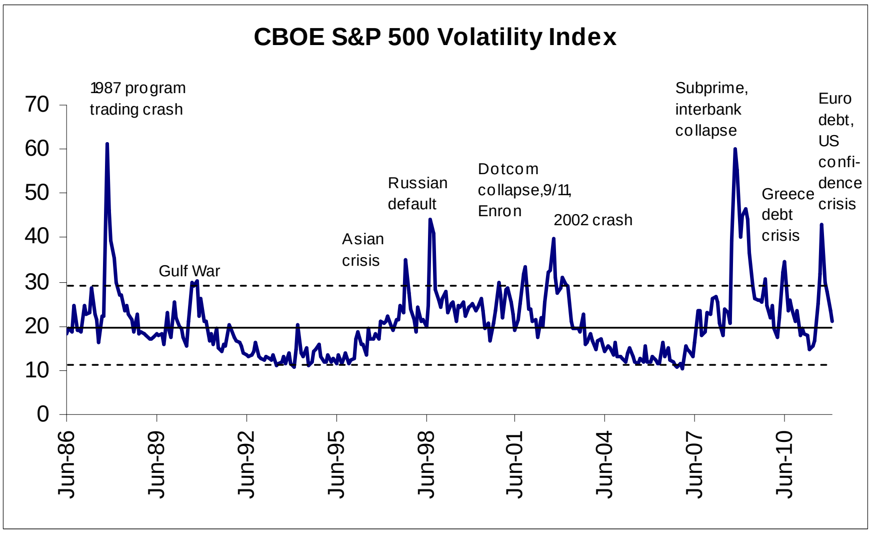
Plexus Asset Management

AROUND THE FINANCIAL GLOBE IN 5 MINUTES
January 2012

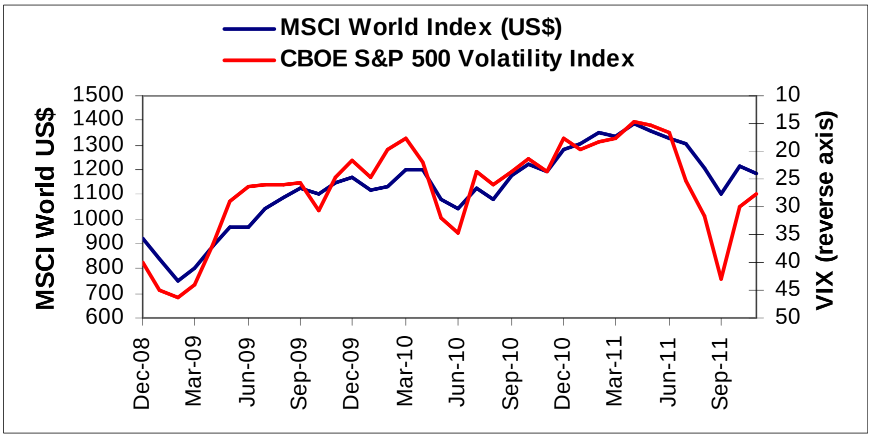
POST-CRISIS CHART BOOK: PAST THE WORST?

The CBOE S&P 500 Volatility Index (VIX) has moved decisively out of the crisis range and is again close to the historical average.



Sources: CBOE; Plexus Asset Management

At this stage the danger for equity markets has eased as the gap between price levels and volatility has narrowed considerably.



Sources: CBOE; I-Net Bridge; Plexus Asset Management

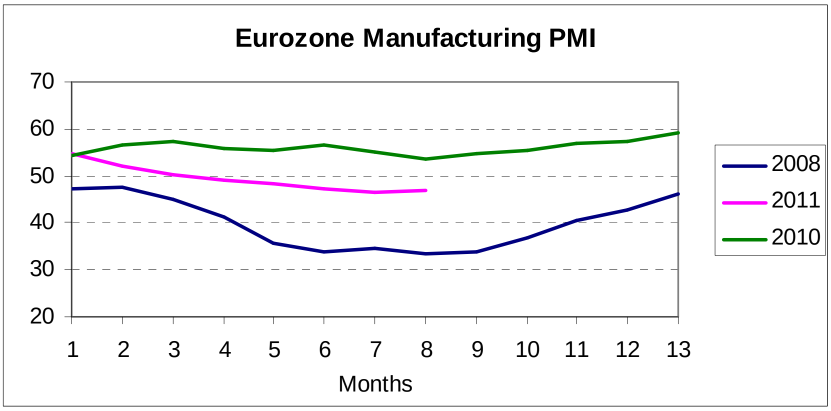
It remains extremely difficult to advocate that the crisis is over and to call market and economic trends in the short term. I still think the trends during previous crises perhaps hold the key for the immediate future. I compared the trends of the current crisis with those of the great financial crisis in 2008/2009 and the mini-crisis in 2010 (initial Greece debt crisis).

I have charted the series, starting with two months before each crisis developed, then the crises and ended all the series 11 months later. The respected series are as follows:

2008 crisis: July 2008 to July 2009
2010 crisis: February 2010 to February 2011
2011 crisis: From May 2011.

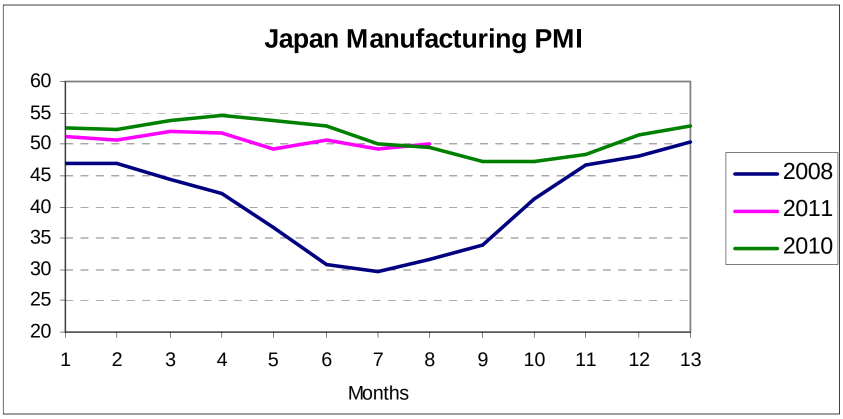
Let me begin with the current global economic situation and compare that to the previous crises. I used the manufacturing PMIs as a proxy for the state of the underlying economies.

The Eurozone economy is significantly weaker than during the 2010 crisis but much stronger than at the same time during the 2008 crisis. The trends of the 2008 and 2010 crises indicate that the Eurozone Manufacturing PMI should bottom soon and improve in coming months.



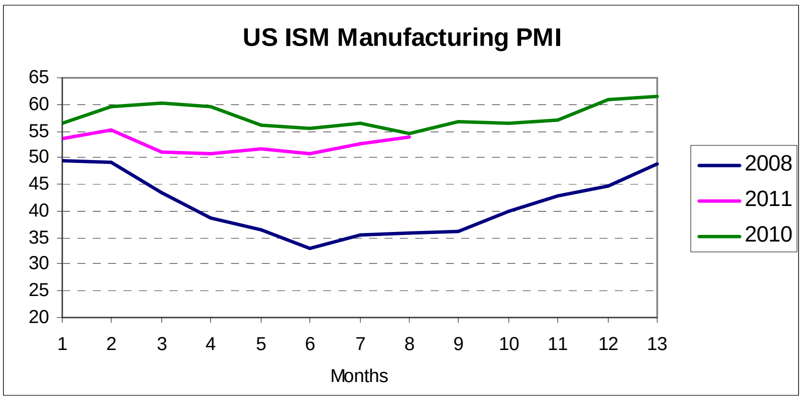
Sources: Markit; Plexus Asset Management

Japan's manufacturing PMI initially followed the initial downward trends of the previous crises but surprisingly stabilized. At this stage it seems to me that Japan's economy is no worse off than during the 2010 crisis and substantially better off than at this stage during the 2008 crisis. It is unlikely that the PMI will drop again as indicated by the 2010 trend as the drop was as a result of Japan's twin disasters in March 2011. I will not be surprised if Japan's PMI soon commences a new uptrend similar to the trend of the 2008 crisis but at a much lower gradient.



