Seed Market Overview

31 May 2019

Local Market

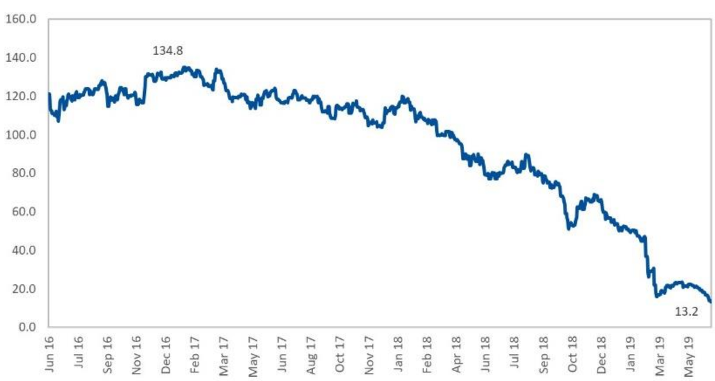
The FTSE/JSE All Share Index lost 4.8% in May bringing to a halt five consecutive months of positive returns. This was on the back of heightened trade tension, as the rhetoric between the US and China took a sharper tone. Losses were broad based, with industrials and resources recording the largest losses (down 6.0% and 5.1% respectively). Heavyweight counters like Naspers, Sasol and British American Tobacco suffered significant losses ranging from 9.0% to 22.7%.

The local elections delivered a largely market friendly outcome, but economic data continued to disappoint, along with mining, manufacturing and retail. GDP data subsequently released at the beginning of June showed the biggest quarterly drop in a decade. The Rand continued on its volatile path and ended May 2.0% lower against the US dollar.

The local market is yet again faced with another accounting scandal of Steinhoff proportions, this time involving the country's leading sugar producer, Tongaat Hulett. The trading of Tongaat Hulett shares on the Johannesburg Stock Exchange and London Stock Exchange was suspended on the 10th of June 2019 upon request of the company's board. This, after it emerged that certain accounting practices employed by the firm were questionable and do not reflect the company's business performance accurately.

The company's equity reported in the 2018 financial statements is believed to have been overstated by between R3.5bn – R 4.5bn. Last year's financial statements have been deemed unreliable and will have to be reproduced. Furthermore, there will be a delay in the March 2019 year-end financial statements. The share price, which has been on a gradual decline over the last 3 years as illustrated in Chart 1 (below), plummeted further. The share price has declined 90% from the January 2017 peak of R134.80 to a closing price of R13.21 on the 10th of June 2019. Deloitte, Tongaat's auditors, are understandably in the firing line, and trading is expected to resume at the end of October post the release of the reviewed financial statements.

Chart 1: Tongaat Hulett Ltd Share Price Over the Last 3 Years



Source: Seed Investments, Morningstar Direct (31 May 2019)

Global Market

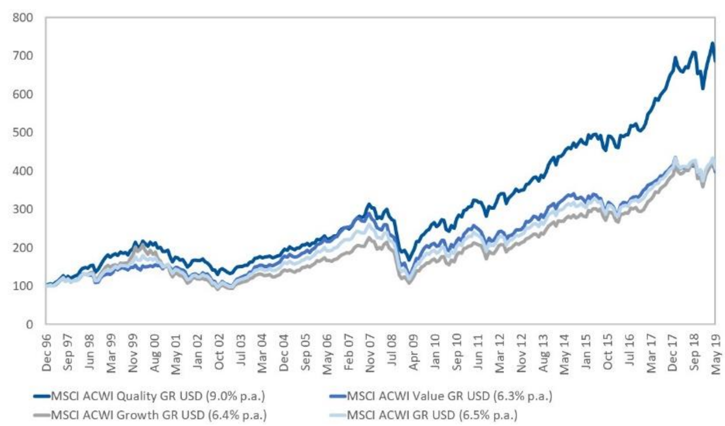
Global markets suffered losses on trade war rhetoric and worries of a global economy slowdown induced by trade related issues. The MSCI All Country World Index lost 5.9%, with developed markets outperforming emerging markets. The MSCI World Index (developed markets) fell 5.8%, while the MSCI Emerging Market Index lost 7.3%. The market was quite jittery as Donald Trump's administration proposed tariffs on Mexican goods, before turning attention to India, while the spate with China continued.

