Seed Market Overview

31 March 2019

Local Market

South Africa received another lifeline from Moody's as the credit ratings agency kept the sovereign credit rating at investment grade. The statement issued said that while the local economy faces numerous problems, it still falls in line with other sovereigns that are rated Baa3. Eskom and other state-owned enterprises pose significant risks, but the country has proven to be resilient with strong core institutions and a solid financial sector. The following strengths and weaknesses were highlighted :

Credit Strengths
- Sustained strength of core institutions such as the judiciary and the Reserve Bank
- A well-capitalised banking sector and relatively deep financial markets
- Low share of foreign-currency liabilities for the government and broader economy

Credit Challenges
- Deep-rooted social and political divisions that hamper reform advancements and generate policy uncertainty.
- Structural economic bottlenecks that limit growth potential and employment.
- Weak state-owned enterprises.

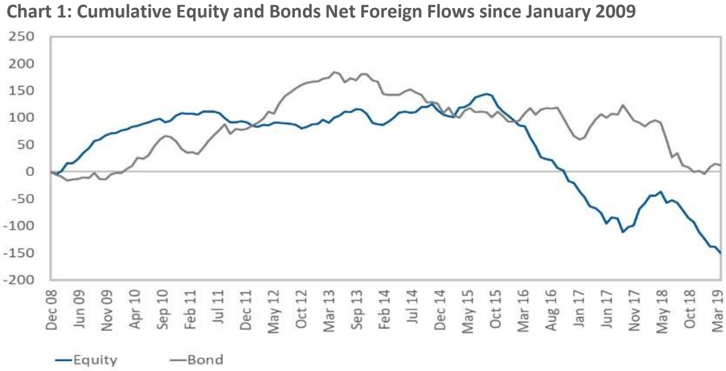
The FTSE/JSE All Share Index rallied for a fourth consecutive month ending 1.6% in the green. The local equity market returned 8.0% during the quarter, and 12.6% post the last recorded negative month. Key contributors included Naspers and AB InBev up 9.4% and 10.6% respectively in March, and 19.5% and 26.7% over the quarter.

The FTSE/JSE SA Listed Property Index, although down for a second consecutive month, ended the quarter 1.5% up. The All Bond Index gained 1.3% during the month and 3.8% over the quarter.

Data from the Institute of International Finance (IIF) showed that South Africa had a good start to the year, accounting for 52% of the $ 32-bn net capital flows to emerging markets in January. Sentiment towards emerging markets swung positively with the more dovish sounding Fed, easing trade tension and uneasiness over global growth.

Local equities continued to experience net outflows from foreign investors during the quarter, while bonds recorded net inflows. **Chart 1** (below) illustrates the foreign net flows into South African bonds and equities. Total net flows peaked in 2013, and have declined since then. Foreign net flows in equity in particular have declined sharply.

Chart 1: Cumulative Equity and Bonds Net Foreign Flows since January 2009



Source: Iress (03/04/2019)

Global Market

Global Markets rebounded during the first quarter of 2019 after a difficult end to last year. The MSCI All Country World Index gained 1.3% in March and 12.2% over the quarter. Developed markets outperformed emerging market counterparts. The MSCI World Index (Developed Markets) gained 12.5% during the quarter, while the MSCI Emerging Market Index gained 9.9% with China a major contributor. Risk assets benefitted from the Fed's reversal in monetary policy stance and optimism on the success of the US/China trade talks.

