The Weekly Focus

A Market and Economic Update

11 February 2019

STANLIB

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Newsflash

- At this stage the dollar is too strong as well, trading near its three-month high versus the euro at $1.131.

Market Comment

- There certainly seems to be a lot for markets to worry about at this time, from very weak growth in Europe to China slowing down, bad news on the trade front (no meaningful progress reported from the Chinese side), Brexit dragging on and on, another partial US government shutdown looming on Friday (if the parties fail to reach agreement)…AND now load-shedding for our poor economy.
- So it is interesting that offshore markets are so far holding their own. The S&P 500 has gained +16.4% from its 24th December low and is now just below its 200-day moving average (+7.9% in 2019), considered a key level by most chartists. Many feel that it is due for a pullback after its strong bounce, especially because of the total lack of good news, apart from buoyant company earnings…and possibly the very strong bond market (lower yields/lower medium- and long-term cost of money).
- The US 10-year bond yield has sunk to 2.63% (price up), back at 2013/2014 levels.
- The German 10-year bond yield was at 0.75% a year ago versus today's 0.08%!
- At this stage the dollar is too strong as well, trading near its three-month high versus the euro at $1.132.
- Maybe (hopefully) Trump has some positive news up his sleeve about the trade story. Who knows, he may be playing games (as in his book "The Art of the Deal") with the Chinese, creating the impression of slow progress, with the threat of 25% tariffs up ahead.
- The JSE ALSI is trading this morning where it was a week ago. It had a nice move earlier last week, but gave it all up on Thursday and Friday, aggravated by the -6.5% tumble in Sasol's share price to a 15-month low on news of the delay in and higher cost of the construction of the Lake Charles Chemicals Project in the US.
- So far in 2019 the JSE Listed Property Index continues to lead with a total return so far of +9.6% (was +9.2% at end January), then the All Bond Index with +2.8% (+2.9% at end January), then the ALSI with +1.1% (+2.8% at end January).
- SA Listed Property is trading back at June 2018 levels, although it is still -24.6% from end 2017 (excluding dividends). Including dividends it is -17.9% lower; but bear in mind that 2017 saw returns of +17.2%. So it's back at 2016 levels, which is actually not that bad.
- Our platinum and gold shares remain in strong uptrends (a fairly rare occurrence over the past few years), with Implats, Anglo Plats and Sibanye consistently hitting new 52-week highs. Last week Sibanye gained +17%, Implats +17%, Mpact +15%, Harmony +11% and Clover +10%, while Omnia fell -12%, Gold Fields -10%, Truworths -9%, Stadio -8% and Sappi -8%.
- So far in 2019 Sibanye is +31%, Impala Platinum +26% and Anglo Platinum +21%. That's in just six weeks, thanks to the firmer gold price, also palladium and rhodium prices. The palladium price is up another +11.5% in dollars this year, close to a new record high.
- But the gold price needs the dollar to weaken a bit. It is too strong.

Other Commentators

US Market Analyst, Elaine Garzarelli

- The quants model remains in bullish mode with a high reading of 75.5% out of a maximum possible 100%.
- S&P 500 earnings estimates for the 4th quarter continue to improve, now +18% year-on-year from +15.3% about a month ago. Garza is forecasting +1.6% in 2019, up a little from 0% last week.

- Fair value for the index is now 2 844, +5% above current levels.
- US economic growth remains healthy. The US manufacturing PMI (leading indicator) rose in January, household employment remains strong and average hourly earnings are up +3.2% year-on-year. Consumer incomes are up almost +4% in real terms (after inflation).
- This supports consumer spending which accounts for two-thirds of US economic activity.
- The US economy has many pillars, such as strong employment, low inflation and good earnings going forward.
- Garza expects inflation to remain low due to technology and global competition.
- Garza expects +2.5% US GDP growth this year and +2% growth next year.

BCA Research

- Global growth should accelerate by mid-2019, as Chinese stimulus kicks in and the headwinds facing Europe fade.
- Investors should overweight global equities and underweight global bonds over the next 12 months.
- Global equities should finish the year 5-10% above current levels.
- The leadership role in the equity space will gradually shift outside the US, towards Europe and Emerging Markets.
- Today the US private sector financial balance (the difference between what the private sector earns and spends) stands at a healthy surplus of +2.1% of GDP. Both of the last two recessions began when the private sector balance was in deficit.
- With the S&P 500 Index trading at 16.1 times forward earnings, US shares are not cheap, but they're also hardly in a bubble.
- Housing is also doing well, with the home-owner vacancy rate near all-time lows, while the quality of mortgage lending is much higher than in the 2007/8 period.
- Exports are only 12% of US GDP, so it would take a sizeable external shock to knock the US into recession.
- The trade war is likely to take a break as Trump seeks to take credit for a deal with China.
- Euro area growth should reaccelerate over the coming months, thanks to lower oil prices, a revival in Emerging Market demand, modestly more stimulative government spending policies and the helpful stimulus of lower bond yields in the region. The risks of a 'hard Brexit' should also fade.