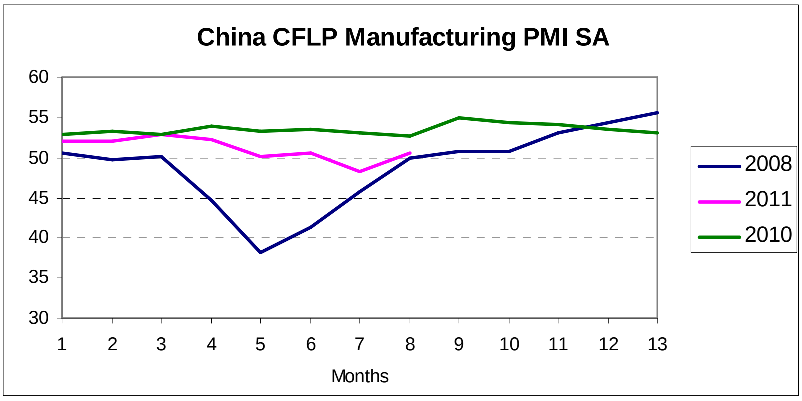
Sources: Markit, Plexus Asset Management

During the 2010 crisis the U.S. economy was slow to react, but this time around the U.S. ISM Manufacturing PMI followed the same trend as during the 2008.crisis. The economy is in a much better shape than during the 2008 crisis, though. However, the trend is markedly similar to the PMI bottoming six months after the onset of the crisis. All things being equal I expect the PMI to continue to head North in coming months.



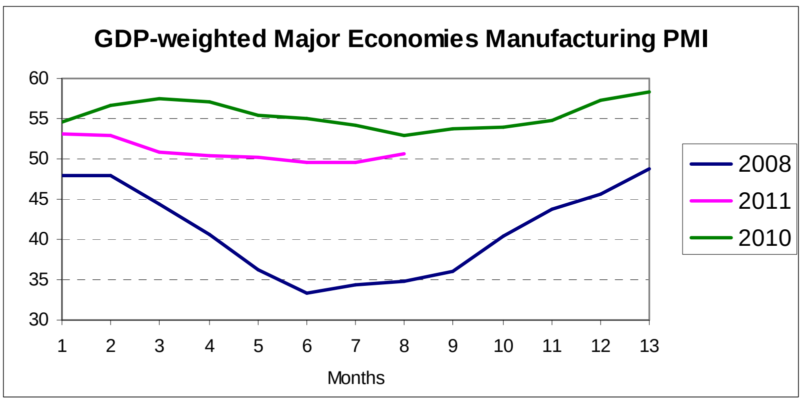
Sources: ISM; Plexus Asset Management

In 2010 China's economy was unmoved by the mini-crisis but has shown symptoms of distress during the current crisis. Unlike 2008 when the economy bottomed five months after the onset of the crisis, the economy was plodding along and only recently showed any signs of improving.



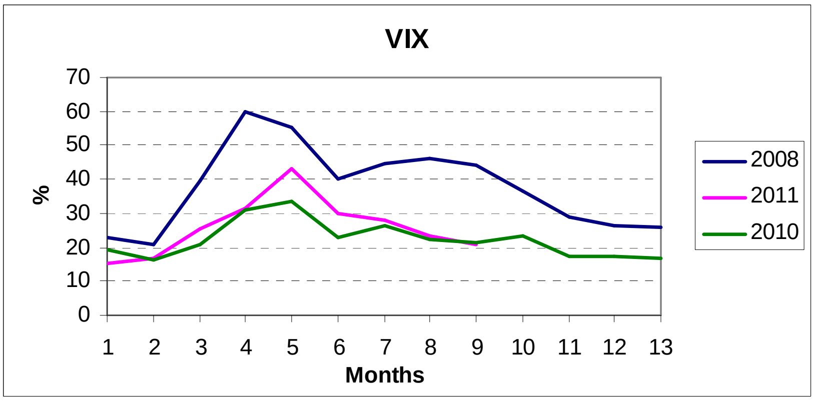
Sources: CFLP; Plexus Asset Management

In 2010 the global economy was also unmoved by the mini-crisis. The trend of the 2011 crisis is similar to that during the 2008 crisis but less severe. I expect the recent uptick in the PMI to continue in coming months.



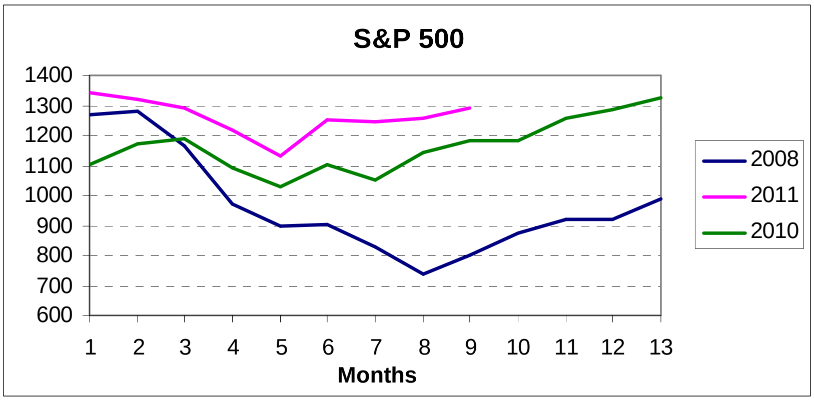
Sources: Markit; ISM; CFLP; Plexus Asset Management

The anxiety level (measured by using the CBOE S&P 500 Volatility Index or VIX) is following virtually the same trend as in 2010. If the trends of 2008 and 2010 are repeated, anxiety levels are likely to stabilize over the next three months before receding further.



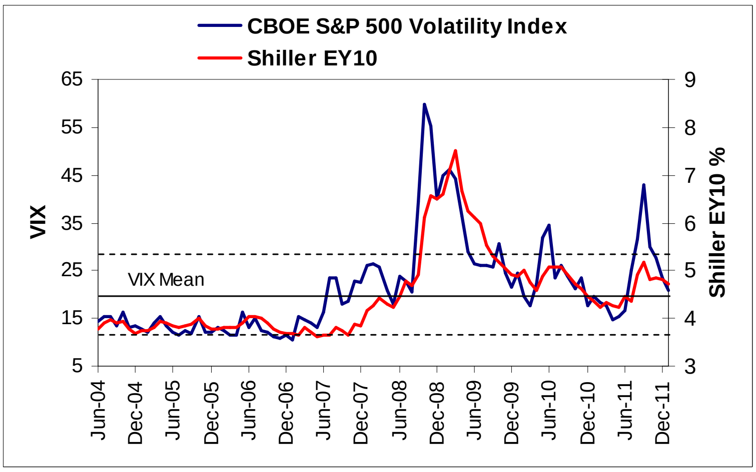
Sources: CBOE; I-Net Bridge; Plexus Asset Management

The trend of the S&P 500 Index is in line with that of 2010. The trends of the 2008 and 2010 crises indicate to me that the uptrend in U.S. stock prices is likely to continue.



