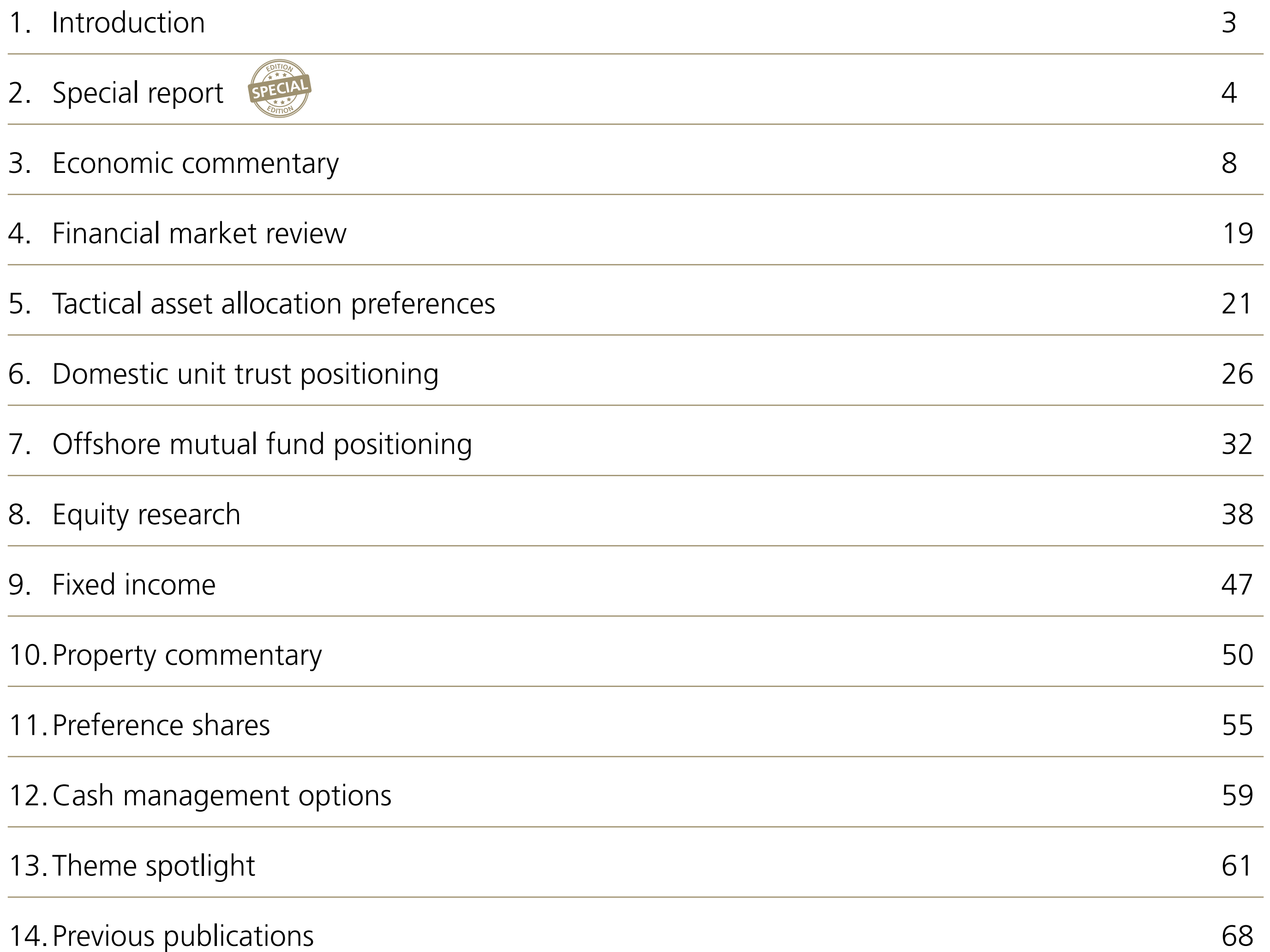
PSG Wealth

INVESTMENT RESEARCH AND STRATEGY REPORT

SUMMER 2017

PSG Wealth

Contents



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PSG Wealth

Introduction

From historic elections to flat markets: 2016 was a rough ride

From a historic election in the US and a referendum in the UK, to terror attacks in Europe, and South Africa which avoided junk status. These are just some of the events which caused volatility in markets last year.

The majority of the predictions we made for 2016 came to pass; others did not. We said the rand would strengthen against other major currencies. And during 2016, the rand strengthened by 12.62% against the USD, by 34.4% against the UK pound and 16.3% against the euro. We thought that growth would underperform value. In 2016, value stocks rose by 2.4% as measured by the S&P 500 Value Index, while the S&P 500 Growth Index dropped 1%. The MSCI EAFE Value Index (Developed markets excluding North America) outperformed the MSCI EAFE Growth Index by 8.3%, while value stocks in emerging markets outperformed growth by 7.6%.

We also believed that investors would lose money in the perceived safety of offshore bonds as yields normalise. And in rand terms, US treasuries generated a loss of 10.50% for the year before trading expenses. As is always the case in investments, no one can predict with certainty the outcome of events, especially political ones. And 2016 was filled with many political surprises on both the domestic and global fronts. Read our special report in which we talk more about the events that shaped markets in 2016 and what we expect for this year.

In the rest of the report our analysts and contributors also reflect on some of the events that contributed to market instability in the last quarter of 2016. We also consider the performances of local and international markets, as well as our own investment solutions.

We discuss the results of our spring survey in the theme spotlight article. Please also take part in our summer 2017 survey on the perceived value offered by the local market.

Our message has stayed the same as during volatile times last year. Stick to three core investment beliefs: manage expectations, adopt appropriate investment horizons and diversify. It is especially crucial to follow these beliefs in the months ahead.

We hope you enjoy the read. Please feel free to send us any feedback you might have – we always look forward to hearing from you.

Regards

Adriaan Pask
PSG Wealth Chief Investment Officer

How to navigate this document

You can navigate this document in two ways.

- **Links in table of contents:**
  Simply go to the table of contents page. Click on the headline of the article you want to read and enjoy.
- **Links on each page:**
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Special report

SPECIAL EDITION

2016: Year in review and look ahead

From historic events in an array of sovereign states to credit rating agencies which offered South Africa another reprieve. These events all had a part in market volatility last year.

Last year was filled with political surprises on both the domestic and global fronts. We also made a few predictions of what would happen in markets during 2016. Some of these materialised, others did not. No one can predict with certainty the outcome of events, especially political ones. The Finance Minister Pravin Gordhan faced criminal charges, which were later withdrawn. The former public protector, Thuli Madonsela, released her findings in the State Capture report.

This led to renewed calls for President Jacob Zuma to be replaced. And the main opposition party took control of some of the large metros in the country after the municipal elections in August.

As predicted the rand strengthened against the US dollar during the calendar year, while a rally in commodity prices helped domestic resources earn a total return of 34.2% for the same period. Read our 11 January Weekly Investment Update for some more information on the performance of the main asset classes in 2016.

While South Africa avoided a recession and being downgraded to junk status by rating agencies, our GDP growth forecasts were lowered substantially from previous periods. The monetary policy committee (MPC) of the South African Reserve Bank (SARB) did not raise rates as initially expected. Although local inflation did not near the 8% level, it did reach a high of 7% y/y in February 2016.

OUR EXPECTATIONS FOR 2016 WERE:

Prediction for 2016	Actual result
MPC reverts back to 0.50% rate hikes on the back of accelerating inflation	This materialised as the MPC raised rates in January by 50bps, but they soon reverted back to a 25bps pace in March, and then paused rates for the remainder of 2016.
Organisation of the Petroleum Exporting Countries (OPEC) meets before their scheduled meeting date in June to discuss lower prevailing oil prices and their pricing strategy for 2016	OPEC agreed to cut its collective output to 32.5 million barrels per day (mb/d), a cut of about 1.2 mb/d from October levels. But they leveraged those cuts to bring some key non-OPEC producers on board, including Russia, for an additional cut of about 600 000 barrels per day.
The rand strengthens against other major currencies	During 2016, the rand strengthened by 12.62% against the USD, by 34.4% against the UK pound and 16.3% against the euro.
Commodity prices move lower and bottom in 2016. As smaller producers are flushed from the industry, decreased supply improves the outlook for supply/demand dynamics in 2017	According to the World Bank, most commodity prices continued to rise in the third quarter from their lows in early 2016. Crude oil prices are forecast to rise to $55 per barrel in 2017 from an average of $43 per barrel in 2016. Metal prices are projected to rise more sharply in 2017 as a result of faster-than-expected mine closures.
Growth underperforms value	In 2016, value stocks rose by 2.4% as measured by the S&P 500 Value Index, while the S&P 500 Growth Index dropped 1%. The MSCI EAFE Value Index (Developed markets excluding North America) outperformed the MSCI EAFE Growth Index by 8.3%, while value stocks in emerging markets outperformed growth by 7.6%.
South Africa fails to avoid a recession. Leading indicators point to much tougher economic conditions for local manufacturers	South Africa avoided a technical recession as only one quarter of negative GDP growth was recorded and not two consecutive quarters, which generally constitutes a technical recession.
Inflation nears the 8% level as the pass-through effects of a weaker currency take effect	The rand strengthened very quickly during 2016. The impact of the weaker rand earlier in the year did not have as big an impact on inflation as initially expected. Inflation did, however, rise to as much as 7% in February.
Prime rates move above 11% as the MPC attempts to combat higher inflation	We expected the prime rate to rise by about 1.25%, but it actually only rose by 0.75% in 2016.

Special report

SPECIAL EDITION

Prediction for 2016	Actual result
The full-term budget informs us that everyone will be subject to higher taxes through higher income taxes, company taxes and VAT	The broader market expected that the state would be under pressure to raise taxes to make up for budget shortfalls. At the end of the day, we were all surprised by their reasonably stable tax policy.
Investors lose money in the perceived safety of offshore bonds as yields normalise	In rand terms, US treasuries generated a loss of 10.50% for the year before trading expenses.
The World Bank revises their global growth outlook upwards for 2017 and onwards	The World Bank recently stated that they projected global growth to rise to 2.7% in 2017.
European Central Bank (ECB) stimulus is more favourable than generally expected, as the ECB does whatever it takes to kick-start the Eurozone's economy	The ECB continued with their negative interest rate policy. This was decided in quarter four after weeks of silence from European Central Bank (ECB) president, Mario Draghi. He waited for a flurry of economic data before he made the ECB's policy decisions public.
China makes the most of a buyers' market in commodities and strengthens ties with Saudi Arabia and Iran	Chinese President Xi Jinping made state visits to both Saudi Arabia and Iran last year. Saudi Arabia and China also signed economic and military agreements.
The S&P 500 surprises with stronger-than-expected returns as the US economy marches on	The S&P 500 Index continued its strong performance, generating 11.96% for the year in US dollar terms. US unemployment declined and the US Federal Reserve hiked interest rates.
Japan continues to struggle regardless of current stimulus measures. More fundamental changes to the economic structure will be needed	Japanese growth fluctuated between 0.4% and 1.1% during 2016, well below the highs of 2.1% seen during 2015.

IN GLOBAL MARKETS AND BY HISTORIC STANDARDS, 2016 WAS A PRETTY MUNDANE YEAR

Although conditions were occasionally choppy, for the most part the markets were flat. The S&P 500 ended 2015 at 2 044, and remained flat throughout 2016, until the rally following the surprise victory of Donald Trump in the US presidential election, when it jumped generating 11.96% for the year. In Europe, the STOXX 600 began 2016 at 366, but ended lower at 359. Asia continued to paint a somewhat mixed picture with the Nikkei up 19.11% over the closing quarter of 2016, whereas the Hang Seng was down 5.52% over the same period.

The regime change that commenced with the US Federal Reserve's 0.25% rate hike in December 2015 continued with another 0.25% boost in December 2016. The prospect of rising rates has given many investors pause for thought. All the bond buying and stimulus has also come at a price: zero or, in many cases, negative interest rates. In fact, the central bankers' ongoing romance with negative interest rates is perhaps the most important story of 2016. Over time, the European Central Bank (ECB) kept rates even further into negative territory. By March 2016, deposit rates were down to -0.40%.

Negative rates became widespread in Europe, and were adopted in Germany, Denmark, Sweden, and Switzerland. In fact, Switzerland has maintained a target rate of -0.75% for some time. Similarly, the Bank of Japan (BOJ) began charging interest to deposited funds at a rate of -0.10% in January 2016, continuing that trend throughout the year. As for 10-year government bonds, Germany's opened the year yielding 0.63%, falling steadily to negative 0.19% by July, and rallying somewhat to finish the year in the positive column at about 0.36%.

Japan followed the same path. 10-year Japanese government bonds (JGBs) began 2016 at 0.26%, dipped to a low of -0.29% mid-year, only to recover to 0.09% in late December 2016.

In Switzerland, the 10-year bond yield started the year at -0.06%, fell to -0.63%, and also rebounded with the yield at -0.07% in December — essentially where it started. Much of that recovery occurred in the wake of Trump's victory in early November.

Special report

SPECIAL EDITION

IN 2017, WE EXPECT THE USUAL ECONOMIC PLAYERS WILL CONTINUE DOMINATING THE GLOBAL AND DOMESTIC MARKETPLACE

These include the world's largest economy, the US, and South Africa's largest trading partner, China. We also expect changes in Europe to dominate headlines, as government elections are planned for various countries on the continent in 2017.

OUR EXPECTATIONS FOR 2017 ARE:

- Domestic inflation will hover around 6% throughout the year.
- SA GDP growth will fluctuate between 0.5% and 1.5% for the year.
- The SA repo rate will remain between 6.5% and 7.5%
- The dispersion between the best performing stocks on the JSE and the worst performing stocks on the JSE will widen further.
- Value will continue to outperform growth .
- The top SA active equity managers will substantially outperform the index.
- SA corporate earnings will exceed inflation by at least 2%.
- The ALSI will materially re-rate its price-to-earnings ratio on the back of higher EPS .
- Offshore equities will outperform other traditional offshore asset classes.
- US treasuries will be under further pressure .
- US credit will outperform US treasuries.
- US GDP growth will breach the 2% level.
- US inflation will breach the 2% level.
- The US Federal Reserve will increase interest rates to around 1.5% during 2017.
- UK GDP growth will be under pressure.
- Reflation and growth in the developed world will support EMs.
- The ECB's monetary policy is likely to remain accommodative.
- 2017 elections will be less highlighted than 2016 elections.

OUR PRODUCT POSITIONING IN LIGHT OF THE STATE OF THE LOCAL AND GLOBAL ECONOMY

In light of the above, our local equity positioning remains as follows:

- underweight interest rate-sensitive stocks and assets
- underweight companies whose earnings rely heavily on domestic drivers
- overweight multi-national stocks
- overweight companies with strong balance sheets and healthy cash flows
- overweight firms that are expanding their operating margins and gaining market share
- cautious on expensive, quality companies

With regards to property, we remain of the view that the interest rate cycle will affect domestic economic strength, affordability and sentiment. In addition, other income-generating assets with positive correlations to interest rates will become increasingly attractive, placing further downward pressure on listed property.

Where we are required by mandate to hold listed property, we prefer to hold shares with the following characteristics:

- low price-to-book ratios
- low levels of debt/gearing and strong credit ratings
- utilisation of structures that offer superior liquidity, such as Real Estate Investment Trusts (REITs)
- superior distribution growth track records

We maintain our view that offshore equities remain attractive on a relative basis. The rand is trading much closer to our estimate of fair value, which makes offshore investing a lot simpler than 12 months ago. We are underweight offshore fixed interest as we believe that most of these asset classes do not sufficiently compensate investors for the inherent risks. We expect the Fed rate and bond yields to move towards normalisation during the course of the year.

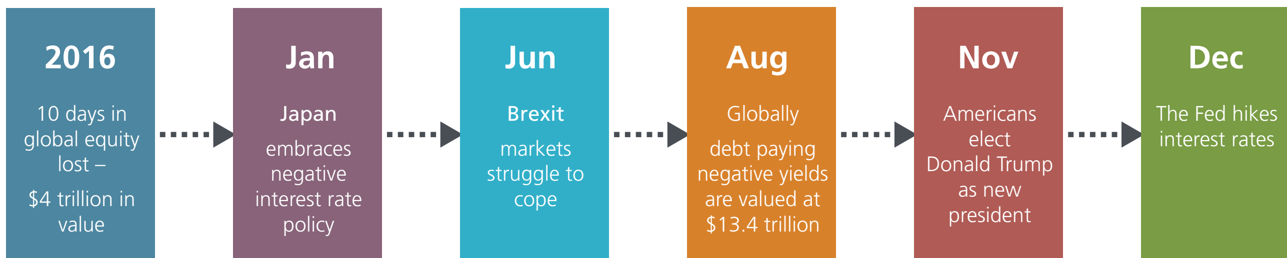
Considering all of this, it is likely that 2017 could be a mixed bag for asset class returns, which reinforces our argument to maintain a well-diversified portfolio.

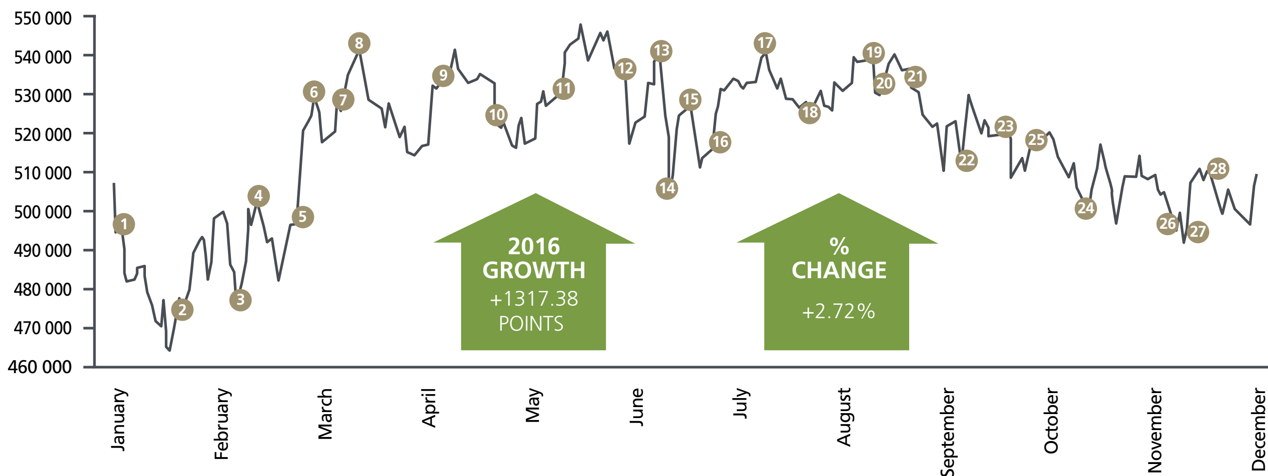
PSG Wealth

Special report

SPECIAL EDITION

EVENTS THAT SHAPED THE JSE IN 2016





January
- IMF downgrades global growth, fears of excess oil supply and S&P cites negative outlook for SA
- SAB and InBev merger concluded

February
- Dovish ECB, accommodative BoJ and Saudi Armaco calls the drop in oil prices 'irrational'
- Agreement to freeze oil output
- ZAR strength

March
- Commodity price run, SA weight uptick in MSCI EM and China do whatever necessary to support growth
- SA current account balance -5.1% of GDP, credit risk fears
- The Fed keeps rates unchanged with a cut in the number of hikes expected
- State capture allegations

April
- Improved Chinese trade data

May
- Dovish Fed, USD weakness and downgrade speculation

June
- SA credit rating unchanged
- Growth concerns persist, lacklustre economic data from China and Brexit fears
- Brexit vote

July
- EMs and commodity prices rally on hopes of ongoing loose monetary policies
- IMF cuts SA growth forecast to 0.1%
- Dovish Fed minutes, China set for 6.5% growth
- No Fed hike, stronger ZAR

August
- General municipal elections
- SARS wars

September
- SA GDP +3.3% q/q
- SA mining production -5.4% y/y, ECB discourages hopes of further stimulus, Oil sells off after Opec makes no formal decision
- Finance Minister Pravin Gordhan summoned

October
- Chinese PPI rises after 54 consecutive negative readings
- MTBPS, more hawkish stance makes Dec Fed hike more likely
- Charges withdrawn against Finance Minister followed by release of State Capture report

November
- Trump victory, commodities rally

December
- SA credit rating maintained
- Non-Opec oil producers cut oil output
- Fed raises rates by 25bps, more hikes likely in 2017

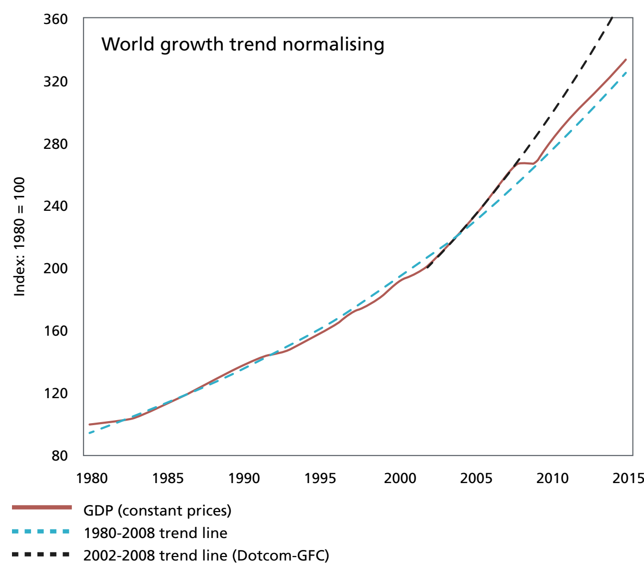
Economic commentary

The international political landscape weighs heavily on global economies

Events in the United Kingdom, Europe and the US shaped much of the prevailing economic conditions. Fortunately, economic conditions in the US seem to keep improving. This is positive as the US remains the main contributor to growth globally.

Globally, growth has slowed since 2010, but forecasts do point to moderate improvements in 2017. Although world growth is less than what was experienced in the period leading up to the global financial crisis (GFC), the current growth path is in line with (and actually marginally above) longer-terms trends. The last graph on the left-hand side of this page from the South African Reserve Bank (SARB) indicates the different projected world GDP trend lines.

Global potential growth and trend



Sources: SARB

Global and local inflation and GDP growth rates

Annual rolling inflation rate				GDP annual growth rate			
Date	SA	UK	USA	Date	SA	UK	USA
2014/03/31	6.05	1.73	1.54	2014/03/31	1.8	2.6	1.6
2014/06/30	6.61	1.91	2.01	2014/06/30	1.5	3.1	2.4
2014/09/30	5.92	1.26	1.66	2014/09/30	1.7	3.1	2.9
2014/12/31	5.31	0.54	0.69	2014/12/31	1.5	3.5	2.5
2015/03/31	4.05	-0.09	-0.02	2015/03/31	2.5	2.8	3.3
2015/06/30	4.74	-0.09	0.17	2015/06/30	1.2	2.4	3.0
2015/09/30	4.59	-0.18	-0.01	2015/09/30	0.8	1.8	2.2
2015/12/31	5.23	0.18	0.67	2015/12/31	0.5	1.7	1.9
2016/03/31	6.28	0.45	0.87	2016/03/31	-0.1	1.8	1.6
2016/06/30	6.27	0.45	1.05	2016/06/30	0.7	2	1.3
2016/09/30	6.12	0.89	1.48	2016/09/30	0.7	2.2	1.7
2016/12/31	6.6	1.2	1.7	2016/12/31	0.7	2.2	1.7
2017/03/31	6.6	1.4	2.0	2017/03/31	0.6	1.8	2.1
2017/06/30	6.5	1.5	1.9	2017/06/30	0.8	1.8	2.2
2017/09/30	6.0	1.7	2.1	2017/09/30	1.0	1.6	2.3
2017/12/31	5.9	2	2.3	2017/12/31	1.2	1.5	2.5
2020	4.7	2.7	2.5	2020	2.6	1.8	2.6

Trading economics | Actual
I-Net Bridge | Estimates

Source: I-Net Bridge, Trading Economics

PSG Wealth

Economic commentary

While we did not believe the US Federal Reserve (Fed) should have raised interest rates in December, this was however, the first glimpse of monetary policy normalisation witnessed in 2016. (See our special report on this topic here). Currently growth forecasts in the US point to a moderately expanding economy, which bodes well for global markets.

Increasing inflation in developed markets are indicative of growth, and this is likely to underpin policy normalisation going forward. Europe remained under pressure during 2016, and will face a range of challenges during 2017 when general government elections take place in some key nations. Unfortunately, growth forecasts for the UK point to decelerating growth, most likely due to tailwinds caused by Brexit. China's performance was one of the biggest concerns going into 2016, but this soon changed. This leaves Asia with a mixed bag of results going into 2017.

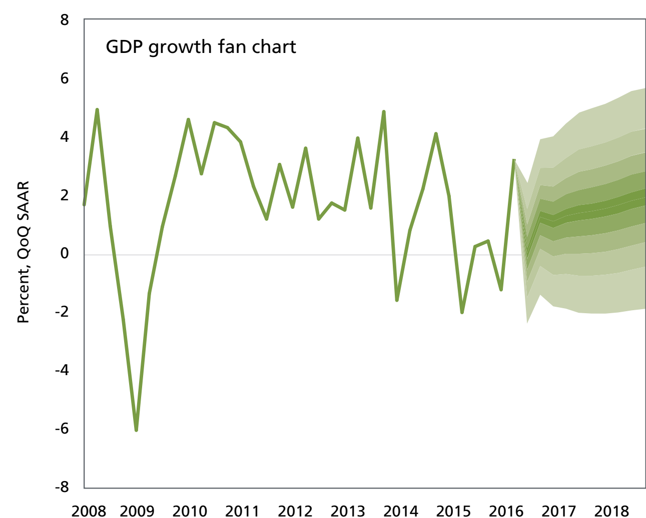
The world economy therefore appears somewhat healthier than it has in the recent past. Nonetheless, there are vulnerabilities which could disrupt the ongoing global recovery, including debt overhangs in emerging markets (especially China) and political shocks comparable to Brexit.

WE EXPECT DOMESTIC GROWTH TO CONTINUE ITS SUBDUED PACE

South African GDP growth has trended steadily lower since 2010. Growth forecasts suggest only a slight rebound over the next two years. The ongoing slow growth episode is proving unusually prolonged. In the past two decades, no other period has had such a low average growth rate. Indeed, over the past century, 5-year moving averages were only lower in the late 1980s and early 1990s – periods of acute political instability – and much earlier, around World War I and the Great Depression. According to the SARB the slump has two components. One is an increasing output gap on the back of weak demand, meaning the gap between what the economy can potentially produce and what it actually is producing. The other component is declining potential growth, defined as the growth rate the economy can achieve with stable inflation. The SARB states that achieving a growth rate closer to the post-1994 average of 3%, or the National Development Plan goal of over 5%, requires higher potential growth. The SARB adds that this is beyond the scope of expansionary macro-economic policies and requires a broader reform agenda.

South Africa's long-term local currency rating was lowered by S&P Global in December last year. While we avoided 'junk status', the lowering of our local currency credit rating reflects their views on continuing local economic conditions. South Africa depends on resident and non-resident purchases of rand-denominated local currency debt to finance its fiscal and external deficits. This leads to increased spending with general government debt set to increase to 4.9% of GDP between 2016 and 2018. S&P recently highlighted (and in their December review) that once again political events have distracted the country from growth-enhancing reforms. However, some of South Africa's institutions remain strong. This was evident when fraud charges were withdrawn against Finance Minister Pravin Gordhan and when the previous public protector, Thuli Madonsela released the State Capture report.

