ECONOMIC REPORT

by Glacier Research

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REVIEW PERIOD: JUNE 2017

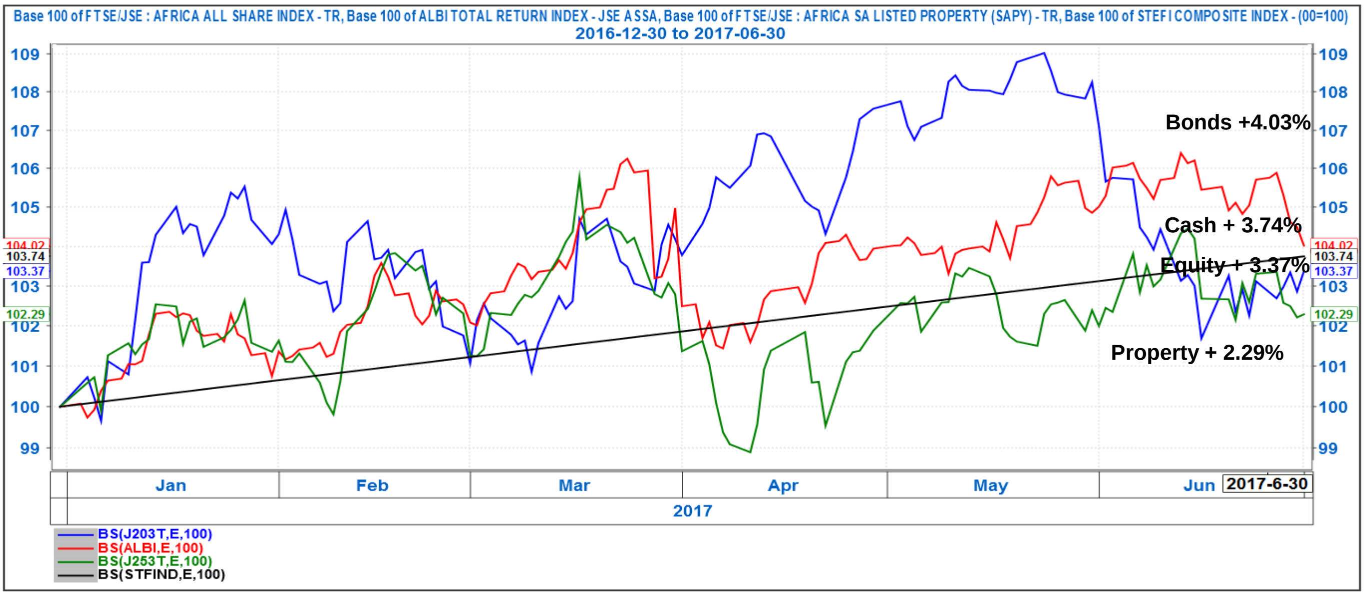
SUMMARY

The shift in tone from central banks drove global financial markets in the month of June. The Bank of Canada, the Bank of England and the European Central Bank (ECB) are now seen as likely candidates to follow the US Federal Reserve (Fed) in raising interest rates before the end of this year. In rand terms, both global bonds and global equities closed lower as the rand strengthened marginally against the US dollar (-0.09%). The US Fed voted to hike interest rates by 0.25% in June, marking the second rate hike this year. US Federal Reserve Chair Janet Yellen, signalled that the US economy would be able to withstand higher interest rates. The ECB kept its interest rate policy unchanged, however there were subtle changes in its guidance and forecasts. In the UK, Theresa May’s decision to call a snap general election has back-fired as the Conservative party lost its parliamentary majority. As a result, this has weakened both the strength and stability of her government at a crucial time as she embarks on the Brexit negotiations. Emerging market equities extended their winning ways in June, edging past developing markets for the sixth successive month. An improving economic landscape and some upbeat earnings resulted in a steady performance despite US interest rates being hiked.

