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Global Overview

Developed Markets: Tightening global liquidity as synchronous growth continues

After a prolonged period of lacklustre growth post the Global Financial Crisis (GFC), the global economy finally saw its fortunes turn last year, with the recovery being highly synchronised in both developed and emerging markets. This growth momentum, albeit slowing, has continued into 2018 with manufacturing PMI indices remaining elevated. The prospect of trade wars has, however, dampened the growth outlook somewhat.

Despite a slight slowdown, the US remains in good shape with continued growth in consumer spending and fixed investment. President Trump's protectionist policies and tax reforms have resulted in a weaker dollar, notwithstanding monetary policy normalisation efforts. The weaker currency has seen increased competitiveness on the global export market. Unemployment remains at low levels with wage growth well contained. The US central bank has therefore continued to unwind its loose monetary policy stance as evidenced when the FOMC raised rates by 25bps (basis points) in their most recent meeting. Expectations for a total of three hikes this year remain.

The Eurozone has seen a strong rebound, led by Germany. Whilst growth has been above-trend and inflation has bottomed, the composite PMI saw a marked decline in February and March. In terms of monetary policy, the ECB kept rates unchanged in March, but they have already halved their quantitative easing programme, following steps taken by the Fed.

In the UK, the economy continues to face challenges post the prolonged volatility of the Sterling due to Brexit concerns. Household consumption has taken a significant leg down and is expected to remain constrained on lower employment growth.

The global economy should however continue to see robust growth barring a correction in financial markets and geopolitical risks.

Commodities: Prices weak over the quarter

Commodity price momentum has faltered following a positive 2017, largely due to investor concerns around potential global trade constraints and a slowing trajectory in China.

Oil continues to recover off last year's lows, gaining 5.1% during the quarter and 33.0% for the year ended March 2018. Healthy demand growth and the disciplined supply curtailment by OPEC should maintain balance in the oil market and see the price of Brent crude oil stabilising.

The gold price had a decent quarter on fears of rising trade tensions between the US and China. In SA, however, the Gold index has been dragged down by the strong Rand.

Iron ore prices remain highly dependent on the Chinese industrial sector; and have come under considerable pressure over the past month due to a larger than expected build in steel stocks. With China's growth decelerating, there could be more downside to commodity prices on lower metal consumption. Further headwinds are likely in the face of deleveraging and tightening conditions.

Lower diesel market share in Europe continues to impact auto catalyst demand, placing pressure in a well-supplied platinum market.

Emerging Markets: Continued momentum

Emerging market (EM) growth remains strong with currencies appreciating and asset prices rising on optimistic growth expectations. The recovery in EM has been broad-based, with most economies registering manufacturing PMI's above the 50 point expansionary level. The rebound has been on the back of a supportive global environment, improved commodity prices post the sharp decline between 2014 and 2016; and healthier domestic conditions.

For the quarter, EM continued its outperformance relative to developed markets (DM), with the MSCI EM returning a dollar return +1.5% vs. the MSCI World Free Index at -1.2%.

Whilst year to date, SA equities and bonds recorded $2.2bn and $1.1bn inflows respectively, the MSCI SA (-4.0%) underperformed its EM counterparts.

SA Overview

Local equity markets take a breather despite 'Ramaphoria'

The quarter started off with much positivity post the election of Cyril Ramaphosa as ANC president. This optimism was further cemented when President Zuma stepped down, marking the start of a new era of hope, with the incoming president revered for his anti-corruption stance and focus on fiscal austerity. President Ramaphosa delivered a credible inaugural State of the Nation Address and also enacted a swift and significant Cabinet reshuffle, with sound new appointments. Business and consumer confidence, whilst still at depressed levels, have finally reversed their downward spiral and the 2018 budget affirmed the new regime's focus on fiscal discipline.

