THE QUART 40IFO

OFFICIAL QUARTERLY NEWSLETTER OF **THE OSRIN GROUP**
INCORPORATING OSRIN WEALTH & OSRIN ADVISORY

Quarter 4 in Review

Introduction – A Test of Endurance

Welcome to the final edition of The Quart for 2019. We thought we would wait for everyone to return from their well-earned holidays before examining the last three eventful months of the decade. We hope you enjoyed some relaxing family time, and have returned to your busy schedules with recharged batteries.

When we compiled The Quart Q3 2019 edition, the Bokke had not yet been crowned rugby World Cup Champions. If ever a country needed some cheer, it was South Africa, and the win was a much-needed boost. At time of writing, the Proteas are hosting England and are 2-1 down in the test series, after a disastrous showing in PE. The cricket theme will be evident in this edition.

Many of you availed yourselves of various Foreign Investment Allowances (FIA) during December, some timing the USD/ ZAR and other forex rates better than others. Timing entry to one side of an exchange rate is a difficult task. The state of the domestic SA economy, as well as policy and political uncertainty, have left many looking at making FIA applications in 2020. Please advise if you require any assistance. We are able to help with the process, working with companies who offer rates far preferable to your local bank branch.

On this rather sad topic, we have forged professional relationships with reputable companies assisting with visa applications in Portugal, Cyprus and the US. Regarding Israel, Australia and the UK, we are able to furnish clients with introductions to professional firms and experts.

Regarding offshore estate planning, we have noticed an uptick in the establishment of offshore trust structures and incorporation of offshore companies. We are able to assist here too.

Q4 2019 kept us captivated until the last day of the year. This edition expands on some of the more interesting quarterly and annual themes. We hope you enjoy the read. Please note that you are able to subscribe to The Quart via our website: **www.osringroup.co.za.**

The Osrin Group looks forward to meeting and assisting clients with financial planning decisions in 2020.

All the best from all of us at the Osrin Group.

Jonathan & Bernard

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[A QUART] Def; A unit of liquid measure of capacity, equal to one fourth of a gallon, or 57.749 cubic inches (0.946 liter) in the U.S. and 69.355 cubic inches (1.136 liters) in Great Britain. Or a unit of dry measure of capacity, equal to one eighth of a peck, or 67.201 cubic inches (1.101 liters).

The Quart is in Session – Tail-end rally

In Q4 2019 equity markets, and in particular the tech sector, were extremely strong. Commodity prices also lifted and the US dollar surrendered gains, mostly against the GBP and EUR that had hitherto performed poorly, but also against commodity currencies such as the AUD, the CAD, and the rand.

You will remember that the late August-early September period saw the yield (interest rate) on the 2-year Treasury get above that of the 10-year Treasury, an outcome called 'yield inversion'. Typically, this occurs when markets are concerned that present monetary policy is too tight (rates are too high, and financial conditions too tight), and that the outlook further down the line is assessed to be bleak.

October saw three important developments. (1) The Federal Reserve (the Fed) cut rates for the third time, (2) the possibility of a trade truce between the US and China emerged, and (3) Boris Johnson secured a revised exit arrangement for Britain from the EU and called a general election.

Fed easing came on top of rate cuts by the Reserve Banks of both Australia and New Zealand, with the European Central Bank taking down already negative rates on bank reserves for the first time since 2017, and recommencing quantitative easing. As a result, fears of a US and global recession receded.

US debt yields normalised. The 10-year yield rose 40 basis points (bps) or 0.4% in Q4 to over 1.9%. At the time of writing it is 29 bps (0.29%) above the 2-year yield, the 'steepest' yield curve in over a year.

These developments helped stocks globally. In the US, the Dow Jones Industrial Average (DJIA) added 6.1%, the S&P500 8.6%, and the Nasdaq Composite 12% in the final quarter. In South Africa (SA), both the FTSE/JSE AllShare Index (Alsi) and the Top40 Tradeable Index (Top40) were higher by just over 4% on the quarter. The UK FTSE100 was better off by 6.6% on Brexit progress.

