South Africa

While the global environment is positive for emerging markets, SA has yet to see the full benefit. In relative terms, emerging-market equities are cheaper than the US and earnings estimates are increasing at a faster rate along with economic growth. South Africa however has yet to see much of this due to its own unique factors. We expect the next quarter to be dominated by political turbulence leading up to the ANC December conference. The impact of this will be most keenly felt via the outlet valve that is the currency and its knock-on effects on SA Incorporated and Rand sensitive sectors. Having said that, there are many factors that favour a cautiously optimistic outlook for the year ahead. Business confidence and consumer sentiment are at multi-year lows and corporate investment is scarce. In addition, there is a lot of risk and pessimism factored into company earnings profiles and indeed their operating costs.

In the context of SA politics leading into December we expect SA Incorporated to be highly volatile however, major pullbacks present an opportunity for meaningful risk/reward investments in quality SA names. Looking forward to 2018, we believe that the greater earnings risk in SA Incorporated lies to the upside as a poor December outcome will likely mean more of the same for South Africa whereas a positive outcome will mean a significant recovery and upside potential off the current low base. We remain constructive on the resources sector (excluding precious metals) for reasons discussed below but are aware that the space can be vulnerable to major corrections. On balance, we believe that the sustained commodity price recovery will help not only the mining sector but the greater SA economy as well.

The currency outlook remains clouded and volatile but we are of the opinion that the ZAR will strengthen in the medium to longer term as it is undervalued on a purchasing power parity basis and has traditionally strengthened in the face of rising yields (see charts below).

Figure 16: Increases in the SA short end typically associated with ZAR weakness

Source: Investec Securities research and Thomson Reuters

Figure 19: Real traded weighted ZAR - 8% undervalued relative to PPP

Source: Investec Securities research and Thomson Reuters

Global Outlook

The overall investing environment remains equity favourable as we continue to see affirmation of the synchronised global growth that is driving many markets to all time or multi-year highs. The global OECD Composite Leading Indicator rose an 18th straight month to its highest level in nearly three years, indicating global economic conditions should remain robust. This came as the IMF raised global growth forecasts for 2017 and 2018, citing improvements in the Eurozone, Japan and emerging markets. All 45 OECD countries are growing and 33 have accelerating growth. Global Industrial Production is up 3.7% from the previous year to its best growth rate since early 2014.

Even as the advent of higher rates and less stimulus begins to take hold it is still a financial environment awash with liquidity. We do not believe that a gradually rising rate path associated with a growth cycle will be equity negative in its own right. Technology, demographics and cheap energy keep the long-term structural picture for inflation muted and as such we do not see global central banks at the beginning of a major rate hike cycle.
The very real risk posed by North Korea is being underplayed by most measures and this is possibly the outlier that could derail the secular bull market.

USA

The steady if unspectacular growth supported by potential tax stimulus, shallow Fed hiking cycle and ongoing earnings growth should see continued market strength. There are no signs of a recession on the horizon, with industrials and financials showing their strongest PMIs since 2014 and technology sustaining its strong growth trajectory. In our opinion, US corporate earnings have been the strongest guiding force for the underlying US market performance this year rather than the potential for political intervention. As energy sustains its earnings recovery off last year's lows, financials start to benefit from the rising rate cycle.

The technology space has been a key driver of the market and we see these powerful earnings continuing. In our opinion, the biggest risk facing the technology sector behemoths lies not in earnings but in the potential for regulation and legislation (potentially in the form of anti-trust law application), as a handful of companies control and influence more and more of people's lives. The market has been defying gravity and is likely due for a corrective move, however we do not feel that the pullback will signal the end of the long-term uptrend.

India

While India's most recent GDP was slightly on the low side at 5.7%, it remains a well-run economy with a proactive governing regime. The embedded labour and infrastructure reforms coupled with the demographic and growth momentum will sustain the positive long-term investment thesis and we remain bullish.

China

The carefully managed Chinese economy continues to be a global growth engine as GDP for Q3 came in at 6.8%. Their specific vision and focus on a number of key areas remains supportive of multiple opportunities.

