OVERBERG MARKET REPORT
Week ending 8th November 2013

GLOBAL

- The Barclays global business confidence aggregate increased from -0.05 in September to +0.18 in October, its highest level since March 2011. The data is consistent with G20 GDP growth of around 3% during the 2nd half 2013, up from 2.5% in the 1st half. The improvement in business confidence has been led by developed economies, although emerging economies have also shown improvement. US business confidence, measured by Institute for Supply Management (ISM) and Purchasing Managers’ Indices (PMI), increased in the 3 months to end October to its best levels since February 2011. Japan’s PMI for October was close to its best level since 2007, while UK business confidence was at a record high in October, 1.8 standard deviations above the mean. Meanwhile, among the main emerging economies, China’s business confidence recovered to its best since January, and Brazil and Russia to their best since December 2012 and May 2013.

NORTH AMERICA

- US 3rd quarter GDP growth was revised upwards from the initially estimated 2.0% quarter-on-quarter annualised to 2.8%. Real disposable household incomes increased 2.5% raising the savings rate to 4.7%, both impressive figures. Residential investment increased a robust 14.6%, helped by strong home sales and housing starts. After detracting from positive growth for the past few quarters government spending increased by 0.2%, boosted by a 1.5% increase in State and local government spending. The balancing of budgets at State and local government level is prompting re-hiring of staff that had been shed during the 2009 recession. The GDP data has raised expectations that Fed quantitative easing (QE) tapering may start as early as December, especially as the GDP “deflator”, a key inflation measure, increased during the quarter by 1.9% annualised, compared with 0.2% in the 1st quarter. However, the Fed will also consider that increased inventories had a large part to play in the GDP data. After stripping out inventories and external trade, the growth rate slowed from 2.1% to 1.7%, showing an actual weakening in underlying economic conditions.

- The Conference Board’s US Leading Economic Indicator (LEI) increased in September by 0.7% on the month, slightly above the 0.6% consensus forecast, attributed to accommodative financial conditions, reduced jobless benefit claims and rising manufacturing orders. The index is now up by 4.2% on a year-on-year basis and should maintain its positive momentum, based on steady improvement in labour and housing markets, while the Fed’s policy tapering is likely to be gradual and maintain supportive financial conditions. The LEI, which provides a guideline for economic conditions around 6 months ahead, suggests the economy should gain momentum in the months ahead.

- Initial jobless benefit claims fell in the past week from 345,000 to 336,000 in line with expectations and in line with the average of the past 2 months of 332,000. The data is normalizing following volatile data over the past few weeks due to the government shutdown in October and the effect of computer system upgrades in California. The employment report, due out today, is expected to show an increase in non-farm
payrolls of 125,000 in October down from 148,000 in September. The data is closely watched by the Fed and any surprise on either side of expectations could alter the monetary policy outlook. The Fed is looking for evidence of sustained strengthening in the labour market to warrant a reduction in the pace of asset purchases.

- The US manufacturing Institute for Supply Management (ISM) index unexpectedly increased from 56.2 in September to 56.4 in October its strongest since April 2011, well ahead of the 55.0 consensus forecast and the key 50 level which demarcates expansion from contraction. While the employment index declined from 55.4 to 53.2 it remained above its average for the past 6 months of 52.5. The forward looking new orders index continued climbing from 60.5 to 60.6 indicating further improvement in the headline index in the months ahead. The report suggests little impact from the 16-day federal government shutdown with manufacturing activity evidently making a solid start to the 4th quarter. The US service sector ISM also unexpectedly increased from 54.4 to 55.4 well above the 54.0 consensus forecast, also showing little effect from the federal government. Encouragingly the services employment index increased strongly from 52.8 to 56.2.

**CHINA**

- China’s official services sector purchasing managers’ index (PMI) increased from 55.4 in September to 56.3 in October, the strongest reading in 13 months and well above the key 50 level which demarcates expansion from contraction. While encouraging, the forward looking new-orders component fell from 53.4 to 51.6, and the commercial services, food and drinks industry, and real estate sub-indices were below the expansionary 50 level. The services sector, which contributed 45% of GDP in 2012, is an increasingly important part of China’s economy as the government tries to rebalance growth away from investments and exports. At the weekend, President Xi Jinping said: “We are currently changing our way of development, adjusting our economic structure, accelerating our new style of industrialization, promoting technology, urbanization and agricultural modernization.” The Plenary Session takes place next week from 19th to 12th November, at which a blueprint for major reforms over the next decade are to be announced. Xi said: “We will put forward a comprehensive plan to deepen full implementation of reforms.” Although positive for rebalancing a more consumer-led economy is likely to slow the rate of economic growth.

