SPEKTRA FINANCIAL SERVICES

CRUDE AWAKENING – UNPACKING THE OIL PRICE SPIKE

- Both global and local markets were hit by the "September Effect".
- The oil price has surged to over $95/barrel due to reduced levels of supply from Saudi Arabia and Russia, coupled with record-high demand globally.
- The increase in oil price will put upward pressure on inflation, further reducing the probability of an interest rate cut in the US in the near term.
- As a result, bond yields in the US have risen to their highest level since 2007, and the dollar has strengthened against its main trading partners.

Markets are infamous for being nearly impossible to characterise and predict. In fact, the more efficient a market is deemed to be, the harder it is to find opportunities that arise due to mispricings. That being said, market anomalies, characterised as patterns or behaviours in markets that seem to contradict the efficient market hypothesis, can and do exist.

The "September Effect" is one such market anomaly which describes a phenomenon in which stock market returns are often negative during the month of September. Historically, when reviewing returns data of the US stock market (measured by the S&P 500) going back to 1945, September has indeed been the weakest month of the year from a return perspective, generating an average loss of -0.7%. Whilst economists have come up with creative arguments to explain the September Effect (such as school holidays in the US reducing demand, seasonal behavioural bias, lower trading volumes, amongst others), there is no rational or logical basis for September being any worse, or indeed any better, than the other months of the year on a consistent basis. In short, it is a market anomaly.

Unfortunately for investors, this particular market anomaly has held true in 2023, as September was a decidedly negative month for both local and global markets. The US market experienced a loss of -4.77% over the month (in USD terms) – its worst month of the year for stocks prices, while our local market was down -2.55% in rands.

Chief among the factors contributing to the negative market returns has been the pronounced rise in the price of oil, which peaked at $97 a barrel in the latter half of September. Since June 2023, the price of oil has risen by an eye-watering 35%, sparking fears of resurgent inflation and the resultant pressure this could place on the global economy.

A driving factor behind the oil price spike is the restricted supply imposed by both Saudi Arabia and Russia, both of which are members of the Opec+ (Organization of the Petroleum Exporting Countries) cartel. In July of this year, Saudi Arabia sparked criticism from global oil importers when it announced it would cut its oil production by 1 million barrels a day. Originally advertised as a temporary measure, Saudi Arabia's state media subsequently extended the cut until the end of September, and has since reported that the 1 million barrels/day reduction will remain in place until the end of December. In a similar fashion, Russia has enacted its own export cuts, reducing its oil production by 300,000 barrels a day.

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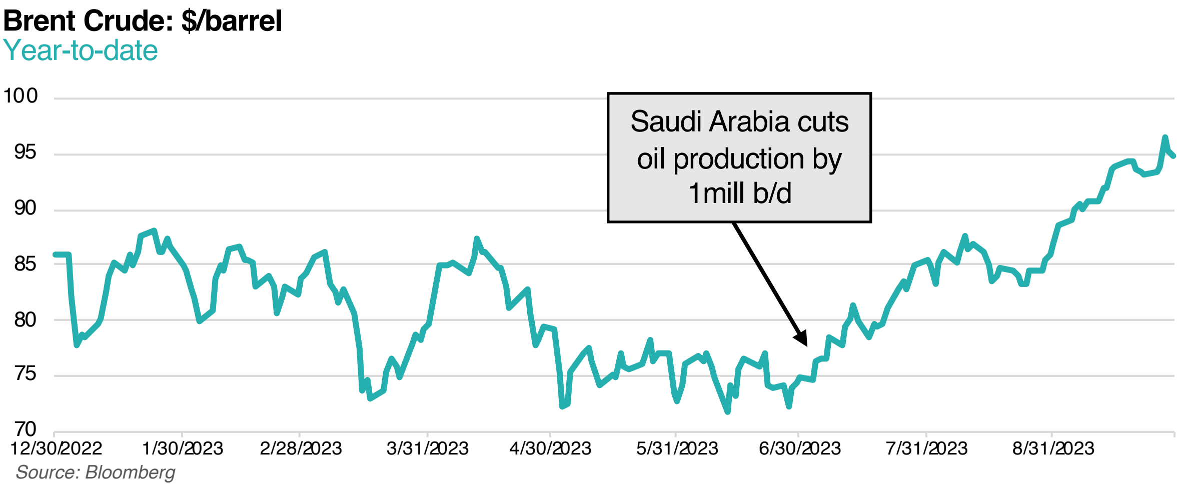

This comes at a time when global demand for oil is at record highs, with the world expected to consume over 100 million barrels of oil a day in 2023 – a number which has never been reached before. The increased demand for oil has largely been driven by big energy-consuming economies such as the US, along with a surge in transportation demand in China as the economy fully reopens from its pandemic lockdowns.

A surge in the oil price could have dangerous knock-on effects on the global economy, particularly concerning the inflation outlook. Elevated oil prices will put upward pressure on inflation, which remains stubbornly above the 2% targeted level set by the Federal Reserve in the US. Should inflation remain at elevated levels, the US Federal Reserve will be forced to keep interest rates high, and may even be forced to implement another rate hike before the end of the year. Already the Federal Open Market Committee (FOMC), the committee tasked with making interest rate decisions in the US, has reduced its expectations for interest rate cuts in 2024.

The expectation that interest rates will remain "higher for longer" will put upward pressure on bond yields and the US Dollar, both of which rose as a result during the month of September. The US 10yr bond yield rose above the 4.5% mark during September, a level not seen since 2007. Rising bond yields are typically negative for investors due to the inverse relationship between bond prices and the prevailing bond yields (i.e when bond yields rise, bond prices fall). Higher interest rates tend to cause bond yields to rise due to the fact that when interest rates rise, newly issued bonds will typically offer higher coupon rates to attract investors. As a result, older bonds with lower coupon rates become less attractive because they offer a lower yield relative to the newly issued bonds, thereby causing their prices to fall.

Additionally, the expectation of higher interest rates can attract capital inflows, driving up the demand for a country's currency, causing it to appreciate. Again, markets witnessed this play out in the US during the month of September when the US Dollar Index strengthened to its highest level since October last year.