ASSET MANAGEMENT House View

International Market Overview

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The third quarter of the year was again held to ransom to a large degree by the continuing trade tensions between the United States and China, which continues to raise fears of a global slowdown. Further uncertainty surrounds a no-deal Brexit and the drive to potentially impeach President Trump.

In the same quarter we saw renewed support for world markets as the US Federal Reserve delivered their eagerly anticipated rate cuts, 0.25% during July, and 0.25% during September.

The European Central Bank followed suit with a cut, but also surprised the market with its renewed pledge to restart quantative easing with the EUR20bn purchase of monthly bonds, starting from November. This was premised by Minister Draghi's July statements that the need for the rate cuts and quantative easing was needed as a countermeasure to the robust economy being threatened by factors outside of the Union, which threatened export businesses and manufacturing.

United States of America

US markets ended the quarter on a mostly stronger footing, continuing the theme for the year as the Dow Jones closed higher by 1.19%, the S&P 500 also up by 1.19%, and the Nasdaq marginally lower by 0.09%.

The 0.25% rate cut in July was the first since December 2008 and was a mid-cycle adjustment with the economy still being driven by strong consumer demand. The rate cut of 0.25% in September, saw the Fed leaving the language used at the July meeting largely unchanged. In addition to the comments regarding an increase in household spending, weakening exports and fixed investments, the take-away was the rising disagreement amongst members of the FOMC, with three members voting to keep rates unchanged, while one voice called for a steeper 0.50% cut.

The US/Sino trade war was significantly ramped up with the US announcing that $300bln of Chinese imports not already subject to tariffs would be subjected to a tariff increase as from 1 September. The Chinese responded in turn by halting farm imports from the US as well as devaluing its currency, causing a downturn in global stocks in early August. The tension was somewhat allayed as both countries agreed to resume talks in early October. This positivity was reinforced by strong economic data out of the US (better than expected payroll and consumer data), which eased fears regarding an imminent recession.

Europe

European markets ended the quarter on a mixed note as the fears of a no-deal Brexit continued to raise concern as well as general economic data pointing to a slowdown in the German market. The FTSE 100 ended the quarter softer by 0.23%, the DAX firmer by 0.24%, and the CAC 40 by 2.51%.

The UK market continued vacillating as the issue of a non-Brexit deal continued to hover, as we saw Theresa May fall on her sword. Boris Johnson, the newly elected Prime Minister wasted no time in trying to put his stamp on the issue, and duly announced the prorogation of parliament, which suspended all parliamentary discussions. He suffered a defeat in a court battle which questioned the legality of his suspension of parliament and which continues to leave a cloud of uncertainty over the exit from Europe.

There is a proposed new Brexit deal on the table, which the EU is considering, but early suggestions are that an agreement is unlikely. MP's are sitting in the House of Commons to debate their options. If they don't back the deal, or there is a non-agreement between the EU and the UK, in terms of the so-called Benn Act, the Prime Minister is obliged to request an extension of Article 50, delaying Brexit until the 31 January 2020.

The German market economy continued to show signs of slowing as gloomy survey data and rising external risks raised the spectre of Germany potentially entering a technical recession. Growth in German domestic demand has weakened from previous quarters as consumption edged up by 0.1% in quarter two, and growth in investment in machinery and equipment rose by 0.5%. The surveyed confidence for the third quarter remains bleak as the German ZEW indicator of economic sentiment fell sharply to negative 43.6 points in August 2019, compared to a previous reading of negative 20.3 in the previous reading. This was confirmed by a drop in the German IFO Business Survey, to its lowest level since 2012 as the index slipped to 94.3 points in August, compared to 95.8 in July and an expected estimate of 95.1.

Asia

Asian markets were generally weaker as they contended with the escalating trade tensions between China and the United States. The Nikkei ended the quarter firmer by 2.26%, whilst both the Hang Seng, and the Shanghai Composite index was weaker by 8.58%, 2.47% respectively.

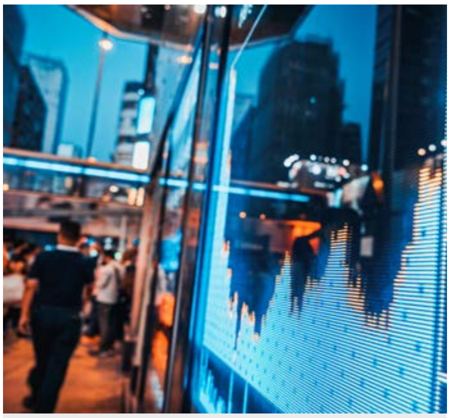
Notwithstanding the rate cuts applied by both the Fed and the ECB, the Bank of Japan (BoJ) maintained its policy stance as well as leaving its asset purchases level unchanged. The BoJ has also indicated that it would review growth and inflation forecasts as the growth in economic activity was revised lower to 1.8%. However, Japanese inflation dropped to 0.3% year-on-year in August, which has raised expectations for the BoJ to further ease before year end. Although the BoJ made no changes in September, they have signalled a readiness to further expand stimulus which has raised some optimism for further monetary policy easing in the coming months.

The escalation in SINO/US trade tensions resulted in a contraction in spending by the Japanese manufactures, whilst capital spending came in lower than expected and net exports, impacted by the slowdown in global growth, detracted from economic activity.

The Chinese economy, as is the US, continues to feel the fall out of the trade war as more tariffs on Chinese goods by the US was announced. An increase from 25% to 30% on US250bn worth of Chinese imports as at 1 October 2019 was announced, as well as an increase from 10% to 15% on an additional US$300bn worth of imports (toys and clothing) with half of the tariffs coming into effect 1 September and the other half by 15 December 2019.