Paul Hansen

Director: Retail Investing

Economic Update

1. **SA State of the Nation: President Ramaphosa presented an ambitious array of initiatives to improve the SA economy, highlighting the fight against corruption and the restructuring of Eskom.**
2. **SA's turnaround score improved to 48% in early February 2019, helped by government's decision to unbundle Eskom and the increased fight against corruption announced by the president in the State of the Nation address**

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1. **On Thursday, 7 February 2019, the President of South Africa, Cyril Ramaphosa, delivered his second State of the Nation Address (SONA) since taking office on 15 February 2018.** Ahead of the event there was a lot of media speculation (locally and internationally) and debate about the likely content and tone of Ramaphosa's speech, especially leading up to this year's National Election.

   A lot of this debate, unsurprisingly, highlighted the need for government to urgently address a number of key challenges facing the country. These include uncertainties surrounding key economic and social policies that have been stifling private sector fixed investment, the need to accelerate the reform of key State Owned Enterprises (SOEs) such as Eskom, steps to improve the efficiency of government administration, including a reduction in the size of the cabinet and the number of government departments, embarking on the process of prosecuting people involved in corruption, initiating private/public partnerships in order to kickstart infrastructural development and further encouraging private fixed sector investment.

   The South African economy has struggled to achieve any meaningful economic growth over the past nine years, despite a relatively positive global economic backdrop. Instead, it has decoupled from the performance of the world economy, averaging growth of a mere 1.6% over the past nine years and a mere 1.3% in the past four years. This underperformance is reflected in rising levels of unemployment, increasing tax revenue shortfalls, depressed levels of consumer and business confidence, a protracted fixed investment recession in the private sector and credit rating downgrades.

   Without a sustained pick-up in economic growth, the fiscal authorities are going to find it increasingly difficult to meet their budget projections and the country will continue to face the risks of additional credit rating downgrades, rising unemployment and further social tension. Moody's remains the only major credit rating agency to assign SA an investment grade rating for both its long-term foreign debt as well as its long-term domestic debt. They will next review the rating at the end of March 2019.

   President Ramaphosa delivered an optimistic assessment on the outlook for the South African economy, suggesting that significant progress has and will be made in key areas of economy activity, government service delivery and the functioning of society. Many of these claims can and will be challenged, especially since the undertone of his remarks do not correspond with the current performance of the economy, especially within the household sector.

   In order to achieve a better economic outcome, **the President indicated that government is going to focus on five urgent tasks**. These are:

   - Inclusive economic growth and job creation
   - Improving the education system and developing the skills that the country needs now and into the future
   - Improving the living conditions of all South Africans, especially the poor
   - Stepping up the fight against corruption and state capture
   - Strengthening the capacity of the state to address the needs of the people.

In discussing how these five broad tasks are going to be accomplished, **the President presented an extremely ambitious array of initiatives** ranging from increased exports of manufactured goods to more competition in industry, improved tourism, introduction of private/public partnerships, increased housing development, better education outcomes, the creation of special economic zones, reforming key SOEs, substantially improving the ease of doing business, extending youth employment incentives, land redistribution (including land owned by government in urban areas), infrastructural development and progress in the fight against corruption.

While the intention of these initiatives is to be applauded, it remains an overly ambitious list of undertakings. This is probably to be expected two months ahead of a National Election, but clearly the risk of once again creating unrealistic expectations that lead to further disappointment is very evident. In that regard the speech can be criticised for simply announcing another list of tasks and initiatives without fully understanding or explaining why all the previous plans have not been fulfilled. The speech also lacks a point of focus to directly lift business confidence, investment, growth and employment.