For the year, the S&P500 was up by 28.9%. A full 15% of the near-29% gain came from two stocks - Microsoft and Apple. This was the best annual return since 2013, and the best-ever market performance for the first three-years of a first-term President. The Index crossed the 3,200 level for the first time. The DJIA, comprising the biggest US stocks by market capitalisation, lifted a more 'sedate' 22.3% (still the best since 2017), while the Nasdaq, made up almost entirely of tech stocks, soared 35.2%. The Nasdaq got above 9,000 points for the first time and also clocked its top return since 2013. The US small cap Russell 2000, which is more domestically focused, put on nearly 32%.

During December, all three major US indices made new record highs on multiple occasions, and ended the year on a five-week winning streak. And all that central bank policy accommodation (easier-to- access money) meant that the decade was the first not to experience a recession. As of December 2019, the US economy had grown for 126 consecutive months, the longest expansion in its history.

It is worth noting that investors sold off stocks in December 2018, believing Fed policy to be too tight. So, shares were coming off a lower base. In effect, by end-2019 the S&P was about 10% higher than the high-point of 2018, the DJIA a little less, and the Nasdaq a little more.

Despite a solid final quarter, SA stocks lagged Emerging Market (EM) peers, reflective of poor domestic economic data and policy trends. The Alsi saw an increment of 8.2% in 2019, while the Top40 got up just over 10%. This compared adversely to the MSCI Emerging Markets Index (15%), Brazil's Bovespa (31%), Russia's RTS (42.5%), China's Shanghai Composite (23.3%) and even India's Sensex (14.4%). India's growth slowed in Q3, its credit rating was downgraded and the reserve bank paused rate cuts.

The dollar was relatively flat on the year, with the trade-weighted US dollar Index (DXY) up 0.2% mainly as a result of more relaxed Fed policy. Weakness was principally witnessed in the final quarter, which saw the rand getting from around R15.50/ USD in late August to just over R14/ USD by year-end for an annual gain of 2.25%. So, in USD terms our markets did a little better than in rands (for a change).

Background geo-political risks (think Hong Kong, North Korea, and the Middle East) and falling US interest rates leading to an inflation-adjusted (real) rate of return of zero (i.e. inflation roughly at the same level as the fed funds rate), meant that gold, which generates no yield, had a barnstorming year. It began 2019 at about US$1,278/oz and ended the year above US$1,500/oz at US$1,517.24 (+18.7%).

Oil prices dipped going into the last quarter, despite the Iranian attack on Saudi oil infrastructure in mid-September, but a larger than expected OPEC production cut in December saw prices recover sharply with Brent crude up 6% and US West Texas Intermediate jumping 10%.

Quarterly Themes

1. The Fed & The US Economy - Expansive Shot-making

The US economy proved resilient to global economic problems. Despite the China trade dispute exerting downward pressure on business sentiment and fixed investment, as well as on export volumes, the economy remained healthy. This was due to 50-year low levels of unemployment, rising incomes, a robust consumer and strong expenditure. Meanwhile, inflation remained muted.

By December, consumer confidence was again at near-record levels with Americans largely shrugging off President Trump's impeachment in the House of Representatives, believing that there was little to no chance of his removal by a Republican-controlled Senate. Instead, the focus shifted to the 'Phase 1' China trade deal, which averted potentially harmful tariff increases on almost US$160 billion's worth of consumer goods in mid-December, and the revised USMCA agreement to replace NAFTA.

In Q3 2019, the final US GDP estimate put growth at 2.1% on the quarter annualised, after 2.0% in the previous quarter. The economy is seen as growing a further 2.3% in Q4 although Boeing 737 Max production cessation could retard the figures. Calendar year GDP is still set to come in over 2.0%.

The Fed took down the target range for the benchmark fed funds rate by 25 bps to 1.50%-1.75% on October 30, the third cut of the year. Two members of the Federal Open Market Committee (FOMC) voted to hold rates steady, their third dissent of the year. Chair Powell made it clear again that the decision was an anticipatory policy adjustment, calculated to provide a cushion against trade developments and weaker global growth, so as to allow for a continuation of US economic expansion.

On December 11, the Fed left rates unchanged in a unanimous decision. The FOMC noted that following three cuts, and a favourable economic outlook, the level of the fed funds rate was appropriate to support continued economic growth, a strong job market, and inflation near 2.0%.

