Seed Market Overview

31 July 2019

Local Market

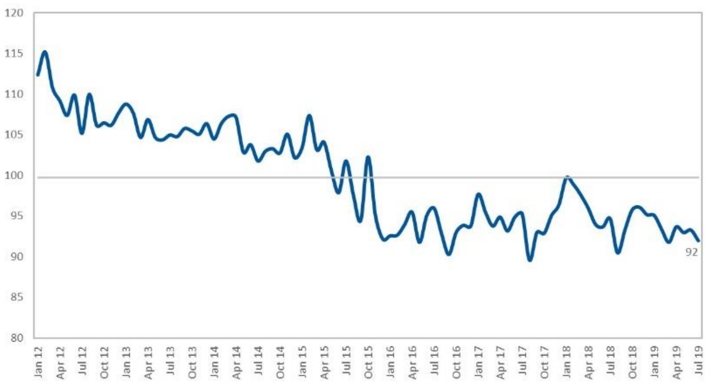
The local market has been dominated by negative headlines and July was no exception. South Africa's unemployment rate jumped to 29%, the worst rate since 2008. The labour statistics are reflective of the lack of fixed investment spending by the private sector, as well as sustained low business confidence. The July South African Chamber of Commerce and Industry Business Confidence Index declined by 1.3 index points, to measure at 92.0 (based to 100 in 2015). Business confidence has continually deteriorated in recent years, as illustrated in **Chart 1** (below).

Fitch announced that they decided to leave South Africa's international and domestic credit rating unchanged at BB+, but revised the outlook down from stable to negative. Fitch cited bailouts to state-owned entities (SOEs), low growth and revenue collection underperformance as key risks. Although Moody's did not change its rating, it released a report highlighting concerns about Eskom's capital requirements from government. Moody's review on South Africa's credit rating might see a revision in the outlook from stable to negative if the rating is kept on investment grade.

For the first time in over a year, The South African Reserve Bank (SARB) cut the repo rate by 25 basis points to 6.5%. This was a unanimous decision by the monetary policy committee. The Reserve Bank governor expects GDP to rebound in the second quarter, with the economy expected to grow by 0.6% in 2019. The news of the interest rate cut was, however, overshadowed by the announcement of additional funding to Eskom by the Minister of Finance. Government's fiscal position is therefore expected to deteriorate with deficits expected to widen more than initially expected.

The FTSE/JSE All Share Index lost 2.4% with financials and resources key detractors. The industrials sector recorded a gain with heavyweights like Naspers and a few other dual listed companies contributing to the performance. The FTSE/JSE South African Listed Property Index lost 1.2%. The All Bond Index lost 0.7% as local bonds and the currency sold off on Eskom's bailout and ratings agencies statements, erasing earlier month gains from the prospect of lower US rates and the SARB's interest rate cut. The Rand weakened by 1.8% during the month, and the local market remains in a precarious position with local economic fundamental weak. This is not helped by challenges facing the global economy.

Chart 1: South African Chamber of Commerce and Industry Business Confidence Index (2015 = 100)



Source: South African Chamber of Commerce and Industry (31 July 2019)

Global Market

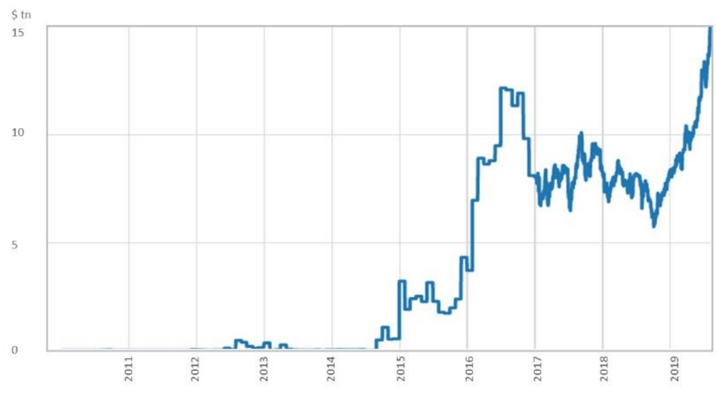
Global equity markets' divergence continued in July, with developed markets and emerging markets experiencing mixed fortunes. Developed markets again outperformed emerging markets, with the US a key contributor to this performance with the Central Bank and US corporate earnings driving the market. The MSCI World returned 0.5%, while the MSCI Emerging Market Index lost 1.2%. European equities fell on Brexit and growth fears. Trade war tension and economic growth fears resulted in the slump in emerging market equities.

US corporate earnings were better than expected for the second quarter of 2019, boosting the market. With 90% of S&P 500 companies having reported earnings, according to Factset 75% of the companies reported positive earnings and 57% a positive revenue. The S&P 500 rose 1.4% in July, with banks posting a strong month as robust consumer credit growth offset interest margin pressure from lower rates. Analysts, however, have become pessimistic about the second half of 2019 earnings, fearing that the S&P 500 earnings could turn negative.

The US Federal Reserve cut interest rates for the first time in a decade, with calls for aggressive monetary policy easing intensifying. Bonds rallied, pushing more bonds into negative yield territory. Approximately $ 15 tn of government bonds worldwide now trade at negative yields as shown in **Chart 2** (below). So far in 2019, there are 27 major developed and emerging market countries that have cut interest rates. Countries like India have been in an interest rate cutting cycle, while others have responded to a shift in the US monetary policy. With the US forecast to cut rates further, the reduction in global interest rates is expected to continue.

