INVESTMENT REVIEW

DECEMBER 2016

GRINDROD ASSET MANAGEMENT

"Democracy substitutes election by the incompetent many for appointment by the corrupt few."
George Bernard Shaw

ECONOMIC OUTLOOK

The US Federal Reserve ("the Fed") voted to increase official interest rates by 0.25% following their policy meeting in December. The Fed's decision was supported by an uptick in economic activity in the US in the second half of the year. Household spending continued to rise at a moderate pace on the back of relatively high levels of consumer sentiment and wealth (following double-digit returns from US equities in 2016). The US economy continued adding approximately 180,000 new jobs each month and the unemployment rate dipped to 4.6% in November (chart 1). The Fed is also confident that inflation is headed towards 2% as the stronger US dollar and lower oil prices are now in the base.

Economists are expecting global growth to accelerate to 3.5% in 2017, up from 3.0% in 2016. Aside from the US, higher growth is expected out of Japan and commodity-exporting emerging markets, offsetting lower growth in Europe and China. The improving growth outlook and higher inflation will allow central banks to withdraw stimulus, with the Fed now expected to raise official interest rates 3 times in both 2017 and 2018. There are still a number of risks to the outlook for global growth, including new protectionist policies in the US, the outcome of Brexit negotiations and elections in France and Germany later this year.

Index	December %	12m %	YTD %
Dow Jones	3.4	16.5	16.5
S&P 500	2.0	12.0	12.0
FTSE 100	5.3	14.4	14.4
EURO STOXX 50	7.9	3.1	3.1
Nikkei 225	7.0	2.9	2.9
Hang Seng	-3.5	0.4	0.4
Australia	3.9	7.0	7.0

Source: I-Net Bridge

In South Africa, the current account deficit ("the CAD") widened to 4.1% of GDP in the third quarter of 2016, from 2.9% in the second quarter. The CAD is now forecast at 3.9% in 2016, widening slightly to 4.0% in 2017. During 2015, when commodity prices were tumbling, economists had forecast the CAD would widen to 5.0% of GDP in 2016. The South African Reserve Bank's ("the SARB") quarterly bulletin also highlighted the fact that unit labour cost growth remained below 6%, improving the prospects of an interest rate cut in 2017, although most economists only expect the SARB to reduce interest rates when consumer inflation drops below 5% on a sustained basis.

South African consumer inflation rose to 6.6% in November from 6.4% in October (chart 2). This was in line with economist forecasts and marks the peak level in this cycle. Inflation is expected to moderate throughout 2017 on the back of lower food price inflation and the recent strength in the rand (chart 3). Consumer inflation is expected to average 5.5% in 2017, not low enough to convince the SARB to lower interest rates, despite the weak growth outlook. A combination of food deflation and a markedly stronger rand are probably what's needed before the SARB starts cutting official interest rates in South Africa.

MARKET OUTLOOK

The momentum in US equity markets established in November, following Trump's surprise victory in the US presidential election, was maintained in December as the Dow Jones Industrial Average rose another 3.4% (chart 4). For the year as a whole, the Dow Jones Industrial average surged 16.5%, while the S&P 500 advanced 12.0%. Although the FTSE 100 index in the UK was up 14.4%, it was down 0.2% in US dollars following the pound's rapid devaluation in 2016. According to FactSet, analysts are expecting the S&P 500 constituents to report earnings growth of 11.5% and revenue growth of 5.9% in 2017, following flat earnings growth in 2016.

Global bond yields continued to inch higher in December. Following the Fed's decision to increase official interest rates at their December policy meeting and expectations that interest rates will rise further in 2017 and 2018, global bond yields are likely to continue inching upwards to more normalised levels. The GPR 250 REIT index gained 4.2% in US dollars during December (chart 5), as US REITs advanced 4.4% and the prices of European REITs increased by 7.0%. Prices of REITs in Asia declined by 0.2% during the month as investors continued to rotate out of emerging markets and into developed markets.

Index	December %	12m %	YTD %
All Share	1.0	2.6	2.6
Resources	-3.6	34.2	34.2
Financials	3.5	5.4	5.4
Industrials	1.8	-6.6	-6.6
Property	4.2	10.2	10.2
Bond	1.6	15.5	15.5
Cash	0.6	7.4	7.4

Source: I-Net Bridge

South Africa's equity market posted a modest gain of 1.0% in December as the stronger rand and lower commodity prices pushed the resources sector lower. Despite December's 3.6% decline, the resources sector was up 34.2% in 2016, significantly outperforming both financials (+5.4%) and industrials (-6.6%). The rand's strength negatively impacted the prices of the large, rand-hedge industrial companies that now dominate the South African equity market. As a result, the FTSE/JSE All Share index returned 2.6% for the year as a whole, despite the strong showing from the resources sector. As a result of the stronger rand, the South African equity market was up 15.9% in US dollars during 2016 (chart 6).

