ECONOMIC REPORT

by Glacier Research

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SUMMARY

Global equity markets ended the month of February suffering a sharp correction following the stellar performance in January. The sharp sell-off was mainly driven by an increase in government bond yields in major markets, especially in the US. The latest rise in global bond yields unsettled equity markets across developed and developing economies. Falling bond and equity prices in February reflect revisions to expectations for inflation and interest rates, rather than any concern that global growth is faltering. Yet, the extent of the equity market sell-off in the first half of the month caught many market participants by surprise. The CBOE VIX volatility index, a broad measure of equity market stress, touched 37 and far above its long-term average of 20. To a large extent, what markets have seen in February is a good sign of real health in markets for a long time. Both global bonds and equities were negative in ZAR terms as the rand strengthened against the US dollar for the month of February. In the Eurozone, inflation remains stubbornly low with the European Central Bank being encouraged by Mario Draghi in his speech to the European Parliament, to remain patient and persistent with regards to monetary policy in order to create conditions for inflation to pick up to the stated target of below or close to 2%. The Bank of England (BoE) sent a more hawkish tone in their February Inflation Report press conference, indicating that interest rates would need to increase much earlier and faster than anticipated in November. The market now sees it as more likely than not that the BoE will raise the base interest rate by 25 basis points in May.

Meanwhile, in the US, Janet Yellen handed over the baton of Federal Reserve Chair to Jerome Powell with markets not anticipating any change in policy as a result of the handover. The minutes to the meeting of the January Federal Open Market Committee suggested that the committee remains optimistic on the outlook for the US economy but believes policy needs to be normalised very gradually. In Japan, Haruhiko Kuroda extended his term as the governor of the Bank of Japan (BoJ) for the next five years. Kuroda reaffirmed that the progress towards lifting inflation in Japan remains slow and that there is a need for powerful monetary easing. It seems likely that the BoJ will keep its 0% yield target for its ten-year government bonds in place in the near term. Emerging markets registered negative returns in February, underperforming its developed market counterpart for the first

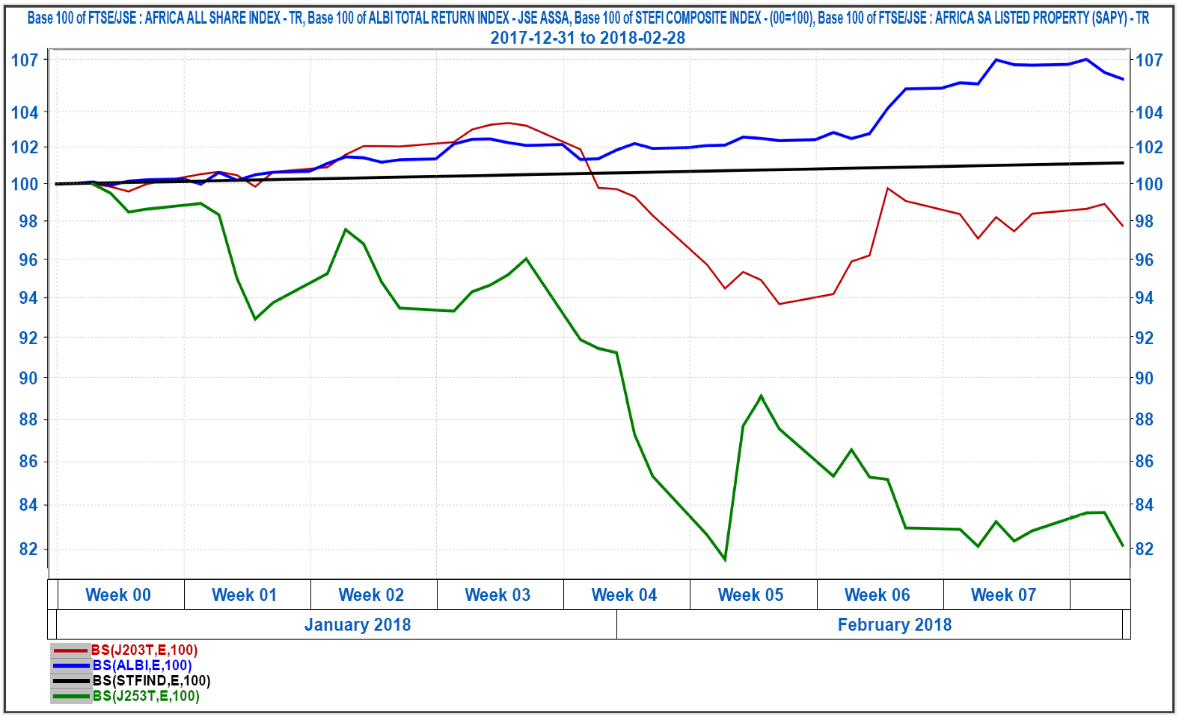
time this year. Emerging market equity confidence was dented by US inflation fears, a spike in market volatility and commodity prices retreating as the dollar gained ground. The spike in volatility was experienced across all regions with India, Korea and China posting the weakest performances among the regions followed by Latin America.