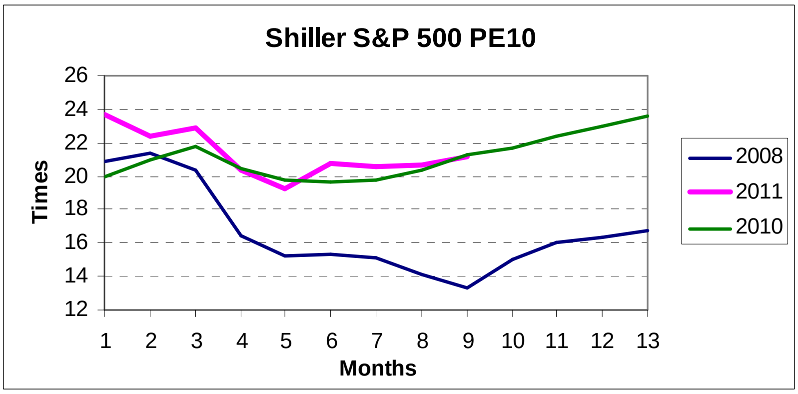
Sources: Robert Shiller; CBOE; I-Net Bridge; Plexus Asset Management

The valuation of the S&P 500 as measured by Robert Shiller's PE10 has increased in line with the easing of the anxiety levels. Please note that I used the EY10 (earnings yield), which is the inverse of the PE10. The graph indicates that the U.S. stock market is priced in line with the underlying volatility.



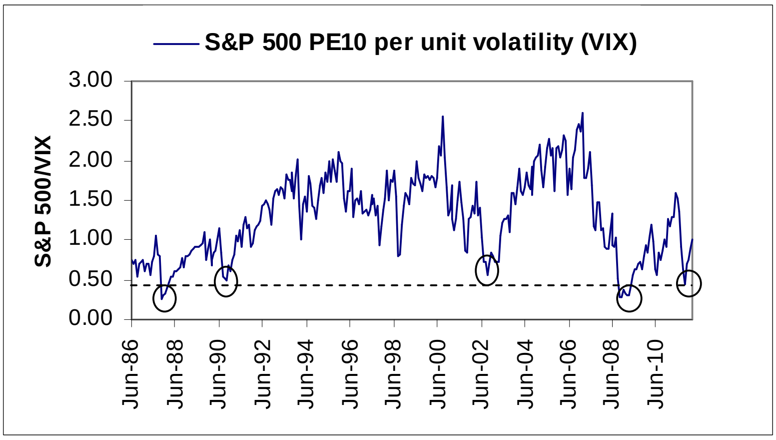
Sources: Robert Shiller; CBOE; I-Net Bridge; Plexus Asset Management

It is noteworthy that the valuation of the S&P 500 or PE10 is tracking the same trend as during the 2010 crisis. We are also at the same stage as during the 2008 crisis when the rating improved strongly. I am therefore of the opinion that the next few months will see a further improvement in market valuations and thus stock prices.



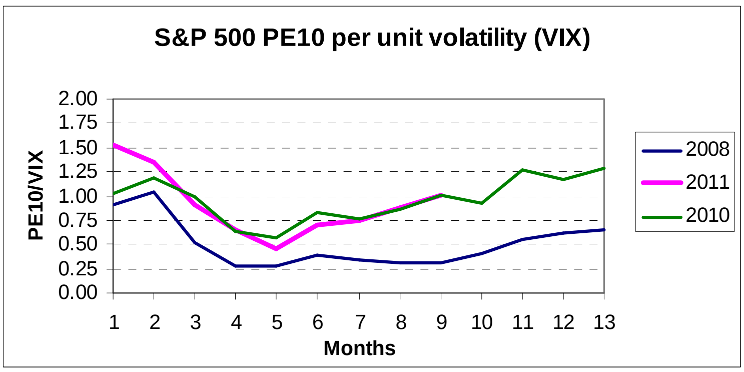
Sources: Robert Shiller; CBOE; I-Net Bridge; Plexus Asset Management

The valuation of the S&P 500 compared to the anxiety level calculated by the PE10 divided by the VIX turned at levels similar to those that in the past coincided with bottoms in major bear markets. It may take a long while before we see similar bargain levels.



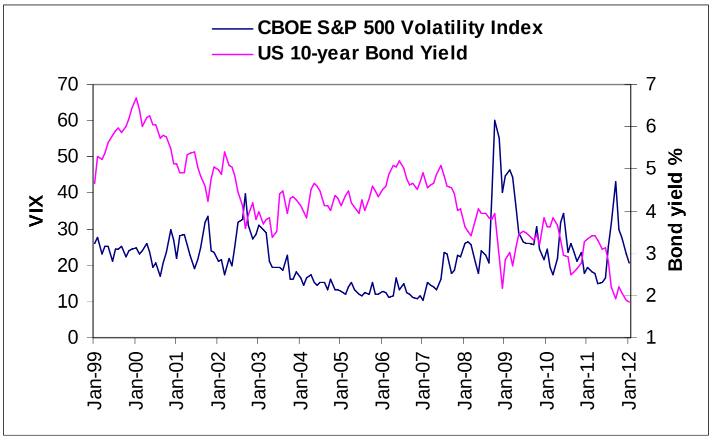
Sources: Robert Shiller; CBOE; I-Net Bridge; Plexus Asset Management

The ratio slavishly followed the trend during the 2010 crisis. We are also now at the same stage of the 2008 crisis when the ratio started to expand. Some levelling off is likely in February before the ratio expands again in March – that is if it continues to mirror the trend during the 2010 crisis.



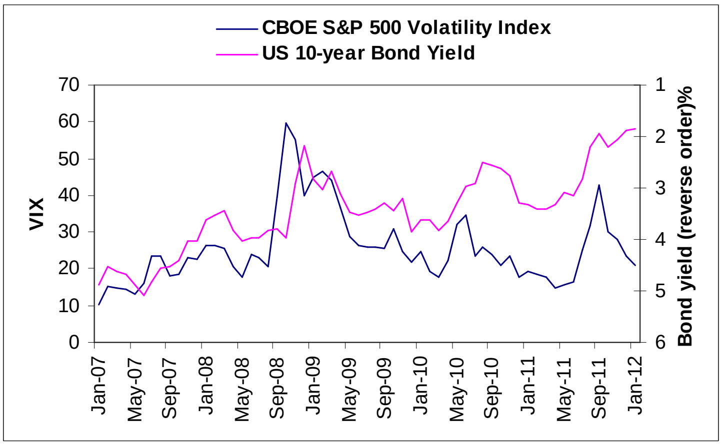
Sources: Robert Shiller; CBOE; I-Net Bridge; Plexus Asset Management

The yield on the U.S. 10-year Government Bond Index has continued to fall despite the easing of anxiety levels.



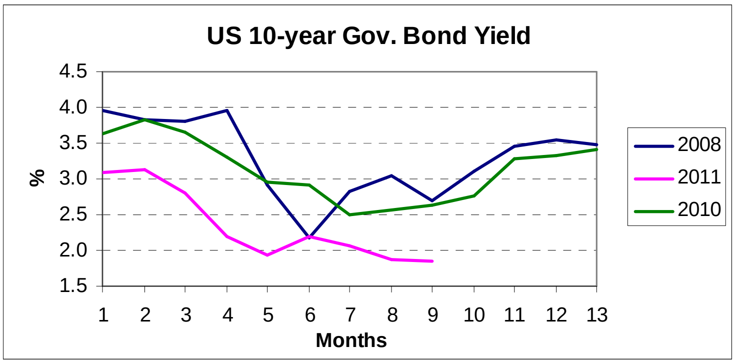
Sources: CBOE; I-Net Bridge; Plexus Aset Management

The significant diversion is an excellent indication of the Fed's Operation Twist – selling shorter-dated bonds and buying long-term bonds (please note the reverse axis of the bond yield).