Locally, the month of June brought a bitter end to quarter two as there was nowhere to hide as all major asset classes, excluding cash, gave meagre or negative returns. The JSE All Share index was firmly down (-3.49%) for the month, with industrials (-3.73%), resources (-3.08%) and financials (-2.17%) all weighing on the index. SA Industrials (-4.18%) was the worst performing major sector over the month, as most rand hedge counters came under pressure. Bonds also underperformed, with the ALBI down -0.95%, as foreigners turned to net sellers of SA bonds for the first time this year. On an economic front, despite many analyst forecasts of SA GDP growth remaining unchanged at 0.7% for 2017, 1.3% for 2018 and 1.9% for 2019, SA’s economy officially entered a technical recession when GDP growth for Q1 2017 came in negative (-0.7%). It was the second consecutive quarter of contraction following the -0.3% contraction in Q4 2016. Economic activity contracted over a wide range of sectors, including construction, manufacturing and transport. Only mining and agriculture made a positive

contribution to output growth. All other sectors contracted. Underpinning all of this is a steady decline in foreign direct investment which has fallen 10.44% y/y from a record high of R2089 billion in Q1 2016 to R1868 billion in Q1 2017. Economic growth depends on foreign investment, which in turn is dependent on confidence and positive expectations of the country's future. President Jacob Zuma's administration unfortunately does not instil this confidence in SA's economic landscape. This partly explains subdued investment. The situation is exacerbated with the recent credit risk downgrades into sub-investment grade which has made South Africa a less attractive investment destination. The lack of confidence is thus reflected in suppressed demand, which in turn results in contractions in economic output.

Developed market equities (+0.25% in USD, -0.39% in ZAR and -0.37% in GBP) underperformed emerging market equities (+0.54% in USD, +0.46% in ZAR and -0.34% in GBP) for the sixth successive month in June. Developed market property added 0.34% in USD terms, while local investors would have experienced a muted return of 0.26% due to the rand strengthening marginally against the US dollar (-0.09%). Meanwhile, global bonds underperformed global equities, losing 0.09% in USD (-0.70% in GBP and -0.72% in ZAR). Locally, the ALSI had a torrid month surrendering 3.49% in ZAR (-2.87% in USD and -3.46% in GBP). The market was dragged lower by SA Industrials, which includes dual-listed companies (-4.18%), Industrials (-3.73%), Resources (-3.08%), Retailers (-2.98%) and Financials (-2.13%). Meanwhile, the SA Listed Property Sector (+0.29%) was the only positive contributor to performance for the month. Fixed interest returns fared better in comparison to local equities, with the ALBI surrendering 0.95% on the back of reduced foreign inflows and continued political uncertainty. Preference shares returned a muted 0.02%, while inflation-linked bonds gave up 0.19%. The longer end of the yield curve (+12 years) was the worst performing fixed interest asset class in June, returning -1.40%, followed by the middle end (seven-12 years) which surrendered 0.56%. The shorter end of the yield curve (one-three years) was the best performer, returning +0.31%. Furthermore, cash outperformed both bonds and equities in June, returning +0.61%.



Source: I-Net - 1 July 2017

LOCAL OVERVIEW

Consumer inflation in South Africa increased 5.1% y/y in June 2017, higher than the 5.4% in May which was the lowest rate since November 2015. Figures came in below market expectations of 5.2% due to the rising cost of cost of transport, clothing and footwear, and restaurants and hotels. Prices rose slower for clothing and footwear (3.8% from 3.9% in May), transport (3.3% from 5.2%), restaurants and hotels (4.1% from 4.8%), household contents and services (2.4% from 2.8%), miscellaneous goods and services (7.1% from 7.3%) and recreation and culture (3.3% from 3.8%). In contrast, inflation was steady for food and non-alcoholic beverages (6.9%), housing and utilities (5.7%), education (7%), while it was accelerated for health (7% from 6.9%) and alcoholic beverages (3.3% from 3.1%). On a monthly basis, consumer prices increased by 0.2% after a 0.3% rise in the previous month. Prices of housing and utilities jumped 0.9%, while the cost of transport fell 0.3% and that of food showed no growth.