The effects of the ANC 2017 December elective conference continued in the month of February as the ANC wrestled internally with a motion to recall President Zuma. This led to the postponement of the opening of parliament, after which President Zuma resigned and Cyril Ramaphosa was inaugurated as the new President of South Africa. Key to the month of February was the budget speech and the cabinet reshuffle, which both sent positive signals to the market after the budget addressed fiscal issues that needed to be addressed in order to avert a ratings downgrade by Moody's. One of the key emphases of this budget, was the raising of VAT by 1 percentage point to 15% and cutting government's infrastructure spend. The cabinet reshuffle boosted a tailwind of positive sentiment following the return of Nhlanhla Nene as Finance Minister and Pravin Gordhan as Minister of Public Enterprises, thereby signalling the importance placed on the country's purse and governance issues that need to be addressed in state-owned enterprises.

The buoyant sentiments were dampened not only by the compromises in the cabinet reshuffle (the retaining of ostensibly compromised ministers) but, to a large extent, by a motion by parliament to move ahead with land expropriation without compensation. The market also welcomed an announcement that flowed from the Finance Minister's budget speech on the new offshore allocation limits for retirement funds and unit trust funds which gave effect to a 30% total offshore allocation limit for retirements and a 40% total offshore allocation for unit trust, 10% of which can be invested in African markets. The changes are effective immediately from both the Financial Services Board and the South African Reserve Bank. The Association for Savings and Investment South Africa (ASISA) has created an exemption in terms of funds utilising this offshore allowance,, but they still need to provide guidance in terms of whether they will change the limits of the ASISA categories. While South African markets had yet another mixed month, resources shares tumbled on the backdrop of a firmer currency, while the listed property sector remained a thorn during the month, recording another 9.9% loss, with the Resilient stable leading the losses.

Developed market equities (-4.14% in USD, -4.71% in ZAR and -1.07% in GBP) outperformed emerging market equities for the month of February (-4.61% in USD, -5.17% in ZAR and -1.55% in GBP). On a global equity style basis using the MSCI World style indices, momentum was the top performing style (-1.62% in USD, -2.20% in ZAR and +1.54% in GBP), followed by growth (-3.24% in USD, -3.81% in ZAR and -0.13% in GBP), quality (-3.24% in USD, -3.81% in ZAR and -0.14% in GBP) and then value (-5.08% in USD, -5.64% in ZAR and -2.04% in GBP). Developed market property lost -6.70% in USD terms, while local investors would have experienced a weaker return of -7.25% as the rand strengthened against the US dollar (-0.66%). Meanwhile, global bonds outperformed global equities, returning -0.89% in USD (+2.29% in GBP and -1.47% in ZAR). Locally, the ALSI gave up 1.97% in ZAR terms (-1.39% in USD and +1.78% in GBP) despite Cyril Ramaphosa being sworn in as South Africa's new president. The local equity sectors posted mainly negative returns with the market being supported by general retailers (+3.45%) and financials (+2.58%).

