MARKET INSIGHT

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Summer 2018

Three recent events are likely to impact our financial environment.

Naspers and Steinhoff International

The Naspers share price rocketed to R4 090 per share before pulling back to R3 282 per share. Its market capitalisation (number of shares in issue times share price) peaked at R1 710 802 million and came down to R1 421 245 million, some R289 557 million lower. Also, Steinhoff International announced that it could not release its annual financial statements as a result of accounting irregularities and its market capitalisation fell from R242 465 million on 30 November 2017 to R25 858 million on 8 December 2017, a loss of R216 607 million.

Free education

Without informing Cabinet and National Treasury, and without reference to the Heher Commission report on the matter, President Zuma announced free higher education for those South Africans who cannot afford it. Admirable as it may be, it is unclear what the funding requirement is likely to be, how it will work or where the money will come from. University vice chancellors reiterated that "walk-in" registrations would not be accepted and a variety of political role players immediately volunteered to assist these so-called "walk-ins" with registration. With this much uncertainty in the process and the propensity of students to protest virulently, the opening of the academic year could create some difficulty.

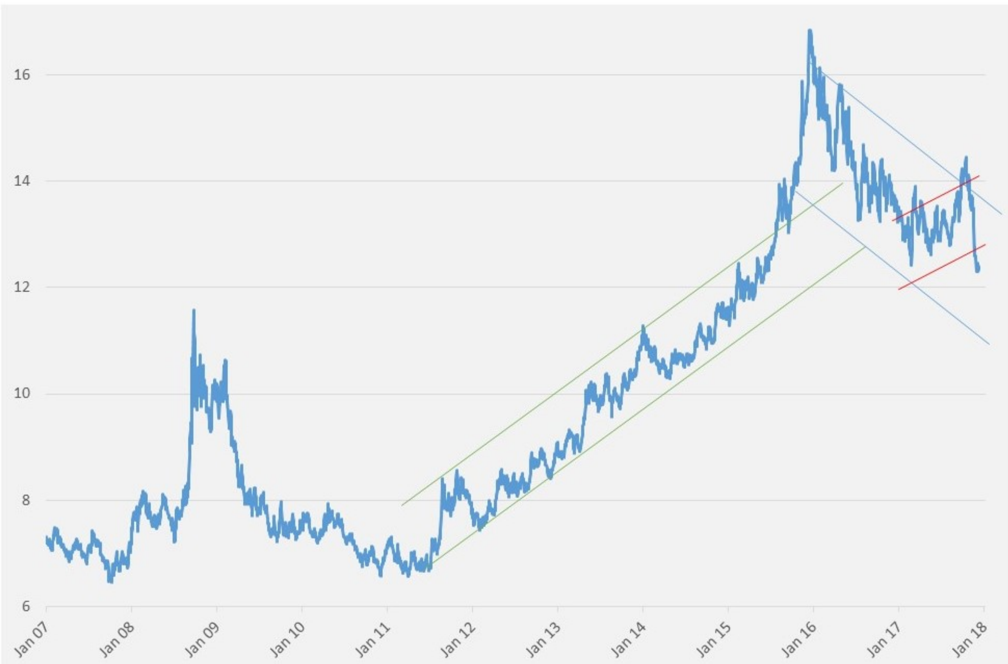
Political leadership

The African National Congress elected its leaders for the next five years with Deputy President Cyril Ramaphosa being elected as President of the party. The collective leadership represents broad interest groups from within the movement and it is not yet clear how future policies will differ from existing policies. The rand/US dollar exchange rate strengthened from R14.45 in November to R12.60 in December 2017.

We believe that the direction of the rand exchange rate will be crucial in 2018 (see graph 1). Generally, a strong rand translates into mediocre price performance on the JSE, while a weak rand supports a rising market. As things stand at present, perceptions are that Government policies and governance of state-owned enterprises will improve and have a positive impact on economic growth.

It is unclear how these expectations will be met in the short term. It does appear that there may be a risk of rand weakening if political direction is not clear and consistent throughout 2018.

*Graph 1: Rand per US$



The possibility of student protests at the opening of the academic year may also change perceptions about social stability in South Africa.

In 2017, the best performing asset class generally available to retirement funds was domestic shares (see table 1). The TOPI40 Index achieved a 23.1% return for the year, largely driven by the performance of large rand hedge shares such as Naspers and CF Richemont. Global equity performed well in rand terms, despite the strong performance of the rand towards year-end. Domestic bonds recovered well in December and delivered an investment return of 10.2% for the year. With the exception of the Small Cap Index and the Mid-Cap Index, all equity indices performed better than interest-bearing investments in 2017.

