The Weekly Focus

A Market and Economic Update
10 December 2018

STANLIB

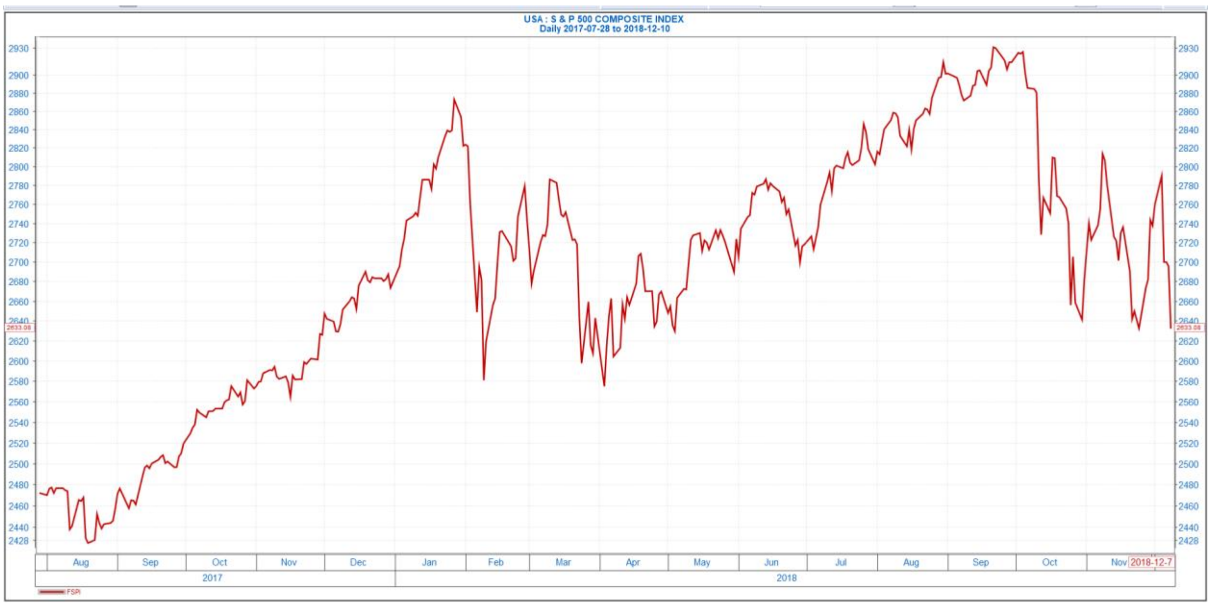
Contents

Newsflash

This is the last issue for 2018! Wishing you all a safe and happy holiday.

Market Comment

- Concerns about global trade, aggravated by the arrest in Canada of the Chief Financial Officer of Huawei, China's biggest telecoms company, as well as concerns about a slowing Chinese economy and weaker-than-expected Japanese economy plus of course the Brexit battle in the UK have all conspired to cause stock markets to fall quite sharply over the past week, back to their previous 2018 lows.
- It is risk-off again this Monday morning as money flees from equities into cash and bonds.
- The S&P 500 Index fell -4.6% last week, undoing the previous week's gain. It is -10.2% from its record high in September, back at November's low - and at a similar level to November/December 2017.
- The MSCI World Index is at a new low for 2018, -12.6% from its late January record high - and back at September 2017 levels.
- The MSCI Emerging Markets Index is holding above its 2018 low, with the help of currencies that have appreciated a bit.
- So the Xmas stock market rally that we usually witness has been notably absent so far.
- The only bright spots have been the rising gold price, at a 5-month high and therefore gold shares - and lately a slightly weaker dollar; also the much lower oil price, despite OPEC and Russia agreeing to cut production between them by a higher-than-expected 1.2m barrels a day from next month. The price has rallied a bit since Friday.
- More commentators are saying that the US and global stock markets are now in a bear market.
- Is there any hope? Well, the US is trying to make the case that the Huawei issue is very separate from the trade issues and is not complicating the progress being made between China and the US in solving the trade disputes.
- Also on the charts the possible double bottom has now morphed into a possible triple bottom, as pessimism climbs even higher! See the chart below of the S&P 500 Index.



- So once again, this looks more like a buying opportunity (price sale on) than a selling opportunity. If your tummy is churning nervously when you buy, that's a good sign of a possible bottom!