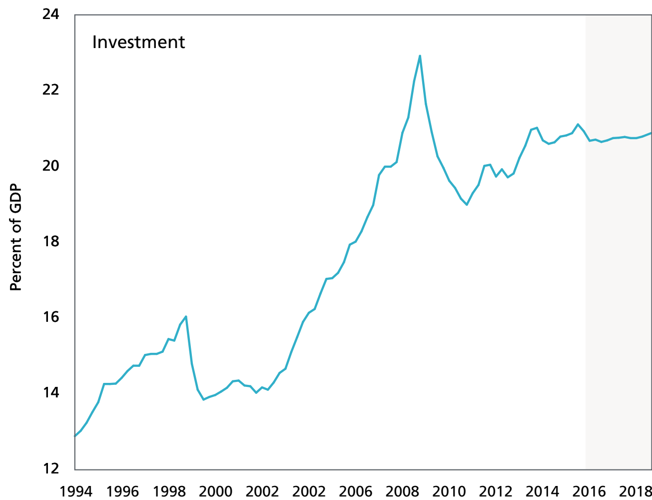
Domestic GDP growth is forecast at 1.2% this year and 1.6% in 2018



Source: SARB

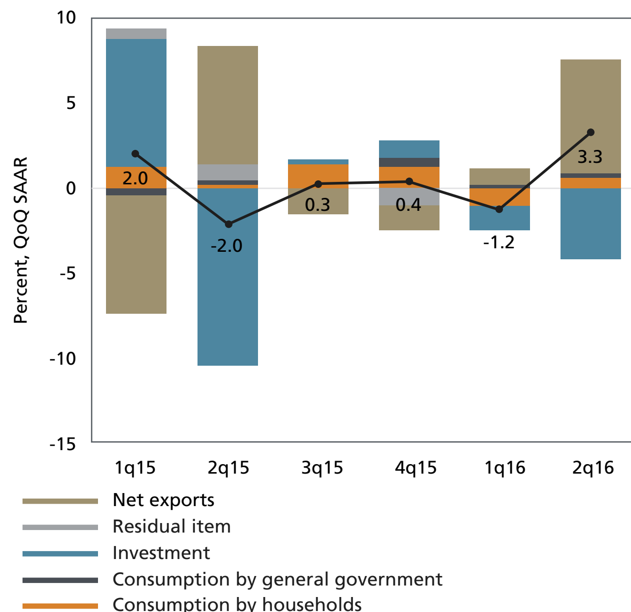
Economic commentary

The outlook for domestic investment is fortunately improving moderately



Source: SARB

Net exports have benefited from the weak currency, but consumption and investment remains under pressure

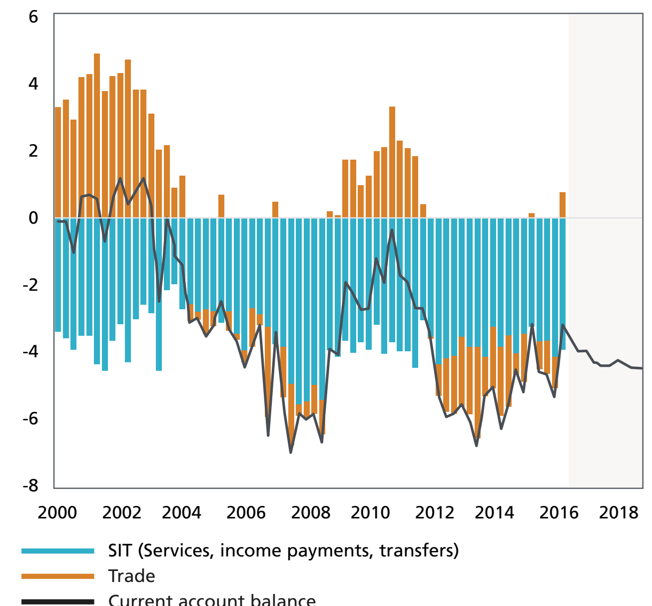


Source: SARB

While forecasts indicate a growing economy and better investment this year, the current account deficit is proving to be a persistent concern. South Africa's current account deficit widened in the third quarter of 2016 as exports of the nation's mining and factory produce fell due to weaker international demand and a stronger currency. The gap on the current account, the broadest measure of trade in goods and services, widened to 4.1% of GDP in the three months through to the end of September 2016 from a revised 2.9% in the preceding quarter, according to the SARB's Quarterly Bulletin released in December.

Mining companies, especially in the platinum industry, drew down their inventory levels and boosted exports in the second quarter, resulting in a trade surplus of R48 billion. This turned around in the three months through September as weaker global demand and a stronger rand led to a drop in export volumes and values, causing a shortfall of R4 billion on the trade account. The volume of exports, excluding gold, fell 7.5% and the value of these goods was 7.2% lower at R1.03 trillion, according to the report. Import volumes were 1.9% down and the value of goods brought in declined by 3.2% to R1.08 trillion. The government forecast the current account shortfall will narrow to 3.9% of GDP in 2016 from 4.3% in 2015.

The current account and its components



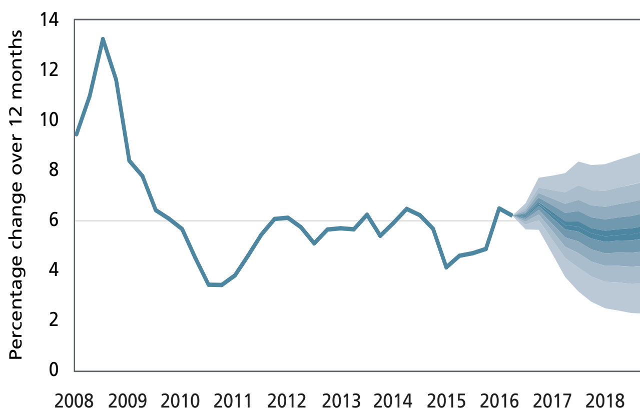
Source: SARB

Economic commentary

Domestically, inflation remains well above the targeted 6%, although forecasts suggest some deceleration. Consumer price inflation (CPI) formed a high base in February 2016 (7%), and we expect February 2017 inflation numbers to surprise to the downside. Similarly, the forecast for South African growth is for a moderate deceleration in the first half of 2017, with some improvement expected in the latter half of the year.

The Barclays Purchasing Manager's Index (PMI) for December has sparked warnings from the manufacturing circle. The index showed that the growth in domestic manufacturing sectors were 'stuck' compared to the global upswing in manufacturing activities. December's seasonally adjusted PMI remained below the neutral 50-point level for a fifth consecutive month, declining to 46.7 index points from 48.3 in November on the back of persistently weak domestic demand.

Domestic targeted inflation forecast from SARB



CPIX for metropolitan and other urban areas until the end of 2008; CPI for all urban areas thereafter

Source: SARB

Headline CPI was outside the 3% to 6% target range for much of last year. According to the SARB the breach of the inflation targets stems mainly from high food prices. However, underlying inflation is also elevated, with core inflation at 7-year highs. This reflects an extended period of currency depreciation, as well as pricing behaviour in labour and product markets, which generate persistent growth in Unit Labour Cost (ULC) which is translated into higher prices. These inflationary factors are being offset by a negative output gap and the credibility of monetary policy. This has more recently been reinforced by some exchange rate appreciation. Accordingly, headline inflation is expected to trend lower, averaging 5.8% in 2017 and 5.5% in 2018.

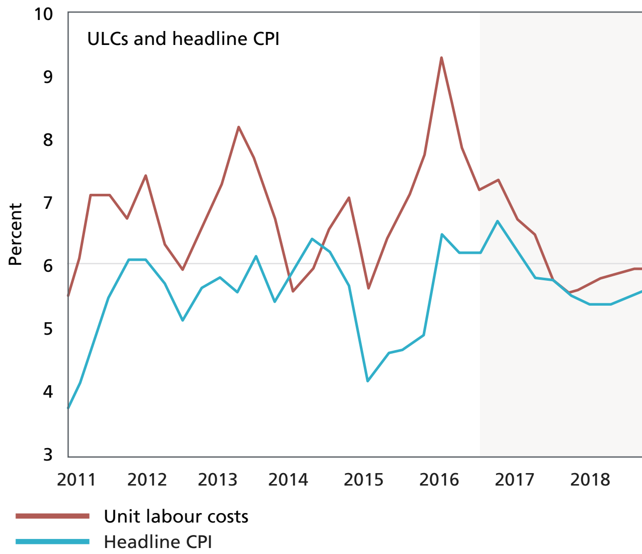
Although the South African inflation rate is set to improve during 2017, price and wage setters are still operating at or above the top of the three to 6% target range. This can be viewed in the following two graphs from the SARB that explain the prospects for the ULC till 2018.

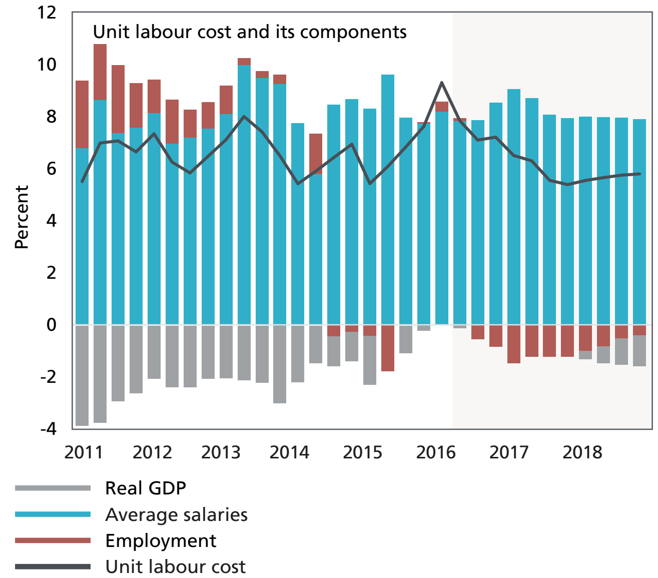
Amendments to interest rates have been very measured in the most recent interest rate cycle. Hiking interest rates have also been paused twice in light of favourable global developments. The cycle has been gradual, and the repo rate remains low compared to longer-term averages. Therefore monetary policy ought not to constrict growth at these levels.

In short, the outlook for domestic inflation is likely to improve, although the expected inflation rate remains stubbornly at the higher end of the targeted 3% to 6% range. We expect policy normalisation to continue, although at a slow pace. Existing policy is only likely to be reversed in light of sustained improvements. This is unlikely, although not impossible. Fortunately, policy stance remains accommodative in a historical context.

Economic commentary

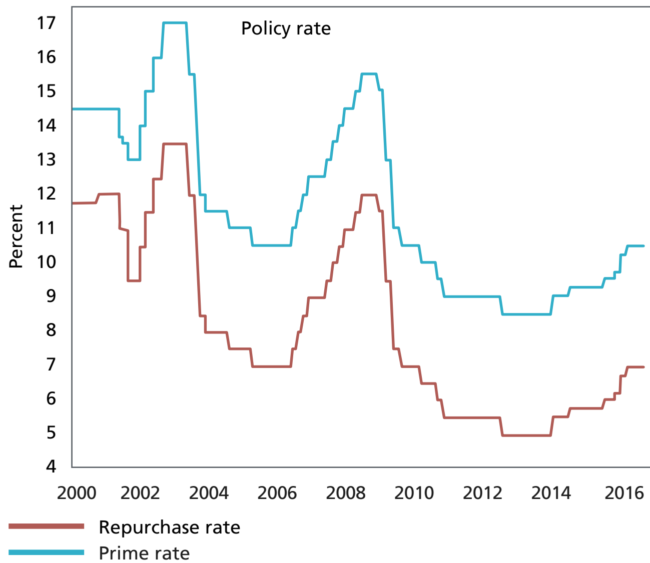
Unit labour cost and headline CPI

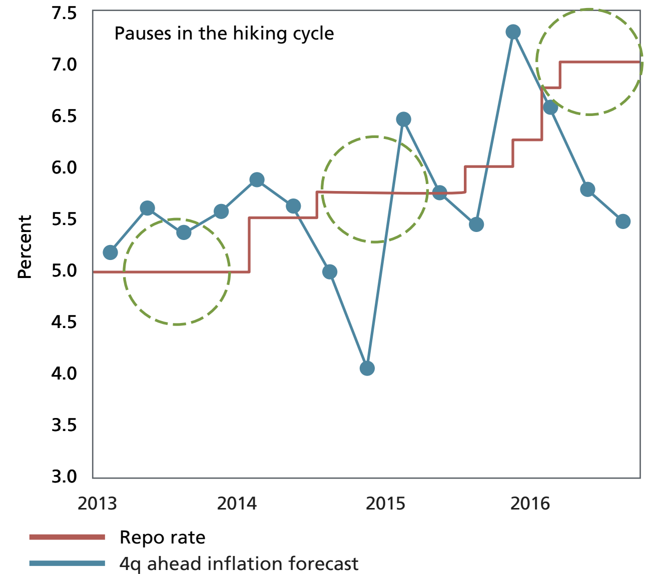




Sources: SARB

Policy rate and pauses in the hiking cycle

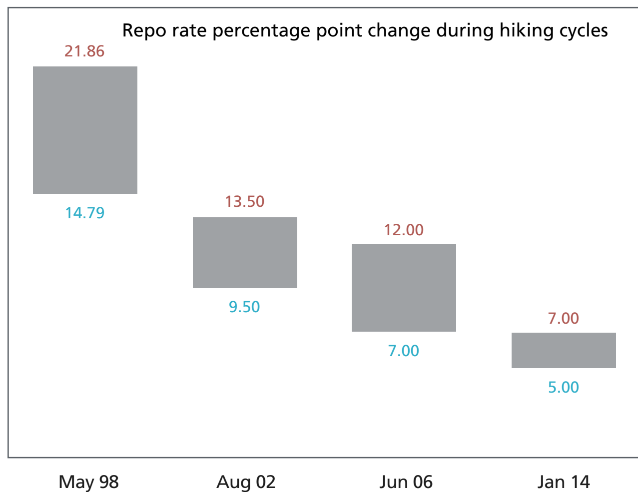


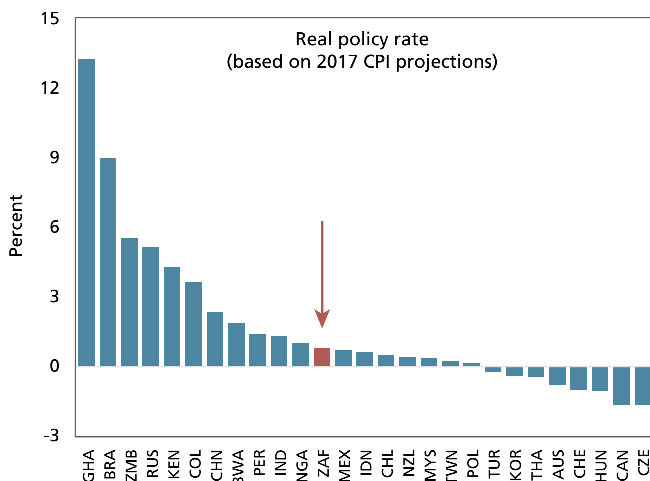


Sources: SARB

Economic commentary

Repo rate percentage point change during hike cycle and real policy rate





Sources: SARB

THE US ECONOMIC EXPANSION DID SLOW, BUT ONGOING JOB GAINS AND LOW INFLATION HAVE BOLSTERED HOUSEHOLD INCOMES

Late last year the US Census Bureau reported a 5.2% increase in middle class incomes in 2015, the largest annual gain on record. In July the International Monetary Fund (IMF) scaled down its forecast for 2016 for US GDP growth to 2.2%, from 2.6% in January. In view of the receding drag from a stronger dollar and excess inventories, the consensus of economists continue to foresee a faster pace of US expansion in 2017.

The prospect that President Trump and Congressional Republicans can do something to boost economic growth in the US appears to have also increased the expectations for future inflation. A stronger economy is poised to generate some consumer price inflation. Some of the increased expectations for inflation come from projections that President Trump may cut taxes more than what he aims to reduce federal spending. Therefore, the increased budget deficit would mean more borrowing, which could push up inflation if the federal government pays for that borrowing by printing money (which is essentially what happens when the Fed buys up government debt).

Kellyanne Conway, counsellor to President Trump, briefly discussed Trump's economic plan as part of his first 100 days in office with Bloomberg's David Westin at the start of January. She told Westin that the 'Trump-effect' could already be seen in, for instance, manufacturing jobs which were already returning to the US. Conway said Trump's job creation plan includes a number of things, like looking at the regulatory framework that 'suffocates' small businesses and reducing taxes across the board.

According to her there would also be more investment in energy, so that the US could become less reliant on foreign oil sources and rather use this sector to create jobs and stimulate the economy. Infrastructure investment is also a part of Trump's 100-day plan.

"We know our roads and bridges are in desperate need of repair and this guy (Trump) knows how to build things for a living," Conway said.

PSG Wealth

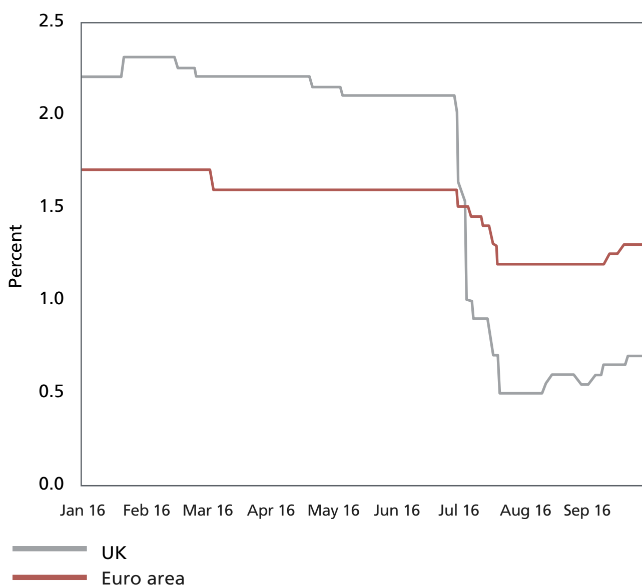
Economic commentary

IN THE EUROZONE, FORECASTERS HAVE LONG BEEN MORE CIRCUMSPECT ABOUT THEIR RECOVERY

This is especially the case due to banks' slow balance-sheet repair, elevated levels of public debt and structural economic rigidities. Nonetheless, GDP growth has remained positive, with output expanding by 1.9% y/y in the third quarter of 2016. Policy rate cuts and quantitative easing measures implemented by the European Central Bank (ECB) have supported a gradual recovery in banks lending to the private sector. Declining unemployment and low inflation have bolstered household spending while exports have continued to grow, albeit at a slower pace than in 2014/15.

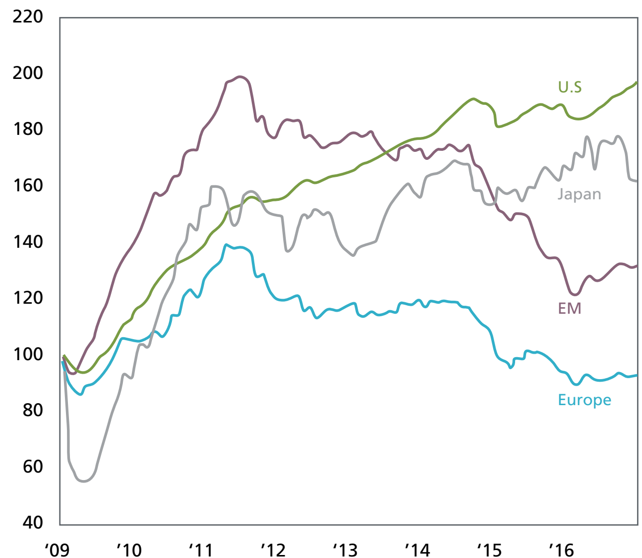
Economic activity also gathered speed in the United Kingdom (UK) until the middle of the year. However, the 'Leave' vote in the June referendum on European Union (EU) membership ushered in a period of economic and policy uncertainty. Subsequently, we saw declines in business and consumer confidence as well as downward revisions to consensus forecasts for GDP growth in both 2016 and 2017. Stronger credit demand in the EU on the back of ECB stimulus bodes well for a recovery in consumer spending which could serve as the catalyst that revives corporate earnings.

Brexit not boding well for UK growth forecasts



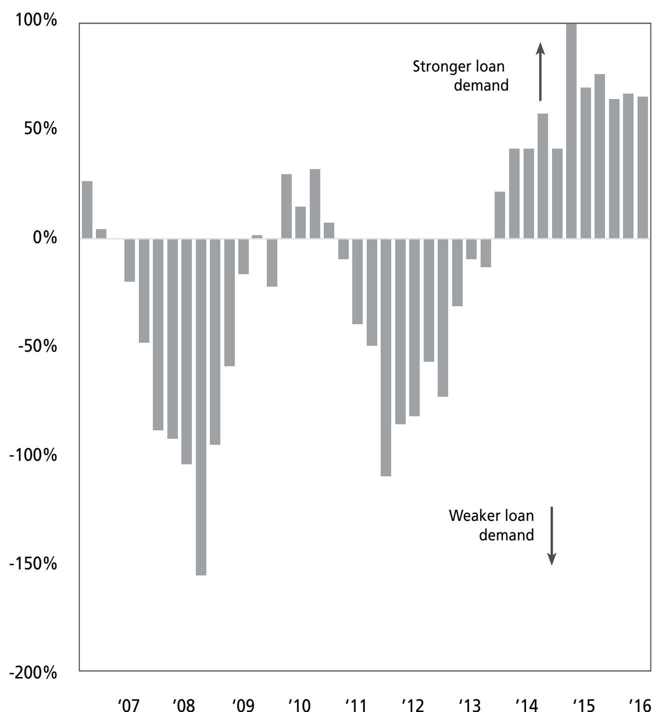
Source: SARB

Brexit not boding well for UK growth forecasts



Source: JP Morgan

Eurozone credit demand



Source: JP Morgan

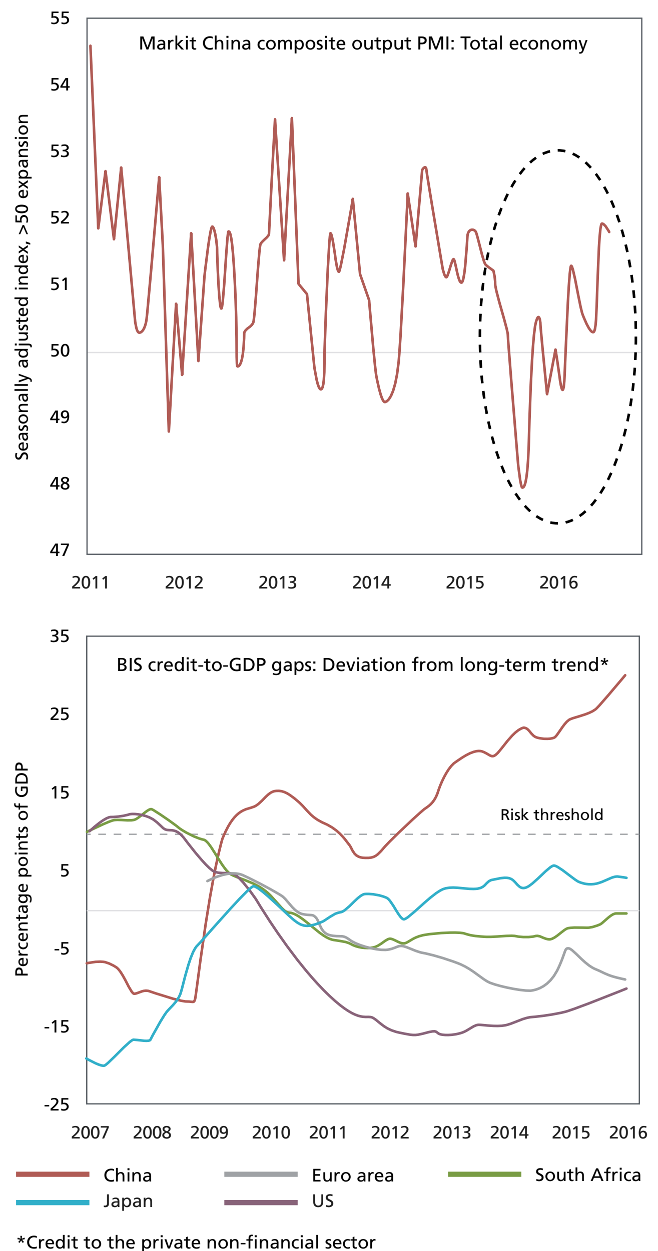
Economic commentary

IN LATE 2015 AND EARLY 2016, A KEY SOURCE OF GLOBAL UNCERTAINTY ORIGINATED FROM CHINA

Which faced a mix of slowing economic growth, industrial over-capacity, high corporate debt and rising capital outflows. In particular, steps taken by the Chinese authorities in the second half of 2015 to reform their exchange rate policy raised fears of a large-scale renminbi devaluation, boosting global financial market volatility and investor risk aversion. Chinese economic data have since stabilised partly in response to fiscal and monetary stimulus, while authorities have allowed the renminbi to depreciate only gradually on a trade-weighted basis, a move that has apparently assuaged market fears of a more abrupt adjustment. Thus for now, it seems that risks associated with the Chinese economy have receded.

At the same time, economic and policy trends in China remain highly uncertain. Historical experience, in particular in developing Asian economies, suggest that rebalancing economies from export- and investment-led growth to a more consumer-led path, rarely happens without significant declines in trend GDP growth. Similarly, comparable periods of rapid debt accumulation have almost invariably ended in abrupt growth slowdowns. A sharper-than-expected deceleration in the Chinese economy could rekindle uncertainties about its impact on world growth, commodity price levels, and Chinese currency trends.

Chinese PMI and GDP gaps



Source: SARB

Economic commentary

JAPANESE ECONOMIC GROWTH HAS BEEN PERSISTENTLY LOW OVER THE PRECEDING TWO DECADES, AVERAGING 0.7% OVER THE PERIOD

A healthy combination of improving unemployment numbers and simultaneous wage growth has supported more persistent real GDP growth since 2015. GDP in Japan was worth $4123.26 billion in 2015. Japanese GDP accounts for 6.65% of the world economy.

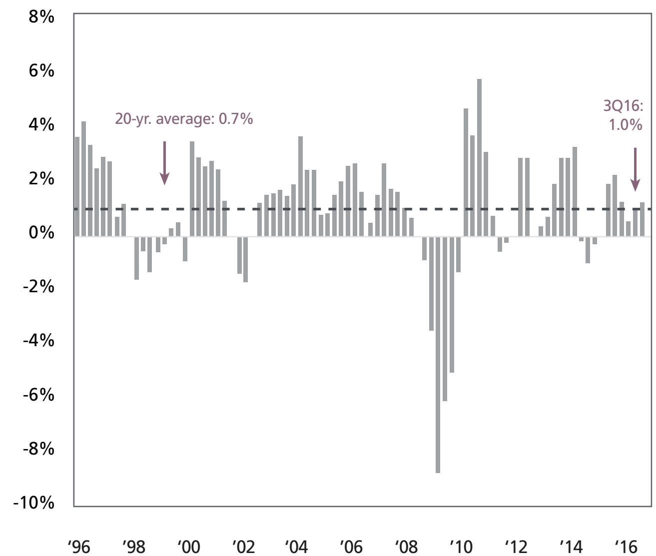
The seasonally adjusted jobless rate in Japan rose to 3.1% in November 2016, from 3% in the previous month and above market expectations of 3%. The jobs-to-applicants ratio increased to 1.41% from 1.4%, hitting a new high for the first time since July 1991.

The Bank of Japan (BoJ) left the interest rate unchanged at -0.1% at its December 2016 meeting, as widely expected. Policymakers also decided to maintain its 10-year government bond yield target around zero percent. A moderate recovery trend in the economy had continued while exports had picked up. The Bank will conduct buying Japanese Government Bonds (JBGs) at more or less the current annual pace of about 80 trillion yen.

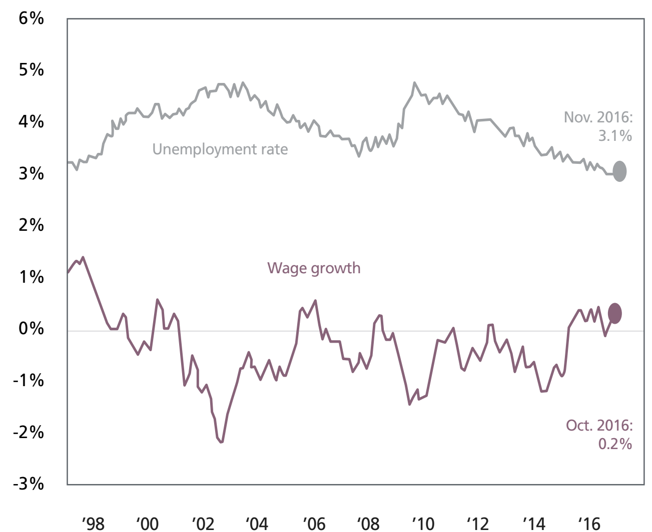
The Policy Board also decided to purchase exchange-traded funds (ETFs) and Japan real estate investment trusts (J-REITs) so that their amounts outstanding will increase at annual paces of about six trillion yen and 90 billion yen respectively. As for commercial paper (CP) and corporate bonds, the Bank will maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen respectively. The interest rate in Japan averaged 2.93% from 1972 until 2016, reaching an all-time high of 9% in December 1973 and a record low of -0.10% in January 2016.