South African government bond yields fell by more than 10 basis points, bucking the global trend of higher yields in December. Amongst South African asset classes, bonds produced the best return in 2016, followed by listed property, cash and equities. The South African listed property sector recouped all of November's losses, gaining 4.2% in December. The sector finished the year with a 10.2% gain. The sector's top performers in 2016 were the domestically focussed smaller companies trading on high yields and large discounts to net asset value. These companies continue to offer significant value.

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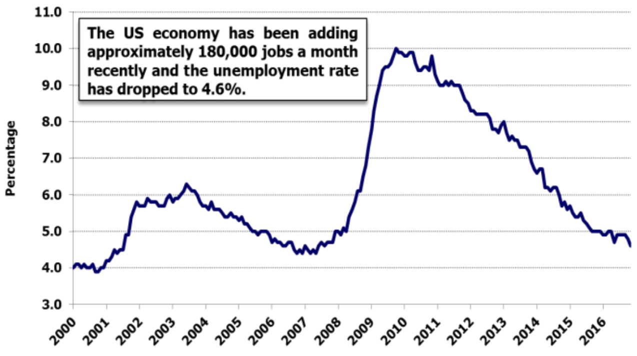
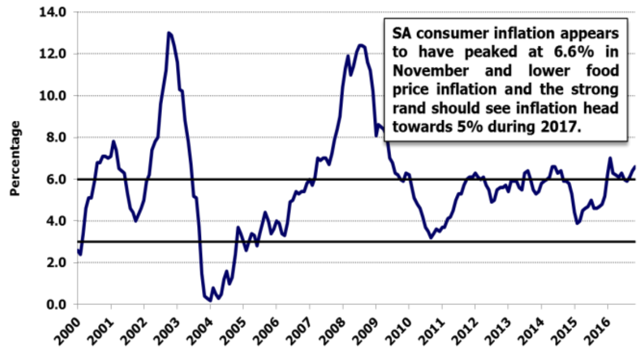
CHARTS

Chart 1: US Unemployment Rate (%)



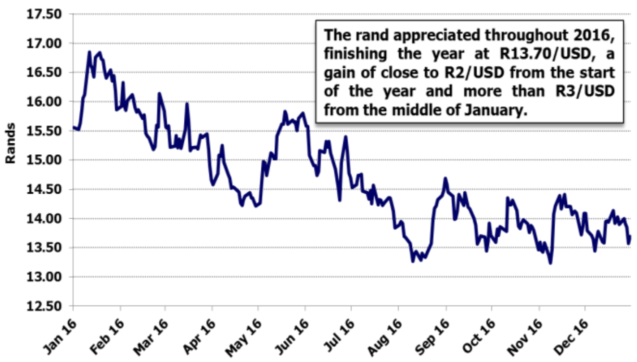
Source: I-Net Bridge

Chart 2: SA Consumer Inflation (%)



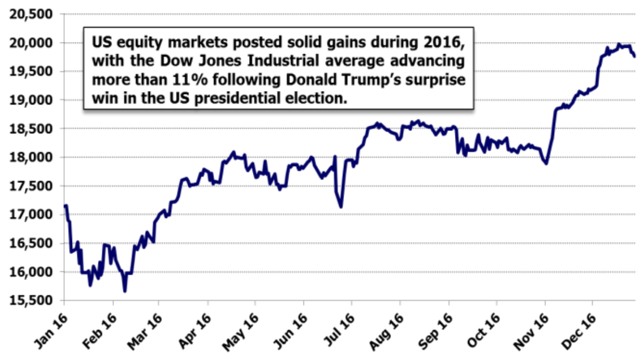
Source: I-Net Bridge

Chart 3: ZAR/USD Exchange Rate (Rands)



Source: I-Net Bridge

Chart 4: Dow Jones Industrial Average

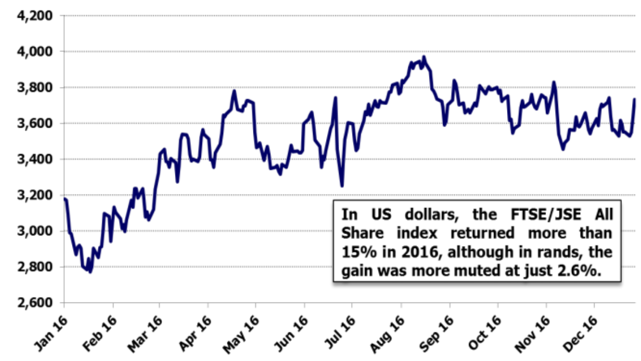


Source: I-Net Bridge

Chart 5: GPR 250 REIT Index (TR)

Source: Global Property Research

Chart 6: FTSE/JSE All Share Index in US Dollars



Source: I-Net Bridge

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