	Jan'17	Feb'17	Mar'17	Apr'17	May'17	June'17
CPI (y/y)	**6.6%**	**6.3%**	**6.1%**	**5.3%**	**5.4%**	**5.1%**
PPI (y/y)	**5.9%**	**5.6%**	**5.2%**	**4.6%**	**4.8%**	**-**

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

South Africa posted a trade surplus of R9.5 billion in May compared to a downwardly revised R5 billion surplus in April and slightly below market expectations of R10.6 billion. Exports rose 15.4% from the previous month to R105.0 billion, boosted by higher sales of miscellaneous manufactured articles (220%), vegetable products (46%), chemical products (28%), vehicles and transport equipment (15%) and base metals (14%). Major destinations for exports were China (7.8% of total exports), the US (7.8%), Germany (7.5%), India (4.8%) and Japan (4.4%). Imports increased 11% to R 95.5 billion, as purchases went up for original equipment components (33%), mineral products (22%), textiles (16%), chemical products (9%), and machinery and electronics (7%). Imports came mainly from China (18.7% of total imports), Germany (12.4%), the US (6.8%), Saudi Arabia (6%) and India (4.4%).

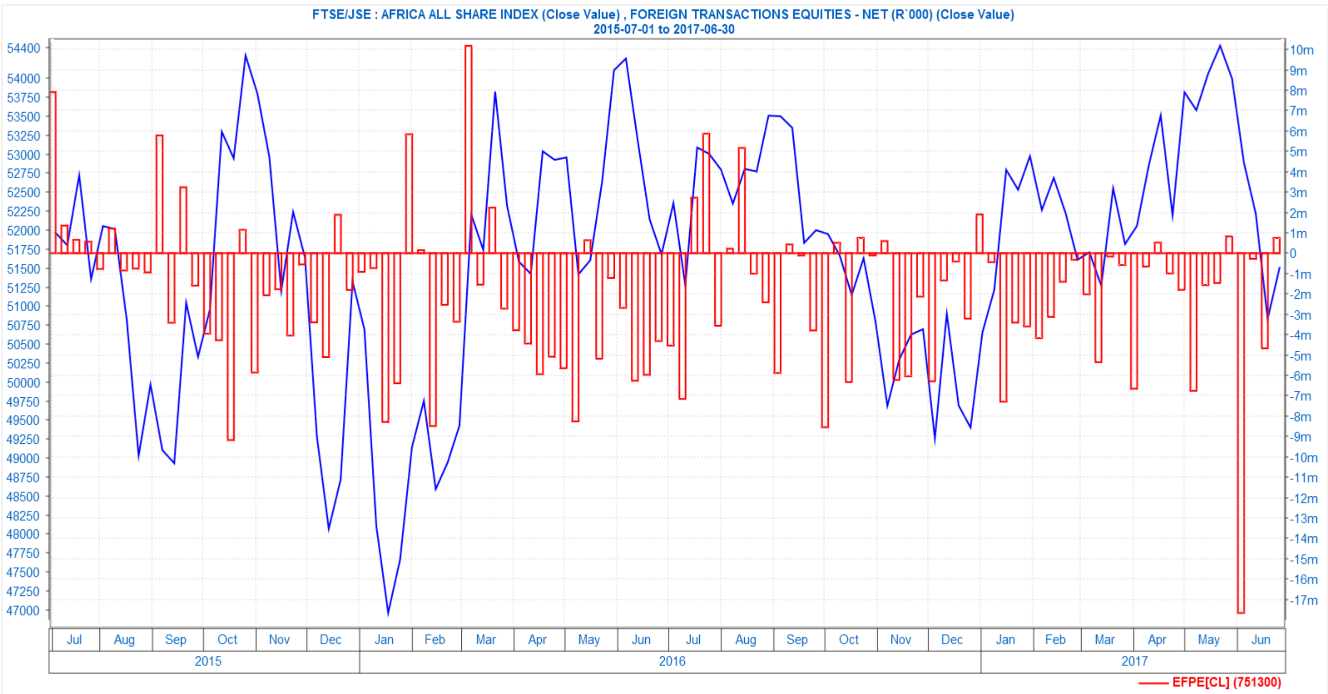
	30 June 2015	**30 June 2016**	**30 June 2017**
USD/ZAR	**12.17**	**14.70**	**13.06**
GBP/ZAR	**19.07**	**19.56**	**16.97**
EUR/ZAR	**13.54**	**16.31**	**14.92**