Developed market bond yields remain a concern with the greater majority of these trading at negative real yields.

Japanese economic growth has picked up since 2015



Japanese labour market since 1998



Sources: JP Morgan

Economic commentary

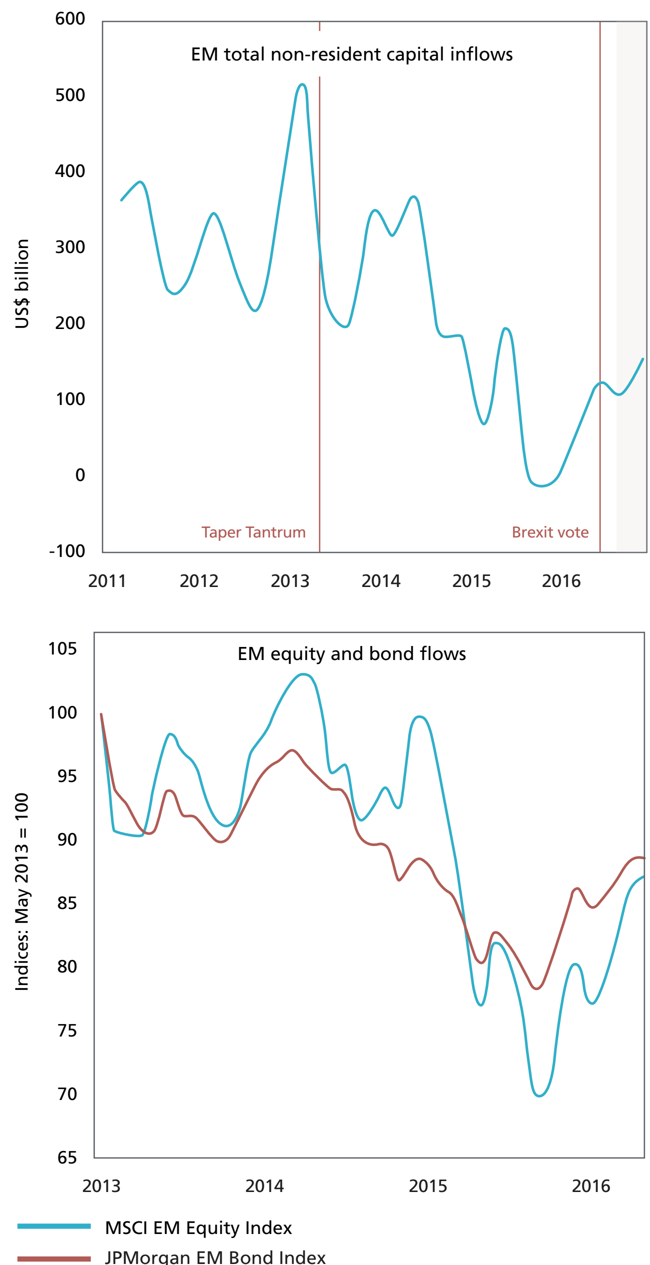
EMERGING MARKET CHALLENGES

In the emerging world, most regions seem likely to face ongoing challenges. Emerging Asia remains the strongest-performing region, with the IMF expecting real GDP growth of 6.3% this year. However, the region is exposed to a slowing Chinese economy and several countries are characterised by high levels of corporate indebtedness. Central and Eastern Europe's strong trade and financial links to the more advanced European economies render it vulnerable to the latter's potentially unfavourable political-economic dynamics.

Latin America continues to display elevated vulnerability to commodity price swings and limited policy space, while the Middle East and North Africa still have to adjust to what now seems a structural decline in oil revenues. Finally, sub-Saharan Africa, which had outpaced world economic growth in 2015, is also increasingly grappling with deteriorating external and fiscal fundamentals, tighter financial conditions and insufficient economic diversification.

However, glimpses of stabilisation can be found in emerging markets, especially after an increase in capital flows and higher commodity prices last year.

Emerging versus developed markets

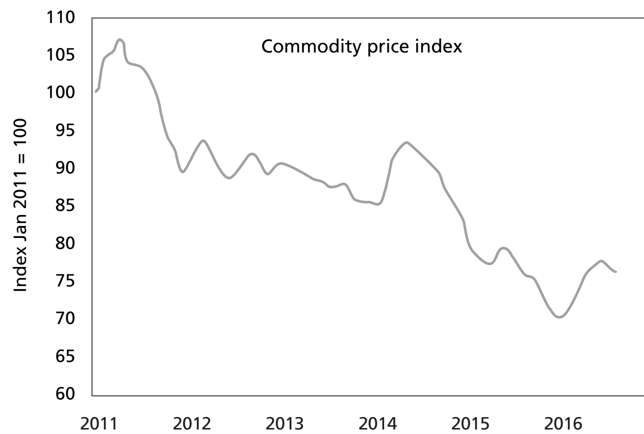


Sources: JP Morgan

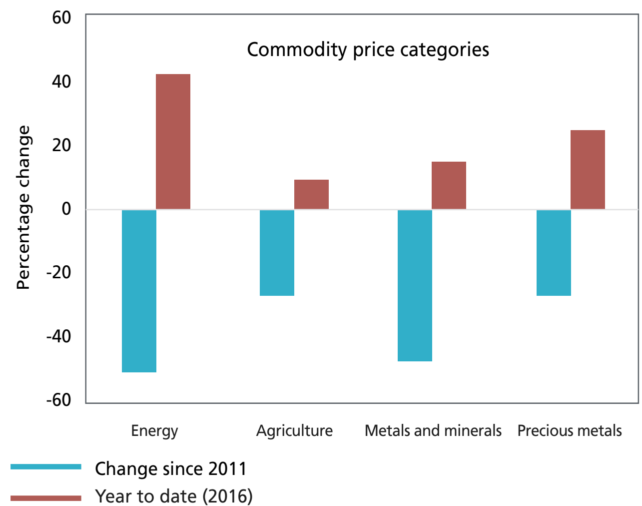
PSG Wealth

Economic commentary

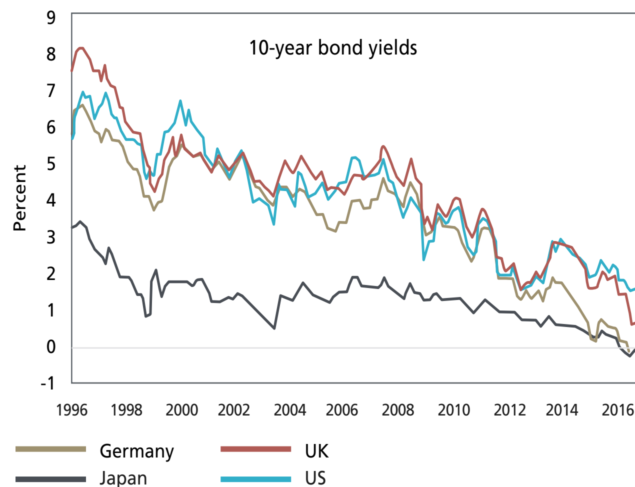
The rise in commodity prices and categories



Source: SARB



Developed market bond yields remain a concern



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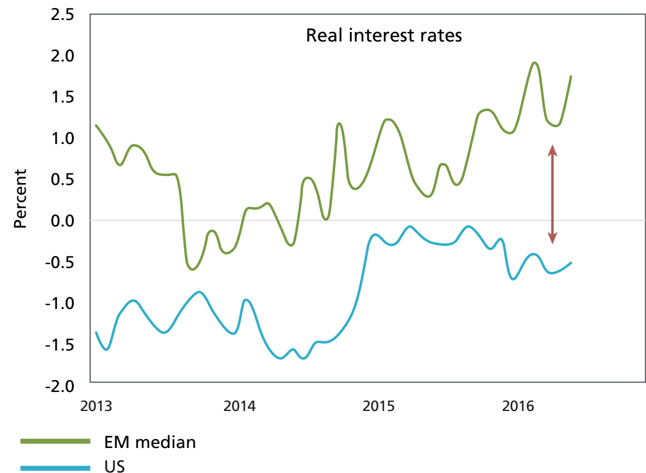


PSG Wealth

Financial market review

Total returns as at 31 December 2016

	Index	Quarter-end value	1M	3M	6M	1Y	3Y	5Y
Local equities	ALSI	50 839.25	0.97%	-2.09%	-1.63%	2.63%	6.16%	12.97%
	Industrials	72 142.29	1.84%	-4.69%	-6.65%	-6.55%	7.96%	19.04%
	Resources	18 748.64	-3.60%	-1.20%	6.77%	34.24%	-10.32%	-5.50%
	Financials	41 032.28	3.45%	2.89%	3.76%	5.44%	11.72%	18.06%
	Listed property	621.74	4.24%	1.26%	0.52%	10.20%	14.65%	17.29%
Local bonds	ALBI	530.34	1.57%	0.35%	3.78%	15.45%	6.90%	7.36%
	ALBI 1-3 years	408.23	0.78%	1.44%	3.68%	10.08%	6.78%	6.60%
	ALBI 3-7 years	502.70	1.21%	1.07%	4.00%	13.44%	7.30%	7.33%
	ALBI 7-12 years	579.19	1.45%	0.69%	3.88%	15.40%	6.56%	7.41%
	ALBI 12+ years	572.58	1.76%	-0.04%	3.94%	17.46%	7.23%	7.78%
	GOVI	523.15	1.58%	0.35%	3.73%	14.93%	6.81%	7.20%
	OTHI	536.23	1.54%	0.33%	3.85%	16.73%	7.40%	8.21%
Local cash	STeFI three month	345.51	0.60%	1.78%	3.59%	7.05%	6.26%	5.83%
	Volatility index	12.72	5.33%	5.64%	-10.17%	-22.90%	0.77%	-9.71%
International equities	S&P500	2 271.72	1.98%	3.82%	7.82%	11.96%	8.87%	14.66%
	Euro Stoxx	3 236.71	7.90%	9.93%	15.52%	3.07%	4.71%	10.49%
	Nikkei	19 253.61	7.02%	19.11%	25.80%	2.94%	6.35%	18.30%
	Hang Seng	22 446.70	-3.46%	-5.52%	5.80%	0.39%	-1.90%	3.60%
	Dax	1 023.66	7.38%	7.43%	16.84%	6.50%	6.92%	14.90%
	MSCI World	1 712.09	1.25%	-0.43%	2.24%	1.04%	1.02%	8.95%
	MSCI World ex US	1 638.99	-1.77%	-2.85%	-1.61%	-5.01%	-4.88%	2.68%
	FTSE 100	6 783.79	-2.45%	0.03%	8.88%	6.73%	0.17%	4.35%

*Performance reported in base currency using total return

Source: INET

Financial market review

DESPITE SOME MATERIAL MACRO-ECONOMIC AND POLITICAL EVENTS DURING 2016, DOMESTIC EQUITIES REMAINED POSITIVE FOR THE YEAR

Domestic equities showed a five-year annualised total return of 12.97% to the end of December 2016. This is broadly in line with our long-term expectation of inflation plus 6% to 7% for this asset class. The challenge in the equity markets has not been returns as much as it has been volatility. A novice investor could easily have been tempted into riskier areas of the market which have been under pressure.

The resources sector for example was a big value trap prior to 2016. Many investors were lured by valuations despite the meagre outlook for global growth. Although the sector made a strong recovery in 2016 (34.24%), the annualised 5-year return is negative at -5.5%.

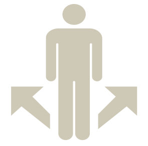
Industrials, financials and listed property were all strong gainers over the preceding five years, generating 19.04%, 18.06%, and 17.29% respectively. Listed property managed to eke out a reasonable 10.20% return for the year, on the back of compression in domestic bond yields. ALBI long-bonds generated quite an astonishing 17.46% for 2016, following dissipating interest rate hike concerns, and a rally following on a weak end to 2015. Even short-dated bonds generated double digit returns (10.08%), and the ALBI as whole, with a duration of roughly seven years, generated a 15.45% return. Like the listed property sector, the bond sector benefited from more dovish interest rate hike expectations on the domestic front and a stronger rand. Cash managed to generate a nominal return slightly above inflation (7.05% versus 6.60%), although after fees and taxes this asset class probably generated negative real returns for most investors.

THE S&P 500 INDEX CONTINUED ITS STRONG PERFORMANCE, GENERATING 11.96% FOR THE YEAR IN US DOLLAR TERMS

The five-year annualised return for the S&P 500 now stands at 14.66% in dollars. Despite the challenges surrounding Brexit, the FTSE 100 fared relatively well with a 6.73% (GBP) return for 2016. The 5-year annualised return is, however, much lower than that of the S&P 500, at only 4.35% per annum in UK pounds. Asia continued to paint a somewhat mixed picture with the Nikkei up 19.11% over the last quarter of 2016, whereas the Hang Seng was down 5.52% over the same period. On a longer term assessment, the Nikkei is up 18.30% (annualised) over the preceding five years, and the Hang Seng rose 3.60% annualised over the same period. The German Dax experienced a strong recovery during the latter part of 2016, with a 16.84% return. This recovery was largely on the back of severe losses in the first half of the year. The full year returns closed at 6.5%. (All returns reported in base currency).

It is clear the primary driver of equity returns was US-listed firms. The MSCI World Index generated a return of 1.04% for 2016, whereas the MSCI World Index (ex-US) generated a 5.01% loss for the year.

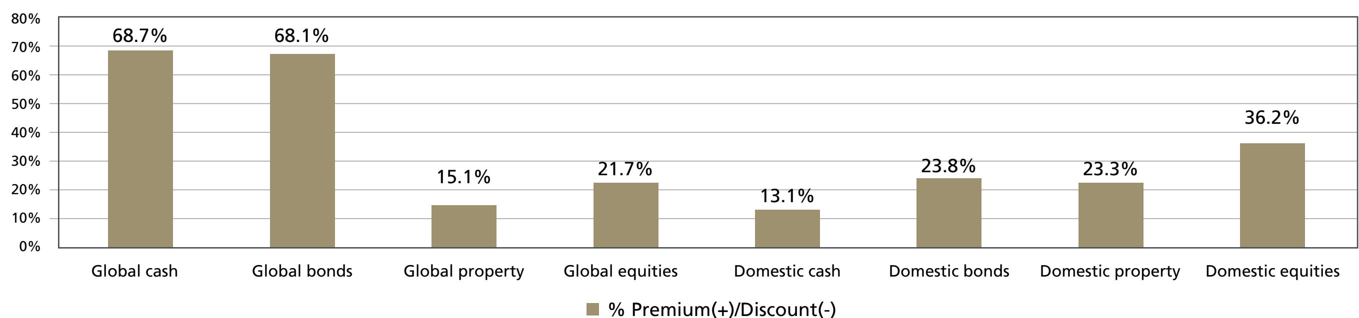
Tactical asset allocation preferences



Overview

Domestic equities are on a similar level as the average P/E-level of the past decade. Some pockets of the market are expensive and investors should expect continued volatility at current levels. That being said, skilled stock pickers should be able to find value in selected shares.

Current earnings yields versus long-term averages - premiums and discounts



Source: PSG Wealth research team

The valuation of the top five market capitalisation shares on the FTSE/JSE All Share Index (ALSI) have been masking value elsewhere in the domestic market. An analysis of the ALSI Top 40 Index shows that when the top five companies are excluded, the forward price-to-earnings (P/E) ratio of the index more than halves, and actually returns to the average P/E-level of the past decade.

Domestic listed property is overvalued by more than 20% relative to its historic earnings yield. In addition, we remain of the opinion that the interest rate cycle will impact the strength and sentiment of the domestic economy, and the affordability of the property sector specifically. This will present headwinds for capital growth in the property sector. We expect property yields, which are calculated as a percentage of capital, to normalise on the back of downward pressure on capital values.

Similarly, domestic bonds are, in general, also overvalued by more than 20% and will struggle if domestic interest rates normalise. There are always exceptions, but generally speaking bond yields seem stretched.

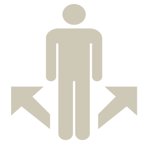
Domestic cash is most likely generating a negative real return for investors, after fees and taxes. We remain of the view that although cash can play a strategic role in a portfolio, there is a material trade-off over the long term.

Cash is not our wealth-building asset class of choice. Global cash yields seem similarly unattractive. Although there may be little nominal risk, returns are near zero and after cost returns are likely negative. Further, considering the anticipated reflationary environment globally, the real, after cost returns from global cash are extremely unattractive.Global bonds paint a mixed picture. Sovereign bonds of countries where accommodative monetary policy is coming to an end or where normalisation is already taking place, will be under pressure as rates move up. We anticipate that bond investors will migrate to cash as rates move up, in an effort to avoid capital losses.

Global property as an asset class seems overvalued, although the picture is somewhat mixed geographically. Selective buying can yield inflation-beating returns, but again monetary policy normalisation poses a challenge for the asset class in some areas.

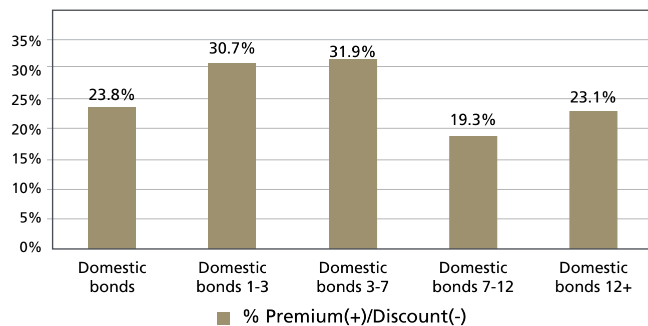
Global equity is overvalued on a historic earnings basis, although the shift towards fiscal stimulus could support the asset class. In the US, further aims at deregulation will support corporate earnings, although the timing of fiscal support policies and potential deregulation is uncertain at this stage. In the EU, simultaneous global reflation and local European Central Bank (ECB) monetary policies are conducive to growth, although the full impact of Brexit and a number of upcoming elections leave some question marks over the headwinds the EU will face in 2017.

Tactical asset allocation preferences



DOMESTIC BONDS

Current earnings yields versus long-term averages - premiums and discounts

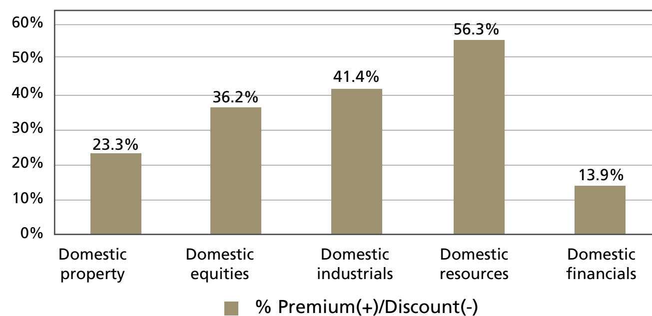


Source: PSG Wealth research team

The aggregate yield of the All Bond Index still implies that this asset class remains generally overvalued. The implied premium is roughly 24%. Demand for bonds may decrease in light of the increased risk of holding them, with money market assets starting to offer some value on a risk-adjusted basis. The relative risk-adjusted returns of bonds are further compromised by higher interest rates on the horizon. The 7-year to 12-year segment offers the lowest premium to historic yield, indicating this area of the yield curve probably has the least valuation risk at the moment. That said, this area of the market is more sensitive to interest rate shocks. We believe very selective buying in the bond market is warranted and best left to skilled professionals who can assess returns and risks holistically. We prefer exposure to the shorter end of the curve where interest rate risk and default risk are generally lower.

DOMESTIC EQUITY SECTORS

Current earnings yields versus long-term averages - premiums and discounts



Source: PSG Wealth research team

Although domestic financials stretched valuations during 2016, we remain of the opinion that the financial sector probably holds the most opportunities from a valuation perspective. Some selective profit taking may however be warranted on certain counters.

We are also aware that there may be hidden value on the local exchange – some counters are trading at very high price-to-earnings (P/E) multiples, but earnings are in a cyclical decline. Although the resource sector seems incredibly expensive from a yield perspective, we know that earnings have dropped in this cyclical part of the market. The mining sector is still consolidating their business operations, with smaller mines closing down and mining managers focusing on cleaning balance sheets. This usually places the sector in a position to make bigger profits. As spot prices recover, earnings should start to flow through at greater operating margins.

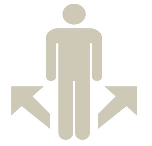
For listed property, some counters are experiencing growing yields, which may present some opportunities. However, in our opinion broad-based property exposure is ill-advised at this stage. Where we do hold listed property, we prefer to hold counters with the following characteristics:

- low price-to-book values
- low levels of debt/gearing and strong credit ratings
- globally diversified portfolios, or counters that generate earnings abroad
- using structures that offer superior liquidity and diversification properties, like REITS
- superior distribution growth track records

We feel that although risks abound for the inexperienced investor, thorough research and careful stock picking could yield attractive returns. The key, in our opinion, is that the investment payoff should adequately reward investors for uncertainty. Secondly, only proceed in cases where there is more than sufficient margin of safety in the valuation, and lastly, monitor active positions very carefully.

We look at corporate balance sheets and debt structures that will be able to ride out the current storms as local economic strength wanes further. We expect smaller businesses, as well as businesses with low cash balances, weak cash flows and high levels of debt, to struggle in prevailing economic conditions. This in turn provides opportunities for players with healthy cash flows and strong balance sheets.

Tactical asset allocation preferences



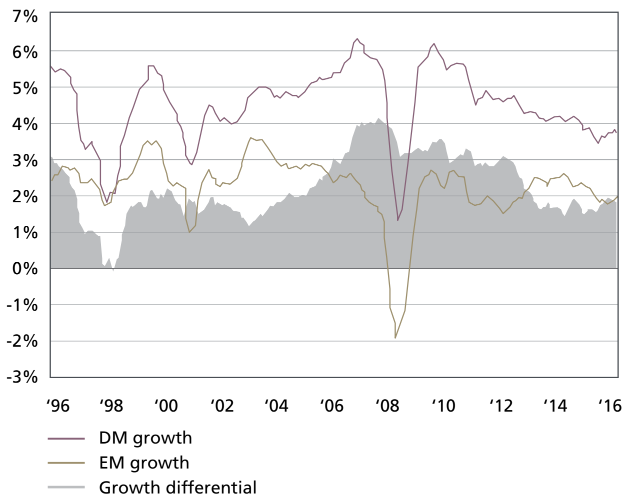
In light of the above, our preferences in terms of domestic equity remains largely unchanged as follows:

- underweight in interest rate-sensitive stocks and asset classes
- underweight in companies whose earnings rely heavily on domestic drivers
- underweight in companies who rely on leverage to grow margins
- overweight in multi-national conglomerates with actively managed exposure to both developed and emerging markets
- overweight in companies with strong balance sheets and healthy cash flows
- overweight in firms that are expanding operating margins and gaining market share

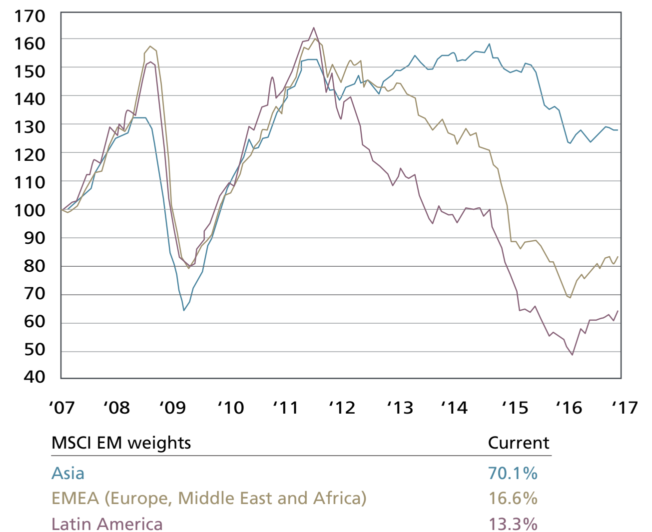
As always, we underpin these preferences with a focus on attractive valuations. This enhances our expected return, while helping us to manage downside risk more effectively.

OFFSHORE PREFERENCES

Growth in emerging and developed markets



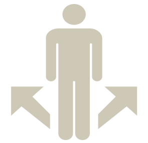
Source: JP Morgan



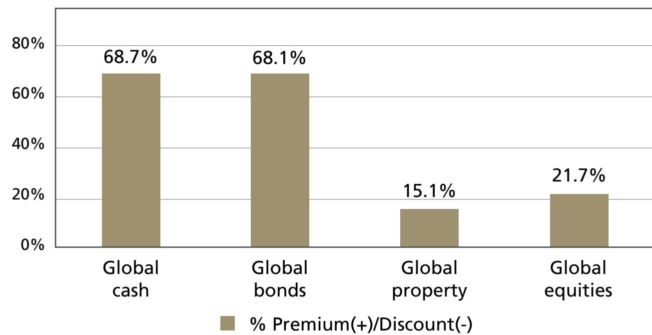
The earnings yields of developed market equities and emerging market equities are similar at this stage, at 2.5% and 2.6% respectively. Historically, the difference in economic growth between emerging and developed markets has been key to emerging market equity outperformance in the past. However, recently the growth gap has narrowed. While emerging market equities have broadly been underperforming in recent years, it is important to differentiate regionally. Forecast dollar-based earnings for emerging markets are expected to be reasonably strong in context of reflation expectations.

PSG Wealth

Tactical asset allocation preferences



Global assets current earnings yields versus long-term averages - premiums and discounts

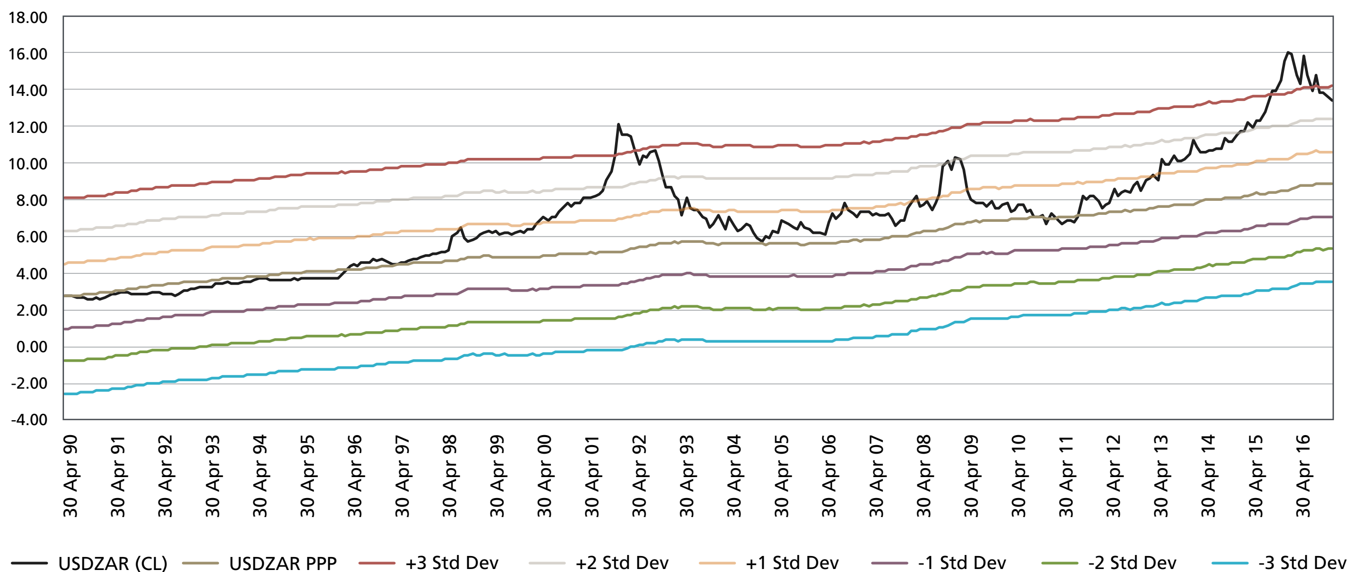


Source: PSG Wealth research team

In general, our assessment of global asset classes show that underlying valuations remain severely stretched for global money market and fixed income assets. Valuations on global bonds remain stretched following on unchartered monetary policy stimulus and subsequent capital flows into credit instruments. In the US, nominal and real 10-year treasury yields have been falling for the past 30 years, leaving both real and nominal yields at historic lows. Federal Open Market Committee (FOMC) research supports the view that current yields need to increase by roughly 3% to normalise. Real assets seem far more attractive on both a nominal and risk-adjusted return basis. From a valuation perspective, global listed property is still a more risk-efficient investment than global bonds. Still, investors should be very cautious in the property sector of the market. Extreme property price fluctuations in structures with high leverage or limited liquidity can hold severe capital consequences for investors.