Meanwhile, SA-listed property (-9.90%), consumer goods (-7.98%), basic materials (-4.82%) and SA industrials (-3.02%), which includes dual-listed companies, dragged the market lower. Fixed-interest returns were strong relative to local equities with the ALBI advancing 3.93%. Preference shares added 0.54%, while inflation-linked bonds gained 1.30%. The longer end of the yield curve (over 12 years) was the best-performing fixed-interest asset class in February, returning 5.02%, followed by the middle end (7-12 years) which advanced 2.94%. The very short end of the yield curve (1-3 years) was the worst performer in this asset class, albeit positively, returning 1.13%. Furthermore, cash outperformed equity, but underperformed bonds in February, returning 0.54%.



Source: IRESS March 2018

In summary, for the month of February those funds and wraps with overweight positions to local bonds, cash and preference shares would have outperformed their category average as local bonds, cash and preference shares were the best-performing local asset classes for the month.

Overweight positions in local equities would have detracted from performance as the All Share Index delivered -1.97% for the month. Offshore, overweight positions in equities would have led to a USD underperformance as offshore equities generated a negative return of -4.14%. This underperformance was exacerbated by rand strength.

With regards to income-generating assets, longer-term bonds (over 12 years) returned 5.02% for the month with the ALBI returning 3.93%. Cash returned 0.54% for the month, in line with preference shares and underperforming inflation-linked bonds (1.30%). On a monthly basis, SA headline inflation increased by 0.28% in February 2018 and Namibian headline inflation increased by 0.15%. Due to poor equity market performance for the month – the majority of the wraps underperformed their CPI plus benchmarks.

LOCAL OVERVIEW

The domestic economic outlook was positive as the market welcomed an uptick in GDP quarterly growth figures of an annualised 3.1% growth in Q4 2017. This followed an upward revision of 2.3% in the preceding period, the last quarter of 2017, marking a higher-than-expected annual economic expansion of 1.3% in the year 2017.

Unemployment figures improved slightly over the quarter as South Africa's unemployment rate decreased by 330 000 to 26.7% in the Q4 2017 from 27.7% in the previous period. This improvement was driven by gains in the informal sector (+119 0000) and agricultural sector (+39 0000), while the formal sector and private households sector shed 135 000 and 43 000. GDP growth is forecasted to be 2.5% for Q1 2018 with a declining expansion of 2%, 1.5%, 1.9% for Q2, Q3 and Q4, respectively, while the unemployment rate is expected to worsen to 28% in Q1 before reaching 27.8% (Q2), 26.6% (Q3) and 26% (Q4).

Consumer prices grew 4% in February 2018 slowing down from 4.4% in the prior month and slightly below market expectations. This was driven by a lower increase in the prices of transport (3.2% down from 4.4%) which came as a result of: fuel (5.1% down from 9.1%) and food (3.9% down from 4.5%). Meanwhile, prices of housing and utilities (4.5% up from 4.4%), alcoholic beverages and tobacco (6.1% up from 5.3%) and household equipment (1.9% up from 1.5%) rose. Inflation is expected to pick up to 4.6% (Q1), 4.9% (Q2) and 5.2% (Q3)

	Sep’17	Oct’17	Nov’17	Dec’17	Jan’18	Feb’18
CPI (y/y)	**5.1%**	**4.8%**	**4.6%**	**4.7%**	**4.4%**	**4.0%**
PPI (y/y)	**5.2%**	**5%**	**5.1%**	**5.2%**	**5.1%**	**5.1%**

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

Trade balance figures are yet to be released for February 2018. However, the January 2018 trade balance shifted to R27.7 billion, compared to a downwardly revised R15.31 billion surplus in December, and well below market expectations of a R5.0 billion deficit. This marks the highest deficit on record.