**JAPAN**

- In a speech to business leaders Bank of Japan (BOJ) Governor Haruhiko Kuroda reiterated the central bank’s policy, that it ”will thoroughly examine both upside and downside risks to economic activity and prices, and make adjustments as necessary to achieve the price stability target.” However, in a departure from previous speeches Kuroda added the words “without hesitation”, which were not in the prepared speech. In this context, and the fact that a few of the BOJ policy board members projected the recent rise in consumer prices may mark time in coming months, suggests an increase in the level of quantitative easing may already be under discussion. The BOJ has pledged to end the country’s deflationary spiral and achieve consumer price inflation of 2%.
EUROZONE

- In a surprise move the ECB cut its benchmark interest rate by 25 basis points to 0.25%. It also extended the maturity of all its long-term refinancing operations (low-cost loans to Eurozone banks) by 1 year, at least until mid-2015 to ensure the banking system continues to function normally. The policy decision is attributed to the sharp decline in inflation, with consumer price inflation (CPI) running at just 0.7% well below the ECB’s 2% target. The IMF welcomed the move, stating that: “The decision is fully warranted by the weak inflation dynamics and substantial slack in the economy.” While unlikely in the near-term, a further decline in inflation may prompt the ECB to cut the benchmark refinancing rate closer to zero. Furthermore the ECB may introduce a negative deposit rate, the rate banks receive on excess reserves left with the central bank. Additional measures may include Very Long-Term Refinancing Operations (VLTRO) or quantitative easing, which has not yet been adopted by the ECB.

- Eurozone retail sales declined in September by -0.6% month-on-month, slightly more than the -0.4% consensus forecast. Although Portugal suffered the worst decline with -6.2%, it showed a quarter-on-quarter increase of 3.6% in the 3rd quarter. Spain followed a similar pattern with a decline of -2.5% on the month but robust 1.8% increase on the quarter, while Ireland also increased 1.1% on the quarter despite lackluster growth of 0.1% on the month. France enjoyed a 1.7% increase on the quarter but Germany surprisingly recorded a decline of -0.1% which seems to contradict recent strength in consumer confidence. While September’s data was generally disappointing Eurozone retail sales are showing a gradual and sustainable improvement. Following 6 consecutive quarters of contraction retail sales increased 0.3% in the 2nd quarter and 0.6% in the 3rd quarter.

- Germany’s industrial production fell in September by -0.9% month-on-month far weaker than the consensus forecast for a flat reading, attributed to falls of -1.1% in manufacturing output, -2.1% in production of investment goods, and -1.8% in construction. This marks the 2nd decline in 3 months: After gaining 4% in the 1st half of the year production has declined by -0.5% in the past 3 months, suggesting a loss in momentum. The data is consistent with a decline in the pace of GDP growth from 0.7% in the 2nd quarter to 0.4% in the 3rd quarter. Corroborating this outlook, the Budesbank reported last month that economic growth probably slowed during the quarter, while business confidence also unexpectedly declined in October.

- Fitch credit rating agency raised its outlook on Spain’s sovereign debt rating from “negative” to “stable” citing an improvement in financing conditions and that the nation’s overhaul of banks has “advanced well.” Fitch also confirmed that Spain has improved its “policy track record” with improvements to its labour market, pension system and budget. Fitch stated the recovery from recession came sooner than it had expected and the adjustment from a current account deficit to surplus had also been faster than forecast. Despite encouraging feedback, the rating agency cautioned that: “Medium-term growth prospects are weak, all sectors of the economy remain very indebted and unemployment is exceptionally high.” According to its forecasts the economy will grow 0.5% in 2014, less than the government’s 0.7% estimate.
UNITED KINGDOM

- As expected the Bank of England (BOE) left its benchmark interest rate unchanged at 0.5% and made no change to its quantitative easing (QE) programme of asset purchases. The BOE’s policy of forward guidance introduced under new governor Mark Carney, has stated that rates will not increase until unemployment reduces to 7.0%, not expected by the central bank before 2016. However, unemployment showed a sizeable decline to 7.7% in the June-August period and may fall faster than anticipated due to the increasing strength of the UK economy, perhaps prompting a tightening in monetary policy as early as 2015. According to David Kern, chief economist at the British Chamber of Commerce: “The Monetary Policy Committee must use next week’s Inflation Report to move towards a more realistic timetable for its forward guidance, to maintain business confidence and keep its credibility.”