With regards to global equity, we see many quality firms trading at reasonable valuations. The biggest short-term risk to return for South African investors is the rand, which is still trading at a material discount to purchasing power parity (PPP).

Rand/USD exchange rate spot price versus PPP



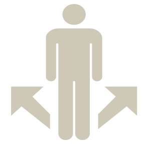
Source: PSG Wealth research team

Two key observations from this would be that:

1. The rand is trading well above the long-term PPP-level which seems excessive even if a sovereign downgrade occurs in 2017; and
2. The PPP-margin that the rand is trading at currently, statistically reduces the possibility of further weakness significantly.

Despite some material headwinds domestically in 2016, we expect this trend (the strengthening of the rand) to steadily continue over the near term.

Tactical asset allocation preferences



EMERGING
South Africa

DEVELOPED
Global

EQUITY | PROPERTY | BONDS | CASH | EQUITY | PROPERTY | BONDS | CURRENCY

Cyclical, Defensive, Residential, Office, Retail, Credit, Government, ZAR

Cyclical, Defensive, Retail, Office, Residential, Government, Credit, USD, GBP, EUR

Strategic asset allocation

Tactical asset allocation

Changes this month

Overweight:
Tactical recommendation to hold more of the asset class than specified in the strategic asset allocation

Neutral:
Tactical recommendation to hold the asset class in line with its weight in the strategic asset allocation

Underweight:
Tactical recommendation to hold less of the asset class than specified in the strategic asset allocation

Source: PSG Wealth research team

Domestic unit trust positioning

Active versus passive: Déjà vu

Named as one of the '15 most important economic journalists' of our time and founder of Ritholtz Wealth Management, Barry Ritholtz said recently:

> "This is the year that active-investment management makes its return to form. It is the year, or so we are told, when active fights back, scores some points, and gets its revenge on passive indexers. For the record, active management never went away. The claim that it has returned, after a run of fairly horrific performance, is likely little more than some mean reversion. This all comes in the midst of a shakeup in the investment industry, as low-cost indexing has dominated growth in the business for the past half-decade".

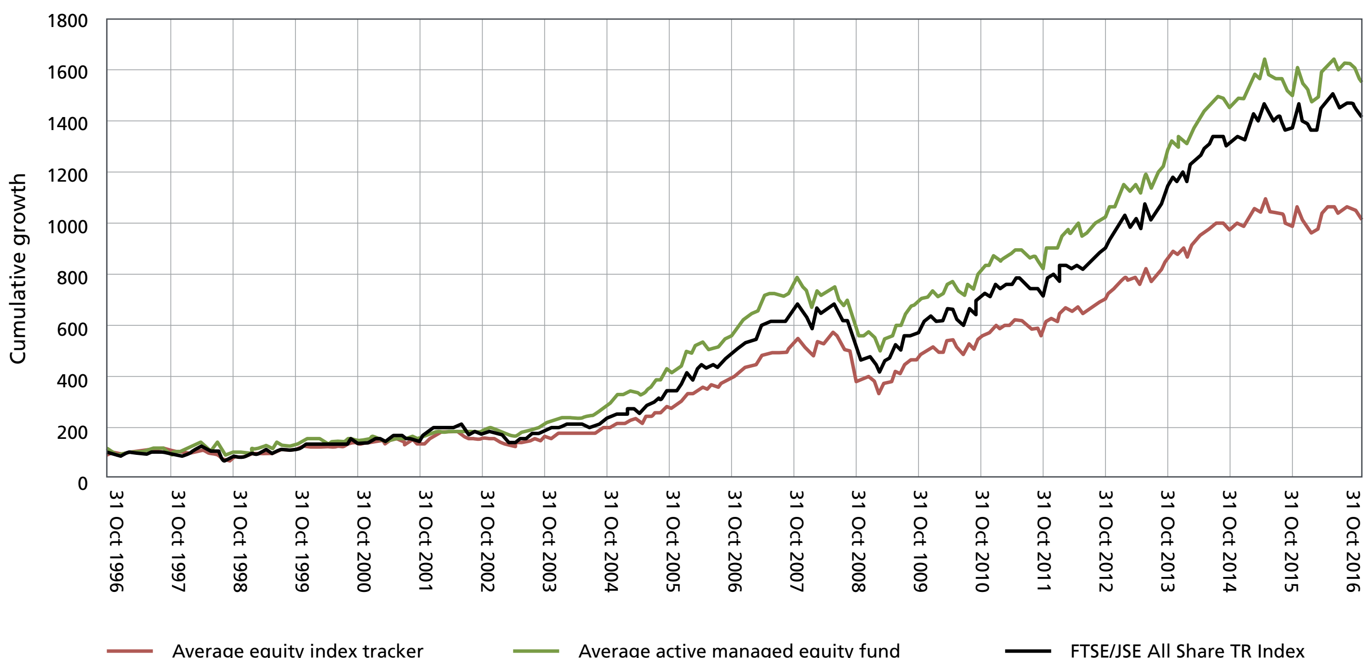
Active or passive? A burning question that does not want to go away. Every now and then it resurfaces to become the centre of almost every investment newsletter. It should not come as a surprise, because the answer to the 'Active or Passive' question is not an easy one.

A COMPARISON CAN SHOW WHICH STRATEGY WORKS IN WHAT MARKET SCENARIO

A simple comparison between the investment returns of the average actively managed domestic equity fund and the average domestic index tracker over the past 20 years (indicated in the first graph), clearly shows that the actively managed funds outperformed the FTSE/JSE All Share Total Return Index, while the average index tracker underperformed this index.

Yet another graph which measures the last 12 years shows that the average actively managed fund and the average index tracker have very similar returns. However in this scenario both underperformed the ALSI. It would also be possible to find specific periods where the average index tracker has outperformed the average actively managed fund.

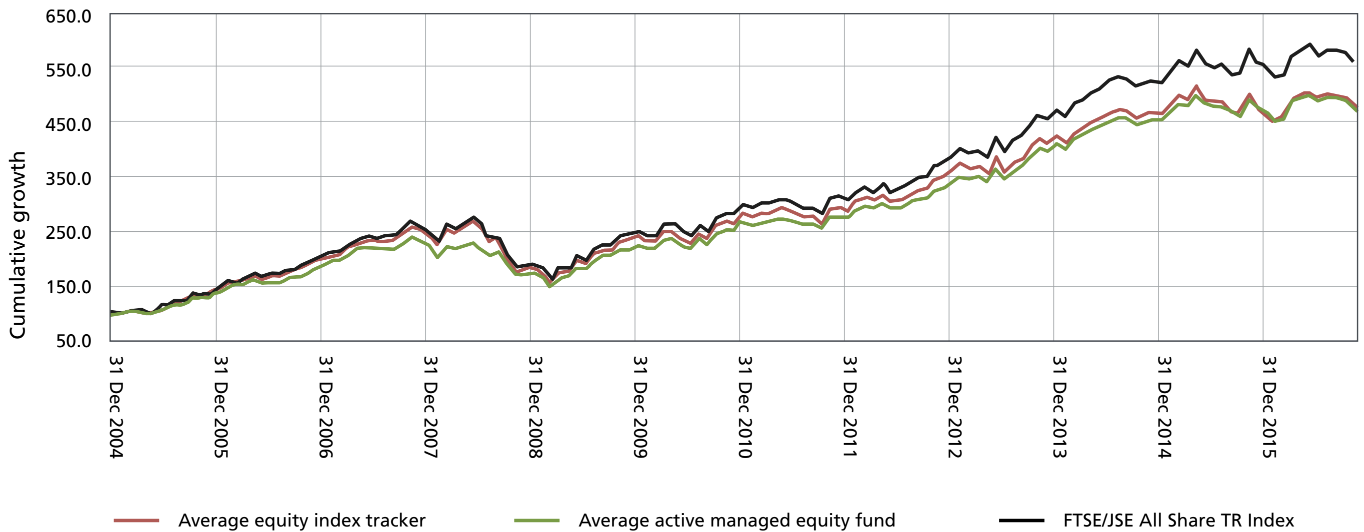
Indices representing cumulative returns of actively managed equity funds, equity index trackers and total return of ALSI (20 years)



Source: PSG Wealth research team

Domestic unit trust positioning

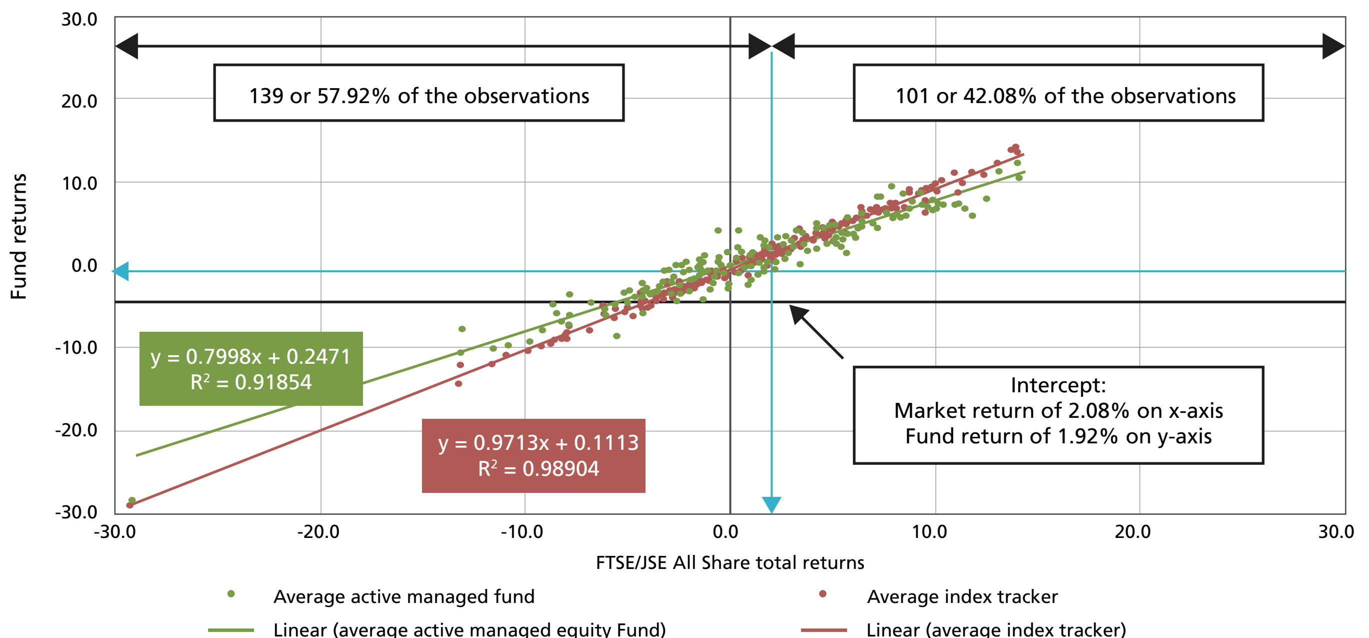
Indices representing cumulative returns of actively managed equity funds, equity index trackers and the total return of ALSI (12 years)



PSG Wealth research team

Another way to compare the performance of the average active managed fund with the average index tracker is to compare their monthly returns against the monthly returns of the ALSI.

Monthly return comparison of actively managed equity funds and equity index trackers compared to total return of ALSI (20 years)



PSG Wealth research team

Domestic unit trust positioning

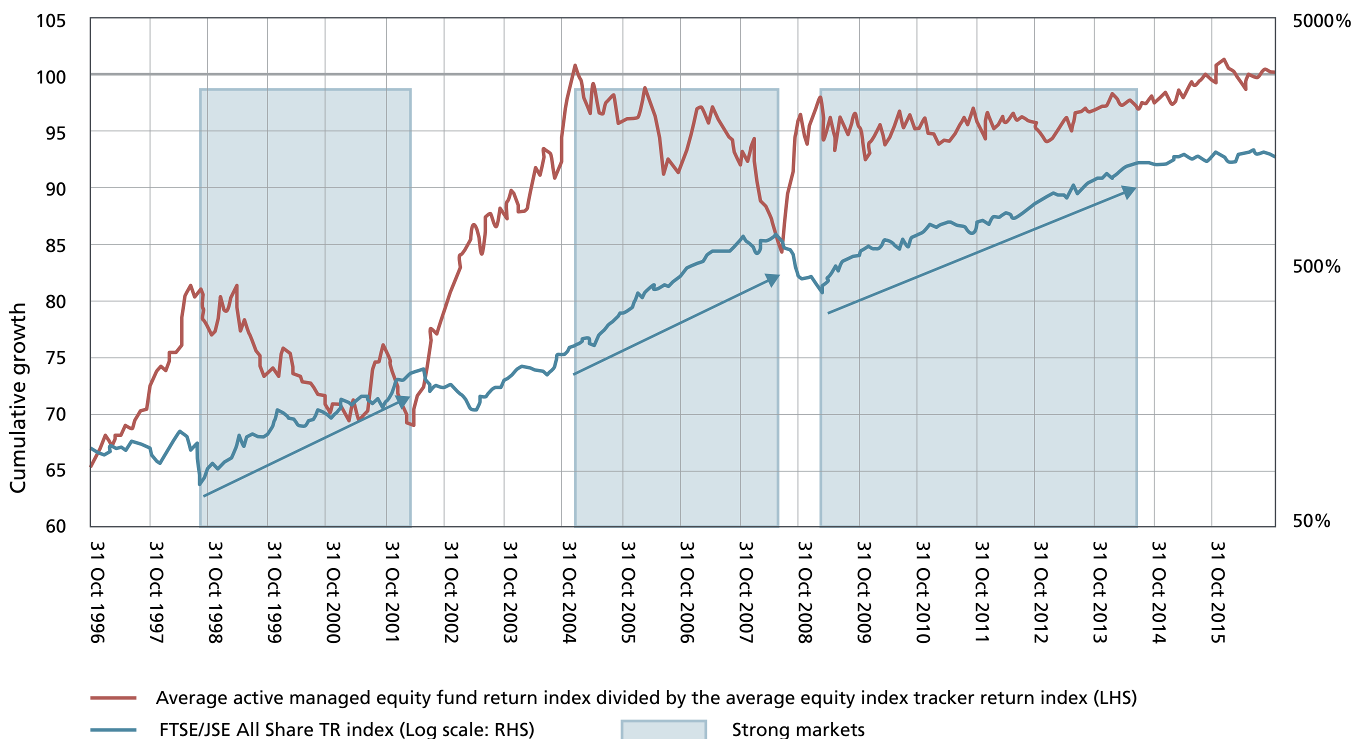
This third graph illustrates the following:

- The linear regression lines of the average actively managed fund and the average index tracker intercept at the point where the market return is 2.08% per month. The average fund return of both active and passive funds are 1.92%.
- In periods of stronger market returns (101 or 42.1% of the 240 observations) the regression line of the index trackers is above the regression line of the actively managed funds. An indication of the tendency to outperform.
- In periods of weaker market returns (139 or 57.9% of the observations) the regression line of the index trackers is below the regression line of the actively managed funds. An indication of the tendency to underperform.
- A final observation is that the beta (slope of the regression line) of the index trackers (0.9713) is higher than the beta of the actively managed funds (0.7998).
- The alpha of the actively managed funds (0.2471), on the other hand, is higher than the alpha of the index trackers (-0.1113). Most importantly, index trackers show negative alpha, because of the annual management fees of the index trackers, in comparison to no fees of the AlSI.

The final deductions from this comparison is that index trackers tend to outperform actively managed funds in periods of strong market returns, due to their higher beta. Secondly, active managers tend to outperform the index trackers in periods of weak and negative market returns, due to their ability to position their portfolios differently and more defensively than the index.

A final test to confirm the observations mentioned above, is to compare the cumulative performances of the actively managed funds and the cumulative performance of the index trackers relative to each other as illustrated in the fourth graph.

Cumulative return of actively managed equity funds relative to equity index trackers (20 years)



PSG Wealth research team

Domestic unit trust positioning

The following is clear from the graph from the previous page:

- The slope upwards of the relative growth line shows that actively managed funds outperform the index trackers, while a slope downwards of the actively managed funds shows they underperform the index.
- The cumulative return graph of the FTSE/JSE All Share Total Return Index (in log scale) helps us to identify periods with strong markets (high slope) as highlighted in blue.
- The relative growth line slope downward in the first two strong market periods is consistent with the deductions made from the third graph - that index trackers tend to outperform in strong markets.
- The relative growth line move sideways in the third strong market period, provides an indication that the two strategies perform very similarly. This is due to the high weight of resources in the AlSI at the start of the period and the very poor performance of resources over the period. Actively managed funds could lower their exposure to resources, while the index trackers had to mirror the index.

BOTH STRATEGIES PERFORM IN DIFFERENT MARKET SCENARIOS

The analysis above shows there are different times when actively managed funds and index trackers, in general, outperform each other. The decision to invest either in an active or passive fund, should therefore be based on your investment philosophy, strategy and process, and not merely on fees.

Other studies have shown that only about 20% of active managers outperform the market index consistently. This does, however, create enough space for true multi-managers to hunt for those 20% of active managers that outperform the market consistently.

The PSG Wealth Solutions are multi-manager funds (FoFs) that are committed to active, managed strategies. The investment process aims to find active managers with the best broad investment strategies, philosophies and processes, as well as the proven ability to outperform the market over every market cycle.

The asset allocation and share selection functions are the sole responsibility of the active manager to execute according to their investment process. If the investment process of the solutions are changed to include passive funds, then part of the asset allocation and share selection function becomes the responsibility of the multi-manager. As such including passive funds in our PSG Wealth solutions could potentially hinder the winning strategies of the active managers in the solutions.

PERFORMANCE AND POSITIONING

PSG Wealth Domestic Equity Fund of Funds and PSG Wealth Domestic Multi-Asset Funds of Funds (FoFs)

Current market conditions, both global and domestic, remain extremely difficult for equity fund managers. Uncertainty around a worldwide economic recovery and rising global interest rates resulted in continuous risk-on/risk-off trades, regardless of the fact that South-Africa escaped a downgrade on its sovereign debt by the rating agencies early in December 2016.

All three equity and asset allocation FoFs managed to outperform their benchmarks over the 3-month, 1-year and 3-year investment periods ending December 2016.

Domestic unit trust positioning

Fund performance versus sector average

Name	3 months to 2016/12/31	Rank	1 year to 2016/12/31	Rank	3 years to 2016/12/31	Rank
PSG Wealth Creator FoF D	-0.3	45	6.6	38	6.6	41
South African EQ General Sector Average	-2.4	178	3.1	162	4.7	122
PSG Wealth Moderate FoF D	-0.5	42	4.2	27	7.9	21
South African MA High Equity Sector Average	-1.5	179	1.3	157	6.1	104
PSG Wealth Preserver FoF D	0.2	40	4.8	32	8.0	9
South African MA Low Equity Sector Average	-0.2	143	3.6	130	6.4	90

Source: PSG Wealth research team

The PSG Wealth equity and asset allocation FoFs are well diversified in terms of investment styles, asset classes and asset class sectors. Prevailing market conditions, however, are never favourable to all investment styles at the same time. It is therefore not uncommon to see one of the underlying managers underperform the benchmark over the shorter measurement periods. The composition of fund of funds should therefore only change when the underperformance becomes excessive.

The underlying managers of the PSG Wealth asset allocation FoFs have slightly increased their exposure to resources and financials, which resulted in a higher overall equity exposure. The managers of the PSG Wealth Creator FoF also increased their exposure to resources and financials, but had to reduce their exposure to industrials slightly due to the consistently high equity exposure of the fund.

Sector allocation

Equity exposure of the PSG Wealth domestic equity and asset allocation FoFs		Previous quarter			Current quarter		
		PSG Wealth Preserver FoF	PSG Wealth Moderate FoF	PSG Wealth Creator FoF	PSG Wealth Preserver FoF	PSG Wealth Moderate FoF	PSG Wealth Creator FoF
Domestic equity sectors	Resources	1.6	5.7	12.8	2.0	6.4	14.9
	Financials	4.7	10.0	22.3	8.5	15.1	23.1
	Industrials	9.4	24.3	47.5	9.6	24.7	43.5
	Other equities	0.3	1.1	0.0	0.3	0.1	-0.0
	Equity hedges (+ Long/ - Short)	-0.6	-0.7		-0.6	-0.8	
Total domestic equities		15.4	40.3	82.6	19.8	45.6	81.5
Total foreign equities		18.1	23.3	12.9	18.4	24.6	15.2
Total equities		**33.5**	**63.6**	**95.5**	**38.2**	**70.2**	**96.7**

Source: PSG Wealth research team

PERFORMANCE AND POSITIONING: PSG WEALTH FIXED INTEREST FUNDS

The PSG Wealth fixed interest funds managed to outperform their benchmarks over the 3-month, 1-year and 3-year investment periods ending December 2016.

The managers in the PSG Wealth Income FoF have decreased their exposure to cash and money market instruments in favour of a higher exposure to the 1-year and 3-year bond segments. This was after the credit rating agencies kept our sovereign rating unchanged. Over the longer term the higher interest rates of the longer-dated instruments will reward when interest rates start to decline.

PSG Wealth

Domestic unit trust positioning

Fund performance versus sector average

Name	3 months to 2016/12/31	Rank	1 year to 2016/12/31	Rank	3 years to 2016/12/31	Rank
PSG Wealth Income FoF D	1.6	34	9.2	18	8.0	6
South African MA Income Sector Average	1.3	78	7.9	72	6.8	52
PSG Wealth Enhanced Interest D	2.0	21	8.0	20	6.9	12
South African IB Money Market Sector Average	1.8	30	7.4	28	6.6	26

Source: PSG Wealth research team

Sector allocation

Non-equity exposure of the PSG Wealth domestic fixed interest FoFs		Previous quarter		Current quarter	
		PSG Wealth Enhanced Interest Fund	PSG Wealth Income FoF	PSG Wealth Enhanced Interest Fund	PSG Wealth Income FoF
Domestic non-equities (incl real estate)	Real estate	-	3.3	-	3.3
	Preference shares	-	1.2	-	1.4
	Inflation-linked bonds	-	3.1	-	3.3
	Bonds 7+ years	-	8.9	-	10.6
	Bonds 3-7 years	-	16.5	-	15.3
	Bonds 1 - 3 years	-	11.5	-	19.2
	Cash, derivatives and money market	100.0	42.7	100.0	34.7
	Total domestic non-equities (incl. real estate)	100.0	87.4	100.0	87.6
Foreign non-equities (incl real estate)	Real estate	-	1.5	-	1.5
	Bonds	-	6.0	-	5.7
	Other	-	0.0	-	
	Cash, derivatives and money market	-	1.9	-	2.0
	Total foreign non-equities (incl. real estate)	-	9.4	-	10.6
Total Non-equities (incl. real estate)		100.0	96.7	100.0	98.3

Source: PSG Wealth research team

Offshore mutual fund positioning

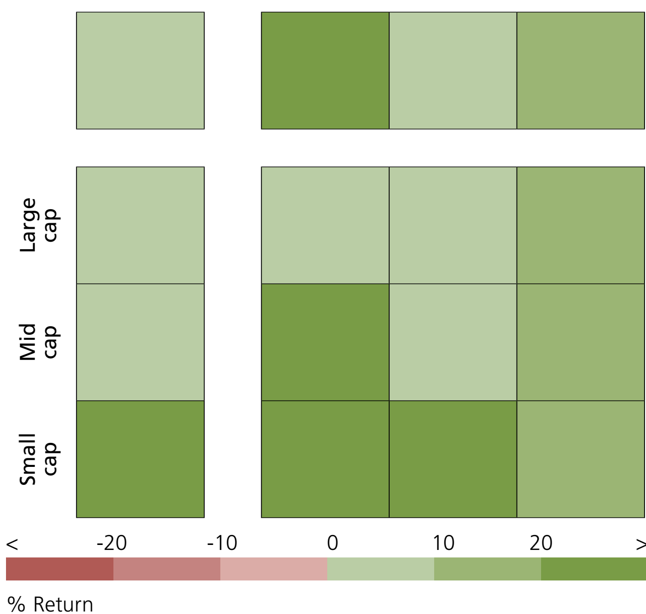
Global funds: 2016 review and outlook for 2017

There was a reversal of a number of trends within offshore markets and the global fund industry in general during 2016.

Negative sentiment and a number of market shocks in 2015 drove investors to look for areas of 'safety'. This resulted in significant flows into assets perceived as less risky. This general risk aversion led to higher bids on prices in many of these asset classes, with 2015 being all about US large-growth stocks. Funds with an overweight to developed markets, and specifically well-known US large cap stocks, did very well in 2015. Morningstar indexes indicate how dramatically the story changed in 2016. Last year many key markets reversed, turning 2016 into a mirror image of the past five years.

Last year was good for US markets in general. A style breakdown based on Morningstar style indices, shows that the lower left hand corner of the style box (small- and mid-cap value) were the biggest winners of 2016. Given post-election growth expectations, the relative US-focused orientation of smaller caps was the key driver of returns.

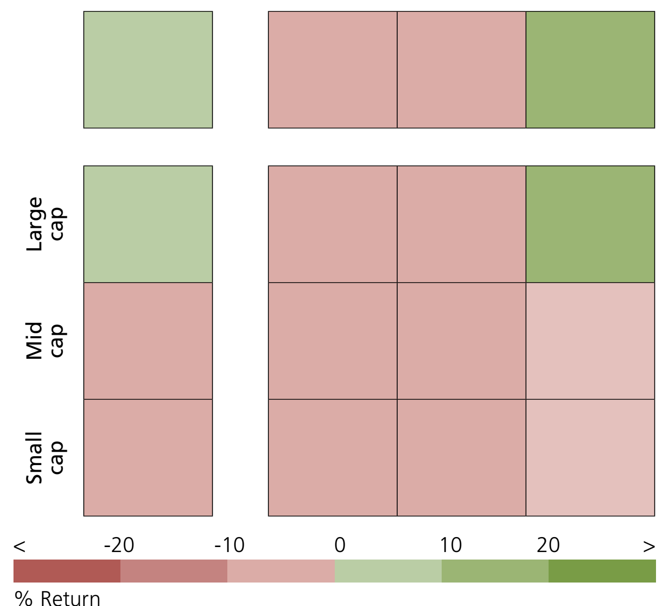
Morningstar US style box: 2016



Source: Morningstar

2015 showed a very different picture. During this time the high-flying FANG-stocks (Facebook, Amazon, Netflix and Google) delivered very good relative returns, which explains why the Large Growth Index was the only size or style-based index in positive territory that year. Indeed, the 5-year period between 2011 to 2015 generally saw large companies outperform smaller ones, while growth investors outperformed value investors. This reflected a risk-averse, weak economic environment where investors favoured established companies possessing secular growth drivers.

Morningstar US style box: 2015



Source: Morningstar

Offshore mutual fund positioning

COMMODITIES AND CYCLICAL REBOUNDS

While the start of 2016 was tough for global markets, this soon changed when commodity stocks started to drive returns by mid-February. The Morningstar Global Upstream Natural Resources Index, essentially a leveraged play on commodity prices, gained 32% in 2016. The commodities rally is commonly explained by resilient Chinese demand and producers' efforts to limit supply.

A further look at US equity markets, reveal that at a sector level, energy, communications, financials, basic materials and industrials delivered respectable returns. These returns were likely caused by post-election expectations of infrastructure spending, tax cuts, regulatory rollbacks and interest rate hikes in the US A number of the indices that drove returns in 2015, delivered negative returns in 2016, for example in US healthcare. An analysis of sector returns helps to explain the style box story - as value stocks and smaller caps are more exposed to the 'heavier' energy, basic materials and financial sectors, but less to the 'lighter' healthcare sector.

EMERGING MARKET REBOUND

From a geographic perspective, 2016 was also very interesting. Most of Morningstar's 45 equity market indexes posted strong gains, at least in local currency terms. Emerging markets like Brazil, Russia, China, South Africa, Poland, Turkey, Thailand and Indonesia performed well, while natural-resource driven markets like Canada and Australia saw strong gains. On the negative side, some countries in the European Union (EU), like Italy struggled. Despite the impact of Brexit, the market in the UK had a relatively good year.

In comparison 2015 was significantly more mixed. The majority of emerging markets delivered negative returns, continuing a multi-year run of underperformance versus developed markets. Weaknesses in commodity prices negatively impacted Latin America and South Africa. There was significant volatility in the EU due to a number of shocks, with the UK and Germany in negative territory.

