# Seed Market Overview

*31 August 2019*

## Local Market

Having been the best performing asset class in 2018, local bonds have continued to outperform other local asset classes so far this year. Bonds appear attractive to investors given the real yields on offer. Furthermore, local bonds trade at a generous yield relative to developed markets as illustrated in **Chart 1** (below). The yield on local bonds is attractive in absolute and real terms. The coupon interest is attractive, and should the search for yield intensify, there should be an opportunity for gains in the asset class.

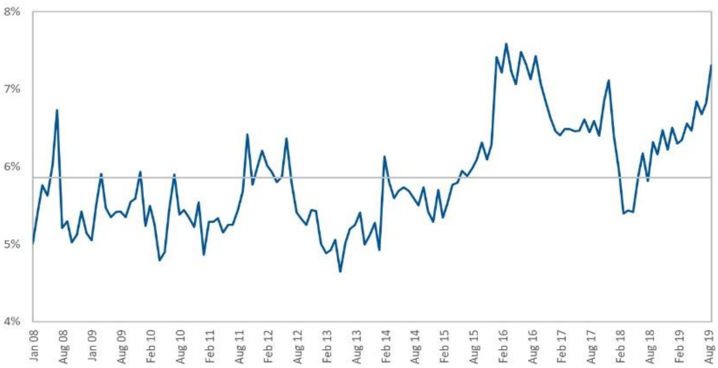
Local bond bears, however, argue that the situation for the asset class is not as rosy given the weak economic fundamentals. Economic growth has been stunted and government debt is high (and expected to increase) with the state-owned enterprises requiring bailouts after years of mismanagement. The yield curve has steepened, as longer duration bonds bore the brunt of weak fiscal conditions. Rising interest rates or rising inflation pose a huge risk for long duration bonds. Therefore, while returns have been good, risks exist.

Risk assets faced another tough month. The FTSE/JSE All Share Index ended August 2.4% in the red with financials, industrials and resources indices recording losses. The local market sold off along with global markets as the escalating trade war continued to spook the market. The FTSE/JSE South African Listed Property Index lost 3.6%. The Rand sold off 5.9% against the dollar, along with other emerging market currencies.

As risk assets faltered, gold was a major beneficiary with the gold price rallying 7.1% in US dollars and 14.7% in Rand. The demand for safe haven assets like gold increased, especially with an increasing amount of global debt with negative yields. The FTSE/JSE Gold Mining Index rose 29.0% as precious metals benefitted from the buoyant prices.

Precious metals were the only shining light in an otherwise difficult month for the local market.

**Chart 1: Spread – South African 10 Year Government Bond versus US 10 Year**




Source: Seed Investments, Iress (31 August 2019)

## Global Market

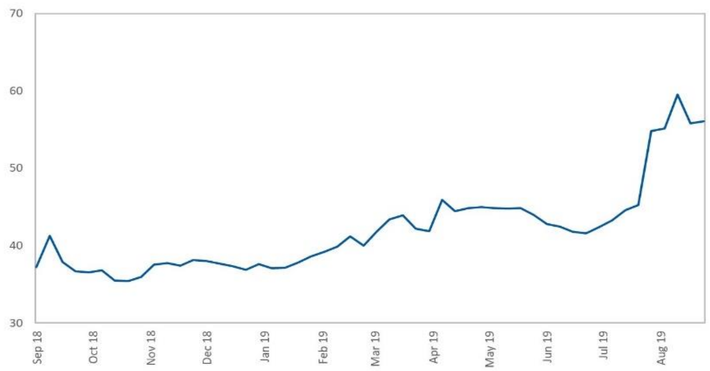
Global markets again suffered losses on the back of the escalating trade war between the US and China. The month started with the usual Trump tweet threatening a 10% tariff on $ 300bn worth of Chinese imports, to which the Chinese retaliated. The month remained volatile with markets moving along based on whether the news coming out of the trade war was positive or negative. Delays in implementation of the threats were received positively, but the situation remains dire.