2010	2011	2012	2013	2014	2015	2016	2017
Mid CAP 30.3%	Gl IB R 28.8%	FINI 38.1%	Gl Eqt R 57.0%	FINI 27.3%	GL Eqt R 34.6%	RESI 34.2%	TOPI40 23.1%
PROP 29.6%	Gl Eqt R 15.8%	INDI 36.5%	Sm CAP 26.3%	PROP 25.1%	Gl IB R 30.8%	Mid CAP 26.9%	ALSH 21.0%
Sm CAP 24.7%	PROP 8.9%	PROP 35.9%	TOPI40 22.8%	Sm CAP 20.6%	PROP 10.8%	Sm CAP +20.9%	FINI 18.4%
INDI 24.0%	ALBI 8.8%	Mid CAP 29.5%	INDI 21.5%	Mid CAP 19.6%	STeFi 6.5%	INDI 19.3%	RESI 17.9%
ALSH 19.0%	FINI 7.4%	Sm CAP 29.0%	ALSH 21.4%	GL Eqt R 16.7%	ALSH 5.1%	ALBI 15.5%	PROP 17.2%
TOPI40 17.2%	STeFi 5.7%	ALSH 26.7%	Gl IB R 20.0%	GL IB R 11.3%	TOPI40 4.2%	PROP 10.2%	INDI 16.9%
FINI 16.6%	Mid CAP 4.7%	TOPI40 26.1%	FINI 19.1%	ALSH 10.9%	FINI 3.9%	FINI 7.4%	GL Eqt R 11.3%
ALBI 15.0%	ALSH 2.6%	Gl Eqt R 21.8%	Mid CAP 13.0%	ALBI 10.2%	ALBI -3.9%	STeFi 7.4%	ALBI 10.2%
RESI 12.3%	TOPI40 2.2%	ALBI 16.0%	PROP 8.4%	TOPI40 9.2%	Sm CAP -3.9%	ALSH 2.6%	STeFi 7.5%
STeFi 6.9%	Sm CAP 1.1%	Gl IB R 8.6%	STeFi 5.2%	INDI 7.0%	Mid CAP -7.5%	TOPI40 -1.6%	Mid CAP 7.4%
Gl Eqt R 0.5%	INDI -3.4%	STeFi 5.5%	RESI 1.4%	STeFi 5.9%	INDI -10.1%	GL Eqt R -4.2%	SM CAP -1.0%
Gl IB R -5.6%	RESI -6.5%	RESI 3.1%	ALBI 0.6%	RESI -14.7%	RESI -37.0%	GL IB R -9.6%	GL IB R -2.9%

*Table 1: Asset class ranking of investment returns from 2010 to 2017

Even though most asset classes produced satisfactory investment returns for 2017, the longer-term investment returns remain lower than the investment returns for the past year. For the three-year period to 31 December 2017, only global equities (in rand) performed better than the commonly used investment objective of 5.5% above inflation after fees, assuming that fees are 0.8% p.a. on average (see table 2).

For the five-year period to 31 December 2017, only listed property and global equity (in rand) performed better than the commonly used investment objective of 5.5% above inflation after fees, again assuming fees to average 0.8% p.a.

*Table 2: Investment returns

To 31 December 2017		MRQ %	1 year % p.a.	3 years % p.a.	5 years % p.a.
FTSE/JSE All Share Index	59 804.9	7.4%	21.0%	9.3%	11.9%
Capped SWIX Index	19 648.1	8.4%	16.5%	8.0%	11.9%
Listed property	2 463.9	8.3%	17.2%	11.7%	13.9%
Bonds	8.815%	2.2%	10.2%	6.9%	6.3%
Money market	7.5%	1.8%	7.5%	7.1%	6.5%
Global equity (ZAR)	8 466.3	-3.5%	11.3%	12.8%	21.3%
Global bonds (ZAR)	484.73	-7.7%	-2.9%	4.7%	8.9%
Rand per US$	R12.3763	9.5%	10.6%	-2.5%	-6.4%
Inflation (November 2017)	4.6%	0.9%	4.6%	5.6%	6.1%

It is clear that the quantum of fees paid to investment managers has a material impact on the ability of retirement funds to achieve an investment return of 5.5% after inflation and fees.

Retirement funds will have had to rely on the active returns added by investment managers to meet the commonly used investment objective of 5.5% above inflation after fees. The investment returns of the risk-based peer groups for balanced portfolios are as follows (table 3):

**Table 3: Peer group investment returns to December 2017 (gross of fees)

Peer group average	MRQ %	1 year % p.a.	3 years % p.a.	5 years % p.a.
Guaranteed Funds	2.2%	7.5%	9.5%	12.4%
ASISA Multi-Asset Low Equity	1.5%	8.3%	6.6%	8.0%
ASISA Multi-Asset Medium Equity	1.7%	9.3%	6.2%	8.6%
ASISA Multi-Asset High Equity	2.1%	9.8%	6.3%	9.3%
Top 10 Global Balanced Funds	2.1%	10.1%	7.0%	10.3%

None of the peer group average returns exceed inflation by 5.5% after costs over any of the periods reflected in table 3.

The top and bottom quartiles of large balanced investment portfolios are shown in table 4.

**Table 4: Top and bottom quartiles of global balanced funds to December 2017

	3 months	1 year	3 years	5 years
Top quartile	Old Mutual	Old Mutual	Investec	Investec
	Prudential	Coronation	Allan Gray	Allan Gray
	Allan Gray	Investec	Prudential	Prudential

	3 months	1 year	3 years	5 years
Bottom quartile	Oasis	Stanlib	Foord	ABSA
	SIM	Foord	Stanlib	Stanlib
	Foord	Oasis	Oasis	Oasis

Allan Gray, Investec, OMIG (over 1 year and less) and Prudential continued to dominate at the top of the table. The fall in the Naspers share price in the Most Recent Quarter (MRQ) and the fall in the Steinhoff International share price in December 2017 extracted a heavy toll from some of the investment portfolios (e.g. Foord and SIM).

Finally, themes we believe that are likely to prevail in 2018 include:

- continued strong performance of global equity markets, particularly emerging equity markets where technology is the major driving force;
- base metals and selected commodities;
- lower inflation;
- strengthening of corporate governance structures.

A level-headed approach is required for 2018!

*Data obtained from IRES INet
**Data for evaluation obtained from Morningstar

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