After the US election, the dollar strengthened significantly. From a US-based investor's perspective, this counteracts gains in securities denominated in foreign currencies. The differential in returns between the local currency and USD variants of the following indexes reflect these currency moves:

Impact of currency on returns

Name	Base currency	2016 return
Morningstar Australia GR AUD	Australian Dollar	12.314
Morningstar Australia GR USD	US Dollar	11.782
Morningstar Brazil GR BRL	Brazilian Real	37.050
Morningstar Brazil GR USD	US Dollar	66.591
Morningstar China GR CNY	Chinese Yuan Renminbi	9.659
Morningstar China GR USD	US Dollar	2.465
Morningstar Europe GR EUR	Euro	3.846
Morningstar Europe GR USD	US Dollar	0.830
Morningstar India GR INR	Indian Rupee	3.188
Morningstar India GR USD	US Dollar	0.583
Morningstar Japan GR JPY	Japanese Yen	0.516
Morningstar Japan GR USD	US Dollar	3.670
Morningstar UK GR GBP	Pound Sterling	17.147
Morningstar UK GR USD	US Dollar	-1.790

Source: Morningstar

The Morningstar Emerging Markets Index (USD) gained 11.3%, while the Developed Markets Index (USD) was up by 8.5%. The margin was much larger earlier in the year. Most of Morningstar's equity market barometers were positive at the end of 2016.

In short, value made a comeback in 2016 after it lagged behind growth for a number of years, while emerging markets outperformed developed markets. This sector reversal saw managers who focused on large cap companies and those with a preference for quality, large-cap stocks, lagging behind their peers in 2016. Managers with a value-focus, as well as those with a larger allocation to small- and mid-caps generally had a good year. Trend-reversals generally provide active managers with significant opportunities. However, as always, not all strategies and investment approaches work in all types of markets. Last year again highlighted the need for diversification - not only between asset classes, regions and instruments – but also between investment managers, philosophies and strategies.

Offshore mutual fund positioning

OFFSHORE FUND OUTLOOK FOR 2017

At the start of this edition of the PSG Wealth Research and Strategy Report, our CIO, Adriaan Pask explained his outlook for 2017. Below you will find some expectations for the markets and fund manager industry from our underlying global fund managers and product providers.

INDUSTRY OUTLOOK

During 2016 a number of global managers mentioned that global multi-asset funds have increasingly become a focus area for them. This is especially the case as investors are looking for an asset allocation solution, rather than security specific funds. This year global fund manager with domestic allocation funds will likely expand their products in this area. An area which has seen a significant rise in funds flowing to global multi-asset funds.

The 'active vs passive' discussion remains important for most managers. Morningstar recently noted that December saw a new monthly record amount of flows into passively-managed US equity funds. This trend continued over most of the major investment categories. Among US equity funds, passively managed funds took in $50.8 billion during December, while investors pulled $23 billion out of actively managed US equity funds. This represents a 33-month streak of consecutive outflows.

Morningstar notes that broadly, investors ended the year favouring equity funds over bond funds. This is a shift from the first 10-months of 2016 where flows strongly favoured bonds over stocks. This changing dynamic came amid growing optimism about the US economy and expectations for continued interest rates hikes and rising inflation. Our expectation is for outflows from equity funds to continue, while investors continue to favour passive equity funds and active asset allocation funds.

MARKET OUTLOOK

Our underlying managers follow various approaches to investing, and subsequently have different views on where opportunities are. The consensus is, however, that US economic growth and inflation could be accelerated by President Donald Trump's fiscal plans. This, along with a warming in the global economy, is positive for global equities and negative for fixed income.

However, growing global debt, the rise of political populism and geo-political threats, still highlight the need for diversification. Interest rates should rise in 2017, but only at a modest pace due to sluggish global growth and very cautious global central banks. Investors may want to be long credit and short duration in their fixed income allocations.

Emerging market (EM) stocks and bonds are threatened by the potential for higher US interest rates which will produce a stronger US dollar. However, with attractive valuations relative to developed market (DM) assets and the return of a widening gap between EM and DM growth, EM assets clearly have an important role to play in producing long-term portfolio growth.

Fiscal stimulus from the US and China could lift expectations for global growth. A higher growth environment would be supportive for value areas of the market. However, several risks remain, including the outlook for free trade globally.

The potential 'wildcard' for markets in 2017 is likely to be European politics with a number of key elections due to take place within an anti-establishment mood globally.

GLOBAL FUNDS – PERFORMANCE AND POSITIONING

The PSG Wealth Global Preserver FoF (USD) had a very strong year in 2016, outperforming the GIFS USD Cautious sector average by 6.7% in dollars for the 12 months ending 31 December 2016. For the fourth quarter of 2016, the portfolio outperformed the sector by 0.4%. The PSG Wealth Global Preserver FoF (GBP) also delivered top quartile returns over the last 12-months, outperforming the GIFS GBP Cautious sector average by 16.07% in GBP. The portfolio outperformed the sector by 2.64% in pounds sterling.

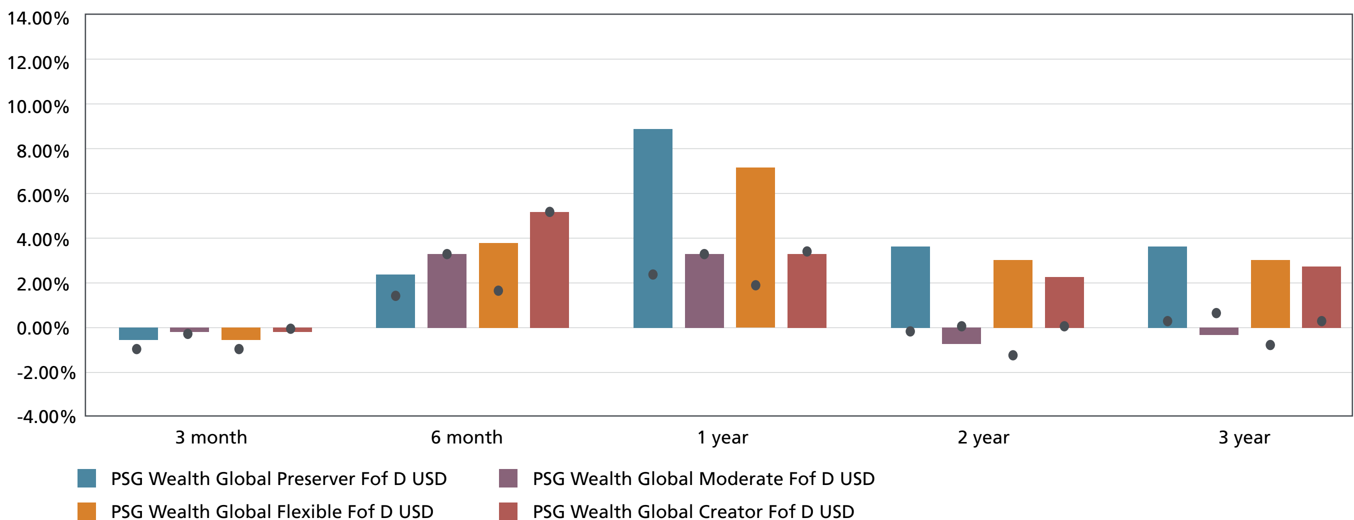
Over the fourth quarter of 2016 the PSG Wealth Global Moderate FoF outperformed the global sector average by 0.1% in USD, and the ASISA Global Multi-Asset Flexible sector by 0.8%. For the 5-years ending 31 December 2016, the portfolio outperformed the GIFS USD Moderate Allocation sector average by 1% per annum and is ranked in the second quartile of global peers since inception.

Offshore mutual fund positioning

The PSG Wealth Global Flexible FoF (USD) delivered strong returns for the 12 months ending December 2016, delivering excess returns of 5.2% in USD over the GIFS USD Flexible allocation sector average. For the fourth quarter of 2016, the fund outperformed the sector by 0.4%. The PSG Wealth Global Flexible FoF (GBP) also delivered top quartile returns over the last 12 months, outperforming the GIFS GBP Flexible Allocation sector by 16.7% in British pounds. For the fourth quarter of 2016, the portfolio outperformed the sector by 4.1% in GBP.

For the fourth quarter of 2016, the PSG Wealth Global Creator FoF slightly outperformed the GIFS USD Global Large-Cap Blend sector average. For the 4-years ending 31 December 2016, the portfolio outperformed the sector average by 2% per annum and is ranked in the first quarter of global peers since its inception.

Performance of offshore solutions in USD



Dots represents the return of relevant sector average.

Source: PSG Wealth research team, Morningstar

PSG Wealth

Offshore mutual fund positioning

Look-through positioning of the PSG Wealth global fund range

PSG Wealth global fund range. Asset and sector allocation as at 31 December 2016						
	PSG Wealth Global Preserver FoF USD	PSG Wealth Global Preserver FoF GBP	PSG Wealth Global Moderate FoF	PSG Wealth Global Flexible FoF USD	PSG Wealth Global Flexible FoF GBP	PSG Wealth Global Creator FoF
Foreign equities	41.5	42.1	56.5	84.6	85.0	94.5
Basic materials	1.0	1.0	2.5	1.1	0.3	1.9
Communication services	2.1	2.2	3.2	1.8	2.8	1.8
Consumer cyclical	4.0	4.0	6.5	10.1	14.0	12.2
Consumer defensive	3.3	3.3	4.8	14.3	10.3	13.0
Healthcare	5.1	5.1	6.8	14.7	14.4	16.1
Industrials	4.0	4.0	6.2	9.2	10.5	10.2
Technology	4.0	4.0	7.5	18.6	15.1	20.4
Energy	1.5	1.5	4.5	3.4	3.2	3.7
Financial services	4.9	4.9	13.1	12.5	14.8	13.8
Utilities	16.2	16.8	1.3	0.5	1.1	0.5
Other/Undisclosed	-4.5	-4.5	0.1	-1.7	-1.7	0.8
Foreign property	11.7	12.0	2.0	4.7	5.2	1.2
Foreign bonds	15.8	15.8	27.4	1.6	1.6	-
Foreign other	25.2	25.2	2.2	3.1	3.2	-
Foreign cash	5.8	4.8	11.8	6.0	5.1	4.4
Domestic assets	-	-	0.2	-	-	-
Portfolio total	100.0	100.0	100.0	100.0	100.0	100.0

Source: PSG Wealth research team

During the fourth quarter of 2016, no changes were made to any of the underlying funds within the PSG Wealth Global FoFs. The overall equity allocation within the PSG Wealth Global Preserver FoF decreased in the quarter by 2.7% in USD and 1.9% in GBP. This was due to changes in the positioning of some of the underlying managers. On a sector basis, the allocation to the energy sector decreased by 2.2%, while the allocation to utilities within the USD and GBP funds increased by 2.5% and 3.2% respectively. The underlying managers indicated that this repositioning is based on post-election expectations of infrastructure spending, tax cuts and regulatory rollback in the US.

Over the quarter, changes made by underlying managers in the PSG Wealth Global Moderate FoF resulted in an increased allocation to equities of 1.1%. On a sector basis, the allocation to both healthcare and consumer discretionary decreased by 0.5%, while the allocation to communication services increased by 0.9%. A number of managers decreased their exposure to global bonds on the expectations for continued hikes in US interest rates. The overall FoFs allocation to bonds decreased by 1.7%, while cash increased by 3.1%.

The allocation to global property (-0.2%), bonds (-0.3%) and cash (-1.6%) decreased over the quarter in the PSG Wealth Global Flexible FoF. On a sector basis there was an increase in the allocation to the technology sector in both USD and GBP funds of 1.4% and 1.8% respectively.

Within the PSG Wealth Global Creator FoF, the largest change during the quarter was the increase in global property from 0% to 1.2% of the portfolio. The allocation to the consumer defensive and consumer services sectors in the last quarter decreased by 1.5% and 1.2% respectively. The largest increase was in the technology sector where the allocation increased by 1.9%.

Offshore mutual fund positioning

Regional allocation as at 31 December 2016

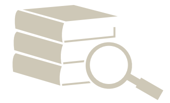
PSG Wealth global fund range. Regional allocation as at 31 December 2016						
	PSG Wealth Global Preserver FoF USD	PSG Wealth Global Preserver FoF GBP	PSG Wealth Global Moderate FoF	PSG Wealth Global Flexible FoF USD	PSG Wealth Global Flexible FoF GBP	PSG Wealth Global Creator FoF
Americas	53.7	53.6	47.8	63.9	65.1	65.4
North America	52.2	52.1	46.4	63.1	64.2	64.7
Latin America	1.5	1.5	1.3	0.8	0.9	0.7
Greater Europe	21.3	21.3	32.5	24.6	25.8	26.2
United Kingdom	7.4	7.4	13.5	12.4	12.2	11.4
Europe developed	11.7	11.7	17.5	10.7	13.4	14.2
Europe emerging	0.8	0.8	0.6	1.0	0.1	0.1
Africa/Middle East	1.5	1.5	0.9	0.5	0.2	0.5
Greater Asia	25.0	25.1	19.7	11.4	9.1	8.4
Japan	10.9	11.0	10.0	3.0	2.2	3.9
Australasia	4.7	4.7	0.9	1.7	2.1	1.0
Asia developed	5.6	5.6	4.5	3.8	2.5	1.4
Asia emerging	3.8	3.9	4.4	3.0	2.3	2.1
Market classification	100.0	100.0	100.0	100.0	100.0	100.0
% Developed markets	92.5	92.5	93.8	95.1	96.6	97.1
% Emerging markets	7.5	7.5	6.2	4.9	3.5	2.9

Source: Morningstar

Over the fourth quarter of 2016, all the PSG Wealth Global FoFs, with the exception of the Global Moderate FoF, increased their allocation to companies based in emerging markets. The PSG Wealth Global Preserver FoF and PSG Wealth Global Moderate FoF are close to, or slightly overweight, emerging markets relative to their global peers. The PSG Wealth Global Moderate FoF holds overweight positions in greater Europe and Japan. The PSG Wealth Global Creator FoF and PSG Wealth Global Flexible FoF continue holding overweight positions in developed markets (9 - 10%) which is due mostly to the preference for high quality stocks by a number of underlying managers.

PSG Wealth

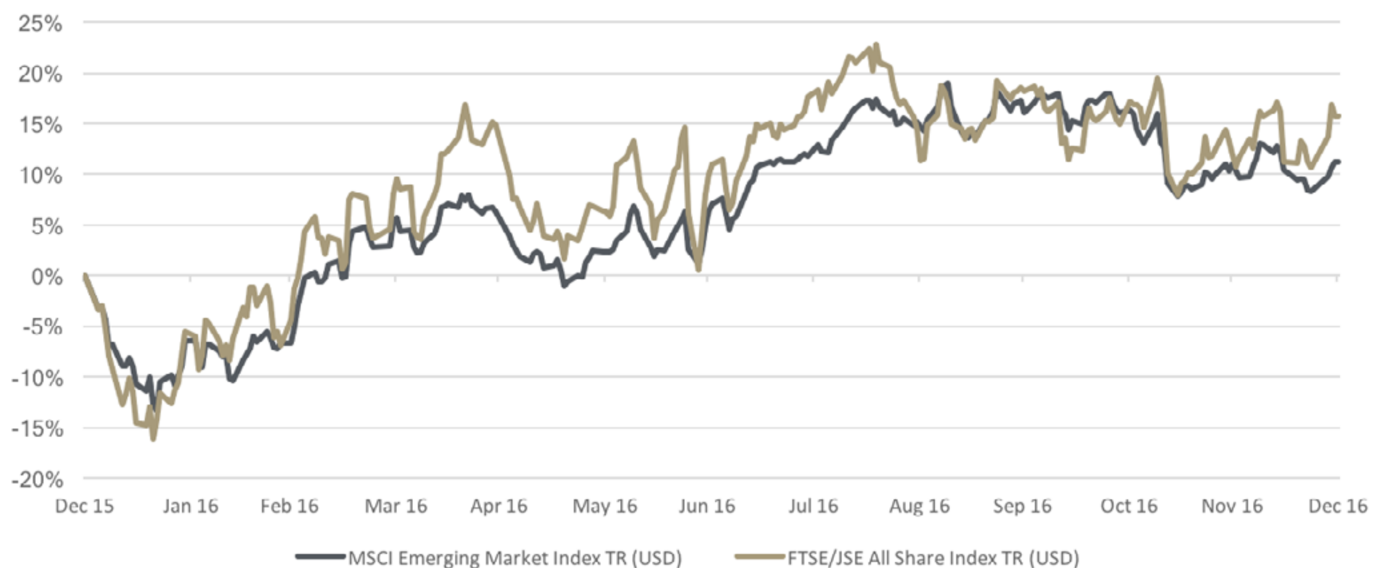
Equity research



A review of 2016 and our domestic equity strategy for 2017

Emerging markets (EMs) posted decent returns for the quarter driven by improved sentiment in EM risk. The FTSE/JSE All Share TR Index (ALSI TR) was up 16% during 2016 in US dollars, outperforming the MSCI Emerging Market Index which increased by 12%. Locally, returns were assisted by credit default swap (CDS) spreads which improved by 121 basis points (bps) during the year. Most of the outperformance was achieved in the last quarter of the year, when the local market declined by 2.1%, compared to a 4.2% decline from its emerging market peers. In local currency, the ALSI TR improved by 2.6% for the year.

The FTSE/All Share Index (ALSI TR) versus emerging market index in 2016



Source: Bloomberg

VALUE CYCLICALS IN THE MATERIAL AND FINANCIAL SECTORS WERE THE BIGGEST CONTRIBUTORS TO RETURNS DURING 2016

The recovery was led by Anglo American and BHP Billiton who maintained their momentum into the fourth quarter despite the materials sector stumbling. Financials also maintained their drive into the fourth quarter. Telecoms was the second best performing sector for the quarter primarily due to the recovery of MTN's share price from a very depressed base. This was offset by weak performances from the consumer discretionary and staple sectors. Naspers, given its weight in the index, was the single largest detractor of the index's return. This followed a deterioration in sentiment towards global technology investments. On a sector level, the return from Naspers concealed a good recovery from Richemont.

The Richemont share price recovered after the group reported a softer rate of decline in sales than the market expected. Gold stocks (Sibanye, Goldfields and AngloGold) were material detractors to index returns impacted by the USD gold price that declined by 13% in the quarter.

*Note: All mentions of P/E or multiples in this article refers to the 12-month blended forward P/E. This means the share price over expected earnings per share 12 months from now. Earnings are calculated as the weighted average of the one-year and two-year forward consensus estimates.

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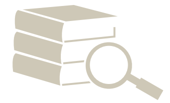
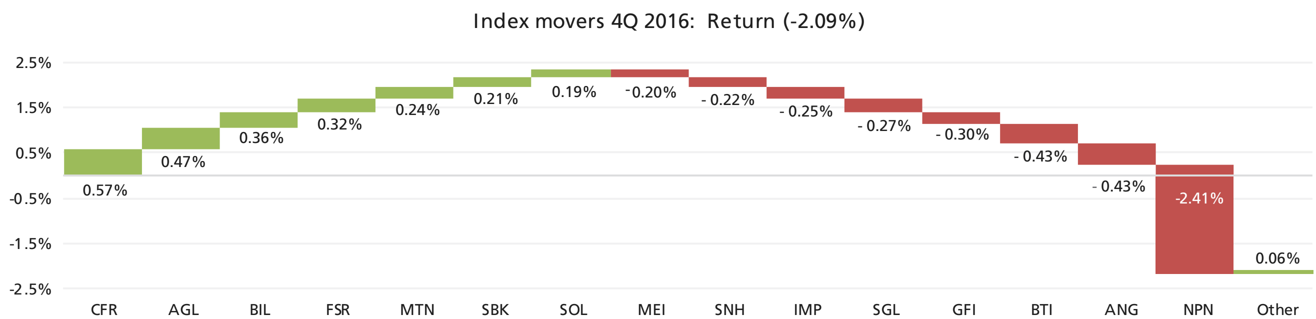
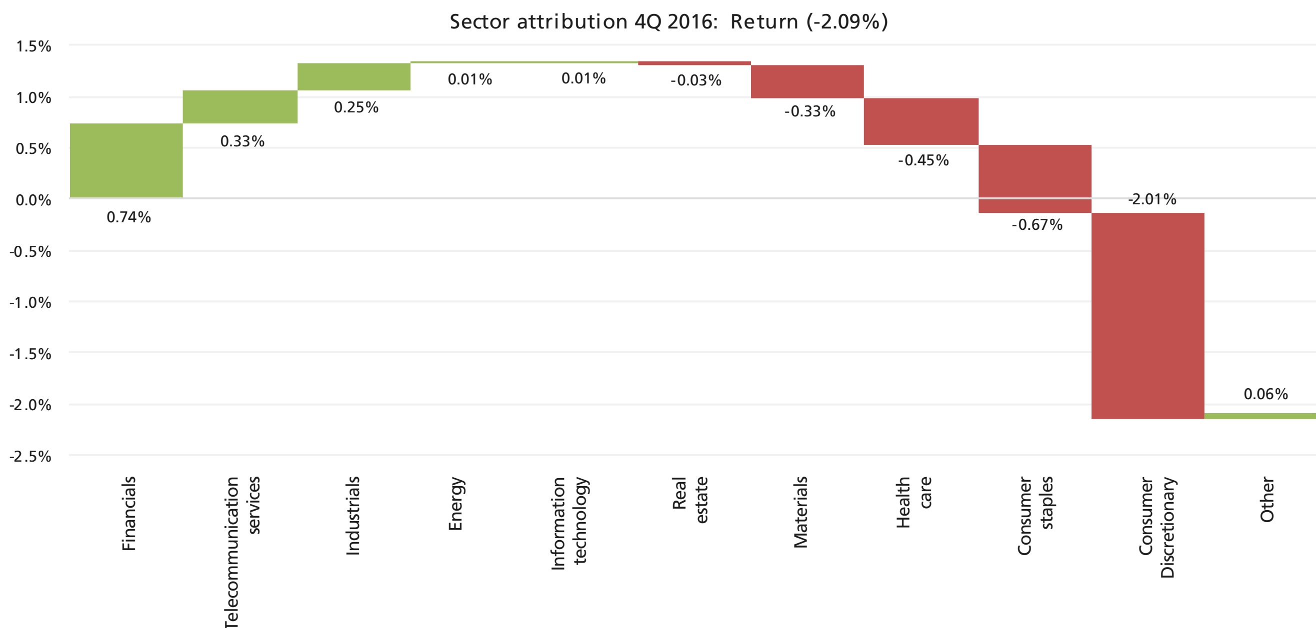


Index movers and sector attributors in 4Q2016





Source: Bloomberg

PSG WEALTH DOMESTIC EQUITY STRATEGY FOR 2017

South Africa's idiosyncratic risks remain while the status quo for growth investments have been disrupted by the election of Donald Trump as the US president. This remains significant for local equity valuations, given the high weighting in the index to bond-proxy rand hedge investments. We remain neutral to selected rand hedge stocks in our portfolio, despite the expectation of monetary stimulus fading. We started to increase our exposure to domestic equities based on the expectation that the worst of the employment contraction is behind us and that inflationary pressures are decreasing given the strength in the rand.

Multiples (12-month blended forward P/E)* are in line with their long-term averages, and we expect returns to materialise primarily through growth in earnings and not through a material change in valuation multiples. We forecast 13% growth in earnings per share (EPS) for the year ahead and a slight decline in the price-earnings (P/E) multiple.

Overall, our base case still targets 12% upside from the ALSI for the year ahead, assuming political risks will normalise and that we would have a stable exchange rate. This return was calculated on a sector level and consolidated taking into account the investments' weight in the index. The goal of this exercise is to highlight the sectors which we believe offer value and to inform the sector positioning of our portfolios.

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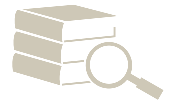


We do, however, believe that the rand could come under pressure in an emerging market sell-off. Conversely, an improvement in public governance could provide further upside to our expectations. South African shares with an exposure in the United Kingdom (UK) have underperformed given the Brexit fallout. We recognise that companies who are considering restructuring their UK-exposed operations might find it more difficult while Brexit-fears linger on. However, we feel that this concern is reflected in current valuations and that a selected number of these investments are starting to show value.

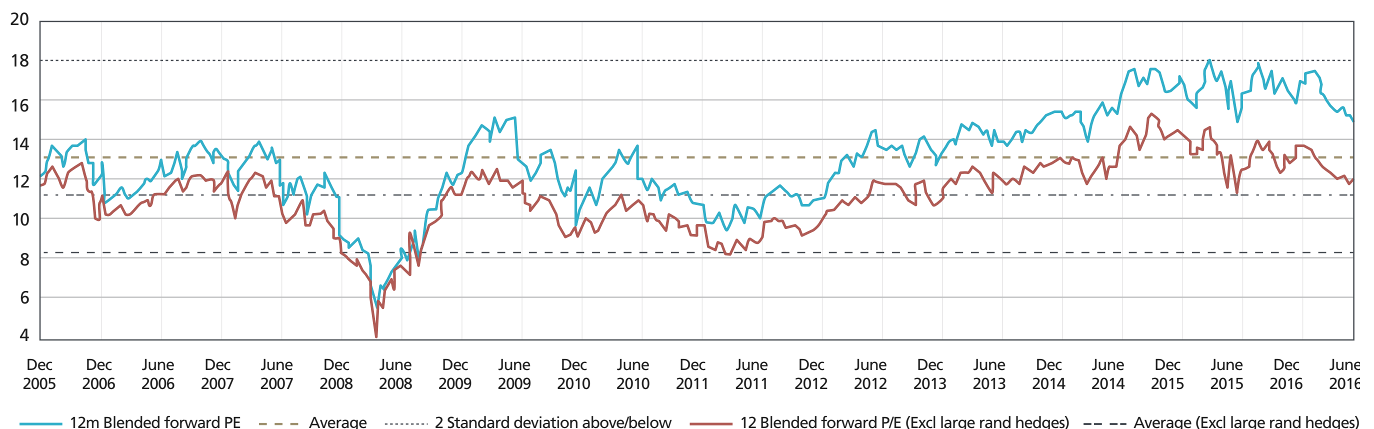
Proposed sector allocation

	Overweight		Neutral		Underweight
All Share					
Consumer discretionary					
Consumer staples					
Financials					
Health care					
Industrials					
IT					
Telecoms					
Large rand hedge					

Expected returns based on share prices on 9 January 2016
Source: Bloomberg

On a P/E basis, the ALSI seems overvalued at its current multiple when heavyweight rand hedge counters are included. The P/E ratio of the ALSI can be deceptive and might prove too simplistic to indicate potential return on its own. The actual valuation is concealed, given the weight and current P/E multiple of rand hedge counters which are dominant in the index. In the table below, we included a chart which excludes the impact of large rand hedge shares to reveal a P/E multiple that is in line with its long-term average. Investors should remember that the P/E multiple of the large rand hedge investments should be considered against prevailing low market interest rates in developed markets and not relative to their domestic peers.

ALSI 12-month blended forward P/E



Based on share prices as on 9 January 2016
Source: Bloomberg

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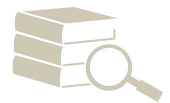

Current valuation levels

	Weight	Forward P/E	P/NAV	P/Sales	Div Yld (%)
Large rand hedges	25.3%	25.37	5.9	8.2	1.29
Consumer discretionary	7.2%	12.96	3.1	0.9	1.62
Consumer staples	6.5%	16.97	5.3	0.8	2.70
Energy	0.3%	7.21	0.9	1.6	1.98
Financials	20.1%	11.20	1.7	1.5	3.86
Health care	2.9%	15.23	2.6	2.1	2.42
Industrials	2.4%	11.86	1.5	0.5	3.61
Information technology	0.5%	12.52	1.6	0.3	1.97
Materials	22.6%	10.93	1.3	1.2	1.67
Real estate	7.1%	12.30	1.0	7.6	5.81
Telecommunication services	5.2%	14.56	2.5	1.6	7.12

Based on share prices as on 9 January 2016
Source: Bloomberg

As a sanity check we calculated the expected return on the metrics mentioned below to confirm our preliminary assessment:

- sector returns based on a reversion to the long-term mean based on:
    - Price to Net Asset Value ratio (P/NAV)
    - Price–sales ratio (P/Sales)
    - Dividend yield
    - Price-Earnings Ratio (P/E)
- consensus target price

A QUICK NOTE ON METHODOLOGY

The returns of large rand hedge stocks were considered separately because their dominance within their sectors skewed the conclusion. When the return for the reversion was calculated, the mean metrics were weighted towards the most relevant technique per sector. The analysis was completed at a sector level and a positive or negative view on a sector will not necessarily translate to all investments within the sector. Larger investments in the sector will dominate its expected return.

