Seed Market Overview

30 November 2019

Local Market

The equity market came under pressure in November, ending the month in the red as the US-China trade tension continued to spook the market. The signing of a new US law supporting protestors in Hong Kong cast doubt whether a resolution to the trade conflict could still be reached, negatively impacting markets.

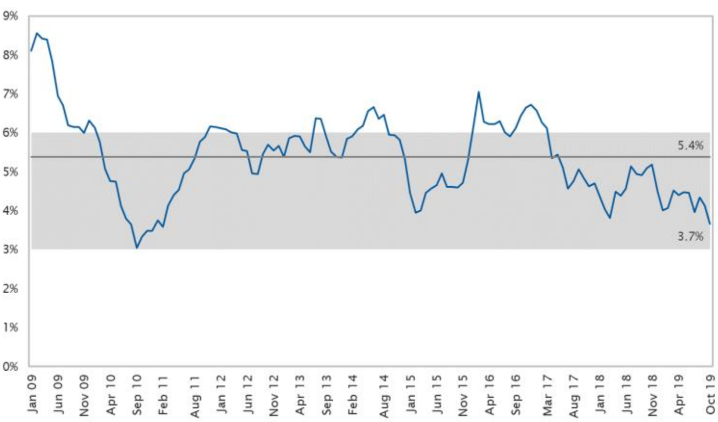
The FTSE/JSE All Share Index lost 2.5% in the last week of the month, erasing earlier month gains to end the month 1.8% lower. As such, the index failed to hold on to the to the double-digit year-to-date return gained thus far. Losses were experienced across sectors with financials, industrials and resources indices all ending the month lower. However, listed property and bonds delivered positive returns, the FTSE/JSE Listed Property Index up 0.8% while the All Bond Index gained 0.2%.

The Rand was range-bound during November, trading between R 14.60 and R 15.00 per $ 1.00. Prospects of trade deal between the US and China oscillated between feelings of optimism and pessimism, driving the currency. For the most part trade negotiations progressed well and, as such, the Rand strengthened 3.0% versus the USD.

The Reserve Bank's Monetary Policy Committee kept the interest rate on hold, which supported the local currency. However, news-flow weighing on the currency included S&P's downgrade of the country's outlook, a negative statement from the IMF and the bleak picture of the country's finances.

On the economic front, consumer price inflation (CPI) came in at its lowest level since February 2011, coming in at an annual rate of 3.7% as illustrated in **Chart 1** (below). The biggest contributors to inflation were food and non-alcoholic beverages (contributing 0.6 percentage points), housing and utilities (contributing 1.2 percentage points) and miscellaneous goods and services (contributing 0.9 percentage points). Although the decline in inflation can normally be viewed positively, this may indicate a structural and cyclical decline in the economy.

Chart 1: South African Equity Market Sector Growth (5 Years to 31 October 2019)



Source: Stats SA (30 November 2019)

Global Market

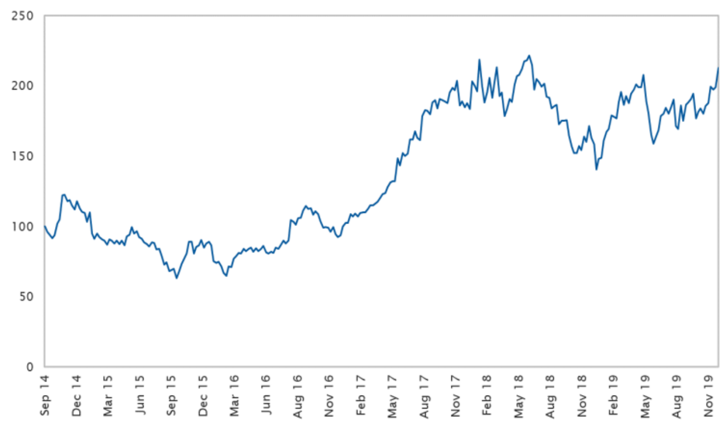
The MSCI All Country World Index rallied 2.4% driven by good performance on the developed market front. The MSCI World Index gained 2.8% on the prospects of a trade deal between the US and China being reached. The S&P 500 gained 3.6%, as all the key US indices posted good gains during the month. However, month-end threats to a potential deal saw emerging markets struggle, led by the Chinese market.

The MSCI Emerging Market Index lost 0.1% while the Shanghai Stock Exchange Composite Index lost 1.8%. Mainland Chinese stocks fell, as the US backing Hong Kong protestors led to a rout of the shares. November saw technology giant Alibaba listing on the Hong Kong Exchange. The share rallied 5.8% in its first week of trading, while other shares endured a torrid time with the Hang Seng Index down 2.0% over the same period. The listing was successful, the largest in 2019 thus far, in spite of the political turmoil. The stock has delivered a total return of 16% per annum since listing on the NYSE in September 2014 – refer to Chart 2 (below).

Technological advancement has seen a proliferation in the use of artificial intelligence (AI) and machine learning (ML) in various industries, including investments. It is important to move with the times, improving efficiency and potentially resulting in a better experience for investors. The benefits of a successful implementation of machine learning in investment management are numerous, but the rush to implement what is trendy can see risk management missed to the detriment of investors.