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

Locally, the ALSI was down -3.49% in rand terms. US foreigners invested in SA equities would have fared similarly with a return of -3.40% in USD, as the rand was only marginally stronger (-0.09%) against the US dollar in June. SA Industrials led the losses on the ALSI, declining 4.18% in June, with large rand-hedge stocks in the Top 40 and SA retailers (-2.98%) taking a knock over the month. Industrials were the lowest returning major sector, ending the month 3.73% lower. Resources dropped 3.08%, as commodity prices for oil, gold, silver and platinum all slid on the back of weaker global demand. The financials index slipped 2.13%, as three of the country's big four banks all shed more than 1.5% over the month.

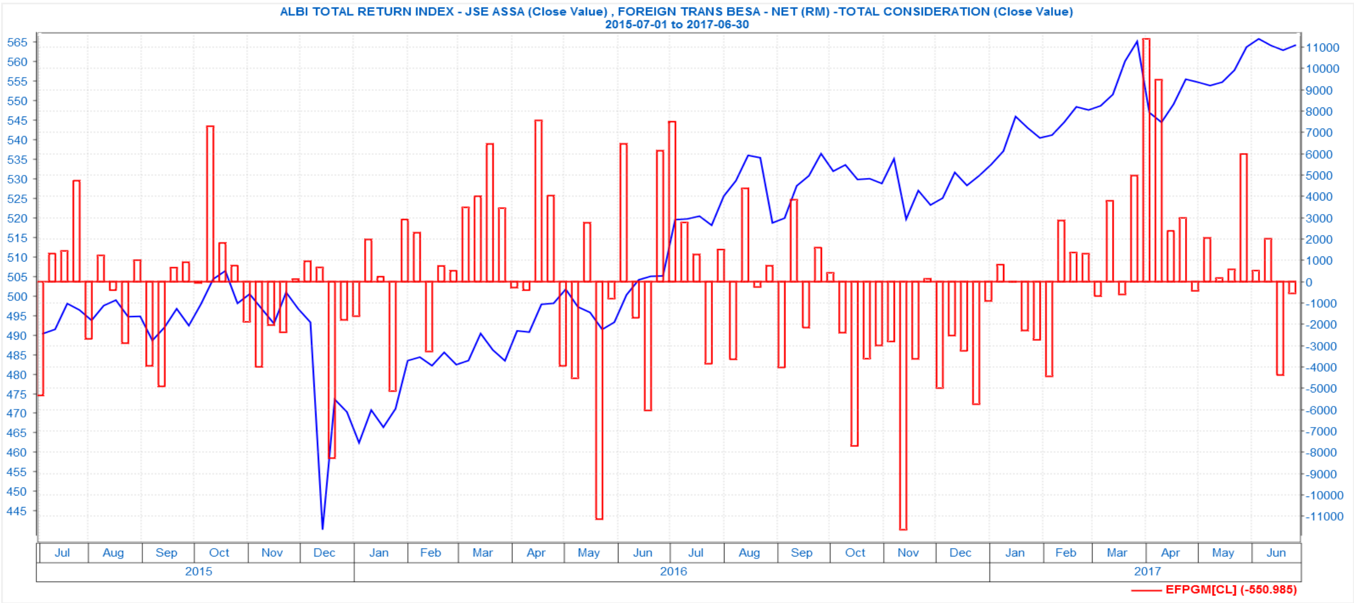
By market-cap, the Top 40 index led the losses, dropping 3.59% as the rand flattened against the US dollar and weakened against other major currencies. Small-cap stocks ended the month 2.78% lower and the mid-cap index lost a notable 3.54% during June.