- The FAANG shares of Facebook, Amazon, Apple, Netflix and Google/Alphabet are as a group down -26% from their recent record highs, while Apple itself is down -27.9%, trading at just 14 times earnings of the past 12 months. Microsoft, down -9% from its recent high, has overtaken Apple as the largest share by value.
- So the corrections have been very sharp and many shares are down over -20%. But is this really unusual for a bull market that will turn 10 years in 3 months?
- The JSE ALSI is trading this morning a bit below its previous 2018 lows (similar lows were hit no fewer than 6 times since late October).
- Last week shares that gained included Sibanje +11.4%, Harmony +10.7%, Anglogold +10.2%, Kumba +10.2% and Amplats +8.6%, while Clicks fell -7.2%, Old Mutual -7%, Motus -5.5%, AB Inbev -5.4% and Investec PLC -4.7%.
- SA Listed Property is trading at a new low this morning, having aborted its attempt at a recover in early November.
- So the risk-oriented SA asset classes total returns for 2018 (including dividends/interest) are now: All Bond Index +6.2% (was +7.1% last week, but bond yields have risen since then with a weaker rand and global risk-off, not to mention the extra pressure on government finances from the mess at Eskom), then the ALSI with -11.9% (actually better than last week's -12.6%), then finally SA Listed Property with -23.6% (-23.5% last week).
- Eskom's woes (coal issues and poor construction issues) are certainly a negative for local investments. Doesn't it all come down to poor leadership over the past few years? The buck stops at the top.
- On the global front, JP Morgan put out some interesting research last week, noting that the current US economic expansion is just shy of becoming the longest uninterrupted expansion since 1860.
- Its sheer longevity has become a source of anxiety, because typically long cycles lead to excesses….and then a crash, as happened in 2008/9.
- But JP Morgan thinks this concern is misplaced, since this long cycle has already experienced what they call 2 intra-cycle resets (economic slowdowns), in mid-2011 and late-2015.
- These resets are healthy and should prolong the overall cycle, as they put a brake on excesses, by repricing risk and draining excess leverage out of the market.
- 2018 could be seen as a 3rd reset - a year characterised by significant deleveraging and unwinding of crowded trades.
- Although so far this reset is different from the previous two in that US economic momentum and earnings growth have remained resilient, even if one normalises for the Tax Act stimulus.
- This reset was caused more by politics, including the tariff war.
- Looking ahead, fundamentals should remain healthy as far as earnings, investment spending, corporate balance sheets and leverage are concerned.
- A trade war could certainly damage earnings in 2019, but JP Morgan believes there is a greater probability of a trade deal than an escalation in tariffs.
- More so, in a pre-election year, the Trump administration cannot afford a falling market and large trade-related layoffs.
- The other key source of risk for equities, the pace of monetary tightening (raising interest rates), will likely be tempered given falling inflation expectations and more cautious remarks by both the Fed Chairman and Vice-Chairman recently.
- Equity positioning has now reached very low levels in the US. They estimate that equity exposure of all hedge funds, discretionary and systematic, is now in the bottom 10th percentile and at levels last seen in early 2016, when the S&P 500 was extremely depressed after tumbling over -12% and global markets were depressed too (MSCI World Index -18% from its high).

- So JP Morgan see far more upside potential to equities than downside risk, given diminishing tariff and Fed-related risks (well hopefully), positive earnings growth, attractive valuations, continued shrinkage of equity supply via buybacks AND given very low investor positioning (i.e. high pessimism towards equities).
- On a probability-weighted basis, JP Morgan sees a 55% probability of a trade deal, 35% probability of a cease-fire and only a 10% probability of an escalation in tariffs.
- Thus they are forecasting an +18% return for the S&P 500 in 2019.
- They estimate that over the next 12 months we could see over $1.5 trillion of demand for US equities through buybacks ($800bn), partial reinvestment of dividend income ($250bn), as well as discretionary hedge fund and other investment flows ($500bn), as volatility normalises.
- They recommend being overweight Technology, Consumer Discretionary, Industrials and Energy shares and underweight Staples, Utilities, Healthcare and Real Estate.
- On worries about yield curve inversion (short-term yields higher than medium- and long-term- yields), they note that the inversion of the 10 year- 3 month spread has better predictive accuracy. It stands at 47 basis points and provides a larger cushion than the frequently cited 10 year-2 year spread (just 15 basis points).
- Also the lag between inversion and subsequent recession has increased to 17 months for the last 3 inversions/recessions. In 2008 the lag was 22 months, i.e. it took 22 months for the recession to begin after the 3 month Treasury bill rate moved higher than the 10-year yield.