The summary of economic projections showed that the median view on the FOMC was for US growth to accelerate at a 2.2% pace in 2019, and 2.0% in 2020, the same as in the September projections. Inflation and the unemployment rate were seen marginally lower for this year. Four members of the FOMC, including two current voting members, saw one rate rise next year with the remaining 14, including the residual eight FOMC voters, foreseeing no rate change at all in 2020.

Of course, Fed policy is not set in stone, and could change in accordance with incoming data. But Chair Powell stated that the Fed would only lift rates if there was a 'persistent' and 'significant' move up in inflation, which is to say a prolonged and material rise in inflation above the 2.0% objective. The Fed appears more concerned about the prospects of inflation running persistently below 2.0%, leading to lower longer-term inflation expectations, which could in turn exert downward pressure on inflation.

The fed funds futures market, as I write, is factoring in a 40% chance of a 25 bps cut by end-2020, and a further 20.6% probability of deeper cuts.

On September 18, the Fed again cut by 25 bps in light of the implications of 'global developments' for the outlook as well as 'muted' inflation pressures, although the US economy was still growing at a 'moderate' pace and the labour market 'remains strong.'

There were three dissents, the most since the December 2014 meeting, with the same two voters, Esther George, and Eric Rosengren, again opting for no cut, while James Bullard preferred 50bps. The summary of economic projections showed that the median view of Federal Open Market Committee (FOMC) member for 2019 US GDP growth actually rose to 2.2%.

The 'dot plot' of the fed funds rate trajectory revealed that five members thought no cut was warranted, five wanted 25bps now, but rates steady for the rest of 2019, while seven sought at least one more cut this year. The median view is that there will be no rate cuts in 2019, nor in 2020. The prevailing view among FOMC voting members is probably for at least one more cut, this or next year. The problem is that markets want more, and if they are not forthcoming, even if Trump de-escalates the trade conflict seeking re-election, the net outcome could be equity- and USD-negative.

So, there is some discrepancy between what the Fed currently thinks (no rate cuts in 2020) and what investors think (a 60.6% chance of at least one cut).

Obviously, uncertainties remain – be they potential policy errors, unsustainable debt levels and related toxic assets, and geo-political risks. That said, the consensus is that the US has about a 20% chance of entering a recession in 2020, which in economic parlance is tantamount to 'close to zero'.

2. China, Hong Kong & Xinjiang - A Free Hit

Public protests in Hong Kong (HK) have been held for years, the most recent in 2014 for direct leadership elections. But from June and particularly through July and August, and then again in mid-November, they became more widespread and violent. The unrest in 2019 began as a response to a bill that allowed untrammelled extradition of suspected criminals from HK to China.

World attention was drawn to the escalating conflict when 5,000 protestors on August 12 commandeered Hong Kong's airport, the 8th largest in the world, forcing flights to be cancelled.

Fears arose that China would deploy the People's Liberation Army (PLA) in a re-enactment of the 1989 Tiananmen Square massacre. This did not transpire, despite the PLA's presence in the territory. The HK Police that includes some Chinese militia, were deployed instead. Over 4,000 protestors have been arrested, hundreds injured and several killed. The police have used tear gas and water cannon, occasionally resorting to rubber bullets. By Chinese standards the response has been 'very mild'.

It was not just the scale and intensity of the protests that set them apart, but the fact that protestors were calling for far more autonomy (some even for independence), and that the protests were taken to key economic infrastructure, police stations and Chinese government sites like the Liaison Office.

HK was handed over to China in 1997 under the 'one country, two systems' policy, to be governed as a Special Administrative Region (SAR), which allowed for greater tolerance and freedom than existed on the mainland. China did not bring about rapid political change, leaving the bulk of career civil servants in place. But that altered in 2002, when the head of the region, the Chief Executive (CE), stopped appointing seasoned administrators as principal officials, but Beijing nominees instead.

The position of the CE has been controversial. In 2014, China offered HK residents the right to directly elect one of five nominees hand-picked by the Communist Party. This was rejected, and the head of the SAR Government is still elected by a 1,200-strong electoral college, comprising mainly of pro-China hardliners. The one-time Constitution with its Bill of Rights has been replaced with the Basic Law, a piece of Chinese legislation, ultimately open to Chinese interpretation and enforcement.

Over time, HK residents' rights and freedoms have been eroded, the media attacked, opposition figures arrested. Constrained space has seen an explosion in property prices preventing younger residents from acquiring homes, and leaving them marginalised in the mainstream economy.