Global growth fears are a key driver for the systematic decline in interest rates. A slowdown in economic growth has been a concern for some time, with fears worsening due to increased trade tensions and the current slowdown in global trade. With little inflationary pressure, particularly in the developed world, a slowdown in growth might result in sustained disinflation or deflation. The reduction in interest rate should help to ease some of the downward pressure. However, challenges to the global economy still exist, notably the US and China trade dispute.

Chart 2: Value of Global Debt with Negative Yields ($ tn)



Source: Bloomberg (5 August 2019)

Asset Class (ZAR)	MTD	YTD	1 Year	3 Years	5 Years	10 Years
Local Equity	-2.4%	9.5%	2.2%	5.6%	5.1%	12.1%
Local Property	-1.2%	4.8%	0.1%	-3.7%	5.0%	12.0%
Local Bonds	-0.7%	6.9%	8.1%	8.8%	8.2%	8.8%
Local Cash	0.6%	3.9%	6.6%	6.8%	6.5%	6.0%
Global Equity	0.8%	14.9%	11.4%	11.0%	12.6%	15.9%
Global Property	1.3%	14.3%	17.4%	3.9%	12.7%	19.2%
Global Bonds	0.1%	3.4%	14.5%	1.3%	7.1%	8.5%
Global Cash	0.7%	0.0%	10.8%	2.3%	6.9%	6.8%

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Seed Local Review

Equity

The JSE All Share index lost 2.4% in July, bringing the YTD return down to 9.5%. Financials (-6.4%) lagged as sentiment towards SA-focused shares deteriorated, while Industrials (1.2%) held up well thanks to outperformance from rand-hedged stocks. Resources (-5.2%) were down sharply for the month, but remains the top sector on a YTD basis. Although the Capped SWIX benchmark index failed to grow its underlying earnings over the last year, prices are also much lower. Our models indicate that there is still reasonable value on offer, and we maintain our equity allocations at levels close to benchmark.

Property

The SA Property Index returned -1.2% in July, with negative equity market sentiment impacting the large-cap constituents. Several SA REITs currently trade at high yields and at discounts to the underlying property values. This makes them very attractive takeover targets, and we have already seen some corporate activity in the sector, which could unlock value. Currently, the SAPY offers an attractive one-year forward yield of 9.3% which is expected to grow at 3.4%. 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 fell by 0.7% this month, as investors demanded higher yields to compensate for SA's deteriorating fiscal outlook. An increase in the risk premium, which includes sovereign and currency risk, pushed the yield on the R186 benchmark bond to 8.31%. The inflation rate priced in by bond markets increased to 5.1%, 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 remained steady at 4.5%, with lower fuel prices offset by higher utility and housing costs. With the SA economy on the back foot, the SARB 0.25% interest rate cut in July was welcomed widely and should support higher economic growth for the rest of 2019. Cash currently delivers an attractive 2.3% 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 against the EUR, GBP and trade weighted basket during July, but weakened against a very strong USD. From a R 14.10/$ starting point the ZAR closed the month at R 14.34/$. The USD remains supported by a resilient US economy, and the Feds' sustained dovish tone. At month end, the ZAR was only 2% undervalued against the trade weighted basket of currencies on a purchasing power parity basis. Significantly, the ZAR was 23% undervalued versus the USD using the same methodology.

Equity

Global equity markets delivered muted returns in July, and Developed Markets once again outperformed Emerging Markets. Various geopolitical concerns weighed down investor sentiment, including renewed trade war threats and a new pro-Brexit UK prime minister. However, interest rate policies across the globe remain very accommodative and should prop up growth. The MSCI ACWI returned 0.3% with US markets the top contributor, while the MSCI EM Index was down 1.2%. We maintain our global equity ranking at overweight, and continue to favour allocation to high quality stocks.

Fixed Income

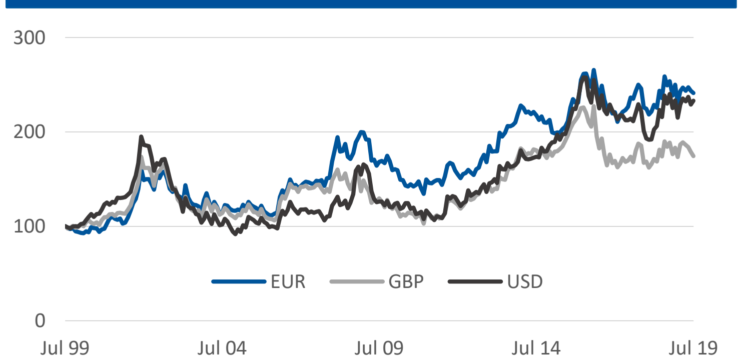
The US 10-year treasury bond yielded 2.02% at month end, and the yield has subsequently dropped to a very low 1.68%. This low yield reflects the global risk-off sentiment and increased demand for safe-haven assets. The US Fed cut rates by 25bps as anticipated, with many interpreting this move as an *"insurance cut"* intended to extend the US bull market. BCA Research opines that yields should rise from this point in line with GDP forecasts, and that the Fed is unlikely to cut rates twice more this year as the future market implies.

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