GOLDILOCKS ECONOMY REVIVAL: A DATA-DRIVEN PERSPECTIVE

BY: BASTIAN TEICHGREEBER, CHIEF INVESTMENT OFFICER AT PRESCIENT INVESTMENT MANAGEMENT

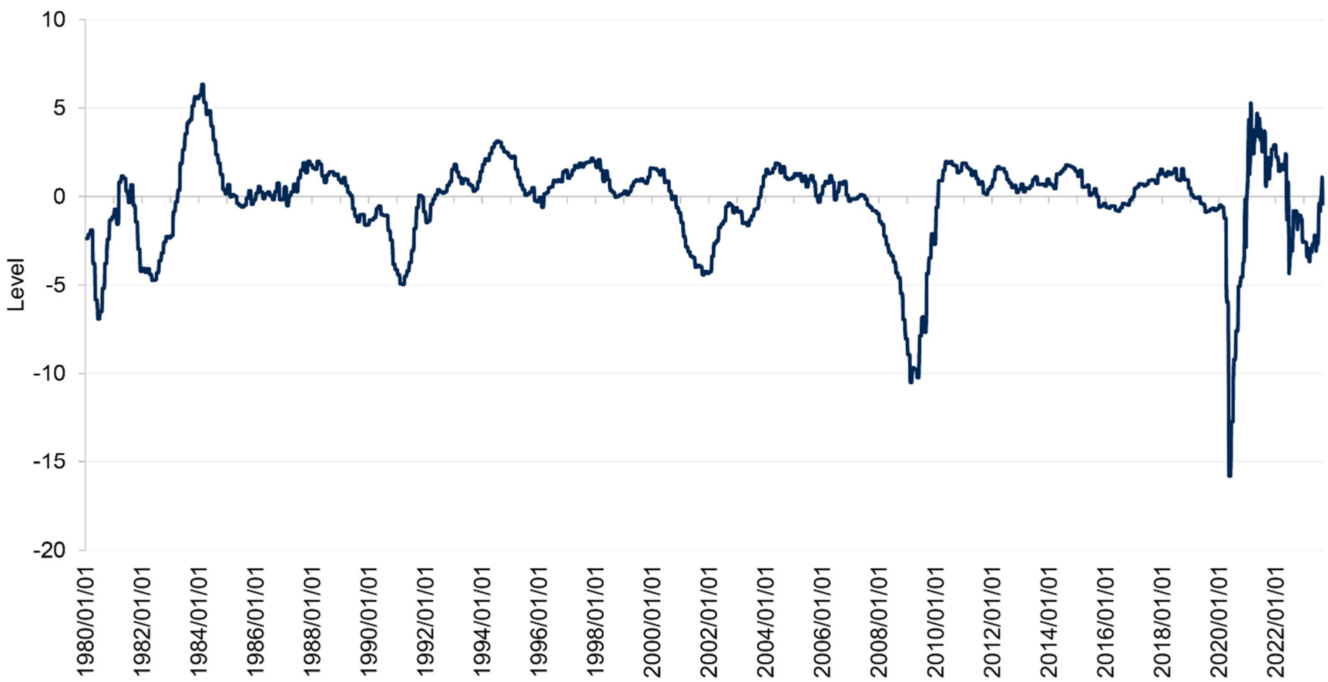
The global economic landscape remains a subject of intense debate, with forecasts oscillating between impending recession and a Goldilocks scenario characterised by balanced economic growth, moderate inflation, and stable employment. But if you filter out the noise and rely on real time data that captures the state of the economy, the evidence shows that the US is in the midst of an economic upswing, dispelling concerns of an imminent recession.

While unpredictability continues to dominate, we rely on our Prescient Economic Indicator (PEI) to consider all the economic data available to build a comprehensive picture of current economic circumstances and use these insights to inform our decision making.

The resurgence of the US economy

Our most recent PEI data points towards a resurgent US economy, dispelling notions of a hard landing or deep recession in the near future. A pivotal factor driving this resurgence is the robust performance of the US consumer sector, which constitutes a substantial 70% of the country's GDP. Both the retail and service industries, critical components of the US economy, have shown upside surprises, affirming our long-held belief that the strong US labour market continues to differentiate itself from the challenges faced by European and Asian economies. The below chart pictures the Prescient Economic Indicator.

Prescient Economic Indicator (PEI)



Source: Prescient Investment Management (as at 7 September 2023)

PRESCIENT INVESTMENT MANAGEMENT (PTY) LTD

Block B, Silverwood, Silverwood Lane, Steenberg Office Park, Tokai, 7945. P.O. Box 31142, Tokai, 7966.
Tel: +27 21 700 3600 Website: www.prescient.co.za

