ASSET MANAGEMENT House View

International Market Overview

The second quarter of 2019 was characterised by the escalation of trade war rhetoric between China and the United States, which again raised concerns of a global economic slowdown. As a result, the major central banks stepped into the breach, indicating that they are prepared to provide the required support by lowering interest rates. This was highlighted when global markets staged a rally mid-June with the Fed Chairman, Jerome Powell, indicating that he was 'ready to act', with the later released FOMC minutes reflecting that he enjoyed the required Fed support for this course of action.

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United States of America

American markets ended the quarter continuing the gains enjoyed during the first quarter, with the Dow Jones higher by 2.59%, the S&P 500 better by 3.79%, and the NASDAQ by 3.58%. Tech counters took a knock during June, however, with regulators announcing the instigation of an anti-competitive conduct investigation among the large cap US tech counters. This was mitigated to a degree by the Facebook announcement of their new crypto currency (libra), as well as a successful developers conference held by Apple.

Economic data released during the quarter revealed a mixed bag, with some numbers continuing to point to a potential US slowdown (both the PMI and Consumer confidence number released in June coming in lower than expected), while the retail sales numbers in May saw an increase. April numbers were revised upward, pointing to a pick-up in consumer spending, easing fears that the economy was headed toward a sharp slowdown in 2019.

Europe

The major European markets followed in the footsteps of their American counterparts, also having a strong second quarter as the FTSE 100 ended up 2.01%, the DAX 30 by 7.57%, and the CAC 40 by 3.52%. Economic data emanating from Germany and Italy led economic sentiment in the eurozone to its lowest level in three years, which resulted in the announcement by the ECB, that although at record lows, they would be looking to cut rates as well as the implementation of other stimulus measures to boost growth.

With the FTSE 100 ending the quarter stronger by 2.01%, the uncertainty of Brexit, and the possibility of exiting the EU without having a deal finalised continues to weigh on the UK economy. The contraction of the economy over the period was highlighted by a 0.4% contraction in April, following on from a 0.1% contraction in March. Growth in April also slowed down to 0.3%, while annual growth fell to 1.3%. there was a larger Brexit impact flow through, with the manufacturing sector shrinking by 3.9%, and car production falling by 24% in April (both MoM numbers), the latter being the biggest drop since 1995.

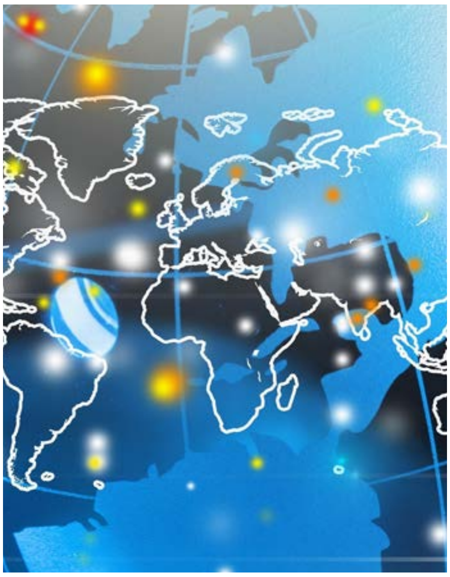
The DAX 30 also ended the quarter higher by 8.9% as economic data late in March boosted investor sentiment with German Business confidence improving for the first time in seven months, with the indicator rising to 99.6, higher than the previous months 98.6, and better than expected. This increase mitigated the negativity induced by the PMI released a few weeks earlier which had pointed to the German economy possibly starting to slow down.

Asia

Unlike the US and European markets, Asian markets were mixed with the Shanghai Composite firmer by 3.6%, the Hang Seng lower by 1.8% for the quarter and the Nikkei better by 0.3%.

Economic data from the Chinese mainland continues to show signs of a weakening economy, with a slowdown in industrial production, a fall in electricity production growth, and infrastructure investment growth also trending lower. A further indication of the bodyblows taken by the Chinese economy on the back of the trade war, saw weaker factory output, flat exports and weaker imports, highlighting the battered sentiment currently experienced.

Local Market Overview



The JSE All Share Index (ALSI) enjoyed further gains in the second quarter, adding another 3.92%, bringing the total gains for the year to 12.2%. After five consecutive months of gains, the local bourse pulled back in May as concerns around a trade-related global slowdown weighed on world markets. Investor sentiment bounced back in June, however, as the US Federal Reserve hinted at future lower interest rates.

As expected, the South African Reserve Bank (SARB) left interest rates unchanged in May. The bank did, however, present a dovish tone, with two members voting for a 25-basis point cut. The first quarter GDP figures were also released in June, coming in much weaker than expected. On an annualized quarter-on-quarter basis, the local economy contracted 3.2%, while on a year-on-year basis, the local economy recorded no growth. Consumer inflation figures have been hovering around the 4.5% mark for the last few months, and we believe the risk of rate hikes has diminished, for now.