Consumer Services was the worst performing sub-sector, after being up for four consecutive months, falling 5.20% over the month. This was followed by Health Care, down 4.94%. Technology (+6.11%) was the best performing sub-sector, followed by Telecommunications (-2.31%). The Gold Mining sub-sector shed a further 9.50% as the gold price dropped 2.14% over the month. Harmony Gold (-17.50%), Anglo Gold Ashanti (-13.80%), Sibanye Gold (-4.87%) and Gold Fields (-3.17%) all led the Gold mining index lower. Under the large diversified miners, Anglo American PLC (-0.25), and BHP Billiton (-0.80) were flat despite higher iron ore, copper and coal prices. Other notable mining company performances include Anglo American Platinum (+7.47%) and Royal Bafokeng Platinum (+18.11%). Rand-hedge stocks in the Top 40, such as Capital & Counties (-7.39%), Mediclinic (-6.96%), Naspers (-6.28%), British American Tobacco (-5.37%), Investec PLC (-5.43%) and Steinhoff (-4.21%) detracted from performance, as the rand strengthened marginally against the US dollar. Anglo American Platinum (+7.47%) and Capitec Bank (+6.58%) were the best performing large-cap stocks. The financials index experienced a weak month, ending 2.13% lower. The index was driven mainly by losses in major banking stocks in the Top 40 index, namely, Nedbank (-5.14%), Firstrand (-4.38%), Standard Bank (-1.71%) and Rand Merchant (-3.35%), while Capitec (+6.58%), Barclays (+3.42%) and Old Mutual PLC (+2.12) bucked the trend and fared well over the month. SA equities were sold off again in June by foreigners as they were net sellers of R19.1 billion worth of equities. YTD they have sold R69.7 billion worth of SA equities.



Source: I-Net 1 July 2017

Local fixed income markets saw dismal returns over the month in conjunction with equities as the ALBI (-0.95%) underperformed cash (+0.61%), and also underperformed Preference Shares (+0.02%). The longer (+12 year) end of the yield curve was the worst performing interest-bearing asset class, returning -1.40%, followed by seven-12 year bonds (-0.56%). The shorter end of the yield curve (one-three years) was the best performer, returning +0.31%. Over the last three months the three-seven year period was the best performer (+2.44%) followed by the seven-12 year period (+2.41%), while the three-seven year (+10.08%) was the best performer over the past 12 months. SA listed property (a hybrid asset class) had a positive performance over the month, returning 0.29%, outperforming all other local major asset classes.



Source: I-Net 1 July 2017

During June, foreigners were net sellers of R6.42 billion worth of bonds. YTD the bond market has experienced a net foreign inflow of R32.98 billion. In a global fixed income context, emerging markets generally remain attractive and the current higher yields in the asset class provide at least some measure of diversification against rising interest rate risk globally. As a result, countries such as SA have been a beneficiary of this market sentiment with foreign investors favouring its bonds. In June, SA's currency returns were mixed against major global peers. The rand marginally appreciated against the US dollar (-0.09%) and more so against the yen (-1.53%), but depreciated against the British pound sterling (+0.80%) and more extensively versus the euro (+1.47%).

