SIMEKA CONSULTANTS & ACTUARIES

MARKET INSIGHT

Quarter 1 of 2015

It's all about energy!

It is all about energy! In South Africa two energy related themes are presently playing out, one positive and one negative.

First, the positive, the **oil price** has dropped from a level above US$100 per barrel to below US$50 per barrel in a very short time. Several reasons are advanced for the drop, firstly the large scale switch from oil to gas in Europe and North America and the unlocking of new sources of oil and gas sources all around the world. The second reason for the dramatic drop in the oil price is a fall in demand from world powerhouse China.

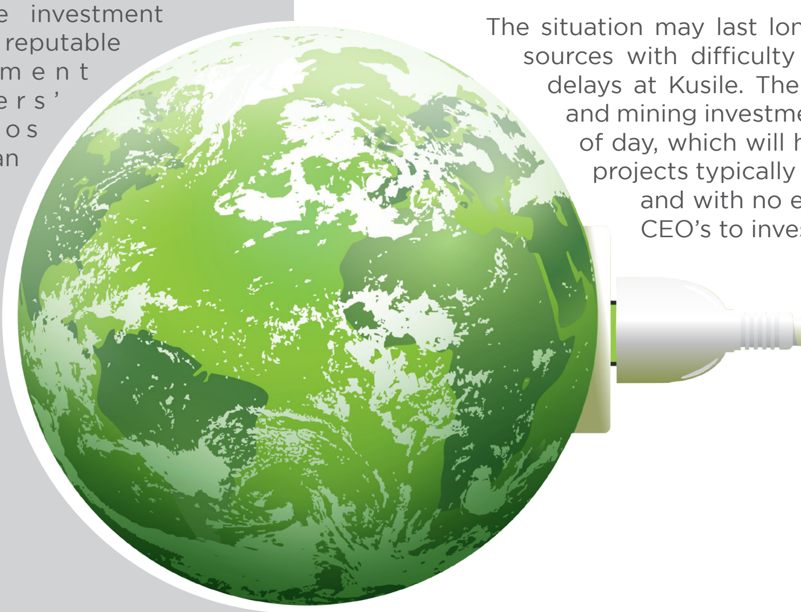
The lower oil price makes many new projects that are being developed (e.g. Sasol's US$7 billion project in Lake Charles in Louisiana, USA) less profitable or even unprofitable. The effect could be seen in the Sasol share price which until recently was a favourite investment in many reputable investment managers' portfolios (e.g. Allan Gray).

The difficult question is whether the oil price can go even lower (it doesn't appear all that likely); or how long it can remain at under $US50 per barrel.

The low oil price has a positive effect on the South African economy. Not only does it cut down on the monthly household fuel bill, but also if businesses pass the effect lower fuel price on to consumers, it will put more disposable cash in the pockets of consumers. This will be positive for our economy.

The second theme is the negative one, where Eskom finds it difficult to provide South Africa consistent and stable access to **electricity**. Based on information published by Eskom, we estimate that in a worst-case scenario, without running the diesel generators, demand for electricity may exceed supply by as much as 17%. Running the cash guzzling diesel generators changes the scenario slightly, but demand could still exceed supply by 10%.

This is negative for the South African economy. Loadshedding, when implemented in phase 2 or 3, could shave off a significant portion of the 2.3% GDP growth for 2015 that has been forecast for South Africa.



The situation may last longer than we are led to believe by official sources with difficulty bringing Medupi online and construction delays at Kusile. The worst part of this is that many industrial and mining investment opportunities will likely not see the light of day, which will have an effect over the longer term. Mining projects typically require more than 10 years making a return and with no electricity surety, it will be more difficult for CEO's to invest capital.

A further issue that should be noted is developments in **currency markets**. While the US$ remains strong, the Euro continues to weaken. The Swiss de-coupled the Swiss Franc from the Euro and caused havoc in currency markets overnight. This is related to the large scale of quantitive easing, increases in money supply, and low growth scenario in Europe, which lowers the relative value against other currencies. Europe is still an important trade partner for South Africa and it makes exports to Europe less competitive. This may support the SA bond and equity market to some extent though.

