MARKET INSIGHT

SIMEKA
member of Sanlam group

Solutions for
Retirement • Actuarial • Investments • Health • Wealth

Winter 2017

The Reality of Single Digit Investment Returns

During the past six months, global investments were directed to emerging markets where the theme that prevailed was a search for earnings growth at reasonable valuations.

Two areas in the world produced good investment returns: Middle-Europe is home to many of the top performing stock exchanges (in USD) with Latvia, Greece, Ukraine, Poland, Bulgaria and Austria showing healthy increases. Southeast Asia also experienced strong growth in share prices (in USD) with notable contributions from South Korea and Taiwan. The best performing share market, however, was in Venezuela where the USD increase of the market exceeded 280% for the six months to June 2017.

Table 1: Investment returns to June 2017 in USD

	United States	Greece	Poland	South Africa	South Korea	Taiwan	Turkey	Venezuela
3 months	2.6%	15.3%	10.9%	2.3%	8.0%	5.6%	16.6%	181.4%
Year to date	8.2%	17.9%	31.5%	8.3%	24.4%	19.2%	29.4%	289.8%
1 year	15.5%	47.6%	45.9%	14.4%	22.2%	27.3%	6.9%	860.8%

South Africa's sovereign credit rating for foreign and domestic debt was either downgraded, or put on negative watch-status by the various ratings agencies. Following the downgrade of South Africa's sovereign debt, many corporate debt ratings were downgraded as well. This affected South African banks especially as these institutions' ratings are capped by the rating of the country.

Despite the downgrades, the exchange rate of the Rand strengthened by approximately 3% to quarter-end; largely because of foreign investment in South African bonds through carry-transactions, (week-by-week re-purchase agreements). Foreign investors invested net R31 billion in domestic bonds, partially offsetting the net R70 billion shares that had been sold.

Some reasons for foreigners selling South African shares appear to be concerns about:

- poor economic growth prospects;
- economic policy concerns, e.g. Mining Charter and questions about the Reserve Bank's independence; and
- governance concerns.

The exchange rate of the Rand remains vulnerable to these concerns. **Graph 1** shows that the Rand can weaken to R14.30 to the USD without reversing the trend.

At the halfway mark of 2017, South African financial markets continued to perform poorly.

Graph 1: Rand/Dollar Exchange Rate

- Investors earned a return of 3.4% on the FTSE/JSE All Share Index for the half-year.
- The BEASSA All Bond Index' return was 4.0% for the half-year.
- The STeFi Composite Index (money market) posted a return of 3.7% for the half-year.
- Listed property achieved a half-year return of 2.3%.
- Global shares achieved a Rand-gain of 5.9% and global bonds a Rand-loss of -0.4% for the half-year.
- The exchange rate of the Rand strengthened by 4.8% for the six months to June 2017.

Graph 2 shows that investment returns for the 12-months to June 2017 are not significantly better and in some cases, even worse.

The present outlook for South African shares depend on the future direction of the Rand exchange rate and South African economic conditions. Many investment managers build their share portfolios by including Rand-hedge industrial shares. These shares (for example Naspers and BAT) perform better when the Rand exchange rate weakens, but underperform when the Rand remains relatively strong. Many of these shares are already expensive.

Some other shares that do not enjoy Rand-hedge status, are under-appreciated, showing concerns about South African manufacturing, consumers and services.

The investment returns of the risk-based peer groups for balanced portfolios are as follows:

Graph 2: Investment returns to June 2017 in Rand

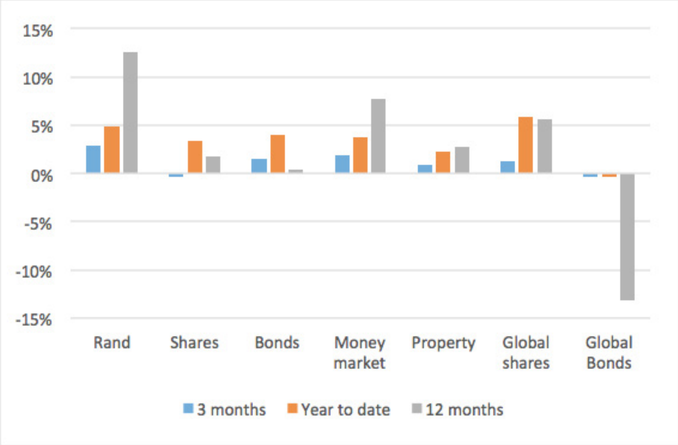

Table 2: Peer group investment return to June 2017

Peer group	3 months	1 year	3 years	5 years	Year to date
Guaranteed funds	1.7%	7.2%	10.8%	12.8%	3.3%
ASISA Multi Asset Low Equity	0.6%	2.1%	4.9%	9.4%	2.9%
ASISA Multi Asset Medium Equity	0.9%	3.6%	5.9%	8.6%	3.0%
ASISA Multi Asset High Equity	-0.1%	1.5%	4.9%	10.2%	2.4%

Guaranteed smooth bonus funds now outperform the ASISA balanced fund averages for all periods shown in **Table 2.** These funds provide a valuable haven in difficult market conditions, but investors should take care to understand the guarantees and how these funds work.

The top and bottom quartile of large balanced investment portfolios are shown in **Table 3**.

Table 3: Top and bottom quartiles of global balanced funds to June 2017

	3 months	1 year	3 years	5 years	Year to date
Top quartile	Investec	Sanlam	Investec	Investec	Coronation
	Foord	Prudential	Allan Gray	Prudential	Sanlam
	Sanlam	OMIG	Prudential	Allan Gray	OMIG
Bottom quartile	Coronation	Foord	ABSA	Stanlib	Stanlib
	ABSA	Stanlib	Stanlib	ABSA	ABSA
	Oasis	Oasis	Oasis	Oasis	Oasis

It is interesting to see Coronation in the bottom quartile for the 3 months to June 2017, but at the top for the half-year to June 2017. In the recent past, the top quartile contains investment managers that use a pragmatic value approach. The bottom quartile contains the same investment managers consistently.

Even though challenging conditions prevail in financial markets presently, we expect an improvement going forward. However, it is prudent to maintain a cautious outlook presently as the reality of single digit investment returns bite.

Marcus Rautenbach
Principal Investment Consultant