Global Economy

During the last few months we have warned on the deflationary forces in the European area. With the ECB unsuccessful in engineering a Eurozone economic recovery, it was only a matter of time before they had to act again. And act they did!

In an attempt to stave off deflation, the ECB lowered the deposit rate to -0.1%, cut its main refinancing rate to 0.15% and the emergency borrowing rate to 0.4%. Europe’s government bond yields are the lowest since the Napoleonic Wars. The ECB stopped short of quantitative easing - but do not rule it out, should it prove to be necessary.

Economists and politicians alike have been far too optimistic in forecasting an economic recovery around the globe.

With global debt at an all-time high a lot more deleveraging needs to take place, which will result in a further delay of monetary policy normalisation.

Global Debt at All-Time High

Source: BIS as of 31 March 2013
With hardly any employment being created and more job cuts from the private sector to keep profit margins intact, consumer spending is muted.

Look at it from an unemployed person’s perspective – low interest rates make no difference if there is no income.

First quarter GDP in the U.S. contracted by -1%. This is a real shocker. It certainly looks as if the U.S. economy is destined for below potential growth over the next few years.

We are now in the fifth year post the financial crisis and even so global growth remains slack.
Markets and Your Portfolio

“We learn from history that we do not learn from history.”
-Georg Wilhelm Friedrich Hegel-

Financial markets don’t seem to care about the state of the global economy. That is just the way markets operate. They don’t care until they do!

**JSE All Share Long Term Price to Earnings**

With the JSE/FTSE All Share Index trading at record price to earnings levels, we are battling to find value for new funds. Few opportunities prevail for an inflation beating return over the next few years, should one buy at these levels (as is evident from history). We have therefore made a decision to start increasing our cash levels to provide for a sufficient cushion should the market pull back - enabling us to fund opportunities as and when they arise.

Another reason for discomfort is the fact that the global dollar liquidity has been collapsing over the last few months. Global dollar liquidity has been one of the most important drivers of asset prices. As is clear from the graph below, a number of financial crises occurred across the globe soon after dollar liquidity started declining. With central banks running on empty, how will they add more liquidity?

**Source:** McGregor BFA

**Source:** Nedbank Capital
Thirdly, the Volatility Index (VIX) in the U.S. is extremely low and is at a level that indicates utter complacency.

![CBOE VIX Volatility Index](image)

Most valuation metrics point to some sort of correction. We would certainly welcome at least a 10% correction, offering us an opportunity to enter equity markets at more reasonable valuations.

**The Rand**

We haven’t moved any funds offshore over the past few months as the Rand remains undervalued. We continue to remain patient in this regard. With so much negativity baked into the Rand, any positive news will have a huge effect on the currency. History confirms that it is the wrong time to move funds offshore as there is too much negativity driving our currency into undervaluation levels. The time will come that the Rand will be strong relative to its fair value – and then it will be time to act swiftly. We have therefore not abandoned our belief that the Rand will still surprise given the pressure on interest rates in developed markets and an interest rate differential getting more attractive.

**Conclusion**

We are more cautious than ever and are increasing our cash levels. Better opportunities will present.  
The global economy is stumbling along with a decent recovery nowhere in sight.  
Monetary policy is to stay accommodative for an extended period – robbing the savers to rescue the indebted.

*Free State Greetings*

Hannes Barnard