The Russian Ruble has weakened by more than 80% in 2014. This reflects the difficult economic circumstances prevailing in Russia. While this may not necessarily affect South Africans directly, there is still the risk of contagion when investors wish to withdraw from emerging markets as in 1998.

In 2014 the initial strong performance provided by shares gave way to a more modest 10.9% increase for the year by the FTSE/JSE All Share Index. The performance to the second half of 2014 was -0.8%. The more conservative FTSE/JSE Shareholder Weighted Index, which has a lower weighting to Resources companies, provided an annual return of 15.4% and 3.2% in the last half of 2014. Amongst the first tier sectors resources were down by -14.7% for the year (-25.1% for H2 of 2014), Industrials were up by 7.0% for the year and Financials by 27.3%. A defensive approach to the domestic share market would have worked best in these circumstances. Star performing sectors during the year include Food Producers (+43.0%) and Pharmaceuticals (+42.6%).

The domestic interest-bearing market provided a comfortable 10.2% return in 2014. Despite the negative return in December, bonds fared well as the likelihood of lower inflation is discounted into bonds prices.

The Rand closed 2014 at R11.45 to the US$, which means that the Rand depreciated by 10.6% during the year. Barring unforeseen events, we expect relative stability to prevail on this front.

Investment returns achieved by asset managers are presently more modest than the investment returns achieved in the past. This is mainly the result of economic reality (slow growth) catching up with overheated share prices.

The average investment return achieved by the risk profile peer groups below shows that smoothed bonus guaranteed portfolios still achieved better investment returns over the last year than risk seeking portfolios, largely as a result of the reserves of positive investment returns built up over the past two years, being released presently.

AVERAGE INVESTMENT RETURN OF RISK PROFILE PEER GROUPS TO DECEMBER 2014

	3 months	1 year	3 years	5 years
Guaranteed	3.8%	18.9%	16.0%	12.2%
Conservative	1.4%	8.8%	12.8%	11.8%
Moderate	2.2%	9.3%	13.6%	12.3%
Aggressive	1.7%	10.3%	17.6%	15.3%

In the fourth quarter of 2014, risk assumed by investment managers was not rewarded as moderate portfolios (e.g. absolute return portfolios) achieved better investment returns than aggressive balanced portfolios.

The changes in the investment environment resulted in significant shifts in the relative positioning of results achieved by bellwether investment managers. The sudden drop in the oil price affected the Sasol share price by -30% in the fourth quarter of 2014 and by approximately -45% from its top in June 2014 to its low in January 2015. The results produced by investment managers with large exposure to Sasol, a popular selection amongst value investment managers, were generally weaker than the results of investment managers with low or no exposure to Sasol. Typically, the FTSE/JSE Shareholder Weighted Index has 2.6% exposure to Sasol, while Allan Gray Equity's exposure to Sasol was 10.3% in December 2014.

For this reason, Allan Gray Global Balanced Fund, a popular choice in a member choice environment, slipped down the relative rankings in December 2014 with a return of -0.85% for the quarter and 10.3% for the year. For the same period, Coronation Managed Portfolio achieved 2.5% over the quarter and 11.2% for the year.

In the peer group Investec Balanced achieved the best performance for both the quarter (4.2%) and the year (13.3%). Foord Balanced achieved commendable investment returns (3.2% for the quarter and 11.0% for 2014).

TOP AND BOTTOM QUARTILES OF GLOBAL BALANCED FUNDS TO DECEMBER 2014

	3 months	1 year	3 years	5 years
Top quartile	Investec	Investec	Coronation	Coronation
	OMIG Macro Solutions	Oasis	Foord	Foord
	Foord	OMIG Macro Solutions	Prudential	Prudential
Bottom quartile	Prudential	Allan Gray	Allan Gray	OMIG Macro Solutions
	Allan Gray	Stanlib	ABSA	Momentum
	Re CM	Re CM	Re CM	Re CM

Foord and Coronation consistently appear in the top quartile and Re CM and Allan Gray consistently appear in the bottom quartile.

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