The unrest in Hong Kong constitutes one of the pre-eminent risks for international markets in 2020, and is presently being understated.

HK's GDP is close to US$380 billion, its currency is liquid and pegged to the US dollar and its monetary policy follows the Fed. Its economy is founded on finance (it is the world's third largest financial centre), trade and logistics, retail trade and tourism. The territory has deep regional networks. The US affords it favourable trade status. In 2018, the US ran a trade surplus of over US$33 billion with HK.

The HK economy went into recession in Q3 2019. It appears likely that calendar 2019 will see a contraction driven by retail and tourism. The banks are diversified and have not yet felt the full impact of the troubles. The authorities have made plans for a stimulus package of HK$19 billion, but this will not soften the blow. Some economic activity has been displaced to Singapore, which is still struggling.

The ripple effect of a failing HK will be felt all over east-Asia and beyond.

HK is also a hub for Chinese financial activity and trade. HK is now under 3% of China's GDP from nearly 19% in 1997. But this is misleading. The Bank for International Settlements reported that in 2016 the city oversaw US$437 billion in forex transactions. It remains the main gateway for capital flows in and out of China. Trade, mainly in Chinese goods, is 22% of HK GDP, and the logistics sector around 4%.

So, where Hong Kong goes, so to an extent does China.

Chinese growth slowed to 6% in Q3 2019, the weakest since 1992. It is seen coming in under 6% in 2020. Its economy is being hindered by trade issues, over-borrowing from state-owned companies, which has crowded out the private sector, and demographic challenges. Food prices have elevated inflation to 8-year highs, weakening the domestic consumer. That said, China's growth is still strong.

Maintaining largescale industrial, export-led growth is unsustainable, both for China and the planet. The authorities have taken some radical steps to re-orientate the economy that have proved disruptive near term. But moving to cleaner energy in China, for example, will ultimately elevate growth. China's ample forex reserves and its massive trade surplus, give policymakers some leeway to support the economy via tax and rate cuts and through relaxing bank capital adequacy requirements.

Currently however, a China with problems accessing capital and whose trade and logistics advantages are hindered, will be potentially adverse for EM economies like South Africa.

More fundamentally, the wave of dissent threatens the one country, two systems policy, and might compel China to ratchet up the level of force to quell what could be depicted as a low-grade civil war.

Regional tensions are building. The Taiwanese are becoming more belligerent and will vote in an anti-mainland government in January 11 elections. China has been forced to provide Macau with added financial services authority and infrastructure to compensate for problems in Hong Kong.

The regime's greatest fear after the crushing of the Chinese Democracy Movement, is widespread, co-ordinated political unrest in China itself. Its Special Economic Zones are semi-autonomous, with wide-ranging legislative powers in trade and broader economic policy. These locales could become the future sites of struggle for basic freedoms. It is significant that even as economic and social reforms have intensified in China, freedoms of speech and association have been even more severely curtailed.

But the Chinese leadership is very aware of its global profile. So, when President Trump on November 26 signed the Hong Kong Human Rights and Democracy Act, requiring annual State Department certification that HK remains sufficiently autonomous to retain favourable trade status, and allowing for sanctions on officials responsible for human rights violations in HK, China responded only with strong language. The Chinese appear to want to separate out the political system issues from trade issues. President Trump was not to know this beforehand, so his move was very bold.

A bill supporting Xinjiang Uyghur human rights awaits Congressional passage and will doubtless generate warnings not to interfere in Chinese internal affairs, but little more. Or so it is hoped.

There is still some prospect that in its controlled economy, the Chinese government might launch a crackdown against targeted US firms operating in its market, and ultimately fail to uphold its side of the bargain in any trade pact with the US. It is almost certain that the 'lame duck' CE Lam will be replaced next year, with Beijing probably open to a less accommodative, more authoritarian leader.

In November local elections, pro-democracy candidates won nearly 90% of 452 district council seats. Voter turnout was high at 71.4%. The elections afford only symbolic powers, but the results indicated widespread unhappiness with the current administration. Legislative elections are slated for 2020.