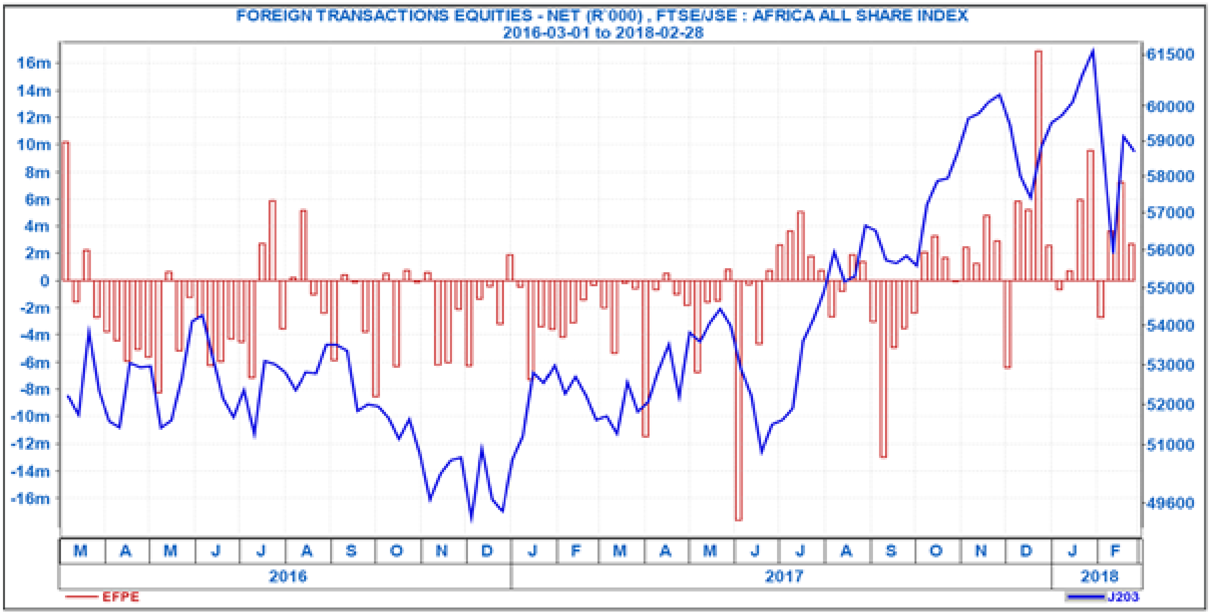
Exports decreased by 22.6% month-on-month to R80.5 billion driven by decreases in precious metals and stones (-34%), mineral products (-21%), vehicles and transport equipment (-47%), machinery and electronics (-21%) and prepared foodstuff (-27%). In contrast, imports increased by 18.3% month-over-month to R108.2 billion, owing to gains from equipment components (+139%), precious metals and stones (+137%), mineral products (+21%), machinery and electronics (+10%), base metals (+56), chemical products (+15%), plastics and rubber (+32%) and textiles (+39%). In terms of trade partners, the main export partners were China (9.5%); the US (7.0%); Germany (5.9%); India (5.3%) and Japan (5.0%) with the main import partners being China (20.4%), Germany (9.5%), Saudi Arabia (6.8%), the US (5.0%) and India (4.2%). The balance of trade is expected to contract to R4.717 billion in Q1 with a further contraction to R1.083 billion in Q2.

	28 February 2016	29 February 2017	28 February 2018
USD/ZAR	15.84	13.13	11.79
GBP/ZAR	22.05	16.25	16.23
EUR/ZAR	17.24	13.88	14.39