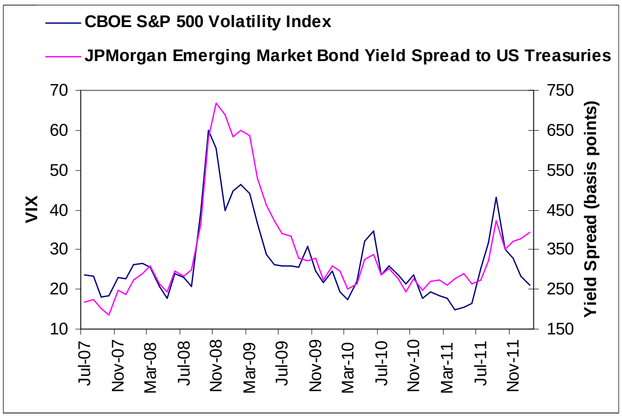
Sources: CBOE; I-Net Bridge; Plexus Asset Management

The trend of the 10-year bond yield was relatively similar to that during the 2010 crisis until two months ago. The 10-year bond yield trend is also way behind the trend during the 2008 crisis. However, we are close to the same stage as during the previous crises when bond rates moved significantly higher. I expect the yield on the 10-year government bond to bottom soon and to rise in coming months.



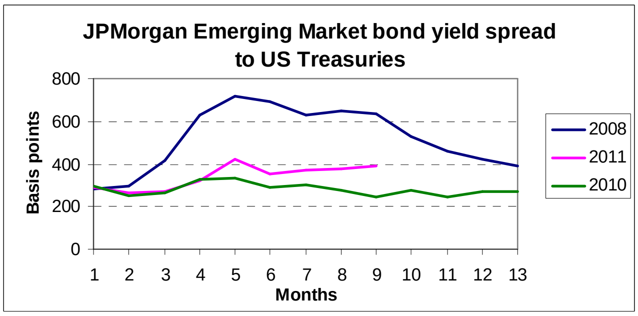
Sources: I-Net Bridge; Plexus Asset Management

Initially the drop in anxiety levels led to a narrowing of the JP Morgan Emerging Market Bond Yield Spread to U.S. Treasuries, as could be expected. The further drop in the VIX failed to narrow the gap further. Normally the yield spread would have narrowed to between approximately 275 and 300 basis points. It seems to me that the global bond market players are aware of the artificially low levels of especially the long end of the U.S. bond market caused by the Fed's Operation Twist. It is therefore an indication that the yield on the U.S. 10-year Government bond would have been closer to 2.75% in normal circumstances instead of close to 1.9% currently.



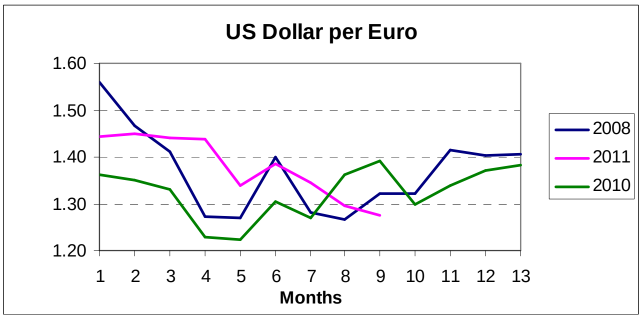
Sources: CBOE; I-Net Bridge; Plexus Asset Management

The trend of the yield spread is in line with that during the 2008 crisis but has moved out of line with the trend during the 2010 crisis. It is interesting to note that we are currently at the same stage as during the 2008 crisis before the yield spread dropped markedly. I therefore expect the spread to narrow in coming months.



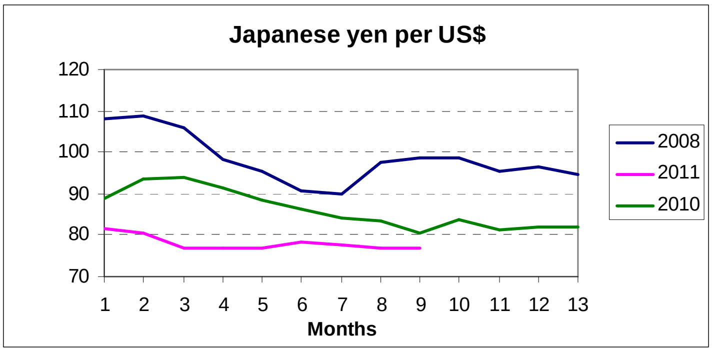
Sources: I-Net Bridge; Plexus Asset Management

The trend in the U.S. dollar per euro during the current crisis was initially behind the curve compared to previous crises, finally caught up but contrary to the previous crises weakened again in January. However, we are approaching the stage when the U.S.$ sold off against the euro in previous crises. I therefore expect the U.S. dollar to peak against the euro soon.



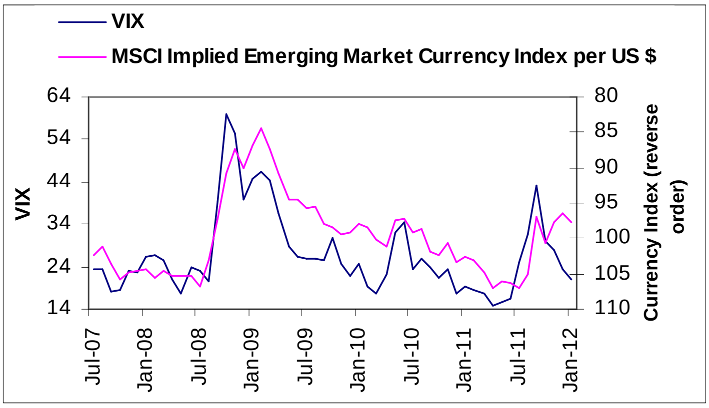
Sources: I-Net Bridge; Plexus Asset Management

Contrary to declining trends in previous crises the U.S.$ continues to maintain its value against the yen. With central bank intervention rife the yen is likely to maintain its "peg" against the U.S. dollar in coming months.



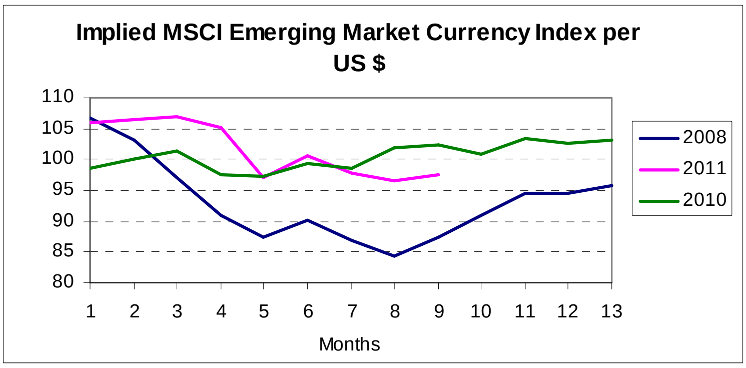
Sources: I-Net Bridge; Plexus Asset Management

Emerging-market currencies as measured by the ratio between the MSCI Emerging Market Index in U.S. dollar and that in local currency initially strengthened against the U.S. dollar as anxiety levels fell. There was no follow-through, though. The current VIX indicates that the U.S. dollar is overpriced by at least 5% against the basket of emerging-market currencies.