- UK industrial production rebounded from the -1.1% month-on-month decline in August with an increase of 0.9% in September, beating the 0.5% consensus forecast. On a year-on-year basis production increased 2.2% its strongest growth since January 2011. The rebound was led by manufacturing output which increased 1.2% on the month, and mining and quarrying with an increase of 1.5%. The data shows the industrial sector is continuing to recover and based on the current record high purchasing managers’ index is set to show further gains in October. According to Samuel Tombs, UK economist at Capital Economics: “As things stand, production looks on course to rise at a faster pace in the 4th quarter than in the 3rd quarter.” The positive outlook is corroborated by the European Commission which this week more than doubled its forecast for UK economic growth in 2013 to 1.3%, making it the fastest-growing of the main European economies.

FAR EAST AND EMERGING MARKETS

- The persistent decline in South Korea’s residential property market seems to have bottomed out. According to data published by Kookmin Bank, national home prices increased in October by 0.21% month-on-month. This marks the strongest increase in 2 years, and the 4th straight monthly increase following 0.15% in September and 0.09% in August. June marked the bottom in the price index with the recovery now becoming more broad-based. The recovery, initially led by regions outside Seoul, included the capital for the 1st time in October with its 1st increase in 26 months. House transactions have also recovered strongly: After falling sharply in July with the expiry of the temporary property acquisition tax cut, introduced to boost the housing market, transaction volumes increased in September by 15.9% on the year, accelerating from 2.5% in August. The data confirms that the export-led expansion is gradually spreading to domestic demand, consistent with the early stages of an economic recovery cycle. Economists may raise their estimates for 2014 GDP growth from the current consensus forecast of 3.9%.

- Malaysia produced a stronger than expected trade surplus in September with exports rising 5.6% year-on-year above the 5.0% consensus forecast, and imports rising by just 2.8% well below the 5.4% forecast. The rise in exports is attributed to gains in the mining and manufacturing sectors, with exports to Asean and China showing an encouraging improvement, contributing to the biggest trade surplus in over 10 months. The data should ease concerns over recent months over Malaysia’s external balances. The central bank said that global economic activity was “improving” and that...
domestic demand remains supportive of growth, expressing rising comfort over the balance of risks to the growth outlook.

**SOUTH AFRICA**

- SA’s mining production increased in September by 0.6% year-on-year, slowing down from the 2.5% increase in August. The slowdown is attributed to declines in production of iron ore of -20.2%, gold -3.1%, and coal -1.3%. On a month-on-month basis mining production fell by -4.1%, the 3rd decline in 4 months and the 2nd largest decline this year. Production in 9 out of the 13 mineral categories suffered a decline over the month with platinum group metals (PGM) suffering the worst with a decline on the month of -10.4%. Unfortunately the mining sector outlook remains bleak with ongoing stoppages at the Sishen iron ore mine and continued labour unrest in the platinum sector.

- SA’s manufacturing production fell in September by -3.3% year-on-year the largest decline in over 2 years. The decline is attributed to vehicles, parts and accessories, which suffered a fall in production of -49.7% due to industrial action. While food and beverages, and wood and paper increased production by a robust 5.1% and 5.2%, these were not sufficient to stem the broader decline. In the 3rd quarter manufacturing fell by -8.1% on the quarter, the largest quarterly decline in 4 years. With manufacturing contributing around 15% of GDP the data suggests weak economic growth will be recorded in the 3rd quarter. However, following the resolution of labour issues in the vehicle sector a solid rebound is expected in the manufacturing sector in the 4th quarter.

- In a detailed review of SA, Goldman Sachs acknowledged key advances since 1994: a tripling of GDP from $136 billion to $385 billion, reduction in consumer price inflation from an average 14% in the 14 years prior to 1994 to an average of 6% in the years that followed, and a rise in gold and foreign exchange reserves from $4 billion to $50 billion. In addition, beneficiaries of social grants have increased from 2.4 million people to 16.1 million, and black ownership of the JSE has increased from 5% to 21%. However, the report warned that it was vital for the government to make a "much more determined and coherent" effort to improve the investment climate entailing "a better balanced and friendly regulatory, productivity and labour picture." This would be essential to staving off the “twin” budget and current account deficits, unemployment and inequality. GDP growth would need to be raised from the last 20-year’s average of 3.3% to 5% in order to reduce the unemployment rate and debt to GDP ratio by half, while doubling the GDP per capita.