3. The UK Election & Brexit Scenarios - A Decent Declaration

On October 17, negotiators reached a new draft agreement to prepare the way for the withdrawal of Britain from the EU. The deal circumvents the need for the contentious Irish 'backstop', by taking Northern Ireland out of the EU customs union, albeit that it remains subject to some European economic regulatory control.

The Irish border will continue to be soft (open), but a hard border is created in the Irish Sea such that any goods being sent to Northern Ireland for export to Europe, will have to proceed through a customs check. Northern Ireland remains part of the UK customs union.

The reality, however, is that the deal while a bit better from a sovereignty perspective, will see the UK less aligned regulatorily than conceived in former PM May's arrangement that was voted down three times. This makes the prospect of a future free trade agreement (FTA) with the EU with zero tariffs and quotas and relatively open borders for goods and services, more difficult to secure.

In October, Johnson received support for the Withdrawal Agreement Bill but not for the truncated timetable for implementation to meet the original October 31 exit deadline. Reluctantly, he requested a further extension to January 31. The Europeans agreed, believing the delay to be short and one that would lead to a more orderly Brexit. Under the existing agreement, the UK has until end-2020 to sort out its post-Brexit relationship with the EU. But, even before the delay, Johnson made it clear that should the October deadline be missed he would attempt to call an election to break the Brexit deadlock. Prior attempts had failed. He made the call officially on October 24, seeking an election date of December 12. On October 29, Johnson secured approval from Parliament for the general election.

The Conservative Party secured a landslide victory, garnering a majority of 163 seats, the biggest since 1987. The Labour Party now has its smallest share of seats since 1935. The whys and wherefores of the election are not the subject of this note. As Johnson graciously acknowledged, many votes were garnered from people not traditionally disposed towards the Conservative Party. Most sought to keep Jeremy Corbyn from office at any cost. And many Remainers voted to go with Johnson's plan, because the Labour alternative of another 'improved' deal and a referendum on that deal, would have merely resulted in protracted uncertainty. This was more of a procedural choice. At least 50% of Labour's support base was in any event, supportive of Brexit and trusted Johnson's deal as the only way to get Brexit done, 'no ifs, no buts, no maybes'.

As such, Johnson has a chance to position the Tories as a broader centrist party for decades to come. But he must come good on promises to undertake deficit spending, for example, to improve the NHS, education, the police and living conditions of poorer voters mainly in the north and rural areas. UKís gross public debt to GDP ratio is around 80%, so quite where funds will come from is anyone's guess.

After the result, the pound stormed to 19-month highs versus the greenback, lifting around 2.5% in a single day. But just because Johnson received an overwhelming mandate to navigate Britain out of the EU, did not mean that the Europeans were more likely to compromise. Furthermore, electoral success did not mean that Brexit was done at all. Some clarity had been achieved, but not closure.

New EU withdrawal legislation will be passed in the House in January. It will allow the UK on January 31 to embark on the transitional Brexit period to end 2020, during which the future affiliation with the EU will have to be determined. It is not just about trade. The entire relationship requires reconfiguring because it was built on a long-standing economic and political alliance. The timeframe appears unrealistic, but to extend it requires a request by June 2020. And the PM has ruled out an extension.

When investors became more realistic about the likelihood or not of such a complicated arrangement being finalised by end-2020, sterling gave up a lot of its gains. Britain has to negotiate a whole lot of other trade agreements as well, because most of its deals were secured via the EU or at least with open access to the EU in mind. These cannot be done on the fly for fear of prejudicial outcomes. There is also the matter of government finances and the February budget, as well as new laws covering immigration and like matters where Britain was bound to follow EU principles.

The manner in which Brexit unfolds and the economic relationship with the EU that results are unclear. It is difficult to foresee a lasting arrangement coming to fruition as early as December 31 despite Johnson setting a hard deadline. That said, I do not believe that the PM will initiate a 'hard Brexit', i.e. take Britain out without a deal. He recognises the importance of economic ties with Europe, just as he does diplomatic and military ties. Like Trump, he gets the popular mood, but unlike Trump, he is no isolationist, nor is he impulsive. He will endeavour to secure the best deal he can for Britain.

His overwhelming electoral mandate could lead to some unexpected compromises to effect a meaningful FTA with the EU. The UK economy is stuttering. The Bank of England does not have much room to manoeuvre with the Bank Rate at 0.75%. There are growing calls for rate cuts, but the Bank has to be aware of any deleterious effect on the pound, which could impact imported inflation.