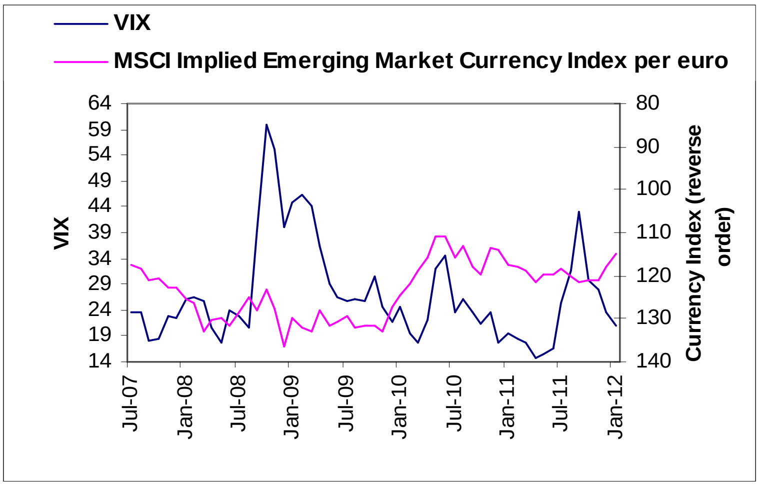
Sources: CBOE; I-Net Bridge; Plexus Asset Management

Although the basket of emerging-market currencies against the U.S. dollar followed the initial trends of the previous crises, it is currently reflecting the same trend as during the 2008 crisis. Further strength of emerging-market currencies against the U.S. dollar can therefore be expected in coming months before levelling off.



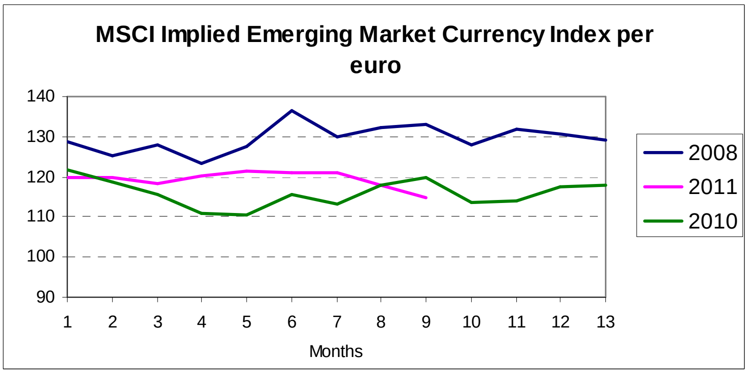
Sources: I-Net Bridge; Plexus Asset Management

The basket of emerging-market currencies as defined previously rerated against the euro at the onset of the 2010 crisis and finds itself in a new trading range. The recent drop in anxiety led to a strengthening of the basket against the euro, but further strength is limited.



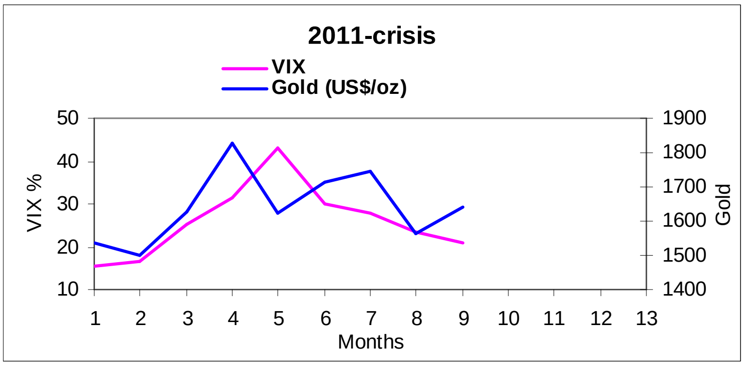
Sources: I-Net Bridge; Plexus Asset Management

The basket of emerging-market currencies against the euro showed relative steadiness during all three crises.



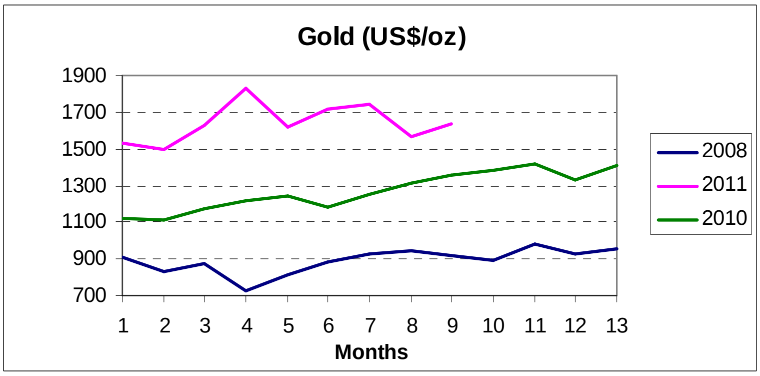
Sources: I-Net Bridge; Plexus Asset Management

As in 2008 the sell-off in gold coincided with a peak in anxiety levels, picked up again as anxiety levels eased, but fell heavily in December as the U.S. dollar surged against other major currencies.



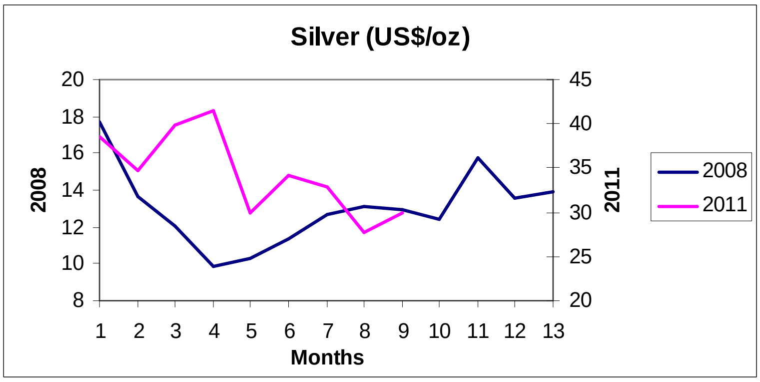
Sources: I-Net Bridge; Plexus Asset Management

In light of the trends during the previous crises I expect some further strengthening is expected in coming months, supported by a weaker U.S. dollar.



Sources: I-Net Bridge; Plexus Asset Management

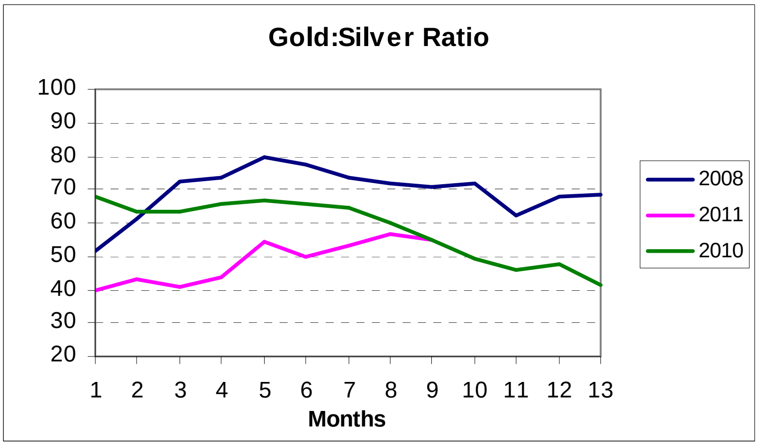
The trend of the silver price during the current crisis has no relation to that during the 2008 crisis.



Sources: I-Net Bridge; Plexus Asset Management

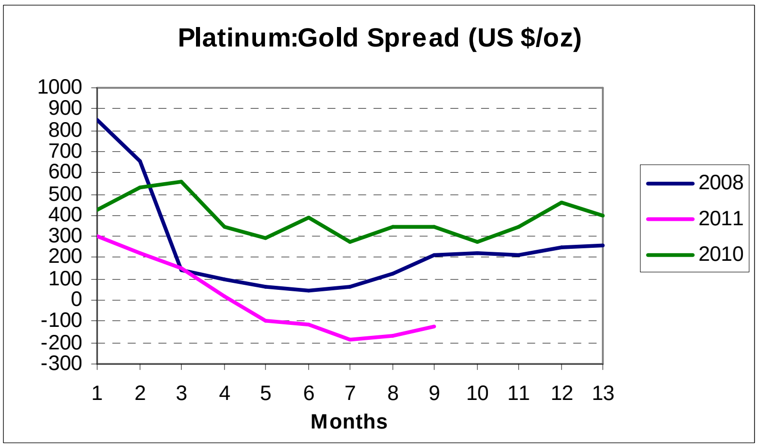
The gold-to-silver ratio is perhaps the best indicator of where silver is heading.

