ECONOMIC REPORT

by Glacier Research

glacier by Sanlam

16 November 2017

REVIEW PERIOD: OCTOBER 2017

SUMMARY

Optimism gripped global equity markets in October driven higher by positive economic data and strong corporate earnings. Several major global indices hit new record highs, while volatility reached a historic low. Global bonds and equity were positive in ZAR terms as the rand weakened against the US dollar for the month of October. Markets appeared to shrug off the threat of North Korea, instability in Venezuela and the Catalan independence vote. The big monetary policy event of the month was the European Central Bank's October meeting, where Mario Draghi announced an extension of the Central Bank's quantitative easing programme for nine months from January to September 2018. Despite cutting its purchasing programme from €60bn to €30bn a month, it is important to realise that they could announce extensions going forward. Catalonia held a referendum on the 1st of October, whereby the Catalan regional parliament unilaterally declared independence from Spain after a secret vote. This move led to Spanish authorities triggering Article 155 of the Constitution and thereby assuming direct control of the region. Ongoing strength in global growth was supportive of emerging markets as they extended their year-to-date gains over their peers in the developed world. Emerging Asia led the advance with Korea, India and Taiwan leading the gains.

Locally, the month of October revealed further weakness in the South African economy, along with significant headwinds for the fiscus, when finance minister Malusi Gigaba delivered the 20th Medium Term Budget Speech. The country faces its biggest tax revenue shortfall since 2009 (a massive R50.8bn) as well as a rising debt-to-GDP ratio which is currently at 54.2% but is forecasted to top 61% by 2022. To exacerbate matters, the National Treasury also revised growth for 2017 downwards from 1.3% to 0.7%. Despite this negative economic backdrop, risk asset returns were relatively strong across the board. The JSE All Share Index delivered a staggering performance, rising 6.26% on a total return basis, with SA industrials (dual-listed) (+7.61%) and resources (+7.37%) being the main contributors. However, in spite of this being a sign of confidence in the local economy and SA companies, it actually means the contrary. Investors have been piling into rand-hedge stocks as a form of protection against the deteriorating local economic environment. This was the major driver of returns on the All

Share Index as the rand weakened significantly against major peer currencies. Subsequently, fixed-income assets suffered heavily after a broad-based sell-off of SA government bonds by foreigners. The longer end of the yield curve was worse hit, falling 2.73%. In terms of monetary policy, the September policy meeting saw policymakers leave the door open for further loosening in November, saying it would be appropriate to reassess the data and the balance of risks at the next meeting. However, given the recent uncertainty surrounding SA's economic outlook, clouded by political turmoil, the threat of further sovereign credit rating downgrades, an uptick in inflation and the resultant impact on business confidence, MPC members may remain cautious in setting monetary policy going forward.

Developed market equities (+1.89% in USD, +6.71% in ZAR and +2.94% in GBP) underperformed emerging market equities for the month of October (+3.51% in USD, +8.40% in ZAR and +4.57% in GBP), after outperforming for the first time this year in September. On a global equity style basis using the MSCI World style indices, momentum was the top performing style, (returning +4.56% in USD, +9.51% in ZAR and +5.64% in GBP), followed by quality (+3.07% in USD, +7.94% in ZAR and +4.13% in GBP), growth (+2.75% in USD, +7.61% in ZAR and +3.81% in GBP) and then value (+1.01% in USD, +5.78% in ZAR and +2.05% in GBP). Developed market property gave up 0.48% in USD terms, while local investors would have experienced a higher return of +4.22% due to the rand weakening against the US dollar (+4.22%).