The EU is a cartel, and if you choose to leave you lose the benefits of cartel protectionism and other anti-competitive policies. Britain's economy is dominated by professional, business and financial services (80%). Without pretty comprehensive regulatory alignment, no level playing field will be guaranteed. The EU will not allow British services firms to enjoy preferential access to the common market. British agriculture, which was sustained by EU subsidies anyway, might have to look elsewhere for export markets. Perhaps so too will British companies in the pharma, aero, auto and tech sectors.

So, as Churchill famously remarked, the withdrawal agreement "is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning."

4. SA's Fiscal & Economic Deterioration - Too Many Slips

South Africa endured a torrid final quarter. Economic data releases together with October's Medium-term Budget Policy Statement (MTBPS) and policy output from the SARB, painted a picture of economic stagnation and marked fiscal deterioration; in reality a descent into an unsustainable debt spiral. In December, Eskom's structural problems, so emblematic of the state sector as a whole, began to be felt again as the country was gripped by severe power cuts. These will impact Q4 GDP growth.

The body politic is fractured and the ruling party at war with itself. Government is incapable or in many instances unwilling, to give effect to structural reforms required to lift the growth trajectory. These reforms should be directed at improving human and institutional capacities and are well documented in the National Development Plan adopted by Cabinet back in September 2012. We are a long way from a coherent programme of skills development, including technical, artisanal, as well as professional training. So, local innovation remains largely locked in. Small business development is an illusory goal while so many impediments to doing business in the country, remain. And the labour market is quite ludicrously overregulated. Some public sector governance issues have been addressed, but set against the collapse of standards in the Zuma epoch, little progress has been made in truth.

The government's economic policy options are limited. It cannot meaningfully raise taxes fearing a revolt from an over-encumbered middle class, nor can it afford to increase social and infrastructural spending, nor indeed can it continue to utilise the civil service as an employer of last resort. Neither can it be seen to be printing money. The most telling comment on our predicament came via a report from China's Emerging Advisors Group in December – "and here is the big problem: We do not see how South Africa can grow again. At least, not in t he foreseeable future."

The MTBPS delivered on October 30 should not have come as a shock. But the scale of fiscal deterioration evident in the budget statement should worry every South African investor.

We know what has gone on at Eskom. Its debt is said to be R440 billion, but probably closer to R650 billion. It is not a going concern. Eskom produces 90% of our electricity so its incapacity derails economic growth, as evidenced by the loadshedding-driven Q1 2019 economic contraction. It is a grave fiscal threat and the rating agencies' main concern. In the February budget, Minister Mboweni noted that SoE's posed 'very serious' risks to economic stability and fiscal sustainability. In September, he revised this risk assessment upwards to 'massive'.

Most of Eskom's debt is guaranteed, i.e. a contingent government liability. The government guarantee framework of R530 billion (60% Eskom) is stretched to breaking point. But even where debt is not guaranteed, Eskom will not be allowed to fail. Over R200 billion in repayments are due end-FY2022/23. Barring a miracle, the debt (much of it held by local institutions) will have to be restructured. However, as serious as the Eskom crisis is, nearly 77% of SA's fiscal weakening has nothing to do with the Eskom.

Obviously, growth is key to fiscal improvement. In November, the SARB slashed the 2019 GDP growth outlook to 0.5%, more in line with the IMF and Moody's. In the MTBPS, the 2019 estimate was also taken down to 0.5%, and growth now seen at 1.2% next FY, then 1.6% in FY2021/22, to reach only 1.7% by 2022. This is over-optimistic. With Eskom issues SA cannot hope to grow near 1.0% next year.

The MTBPS now foresees gross debt to GDP at nearly 61% this FY from 55% before, +-65% next FY vs. 60% and at 71.3% by 2022/23. Our national debt is seen rising by a devastating 50% over three years.

Projections of the ratio of gross public debt plus SoE debt to GDP were not captured in the MTBPS. Accounting for SoE debt adds at least 30% resulting in a ratio to GDP closer to 100% over the framework period. This is a completely untenable metric for a developing economy like ours.