Resources

The JSE Resources Index had a more subdued quarter two, only rising 2.60%, compared to quarter one's 16.18%. Sasol was a significant laggard, falling more than 22% after announcing yet another cost overrun at its Lake Charles Chemicals Project. On the opposite side of the spectrum, gold counters forged ahead as risk off trade had investors flock towards the safe haven precious metal. Gold per ounce traded 9.07% higher in dollars (5.96% in rand) and hit a six year high of USD1423.44 toward the end of June. This helped push Gold Fields and AngloGold Ashanti 44.05% and 32.58% higher, respectively. Yet commodity prices, as measured by the Bloomberg Commodity Index, slumped marginally, down 1.19% in dollars.

Industrials

The INDI25 continued to march higher in 2019, adding another 4.45% in the second quarter. Telco's MTN and Vodacom both had an excellent quarter, gaining 20.46% and 10.88%, respectively. After a very tough first quarter, local retailers bounced back, with the likes of Clicks (+12.07%), TFG (+10.61%), Mr Price (+6.95%) and Pick n Pay (+6.78%) outperforming their peers. Richemont's run in 2019 continued, as the group released a good set of results in May. The luxury goods company gained 14.2% for the quarter. On the downside, healthcare providers had a weak quarter, with Netcare and Life Healthcare declining 23% and 14.88%. After registering strong gains in the first quarter, British American Tobacco shares slid 15.77% after its trading update disappointed investors.

Financials

The FINI15 was the strongest performing major index, gaining 7.02% during the quarter. The banking sector had a very strong quarter, led by Absa (+20.28%), FirstRand (+11.27%) and Standard Bank (+9.22%). Capitec bucked the trend, ending 3% lower. The JSE Life Insurance sector gained 5.64% with Sanlam (+10.38%) and Discovery (+9%) enjoying good gains. Old Mutual (-3.06%) was in the spotlight after the group terminated its CEO's contract, citing a conflict of interest with an investment firm he founded. The FINI15 is now up 6.6% for the year.

Listed property

The local listed property sector had a strong start to the quarter as global growth improved and non-residents pared back on the sale of South African stocks. Heightened foreign selling returned, however, in the middle of the quarter as emerging markets came under fire. Risk sentiment changed once again in June, helping the property market to produce positive returns over the period. The listed property index was up 4.52% for the second quarter of 2019

Property fundamentals remain weak in a low growth environment. The retail sector continues to take strain and the office sector remains a laggard. The near-term outlook remains volatile in a challenging sector.

We maintain a diversified mix of property counters in our portfolios. The investment strategy remains focussed in shares that fall within defined quality and liquidity parameters.

Local currency

The South African rand experienced another volatile quarter, depreciating from ZAR14.50/USD1 at the beginning of the quarter to ZAR14.99/USD at the beginning of June, before paring losses and ending the quarter at ZAR14.09/USD. Trade tariff concerns between China and the U.S., coupled with South African politics, have kept currency pundits on edge. The South African economy contracted by 3.2% quarter-on-quarter in Q1, adding to worries surrounding the stability of the country's economy, and denting rand confidence. The rand appreciated by 1.46% against the euro, 5.67% against the British pound, and 0.11% against the Japanese yen over the second quarter.

Local Fixed Income

Market Review

Global bond yields initially rose as global markets exhibited more optimism than the previous quarter. Global growth prospects were positive, inflation seemed well contained and central banks maintained their dovish stance. Yields started to fall, however, as US-China trade tensions escalated on the back of fears of global supply chain disruption and renewed threats on trade tariffs. By the end of the quarter, sentiment was tested as the market priced in a dovish Fed rate cut in July and potentially another cut later in the year. The US 10-year generic bond yield eventually closed the quarter at 2.0%.

The local bond market was driven stronger initially by a wave of foreign buying early in the quarter. The inflow was short-lived, however, as foreigners turned net sellers later in the period. Yields continued to decline, albeit at a slower pace as the government elections proved to be relatively painless and inflation continued its benign trend. The JSE All Bond index was up 3.70% for the quarter.

Inflation Linked Bonds had a strong showing early in the period as inflation maintained a path close to the midpoint of the target range. Inflation linkers were up more than 2.5% for the period.

Our fixed income outlook for the coming months is detailed as follows:

- Economic growth remains low with little signs of substantive recovery.
- Currency volatility will be fueled largely by international factors.
- The state of our SOE's and the threat of ratings downgrades will weigh heavily on the interest rate sensitive environment.
- Foreign flows are negative, and the economy remains vulnerable.
- Short- and long-term technical trends however remain in positive territory.
- Local sentiment is cautious.

We continue to seek value along the yield curve with careful duration risk positioning of our portfolios.