Meanwhile, global bonds underperformed global equities, returning -0.38% in USD (+0.65% in GBP and +4.33% in ZAR). Locally, the ALSI turned in a strong performance, advancing 6.26% in ZAR terms (+1.46% in USD and +2.51% in GBP). Year-to-date, the ALSI has returned 19.63%, despite political uncertainty, the financially-depleted state of state-owned enterprises and weak GDP growth being top of mind. The market was supported by consumer services (+12.34%), SA industrials, which includes dual-listed companies (+7.61%), resources (+7.06%), technology (+6.53%), industrials (+3.64%), healthcare (+3.33%) and financials (+2.47%). Meanwhile, telecommunications (-2.73%) and general retailers (-2.41%) dragged the market lower. Fixed-interest returns were weak relative to local equities, dampened further by the negative medium-term budget speech, with the ALBI surrendering 2.30%. Preference shares gave up 1.39%, while inflation-linked bonds lost 0.87%. The longer end of the yield curve (over 12 years) was the worst-performing fixed-interest asset class in October, returning -2.73%, followed by the middle-end (7-12 years) which lost 2.41%. The very short end of the yield curve (1-3 years) was the best performer, albeit a negative return for the month, returning -0.18%. Furthermore, cash underperformed equity, but outperformed bonds in October, returning 0.61%.

Source: I-Net November 2017

LOCAL OVERVIEW

Consumer inflation in South Africa increased 5.1% year-on-year in September 2017, higher than 4.8% in the previous month. However, the figures came in above market expectations of 4.9%, mainly boosted by higher prices for housing, transport and miscellaneous goods and services. Prices rose faster for housing and utilities (4.9% compared to 4.5% in August), mainly boosted by the cost of actual rentals for housing (5.7% compared to 5%) and that of the owners' equivalent rent (5.4% compared to 4.9%); transport (5.6% compared to 3.9%), due to higher cost of fuel (12.2% compared to 5.7%) and private transport operation (10.2% compared to 5.2%); miscellaneous goods and services (7.6% compared to 7.5%); alcoholic beverages and tobacco (4.7% compared to 4.3%); household contents and equipment (2.1% compared to 2%); and health (7.2% compared to 7%).

Meanwhile, inflation eased for food and non-alcoholic beverages (5.5% compared to 5.7% in August); clothing and footwear (2.3% compared to 2.8%); recreation and culture (2.2% compared to 2.4%); and restaurants and hotels (3.4% compared to 4.2%). Inflation for communication continued to fall (-1.4% compared to -1.3% in August). On a monthly basis, consumer prices rose to 0.5%, beating expectations of 0.3%.

	May'17	June'17	July'17	Aug'17	Sep'17	Oct'17
CPI (y/y)	**5.4%**	**5.1%**	**4.6%**	**4.8%**	**5.1%**	**-**
PPI (y/y)	**4.8%**	**4%**	**3.6%**	**4.2%**	**5.2%**	**-**

Sources: SA Reserve Bank, Statistics SA, I-Net, BER, Trading Economics, MorningStar, Reuters