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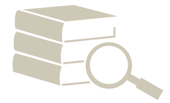
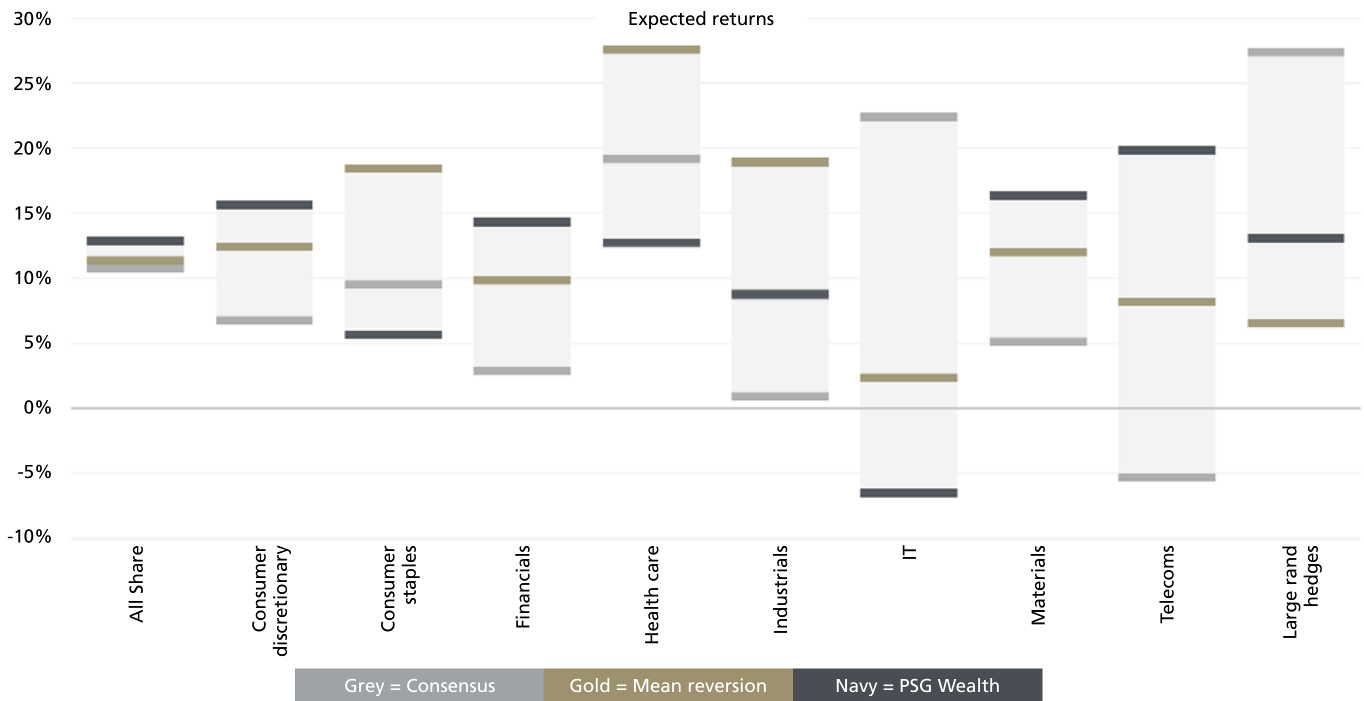


Expected returns for ALSI and its sectors for 2017



Expected returns based on share prices on 9 January 2016
Source: Bloomberg

Although our expectation for the market's return was confirmed, our analysis revealed substantial differences in expected returns at a sector level. Large distributions in expected returns are highlighted for the IT, telecoms and large rand hedge counters. The IT and telecoms sectors were the only sectors where one of the measures highlighted a potential negative return. When the right calls are made on shares where great amounts of uncertainty resides, then the portfolio will likely outperform. The reverse is also possible.

THE KEY STRATEGIC THEMES PER SECTOR WHICH COULD INFLUENCE THE ACHIEVEMENT OF OUR TARGET PRICES

Significant rand hedge
Events that could have a negative impact on tourism, would have a material impact on the sales of Richemont given that most of the group's stores are located in tourist hubs. The group's Swiss manufacturing base could result in periods of margin pressure if the franc appreciates. In the medium-term their results should benefit from the restructuring of the wholesale channel. The group remains confident that the middle class Chinese consumer will recover, which should drive the medium- to long-term demand from China. The outlook for pricing is likely to improve after significant repositioning. The sales growth in jewellery is expected to continue its momentum over watches.

The share price of Naspers is likely to be directed by the sentiment towards investments in global technology. The group's valuation remains vulnerable to a global tech sell-off. The rump the group remains undervalued, despite ongoing asset monetisation and repositioning to unlock value. Increased emerging market risk aversion and exchange rate fluctuations remain key risk to valuations. Local operations are exposed to

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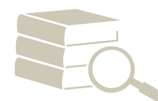

advertising revenues and a weak rand could have an adverse impact on the groups' profitability given the amount of imported content used.

British American Tobacco (BATS) has a wide economic moat, strong brands and cost advantages which are key to its competitive positioning. The stability of its earnings, consistently high returns on capital and high-dividend yields are also key to its popularity as a bond-proxy investment. In contrast to its peers in consumer staples, BATS can launch line extensions at a price premium to its heritage brand, which could translate into an improvement in its price/mix and margins. Global Drive Brands continue to perform exceptionally well with high single digit volumes growth. Significant progress in their new generation products, in terms of geographic rollout and product development, could provide an additional growth vector.

The large rand hedges in our universe seem to offer value on a relative basis, but our combined exposure to these counters remain neutral.

Consumer discretionary
Weak sentiment has created an attractive entry point for contrarian investors and this is our preferred sector going into 2017. The general retail sector remains highly competitive with businesses likely to compromise margin to maintain market share given all the new market entrants. Volatile exchanges rates will continue to impact retailer's profitability due to the high percentage of imported merchandise. The margins of clothing retailers should be assisted by an improvement in real wages as dissipating drought conditions could offer some relief through lower inflation. This could translate into more discretionary spending by consumers. We believe that the sectors' poor short-term prospects have been priced into share prices.

Industrial Transportation: The cyclical nature of businesses in this sector means that profitability is highly dependent on economic activity. Deterioration in global economic activity remains a key risk, with dominant players having diversified offshore. A weak rand constrains new vehicle sales, but support profits from their after-market sales (parts division). We feel a recovery in the growth rate of new cars and an improvement in general economic activity is already priced in and informs our neutral stance on this sector.

The restructuring of Steinhoff's operations presents it with opportunities to grow earnings ahead of its European peers. Despite the better-than-anticipated growth, the share trades on lower forward P/E multiples than its peers, suggesting some re-rating potential. Steinhoff agreed to a proposed transaction to acquire a majority stake in Shoprite via a multi-stage deal. The terms of this deal is still under discussion pending the valuation of Steinhoff's African assets and applicable exchange ratio.

Consumer staples
The earnings of food producers remain dependent on the relationship between the prices of raw material and the prices of products. Food producers are typically geared to the commodity inputs in their operations. Thus, any changes in items like maize, sugar and wheat would impact their profitability. Producers with strong brands should have the necessary pricing power to recover higher input costs through price increases. Local consumer staples struggled with a constrained consumer environment, which to some extent negated the benefit of higher food inflation. Normal weather patterns should alleviate the cost pressures of raw material.

Elements of commoditisation are also present in the food distribution industry. As such, weak demand typically leads to an increase in competitive pressures and margin erosion. The food services market is a highly competitive and fragmented industry. Distributors in food services primarily redistribute other people's products, leading to a limited scope for product differentiation. Increasing urbanisation, the rise of single-person households, the search for convenience and the increase in global tourism, should all provide a structural underpinning to the demand for food services.

We prefer selected food producers within the consumer stables sector relative to food retailers. We remain underweight the consumer staples sector as a whole given valuation concerns.

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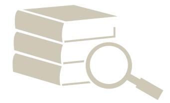

Financials

Banks are faced with numerous challenges, from pressures on their return of earnings (ROE) and weak macro-economic conditions to rising credit charges and tightening regulation. Changes in interest rates also affect their performance, impacting margins through the endowment effect. Lower interest rates squeeze margins, but have counteracting effects on the demand for credit. Given the high level of indebtedness of the South African consumer, this effect is likely be less pronounced given household income and access to credit. New competitors coming into the market, such as Discovery Bank, create additional challenges for the sector.

Although there are high barriers to entry with well-entrenched customer bases and strict regulatory requirements, newer competitors can operate very competitively from a cost perspective, as they are not burdened by the heavy legacy cost-structures of the more mature banking businesses. Another risk is changes to sovereign credit ratings, which impact costs of funding in wholesale markets. Despite these headwinds, the sector has proven its resilience and continues to find opportunities to sustain growth. This includes opportunities in Africa, more effective capital allocation, a focus on capital light operations, technological innovation and cost efficiency. Short-term prospects should be influenced by decreasing inflationary pressures. The sector still offers decent investment opportunities and provides solid returns to investors through dividends.

Profitability in the life and general financial sector is largely a function of the performance of investment markets, through asset-based fees and returns on shareholder assets. Similarly to banks, the highly regulated environment challenges the sector with increasing compliance-related costs and the possibility of operational mishaps. Operating in a saturated local market, the sector has seen an acceleration in deployment of capital into Africa in search of growth, which comes with additional risks. A key theme across the sector is the pursuit of disruptive technologies which presents both risks and opportunities. In the past year, this trend has accelerated with the launch of dedicated units to identify these opportunities.

We remain slightly overweight financials, but do not expect the same level of outperformance the sector achieved last year.

Healthcare

Investments in the healthcare industry are normally lower risk investments, due to the sectors' defensive nature and high barriers to entry. Positive structural drivers include an aging population, increasing rates of diagnosis, particularly for lifestyle diseases, and public sector funding challenges. This results in a continuous drive for private healthcare demand, resulting in hospitals continuing to invest in beds. The slow approval of new beds and nursing shortages hamper this. Changes in legislation remain a risk both locally and abroad. An example was the implementation of the 20%-Thiqa co-payment in Dubai during July 2016 and the proposed implementation the Insurance Contract Act (VVG) levy in Switzerland.

Locally, changing regulation (pending market inquiry into competition) could pose a risk to hospital pricing. The National Health Insurance (NHI) also poses a risk for the industry. A shift in the popularity of low cost medical aid packages (Discovery KeyCare), and changes in formal employment (more medical scheme members) can also influence the sectors' prospects. Shifts between higher-margin surgery caseloads and lower-margin medical cases could cause some unpredictable results. Despite concerns around the sectors' bond-proxy characteristics, we feel that specific investments are starting to reflect value.

Competition in the global pharmaceutical market remains fierce. Growth in this industry is underpinned by strong EM market health/drug demand. Legislative and regulatory changes introduced by the Department of Health (DoH), SA Pharmacy Council (SAPC) and Medicines Control Council (MCC) could impact the turnover and margins of pharmaceutical companies. This could also impact their ability to obtain licences and to launch private label, exclusively scheduled and complementary medicines. Pharmaceutical regulations and the use of increasingly strict quality standards have led to raised costs in compliance across all territories. Low-cost Asian pharmaceutical companies are active in all major territories with many competing generics

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being launched upon patent expiry of a molecule. Shifts toward generic medicines could erode margins (the level of discount to that of the originator molecule presently sold in the market). Exchange rate volatility remains a risk, because most active pharmaceutical ingredients (API) are priced in US dollars. The weaker rand presents an attractive opportunity for exports of API and finished dosage formulations (FDF), which could offset some of the cost-pressures experienced in other product categories.

This sector seems to be priced more realistically after a weak performance during 2016. We are neutral on this sector as a whole, but do recognise potential in specific counters.

Industrials

The performance of industrial shares remains largely dependent on the improvement in the formation of domestic fixed capital, which is a central aspect of the National Development Plan (NDP). Improved commodity prices could significantly increase the capex and most likely be the driver of the sectors' fortunes. Despite the muted macro-outlook, we feel that the construction sector still offers value with earnings having the potential to surprise off a very low base. We prefer construction counters relative to general industrial shares where we feel improved operating conditions are already being factored into the current valuations. We remain slightly underweight this sector as a whole.

Information technology

As workloads increasingly move to cloud, customers are abandoning traditional software solutions, which impacts revenues while firms continue to invest large sums into building and maintaining the infrastructure required to further develop cloud-based product offerings. Thus, competition remains high as firms race to become leaders of the software food chain. Global demand for IT products and services remains strong. The public cloud market is expected to grow significantly which provides opportunities for firms to grow. Local investors have limited options when considering an investment in this sector. The sector is a small part of the index and not very liquid. We do not recognise substantial value in the sector resulting in our underweight positioning.

Telecommunications services

The subdued growth trend in voice revenue is expected to persist. The number of internet enabled mobile phone users, however, continues to grow which contributes to higher data revenue as the demand for mobile data accelerates. The focus for telecom-operators remain the monetisation of data revenue through value-added services and a reduction in churn-through innovative promotions.

Lower dollarised network costs and improved operating expenditure controls should support margins. Sector sentiment remains sensitive to changes in government regulation. The government's September white paper policy is aimed at achieving mobile and fixed open access. The changes will likely guide providers to become more competitive at a service level, rather than at an infrastructure level. This policy is also focused on lowering structural barriers to entry across the market. The shift in competition is expected to increase accessibility of mobile services with prices becoming more affordable for the consumer. The competitive landscape in fixed line is also adjusting with a material shift from traditional fixed line connections to fiber to the home (FTTH) connections.

Valuation in the telecoms sector remain divergent with sentiment toward MTN being top of mind.

Opinions regarding the valuation of MTN remains divergent, given the impact of the Nigerian macro-environment on the company. Current oil price levels and complications in repatriating earnings could lead to a concern that dividends might be at risk.

The group, however, has an enviable position across 21 markets, which still has low SIM penetration and even lower data penetration. In addition, value-added service (VAS), e-commerce and mobile money offers the sector additional revenue opportunities.

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WITH MULTIPLES IN LINE WITH THEIR LONG-TERM AVERAGES WE EXPECT RETURNS TO MATERIALISE PRIMARILY THROUGH GROWTH IN EARNINGS AND NOT THROUGH A MATERIAL CHANGE IN VALUATION MULTIPLES

We forecast 13% growth in EPS for the year ahead, with a slight decline in the P/E multiple. We see value in the general retail sector and to a lesser extent in the general financial sector, while selected rand hedge hold value on a relative basis. We remain underweight food and drug retailers which we feel are fully priced.

We believe ongoing political and policy uncertainty will continue to create volatility. Changes in the perception of sovereign risk (positive and negative) and its flow through to exchange rates and interest rates, can have an impact on portfolio values. Global investment markets are expected to remain volatile given the difficulty to forecast macro-variables. Euro-populism and Brexit hold risks to investment markets that are difficult to quantify.

PSG Wealth

Fixed income

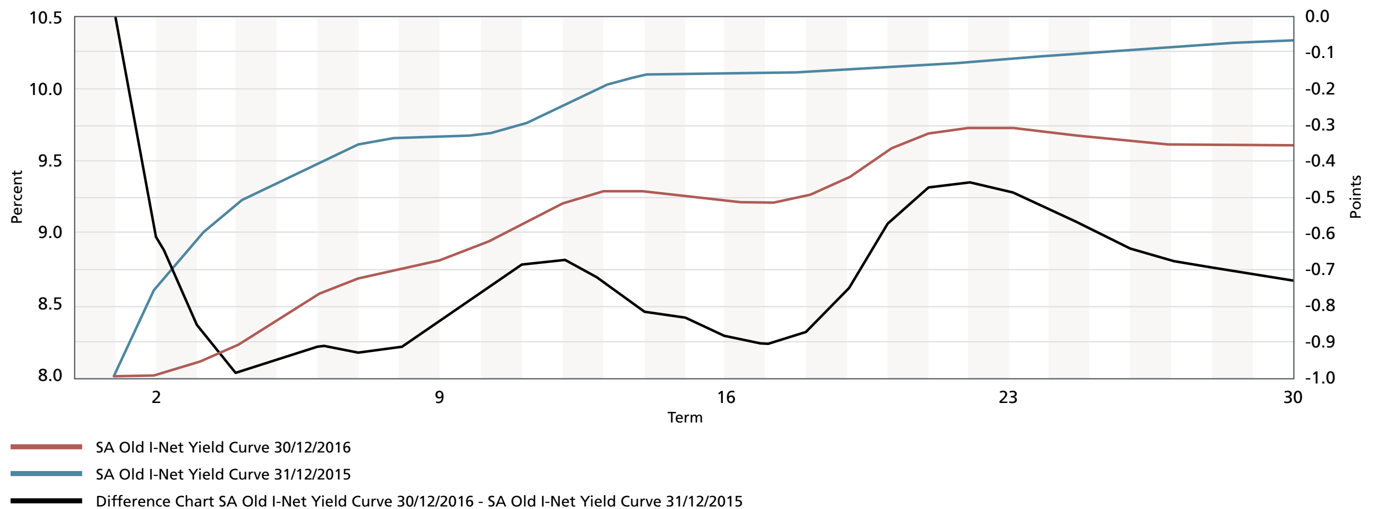
Over the course of 2016, the yield curve moved lower across the board

However, to a different extent, the yield curve also moved over various maturities with no clear correlation to the duration of the long bond space.

The table below shows that ALBI long bonds generated quite an astonishing 17.46% return for 2016, following dissipating interest rate hike concerns, and a rally following on weak performances at the end of 2015.

Even short-dated bonds generated double digit returns (10.08%), and the ALBI as whole, with a duration of roughly seven years, generated a 15.45% return. The bond sector benefitted from more dovish interest rate hike expectations on the domestic front.

Yield curve for last year



Source: I-Net Bridge

Domestic bond performance for the past five years

	Index	Value as at 31 December 2016	1M	3M	6M	1Y	3Y	5Y
Local bonds	ALBI	530.34	1.57%	0.35%	3.78%	15.45%	6.90%	7.36%
	ALBI 1-3 years	408.23	0.78%	1.44%	3.68%	10.08%	6.78%	6.60%
	ALBI 3-7 years	502.70	1.21%	1.07%	4.00%	13.44%	7.30%	7.33%
	ALBI 7-12 years	579.19	1.45%	0.69%	3.88%	15.40%	6.56%	7.41%
	ALBI 12+ years	572.58	1.76%	-0.04%	3.94%	17.46%	7.23%	7.78%
	GOVI	523.15	1.58%	0.35%	3.73%	14.93%	6.81%	7.20%
	OTHI	536.23	1.54%	0.33%	3.85%	16.73%	7.40%	8.21%

Source: PSG Wealth research team

Fixed income

THE PRIME RATE IS AT THE SAME LEVEL AS EIGHT YEARS AGO

The prime rate is currently at the same level as it was in August 2009, at 10.50%. Although rate normalisation has been topical for some time, South Africa's official short-term interest rate has actually only increased by 2% over the last four years. At that stage (July 2012) rates were at 30-year lows of about 8.50%.

In 2012, the Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) followed very accommodative monetary policies, especially after the strain placed on our economy during the global financial crisis. Interest rates were slashed by 5% from 15.5% to 10.5% from June 2008 to August 2009. Although the general outlook on interest rates has been negative (especially after the MPC indicated earlier last year that it intends to normalise rates as required), the absolute cost of finance in the economy remains fairly accommodative, relative to long-term averages.

WE BELIEVE RATE NORMALISATION IS INEVITABLE OVER THE MEDIUM TERM

Although rates are higher than what we experienced over the recent past, they still remain unsustainably low. Since inflation is only marginally breaching the upper target limit of 6% at this stage, we expect the MPC to follow a more accommodative stance given poor economic growth. However, if inflation breaches the 6% upper target limit by a material margin, we believe the MPC will proceed with small incremental rate increases.

When the rising interest rate cycle does start to take effect, we naturally expect that it will have a negative impact on more flexible, negatively correlated fixed interest instruments like bonds, preference shares and property income assets. However, given our expectations that these moves will be small, protracted and reasonably anticipated, we don't expect that the impact of these individual hikes will contribute to excessive volatility in capital markets.

The cost of capital, however, will continue to rise as interest rates increase and bond yields will adjust accordingly. In addition, profile changes to sovereign debt will also impact the cost of capital negatively. We think most of the immediate effects of a potential downgrade

Repo rate increases since 2006

Year	Day and month	Repo rate
2016	18 March	10.50
	29 January	10.25
2015	20 November	9.75
	24 July	9.50
2014	18 July	9.25
	31 January	9.00
2012	20 July	8.50
2010	19 November	9.00
	10 September	9.50
	26 March	10.00
2009	14 August	10.50
	29 May	11.00
	4 May	12.00
	25 March	13.00
	6 February	14.00
2008	12 December	15.00
	13 June	15.50
	11 April	15.00
2007	7 December	14.50
	12 October	14.00
	17 August	13.50
	8 July	13.00
2006	8 December	12.50
	12 October	12.00
	3 August	11.50

Source: SARB

Fixed income

of sovereign debt are already reflected in asset prices. However, we are aware that a 'second-round effect' may occur. What the cost of this second round may be, remains uncertain.

IT WOULD BE WISE TO POSITION INVESTMENTS FOR UNCERTAINTY

We believe now is the time to place even greater focus on liquidity, quality and diversity. There are many unknowns in prevailing market conditions. Therefore, a degree of quality and manoeuvrability are essential components of an investment strategy. We will continue to assess the value and risks of investment opportunities as and when they present themselves, and adjust our solutions accordingly.

We are in favour of increasing our position in cash and short-dated sovereign debt given the conditions mentioned above. We maintain a somewhat more negative view on longer-dated nominal bonds.

Our positioning

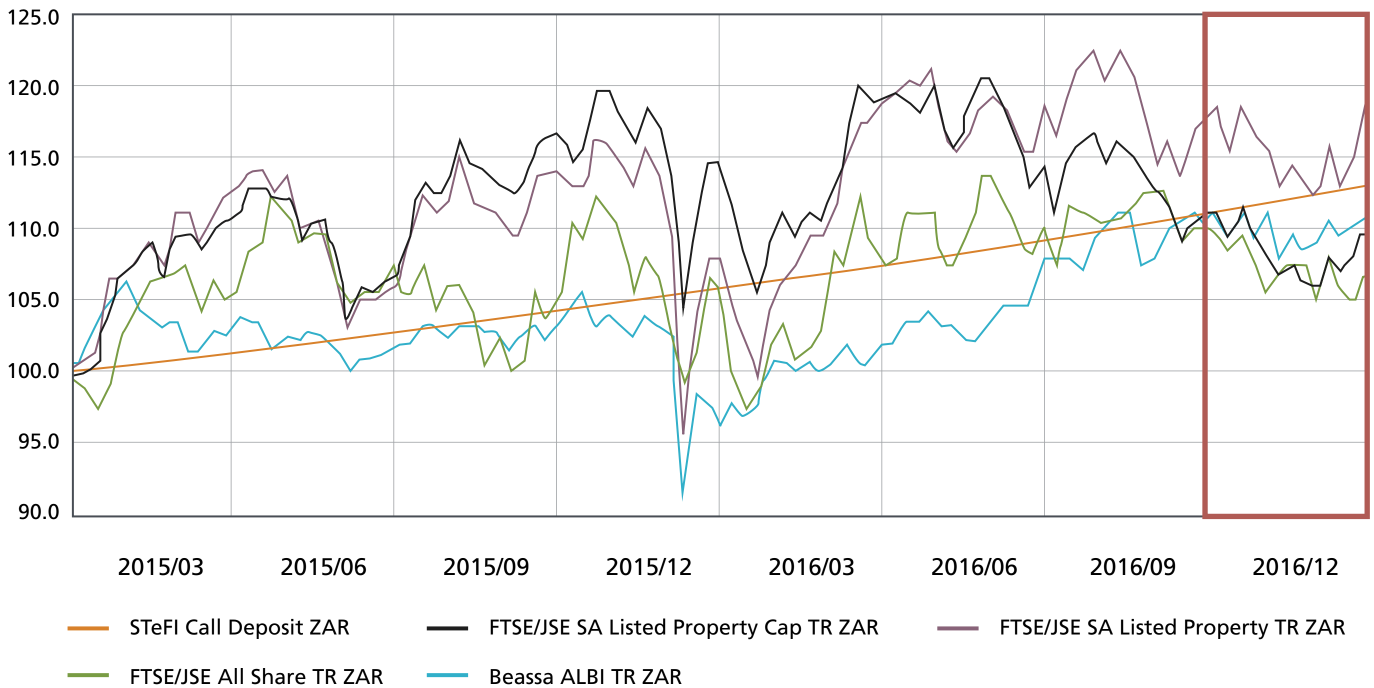
Metric	Position	Direction	Reasoning
Modified duration	Underweight	-	Interest rate risk
Credit risk	Underweight	-	Deterioting domestic economic climate
SA cash	Neutral	+	Real yields entering positive territory
SA sovereign debt	Neutral	+	Negative economic outlook by rating agencies priced in
Nominal bonds (1 - 3 years)	Overweight		Due to underweight positioning in longer-dated bonds
Nominal bonds (3 - 7 years)	Underweight		Prefer cash
Nominal bonds (7+ years)	Underweight		Reducing interest rate risk
Inflation-linked bonds	Overweight	-	Stronger rand expected over medium term

Source: PSG Wealth research team

PSG Wealth

Property commentary

Investment growth



Source: Morningstar

THE SOUTH AFRICAN LISTED PROPERTY INDEX (SAPY) WAS THE SECOND BEST PERFORMER OUT OF THE FOUR TRADITIONAL ASSET CLASSES FOR THE FOURTH QUARTER OF 2016

Local cash was the best performer, returning 1.69% for the fourth quarter. The SAPY returned 1.26%, wiping out losses in the previous two quarters. South African bonds only returned 0.32% for the quarter, however, on a year-to-date (YTD) basis bonds returned a solid 15.42%. Domestic equities ended the quarter in the red, down 2.09%.

In October, the performance of income generating assets like cash (+0.57%), the SAPY (+0.5%) and bonds (+0.64%) were in line with each other. The equity market struggled with declines across the board and ended in the red, down 2.5%.

The outcome of the US presidential election had a profound impact on bond markets in November. Trump's policies concerning fiscal stimulus sent the yield of 10-year US treasuries up by more than 50 basis points. Uncertainty about the outlook for emerging markets weakened the rand by 4.4%, with bond yields rising more than 30 basis points. The SAPY followed the bond market lower and reversed its earlier gains, declining by 3.34% in November.

In December, the US Federal Open Market Committee (FOMC) approved the Fed's first interest rate hike in a year. However, the FOMC also surprised saying they foresee three more rate increases in 2017. All four major asset classes ended December in the green, led by the SAPY with a return of 4.24%, followed by local bonds with a return of 1.54%.

PSG Wealth

Property commentary

REPORTING SEASON

The reporting season and year came to an end with most companies reporting either half- or full-year results. Here are some of the highlights:

Company	Market cap (R mil)	Reporting period	DPS growth	DPS forecast
Accelerate	6964.52	Interim	8.1%	7%-8%
Arrowhead A	9029.87	Full year	9.9%	6%-8%
Investec Australia Property fund (IAPF)	4386.34	Interim	6.0%	6%-8%
Investec Property fund	10846.53	Interim	2.2%	Flat
Rebosis	6869.98	Full year	8.2%	7%-9%
Redefine	57207.51	Full year	7.5%	7.5%-8.5%
Sirius	6642.08	Interim	51.1%	
Stenprop	5303.61	Interim	7.1%	1%
Vukile	13111.22	Interim	7.0%	7%

Sources: Bloomberg, Catalyst Fund Managers

WE FOUND THAT ALL SUBSECTORS IN THE PROPERTY ARENA HAVE FUNDAMENTALLY DETERIORATED, WITH THE OFFICE SECTOR THE WORST HIT

Generally there is an oversupply of office space in an environment of low GDP growth. Given the low growth environment in the South African economy, demand for vacant space will remain muted, placing further pressure on rentals. Retaining tenants in general has become a difficult task, and those with improving tenant retention rates, have done so at the expense of lower escalations on the renewal of rentals (rental reversions). New lease escalations across all subsectors are also trending lower. The shortage of residential space, particularly student housing, will create some opportunities.