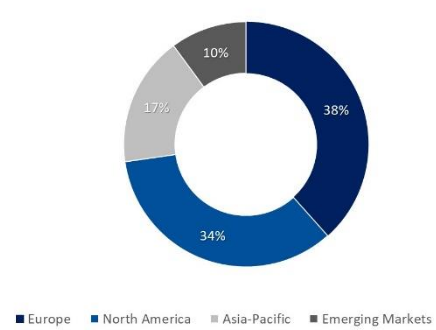
The last decade has seen the rise of family offices in the investment fraternity. A family office is a private wealth management firm for ultra-high-net-worth investors, offering solutions which include budgeting, insurance, charitable giving, family-owned businesses, wealth transfer and tax services. These can be single family or multi-family offices, and are traditionally used by families with fortunes worth over $ 100-mn. With assets of up to $ 4-tn, more than hedge funds and approximately 6% of the value of the global stock markets, family offices have become a force in investing. Of the 311 family offices surveyed by UBS, most family office headquarters are located in Europe and North America as illustrated in **Chart 2** (below).

In an era of populism and as family offices grow larger, they are likely to face uncomfortable questions about how they concentrate power and feed inequality. An article in The Economist highlighted some risks that could threaten global markets. Some of these risks are as follows :

- Endangering the stability of the financial system through a combination of ultra-rich individuals and an opaque system. However, with data indicating lower debt on average and with funds deployed over long periods, family offices seem unlikely to be the next disaster.
- Magnifying the power of the wealthy over the economy as they can own huge chunks within specific economies. However, the aim usually is to diversify risk rather than concentrate power. Habits including longer-term horizons and an appetite for start-ups are positive for the market.
- Privileged access to information, deals and tax schemes. Tycoons are generally well connected, and with banks and brokers rolling out the red carpet and pitching deals to unlisted firms not available ordinary investors, the extent of inequality could be far worse if compounded over decades.

Therefore, regulators, treasuries and tax authorities need to be vigilant in dealing with family offices.

Chart 2: Regional Breakdown of Core Family Offices Headquarters



Source: UBS Global Family Office Report (2018)

Asset Class (ZAR)	MTD	YTD	1 Year	3 Years	5 Years	10 Years
Local Equity	1.6%	8.0%	5.0%	5.7%	6.5%	14.0%
Local Property	-1.5%	1.5%	-5.7%	-3.8%	5.6%	12.4%
Local Bonds	1.3%	3.8%	3.5%	10.1%	8.3%	8.7%
Local Cash	0.6%	1.6%	6.6%	6.8%	6.4%	6.0%
Global Equity	3.9%	12.5%	24.9%	10.0%	13.4%	16.7%
Global Property	6.0%	14.8%	39.9%	5.1%	14.9%	21.1%
Global Bonds	4.0%	2.1%	20.5%	0.3%	7.5%	6.8%
Global Cash	2.8%	0.9%	24.4%	0.7%	7.5%	4.8%

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Seed Local Review

Equity

The JSE All Share returned 1.6% in March, closing out a strong Q1 that delivered 8.0% on a total return basis. Resources (4.6%) performed well this month as commodity prices keep rising, while Industrials (3.5%) with offshore earnings benefitted from a weaker rand. Financials (-4.8%) lagged, as banks and retailers exposed to domestic consumers took strain. The market has recovered well from its lows in December 2018, and combined with moderate growth in underlying earnings, our models are still showing reasonable value. We are maintaining our equity allocations at levels close to benchmark.

Property

The SA Property Index gave up a further 1.5% in March, but remains in positive territory (1.5%) for the YTD. Property fundamentals remain constrained, especially in the office sector, which currently suffers from oversupply and high vacancy rates in major hubs. In current conditions, a property portfolio with an exceptionally high 1-year forward yield of 15.4% can be constructed, although the growth on this yield will be lower than inflation. Our valuation models continue to indicate a maximum weighting, despite the risks of expected distributions not materialising.

Bonds

The ALBI returned 1.3% this month, as ratings agency Moody's kept the SA debt rating at investment grade combined with a stable outlook. The yield on the R186 benchmark bond decreased slightly to 8.60%, while the 10-year rate is at 8.99%. Implied inflation, as determined by the relationship between nominal and inflation-linked bond yields, is at 5.3%. Our valuation model indicates that bonds are on the expensive side, and practically we continue to take duration risk in the Property sector in our funds.