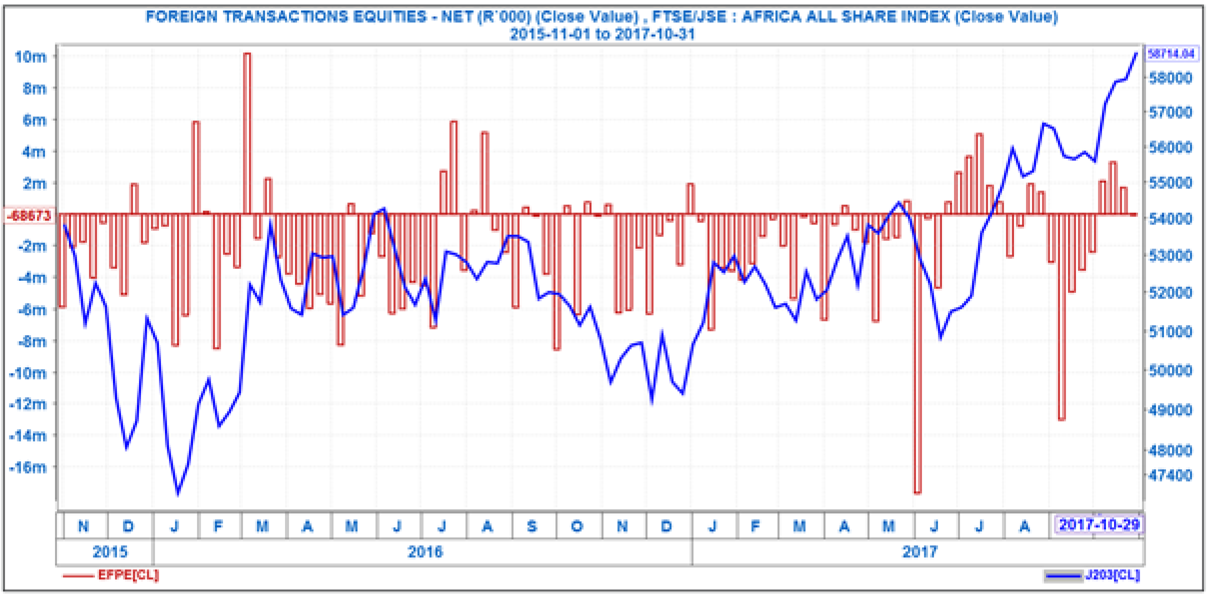
South Africa's trade surplus decreased to R4bn in September 2017 from an upwardly revised R5.98bn surplus in August, but below market expectations of a R7bn surplus. Exports decreased 1.6%, while imports advanced marginally faster by 0.4%. Compared with the previous month, exports decreased to R101.8bn from R103.4bn, led by a fall in shipments of base metals (-12%); vegetable products (-16%); chemical products (-15%) and precious metals and stones (-6%), while vehicles and transport equipment (14%) and mineral products (7%) rose. Major destinations for sales were China (9.9%); the US (8.2%); Germany (6.1%); India (6%) and Japan (4.9%). Imports advanced to R97.8bn from R97.4bn, due to higher purchases of vegetable products (107%); mineral products (5%); chemical products (5%); prepared foodstuffs (11%) and animals and vegetable fats (47%). Imports came mostly from China (17.9% of total imports); Germany (11.8%); the US (6.7%); Saudi Arabia (4.7%) and India (4.2%).

	31 October 2015	31 October 2016	31 October 2017
USD/ZAR	13.80	13.46	13.63
GBP/ZAR	21.31	16.48	17.93
EUR/ZAR	15.21	14.78	16.07

Sources: SA Reserve Bank, Statistics SA, I-Net, BER, Trading Economics, MorningStar, Reuters

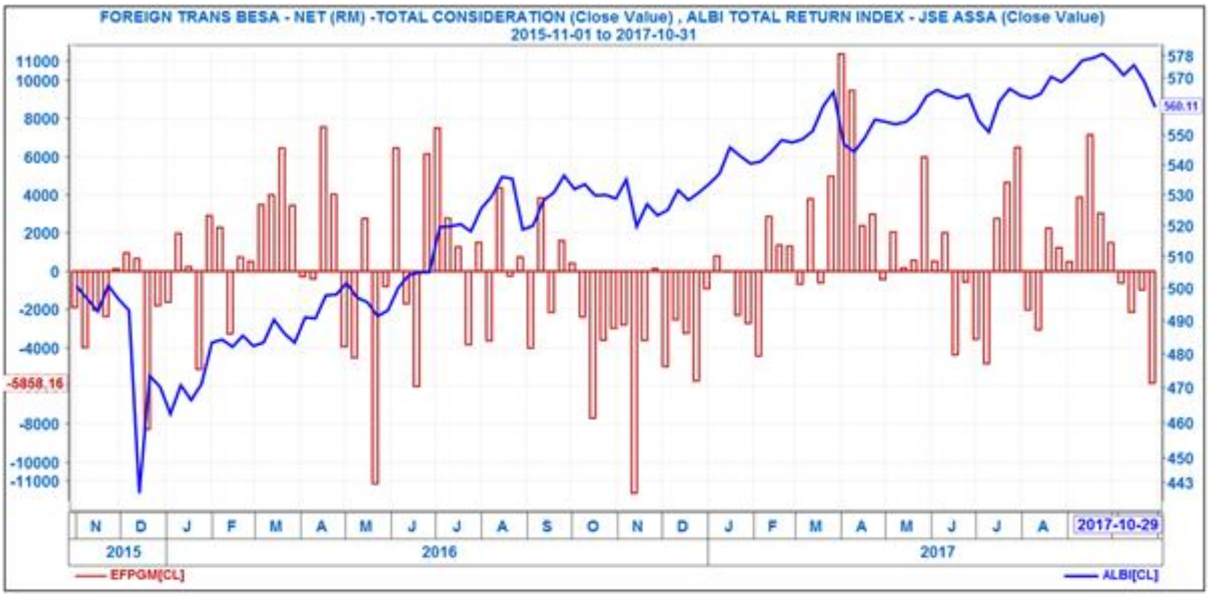
Locally, the ALSI was up 6.26% in rand terms. US foreigners invested in SA equities would have made modest gains off SA equity, 1.46% in USD, as the rand weakened (+4.22%) considerably against the US dollar in October. Resources led the rally of the ALSI rising 7.06% over the month. Industrials followed suit adding 3.64% in October, with the SA industrials (dual-listed) index benefitting from the weakened rand, adding 7.61%. Financials closed positive for the month as well, adding 2.47%, despite banks taking a knock after the medium-term budget policy statement on the 25th October 2017. By market-cap, the Top40 (+6.60%) led the gains. Mid-cap stocks rose 4.12%, while small-cap stocks ended the month 2.56% higher.