GLOBAL OVERVIEW

Global equities continued their upward trend in June, while bonds in US dollar terms were weaker as the major central banks expressed a more dovish tone. The US economy continues to look healthy, with the current unemployment level at a level last seen in the 1970s. Given the tight labour market, the Federal Reserve hiked interest rates in June and announced that it is likely to start reducing the size of its balance sheet 'relatively soon'. The balance of trade in the US narrowed to $46.5 billion in May from a $47.6 billion gap a month earlier. The unemployment rate in the US increased to 4.4% in June from 4.3% in May. Consumer prices in the US increased 1.9% y/y in May, easing from a 2.2% rise in April. Technology stocks, which was the top performing sector for the year thus far, came under pressure in June. Crude oil tumbled into bear market territory on concerns that a global oil supply glut would persist, which dragged the share prices of oil-related stocks lower. Despite the fact that technology and energy-related shares remained under pressure, financials and banks were supported by higher interest rates in June.

The broader commodities index added 1.76% in the month of June. The gold price retreated 2.14%, whereby the safe-haven appeal of gold has abated amidst record highs in the equity markets and geopolitical concerns. The price of Brent crude oil fell for the sixth consecutive month in June, surrendering 4.20% as prices dropped below the $50 per a barrel level once again. Furthermore, the price of iron ore rebounded by 13.91%, nickel added 5.33% and copper gained 5.2%, while the price of platinum and silver closed 2.64% and 4.10% lower.

On a total return basis, the global financial sector was the top performing sector for the month of June returning 5.5% in USD, 4.8% in GBP and 4.8% in ZAR. This was followed by the healthcare sector which returned 5.0% in USD, 4.3% in GBP and 4.3% in ZAR. Financial services was the top performing sector over a one year period in USD (+36.6%), GBP (+40.6%) and ZAR (+22.2%). The worst performing global sector in June was the communications services sector returning -3.0% in USD, -3.6% in GBP and -3.7% in ZAR. Furthermore, the energy sector was the worst performing global sector over a one year period returning -4.1% in USD, -1.3% in GBP and -14.2% in ZAR.

In rand terms, global developed market equities (+0.16%) underperformed emerging market equities (+0.46%) once again in June. In USD, the MSCI World added 0.25% and the MSCI Emerging Markets Index gained 0.54% for the month. Developed market property added 0.34% in USD, outperforming bonds, which gave up 0.09% in USD. Developed markets indices in ZAR terms were mostly negative for the month of June, with the rand strengthening marginally against the US dollar (-0.09%), but weakening against the Australian dollar (+3.38%), the pound sterling (+0.80%) and the euro (+1.47%). The ASX 200 (+2.56% in ZAR, +3.21% in USD and +2.58% in GBP), the Canadian TSX (+2.43% in ZAR, +3.09% in USD and +2.45% in GBP) and the Dow Jones (+1.10% in ZAR, +1.74% in USD and +1.12% in GBP) were the top performers for the month. Meanwhile, the FTSE 100 (-2.46% in ZAR, -1.83% in USD and -2.44% in GBP), the Euro Stoxx (-2.21% in ZAR, -1.59% in USD and -2.20% in GBP), the CAC (-1.74% in ZAR, -1.11% in USD and -1.72% in GBP), the DAX (-1.53% in ZAR, -0.90% in USD and -1.51% in GBP) and the S&P 500 (-0.06% in ZAR, +0.58% in USD and -0.04% in GBP) were the worst performers for the month. In emerging markets, China's Shanghai Composite index advanced 3.53% in its base currency (+3.50% in ZAR, +4.16% in USD and +3.52% in GBP) and the Indian Nifty 50 gave up -1.51% in its base currency (-1.85% in ZAR, -1.22% in USD and -1.83% in GBP), while the Brazilian Bovespa equity index gained 0.30% in its base currency (-2.46% in ZAR, -1.83% in USD and -2.44% in GBP). The US dollar weakened against both the euro (+1.66%) and the British pound (+1.18%).

Spot Rates	30 June 2015	30 June 2016	30 June 2017
EUR/USD	**1.11**	**1.11**	**1.14**
GBP/USD	**1.57**	**1.33**	**1.30**
USD/JPY	**122.42**	**103.18**	**112.38**

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