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QUARTERLY REVIEW

Quarter One
2019

Part one: Market review

The table below provides a review of key domestic and international investment indicators for the past quarter, as well as over longer periods.

South African asset classes (in rands)

(Performance over periods to 31 March 2019)

Asset class	Indicator	3 months	1 year	3 years	5 years	LT-average*
Equities	All Share Index	8.0%	5.0%	5.7%	6.5%	12.3%
	Shareholder Weighted Index	6.0%	0.4%	3.7%	6.2%	
Property	Listed Property Index	1.5%	-5.7%	-3.8%	5.6%	11.8%
Bonds	All Bond Index	3.8%	3.5%	10.1%	8.3%	6.9%
Cash	STeFI Call	1.6%	6.6%	6.8%	6.4%	5.9%
Inflation	CPI (one month in arrear)	0.5%	4.1%	4.8%	5.1%	5.7%

Source: Morningstar

Global asset classes (in dollars)

(Performance over periods to 31 March 2019)

Asset class	Indicator	3 months	1 year	3 years	5 years	LT-average*
Equities	MSCI AC World Index	12.3%	3.2%	11.3%	7.0%	8.5%
Property	FTSE EPRA/NAREIT Developed Property Index	14.9%	14.3%	6.7%	7.4%	6.7%
Bonds	Barclays Global Bond Index	2.2%	-0.4%	1.5%	1.0%	4.6%
Cash	US 3-month deposits	0.7%	2.4%	1.4%	0.9%	4.3%
Inflation	US CPI (one month in arrear)	0.3%	1.5%	2.2%	1.5%	3.0%

Source: Morningstar

Currencies

(Movements over periods to 31 March 2019)

Currency	Value at month-end	3 months	1 year	3 years	5 years	LT-average*
Rand / Dollar	14.42	-0.3%	-17.8%	0.7%	-6.1%	-5.5%
Rand / Sterling	18.79	-2.6%	-11.5%	4.0%	-1.4%	-4.1%
Rand / Euro	16.19	1.6%	-10.0%	1.2%	-2.2%	-5.5%

Source: Morningstar

** Updated annually from 1900, or longest available period*
Returns for periods longer than 12 months are annualised.

International market commentary – Q1 2019

After the doom and gloom of the fourth quarter of 2018, financial risk assets sprang back to life in the first three months of 2019. There were various catalysts for this sudden change to investor fortunes. However, we believe the most influential factor was the shift in central bank policy guidance, as they reacted to disappointing data releases and a deteriorating economic outlook. Indeed, both the Federal Reserve and the European Central Bank have stated that they no longer expect to raise interest rates in 2019. In reaction, bond yields shifted lower across the curve, and all asset classes advanced as their relative attractiveness improved and investors re-engaged in the hunt for yield.

Although the economic news flow deteriorated over the quarter, we would argue that the political news flow improved. Firstly, the US government shutdown came to an end, and having suffered an obvious defeat over his border wall funding demand, Trump seems to have moderated his behaviour over recent months. A second factor that helped sentiment was the apparent improvement in relationships between the US and China, with the trade talks appearing to be constructive, and both sides suggesting real progress is being made. Finally, even though the UK Parliament remained deadlocked over Brexit, it would appear that the probability of an economically damaging hard Brexit has significantly diminished, and we are now much more likely to see a long extension to Article 50 or a very soft Brexit.

It was a terrific quarter for global equities as they advanced by +12.2% when judged using the MSCI AC World Index in US dollars. All markets rose, but the US (+13.7%) was the strongest major as it recovered from the low reached in late December. At the sector level, cyclical and interest-rate stocks clearly outpaced stable earners, with Real Estate (+16.2%), Information Technology (+18.9%), Energy (+14.3%) and Industrials (+13.9%) all ahead, whilst Financials (+8.3%) and Healthcare (+8.2%) underperformed. Viewed from a style perspective, Growth (+14.6%) outperformed Value (+10.1%), whilst Smaller Companies (+13.2%) marginally outpaced Larger Companies (+12.2%).

