ATOM CAPITAL

MARKET OVERVIEW

MAY 2024 IN REVIEW

ECONOMIC AND MARKET OVERVIEW

Sticky inflation and interest rate decisions are still frequently appearing in headlines. However, the change in May was that some central banks are starting to talk about decoupling from the US Federal Reserve as their local economic conditions are calling for rate cuts despite the Fed's reluctance to reduce rates.

The Swiss National Bank became the first major western central bank to cut rates this cycle, with a 25 basis point cut in March. Following that, the Swedish Riksbank cut its policy rate by 25 basis points to 3.75% early in May. At the start of June, the Bank of Canada became the first of the G7 economies to follow suit by dropping their rate from 5% to 4.75%, and the European Central Bank one day later decided to also reduce their rate by 25 basis points to 3.75%.

Election results in South Africa and India were surprising, as both incumbents lost far more support than anticipated, forcing the ruling parties to form either coalitions or governments of national unity. It underlined how difficult it is to forecast outcomes, even when tens of thousands of potential voters are polled prior to the election.

In South Africa, the ANC attained 159 seats in South Africa's National Assembly, down 31% from the previous 230 seats. Jacob Zuma's MK Party exceeded all expectations by winning 58 seats in parliament and then also contesting the result.

Claudia Sheinbaum has been elected as Mexico's first female president in a historic landslide win. She won by a margin of about 30 percentage points over her main rival, businesswoman Xóchitl Gálvez.

The Monetary Policy Committee (MPC) of the South African Reserve Bank has unanimously voted to keep interest rates unchanged at 6.50%, with the risks to the inflation outcome assessed to be largely balanced.

In his statement, Governor Lesetja Kganyago noted that South Africa's annual inflation rate eased for the second consecutive month to a four-month low of 5.2% in April 2024. However, South Africa's unemployment rate increased to 32.9% in Q1 of 2024, the highest in a year and up from 32.1% in the prior period.

MARKET PERFORMANCE

In May, global equity markets continued their upward trend (which in many instances paused in April), with a large number of markets reaching all-time highs. As impressive as this sounds, it's important to remember that as markets generally rise over time, they are bound to hit all-time highs fairly frequently.

Emerging market equities (up 0.2% in US dollars) lagged their developed counterparts (up 4.5%). Global bond yields drifted lower during the month but gave up some of these gains towards the end of the month as the Federal Reserve exhibited a more hawkish stance. South African bonds followed a similar path, ending the month with higher yields than at the end of April.

South African equities ended the month slightly stronger than their emerging market peers. However, in the wake of the election results and subsequent negotiations about the formation of a new government, the equity market is expected to remain volatile as both rumours and facts emerge. Only once a new dispensation is announced and it's efficiency assessed will South Africa specific risks subside.

The gold price remained steady in May, while the price of a barrel of oil dropped by a little over 7%.

MARKET INDICES[1]	29 FEBRUARY 2024		
(All returns in Rand except where otherwise indicated)	3 months	12 months	5 years[2]
SA equities (JSE All Share Index)	7.3%	6.3%	10.7%
SA property (S&P SA Reit Index)	-2.3%	17.5%	-3.8%
SA bonds (SA All Bond Index)	0.2%	13.0%	7.2%
SA cash (STeFI)	2.1%	8.5%	6.0%
Global developed equities MSCI World Index)	2.1%	19.2%	19.3%
Emerging market equities (MSCI Emerging Markets Index)	1.7%	7.2%	9.4%
Global bonds (Bloomberg Barclays Global Aggregate)	-2.5%	-4.3%	3.6%
Rand/dollar[3]	-1.9%	-5.0%	5.3%
Rand/sterling	-1.2%	-2.4%	5.5%
Rand/euro	-1.5%	-3.3%	4.7%
Gold Price (USD)	13.6%	18.3%	12.2%
Oil Price (Brent Crude, USD)	-2.4%	12.3%	4.8%

1. Source: Factset
2. All performance numbers in excess of 12 months are annualised
3. A negative number means fewer rands are being paid per US dollar, so it implies a strengthening of the rand.

DID YOU KNOW?

THE FASTEST AND EASIEST WAY TO MAKE MONEY (AND PERHAPS LOSE IT TOO)

Crypto-currencies (Bitcoin in particular) have captivated investors over the last decade. Speculators are particularly fascinated, and some enthusiasts even liken this phenomenon to a religion. Regardless of your stance, it's important to understand the hype surrounding this (dare we say) asset class and what to consider when exchanging physical currency for a crypto-currency related product.