The current trend in the gold-to-silver ratio initially lagged that during the 2008 crisis. I expect the ratio to decline somewhat over the next few months. In view of the positive outlook for gold I expect the silver price to move strongly higher in the coming months.



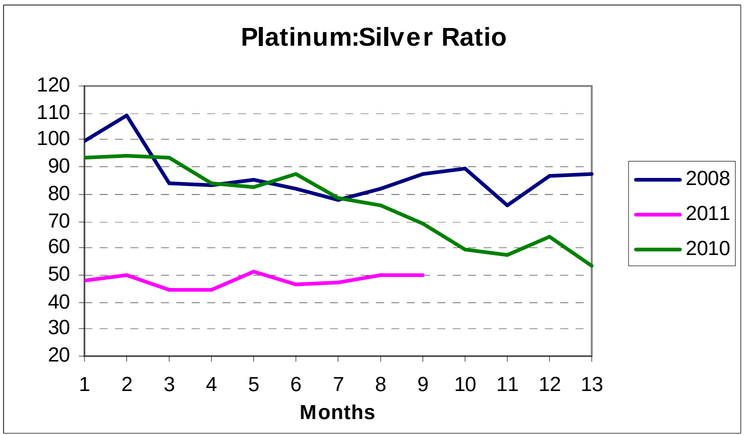
Sources: I-Net Bridge; Plexus Asset Management

The platinum-to-gold spread initially also lagged the trend during the 2008 crisis but caught up afterwards. It seems to me that the spread has bottomed.



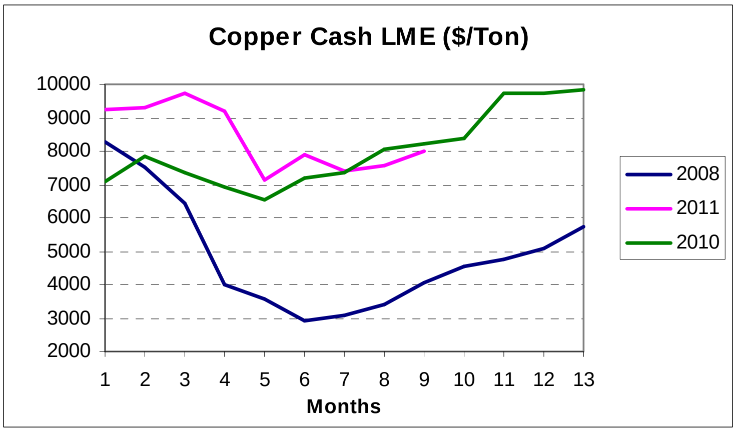
Sources: I-Net Bridge; Plexus Asset Management

The platinum-to-silver ratio has been markedly steady since the onset of the current crisis. I expect the stability to continue in coming months – similar to the 2008 crisis.



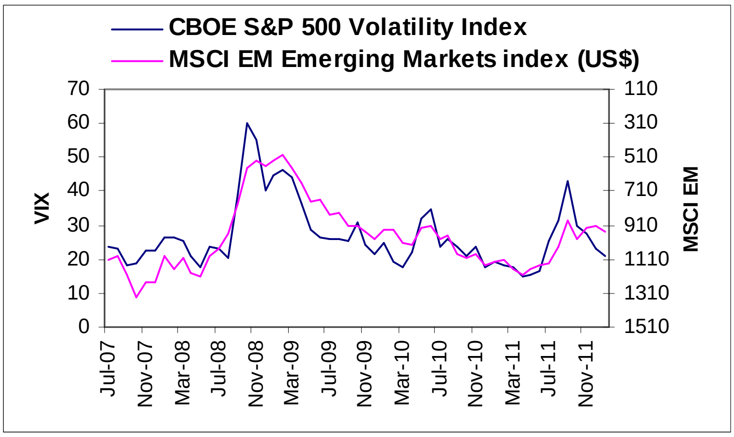
Sources: I-Net Bridge; Plexus Asset Management

The outlook for copper is positive.



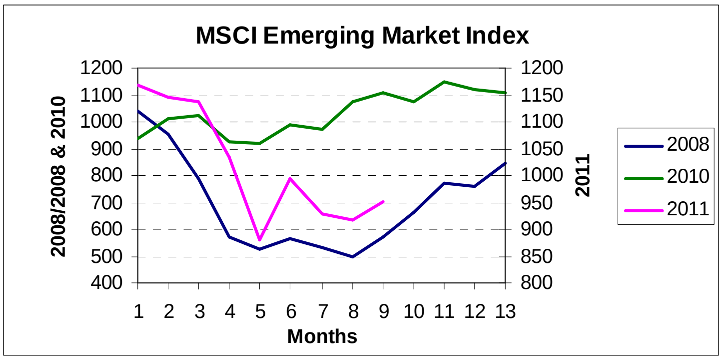
Sources: I-Net Bridge; Plexus Asset Management

Initially emerging-market equities as measured by the MSCI Emerging Market Index in U.S. dollar rallied as financial market anxiety levels eased. Although the VIX has retreated further, the rally in emerging-market stocks has stalled (please note the reverse axis of the Emerging Market Index). Given the current level of the VIX the MSCI Emerging Market Index is at a discount of approximately 17%.



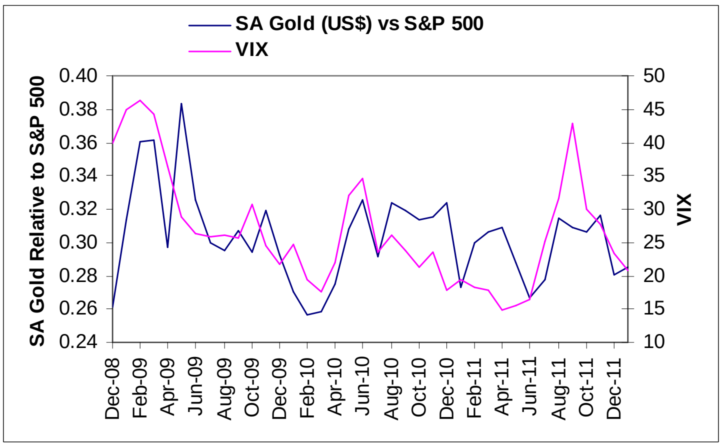
Sources: CBOE; I-Net Bridge; Plexus Asset Management

The trend of the MSCI Emerging Market Index is in line with the trends during the 2008 and 2010 crises. I think there is significant upside potential for emerging-market equities in coming months.



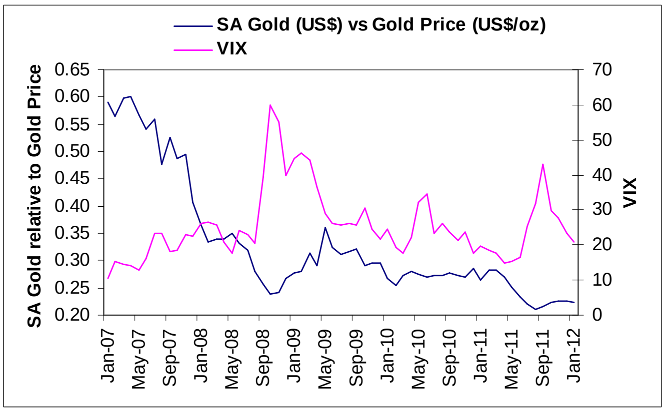
Sources: I-Net Bridge; Plexus Asset Management

South African gold shares in U.S. dollar weakened in relation to other equities as anxiety levels eased. With the VIX expected to remain relatively subdued in coming months I think SA gold shares in U.S. dollars are likely to perform in line with the S&P 500 Index.