Cash

Annual inflation ticked to 4.1% in March, up slightly from 4.0% last month, but still at the lower end of the SARB's target band. The SARB kept interest rates unchanged following its March MPC meeting, which was in line with market expectations given SA's low growth rate. Cash currently delivers a very attractive 3.1% real yield. We appreciate the optionality in cash, but recognise that several other asset classes offer more value at the moment. As a result, we remain neutral.

Seed Global Review

Currency

The rand weakened against the majors during March, but still outperformed most other EM currencies. From a R 14.09/$ starting point, the ZAR closed the month at R 14.49/$, but has strengthened again into April. The USD remains supported by strong US fundamentals, and the Fed's dovish tone. At month end, the ZAR was 8% undervalued against the trade weighted basket of currencies on a purchasing power parity basis. Significantly, the ZAR was 26% undervalued versus the USD using the same methodology.

Equity

Global markets maintained 2019's positive momentum, as accommodative policies by global central banks continue to create a favourable environment for risk assets to thrive in. The MSCI ACWI delivered 1.3% during March, while the S&P500 returned 1.9% and the MSCI EM Index lagged with a 0.8% return. Within Emerging Markets, Chinese mainland shares continued to shine, with the 6.1% return in March contributing to a 33.0% rebound for the YTD. We maintain our global equity ranking at overweight, but continue to favour allocation to high quality stocks.

Fixed Income

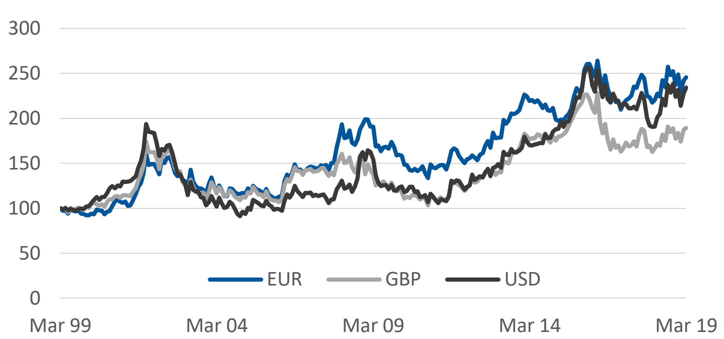
The yield on the US 10-year treasury bond decreased to 2.44% this month, which is some way off of the 3.16% high in October 2018. The Fed confirmed its dovish stance during its March MPC meeting, and the market consensus is that rates will be kept unchanged throughout 2019. US growth seems to be stabilising, and inflation is still trending up, leading BCA Research to opine that long-term bond yields are unlikely to fall further from these levels.

Alternative

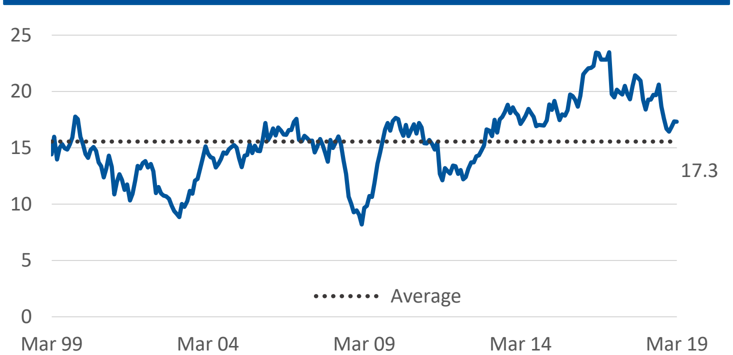
Other asset classes that can be considered include structured notes, private equity, direct real estate, commodities and hedge funds, and can provide investors with uncorrelated returns. However, as interest rates are slowly but surely rising, these alternative investments do become less attractive. These assets can perform a useful role in multi-asset portfolios, as they help provide more consistent returns.

ZAR vs USD

Currencies vs ZAR (rebased to 100)



ALSI vs PE Ratio



SA Government 10 Year Bond Yield