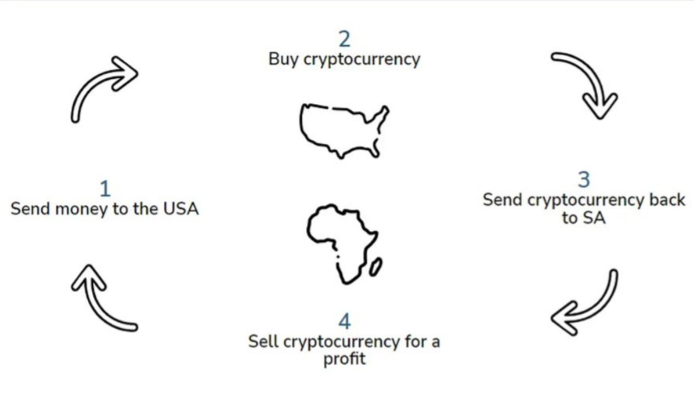
The global equity market today has a total market capitalization of around USD 110 trillion. South African listed equities amount to just over USD 1 trillion, while the total value of all crypto-currencies (nearly 15 000 different coins) across all the exchanges (more than 1 100 of them) adds up to around USD 2.6 trillion. This figure was below USD 1 trillion as recently as December 2022, after peaking at around USD 3 trillion one year earlier.

Cryptocurrencies are therefore not insignificant in global markets and have demonstrated longevity. They benefit from the growth in financial technology and are increasingly recognized as a currency by a growing number of market participants.

One application of cryptocurrencies is in the crypto arbitrage investment strategy. Arbitrage involves simultaneously buying and selling securities, currency, or commodities in different markets or derivative forms in order to take advantage of differing prices for the same asset. Given that a crypto-currency like Bitcoin is traded on over 1 000 exchanges in more than 50 countries, there is a chance that, at any particular moment, it would trade at different prices. This discrepancy presents an opportunity to make a low-risk profit by buying the cheapest asset and selling the more expensive simultaneously. If there was no friction (currency exchange, regulatory approval or transaction costs) this would be an easy profit until enough market participants caught onto this. At this point the basic forces of supply and demand will cause the difference between the two prices to shrink until the arbitrage opportunity disappears.

In practice, frictional costs and the existence of more than 1 000 crypto exchanges means hundreds of (slightly) different prices exist for Bitcoin. Combined with nearly 15 000 other coins, thousands of arbitrage opportunities arise – far more than with (say) Investec being listed in Johannesburg and London.

This opportunity has led to crypto-currency arbitrage strategies being offered to investors in South Africa. These strategies use an individual's annual offshore allowance to exploit the price difference between local exchanges (such as Luno) and global exchanges (such as Kraken or Coinbase). The following diagram shows a simplified flow of the trades required to complete an arbitrage transaction:



There are dozens of providers of these strategies in South African today. In fact, the Financial Sector Conduct Authority has to date approved over 70 licences for crypto asset service providers. Some of these providers even offer to lend investors money so that they can participate in the "risk-free" profits without having to put their own capital at risk. On one provider's website, investors are greeted by "Welcome to the fastest, easiest way to make money". Another one is your "Partner in low-risk, high-yield Crypto Arbitrage" while a third one promises crypto-currency arbitrage as the "Easiest, safest way to earn returns from digital assets."

It sounds almost too good to be true. If this is such a safe investment strategy where nothing can go wrong, why is everyone not doing it? Social media's certainly plays a pivotal role in sharing the benefits of these investment strategies, but as these pundits are rarely regulated (and probably earning a fee for promoting the idea), it's not in their interest to inform potential investors of the possible drawbacks. When assessing such an opportunity a few questions need to be asked:

Is there a chance that this failsafe strategy can fail?

Yes. For example, if trades on the two exchanges/markets cannot be executed simultaneously and the price moves, a loss can arise. Given the volatility in crypto-currency markets, this is not entirely impossible. There are also other risks that investors need to consider.

What kind of returns can an investor expect?

Given the increase in clients and providers that are making use of this arbitrage, the returns are likely to reduce over time. Forex fees, performance fees, fee sharing, and other transaction costs will all contribute to lowering the returns. In some cases,the product providers are entitled to almost half the gross profit. This is not true for everyone, so it's important to do proper homework.

According to one provider, the total returns on capital deployed ranges between 24% (when the price difference between exchanges is 1%) and 90% (when the price difference between exchanges is 3%). This is if all goes according to plan. Returns can be way outside of these indications if there are any hiccups.

What can go wrong?

When parting with their capital, an investor takes on another entity's balance sheet risk. It's therefore paramount to assess the balance sheet strength of all the entities that holds the investment at different times during the transaction.

As mentioned earlier, volatility and trades not executed while the arbitrage exists can also cause the strategy to lead to a loss. The tax treatment of these trading gains need to be carefully considered as this may have a significant impact on an investor's after tax return.

Lastly, a regulatory risk exists as this strategy depends on the investor being successful in obtaining a Foreign Investment Allowance Tax Clearance Certificate.

In considering any investment strategy, it may be a sound decision to partner with an adviser that's not only familiar with the pitfalls but also doesn't stand to gain financially based on the choice of strategy. Listen to the disciples but don't be deaf to the naysayers. In this instance, good advice is likely worth far more than the price of paying for it.

As is said in Latin: Caveat emptor (let the buyer beware).

Source: Daily Maverick, Currency Hub, Proprietary research, Coinmarketcap.com

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