The MTBPS showed that an amount of R57.3 billion was actually under-collected in FY2018/19, the largest miss since the 2009 financial crisis. Assumptions for the next three FY's lead to tax revenue projections under February budget estimations by a further R251 billion, a quite eye-watering downward fiscal adjustment. All this means a widening of the main fiscal deficit to GDP ratio. The MTBPS is looking at a ratio of 6.2% this FY from a prior 4.5% then 6.8% (4.3%) and 6.5% (4.0%). A ratio of 6% is a rating agency hazard light.

The public wage bill is nearly 45% of non-interest spending. The cost of servicing debt is over 12% of expenditure now and rising exponentially such that it is the fastest growing expenditure line item. Adding subsistence social grants gets you to 70% of total public outlays. So, there is virtually nothing over for pro-growth funding by the fiscal authorities. As a result, more borrowing is assured.

SA Q3 2019 GDP growth contracted by 0.6% on the quarter annualised after a revised 3.2% expansion in the prior quarter. It could be that the economy will enter a technical recession in the final quarter although on a calendar year basis we will see modest growth of 0.5% or less. This is way under the EM norm. Mining, manufacturing and agricultural activity shrank, but services remain relatively healthy. Household consumption and business investment expenditure are rising off a very low base.

The SARB is caught in a bind despite policy easing in the US and moderating domestic inflation. It did trim rates by 25 bps in July, but held steady in September and again in November, when two MPC members voted to cut. The holding pattern goes against the EM policy grain. In October and November leading EM central banks delivered a total of 17 rate cuts. SARB recalcitrance is founded on the reality that our fiscal conditions demand higher rates than would otherwise be warranted (we pay nearly 0.4% more than the average EM economy to get investors to take up our debt). The Bank is concerned that should it embark on a radical easing cycle, which is desperately required for growth, support for the rand would be badly undermined, resulting in even direr outcomes in the form of stagflation.

On November 1, Moody's downgraded the outlook on SA debt to 'negative' from 'stable'. Moody's has been remarkably tolerant of domestic economic mismanagement. Now, it has put the government on notice that within six months, or at most a year, should the policy and growth course remain unaltered, it will move to downgrade SA debt to sub-investment grade. Moody's cited the all-too familiar 'deeply entrenched' constraints on growth and reform, high unemployment, and the reality of a continually rising debt trajectory. Three weeks later, S&P also cut its outlook on the nation's debt from 'neutral' to 'negative', citing mainly fiscal concerns. S&P has our debt at 'BB', two notches below investment grade. This was followed by an IMF report warning that time was running out for the implementation of reforms to put the economy 'on a sustainable and inclusive growth path'.

Should a Moody's ratings downgrade in 2020 occur all three of the rating agency majors will have assigned junk status to South African debt. Such a downgrade will result in the removal of SA debt from key investment-grade bond indices most notably the World Government Bond Index. This, it is estimated by government, could lead to an US$8 billion hard currency outflow (some say as much as US$15 billion) and doubtless result in severe pressure on the rand.

The clock is ticking.

5. 20/20 Vision - Trying to Predict Match Outcomes

As the year ends it is customary for analysts to indulge in some crystal-ball gazing. I say 'indulge', because given the variables at play it is understood to be impossible to make an accurate call on specific outcomes. Analysts have widely varying predictions for what US stocks will do in 2020, for example. JP Morgan analysts see an S&P rise of 6.5%, while Morgan Stanley, a drop of 6.0%.

I am not really interested in specific outcomes. My focus is on possible macro-economic data, economic policy and geo-political outcomes and the trends they establish for asset class performance.

These are some of the key events we know will take place in 2020.

A Senate impeachment 'trial' of the President will be held. It is called a trial and is overseen by the US Chief Justice, but it is a political process. Although the allegations of abuse of power and obstruction of Congress are very grave indeed, Republicans will rally around Trump and will hold a perfunctory trial probably without witnesses.

It strikes me that Senate Majority Leader McConnell's assertion that he would liaise with the White House in the conduct of the trial leaves him and the upcoming trial open to legal challenge. But for now, Impeachment is a non-issue for the markets.