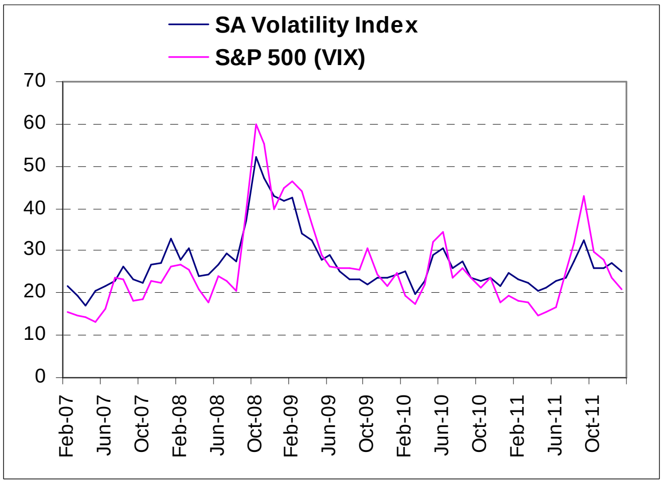
Sources: CBOE; I-Net Bridge; Plexus Asset Management

SA gold shares in U.S. dollar are expected to outperform gold bullion if anxiety levels remain depressed.



Sources: I-Net Bridge; Plexus Asset Management

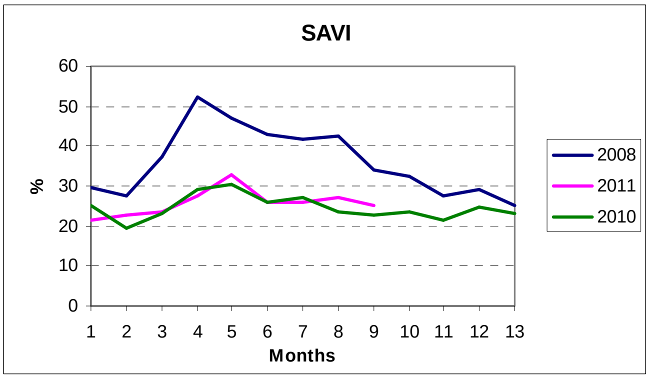
The South African Volatility Index (SAVI) has dropped in line with the CBOE S&P 500 Volatility Index (VIX).



Sources: I-Net Bridge; Plexus Asset Management

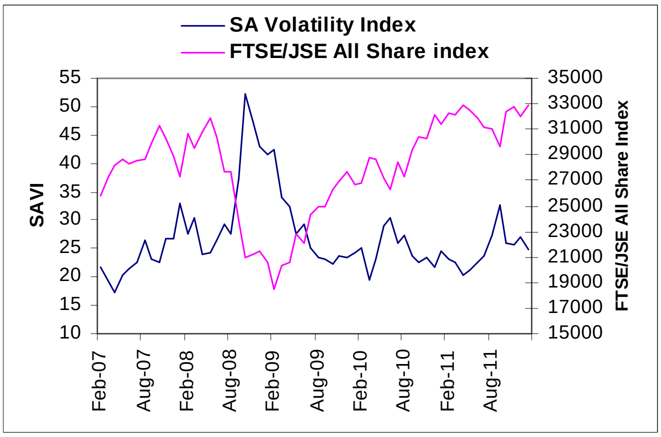
South Africa

The SAVI is following the same trend as that during previous crises and is especially mirroring the trend of last year. Some consolidation is expected in the next month or two before the SAVI heads lower.



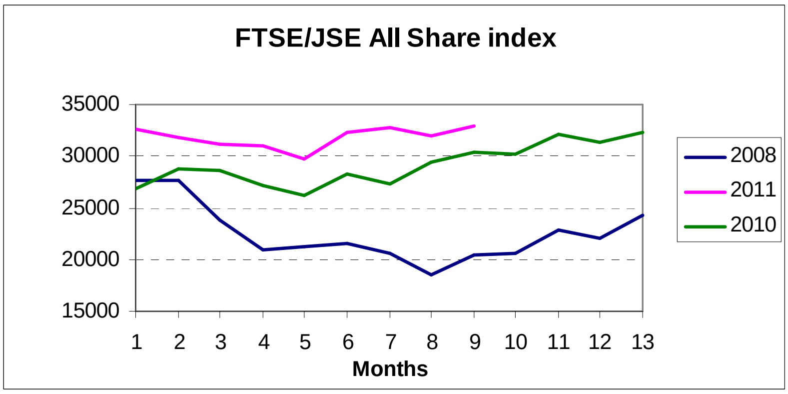
Sources: I-Net Bridge; Plexus Asset Management

The easing of anxiety is underscoring the strong rally in the FTSE/JSE All Share Index in the local currency.



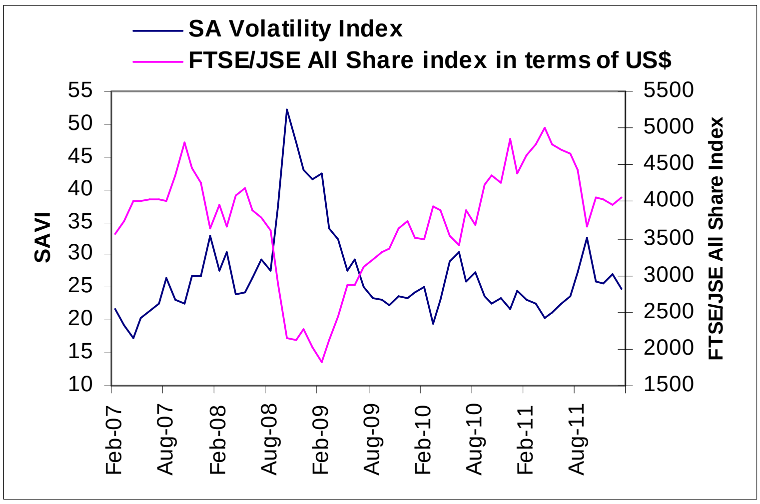
Sources: I-Net Bridge; Plexus Asset Management

The rally is mirroring the trends during the previous two crises. I therefore expect further advances in coming months.

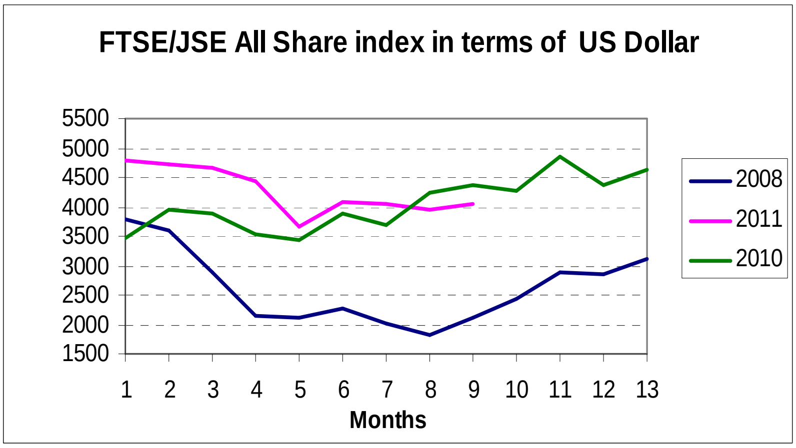


Sources: I-Net Bridge; Plexus Asset Management

The same is apparent if the FTSE/JSE All Share Index is expressed in U.S. dollar.

