SIMEKA CONSULTANTS & ACTUARIES

MARKET INSIGHT

Autumn 2015

Shares made a strong start in the first quarter of 2015 as the FTSE/JSE All Share Index increased by 5.9%. Bonds increased by 3.0% over the quarter, listed property closed up 11.6% and the money market added 1.5% for the period. Globally, shares went up 8.6% and bonds 3.9% in Rand terms for the quarter. The investment returns for domestic equity and bonds were negative in March after a strong start to 2015.

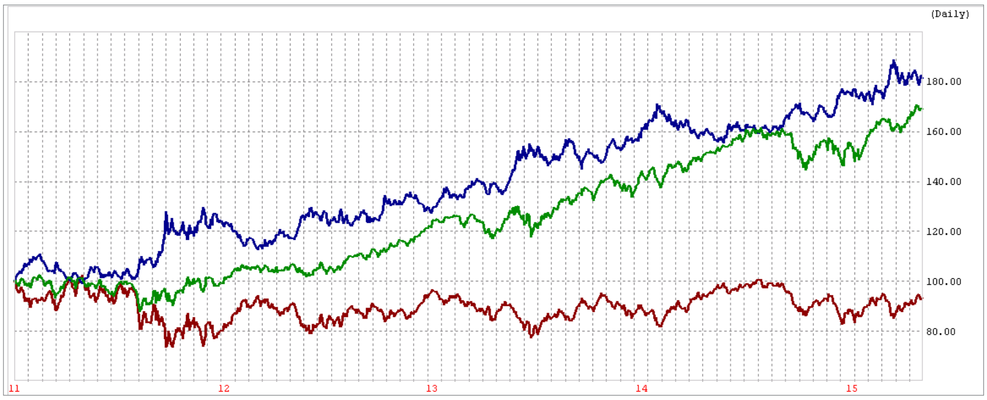
The annualised investment return for our shares for the past three years is 23.4% and for five years is 22.2%. However, in US Dollar the share prices increased by only 2.5% per year for the past three years and 5.3% per year for the past five years.

Theoretically, South Africans and foreign investors should get the same return from the JSE if the currency (Rand/Dollar exchange rate) remains stable. If the exchange rate weakens (e.g. from R11 to R12), foreign investors get a lower return from the JSE than South Africans do and if the exchange rate strengthens, foreigners get a better return from the JSE than South Africans.

The graph that follows shows that the FTSE/JSE All Share Index in US Dollar (brown) does not follow the FTSE/JSE All Share Index in Rand (blue). In fact, the Rand/Dollar exchange rate (green) seems to explain the increase to the FTSE/JSE All Share Index in Rand (blue) better.

FTSE/JSE All Share Index | ZAR/USD | FTSE/JSE All Share Index in USD

(based to 100)



The reasonable conclusion is that increases to the FTSE/JSE All Share Index for the past five years were not driven by earnings growth and fundamentals in South Africa as much as the weakening of the Rand to the US Dollar.

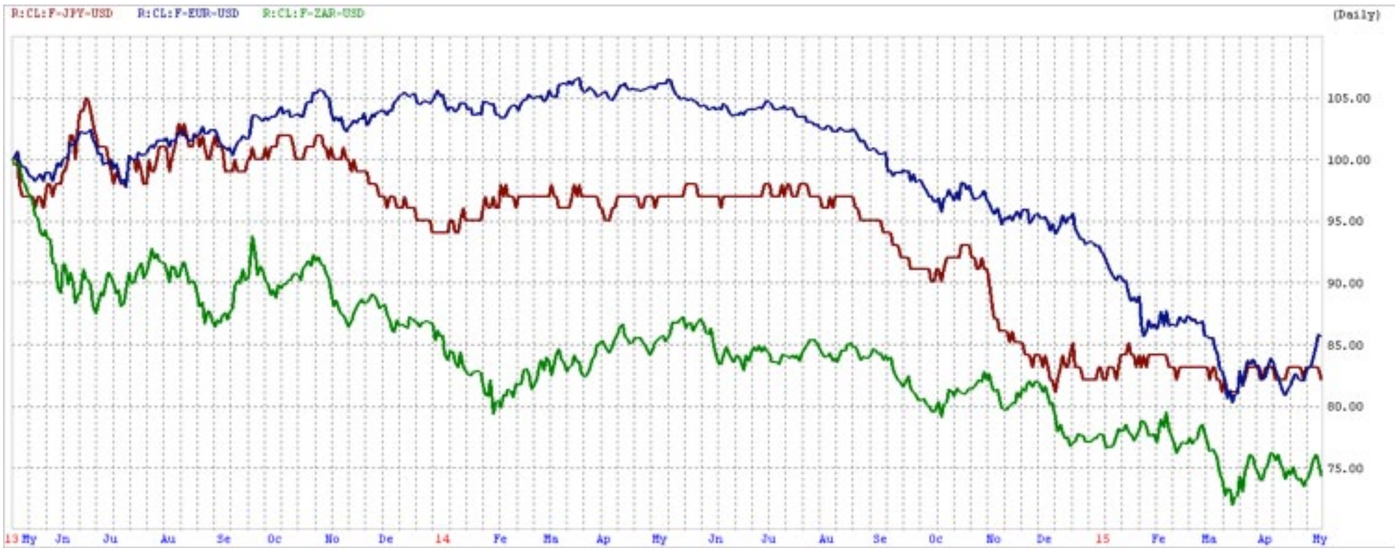
This means that:
- investors should follow the Rand/Dollar exchange rate as indicator to the likely future performance of shares;
- share prices are likely to go up as long as the Rand weakens against the Dollar; and
- share prices could experience headwinds if the Rand strengthens against the Dollar.