Despite sluggish local fundamentals, South African-focused funds have outperformed foreign-focused funds. Locally listed companies with exposure to the United Kingdom (UK) and the rest of Europe were among the worst performers. The historically strong correlation between bonds and domestic property has been somewhat diluted by the increasing number of offshore companies on the SAPY.

THE LACK OF GROWTH IN THE LOCAL ENVIRONMENT LED TO INVESTORS LOOKING FOR OPPORTUNITIES OFFSHORE

Growthpoint was the latest company to venture out into Central Eastern Europe (CEE), through its 26.88% stake in Globalworth Real Estate. Globalworth has agreed to issue Growthpoint with 23.3 million subscription shares and one million fully-paid up fee shares. This gives Growthpoint an initial stake of 24.3 million shares for a total purchase consideration of €186.4 million. This represents less than 5% of Growthpoint's market capatalisation. Hyprop also concluded the acquisition of the Else Macedonian Mall and Skopje City Mall for €92million. This is the group's third purchase in South Eastern Europe, through its UK subsidiary, Hystead Limited. Earlier in the quarter, MAS Real Estate entered into proceedings to expand into central and Eastern Europe with a focus on acquiring a leading regional shopping centre.

The property sector continued with the consolidation-theme during the fourth quarter of 2016. The largest and most recent was the proposed merger of NEPI and Rockcastle. NEPI and Rockcastle concluded a framework agreement pursuant to which their respective businesses would effectively be merged in an entity named NEPI Rockcastle PLC, newly-incorporated in the Isle of Man. The merged entity is expected to become the largest listed real estate player in CEE.

Property commentary

Fortress made a general offer to acquire all Lodestone shares by exchange of one Fortress A ordinary share and one Fortress B ordinary share for every 6.66667 Lodestone shares held. The offer was accepted by the holders of 99.43% of all Lodestone shares in issue.

Pivotal was recently delisted as a result of the acquisition of its entire issued share capital by Redefine. The acquisition concluded in an exchange for the issue of 460 million Redefine shares to scheme participants. This translates into an assumed swap ratio of 1.38537 Redefine shares per scheme share and 31.2 million Echo Polska shares, which equates into 0.09382 Eco Polska shares per scheme share.

Accelerate announced its intention to issue up to 125 million new Accelerate shares at an issue price of between 610 and 650 cents per share. The pricing range represents an estimated 7.1 to 12.9% discount to Accelerate's NAV per share.

IAPF entered into a contract for sale with associated entities of Dexus Property Group and Brookfield to acquire a 50% share in the property located at 324 Queen Street, Brisbane, with Abacus Property Group for a total purchase consideration of 132 million Australian dollars. This represents attractive value and upside at an acquisition cost per m² of of 6600 Australian dollars per square meter.

Rebosis entered into an agreement to acquire a 100% shareholding in Baywest City, Billion Property Developments, Billion Asset Managers and Billion Property Services. In terms of the transaction, the amount of R533.8 million, being a portion of the aggregate transaction amount, is payable in cash to Billion Group, Nedbank Corporate and Investment Bank. Rebosis will raise the R533.8 million from shareholders by way of a fully subscribed claw-back offer, at a price of 1 071 cents per ordinary share in Rebosis. Billion and Nedbank will therefore be issued with up to 41.8 million and 8 million Rebosis shares respectively.

DOMESTIC-HEAVY PROPERTY COMPANIES TOPPED THE CHARTS IN THE FOURTH QUARTER

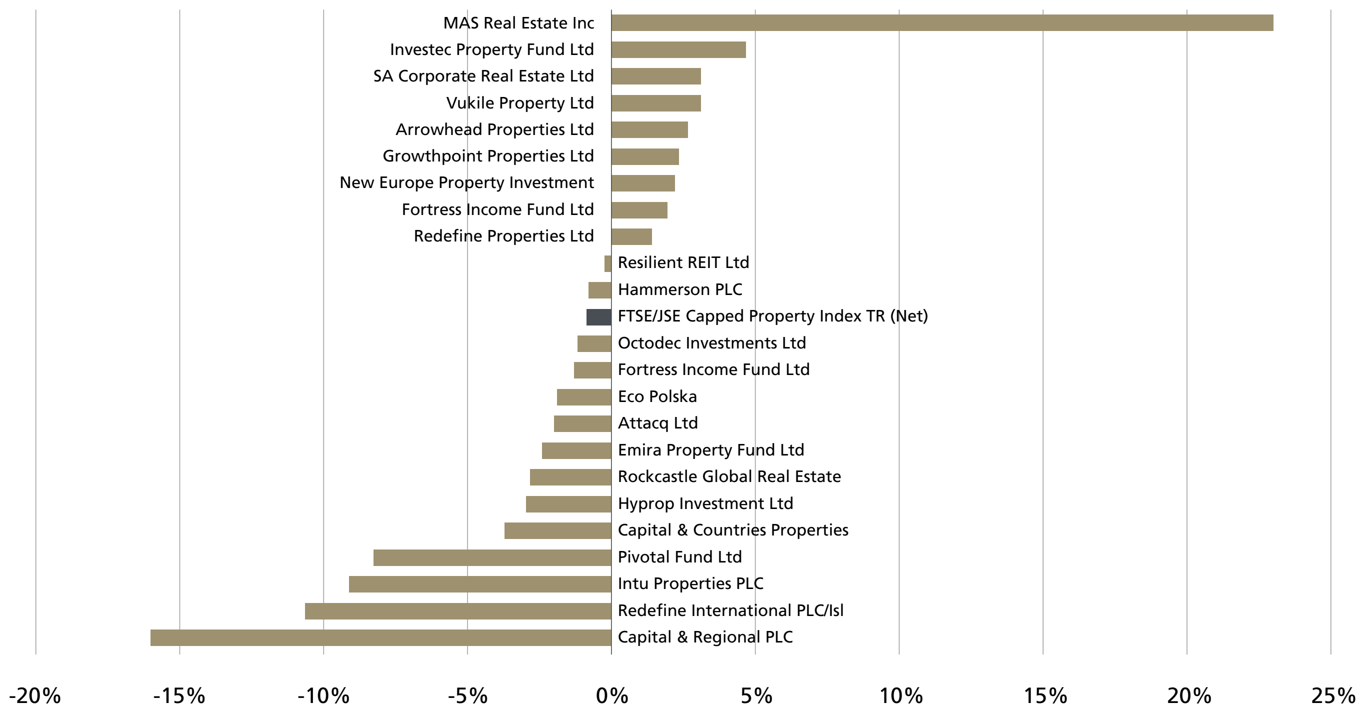
UK-focused real estate investment trusts (REITs) were amongst the worst performing counters, as fears over lower UK property prices continued, following the UK's vote to leave the EU. Mas Real Estate was the top performing stock with a return of 22.9%. Investors reacted favourably to the group's announcement to expand into the CEE region. Next on the list of top achievers was Investec Property Fund (+4.65%) and SA Corp (+3.12%).

The continued devaluation of the sterling penalised those with UK asset exposure such as Capital & Regional (-15.97%), Redefine International (-10.7%) and Intu Properties (-9.3%).

PSG Wealth

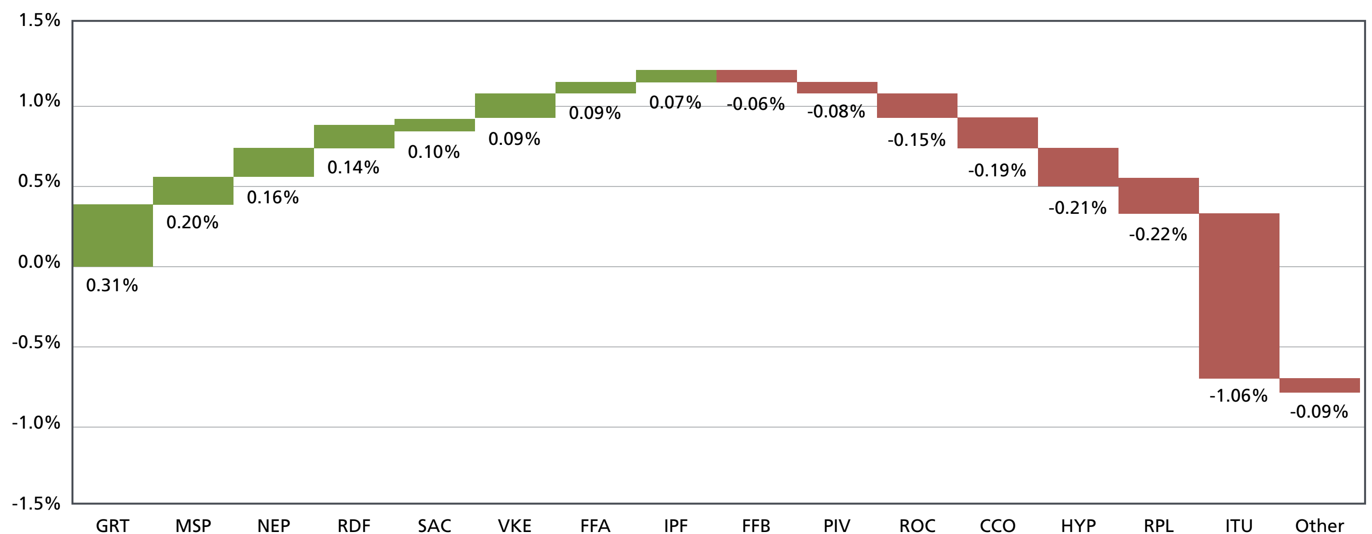
Property commentary

FTSE/JSE Capped Property Index underlying quarter four returns (-0.82%)



Source: PSG Wealth research team, Bloomberg

Largest detractors and contributors to FTSE/JSE Capped Property Index



*FTSE/JSE Capped property Index TR (Net)

Source: Bloomberg, Catalyst Fund Managers, PSG Wealth research team

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Property commentary

THE FTSE/JSE CAPPED PROPERTY INDEX ENDED THE QUARTER IN THE RED, DOWN 0.82%

UK-focused REIT, Intu was the largest detractor for the last quarter of 2016 and contributed 106 basis points to the overall decline of the index. This was followed by Redefine International and Hyprop Investments, which contributed a further 43 basis points to the index's decline. The largest South African-based real estate company, Growthpoint, added 31 basis points to the index. This was followed by Mas Real Estate and NEPI who contributed 20 and 16 basis points, respectively.

ON THE GLOBAL FRONT THE FTSE EPRAN/NAREIT DEVELOPED RENTAL INDEX ENDED THE QUARTER ON A NEGATIVE NOTE, WITH A NET TOTAL RETURN OF -5.92% (IN USD)

Germany came in as the worst performing listed real estate market, with a double digit decline of 13.99%, followed by a subdued performance in Hong Kong with a total negative return of -12.62% (in USD). This was despite a strong performance in the Hong Kong Central CBD region, which showed a high demand for office space by Chinese firms, low vacancy rates and soaring rental prices. Although luxury retail sales have declined significantly due to the pressures of a decline in tourism, restaurants and necessity-shopping focused retailers continued to deliver solid results. Greece ended the quarter with the best performance, recording a 6.71% return for the same period, while Israel achieved the second spot with a total return of -1.52%.

The Australian property market was led by large returns generated by steady demand and low supply for office space in Sydney. The retail sector saw a shift in performance from small neighbourhood grocery stores to upper-end shopping malls as consumers became more focused on the quality of shopping experiences and with e-commerce accounting for an increasing percentage of marginal sales.

The effects of 'Brexit' impacted the London office space sector with a rise in supply, while occupancy levels declined due to the uncertain future of businesses in the region.

The US reporting season saw results generally on par with market expectations with solid growth achieved by their REITs.

THE EFFECT OF A LACKLUSTRE LOCAL ECONOMY WAS REFLECTED IN THE REPORTED RESULTS AND WE ANTICIPATE THIS TO PERSIST ACROSS ALL SECTORS

This is especially likely as sluggish demand for vacant space continues to put pressure on rentals. Despite the recent underperformance and an uncertain outlook for the UK-economy post Brexit, UK-focused REITs continue to experience a stable footfall, high occupancy rates, steady rental-renewals and property development in the UK remains robust. We will continue to monitor the risks of illiquidity in the South African listed property sector, which remains a general concern. We remain of the view that the interest rate cycle will impact domestic economic strength, affordability and sentiment.

Where we are required by mandate to hold listed property, we prefer to hold counters with the following characteristics:

- low price-to-book values
- low levels of debt/gearing and strong credit ratings
- using of structures that offer superior liquidity, like REITs
- superior distribution growth track records

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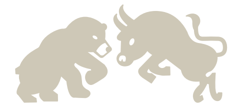
Preference shares



The FTSE/JSE Preference Share Index gained 2.0% in the final quarter of 2016

This follows a 2.2% gain in the third quarter and a 9.0% gain in the second quarter of the year. This strong recovery in prices brought the total return for 2016 to 18.8%. This push is surely welcomed by preference share investors, given that the total return for 2015 came in at a meager 2.6%. The recovery in prices was largely buoyed by a more dovish interest rate environment and a general improvement in preferences share market sentiment.

Returns on income-orientated asset classes

	1 month	3 months	6 months	1 year
Beassa 1-3 year TR ZAR	0.8	1.4	3.7	10.1
Beassa 3-7 year TR ZAR	1.2	1.1	4.0	13.4
Beassa 7-12 year TR ZAR	1.4	0.7	3.9	15.4
FTSE/JSE Preference Share TR ZAR	-0.2	2.0	4.3	18.8
FTSE/JSE SA Listed Property TR ZAR	4.2	1.3	0.5	10.2

Source: I-Net BFA

Issued yields expressed as a percentage of prime are generally below the prime rate. However, some current effective yields (yield over clean price) are generally above prime at 10.50% due to lower prevailing clean prices.

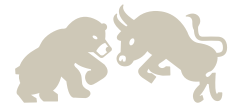
Domestic preference share characteristics

	STANDARD	ABSA	FIRSTRAND	NEDBANK	INV-LTD	INV-BANK	INV-PREF	CAPITEC	SASFIN
VALUE	SBPP	ABSP	FSRP	NBKP	INPR	INLP	INPPR	CPIP	SFNP
Price	R 89.18	R 780.00	R 85.10	R 9.30	R 76.50	R 83.20	R 102.00	R 92.50	R 82.00
Yield as % of prime	77.00%	70.00%	75.56%	83.33%	77.78%	83.33%	95.00%	83.33%	82.50%
Dividends	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum	Non-cum
Accrued dividends	R 2.75	R 24.97	R 2.89	R 0.33	R 0.89	R 0.96	R 1.09	R 2.64	R 2.28
Clean price	R 86.43	R 755.03	R 82.21	R 8.97	R 75.61	R 82.24	R 100.91	R 89.86	R 79.72
Liquidity	SBPP	ABSP	FSRP	NBKP	INPR	INLP	INPPR	CPIP	SFNP
Market cap (Rm)	R 4.725m	R 3.857m	R 3.830m	R 3.333m	R 2.464m	R 1.285m	R 13m	R 168m	R 152m
Avg monthly trade (Rm)	R 67.29m	R 49.95m	R 48.46m	R 52.35m	R 29.60m	R 15.39m	R .12m	R 4.47m	R 1.53m
% of market cap traded monthly	1.42%	1.30%	1.27%	1.57%	1.20%	1.20%	0.88%	2.65%	1.01%
Effective yield as a % of prime	89.09%	92.71%	91.91%	92.91%	102.87%	101.33%	94.15%	92.73%	103.49%
Effective yield	9.35%	9.73%	9.65%	9.76%	10.80%	10.64%	9.89%	9.74%	10.87%

Source: Grindrod Bank

PSG Wealth

Preference shares

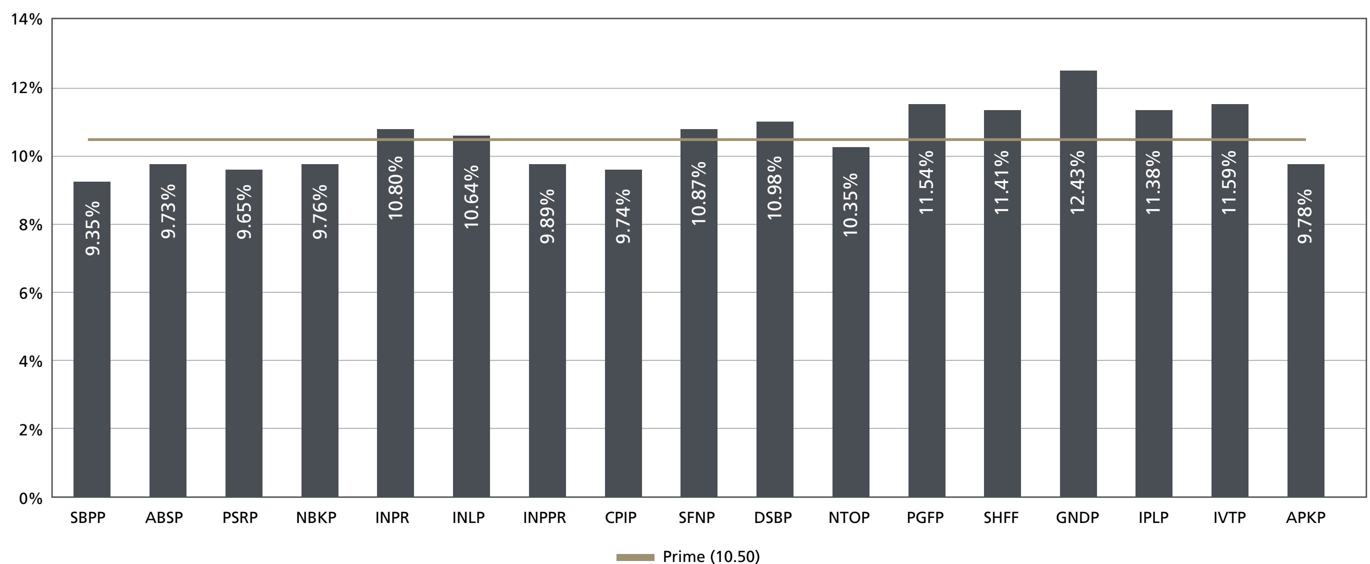


Domestic preference share characteristics

	DISCOVERY	NETCARE	PSG	BRAIT	STEINHOFF	GRINDROD	IMPERIAL	INVICTA	ASTRAPAK
VALUE		NTCP	PGFP	SHFF	GNDP	IPLP	IVTP	APKP	
Price	R 99.00	R 85.50	R 78.45	R -	R 78.00	R 77.27	R 78.70	R 94.00	R 98.25
Yield as % of prime	100.00%	82.50%	83.33%	104.00%	82.50%	88.00%	82.50%	102.00%	88.89%
Dividends	Non-cum	Cum	Cum	Cum	Cum	Cum	Cum	Cum	
Accrued dividends	R 3.37	R 1.78	R 2.64	Redeemed	R 2.11	R 2.96	R 2.61	R 1.58	R 2.81
Clean price	R 95.63	R 83.72	R 75.81	R -	R 75.89	R 74.31	R 76.09	R 92.42	R 95.44
Liquidity	DSBP	NTCP	PGFP	SHFF	GNDP	IPLP	IVTP	APKP	
Market cap (Rm)	R 792m	R 556m	R 1.366m	R m	R 1.170m	R 572m	R 357m	R 705m	R 147m
Avg monthly trade (Rm)	R 11.16m	R 35.45m	R 22.17m	R .00m	R 12.60m	R 10.71m	R 19.58m	R 7.07m	R 3.06m
% of market cap traded monthly	1.41%	6.38%	1.62%	0.00%	1.08%	1.87%	5.48%	1.00%	2.08%
Effective yield as a % of prime	104.57%	98.54%	109.92%	0.00%	108.71%	118.43%	108.43%	110.37%	93.14%
Effective yield	10.98%	10.35%	11.54%	0.00%	11.41%	12.43%	11.38%	11.59%	9.78%

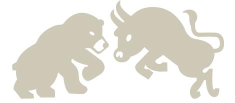
Source: Grindrod Bank

Effective yield



Source: Grindrod Bank

Preference shares



The market capitalisation of some preference share issues are well below R1 billion, and some trading volumes remain very low in absolute terms. Investors should be mindful of potential liquidity constraints on certain preference shares. In many cases it is more sensible to consider a unitised product holding a diversified selection of preference shares. These collective investment scheme structures also offer additional peace-of-mind in terms of approval from the Financial Services Board, improved liquidity and ongoing portfolio management.

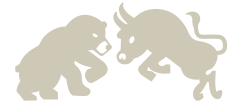
In addition, Basel III capital adequacy requirements stipulate that banks must hold specified minimum amounts of capital in their tier one common equity, as set out by the South African Reserve Bank (SARB). Existing preference share listing documents of South African banks currently do not satisfy the requirements under Basel III. However, the SARB has allowed a 'grandfathering' period during which preference shares allocated towards tier one capital will be reduced by 10% per annum (currently 70%).

Over the last two years we have communicated that we expect some banks to repurchase their preference shares in the open market, or incentivise investors to accommodate any changes to the legal risks in the listing documents.

This may lead to a decline in both the variety and number of preference shares available for investment in the short term. The first announcement by one of the big domestic banks (Nedbank Group Limited) was on 14 April 2016. Nedbank is the fourth-biggest issue (R3.33bn) on the FTSE/JSE Preference Share Index.

Since the Nedbank announcement, Investec also announced that they would be redeeming their perpetual preference shares issued out of their UK operations through a voluntary tender offer process. This redemption was funded by an equity capital raise by the company and covered only the INPPR and INPP units (Investec PLC preference shares), and none of the perpetual preference shares issued out of their South African business.

Preference shares



Market capitalisation (R'mil)

Standard, 4725
ABSA, 3857
Firstrand, 3830
Nedbank, 3333
Inv-Ltd, 2464
Inv-Bank, 1285
Inv-Pref, 13
Capitec, 168
Sasfin, 152
Discovery, 792
Netcare, 556
PSG, 1366
Brait, 0
Steinhoff, 1170
Grindrod, 572
Imperial, 357
Invicta, 705
Astrapak, 147

Source: Grindrod Bank

CURRENT RISKS FOR PREFERENCES SHARES

Although preference shares can be viewed as suitable income-generating investments for some high-net-worth investors, and although prime-linked yields are set to increase as interest rates eventually normalise, we feel that there are some significant capital risks in this asset class. The domestic economy is struggling, making further downgrades to South African sovereign ratings, local banks and state-owned enterprises that are guaranteed by the South African government increasingly likely. If this happens, large international institutional investors and passive investment funds may be compelled to exit these markets.

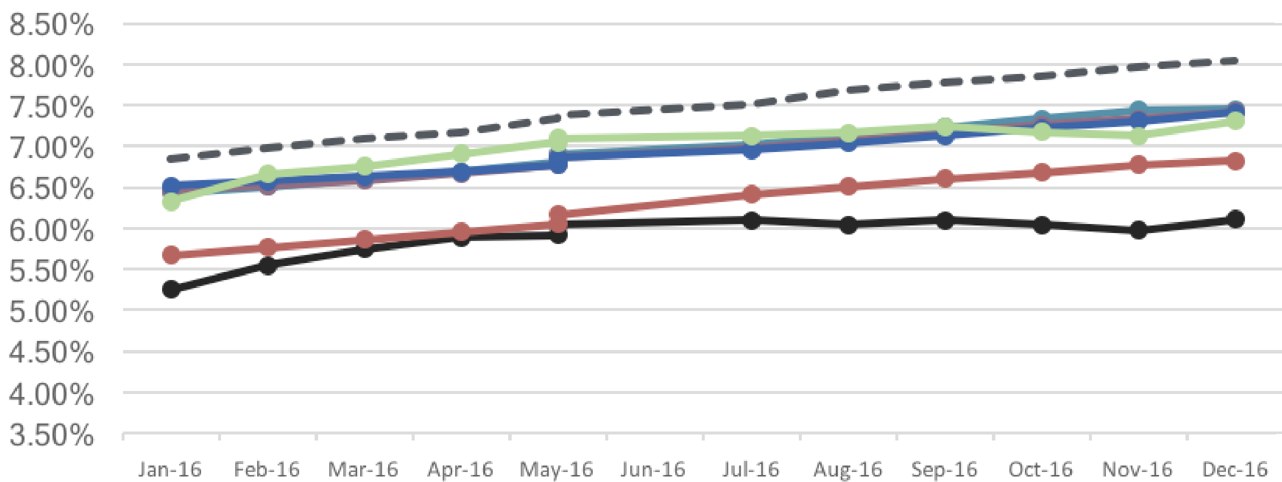
This will drive yields higher and will put capital values of preference shares under pressure. In addition, we don't easily sacrifice liquidity, as it often places an investor in the position of price-taker when fundamental asset values are skewed disproportionally to what can be obtained in the open market.

Cash management options

If you require exposure to cash, then the PSG Wealth Enhanced Interest Fund remains one of the most preferred investment vehicles for returns and flexibility

The effective after-cost yields for both the PSG Wealth Enhanced Interest Fund (8.05%) and the PSG Money Market Fund (7.41%) are currently well above the STeFI call rate (6.82%). The average yield of the ASISA Money Market Fund peer group is 7.45%.

Rate comparison (Net of fees)



	Jan-16	Feb-16	Mar-16	Apr-16	May-16	May-16	Jul-16	Aug-16	Sep-16	Oct-16	Nov-16	Dec-16
JSE Trustees Rate (Net)	5.25%	5.55%	5.75%	5.89%	5.92%	6.04%	6.10%	6.04%	6.10%	6.04%	5.97%	6.11%
ASISA MM Avg (Net)	6.43%	6.51%	6.60%	6.69%	6.80%	6.91%	7.02%	7.13%	7.23%	7.34%	7.44%	7.45%
AlexForbes MM Index (Net)	6.46%	6.51%	6.58%	6.67%	6.77%	6.87%	6.97%	7.07%	7.16%	7.26%	7.34%	7.42%
STeFI Call (Net)	5.67%	5.77%	5.85%	5.95%	6.05%	6.16%	6.41%	6.51%	6.60%	6.68%	6.77%	6.82%
PSGW EI D (Net)	6.84%	6.97%	7.09%	7.17%	7.34%	7.38%	7.51%	7.68%	7.77%	7.86%	7.96%	8.05%
PSG Money Market (Net)	6.51%	6.57%	6.63%	6.69%	6.77%	6.86%	6.95%	7.04%	7.13%	7.22%	7.31%	7.41%
Investec CCM (Net)	6.33%	6.66%	6.75%	6.91%	7.05%	7.10%	7.13%	7.16%	7.24%	7.17%	7.13%	7.31%

Source: PSG Wealth Investment Division, Morningstar, JSE, Investec

BOTH THESE FUNDS INVEST ONLY IN INVESTMENT-GRADE INSTRUMENTS AND ARE REGULATION 28-COMPLIANT

The PSG Money Market Fund maintains a slightly shorter duration as required by its fund classification and mandate. The mandate of the PSG Wealth Enhanced Interest Fund still maintains a slightly longer duration profile to enhance yield. The JSE trustees rate (net 6.11%) offers a reasonable yield for investors who want to keep cash in their stockbroking accounts. This will enable swift action if and when opportunities in equity investments present themselves.

INTEREST RATE HIKES PROBABLY PAUSED FOR NOW

On 30 June 2016, the South African forward rate curve was pricing in rate hikes totalling 0.50% over the next three meetings by the South African Reserve Bank's Monetary Policy Committee (MPC) (these were scheduled for July, September and November). At that stage we indicated that we were of the opinion that these hikes were unlikely to materialise given prevailing weak economic conditions and the fact that inflation had only moderately breached its upper target limit at the time. Subsequently the MPC left rates unchanged following

Cash management options

the committee's meetings during July, September, and November. We anticipate that the outcome of the meeting scheduled for 24 January 2017 will also be to keep rates unchanged. At this stage, although inflation is above the 6% upper target limit (6.6%), we are of the opinion that the MPC is continuing its pragmatic approach to policy implementation. The MPC already indicated that they expect inflation to peak at current levels and start to flatten off slightly, to just under the 6% target for the rest of this year.

As indicated earlier, we also expect inflation to peak at current levels and potentially surprise on the downside form February 2017. Given that GDP growth is low, inflation is receding and likely to fall into the targeted range, and it's unlikely that the MPC will elect to hike rates at this stage. At the very least, aggressive rate hikes are certainly not on the cards when looking at existing economic indicators.