Other Commentators

US Market Analyst, Elaine Garzarelli

- The quants model declined quite sharply from 79% to 58%, but remains bullish.
- Garza recommends long-term investors buy on the dips.
- Four indicators of the quants model were downgraded, with the number of bullish advisors (sentiment), industrial production and the leading economic indicators all downgraded to neutral and the Bloomberg Financial Conditions Index downgraded to bearish.
- The Bloomberg Financial Conditions Index gives an indication of the health of the financial industry. The index continues on a downward trend and is below zero, so it has been downgraded to bearish in the quants model.
- Garza expects earnings for the S&P 500 Index to be up +6.5% next year to 168 (consensus is at 174). Her PE model suggests fair value for the S&P 500 Index is now at 3,024, a +15% gain from current levels.
- The S&P 500 Index is now negative in 2018 at -1.2% (excluding dividends). Health Care has the best return at +9.3%, followed by Utilities at +7.2%, then Consumer Discretionary at +4.8%, Real Estate at +3% and IT at just +0.7%. Communication Services is at +1.2% since 19th June.
- Both Financials and Industrials are at -10.2%, Energy is -11.2% and Materials -14.3%, while Consumer Staples are -4%.

BCA Research

- BCA is somewhat negative about the trade war. Their view is that deep-seated economic and political forces will undermine the trade truce between the US and China.
- They say China wants access to Western technology, but the West, fearful of China’s ascent, is reluctant to provide it.
- US economic momentum is strong enough for the Fed to raise interest rates next year more than the market is expecting (by 125 basis points versus just 40 expected).
- Global growth should stabilise by the middle of next year as China picks up the pace of stimulus and the dollar peaks.

- Until then a cautious stance towards global equities and other risk assets is warranted.
- Global bond yields will decline further in the near-term, but will rise at a faster-than-expected pace over the next 6-18 months.
- Equity bull markets typically end about 6 months before the start of a recession.
- If the next global recession does not occur at least for another 2 years, this will provide enough time for a blow-off rally in shares, starting in mid-2019.

Paul Hansen
Director: Retail Investing

Economic Update

1. **SA GDP grew by +2.2%q/q in Q3 2018, better than expected, helped by manufacturing, finance, transport and retail. SA out of recession, but growth still weak overall.**
2. **SA current account deficit widened modestly in Q3 2018, but remains manageable at -3.5% of GDP. Unfortunately, SA trade balance likely to deteriorate further in 2019, which could see SA current deficit widen to -4.5% of GDP.**
3. **The seasonality of SA shopping activity. Xmas shopping remains as significant as ever, with December SA's biggest month for retail sales.**

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1. **In the third quarter of 2018, SA GDP rose by 2.2%q/q**, annualised (seasonally adjusted). This compares with a revised decline of -0.4%q/q in Q2 2018 and -2.6%q/q in Q1 2018. The latest GDP performance was above market expectations, which was for an increase of +1.9%q/q (Bloomberg). During 2017 as a whole, SA GDP rose by a modest 1.3%, averaging growth of only 1.3% from 2014 to 2017. This is massively below the rate of growth rate required to lift SA employment meaningfully. The latest GDP performance signals that South Africa has emerged from its technical recession in the first half of 2018, but the rate of expansion remains very weak and fragile given the latest round of electricity outages.

   On an annual basis, SA GDP rose by 1.1%y/y in Q3 2018, which is up from a revised 0.4%y/y in Q2 2018, and 0.8%y/y in the first quarter 2018. For 2018 as a whole, SA GDP growth is now forecast at 0.7%, which is fractionally up from our mid-year 2018 GDP growth estimate of 0.6, partly as a result of the revisions to the historical data.

   The better than expected GDP performance during Q3 2018 was fairly broad-based including welcome increases in manufacturing (+7.5%q/q, off a very low base), agriculture (+6.5%q/q, helped by the improved winter crops), transport (+5.7%q/q, helped by air and land transport), retail trade (+3.2%q/q, including wholesale trade) and financial services (+2.3%q/q, especially banking and insurance). These performances were partially offset by another decline in mining production (-8.8%q/q, especially previous metals) and construction (-2.7%q/q, including non-residential building).