Commodities and resources

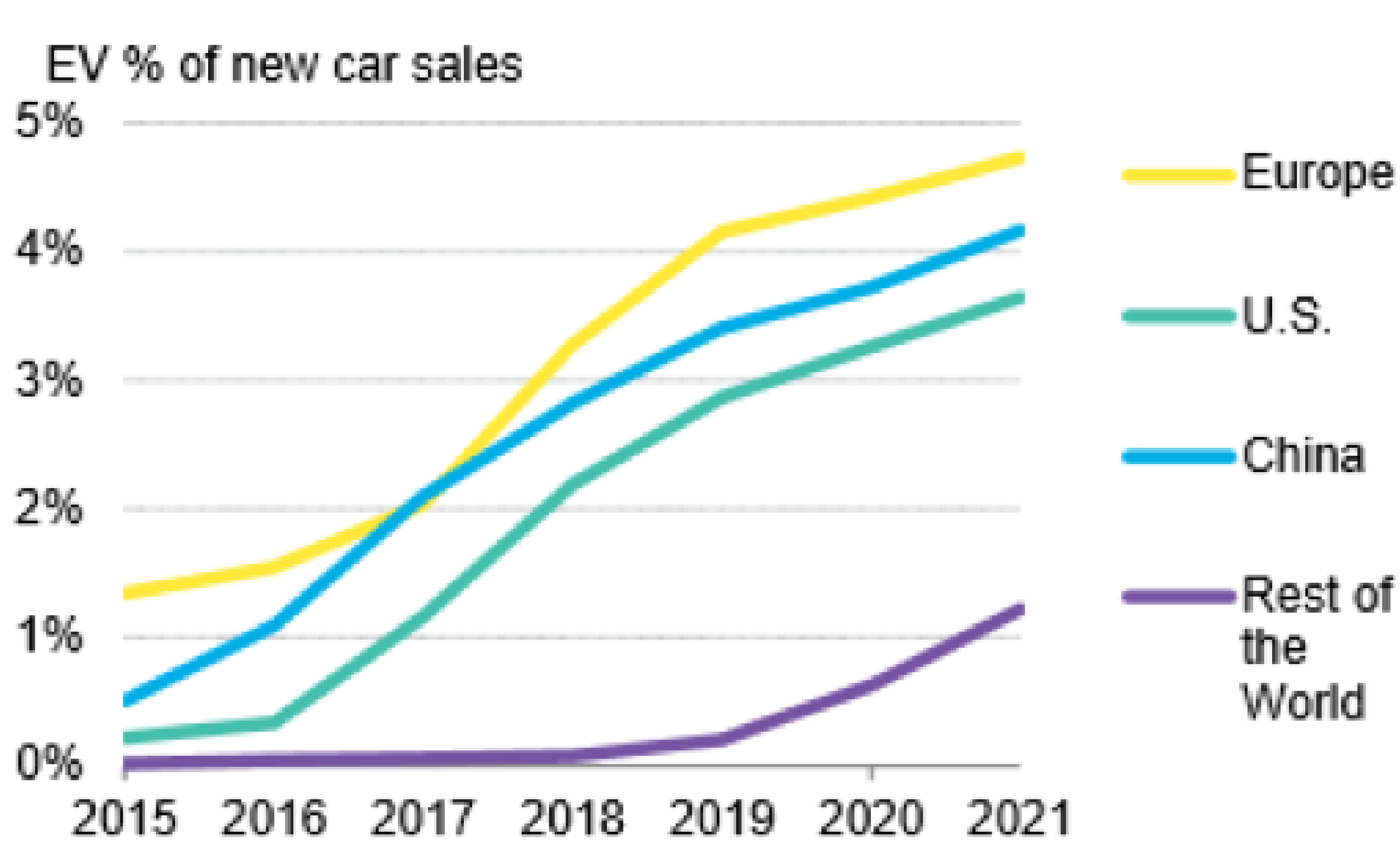
We have been and remain constructive on the longer-term outlook for many of the old world and new world commodities. There are a number of reasons for this:

China's commitment to the development of a modern 'Silk Road' will lead to an infrastructure building boom which will run through Central Asia to Europe and Africa with the aim of boosting trade and improving transport logistics. It already has USD 1 trillion of projects initiated supporting robust demand for industrial and base metals and will involve 65 countries (see chart to the right).

China's focus on reducing pollution has several implications. The shuttering of low grade, marginal steel producers has driven iron ore lump premiums significantly higher, a fact which favours the high-quality iron ore producers such as Kumba Iron Ore and BHP Billiton. The push for faster adoption of clean alternatives such as electric vehicles (EVs) and lithium-ion batteries will support copper, lithium, cobalt and nickel as we move quickly toward the future. For example, there is up to four times more copper in an electric drivetrain than a traditional one.