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

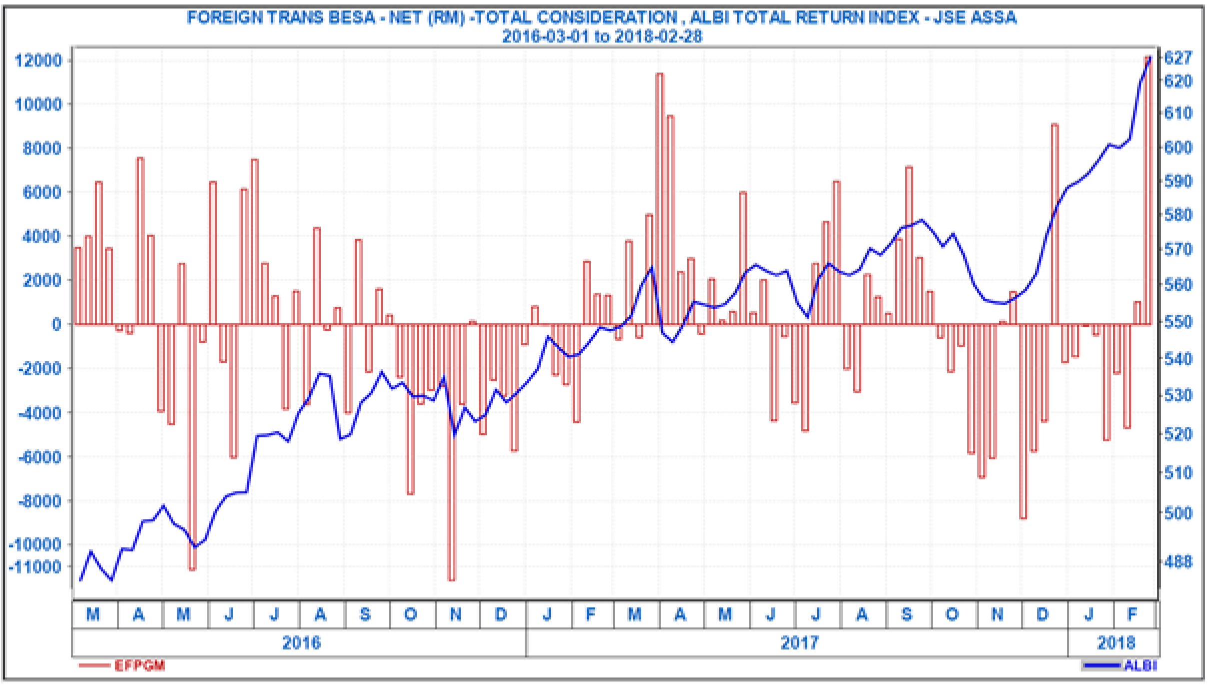
In South African equities markets, the All Share Index (ALSI) fell -1.97% in rand value, dragged down by resources (-4.82%) which were hurt by declining commodity prices and rand appreciation, following increased optimism over South Africa's economic trajectory under the new administration. The global downturn in February also impacted on domestic sentiment as the MSCI World Index plunged -4.71% in rand terms. Financials led the gains on the ALSI adding +2.58% during the month as banks and financial services companies advanced, and retailers rallied 3.45%. Industrials, however, took a knock of -2.27%. The Top40 index fell -2.34%, mid-cap stocks gave up 0.14% while small-cap stocks closed the month 0.29% higher. General retailers posted the highest gains in the sub-sector universe, adding +3.45%, while listed property (-9.90%), consumer goods (-7.98%) and resources (-4.82%) closed lower.

The Top40 index surrendered -2.34% as rand hedges were shaken by the rand rally, with Anglogold Ashanti bleeding -17.86%, British American Tobacco down -13.18% and Naspers losing -3.30%. Property shares, once more, took the biggest knock during the month as Fortress Income (-46.81%), Nepi Rockcastle (-25.90%) and Resilient (-42.99%) suffered exponential downturns. Steinhoff surrendered -15.20%. Major contributors to Top40 performance came from banks as shares of Barclays (+10.22%), Investec (+10.32%), Standard Bank (+8.55%) and Firstrand (+11.13%) added significant gains. Foreigners continued to be net buyers of SA equities (R14.3 billion) for the month of February.



Source: IRESS March 2018

The local fixed-income market advanced as the All Bond Index (ALBI) added gains of +3.93% during the month of February, up from 1.86% delivered in January. Cash maintained its steady positive return of +0.54% while the 1 to 3-year period of the yield curve added +1.13% and the 3 to 7-year period closed the month at +1.55%. The longer end of the yield curve (12yr+) recorded the highest gain of +5.02% followed by the 7 to 12-yearr period which ended the month at +2.94%. Inflation-linked bonds ended higher at +1.30%. Foreigners continued to be net buyers of R7.5 billion worth of SA bonds for the month of February