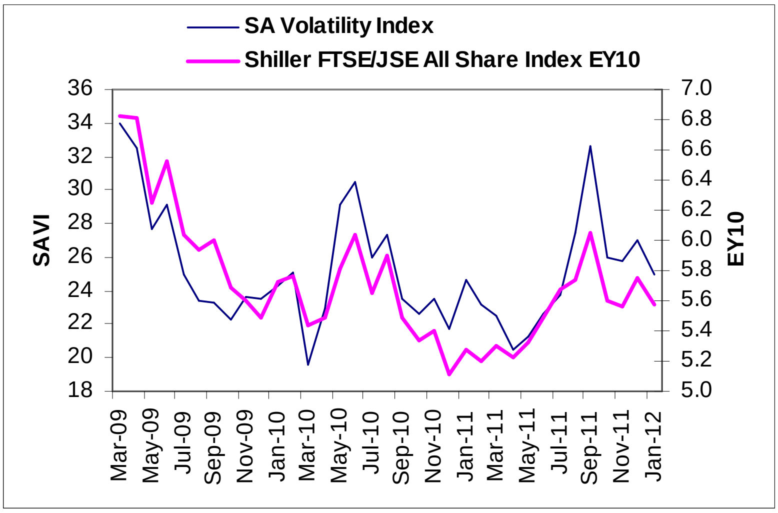


Sources: I-Net Bridge; Plexus Asset Management



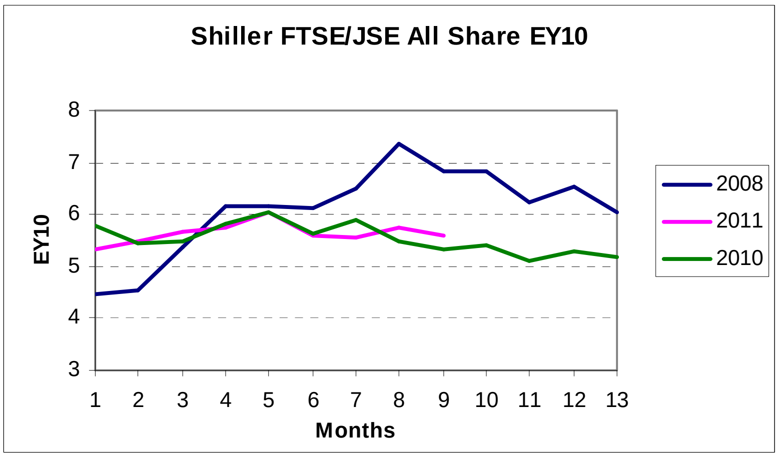
Sources: I-Net Bridge; Plexus Asset Management

The valuation of the FTSE/JSE All Share Index calculated by using Robert Shiller's PE10 became a lot richer as anxiety eased.



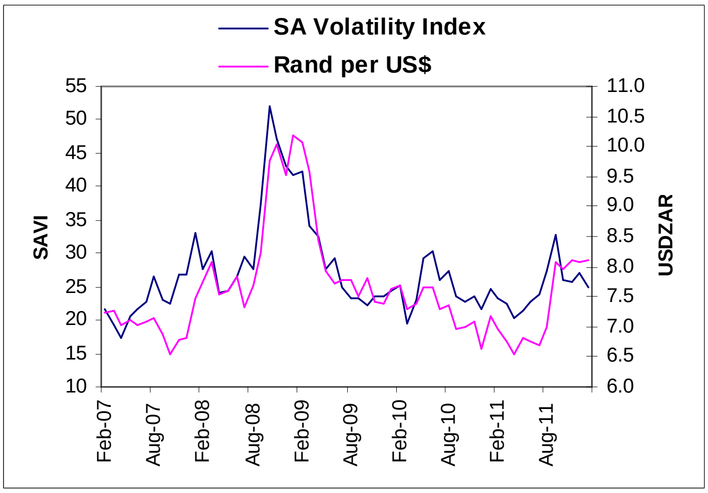
Sources: Robert Shiller; I-Net Bridge; Plexus Asset Management

The valuation levels as measured by Robert Shiller's DY10 (the inverse of the PE10) is a mirror image of those during the 2010 crisis. A further rerating is expected in coming months.



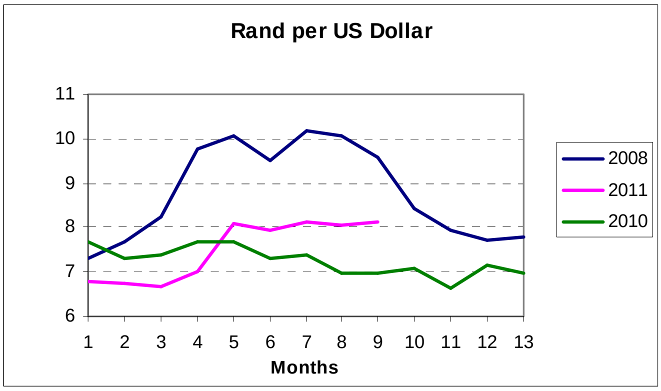
Sources: Robert Shiller; I-Net Bridge; Plexus Asset Management

The U.S. dollar weakened against the rand as anxiety eased. I think the true value of the rand given the level of the SA Volatility Index should be closer to between R7.50 and R7.00 against the U.S. dollar than the current R8,00.



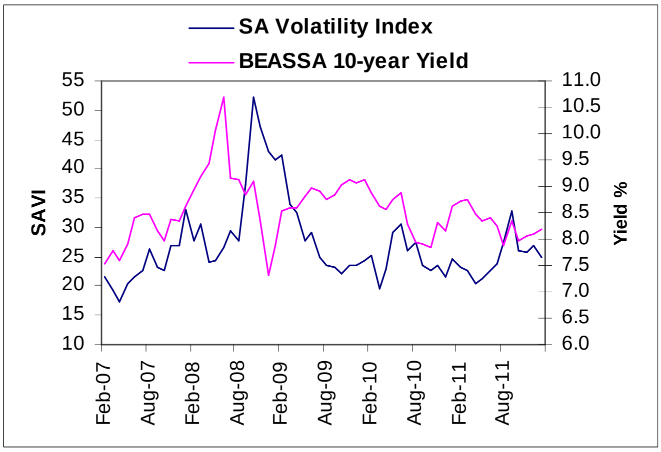
Sources: I-Net Bridge; Plexus Asset Management

The trend of the U.S. dollar/rand exchange rate during the current crisis initially followed the trends of the previous crises but has steadied to approximately R8 against the U.S. dollar. I think a strengthening of the rand against the U.S. dollar is overdue and I will not be surprised to see the dollar weakening to R7.50 and below in coming months.



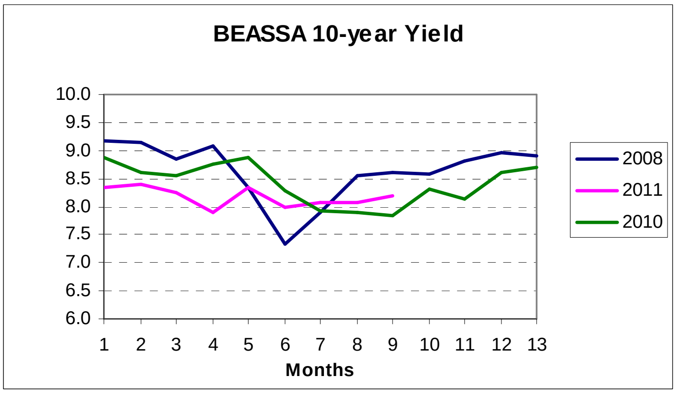
Sources: I-Net Bridge; Plexus Asset Management

I expect upward pressure on South African long bond yields if my expectation of subdued anxiety holds true.



Sources: I-Net Bridge; Plexus Asset Management

At this stage of the current crisis compared to other crises South African bond yields are set to rise soon.



Sources: I-Net Bridge; Plexus Asset Management

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