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INVESTMENT REVIEW

JUNE 2017

BRIDGE FUND MANAGERS

"The illegal we do immediately. The unconstitutional takes a little longer."
Henry Kissinger

ECONOMIC OUTLOOK

The US Federal Reserve (the Fed) raised official interest rates by 0.25% following the conclusion of its policy meeting in June. According to the Fed, the US labour market has continued to strengthen and the latest batch of US economic data shows that economic activity has been rising moderately in 2017. The US unemployment rate has fallen to the lowest level in 16 years (chart 1) following 80 consecutive months of jobs growth. The Fed also announced that the US$4.5 trillion bond portfolio it had acquired through a series of quantitative easing programmes would be sold gradually. While the Fed appears committed to a further rate hike this year, current economic data suggests that economic activity has slowed, which may push the next hike into 2018.

Central bankers took centre stage in the UK and Eurozone during June. Governor of the Bank of England, Mark Carney, suggested that interest rates in the UK may need to be raised soon. He did qualify his statement by adding that any upward move in official interest rates would depend on several factors, including how the UK economy responds to tighter financial conditions and the reality of Brexit negotiations. Carney's comments followed a statement from the European Central Bank (ECB) that it was considering removing some stimulus as the European economic recovery continued to gather momentum.

Index	June %	12m %	YTD %
Dow Jones	1.7	22.1	9.3
S&P 500	0.6	17.9	9.3
FTSE 100	-2.8	12.4	2.4
EURO STOXX 50	-3.0	23.3	6.7
Nikkei 225	1.9	28.6	2.2
Hang Seng	0.4	23.9	17.1
Australia	0.0	8.5	0.8

Source: I-Net Bridge

South Africa's economy contracted for the second quarter in a row and is now technically in recession. According to Stats SA, South Africa's gross domestic product (GDP) contracted by 0.7% (seasonally adjusted and annualised) in the first quarter of 2017. Although agricultural output surged by 22.5% and mining output increased by 12.8%, weak consumer demand and further declines in manufacturing production dragged the economy into recession. Of concern was the 1.2% decline in the finance, business services and real estate sector, which has proved to be resilient in the past. GDP growth forecasts have been scaled back, with economists now forecasting growth of less than 1% in 2018.

Early indications suggest that the second quarter will prove just as difficult as the first, following President Jacob Zuma's recent cabinet reshuffle. According to the Bureau of Economic Research (BER), business confidence in South Africa's manufacturing sector has plummeted to its lowest level since the global financial crisis. The deteriorating outlook for economic activity in South Africa, along with lower consumer inflation, has prompted some economists to suggest that the South African Reserve Bank (SARB) will cut interest rates on more than one occasion this year, despite the SARB's hawkish comments following their May policy meeting.

MARKET OUTLOOK

Although both the Dow Jones Industrial Average and the S&P 500 index were up in June, the NASDAQ Composite index declined by 0.9% (chart 2). The NASDAQ Composite index is dominated by heavyweight tech-stocks like Apple, Amazon, Alphabet (Google's parent) and Facebook which have all posted strong gains during 2017. Following hawkish comments from central bankers in the US, UK and the Eurozone, many investors have started to question the lofty valuations of the world's leading tech stocks. The NASADQ Composite index lost more than 2% of its value in the final week of June and 3% since rising to a record high on 8 June. Equity markets in the UK and Europe declined as both pound sterling and the euro appreciated against the US dollar (chart 3).

Having fallen throughout 2017, global bond yields rose sharply in June as central bankers in most developed economies warned that stimulus could be removed and that higher interest rates are now on the cards. The yield on US 10-year Treasuries rose 7 basis points in June, while the yield on German 10-year bunds increased by 18 basis points to their highest monthly close since December 2015 (chart 4). Despite the increase in global bond yields, the GPR 250 REIT index increased by 1% in June on the back of a 2.4% rally in US REITs. European and UK REITs declined following the hawkish central bank comments.

Index	June %	12m %	YTD %
All Share	-3.5	1.7	3.4
Resources	-3.1	1.9	-4.6
Financials	-2.1	2.6	-1.1
Industrials	-4.2	1.7	9.0
Property	0.3	2.8	2.3
Bond	-0.9	7.9	4.0
Cash	0.6	7.7	3.7

Source: I-Net Bridge

In South Africa, a 6.3% decline in the price of Naspers (chart 5) dragged the FTSE/JSE All Share index lower. Domestically-focussed sectors continued to struggle following confirmation that South Africa's economy is technically in recession. Continued political uncertainty is also weighing on investor confidence as the ANC began its fifth National Policy Conference at the end of June. Although no major announcements are expected from the conference itself, it is likely to set the tone in the ANC's leadership race, where Cyril Ramaphosa and Nkosazana Dlamini-Zuma are the early pacesetters. The ANC will choose a successor to Jacob Zuma at their National Conference in December this year.