- The Promotion and Protection of Investment Bill proposed by the government diminishes the rights contained in previous bilateral treaties SA had with various countries. These treaties have been cancelled in the past few months, to the regret of foreign governments, and unfortunately the new bill does not offer the same protection. According to Webber Wentzel partner Peter Leon, the bill "Removes the obligation to international arbitration, compensation is not at full market value and, very importantly, there is no mention in it of "fair and equitable" treatment of investors.” The bill increases the leeway for expropriation and allows the government to provide compensation at less than market value if certain conditions apply. If legislated, the bill is likely to make SA less attractive as a destination for foreign direct investment.
KEY MARKET INDICATORS

YEAR TO DATE %

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TECHNICAL ANALYSIS

- The US dollar has again dropped below the key $/€ 1.30 level versus the euro suggesting a continuation in the dollar’s long-term weakening trend.
- The rand has fallen through successive support levels at R/$9.30 and R/$9.50 and now R/$10.0 suggesting a potential acceleration in the rand’s depreciation.
- The recent sharp increase in the JP Morgan global bond yield suggests the major bull trend which started in the early 1980s may be close to exhaustion. However, there is unlikely to be a major bear trend as the deleveraging phase is still in its infancy.
- The US 10-year Treasury yield is unlikely to accelerate through the major support line from 2007, currently at around 2.7-2.9%. Oversold and diverging momentum indicators suggest the yield is at a peak.
- The longer dated R186 SA Gilt yield has increased in 2 even steps from 7.8% to 8.8% since mid-July. Another step upwards is projected to the lower 9.00s but this is likely to mark the peak in yield.
- Ultra-loose central bank monetary policy has led to increased demand for riskier assets. The Leuthold risk-aversion index is trading close to 30 year lows.
- US and global equity markets have risen in many cases to all-time record highs suggesting a strong bull trend and further gains in the near-term. However, the MSCI World Equity index is in the 5th and final wave of a rising-wedge formation. A rising-wedge formation is a typical trend-ending signal. European equities are breaking out of 5-year resistance levels and are set to outperform US markets.
- The Nikkei exhibits the most bullish pattern in spite of the recent 20% correction from recent highs.
- The Coppock Curve is a long-term momentum indicator with an excellent track record in identifying major market bottoms. It shows that the March 2009 low was a long-term low unlikely to be broken.
- The Brent crude oil price has broken above key resistance at $110 suggesting further near-term gains to $120, although the geo-political risk premium is quite high at an
estimated $8 per barrel, suggesting recent gains are not sustainable over the long-term.

- Copper is regarded a reliable lead indicator for industrial commodity prices and barometer of global economic growth. It has broken below key support of $7,500 suggesting a downside move to the 2011 low of $6,500.
- The Economist’s world food index has tripled since its base in 1999-2001 and continues to threaten rising global food price inflation. However, agricultural prices have fallen steadily since mid-2012 which suggests a gradual leveling-off in the strong long-term upward trend.
- Gold has reversed recent losses but needs to break back above the key $1550 level to restore the bull trend.
- The All Share index has broken to new highs suggesting the long-term upward trend is intact. However, the index is trying to break up through the top of a channel which has been in place since 1987. Since the Industrial-25 index, which has been the key driver of the All Share index, is beginning to lose momentum, it is doubtful that the All Share will maintain its upward break. A return to the middle of the channel would bring the All Share index back to 33,300, equivalent to a decline of around 27%.

**BOTTOM LINE**

- While the US Fed is almost certain to begin tapering its quantitative easing (QE) programme in the next few months, either next March or perhaps as early as December, the Bank of Japan (BOJ) is likely to enhance its programme of asset purchases. Due to slowing momentum in the Abe government’s restructuring efforts the BOJ is likely to expand its Quantitative and Qualitative Easing (QQE) policy in the 2nd quarter 2014. The timing would coincide with fiscal contraction resulting from next April’s consumption tax hike.
- It is expected the BOJ will emphasise the "qualitative" aspect of its QQE programme with greater purchases of Exchange-Traded Funds (ETFs) and other "riskier" assets, while also altering the maturity of its Japanese Government Bond (JGB) purchases, from medium term maturities to both the shorter and longer end of the yield curve. The qualitative shift could have a major impact on financial markets, potentially leading to a bubble in financial asset prices.
- In contrast to the US where the negative real interest rate policy is coming to an end, Japan’s real interest rates are just starting to go into negative territory. As a result Japan’s equity markets are likely to strongly outperform the US over 2014.