Amplify SCI*
Strategic Income Fund

Fund Commentary | February 2024

Erik Nel
Chief Investment Officer
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"Opposition politicians, local and global investors, the media, and big business have been vocal in their rebuke: the only thing that will arrest South Africa's economic decline is urgent execution on reform – logistics, power, and network industries."

Global overview

Materially tighter financial conditions or a negative credit shock for the US economy

We have run out of superlatives to write about Nvidia and tech at this stage. Records were broken all over the show in February, the S&P clocking up an impressive consecutive weekly run of positive closes (and closing above 5 000 for the first time ever), Nvidia chalking an all-time record market cap gain for a single day, and the Nikkei scaling levels not witnessed in decades (not to steal its thunder, but Chinese equities, up 9.35%, exceeded that of the Nikkei, up 7.99%). Not to be outdone, crypto also had a phenomenal run, with Bitcoin's market cap boosted courtesy of ETF inclusion. At US$1.3 trillion, it means only seven listed stocks have market caps greater than the king of crypto assets.

US inflation still above target

With gold also recovering smartly from a brief dip below US$2 000 intramonth, it is probably safe to say that hawkish Federal Open Market Committee members will have much to say about easing financial conditions and too much liquidity at the upcoming March meeting, despite another early-month CRE wobble after New York Community Bancorp reported a loss on 31 January as they raised their expected loan losses on commercial real estate. With inflation still above target and surprising on the upside in the US, investors pushed out the timing of future rate cuts (from six cuts to three, and in addition, they pushed out the likely timing of the first rate cut to the June meeting), and sovereign bonds lost further ground.

Leading indicators are not supportive of a high conviction upturn

On the data new home sales, durable goods orders, Chicago PMI, ISM PMI, and construction spending all fell short of expectations, while personal income was strong due to government social benefits. Real retail sales, industrial production, and the employment level, which comes from the household survey, are contracting or nearly negative, while nonfarm payrolls, broader personal consumption, and real personal income are at or above 2%. The blend is what leaves us with a roughly 1.3% trending growth rate – a tenuous position. Leading indicators are not supportive of a high conviction upturn other than the picture portrayed by stock prices. The Atlanta Fed GDPNow nowcast for Q1 2024 was knocked down to 2.1% after the late-month run of poor data, and if we add the trending level of personal consumption expenditures inflation of 2.5%, we arrive at a nominal GDP level in the mid-4% range, following a Q4 2023 reading of 4.9%.

In the euro area, German growth remained stagnant, while inflation surprised modestly to the upside. OPEC extended its supply curtailment stance. On the radar for March will be employment and wage growth data, central bank meetings, and specific focus on potential further Chinese stimulus initiatives.

No recession for the US economy

While we are still way off from having to worry about sell-in-May-and-go-away vibes, there seems a growing sense of paying homage to the IDES of March. Worries about overvaluation, rising volatility, poor seasonality, somewhat sticky inflation, and a less dovish US Federal Reserve are all good reasons to dance closer to the door. The Conference Board no longer anticipates a recession for the US economy, shifting its forecast to a slowdown in consumer spending growth and an overall GDP growth deceleration to under 1% in Q2 of 2024: "While we no longer forecast a recession, we do expect the consumer spending growth to cool and for overall GDP growth to slow to under 1% in Q2 and Q3 2024. Thereafter, inflation and interest rates should normalise, and quarterly annualised GDP growth should converge toward its potential of near 2 percent in 2025."

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We wrap up the global section with an interesting thought from one of the largest asset management firms on the planet:

"If current macro trends don't reverse in the coming months, a new question may emerge: If banking turmoil, tight monetary policy, and a weak global growth environment can't rein in the hot-running US economy, what can? We fear the answer may be materially tighter financial conditions, or a negative credit shock."

Local overview

The JSE is now the worst performing stock market

Another tough month for local equities means the late-December surge is now very much in the rear-view mirror, with a 12-month return profile (-2%) probably more reflective of growth opportunities in the local economy than the almost 8% return reported by the end of 2023. The JSE is now the worst-performing stock market among emerging markets this year, with the MSCI SA down 12.1%, followed by resource-rich Chile, down 9.5%. On the other end of the spectrum Turkey is leading the charge with a year-to-date gain of 13.1%. SA government bonds (-0.58%) and inflation-linked bonds (-0.70%) also struggled, while listed property seems to have left behind its troubles of the past few years with another 0.82% advance to lift its 12-month returns to an impressive 17.58%, wiping out the 2018 resilient-led losses to move into the black on a 5-year return basis.

February was not short of risk events. National Treasury delivered another pragmatic, anti-populist Budget, and was not rewarded for such (it was asked to tap the Gold and Foreign Exchange Contingency Reserve Account, which it duly did, and then got punished for doing so). The SA Reserve Bank (SARB) published a policy paper that suggests we are likely one step closer to a lower inflation target, with National Treasury echoing this sentiment via its macro policy update. Importantly, it also explicitly asks the SARB in the document to be more critical of fiscal actions where it sees room for improvement. This should be seen against a backdrop of an ANC manifesto that left very little to the imagination in terms of populist revolutions through taxing, prescriptions, expropriation, and more state control.

The only thing to save South Africa's economic decline

Opposition politicians, local and global investors, the media, and big business have been vocal in their rebuke: the only thing that will arrest South Africa's economic decline is urgent execution on reform – logistics, power, and network industries. Some positives in this regard include the permanent appointments of Michelle Phillips as Transnet group CEO and Russell Baatjies as CEO of Transnet Freight Rail (TFR), and Dan Marokane as Eskom's new CEO. These appointments have been followed by news of Sasol and TFR announcing a first-of-its-kind public-private partnership to improve rail transport reliability. And Transnet has completed its financial due diligence on International Container Terminal Services, Inc. (ICTSI), a Philippines-based port operator, in connection with the DCT Pier 2 transaction.

Another big event in February involved the passing of the Public Service Amendment Bill, which in practical terms seeks to depoliticise the appointment of civil servants, which had become endemic under the Public Service Act of 1994, one of the first pieces of legislation passed by the ANC. Foreign investors appear nervous of a negative election outcome, which means the lead up to the late-May event will likely be characterised by elevated volatility and poor liquidity.

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INTELLIGENT IMPACT THAT MATTERS