The Rand is notoriously difficult to forecast with any degree of confidence. The trend in recent years, where the Rand weakened to R12.50 from R6.75 to the US Dollar in 2011, has more to do with the enduring strength of the US Dollar than weakness in the Rand.

The US Dollar strengthened against the major currencies in the world.

Yen in brown Euro in blue ZAR in green

(based to 100)



The Euro appears to be weakening as much as the US Dollar is strengthening. The European Central Bank is presently expanding money supply and liquidity in an attempt to stimulate growth. The higher money supply and liquidity has made the already weak Euro even worse. This has led to share prices in Europe rising, with a possible spill over into emerging share markets such as South Africa.

The key to understanding the likely direction of share prices therefore seems to be to understand the future of the US Dollar.

The US Dollar has been strengthening for five main reasons:
- steady economic recovery in the US is expected to continue for the foreseeable future;
- economic growth elsewhere in the world is slowing (e.g. Europe, China, Japan);
- confidence in the considered management of US monetary policy;
- the US Dollar remains a safe haven in times of geo-political turmoil; and
- there is no viable safe haven alternative to the US Dollar presently.

What could possible derail the strengthening of the US Dollar?
The most obvious factor that comes to mind is that growth in the US slows possibly as the Federal Reserve in the US increase interest rates and look to reduce the excessive liquidity in markets. This could affect other markets around the world as well.

A further aspect that could derail the strengthening US Dollar is recovery of major economic nodes in the world, e.g. Europe and Japan. As economic growth in the world powerhouse China continues to slow, it is difficult to foresee events that would result in significant growth elsewhere.

Yet another factor that could possibly derail the strengthening US Dollar, is change to the political landscape and how that affects US economic policy. A major change in the short-term appears to be unlikely.

It is more likely that the US Dollar will continue to strengthen to the extent that underlying fundamental factors do not support its level anymore and from there adjust downward toward fair value.

We believe that Dollar strength is likely to continue in the short-term and on that basis, that South African share prices would continue to remain at high levels. We realise that expectations of high share prices based on mediocre fundamental factors lead to a risk of sharp adjustments to share prices down the line.

The ideal investment strategy at present may therefore be to remain invested in share portfolios or balanced portfolios with high exposure to shares to benefit from rising share prices, but to take steps that would limit the impact of share prices possibly falling on the portfolio.

Investment managers sometimes implement these strategies in portfolios and it is important for retirement funds to make such investment portfolios available to members, particularly those whose investment horizons are shorter because of impending retirement.

The investment returns achieved by investment managers during the first quarter of 2015 improved from the previous quarter. Most asset classes contributed positively, with the exception being resource shares. Investment managers with a high allocation to shares, but low exposure to resource shares, performed well.

The average investment return achieved by the risk profile peer groups below shows a normal dispersion with higher risk (aggressive) portfolios being rewarded for the additional risk included in the portfolios.

AVERAGE INVESTMENT RETURN OF RISK PROFILE PEER GROUPS TO MARCH 2015

	3 months	1 year	3 years	5 years
Guaranteed	4.0%	18.5%	17.3%	13.5%
Conservative	4.5%	13.4%	17.1%	16.5%
Moderate	5.4%	15.4%	20.8%	19.4%
Aggressive	6.2%	17.1%	23.5%	21.7%

The investment returns for investments in South Africa largely shaped by changes to the value of the Rand's exchange rate to larger currencies such as the US Dollar and Euro. It is important to understand investments or withdrawals made by global investors and how that affects our financial markets.

It is not surprising those investment managers who rely more on a bottom-up valuation process than a top-down macro assessment outperforms its peers presently. Market conditions are such that macro factors such as currency and liquidity appears to be more important than fundamental valuations.

To March 2015 Investec Balanced still dominates the peer group for global balanced portfolios with the best performance for both the quarter (9.5%) and the 12-months (20.3%) and for the 3-year period with performance of 20.6% p.a. For the 5-years Investec Balanced ranks 3rd in the global balanced peer group with performance of 16.8% p.a. OMIGSA Macro Solutions and Coronation remain safe choices.

TOP AND BOTTOM QUARTILES OF GLOBAL BALANCED FUNDS TO MARCH 2015

	3 months	1 year	3 years	5 years
Top quartile	Investec	Investec	Investec	Coronation
	OMIGSA Macro Solutions	OMIGSA Macro Solutions	Coronation	Foord
	Momentum	Coronation	Prudential	Investec
Bottom quartile	Allan Gray	Oasis	Allan Gray	ABSA
	Oasis	Allan Gray	ABSA	Momentum
	ReCM	ReCM	ReCM	ReCM

ReCM has been underperforming consistently for an extended period now and only those with the ability to sustain the protracted underperformance will not be concerned. In the bottom quartile of the global balanced peer group, one also finds the names of bottom-up valuation stalwarts such as Allan Gray and Oasis. This indicates that the investment style (e.g. value vs. momentum) are important presently.

One should take care not to react too drastically even though valuation based portfolios underperform presently. These Investment managers have established their pedigree in the past and cannot be ignored.

Cape Town

Simeka House
The Vineyards Office Estate
99 Jip De Jager Drive
Bellville 7530
Tel: +27 (0) 21 912 3300

Durban

1st Floor, Northwing
2 Cranbrook Crecent
Douglas Saunders Drive
La Lucia Ridge 4051
Tel: +27 (0) 31 566 2302

Pretoria

3rd Floor, Podium at Menlyn
43 Ingersol Road
Cnr Lois and Atterbury Road
Menlyn 0181
Tel: +27 (0) 12 369 8800

Sandton

Building 2 Alice Lane
11 Alice Lane
Sandton 2196
Tel: +27 (0) 11 263 4300

www.simekaconsult.co.za | info@simekaconsult.co.za