Machine learning interpretability is a key area of research that has often been neglected. Many of the early implementers have not bothered to further invest into interpretability in order to understand and explain exactly what the computers are doing. Issues can arise in model set-up, including overfitting to noise in historical data or non-stationarity due to cyclical trends. Both problems can make ML models underperform, and require different fixes that can be tackled by making models interpretable. In order to see success in the use of AI and ML, interpretability should be primary to the process.

Chart 2: Alibaba Group Holding Limited ADR (16% Annualised Total Return per Annum in USD)



Source: Morningstar Direct (30 November 2019)

Asset Class (ZAR)	MTD	YTD	1 Year	3 Years	5 Years	10 Years
Local Equity	-1.8%	8.5%	13.1%	6.6%	5.3%	10.7%
Local Property	0.8%	4.1%	3.0%	-1.7%	1.9%	11.2%
Local Bonds	0.2%	8.3%	9.0%	9.3%	7.0%	8.8%
Local Cash	0.5%	6.1%	6.6%	6.7%	6.5%	6.0%
Global Equity	-0.4%	24.6%	20.1%	13.6%	13.5%	16.3%
Global Property	-3.8%	26.0%	23.0%	11.9%	13.2%	18.7%
Global Bonds	-3.8%	7.8%	14.6%	5.3%	8.0%	8.7%
Global Cash	-2.6%	4.1%	8.2%	3.3%	7.1%	7.8%

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seed investments

Seed Local Review

Equity

The JSE All Share Index gave up 1.8% in November, bringing the YTD return down to 8.5% from a high of 12.5% in May. The Resources sector (-1.0%) was the best performing sector, as platinum shares rallied despite lower commodity prices. The Industrials sector (-2.4%) was dragged down by heavyweight Naspers (which has underperformed since Prosus was spun off in September), while Financials (-1.4%) also closed in the red. The Capped Swix index currently trades at a PE of 15.4, and our models indicate that there is still reasonable value on offer. We therefore maintain our equity allocations at levels close to benchmark.

Property

The SA Property Index returned 0.8% in November, and this asset class has now delivered 3.0% on a 1-year basis, while returns over 3-year and 5-year are even lower. The prices of high-yielding counters have collapsed on a YTD basis, while REITS with more sustainable payout ratios have held up much better. The SAPY offers an attractive 1-year forward yield of 9.4%, but growth on these distributions are expected to be much lower than inflation.

Bonds

The ALBI delivered a positive 0.2% this month, and bonds have been a great local asset class over the last 5 years. While SA survived a potential downgrade by Moody's last month, S&P revised their outlook from stable to negative during November citing fiscal deterioration as the main reason. The benchmark R186 yield decreased slightly to 8.45% at month end, and the risk premium component remains close to 15-year highs. Our valuation model indicates that bonds are fairly valued, and the high yield in real terms is looking attractive compared to other asset classes.

Cash

Annual inflation surprised on the downside at 3.7% and remains at the very low end of the SARB's target band. Despite SA's dismal economic growth rate, the SARB did not cut interest rates at its November MPC meeting, opting instead to shore up the rand. Cash currently delivers a very attractive 3.1% real yield. We appreciate the optionality in cash, but recognise that several other asset classes currently have higher expected real returns.

Seed Global Review

Currency

The rand strengthened against the majors during November and closed the month at R 14.65/$ from a starting point of R 15.09/$. The trade-weighted USD had another strong month as US-China trade talks progressed, and most other EM currencies took some strain. 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 25% undervalued versus the USD using the same methodology.

Equity

Global developed equity markets continued their excellent run this month, with the MSCI ACWI returning 2.4% and the S&P500 up 3.6%. The MSCI Emerging Markets index lagged, returning -0.14% on the back of a weaker Chinese market. The global manufacturing cycle is starting to bottom and easier financial conditions and moderate stimulus from China should lead to a favourable environment for risk assets. We therefore upgrade our global equity ranking to overweight, and continue to favour allocation to high quality stocks.

Fixed Income

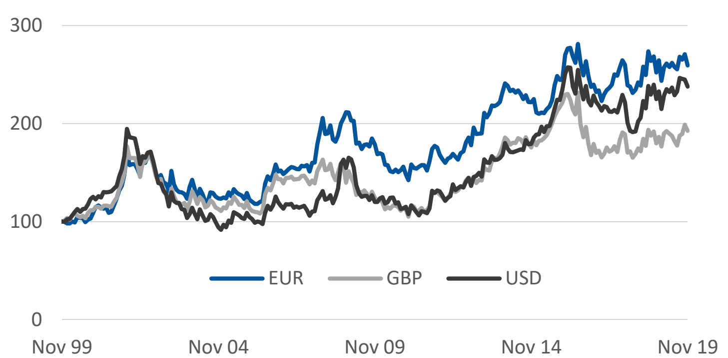
The US 10-year treasury bond yield increased to 1.77% this month, with renewed risk-on sentiment driving some investors towards equities. The US Fed is expected to remain on hold for the next 12 months, while an uptick in economic growth is likely to push up longer-term rates. US inflation expectations have moderated in light of a strong dollar. BCA Research opines that yields should not rise above the long-run equilibrium rate of 2.5%.

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