RISKS: 1) INFLATION**



Sources: Toyota SA website, Google

AN INDIVIDUAL'S MAIN INVESTMENT **RISKS: 2) TAXES**

Source: www.google.com

AN INDIVIDUAL'S MAIN INVESTMENT **RISKS: 3) LONGEVITY**

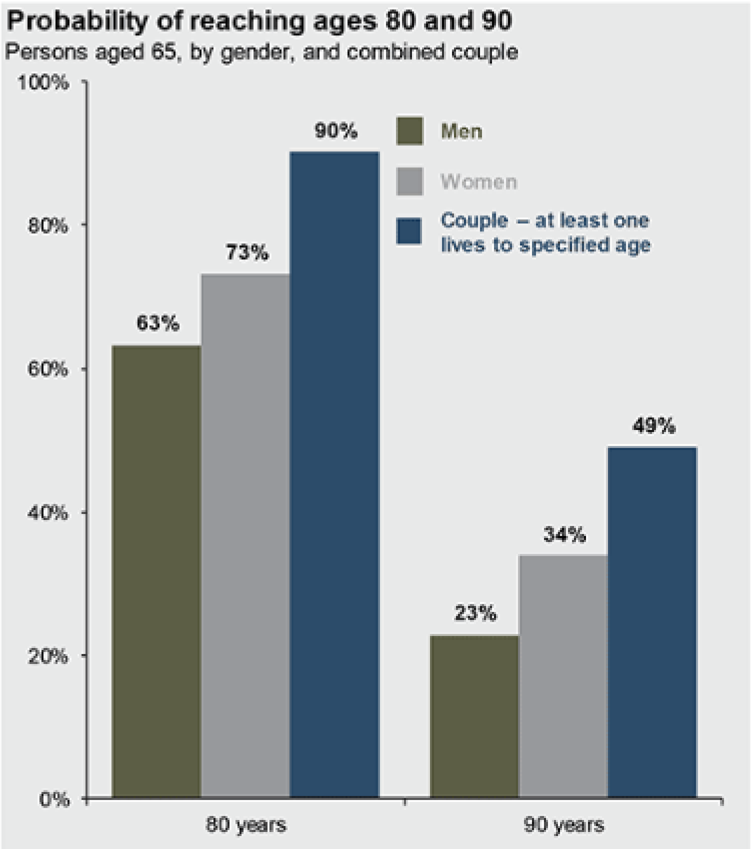
"A 20-year-old today has a better chance of having a living grandmother than a 20-year-old in 1900 had of having a living mother."

"If you are born today, you will have a one in three chance of living to 100."

"Those of us who make it into our 60s have an excellent chance of living into our 90s."

Sources: FT.com article on 9 Nov 2018: "Life begins at 60 — with consequences for all of us", https://www.bbc.com/news/uk-england-hampshire-47744752

AN INDIVIDUAL'S MAIN INVESTMENT **RISKS: 3) LONGEVITY**



Source: JPMorgan Guide to Markets – US data, 31 October 2019

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SOURCES

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