Consumer services (+12.34%) was the best-performing sub-sector over the month of October. This was followed by basic materials, up 7.06%, and technology up by 6.53%. Telecommunication (-2.73%) was the worst-performing sub-sector, followed by healthcare, returning 3.33%. The gold mining sub-sector added 4.05% over the month, despite the price of gold falling 0.58%. This was largely driven by ‘global synchronized growth’ rhetoric spurring on positive market sentiment and general risk-on trade in global equities and safe haven assets not being in favour over the month. Major resource counters in the Top40 had a stellar month under higher bulk and platinum commodity prices, with Impala Platinum rocketing 26.51%, Anglo American Platinum adding 14.06% and Anglo American gaining 9.36%. Rand-hedge stocks in the Top40, such as Naspers (+17.98%), British American Tobacco (+7.51%) and Richemont (+6.05%) contributed to performance, with the strong earnings expectations and the rand weakening significantly against the US dollar and other global peer currencies. SA equities were bought heavily by foreigners in October, as they were net buyers of R9bn worth of equities. Year-to-date, however, they are net sellers of R76.48bn worth of SA equities.



Source: I-Net November 2017

Local fixed-income markets saw negative returns over the month as the ALBI (-2.30%) fell sharply amid foreigners fiercely selling off SA bonds. Cash, however, returned a positive 0.61%. The longer end (12yr+) of the yield curve was the worst-performing interest-bearing asset class, returning -2.73%, followed by 7-12yr bonds (-2.41%). The 1-3yr section of the yield curve was the best performer, returning -0.18% over the month. Year-to-date, however, the 3-7yr period has still been the best performer (+7.78%) followed by the 1-3yr period (+7.27%), while the 12yr+ (+4.35%) was the worst performer over the past 12 months. SA listed property (a hybrid asset class) had a positive performance over the month returning 1.99% and is the second best-performing SA asset class year-to-date (+10.30%), following equities.



Source: I-Net November 2017

During October, foreigners turned to being net sellers of R13.70bn worth of SA bonds. Year-to-date the SA bond market has still experienced a net foreign inflow of R42.82bn. In a global fixed-income context, global bonds performed negatively yet again, as the Barclays Global Aggregate Bond Index (-0.38%) and the Citigroup World Government Bond Index (-0.54%) both closed lower in USD terms. However, due to rand weakness they both closed positively (+4.33% and +4.17% respectively). In October, SA's currency weakened yet again amid economic worries, following the country's medium-term budget speech. The rand depreciated heavily against the British pound sterling (+4.11%), the US dollar (+4.22%) and against the euro (+2.77%).