The MSCI All Country World Index fell 2.4% with emerging markets underperforming developed markets. The MSCI Emerging Market Index lost 4.9% while the MSCI World Index lost 2%. Emerging Market currencies accordingly weakened against the US dollar. The Argentinian Peso in particular added pressure to the market, following a surprise election result favouring populism. The Peso fell 25.9% during the month, reaching a record low before a brief recovery as shown in **Chart 2** (below).

As the global markets were seemingly burning, a record number of real fires ravaged the Amazon rainforest. Deforestation rates have reached unprecedented rates. Droughts, wildfires and other human-induced changes have compounded the damage from cutting down trees. Climate change is proving to be a big issue as the forests continue to heat up. With the President under pressure due to the wide-ranging negative impact on the environment, it seems that he would prefer to focus on sabotage conspiracy theories.

Social media widely shared pictures of more fires burning in Africa than anywhere else on earth, in response to the burning Amazon. The pictures are, however, a bit misleading or have been misinterpreted to reach the wrong conclusions. The charts detect *"hot pixels"* and, thus, fires as small as a garden fire to burn rubbish. The situation is also slightly different from the Amazon, as the annual savannah fires are part of the ecosystem and mean renewal. Avoiding massive deforestation is key, as forests absorb huge amounts of carbon dioxide from the fires. It is critical that the fires be kept under control for the good of the environment.

**Chart 2: US Dollar - Argentinian Peso Exchange Rate**




Source: Seed Investments (31 August 2019)

| Asset Class (ZAR) | MTD | YTD | 1 Year | 3 Years | 5 Years | 10 Years |
|---|---|---|---|---|---|---|
| Local Equity | -2.4% | 6.9% | -2.6% | 4.7% | 4.7% | 11.5% |
| Local Property | -3.6% | 1.0% | -5.5% | -3.3% | 3.6% | 11.4% |
| Local Bonds | 1.0% | 7.9% | 11.2% | 9.8% | 7.8% | 8.7% |
| Local Cash | 0.5% | 4.4% | 6.6% | 6.7% | 6.5% | 6.0% |
| Global Equity | 4.6% | 20.1% | 3.3% | 10.3% | 13.3% | 16.1% |
| Global Property | 10.0% | 25.7% | 13.6% | 6.1% | 14.5% | 18.9% |
| Global Bonds | 10.3% | 14.0% | 12.9% | 2.9% | 9.2% | 9.4% |
| Global Cash | 7.3% | 7.3% | 6.2% | 2.7% | 8.5% | 7.6% |

# Seed Market Overview

*31 August 2019*

## Seed Local Review

### *Equity*

The JSE All Share Index closed down 2.4% in August, bringing the YTD return down to 6.9%. Resources (-1.0%) held up reasonably well, with gold and platinum shares boosted by higher precious metal prices during a global flight to safety. Industrials (-2.8%) and Financials (-4%) lagged, as ongoing trade war concerns hurt sentiment towards Emerging Markets. With the local equity market pulling back over the last four months, and earnings growing slightly, valuations are now less demanding. 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 lost 3.6% in August, and both 1-year and 3-year returns on listed property are, once again, in negative territory. A weaker rand provided welcome relief to dual listed counters, but this was outweighed by ongoing concerns around property fundamentals. SA's consumers have seen rising living costs but no income growth, leading to increased pressure on retailers and their landlords. The SAPY offers an attractive 1-year forward yield of 9.7%, but there is a significant risk that expected distributions or growth thereon may not materialise.

### *Bonds*

The ALBI returned 1% this month, with local yields following global yields lower. The risk premium, which includes sovereign and currency risk, increased once again, signalling increased concerns around SA's low growth rate and high debt burden. The inflation rate priced in by bond markets dropped to 4.9%, 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 surprised on the downside, with the 4.0% rate now at the lower end of the SARB's target band. The SA economy bounced back strongly from the contraction in Q1, with a 3.1% annualised growth rate in Q2. Mining and Financial services contributed positively, while Construction and Agriculture slumped. Cash currently delivers a very attractive 2.8% 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 6% against the majors during August. From a R 14.34/$ starting point, the ZAR closed the month at R 15.19/$. The trade-weighted USD remains strong, and as a counter-cyclical currency is supported by weak global growth. 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 31% undervalued versus the USD using the same methodology.