One of the key stand-out features within the President's speech is a clear intention to restructure Eskom, acknowledging that the institution is in crisis. There appears to be an acceptance that the survival of Eskom (and probably many other SOEs) will require private sector involvement. In particular the President indicated that:

- Where SOEs are not able to raise sufficient financing from banks, from capital markets, from development finance institutions or from the fiscus, the government will need to explore other mechanisms, such as strategic equity partnerships or **selling off non-strategic assets**.
- In helping Eskom, government needs to safeguard the national fiscal framework, achieve a positive impact on the sovereign credit rating, and **pay attention to the rights and obligations of Eskom's funders**.
- Government needs to take steps to **reduce municipal non-payment and confront the culture of non-payment** that exists in some communities.
- **Government will support Eskom's balance sheet, without burdening the fiscus with unmanageable debt**. The Minister of Finance will provide further details on this in the Budget Speech on 20 February.
- **Eskom will develop a new business model**, which will include establishing three separate entities – Generation, Transmission and Distribution – under Eskom Holdings. It is hoped that this will enable Eskom to raise funding for its various operations more easily from funders and the market.

Overall, the key points the president chose to emphasis in the speech, especially the fight against corruption and the restructuring of Eskom, together with the tone and style of delivery should, on balance, help improve consumer and business confidence. The focus will now shift to the content of the National Budget that is scheduled to be presented on Wednesday, 20 February and then the outcome of the National Election on 8 May 2019. Hopefully, the South African economy can start to make more meaningful progress after nine years of disappointment.

2. **Given the importance of an economic turnaround in SA, we have compiled a list of 12 key indicators that we closely monitor and have scored on a monthly basis since the beginning of 2018** to consistently and systematically assess if SA is making meaningful progress in revitalising the broader economy. These 12 indicators, which are detailed in the charts attached, focus on a wide range of variables including political stability, policy clarity, business confidence, employment, capital expenditure, housing activity and consumer income.

   Every month, each of the selected indicators are scored on a scale of one to 10, with a score of 10 indicating an extremely high level of vibrancy and a score of one suggesting extreme underperformance. The scores are averaged across all 12 variables in order to derive an overall level of progress, which we analyse and distribute each month through email. Please note the progress/score will be reflected as a percentage ranging from 0% to 100%.

As a point of reference, a score of three or less out of 10 (i.e. 30% or less) would be consistent with economic stagnation, a high risk of an outright recession, declining levels of confidence, declining levels of fixed investment, rising unemployment and further credit rating downgrades. An average score of between three and five (i.e. between 30% and 50%) would signal positive but sluggish growth, a lack of meaningful capacity building, constrained budgets, and a stagnant labour market. A score of between five and seven (ie between 50% and 70%) would argue for GDP growth of around 2% to 3%, some expansion capex, modest employment growth, and an improving fiscal position. Lastly, a score above seven (i.e. above 70%) would be consistent with strong growth, broadening infrastructural development, a vibrant labour market, a robust housing market, and positive wealth effects.

The South African economy emerged from recession in Q3 2018 with GDP growth of 2.2%q/q and probably remained positive in Q4 2018. However, for 2018 as a whole the economy probably grew by only around 0.7%, which is far below the level of growth required to meaningfully lift the level of employment.

Taking into account the recent positive statements and initiatives announced in SONA, the average score of the 12 indicators has improved somewhat in early February 2019 to 4.8 out of 10 (48%). This is up from 4.5 at the end of December 2018. The score of 48% is consistent with the expectation of some improvement in the performance of the South African economy over the next 12 to 18 months (GDP growth forecast at 1.5% in 2019, rising to 1.9% in 2020), but is still extremely disappointing relative to the early 2018 expectations as well as the employment needs of the country. Hopefully the President's initiatives to stimulate the economy will start to have a visible impact on economic sentiment and growth in the coming months, and especially during the second half of 2019. It is critical that the government's renewal strategy starts to yield meaningful results before the end of 2019 for the country to avoid a further credit rating downgrade as well as a further escalation in social and political tension.

The focus will now shift to the content of the National Budget that is scheduled to be presented on Wednesday, 20 February and then the outcome of the National Election on 8 May 2019.

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:	6.79%
Effective:	7.01%

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 08 February 2019. 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:	7.95%

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 08 February 2019. 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:	8.31%
STANLIB Extra Income Fund	
Effective Yield:	7.71%
STANLIB Flexible Income Fund	
Effective Yield:	7.48%
STANLIB Multi-Manager Absolute Income Fund	
Effective Yield:	7.6%

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 08 February 2019.

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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STANLIB

17 Melrose Boulevard, Melrose Arch, 2196
P O Box 202, Melrose Arch, 2076
T: 0860123 003 (SA Only)
T: +27 (0) 11 448 6000
E: contact@stanlib.com
Website: www.stanlib.com
STANLIB Asset Management (Pty) Ltd
Reg. No. 1969/002753/07
Authorised FSP in terms of the FAIS Act, 2002 (Licence No. 26/10/719)
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