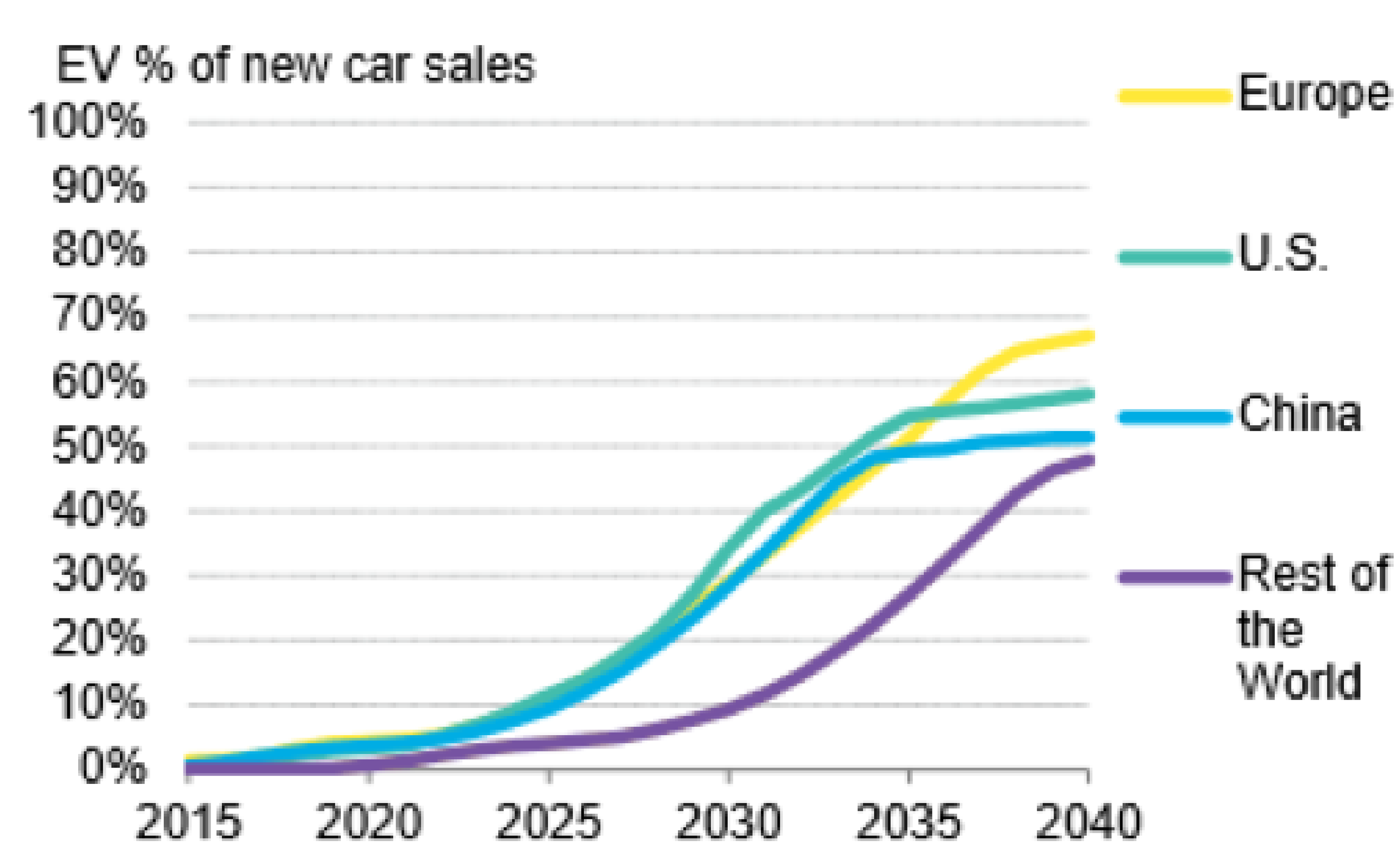
A Bloomberg New Energy Finance study estimates that by 2040, 54% of new car sales and 33% of the global car fleet will be electric. Falling battery prices will bring price-competitive electric vehicles to all major light-duty vehicle segments before 2030. Lithium-ion battery demand from EVs will grow from 21GWh in 2016 to 1,300GWh in 2030, making lithium and other battery inputs key long term commodities.

Figure 5: Short-term EV sales penetration by country



Source: Bloomberg New Energy Finance

Figure 6: Long-term EV sales penetration by country



Source: Bloomberg New Energy Finance

Conclusion

In summary, we see potential pockets of opportunity in SA in the cyclical industrials, financials and discretionary retailers on an opportunistic basis between now and December and more fundamentally on a longer-term basis looking beyond December. We also like the defensiveness and rand hedge qualities of the global cyclicals and industrials heading into December. The global technology earnings momentum is expected to continue while any pullback in selected commodities is expected to be an opportunity to participate in a positive long term structural trend. From a global perspective, it is clear the macro environment for emerging markets is supported by solid global growth, particularly Asia and China, with easing financial conditions and plentiful liquidity and as such we remain constructive overall, despite the fact that few global markets offer true value at this point in time.