   While the Q3 2018 GDP performance was better than expected, there is still no clear evidence that SA economic activity has gained further momentum in the final quarter of 2018, especially given the 25bps increase in interest rates in November, the renewed electricity outages, the extremely weak new vehicle sales in November and the sluggish performance in global trade. **Furthermore, there is a fairly widespread expectation that the SA economy will continue to "tread-water" until after the National Election next year, which could become self-fulling**. Hopefully, the massive petrol price reduction in December (R1.84/l) will support some improvement in household spending over the next few months, while at the same time the President's economic stimulus and recovery plan could start to have a more positive impact.

   Given the still relatively positive global economic backdrop, the South African economy should be growing at around 2.5% to 3.0% currently instead of less than 1%. Closing the gap between South Africa's current growth rate and the 2.5% on a sustained basis is going to require a significantly larger effort than is currently evident, including the co-ordination of policy efforts across key government departments. **Unfortunately, 2% or 2.5% GDP growth will still not be anywhere near sufficient to stop the upward drift in the unemployment rate and rise in social tensions. Instead, the target GDP growth rate needs to be around 4% to 5% on a sustained basis, generating at least 600 000 new jobs each year.**

2. **In the third quarter of 2018, South Africa's current account deficit widened by R9.2 billion to R176.6 billion, which equates to -3.5% of GDP.** This compares with a deficit of -3.4% of GDP in Q2 2018**. The Q3 2018 deficit was largely in-line with expectations**. For 2017 as a whole, the current-account deficit was recorded at -R110.5bn (-2.4% of GDP), which is somewhat better than the 2016 deficit of -2.8% of GDP and a lot better than the 2015 deficit of -4.6% of GDP. For 2018 as a whole, we now expect the current account to have widened to around -3.8% of GDP for the year as a whole.

   Crucially, South Africa was able to sustain a trade surplus in Q3 2018, although the extent of the surplus narrowed from R38.3 billion in Q2 2018 to only R14.0 billion in Q3 2018. The deterioration in the trade balance came about as the value of merchandise imports increased more than that of net gold and merchandise exports. **Looking forward, the current rhetoric and trade tariff changes associated with the "global trade war" is extremely unhelpful. Already there is evidence that the growth in global trade has softened. This together with a moderation in the pace of global growth will most likely continue to undermine South Africa's export performance in 2019. All of this implies a sustained trade deficit in 2019.**

   More positively, the shortfall on South Africa's services, income and current transfer account narrowed to R190.6 billion in the third quarter of 2018 from R205.7 billion in the second quarter. This was mainly due to an improvement in the deficit on net income and current transfer payments which were partially countered by a widening of net service payments.

   Looking forward, and as mentioned above, we are concerned that SA export performance could soften in 2019 given the anticipated moderation in the pace of world growth as well as the increase in global trade protection. While this effect might be partially offset by any Rand weakness during 2019, it does highlight that South Africa remains extremely vulnerable to changes in global economic activity. Furthermore, SA's export performance would be further undermined if "load-shedding" continues into the first half of 2019.

   It is also clear that any serious endeavour to lift SA's economic growth in 2019 through an increase in domestic demand will most likely lead to a sharp rise in imports, adding to concerns about the size of the current account deficit. All of this implies that the Rand remains vulnerable in 2019 as foreign capital flows continue to adjust to a world of tighter financial market conditions, especially in the developed market, unresolved structural weaknesses in the Euro-area (including a messy Brexit), increased global trade protection, more modest world economic growth and increased vulnerabilities in a number of key emerging markets.

3. Ordinarily, our analysis of South African retail sales tends to focus on the seasonally adjusted data as well as the retail values after adjusting for the impact of inflation. However, **it can be useful to specifically examine the seasonal pattern of retail spending in order to determine if there are any longer-term changes in consumer behaviour that have developed in recent years**. These changes in shopping patterns could include, for example, the importance of "Black Friday" or the ongoing relevance of Xmas shopping or the propensity for people to shop during winter vs summer, or the significance of "back to school" supplies etc.

   Using the unadjusted SA monthly retail sales data for the past eight years as a point of reference, the following seasonal factors appear to be relevant within the SA context:
   - The "**Black Friday**" event has provided a meaningful uplift to retail sales in November, especially in the past three years. November is comfortably SA's second most important month of the year for retail sales. This has been the case for decades, but the introduction of "Black Friday" has boosted the importance of November for SA retailers.

