Seed Market Overview

30 June 2019

seed investments

Local Market

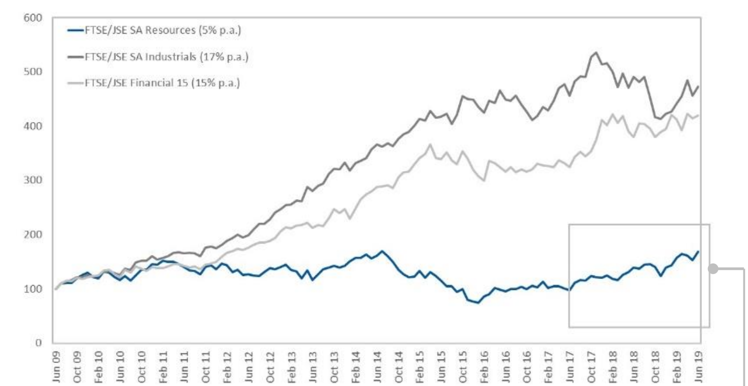
Risk assets were beneficiaries of a more dovish tone by major central banks and the potential easing of trade war tension. Fears of flagging economic growth has seen major central banks suggesting support through lower interest rates. Furthermore, with the US and China agreeing to press pause on the trade war, equities rallied. The local market rebounded from losses in May, posting a strong return for the month in line with other markets. The FTSE/JSE All Share Index rose 4.8% in June to take the YTD gains up to 12.2%.

Gains in the local market in June, and so far this year, have largely been driven by the resources sector. In June, precious and industrial metals prices gained, as geopolitical tension rose with the US facing off with Iran. Iron ore prices rose strongly for a second consecutive month, benefitting diversified miners, while gold miners rose on the back of an 8% spike in the gold price. The South African Resources sector rose 10.2% in June, and is up 20.7% YTD. Industrials returned 3.8% for the month, and 11.7% YTD, while financials rose only 1.4% during the month and 6.5% YTD.

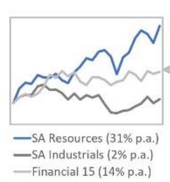
Resources, however, still have a long way to go to recover from a decade of lacklustre performance - illustrated in **Chart 1** (below). Resources have lagged both industrials and financials by over 10% per annum over the last 10 years. However, the last 2 years has seen the sector as a key driver of local equity returns. The SA Resources Index returned 31% per annum over the 2 year period to 30 June 2019, while SA Industrials and Financials 15 indices rose 2% and 14% per annum respectively

The Rand, buoyed by higher precious and industrials prices and the US dollar, gained 3% on the dollar. Bond yields declined, pushing the All Bond Index 2.3% up in June and 7.7% YTD. The FTSE/JSE South African Listed Property Index gained 2.2% in June, and 6% YTD. There was positive news on the economic front, with retail sales and manufacturing production coming ahead of expectations, and inflation in line with expectations. The economic environment, however, remains challenging.

Chart 1: Local Market Sector Performance over the last 10 Years and 2 Years



Source: Seed Investments, Morningstar Direct (30 June 2019)



Global Market

Global markets rallied with the dovish central bank tone and easing of trade war tension between the US and China. The MSCI All Country World Index gained 6.5% in June (16.2% YTD). Developed markets outperformed emerging markets for a fifth consecutive month. The MSCI World Index rose 6.6% during the month, and 17% YTD while the MSCI Emerging Market Index gained 6.2% month-on-month, and 10.6% YTD.

With the potential for slower economic growth, the US Federal Reserve (Fed) President, Jerome Powell, affirmed that he stood *"ready to act''* with respect to lower interest rates being an appropriate path for the US. This notion had the support of at least half of the Federal Open Market Committee (FOMC) members. The US 10-year bond yields dropped further, ending June with a yield of 2%, the lowest level since the November 2016 US presidential election – illustrated in **Chart 2** (below).

Liquidity has been a key area of concern in recent months, particularly in the UK. Woodford Investment Management had well documented challenges in managing redemptions, which led to the suspension in dealing of one of their funds. Morningstar suspended bond ratings on a bond fund managed by H2O Asset Management, citing concerns over the *"liquidity of certain bonds"*. The share price of H2O's shareholder subsequently dropped with investors and regulators increasingly asking investment managers questions around liquidity risk.

Active funds have been bearing the brunt of nervous investors, experiencing huge outflows in potential contagion resulting from the suspension of a fund that is well known. It has been reported that over the last 3 months, £ 1.9bn has been pulled from active funds in favour of passive funds. In spite of these issues that have dogged the industry, most active investment managers take liquidity into consideration in the investment process, thus mitigating liquidity risks. The proliferation of passive funds can also potentially exacerbate liquidity problems.

Chart 2: US 10 Year Bond Yield since November 2016

Source: Seed Investments, IRESS (30 June 2019)

Asset Class (ZAR)	MTD	YTD	1 Year	3 Years	5 Years	10 Years
Local Equity	4.8%	12.2%	4.4%	6.9%	5.8%	13.5%
Local Property	2.2%	6.0%	0.8%	-2.3%	5.6%	13.0%
Local Bonds	2.3%	7.7%	11.5%	9.9%	8.6%	9.0%
Local Cash	0.5%	3.3%	6.6%	6.8%	6.4%	6.0%
Global Equity	3.2%	13.9%	8.8%	10.2%	12.3%	17.0%
Global Property	-1.9%	12.8%	11.8%	3.1%	12.5%	20.4%
Global Bonds	-1.1%	3.3%	8.7%	-0.4%	7.0%	8.8%
Global Cash	-3.0%	-0.8%	5.3%	0.2%	6.9%	6.9%

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Seed Local Review

Equity

The JSE All Share index gained 4.8% in June, bringing the YTD return to a very solid 12.2%. The Resources sector (10.3%) performed exceptionally well on the back of higher commodity prices, while Industrials (4.4%) were underpinned by gains from Naspers' holding in Tencent. Financials (1.4%) lagged as investors steered away from this more SA-centric sector. The strong market YTD performance has outpaced earnings growth, and the more demanding valuations mean that less value is now on offer. We are maintaining our equity allocations at levels just below benchmark.