Heightened volatility within the markets saw safe-haven asset classes and defensive sectors performing better than riskier counterparts. A key feature in the construction of the Seed Global Fund is the high allocation to global equity managers, with a focus on quality businesses. These businesses are considered more resilient to tough conditions and the thesis is, therefore, that they are expected to outperform over the long run. Chart 2 (below) illustrates the historic performance of the MSCI All Country Quality Index relative to Growth, Value and the broad market. As shown in the chart, the quality index has outperformed since the beginning of 1997 by over 2.5% per annum.

Quality companies have strong growth characteristics and screened on high returns on equity, stable earnings growth and low financial leverage. The companies tend to be in stable, growing industries with high margins, have strong cash generation, strong balance sheets and experience organic growth as opposed to high level mergers and acquisitions. Value as an investment style is also expected to do well over the long run, but has underperformed over the last decade, proving to be more difficult in practice than theory suggests.

As trade and global growth concerns continue to weigh on global markets, we expect quality business to be better prepared to ride through the tough times. Even with valuations considered expensive, a worry for investors, the quality of the businesses may warrant trading at higher multiples. As such, we remain convinced such businesses should do well over the long term.

Chart 2: MSCI All Country World Index Factor Returns (USD)



Source: Seed Investments, Morningstar Direct (31 May 2019)

Asset Class (ZAR)	MTD	YTD	1 Year	3 Years	5 Years	10 Years
Local Equity	-4.8%	7.1%	2.4%	4.2%	5.4%	12.6%
Local Property	-0.9%	3.8%	-4.8%	-2.6%	5.9%	12.6%
Local Bonds	0.6%	5.3%	7.7%	10.5%	8.3%	8.8%
Local Cash	0.6%	2.7%	6.6%	6.8%	6.4%	6.0%
Global Equity	-4.5%	10.4%	13.5%	6.3%	12.1%	16.1%
Global Property	1.7%	15.1%	26.3%	2.8%	13.4%	20.0%
Global Bonds	3.4%	4.4%	18.6%	-1.2%	7.5%	8.5%
Global Cash	1.8%	2.3%	17.6%	-1.1%	7.6%	6.8%

Seed Market Overview

31 May 2019

Seed Local Review

Equity

The JSE All Share Index retraced last month's gains and fell by 4.8% in May, bringing the YTD return down to 7.1%. All three super sectors on the JSE closed in the red this month, with a positive local election outcome being more than offset by global trade war fears. Resources (-5.3%) and Industrials (-6.1%) underperformed, while Financials (-1.9%) held up better, despite a slightly weaker rand. With markets pulling back and earnings remaining stable, valuations are now slightly less demanding. We are, therefore, maintaining our equity allocations at levels in line with the benchmark.

Property

The SA Property Index returned -0.9% in May, with small caps and counters with global exposure taking the most pain. Headwinds to the sector, including slow economic growth, high vacancy levels and negative real rental growth, came through clearly in reported company earnings. In current conditions, a property portfolio with a very attractive one year forward yield of 13.8% can be constructed, although there will be very little growth in this yield. Given the value on offer, our valuation models continue to indicate an overweight allocation, despite the risks of expected distributions not materialising.

Bonds

The ALBI returned 0.64% this month, and provided a buffer for multi asset class portfolios. Bonds have lagged equities on a YTD basis, but remains the top local asset class over 3 years (10.5%) and 5 years (8.3%). The yield on the R186 benchmark rose slightly this month, while inflation-linked bonds also closed lower. Implied inflation dropped to 5.35% from last month's 5.61%. Our valuation model indicates that bonds are slightly expensive, and practically we continue to take duration risk in the Property sector in our funds.