- There is no clear evidence to support the idea that "Black Friday" is taking sales away from the xmas shopping season. Instead, the data suggests that people are holding back on purchases in October in order to try to get a better deal in November. Consequently, in recent years the importance of October for retailers has diminished fairly noticeably, especially in the past two years.
- December remains South Africa's biggest month for retail sales. This has obviously been the situation for decades and there is nothing in the data to suggest that there has been any change in the **relative importance of Xmas** for retailers or consumers. Xmas shopping in the past three years is exactly in-line with the long-term average in terms of its share of consumer spend.
- SA consumers spent much more money shopping in the **second half of the year**, compared with the first half. This is not just because of "Black Friday" and Xmas shopping. In fact, SA's five biggest shopping months occur in the second half of the year, namely August, September, October, November and December. SA's sixth biggest shopping month is May, and not the Easter period.
- The two **worst months for SA shopping** are January and February. This is despite the "back to school" specials. It is most likely that January retail sales are impacted by the fact that consumers don't have much disposable income at the start of the year having spent disproportionately more in November/December. This lack of income is most likely carried-over to February, although February sales are also impacted by the fact that it is the shortest month of the year.
- There is no clear data to support the idea that SA shops more in **summer rather than winter**, but is does seems fair to suggest the emergence of spring tends to signal an uplift in shopping activity.
- Although on-line retail activity is growing fairly rapidly, it comprises less than 2% of total shopping activity and does not appear to have distorted the typical seasonal pattern in consumer spending.
- Foreign tourism is a reasonably important contributor to SA shopping activity, especially in certain regions of the country such as the Cape Town area. This contribution to SA shopping activity would tend to boost retail sales in the second half of the year.

The comments above provide no insight into the current rate of growth in retail sales, which remains relatively weak overall - but retail sales have at least recorded positive growth in the past three months, and should receive some support from the recent significant cut in the petrol price. This will be partially offset by the November 25bps increase in interest rates.

*Please follow our regular economic updates on twitter **@lingskevin***

Kevin Lings & Laura Jones
(STANLIB Economics Team)

Rates

These rates are expressed in nominal and effective terms and should be used for indication purposes ONLY.

STANLIB Money Market Fund	
Nominal:	6.50%
Effective:	6.69%

STANLIB is required to quote an effective rate which is based upon a seven-day rolling average yield for Money Market Portfolios. The above quoted yield is calculated using an annualised seven-day rolling average as at 7 December 2018. This seven- day rolling average yield may marginally differ from the actual daily distribution and should not be used for interest calculation purposes. We however, are most happy to supply you with the daily distribution rate on request, one day in arrears. The price of each participatory interest (unit) is aimed at a constant value. The total return to the investor is primarily made up of interest received but, may also include any gain or loss made on any particular instrument. In most cases this will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of reducing the capital value of the portfolio.

STANLIB Enhanced Yield Fund	
Effective Yield:	7.88%

STANLIB is required to quote a current yield for Income Portfolios. This is an effective yield. The above quoted yield will vary from day to day and is a current yield as at 7 December 2018. The net (after fees) yield on the portfolio will be published daily in the major newspapers together with the "all-in" NAV price (includes the accrual for dividends and interest). This yield is a snapshot yield that reflects the weighted average running yield of all the underlying holdings of the portfolio. Monthly distributions will consist of dividends and interest. Interest will also be exempt from tax to the extent that investors are able to make use of the applicable interest exemption as currently allowed by the Income Tax Act. The portfolio's underlying investments will determine the split between dividends and interest.

STANLIB Income Fund	
Effective Yield:	8.30%
STANLIB Extra Income Fund	
Effective Yield:	7.67%
STANLIB Flexible Income Fund	
Effective Yield:	6.70%
STANLIB Multi-Manager Absolute Income Fund	
Effective Yield:	7.0%

Collective Investment Schemes in Securities (CIS) are generally medium to long term investments. The value of participatory interests may go down as well as up and past performance is not necessarily a guide to future performance. A schedule of fees and charges and maximum commissions is available on request from the company/scheme. CIS can engage in borrowing and scrip lending. Commission and incentives may be paid and if so, would be included in the overall costs." The above quoted yield will vary from day to day and is a current yield as at 7 December 2018.

For the STANLIB Extra Income Fund, Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. The historical yield over the last 12 months is reported for the STANLIB Multi-Manager Absolute Income Fund.

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