The sharp adjustment in interest-rate expectations underpinned strong performance across the fixed income markets. As yields declined everywhere, the hunt for yield was revived, which forced credit spreads to tighten and corporate bonds to outperform sovereign bonds. Overall, the JP Morgan Global Government Bond Index rose +2.7%, whilst the Merrill Lynch Global Investment Grade Corporate Bond Index gained +4.6%, the Merrill Lynch Global High Yield Index turned in +6.9% and the JP Morgan Emerging Market Bond Index delivered +6.6% (all hedged to US dollars).

The Bloomberg Commodities Index rose +6.3% as fears of an escalation in the US-China trade war faded. A more stable outlook for China helped Industrial Metals (+12.8%), whilst falling inventories and production cuts also saw a sharp rise in the price of Crude Oil (+30.2%). Other sectors were generally quieter, with Agriculture down -3.2% and Gold up +0.9%.

In the currency markets, the majors were relatively quiet against each other. Sterling strength (+4.3% versus euro and +2.3% against the US dollar) was a feature, as the likelihood of a hard Brexit diminished. At the other end of the spectrum, some emerging market currencies stood out for their weakness, such as the troubled Turkish lira (-6.4% versus the dollar) and Argentinian peso (-15.1%).

Notes: All quarterly data is quoted in US dollar terms unless otherwise stated.

Domestic market commentary – Q1 2019

In the first quarter of 2019, South Africa faced another setback in efforts to revive domestic activity with load shedding progressing to stage 4. The precarious state of Eskom's infrastructure was further revealed when tropical cyclone Idai hit neighbouring Mozambique in early March, disrupting two lines from Cahora Bassa that supply an estimated 1,200 megawatts of electricity to South Africa. This loss of energy from Mozambique emphasised a legacy of design flaws, lack of maintenance and a grid under tremendous pressure.

Eskom continues to be a key performance indicator for South Africa's economy over the medium term, both in their ability to stay financially viable and operationally, to keep the lights on. The 2019 Budget, delivered in February, outlined a support package for Eskom of R69bn over the next three years. The subsequent debate in parliament would also reveal a further committed R23bn per annum for the next seven years, amounting to a total support package of R150bn in present value terms, as estimated by Treasury. This 10-year commitment was welcomed by Eskom debt holders, but certainly not by other market participants that continue to watch the fiscal metrics deteriorate. Although the budget should be commended for being frank about the fiscal difficulties, the numbers were tough to stomach. The multi-year financial commitment from the government should support the entity's most immediate financial challenges but may fall short given the additional costs incurred over this period to reinstate power. The impact of load shedding and inconsistent electricity supply has been felt across industries and will no doubt be evident in the first quarter GDP numbers.

In line with expectations, the South African Reserve Bank (SARB) kept interest rates on hold, despite very dovish inflation data (up 4.1% year-on year as at February 2019). The committee also revised down its GDP growth forecasts and acknowledged some upside risks to inflation, such as the exchange rate movements, oil price volatility and the impact of the recent announcement by NERSA of a 9% electricity tariff increase.

The much-anticipated credit review from Moody's delivered no change in credit rating or outlook. Generally, the review was positive given the tough conditions we are facing. Against this backdrop, South African nominal bonds delivered +3.8% over the quarter. A weak macro backdrop, increased services and municipal costs and the Edcon restructure has plagued property companies as investors try and quantify the downside risk to earnings. The property index traded 1.5% over the three months to March 2019.

South African equities delivered one of the best quarters in some time with the FTSE/JSE All Share up +8%. While the rally in commodity prices and resource stocks continued to drive the headline index higher, this was not a tide that lifted all boats with results season triggering some aggressive moves in share prices. Aspen traded down -31.0%, for the quarter, following results which offered little in terms of top line growth but lots in terms of balance sheet issues. Year-to-date, the resource sectors have delivered the strongest sector performance, up +17.8%.

The rand ended the first quarter of the year largely flat against the major currencies at R14.42/$, R18.79/£ and R16.19/€.