In January, China will sign the 'Phase 1' trade deal. By December, the draft was incomplete, loosely translated and contained vague and probably unenforceable promises regarding IP theft. It also provided for far more Chinese purchases of US agri-produce, vehicles, energy, and easier access to the Chinese market for US financial services firms. I was frankly disappointed that tariffs were not eliminated or rolled back more substantially. Tariffs on US$250 billion's worth of China exports were kept at 25% and Chinese tariffs remain in place on many US goods' exports. This was less of a deal and more of a truce. However, sentiment is everything and even if it is only a thaw, markets are still pleased, all the more so because a Phase-2 deal is promised some time in the future. Estimates of a 1% input to US GDP from the China and North American trade deals are implausible, all the more so because Trump started the trade conflict in the first place and he will maintain the tariff threat.

Trade disruptions were the principal risk playing on investors' minds last year. But, even if the China-US trade truce holds, US policy is to re-write trade arrangements all over the world, including in Europe, South America and South-east Asia. Trade uncertainty will not go away in 2020.

On balance, I would say that trade will have a moderately positive effect on markets and global growth in 2020.

The US election is slated for November 3. A December USA Today poll put President Trump ahead, for the first time, of any potential Democratic candidate. Voters in the US do not vote nationally, but via states, so the poll may be misleading. In my view, Joe Biden is the only candidate likely to give Trump a contest because of his popularity in blue collar states. The Democratic National Convention to choose presidential and vice-presidential candidates begins July 13. Trump's approval rating is still only around 40%, but his economic approval rating tops 50%, high in a country deeply divided politically. It will be difficult for any challenger to fight the 'Trump market'. De-regulation, tax cuts, and pro-business policies have served investors well. In the longer term, Trump's unpredictability, the anti-globalisation crusade, his undermining of established political, military and economic alliances, not to mention climate denialism, will not serve US or global markets well. Trump should win a second term of office. Some analysts have claimed that markets have wrung all they can out of his presidency, such that a change will have little impact. I disagree. When Nancy Pelosi first announced that impeachment hearings were to proceed in the House, US markets tanked. This is a sure sign that investors, at least in the US, favour more of the status quo, although many American CEO's think differently. And with re-election it is possible that Trump will appoint a more dovish Fed Chairperson.

Britain will enter the transitional phase of Brexit end-January. I have spoken at length about possible Brexit outcomes. As long as Boris Johnson sticks to the 2020 deadline for finalising a post-Brexit deal with the EU, fears of a hard Brexit will remain. Sterling is likely to be extremely volatile in 2020.

The SA budget is due in the last week of February. The fiscal failings evident in the MTBPS should not deepen too materially. Do not rule out some form of luxury or similar wealth tax. Eskom's problems have not really come though into the budget, and this generates a downward bias for the rand and SA bonds, given that our debt trajectory is already rising exponentially. It is true that EM stocks have grossly lagged developed market counterparts for a decade now, but this does not mean a trend reversal in 2020. And even if it does, a good year for SA stocks is not guaranteed, although many say our market holds value. A Moodyís downgrade will hit SA assets. I rate the chances at better than 50%.

The USD will be supported by no likely Fed rate cuts in 2020, and an improving trade balance due to the China deal. Still, Trump would like to see a weak dollar to boost exports and to prop up the S&P (43% of revenues are from overseas sales), the budget deficit is widening, there is ample easy money with the Fed rebuilding its balance sheet, and growth will slow. So, I expect the USD to weaken a little.

Stocks have had a stellar 2019. It would be foolish to expect more of the same in 2020. Global markets take their cue from the US where corporate debt is anywhere between US$10 and US$15 trillion, earnings retreated in 2019 and share buybacks are ending. 77% of world CFO's (Deloitte CFO Survey), view stocks as overvalued, less so in the US than elsewhere, but nonetheless quite pricey. I think investors would be happy with an achievable 5% to 6% advance in US share prices in 2020.

Bonds are another issue. The preponderance of negative rates in the developed world is bad for the financial services sector, just as it is for savers. It has not led to more productive lending, rather has helped fuel the asset buying spree. To my mind, bond markets are in a bubble, pricing in too much negativity, and so are some debt derivative instruments. A correction in these markets is possible.

Geo-political risk will play out more directly in commodity markets. Despite a largely risk-on approach by investors, certain parts of the world remain very unstable and President Trump's sometimes reckless policy approach has resulted in many investors hedging their bets via gold. Oil markets tend to normalise quickly after an external shock because the US is a net exporter and demand is softening.

The Quart is adjourned
By order of the Judge (GPP)

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