Weaker Chinese manufacturing data also added to the woes for the Chinese economy as growth in industrial production fell to a 17-year low in July, putting further pressure on Chinese stocks.

As a result, according to the US-China Business Council Annual Member Survey for 2019, a higher percentage of American companies are looking to reduce or stop new investments into the Chinese market. Notwithstanding the fact that the Chinese market is seen as a significant revenue growth driver for these companies with the profit margin rate for their Chinese operations seeing an increase in 2019 which has exceeded the rate they have received for their overall operations.



Local Market Overview

The JSE All Share Index (ALSI) experienced a turbulent third quarter, as the US-China trade war continued to drive global market volatility. After a strong first half in 2019, the ALSI pulled back 4.57% in Q3, to finish the quarter up 7.08% for the year.

After the dovish tone that was present in the May meeting, the South African Reserve Bank (SARB) cut rates by 0.25% in July, largely in line with market expectations. The rate cate seems justified as the South African economy continues to struggle with very weak economic growth, and lower than expected inflation. The second quarter GDP figures were released in September, recovering somewhat from the dismal first quarter figures. On an annualized quarter-on-quarter basis, the local economy expanded 3.1%, whilst on a year-on-year basis, the local economy recorded growth of 0.9%. Consumer inflation dipped to 4% in July, before rising to 4.3% in August, still below the halfway mark of the SARB's target of between 3% and 6%.

Resources

The JSE Resources Index back-tracked over the quarter, losing 7.33%. Despite the pullback, resources have managed to return 10.46% year-to-date. Sasol continues to struggle, losing 27.74% over the quarter, with uncertainty surrounding the Lake Charles Chemicals Project. Heightened risk within the global economy has helped push gold counters higher, along with driving the gold price through the psychologically important $1500/ ounce level. Sibanye Gold gained 25.18%, while AngloGold Ashanti rose 11.84%. Commodity prices, as measured by the Bloomberg Commodity Index, slumped 2.35% in dollars (+5.00% in ZAR).

Industrials

Despite falling 2.28% in the third quarter, the INDI25 was the best performing major index. The index was pulled down by the likes of Truworths (-22.4%), Shoprite (-21.1%) and Mr Price (-20.3%). All three retailers released results/updates that disappointed the market and highlight how difficult the current environment is. Bucking this trend was Woolworths, which managed to gain 14.6% for the quarter. Some of the large rand hedge shares benefitted from the weaker rand, with AB Inbev (+15.9%), British American Tobacco (+13.7%) and Mediclinic (+13.2%) outperforming. During the quarter Naspers completed its eagerly awaited corporate action, which resulted in the listing of Prosus on the Euronext Stock Exchange in Amsterdam (and a secondary listing on the JSE). On a total return basis, the INDI25 is now up 11.06% for the year to date.

Financials

The FINI15 was the worst performer of the major indices, falling 7.67% for the quarter. Discovery was hit the hardest, with the share price declining 23.5% as government unveiled the long-awaited National Health Insurance (NHI) Bill during the quarter. Investors are concerned about the impact this may have on private medical aid schemes. The banking sector had a tough quarter with the big four all ending in negative territory. After gaining 20% in the previous quarter, Absa led the way down in Q3, falling 10.3%. Capitec (-0.87%) was the best performing bank, as the group released another good set of results. Of the property counters within the index, Redefine lagged, with the share price sliding 13.38%. As at the end of the third quarter, the FINI15 is 1.62% lower for the year to date.

Listed property

The uplift experienced in the local listed property sector during the second quarter of 2019 was short-lived as local and global growth continued to slow. This coupled with the return of foreigners selling our local markets weighed heavily on the sector. The persistent decline in risk appetite for emerging markets further exacerbated the retracement of stock prices. The listed property index was down 4.44% for the third 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 traded in a range of ZAR15.46/ USD1 to ZAR13.84/ USD1 over the quarter. Continued weakness in the local economy, along with moderating inflation, has given the SARB some wiggle room with repo rates. A 0.25% cut was announced in July, while the rate was held at 6.50% in September. Against other major currencies, the rand weakened by 3.76% against the pound Sterling, 2.88% against the euro, and 6.72% against the Japanese yen.

Local Fixed Income

Market Review

The global bond market was characterised by declining yields over the third quarter of the year. The drop in yields was largely driven by rate cuts implemented by central banks in response to the persistent slowdown in global economic growth. Further volatility crept into the global bond market towards the end of the quarter amidst ongoing US-China trade tensions, an oil price spike and heightened Brexit uncertainty. The implications of an inverted US yield curve were hotly debated while the European Central Bank (ECB) prepared to restart its asset repurchase program. The US 10-year generic bond yield closed the quarter at 1.66%.

Returns from the local bond market were heavily constrained as non-residents remained net sellers for the period under review. Yields failed to decline substantially despite a 0.25% rate cut by the reserve bank early in the quarter. The JSE All Bond index was up a mere 0.78% for the quarter.

Inflation Linked Bonds were governed by rising real yields stunting returns from this asset class for the third quarter of the year. Inflation linkers were up 0.25% for the period despite August inflation surprising to the upside.

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

- Economic growth remains low with little signs of substantive recovery.
- Currency volatility continues to be fueled largely by international factors.
- The state of our SOE's, the threat of a ratings downgrade and foreign capital flight remain the critical event risks.
- Foreign flows are negative, and the economy remains vulnerable.
- Short- and long-term technical trends are in neutral territory.
- Local sentiment is cautious.

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