Weekly Investment Update

9 November 2016

PSG Wealth

Fed has everything it needs to raise rates in December - pg. 2

Truworths releases bearish update - pg. 3

Market moves

Performance: 28/10/2016 to 03/11/2016	Return (Cumulative)
Local Markets	
All Share TR ZAR	-1.76
Ind/Financials TR ZAR	0.06
Ind/Industrials TR ZAR	-2.82
Financials&Indl 30 TR ZAR	-1.92
Ind/Basic Materials TR ZAR	-1.16
Gold Mining TR ZAR	3.18
SA Listed Property TR ZAR	-0.48
Beassa ALBI TR ZAR	2.08
Commodities	
Oil Price Brent Crude PR	-8.16
LBMA Platinum AM PR USD	2.60
Gold London AM Fixing PR USD	1.87

The week ahead

Domestic

10 Nov Mining production

15 Nov Unemployment rate

International

11 Nov Hong Kong: GDP growth rate

14 Nov EA: Industrial production

Macro

South Africa

The seasonally adjusted Barclays Purchasing Managers' Index decreased by 2.6 points to 45.9 in October. Its lowest level since January. Meanwhile the trade account switched from a deficit amounting to R8.89 billion in August to a R6.70 billion surplus in September.

Germany

Germany posted the largest trade surplus in three months. The 24.4 billion euro trade surplus in September is up from the 22.3 billion euro reported a year earlier. It was the largest surplus since June, as exports rose 0.9% yoy while imports fell by 1.4%.

China

Imports to China declined by 1.4% yoy to 129.12 billion in October, compared to a 1.9% fall in September and expectations of a 1.0% fall. Considering the first ten months of 2016, inbound shipments dropped by 7.6%.

Markets*

Best performer

For the week was Lonmim with a return of 18%. Richemont was second with an 8% return for the same period.

Worst performer

Trustco was the worst performer for the week with a loss of 13%. Followed by RCL Foods and Choppies Enterprises both with a 9% drop for the week.

Sectors

The best performing sector for the week was personal goods with a return of 7.7% for the week. The sector representing general retail was the worst performing sector for the week with a 4.8% loss.

*Disclaimer: Total weekly returns based on closing values from Monday to Monday.

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Macro note

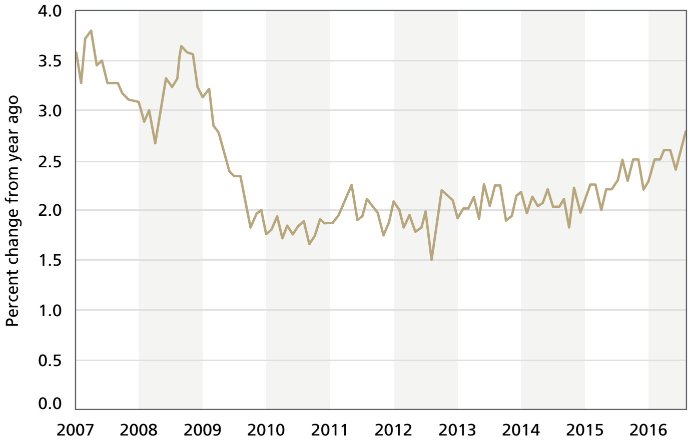
Fed has everything it needs to raise rates in December

On Friday, the US Federal Reserve (Fed) got more of the evidence it wanted before making any decisions on raising interest rates this year.

The US jobs report showed that wages grew at the fastest pace since the recession. Year-over-year, average hourly earnings rose 2.8%, the most since 2009. This upturn in wages provides more evidence that inflation is building in the US. When consumers have more to spend, their demand for goods increases. Also, companies may respond to higher labour costs by raising prices. Both of these things put upward pressure on inflation.

Secondly, the latest employment report is also encouraging despite the slightly lower-than-expected gains in jobs. It is considered normal for the economy to add progressively fewer jobs as the system nears full employment. On that basis, the job gain of 161 000 in October following a revised job gain of 191 000 in September can be considered solid. Lastly, there is some evidence to suggest the US is starting to add jobs more meaningfully in higher paying sectors of the economy. Consequently, the only real disappointment in this month's employment report was the slight fall-off in the labour market participation rate. Overall, the employment report for October suggests that the US labour market continues to expand at a solid pace. From the Fed's perspective the latest employment data will most likely further encourage them to hike rates by another 25bps on 14 December 2016.

USA average hourly earnings



Source: US Bureau of Labour Statistics

Bottom line

We have seen a continuous debate throughout 2016 about whether the Fed will hike interest rates in 2016 or not. While a hike was not seen on 2 November regardless of improvements in the various economic targets set by the FOMC. Recent improvements in their wages is a positive indicator. Current expectations are that the FOMC would now consider a rate hike more seriously on 14 December.

What is more important - the actual interest rate hike or the knowledge that it will happen sooner or later? There's solid proof that markets are discounting mechanisms that discount such important changes well in advance of the actual event. An important part of this discounting process is the changes that active managers will make to their investment portfolios in order to be ready for when the event actually takes place.

Market note

Truworths releases bearish update

Truworths International was punished by investors after the fashion retailer released a bearish sales update last week. In the trading update for the first 18 trading weeks of their 2017 financial year (27 July to 30 October 2016) Truworths indicated that excluding retail sales recorded by the Office group:

- Retail sales declined by 1% vs the 16% increase in previous period
- Like-for-like retail sales declined by 5%
- Product inflation averaged 16%
- We estimate that overall sales volumes declined by 21%
- Cash sales declined by 1% vs the 14% increase the previous period
- Credit sales declined by 1% vs the 16% increase the previous period
- Their credit:cash sales mix stood at 70%:30%

Markets reacted negatively to the trading update, and sent Truworths' share price sliding by as much as 10% on the day. The decline in cash sales came as a surprise and speaks to the value proposition of the retailers offering. The product inflation average of 16% is much higher than its competitors. Other fashion retailers such as Woolworths, Mr Price and TFG contained their product inflation at 10% to grow market share and attract shoppers. The decline in credit sales was anticipated after the new affordability regulation came into effect in September 2015.

Investors should be aware of the following factors when making an investment decision:

- In the absence of changes to new credit regulations, credit sales will remain under pressure and it will be increasingly more challenging to generate positive credit sales growth. Changes to the legislation currently seems probable.
- International retailers currently exhibit a healthier value proposition which enable them to gain market share.
- Lower credit sales is impacted by a high comparative base
- Consumer spending is currently constrained

These factors make it hard to judge whether current trading conditions are structural or cyclical. One's conclusion here will inform your investment decision.

Forward PE of Truworths

Source: PSG Wealth research team

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Previous publications

Daily

9 November 2016

Weekly

02 Nov	10 Aug	01 Jun	30 Mar
26 Oct	02 Aug	25 May	23 Mar
12 Oct	27 Jul	18 May	16 Mar
05 Oct	13 Jul	11 May	09 Mar
28 Sep	06 Jul	04 May	01 Mar
14 Sep	29 Jun	26 Apr	23 Feb
07 Sep	22 Jun	20 Apr	11 Dec
31 Aug	15 Jun	12 Apr	20 Nov
17 Aug	08 Jun	05 Apr	16 Nov

Monthly

Oct 2016	Nov 2015
Sep 2016	Oct 2015
Aug 2016	Sep 2015
Jul 2016	Aug 2015
Jun 2016	July 2015
May 2016	Jun 2015
Apr 2016	May 2015
Mar 2016	
Feb 2016	
Dec 2015	

Quarterly

Spring 2016
Winter 2016
Autumn 2016
Summer 2015
Spring 2015

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