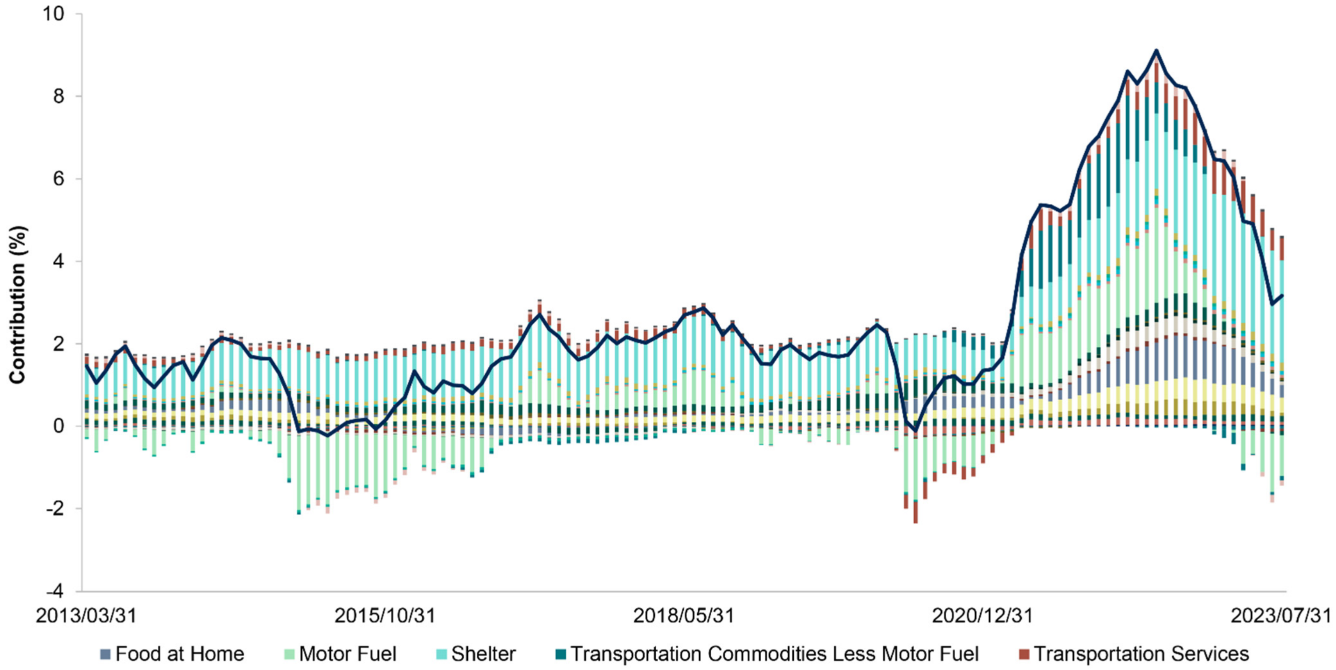
Prescient
INVESTMENT MANAGEMENT

Mitigating concerns on interest rates

While some investment banks express concerns about the potential for higher interest rates, we have a more nuanced perspective of the interest rate outlook for several reasons:

1. Incomplete inflationary pressures: The strong labour market alone does not necessarily lead to inflationary pressures. Notably, wage growth has moderated in recent times.
2. Offsetting effects: Even if wage growth were to remain robust, substantial gains in productivity would mitigate inflationary impacts.
3. Shelter component influence: A significant portion of inflation is attributed to the shelter component, which we anticipate will trend lower over the next year, aligning with a decrease in house price inflation.

US CPI attribution



Source: Prescient Investment Management, Bloomberg (as at 31 July 2023)

The recurring debate surrounding inflation, that has spanned the last two years, warrants reevaluation. In hindsight, the transient nature of inflation appears increasingly evident, suggesting a return to a regime of well-contained inflation after the inflationary impulses introduced by the Covid-19 pandemic work their way out of the system.

Implications for asset classes

In a Goldilocks scenario, favourable conditions typically prevail for risky assets. However, we are cautious of this interpretation for two key reasons:

1. Persistent Fed tightening: Concerns linger that the Federal Reserve may maintain higher interest rates despite decreasing inflation. The impact on the real economy cannot be underestimated.
2. Valuation worries: Equities across global markets are trading at elevated multiples, raising concerns about valuation. We generally favor local markets, where more pessimistic sentiment is already priced in, offering investors comparatively more attractive valuations.

Implications for South African investors:

It’s not all good news for South African equity investors either, with domestic equities largely taking the US’s lead, given the significant exposure a large portion of the listed companies have to the global economy. Deteriorating valuations and tight financial conditions in SA equities also highlight potential challenges that lie ahead for the asset class, which has moved from a neutral to a moderately negative outlook. With SA inflation having come down, increasing real yields on fixed interest assets, and the unpredictability of economic and financial market conditions, there is a strong case for a continued rally in diversified multi asset class investments.

Prescient's approach: A beacon amid uncertainty

At Prescient, we acknowledge that the uncertainty that currently defines the contemporary economic landscape is likely to endure, and we reject the notion that there will be a shift to "new normal" and thus investors can expect instability to become the status quo. Our approach, underpinned by meticulous investment processes and data-led insights, remains impervious to the emotional biases that often result in misguided investment decision-making. Leveraging cutting-edge technologies, we continuously monitor and adjust our positions based on real-time data, ensuring that we navigate these ever-shifting economic tides with precision and as they unfold.

Ends

DISCLAIMER