### *Equity*

Most global equity markets ended August in the red, with renewed escalations in the US/China trade war once again ruffling investors. The MSCI ACWI returned -2.4%, while the MSCI EM index was down 4.9% as sentiment turned against riskier Emerging Markets. Thus far, global consumption has remained robust in the face of poor fundamentals, but manufacturing has slowed down markedly. Easy monetary policy by central banks globally should support growth in the short term, while recession risks are on the rise looking further out. We shift to a benchmark weight in global equity ranking, and continue to favour allocation to high quality stocks.

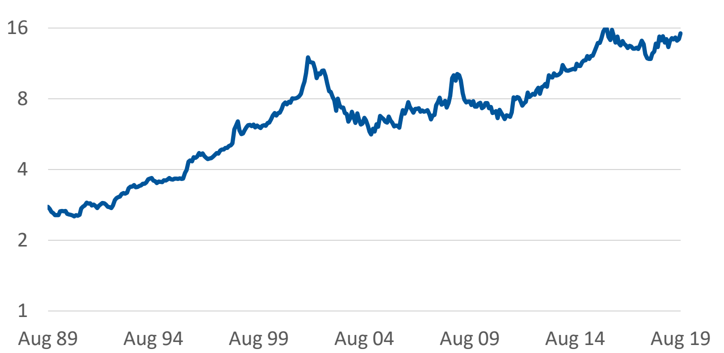
### *Fixed Income*

The US 10-year treasury bond yielded a very low 1.5% at month end, not far off the July 2016 historic low of 1.4%. This low yield reflects the increased demand for safe-haven assets amidst the volatile geopolitical environment. Bond yields appear to have very little room to fall further, and should rise over the next 12 months given that US inflation is slowly trending up. BCA Research opines that yields should rise from this point in line with GDP forecasts, and that the Fed will cut rates twice more this year in 25bp intervals.

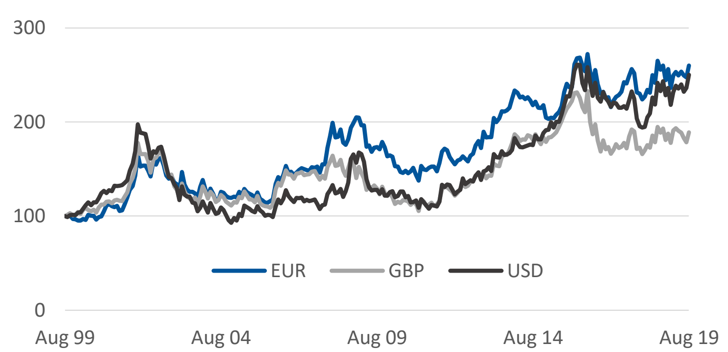
### *Alternative*

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.

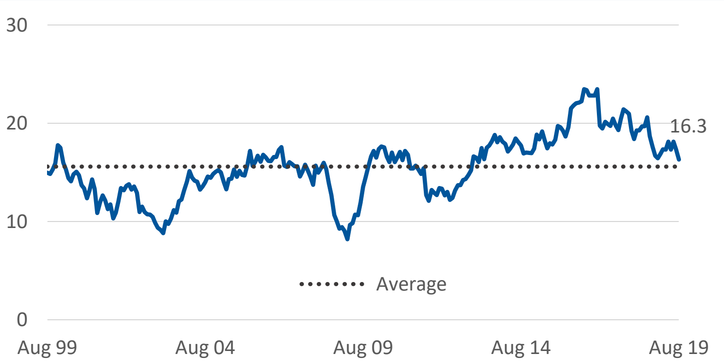
## ZAR vs USD




## Currencies vs ZAR (rebased to 100)




## ALSI PE Ratio




## SA Government 10 Year Bond Yield