Property

The SA Property Index returned 2.2% in June, with losses from high-yielding local counters more than offset by gains from stocks with global earnings. News that SA's GDP contracted by 3.2% in the first quarter highlighted the extremely difficult economic environment for REITS, while high vacancy rates persist. As it stands, the SAPY offers an attractive 1 year forward yield of 9.3%, which is expected to grow at 3.5%. 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 2.27% this month, as SA bond yields followed global yields lower. The yield on the R186 benchmark bond dropped by 40bps this month, while yields on inflation-linked bonds remained steady. Implied inflation dropped to below 5% for the first time since 2015, resulting in a lower expected return from bonds over the next 12 months. Our valuation model indicates that bonds remain slightly expensive, and practically we continue to take duration risk in the Property sector in our funds.

Cash

Annual inflation increased again to 4.5% from last month's 4.4%, but remains in the middle of the SARB's target band. SA's GDP contraction of 3.2% in the first quarter points to a need for lower rates to stimulate economic growth, but market expectations are for a possible rate cut only early next year. Cash currently delivers an attractive 2.5% 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 strengthened by around 3% against the majors during June. From a R 14.58/$ starting point, the ZAR closed the month at R 14.10/$ and has strengthened further into July. The USD started the month on the back foot, but news that trade talks between the US and China will resume led to a partial recovery. Over the medium term, the USD remains supported by a resilient US economy and the Fed's sustained dovish tone. At month end, the ZAR was only 3% undervalued against the trade weighted basket of currencies on a purchasing power parity basis. Significantly, the ZAR was 22% undervalued versus the USD using the same methodology.

Equity

June saw a rally in global equity markets after May's pullback, as central banks around the globe remain very accommodative and news that trade talks between the US and China will resume boosted investor sentiment. Both developed and emerging markets showed strong gains, with the MSCI ACWI up 6.6% and the MSCI EM Index up 6.2% for the month. We expect that an uptick in global growth in the second half of the year, combined with stimulus form China, will continue to support global equities over the medium term. We maintain our global equity ranking at overweight, and continue to favour allocation to high quality stocks.

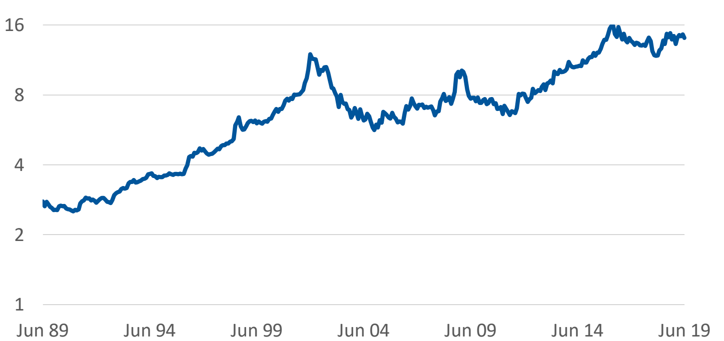
Fixed Income

The US 10-year treasury bond yield fell to 2% this month, a level last seen in 2016 and significantly lower than the 3.2% high of October 2018. The US Fed remains dovish, and signalled that it is ready to support markets by lowering rates if needed. The futures market now implies four rate cuts in the next year. BCA Research maintains that one or two rate cuts are more likely, with actual underlying US inflation higher than the market realises and unemployment still exceptionally low.

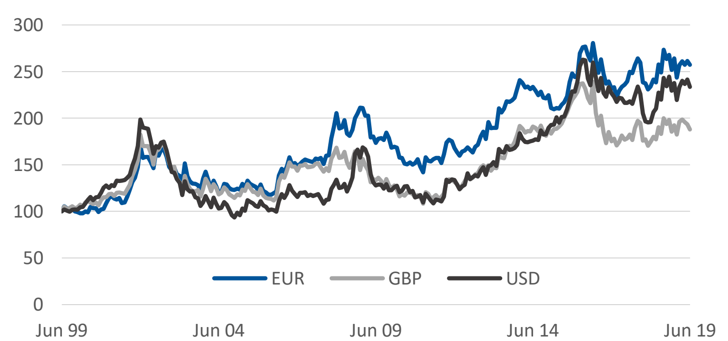
Alternative

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.

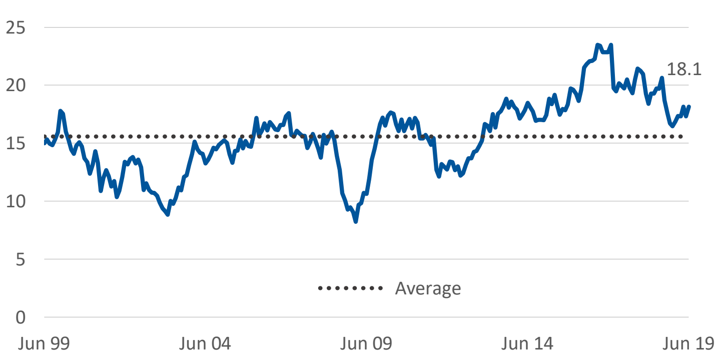
ZAR vs USD



Currencies vs ZAR (rebased to 100)



ALSI PE Ratio



SA Government 10 Year Bond Yield