GLOBAL OVERVIEW

Globally, the US equity market ended October within touching distance of record highs, supported by economic data that remained positive despite the disruption caused by hurricanes Harvey and Irma. The Trump administration made some progress in the Senate with its proposed tax reform bill. However, reports suggest that the corporate tax cut will be phased in as opposed to being a once-off event. Microsoft, Intel and Alphabet all reported stronger-than-expected earnings, helping the technology sector reach an-all time high of its own. The US trade balance deficit widened to $43.5bn in September from a $42.8bn gap in August. The unemployment rate in the US edged down by 0.1% to 4.1% in October from 4.2% in September. Meanwhile, consumer prices in the US increased 2.2% year-on-year in September, following a 1.9% gain in the previous month. In corporate news, enthusiasm for mergers and acquisitions picked up pace following low levels of activity in the early part of the year, as many businesses were waiting to see Trump's tax reform plans. Over the past month, Lennar and CalAtlantic Group merged to create the biggest US homebuilder, and Pfizer announced that it was considering to sell or spin-off its healthcare business.

The broader Bloomberg Commodities Index closed 2.14% higher for the month of October, led higher by the industrial metals component. Nickel rallied 17.14% and zinc advanced 4.27%. The energy component posted a positive return with the price of Brent crude (+7.79%) increasing amid ongoing signs of market tightening. Furthermore, precious metals were more subdued, with gold losing 1.02%, while platinum and silver added 0.54% and 0.20% respectively.

On a total return basis, the global technology sector was the top-performing sector for the month of October returning +7.70% in USD, +8.80% in GBP and +12.80% in ZAR. This was followed by the utilities sector which returned +4% in USD, +5% in GBP and +8.90% in ZAR. The top-performing sector over a one-year period was the technology sector, returning +38.30% in USD, +27.20% in GBP and +45.10% in ZAR. The worst-performing global sector for the second consecutive month in October was the communications services sector returning
-3.60% in USD, -2.70% in GBP and +0.90% in ZAR. Furthermore, the energy sector remains the worst-performing global sector for the third consecutive month over a one-year period, returning +1.80% in USD, -6.40% in GBP and +6.80% in ZAR.

In rand terms, developed market equities (+6.71%) underperformed emerging market equities (+8.40%) for the month of October. In USD, the MSCI World added (+1.89%) and the MSCI Emerging Markets Index gained 3.51% for the month. Developed market property weakened by 0.48% in USD, underperforming bonds, which surrendered 0.38% in USD. Developed markets indices in ZAR terms were positive across the board for the month of October, due to rand weakness.

The rand weakened against the US dollar (+4.22%), the Australian dollar (+1.09%), the pound sterling (+4.11%) and the euro (+2.77%). The Nikkei (+12.21% in ZAR, +7.41% in USD and +8.25% in GBP), the Dow Jones (+9.38% in ZAR, +4.44% in USD and +5.52% in GBP), the S&P 500 (+7.17% in ZAR, +2.33% in USD and +3.39% in GBP), the CAC 40 (+6.59% in ZAR, +1.78% in USD and +2.83% in GBP), the ASX 200 (+6.45% in ZAR, +1.64% in USD and +2.69% in GBP) and the DAX (+6.43% in ZAR, +1.62% in USD and +2.67% in GBP) were all higher in ZAR terms for the month.

In emerging markets, China's Shanghai Composite Index added 1.52% in its base currency (+6.57% in ZAR, +1.76% in USD and +2.81% in GBP), the Brazilian Bovespa Equity Index was flat 0.02% in its base currency (+1.29% in ZAR, -3.29% in USD and -2.29% in GBP) and the Indian Nifty advanced 5.59% in its base currency (+11.52% in ZAR, +6.48% in USD and +7.58% in GBP). The Argentina Merval Index surged 7.12% in its base currency (+10.23% in ZAR, +5.25% in USD and +6.34% in GBP) and the Nigerian All Share Index added 3.50% in its base currency (+8.09% in ZAR, +3.21% in USD and +4.28% in GBP). The US dollar strengthened against both the euro (-0.76%) and the British pound (-0.79%).

Spot Rates	31 October 2015	31 October 2016	31 October 2017
EUR/USD	**1.10**	**1.10**	**1.17**
GBP/USD	**1.54**	**1.22**	**1.32**
USD/JPY	**120.60**	**104.83**	**113.49**

Sources: SA Reserve Bank, Statistics SA, I-Net, BER, Trading Economics, MorningStar, Reuters