Cash

Annual inflation decreased to 4.4% from last month's 4.5%, and remains in the middle of the SARB's target band. SA's low economic growth expectations limit the possibility of any further rate increases, and rather points to a possible rate cut early next year. Cash currently delivers an attractive 2.7% 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 by around 2% against the majors during May. From a R14.30/$ starting point, the ZAR closed the month at R14.58/$ and has continued to weaken into June towards the R15.00/$ threshold. The USD remains supported by strong US GDP growth and the Fed's sustained dovish tone. A large rebalance of the MSCI EM Index, with SA's weight trimmed by 0.3%, also contributed to the selling pressure. At month end, the ZAR was 7% undervalued against the trade weighted basket of currencies on a purchasing power parity basis. Significantly, the ZAR was 27% undervalued versus the USD using the same methodology.

Equity

During May, global equities pulled back across both Developed and Emerging markets, as the escalation in the US/China trade war weighed heavily on investor sentiment. The MSCI ACWI fell by 5.9%, dragging the YTD return down to a still reasonable 9.1%. US markets underperformed the rest of the globe as corporate earnings growth start slowing, and the S&P 500 index dropped by 6.4%. Finally, the MSCI EM fell sharply by 7.3% as Chinese tech firms came under severe selling pressure. We maintain our global equity ranking at overweight, and continue to favour allocation to high quality stocks.

Fixed Income

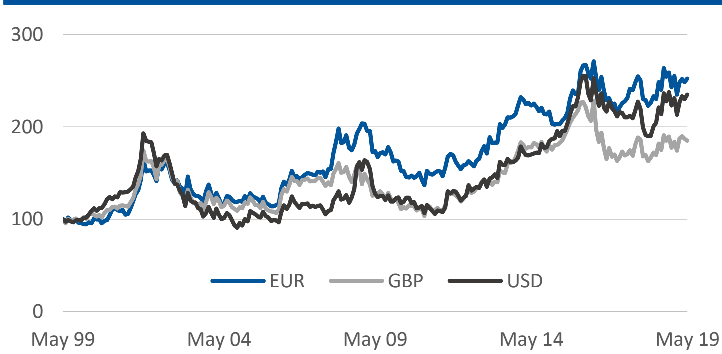
The US 10-year treasury bond yield fell to 2.13% this month, as investors scrambled for safety amidst the turmoil in equity markets. The US Fed remains dovish. Market consensus is for rates to remain unchanged for the rest of the year, and to be cut at least twice next year. US GDP growth for Q1 has beaten expectations, and inflation is stable to trending up, leading BCA Research to opine that long-term bond yields will slowly grind higher from these levels.

Alternative

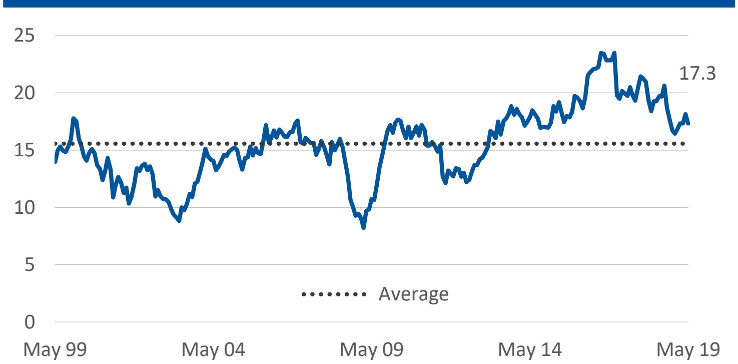
Other asset classes that can be considered include structured notes, private equity, direct real estate, commodities and hedge funds, and can provide investors with uncorrelated returns. However, as interest rates are slowly but surely rising, these alternative investments do become less attractive. These assets can still 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 PE Ratio



SA Government 10 Year Bond Yield