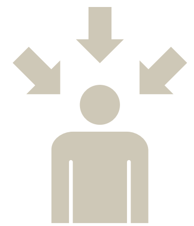
One has to concede however that, similar to the US scenario, interest rates will have to normalise at some stage in order to have sufficient scope to implement monetary policy as an expansionary tool in the event of future major economic turbulence, should it be required.

CASH PLAYS A STRATEGIC ROLE IN THE PORTFOLIO MANAGEMENT PROCESS

Although cash rates are only marginally positive in real terms, we feel that cash is playing an increasingly important role in the portfolio management process. Cash helps to reduce overall portfolio volatility. It also gives active managers access to funds so that they can take advantage of investment opportunities in equity markets as volatility increases. That being said, there is a material trade-off over the long term. ***Cash is not our wealth-building asset class of choice.***

We strongly discourage clients from investing solely in cash in an attempt to time markets. By adopting such a strategy, a whole range of other unintended risks are introduced to longer-term wealth creation prospects. ***Both longevity risk and inflation risk could increase to excessive levels.***

Theme spotlight



Political challenges a weakness for rating agencies' institutional assessments

Prevailing political and institutional frameworks shape policies, and policies in turn shape economic outcomes and therefore sovereign ratings. In a recent article the Global Chief Rating Officer for sovereign ratings at S&P Global Ratings, Moritz Kraemer, said they believe political and institutional uncertainties are on the rise in so-called emerging and advanced economies alike.

Among the five main factors that determine S&P's rating criteria, the institutional assessment has been the most important negative driver distinguishing emerging market sovereigns that were downgraded from those that were not.

"Growing protectionist and nationalistic policies, and a focus on domestic agendas to the detriment of economic issues, are the main risk trends we see for sovereigns worldwide. We (also) see several key political challenges for sovereigns as we enter 2017," Kraemer noted.

Five factors that determine S&P's rating: SA snapshot

Key rating factors	Jun 2016	Dec 2016
Institutional assessment	Neutral	Neutral
Economic assessment	Weakness	Weakness
External assessment	Neutral	Neutral
Fiscal assessment: flexibility and performance	Weakness	Weakness
Fiscal assessment: debt burden	Neutral	Neutral
Monetary assessment	Strength	Strength

Source: S&P Global Ratings, PSG Wealth research team

SOUTH AFRICA RECEIVED A REPRIEVE AS S&P LEFT ITS ASSESSMENT OF THE NATION'S FOREIGN-CURRENCY DEBT UNCHANGED AT ONE LEVEL ABOVE JUNK

The agency did however lower SA's local-currency rating in December 2016 and warned that political interference in government policy could lead to a downgrade. The affirmation of South Africa's foreign-currency rating of BBB- is on the same level as that of Italy and India.

In their 2 December review S&P noted that political events have distracted from growth-enhancing reforms, while low GDP growth continues to affect South Africa's economic and fiscal performance and overall debt stock.

The agency warned that ongoing continued tensions and the potential for event risk could weigh on investor confidence and exchange rates, and potentially affect government policy direction. (See our view on the S&P review here.)

Kraemer says the trend toward rising political and institutional risk could be considered a reflection of complacency.

"Years of quasi-effortless growth thanks to generous terms of trade, global demand, and cheap financing have led some emerging market policymakers to succumb to complacency. Attempts to further enhance resilience and underlying growth potential appear to have become a second-order priority in many places. Why push for further opening up of markets and antagonize important stakeholders at home, when things appear to be running rather smoothly anyway?"

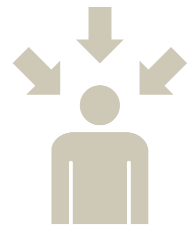
He adds that politically more rewarding issues have attracted policymakers' attention. Some sovereigns have failed to establish robust regulation that would have prevented excessive leverage from creeping into the economy. In other cases central banks may have been put under pressure to accommodate political priorities.

Others were tempted to accommodate domestic stakeholders by increasing current government spending, for example on subsidies, or civil servants, or by directing credit into favoured sectors or regions. Anecdotally, in some countries, perceptions of corruption have been on the rise. The vulnerabilities that were thus created are now being felt.

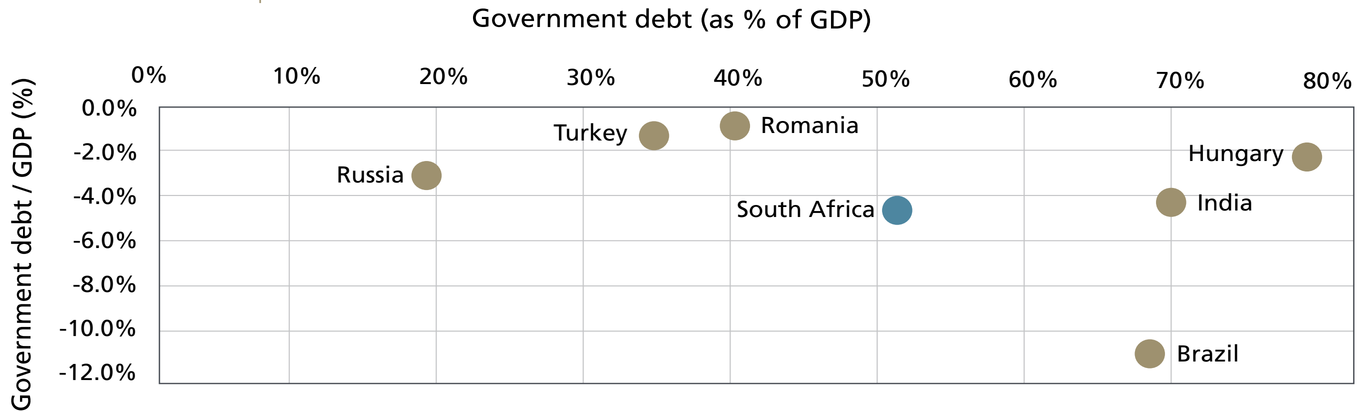
The opinions expressed in this article are not necessarily those of PSG and do not constitute advice.

PSG Wealth

Theme spotlight

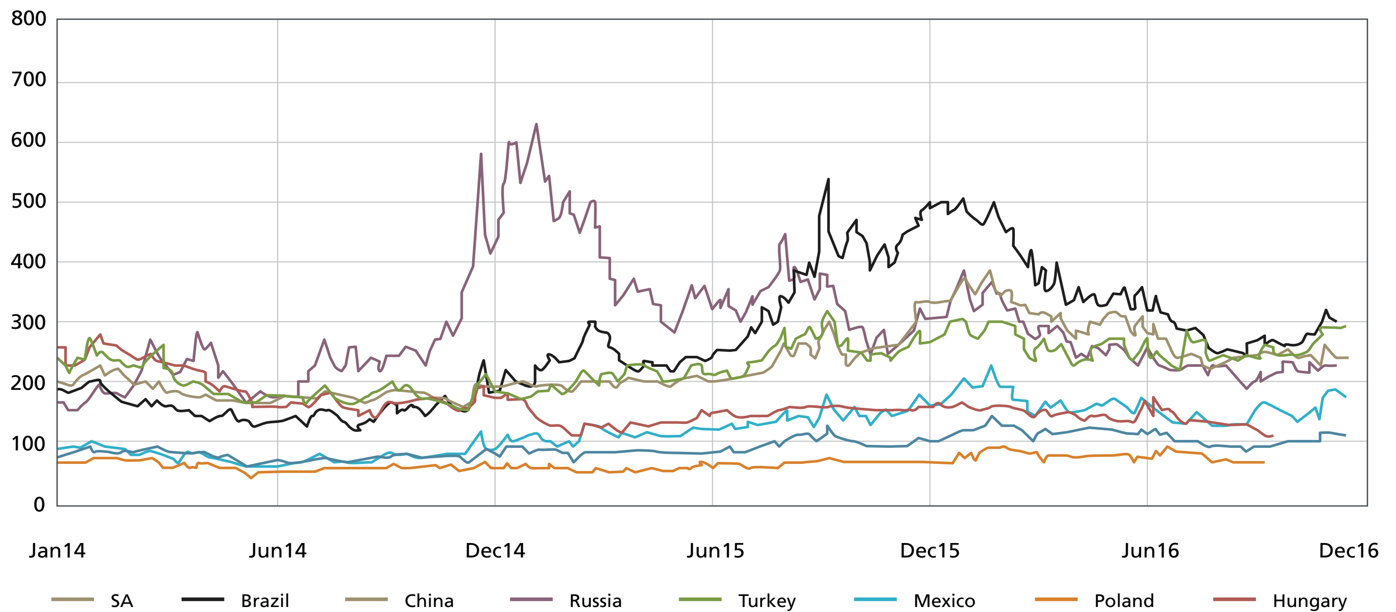


Debts and deficits of EM peers



Sources: Trading Economics, PSG Wealth research team

Credit default swap (CDS) spreads



Sources: PSG Wealth research team, S&P Global Rating

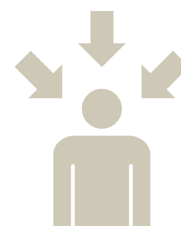
A QUESTION TO PONDER

A political economist at the University of KwaZulu-Natal, prof. Patrick Bond, says the main question to ponder is why, given utterly zany politics and the stagnant economy, was South Africa not downgraded all the way to junk? S&P lowered the risk rating of local state securities, but not the sovereign (foreign) debt grade. He adds that the main reasons S&P gave are telling:

In their review S&P said: "(T)he ratings on South Africa reflect our view of the country's large and active local currency fixed-income market, as well as the authorities' commitment to gradual fiscal consolidation. We also note that South Africa's institutions, such as the judiciary, remain strong while the South Africa Reserve Bank (SARB) maintains an independent monetary policy."

The opinions expressed in this article are not necessarily those of PSG and do not constitute advice.

Theme spotlight



Bond says this statement needs to be translated as follows:

S&P statement	Prof Bond's translation
"the country's large and active local currency fixed-income market"	= pension and insurance funds keep buying government bonds because residual exchange controls force 75% of such funds to stay inside SA and create a large artificial demand for state securities
"the authorities' commitment to gradual fiscal consolidation"	= Gordhan promised that the budget deficit will fall from this year's 3.4% to 2.5% by 2019, even though this requires cuts into social grants. It will result in recent increases for 17 million recipients falling below the inflation rate faced by poor people
"South Africa's institutions, such as the judiciary, remain strong"	= not only do the courts regularly smack down Zuma's excesses, but more importantly they also religiously uphold property rights, which in South Africa are ranked 24th most secure out of 140 countries surveyed by the Davos-based World Economic Forum
"the SARB maintains an independent monetary policy"	= in spite of incredibly high consumer debt loads (nearly half the country's active borrowers are 'credit impaired,' according to the National Credit Regulator, having missed three repayments), the SARB has raised interest rates six times since 2014, to levels amongst the world's highest

BOND ADDS THAT THE SILENCES IN THE S&P REVIEW ARE VERY REVEALING

If we consider crunch problems that might lead to a drastic financial crisis in South Africa, S&P was surprisingly blasé about the country's foreign debt. The last SARB Quarterly Bulletin records that debt are at the highest ever (as a ratio of GDP) in modern SA history: 43% (higher than PW Botha's default level of 40% in 1985).

S&P also did not mention:

- illicit financial flows which have been estimated by Global Financial Integrity at $20 bn/year
- the balance of payments deficit due to profit and dividend outflows, which are usually more than $10 bn/year, following excessive exchange control liberalisation
- South Africa's exceptionally high international interest rates on 10-year state bonds, at 9% (third amongst 60 major economies, only lower than rates in Brazil and Turkey which both pay 11%)
- Corporate overcharging on state outsourcing – which the Treasury's Kenneth Brown says costs taxpayers $17 billion per year

Bond adds that S&P did, however, give critics of big business at least minor affirmation by observing "the corporate sector's current preference to delay private investment, despite high margins and large cash positions."

IT MAY NO LONGER BE POSSIBLE TO SEPARATE ADVANCED ECONOMIES FROM EMERGING MARKETS BY DESCRIBING THEIR POLITICAL SYSTEMS

Kraemer adds that advanced economies are struggling to display superior levels of stability, effectiveness, predictability of policymaking and political institutions.

"For example, the lowering of our ratings on the US in 2011 and the UK in 2016 stemmed from our negative reassessment of institutional quality and governance effectiveness. The downgrade of more than half of the Eurozone sovereigns in early 2012 was driven by similar considerations."

According to S&P ratings have converged. A decade ago, there was little overlap between sovereign ratings

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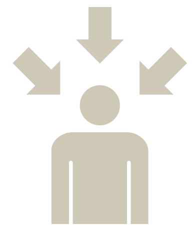

on advanced economies (typically in the 'A' category and above) and ratings on emerging market sovereigns (mostly in the 'BBB' category or in speculative grade 'BB+' and lower). Today this differentiation is much less pronounced. In fact, the biggest sovereign default of all time was by an Organisation for Economic Co-operation and Development (OECD) member normally classified as an advanced economy (Greece).

As the ratings have converged, so have the political and institutional risks. Predictability of policies and democratic choices have diminished in the Western world, as reflected in the surprise votes for Brexit in the UK and the election of a non-political outsider to the presidency of the US. Voters' rejection of constitutional reform in the Italian referendum can be seen in a similar context.

Kraemer says this trend reflects a backlash in the advanced economies of what is perceived as an increasingly unequal distribution of the benefits of economic growth and globalisation. This is reflected in the growing dispersion of incomes and wealth in many advanced economies. It may also partly reflect aging societies and related anxieties surrounding a quickly evolving economic environment.

When S&P analysed the socio-demographic voting patterns in the election of Donald Trump, or the referendum decision by the UK to leave the EU, they found these motives at play. The same current is observable when analysing the recently buoyant support for populist parties in Europe. These movements have been able to bring previously apathetic strata of society back to the polling booth to cast their protest vote.

We believe that the success of these political movements will lead to a halt, or maybe even a reversal of globalisation, including the risk of protectionist tendencies. This would risk reducing economic efficiency and growth, without self-evident gains in improving social justice. Most of the economic fallout of less open economies will be in the countries turning protectionist themselves. But there can also be non-negligible knock-on effects to third countries, which have important economic ties with the potentially inward-turning countries.

The possible effect on emerging markets of a potential US pivot toward itself is a clear reminder of the web of relations that connects the global economy in the 21st century. Each country has its own idiosyncratic aspects and may be in a different stage of a ‘populism cycle’. For example, the pendulum of political risk may be swinging back toward the traditional political mainstream in Brazil, Argentina, and Greece, while it is still in its early stages in places as diverse as the US and the Philippines.

SIMILAR ANTI-POPULIST MOVEMENTS HAVE STARTED TO EMERGE IN SOUTH AFRICA

Nowhere was this more telling than when the main opposition party, working with the left, took over the control of main metropolitan municipalities in the country in August last year. Here voters were showing the ruling party they were not happy with the status quo.

All the rating agencies have now raised concerns about political dynamics – ‘infighting within the ANC’, ‘ANC factional battles’ and ‘political infighting’ – underlining the fact that it’s the politics that is killing the economics in South Africa. Many believe a ‘government is at war with itself’ could continue to be a risk to our sovereign credit rating this year.

Keeping the foreign-currency rating at investment grade may have boosted sentiment and supported the rand after a year of domestic political upheaval and emerging-market uncertainty fuelled by Brexit and the election of Donald Trump as US president-elect.

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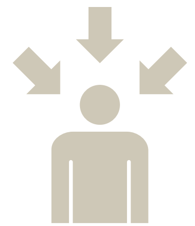
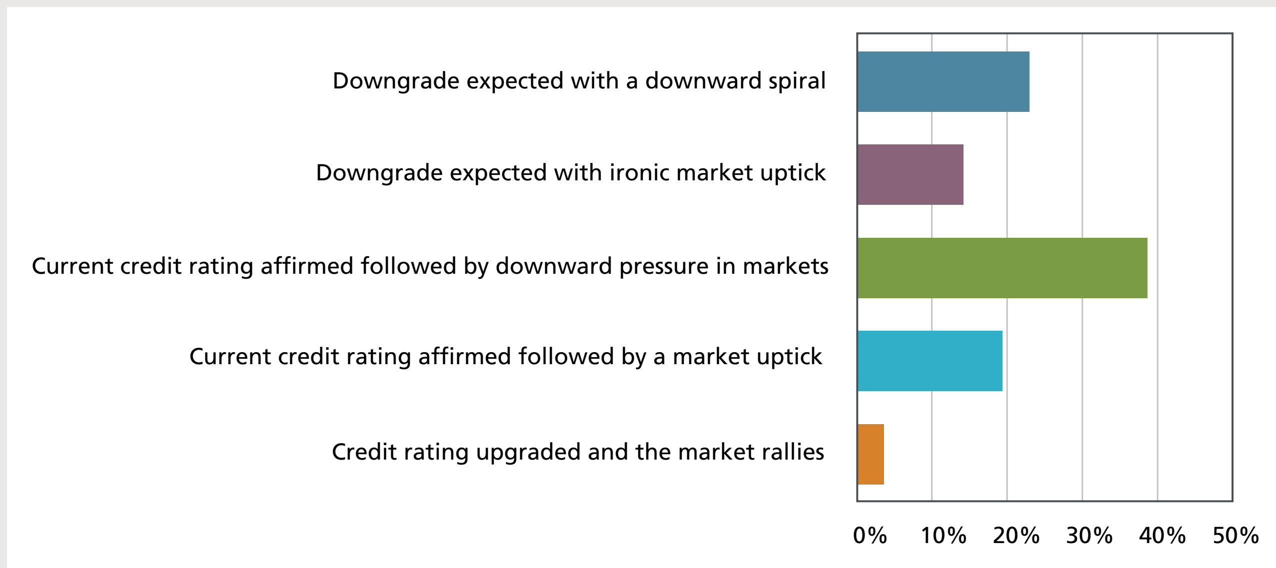
PSG Wealth

Theme spotlight



SPRING 2016 SURVEY: SOUTH AFRICA HEADING FOR JUNK STATUS?



Source: PSG Wealth Investment Division survey in the spring edition of the PSG Wealth Investment Research and Strategy Report.

Take part in our new survey on the valuation of the local market by clicking here.
The results from each quarter's question will be discussed in the next edition of the report.

Most (39.46%) participants in the PSG Spring 2015 survey felt that S&P would affirm our credit rating on 2 December, after which downwards pressure would be experienced in markets. However, after our foreign currency rating was affirmed, markets actually reacted positively to the news, especially after a downgrade to junk status was mostly priced-in. On the Monday following the S&P review the rand strengthened by 0.82% from the Friday's close. The JSE was also 0.94% stronger the Monday morning after the S&P review. The second chart below shows how the JSE performed relatively flat in the weeks after the S&P review. The rand tracked the performance of the JSE, but weakened by about 3% from 5 to 20 December.

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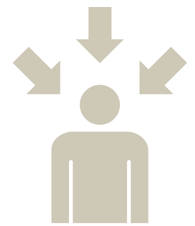
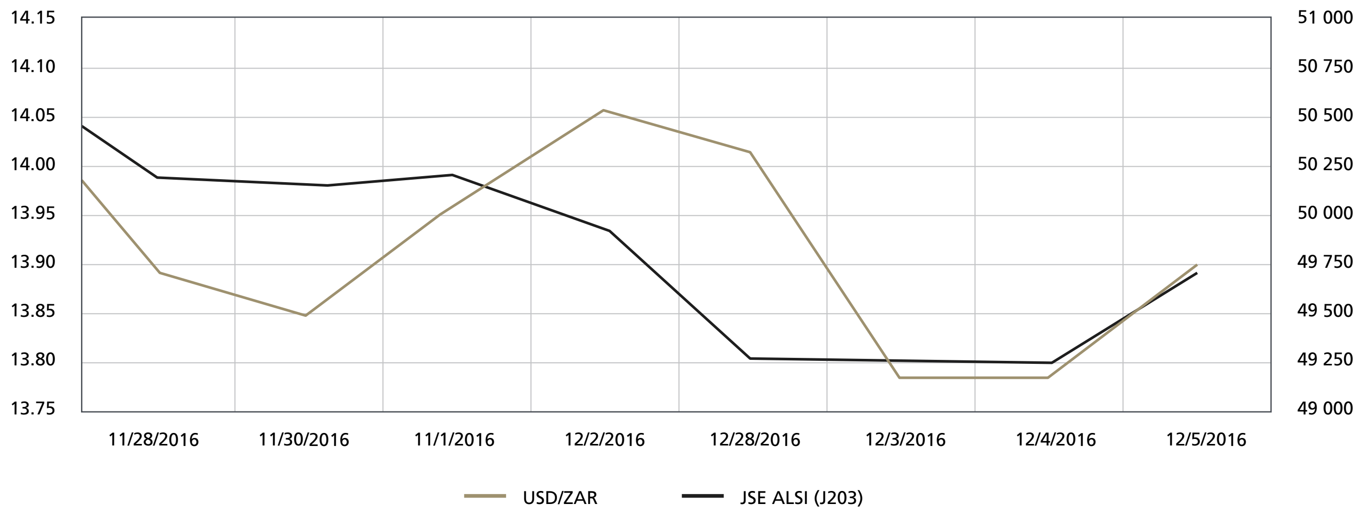
PSG Wealth

Theme spotlight

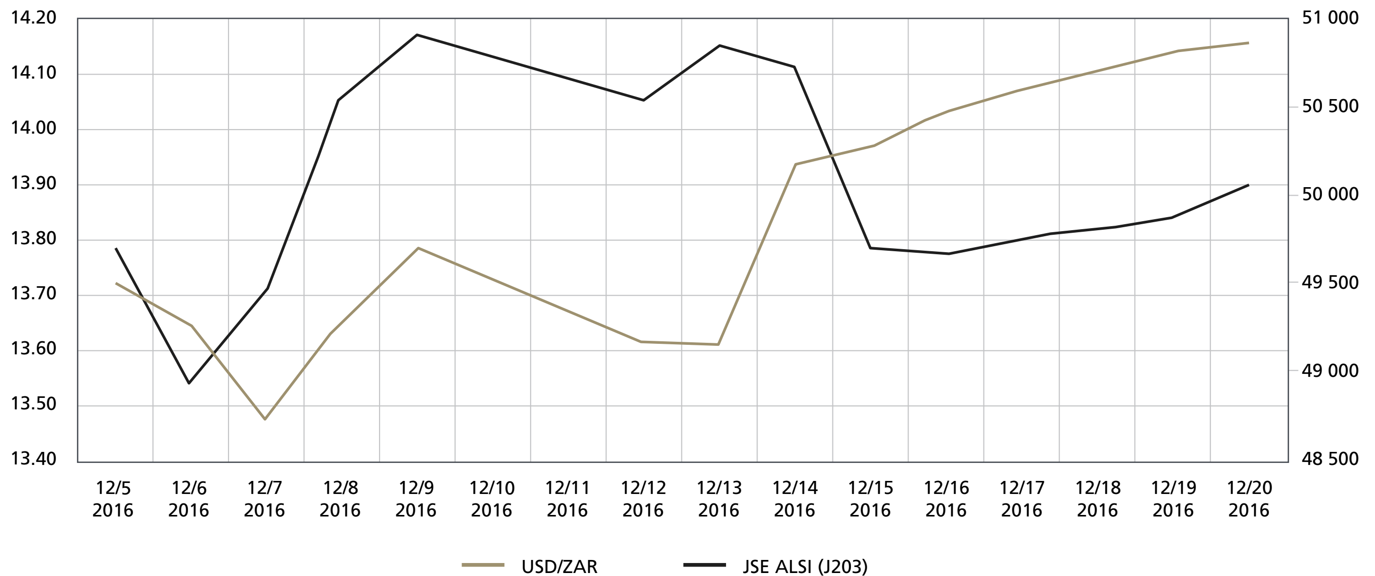


The ALSI and rand movement just after the S&P announcement



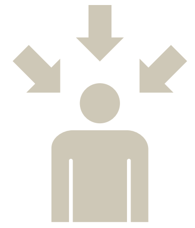
Source: PSG Wealth research team, Oanda

The ALSI and rand movement in the weeks after the S&P announcement



Source: PSG Wealth research team, Bloomberg

Theme spotlight



SOME MARKET COMMENTATORS BELIEVE WE ARE NOT OUT OF THE WOODS YET

While South Africa managed to avoid the damaging 'junk' status from ratings agencies in 2016, it does not mean the country has worked its way out of its slow economic spiral downwards. Research analyst, Peter Attard Montalto, said while S&P gave the country the benefit of the doubt on the back of a more stabilised labour strike situation and an improved energy supply – these kinds of reprieves cannot continue forever.

'The downgrade of the local currency rating is a crystallized view of increasing risk in the eyes of S&P – from politics, a poor growth outlook, and 'piecemeal' implementation of reforms. S&P also noted the long run fiscal and debt outlook is deteriorating faster than they had previous presumed. They remain very worried about the risks of increasing political noise and contestation in 2017 – saying specifically there was a risk (that it could) alter the direction of policy (which might be a coded reference to a reshuffle).'

Attard Montalto says South Africa is not a 'shock wham bham' crisis country that just suddenly jumps to junk status, rather it is 'a slow grind of under-performance. Every time a review comes up, more and more is chipped away, little by little.' Or as Bond puts it: 'The whip remains poised above South Africa's head, awaiting (this) June's ratings.'

RATING REVIEWS FOR 2017

Credit agency	Expected release dates
S&P Global Ratings	2 June and 24 November 2017
Moody's	7 April, 11 August and 24 November 2017
Fitch	Not on the calendar for 2017

BOTTOM LINE

Investors in PSG Wealth Solutions should be assured that they are in good hands:

- Their financial planning is done by the best financial planners available in South Africa
- The investment process allows for tailor made solutions that align the investment objective with their investment goals.
- The investment portfolios are managed by the best portfolio managers, both locally and offshore. We actively align our portfolios to protect against current risks, and to benefit from both current and expected future conditions

SUMMER 2017 SURVEY: THE VALUATION OF THE LOCAL MARKET

The FTSE/JSE All Share Index is currently (10 Jan 2017) trading on a price-to-earnings (P/E) multiple of close to 29. This is the highest level it has been since early 1969, just before a crash that saw the market lose over 60% in two years. The current valuation is also well above the 50-year average P/E of around 13. This historical average would usually be a measure of what could be considered "fair value". Some market watchers might argue that at these kind of stretched multiples, the market is in extremely dangerous territory.

However, others question whether this long term average is really an appropriate guide. For a number of reasons, comparing the current market with its past manifestations is problematic. On top of this, the nature of the JSE has also changed significantly over the past two decades. Most earnings generated by listed companies now come from outside the country. Still others see opportunities.

Take part in our new survey by clicking here.

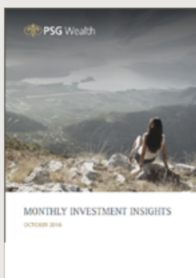
Previous publications

Daily

8 February 2017

Weekly

18	Jan	10	Aug	26	Apr
11	Jan	2	Aug	20	Apr
7	Dec	27	Jul	12	Apr
30	Nov	13	Jul	5	Apr
16	Nov	6	Jul	30	Mar
2	Nov	29	June	23	Mar
26	Oct	22	June	16	Mar
12	Oct	15	June	9	Mar
5	Oct	8	June	1	Mar
28	Sept	1	June	23	Feb
14	Sept	25	May	11	Dec
7	Sep	18	May	20	Nov
31	Aug	11	May	16	Nov
17	Aug	4	May		

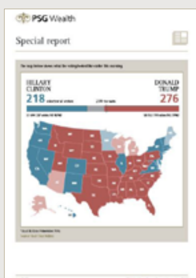


Monthly

Jan	2017	May	2016
Nov	2016	Apr	2016
Oct	2016	Mar	2016
Sept	2016	Feb	2016
Aug	2016	Dec	2015
July	2016	Nov	2015
June	2016	Oct	2015

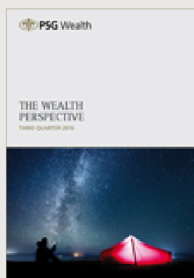
Research & Strategy Report

Spring	2016
Winter	2016
Autumn	2016
Summer	2015
Spring	2015



Special Reports

Research part of value proposition
Fed hike inevitable?
S&P 2 Dec review
US election
Market PE's
Domestic local government elections
Brexit vote
Cash vs Long-term instruments
S&P June 2016 rating decision explained
Fed Dec 2015 interest rate hike
Impact of political moves on investments
FoF fees small compared to actual gains
SARB hikes rates
Weak PMI support foreign diversification



Wealth Perspective

December	2016
September	2016
July	2016
April	2016
January	2016
October	2015
July	2015

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