Source: IRESS March 2018

GLOBAL OVERVIEW

US equity markets corrected sharply lower in February, after posting a very strong performance in January. The correction in the equity market was mainly driven by fears over rising inflation and bond yields. The market sell-off that occurred was also in part profit-taking following several months of rising markets. This was accelerated by forced selling by some investors of complex passive ‘inverse volatility’ products. As the month progressed, markets regained their composure in view of continued strong fundamental corporate and economic data. In economic news, the annual pace of US GDP growth was broadly steady at 2.5% in the fourth quarter. The labour market remains strong, with jobless claims continuing to trend lower. Strong job prospects and tax reform are supporting consumer confidence, which this month reached its highest level since 2000. At a sector level, IT proved to be the best performer which surprised many analysts who expected it to be a victim in the correction, given relatively high valuations and recent strong performance. The energy sector by contrast was the weakest performer with rising shale oil production in the US continuing to concern investors who worry about the outlook for the oil price. Commodity markets had a disappointing month with Brent crude oil falling towards $65 per barrel. Natural gas and precious metals also retreated as the US dollar gained ground against a basket of emerging market currencies. The telecom sector was also weak on continued industry pricing pressure

The broader Bloomberg commodities index lost -2.31% for the month of February, dragged lower mainly by natural gas (-11.60%), Brent Crude (-6.04%) and silver (-5.76%) in ZAR terms. Wheat surged (6.16%) and nickel gained (0.80%). Meanwhile, precious metals surrendered 3.13%, platinum lost 2.08% and gold lost 2.34%.

On a total return basis, the technology sector was the top-performing sector for the month of February returning +0.20% in USD, +3.4% in GBP and -0.40% in ZAR. The top-performing sector over a one-year period remains the technology sector, returning +34.40% in USD, +21.40% in GBP and +21.30% in ZAR. The worst-performing global sector for the month was the energy sector returning -10.60% in USD, -7.80% in GBP and -11.20% in ZAR. Furthermore, the worst-performing global sector over a one-year period was real estate, returning -8.00% in USD, -16.90% in GBP and -16.90% in ZAR.

In rand terms, developed market equities (-4.71%) outperformed emerging market equities (-5.17%) for the month. In USD, the MSCI World lost 4.14% and the MSCI Emerging Markets Index gave up 4.61% for the month. Developed market property fell -6.70% in USD, underperforming bonds, which lost 0.89% in USD. Developed market indices in ZAR terms were mainly negative across the board for the month of February. The rand strengthened against the US dollar (-0.66%), the Australian dollar (-4.81%), the pound sterling (-3.90%) and the euro (-2.73%). The Euro Stoxx 50 (-7.16% in ZAR, -6.61% in USD and -3.61% in GBP), the Nikkei (-2.79% in ZAR, -2.21% in USD and +0.93% in GBP), the Dax (-8.23% in ZAR, -7.69% in USD and -4.73% in GBP), the NASDAQ (-2.32% in ZAR, -1.74% in USD and +1.42% in GBP), the CAC 40 (-5.72% in ZAR, -5.16% in USD and -2.12% in GBP) and the S&P 500 (-4.25% in ZAR, -3.69% in USD and -0.60% in GBP) all closed lower in ZAR terms. In emerging markets, China's Shanghai Composite index gave up 6.00% in its base currency (-7.15% in ZAR, -6.60% in USD and -3.61% in GBP), the Brazilian Bovespa equity added 0.52% in its base currency (-2.59% in ZAR, -2.01% in USD and +1.13% in GBP) and the Indian Nifty lost -4.85% in its base currency (-7.65% in ZAR, -7.10% in USD and -4.12% in GBP). The Argentinean Merval Index fell 6.93% in its base currency (-9.79% in ZAR, -9.26% in USD and -6.35% in GBP) and the Nigerian All Share Index lost -2.28% in its base currency (-2.73% in ZAR, -2.15% in USD and +0.99% in GBP). The US dollar strengthened against both the euro (-2.10%) and the British pound (-3.23%).

Spot Rates	28 February 2016	29 February 2017	28 February 2018
EUR/USD	1.09	1.06	1.22
GBP/USD	1.39	1.24	1.38
USD/JPY	112.42	113.10	106.68

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