A number of encouraging indicators have since paved the way for a recovery in SA:

- Fourth quarter GDP numbers surpassed expectations at 3.1% vs. 1.8% forecast
- The much anticipated Moody's rating announcement surprised on the upside when the outlook was upgraded from negative to stable and the rating maintained at Baa3, implying SA's continued inclusion in the World Government Bond Index (WGBI)
- The South African Reserve Bank (SARB) cut the repo rate by 25bps to 6.5%, with inflation risk evenly balanced

Following a solid 12 month performance (+21%) to end December 2017, the first quarter of the year saw a severe pullback, with the All Share Index retracing almost 6%, posting its worst quarterly performance in 8 years. The Rand however continued to strengthen during the quarter, appreciating 4.9% relative to the

dollar, due to both local political developments and increased global risk appetite. For the year ended March 2018, the Rand gained 14.5% relative to the dollar and has been one of the best performing EM currencies. The Rand has been resilient in spite of anxiety around property rights and land expropriation without compensation. Local and domestic participants believe that the Ramaphosa-led ANC will proceed in a responsible manner.

Market Review

During the quarter, SA bonds (+8.1%) outperformed SA Equities (-6.0%), SA Property (-19.6%) and SA cash (+1.8%).

Bond performance was aided in March by Moody's decision to maintain SA's sovereign credit rating and upgrading the outlook to stable from negative. SA Equities, however, saw a sharp sell-off in March as US and Asian equities retreated on tech stock concerns.

During the month SA Industrials lost 5.5%, driven by index heavyweight Naspers, which regressed 11.6% after they announced the sale of up to 2% in Tencent, as well as the global tech contagion following the Facebook scandal. For the quarter, SA Industrials posted a dreary -8.0% return, impacted by a poor showing from Naspers (-16.2%) and British American Tobacco (-15%). British American Tobacco's underperformance stemmed from forex headwinds, regulatory concerns and the rotation back into cyclicals. After shedding almost 95% in the 12 months ended March, Steinhoff continued its demise, losing 43% during March and 29% over the quarter. Fixed Line Telecoms (+10%) and General Retailers (+9.2%) were the top performing Industrial sub-sectors this quarter.

SA Resources retraced -2.1% in March and ended the quarter down -3.9%. For the quarter, Forestry (-2.2%) outperformed on a sub-sector basis, with Coal (-26.7%) and Industrial Metals (-22.5%) the laggards. The threat of trade wars and slowing Chinese growth has impacted the latter.

SA Financials fared best for the second consecutive quarter, returning -3.6%, and driven largely by Non-life Insurance (+24.4%) and Banks (+4.2%). Within Non-life Insurance, Santam was up +24.4% during March, following a strong set of results owing to robust investment returns and a sharp recovery in the underwriting margin.

SA Property was the worst performing asset class, impacted by inordinate share price pressure on the Resilient stable amidst speculation, which was then compounded by the release of a research paper by an SA hedge fund manager. Investor concerns centre on financial re-engineering thereby inflating growth in distributions; share manipulation; the BEE trust and the complex cross-holding structure as well as the related party activities of the associated companies. Within the stable, Fortress B, Resilient, Greenbay and NEPI Rockcastle suffered most at -69.7%, -64.9%, -60.8% and -44.5%, respectively over the quarter.

Environmental, Social and Governance (ESG) concerns: Top of mind

Since the Steinhoff upheaval last year, ESG has strongly come to the forefront of both investors and clients' minds alike. We saw this during the quarter, in both the Resilient stable as discussed above, as well as with the scathing report released by Viceroy on Capitec Bank earlier during the year. The report criticised the

bank's lending practises and provisioning policies, although management have vehemently refuted allegations.

At Afena Capital, we explicitly incorporate ESG into our investment process, which directly impacts our assessment of a company's margin of safety and valuation, and ultimately investability and inclusion in client portfolios. We also undertake active voting and engagement in terms of proxies, with board composition, director independence and remuneration structures some of the key considerations. Our framework has proven to be robust and continues to assist in the calibration of investment ideas that are prudent.