South African government bond yields took their lead from global markets and rose 20 basis points during June (chart 6). The rand weakened against the euro and pound sterling during the month, which also helped push SA bond yields higher. South Africa's listed property sector has failed to make much headway in the face of rising bond yields and lower levels of economic activity. During the second quarter, several companies warned investors that domestic fundamentals were deteriorating, putting pressure on market rentals and driving up vacancy rates. Despite this, the sector is still forecast to produce inflation-beating dividend growth in 2017.

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*NON EXECUTIVE

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CHARTS

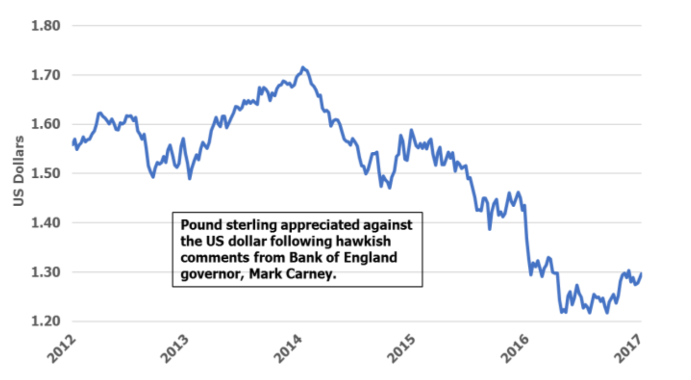
Chart 1: US Unemployment Rate (%)

Source: I-Net Bridge

Chart 2: NASDAQ Composite Index

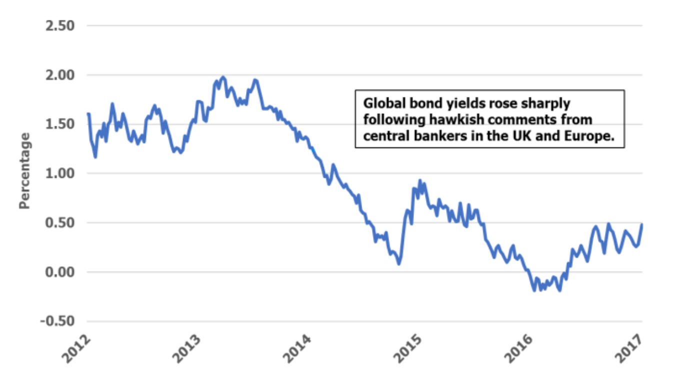
Source: I-Net Bridge

Chart 3: USD/GBP Exchange Rate (USD)



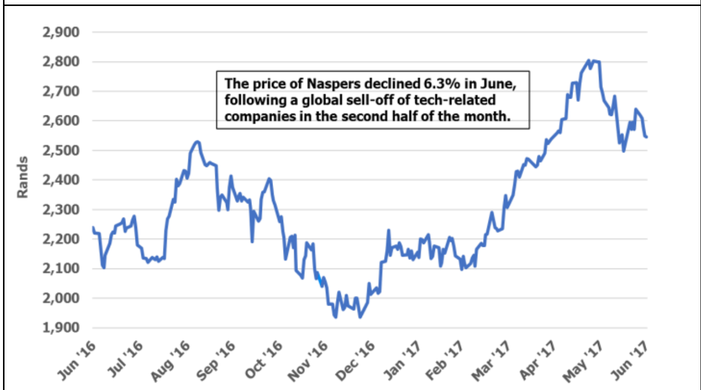
Source: I-Net Bridge

Chart 4: German 10-Year Government Bond Yield (%)



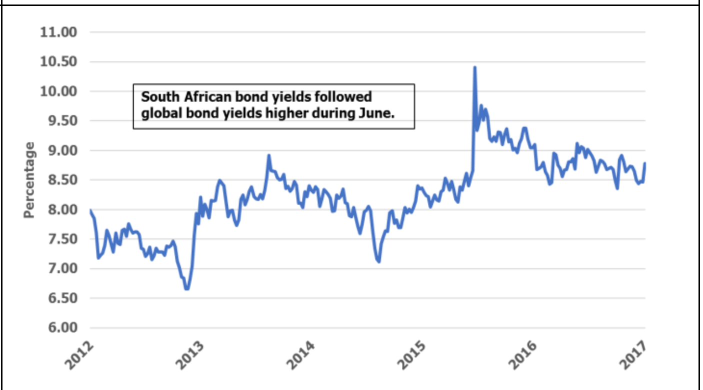
Source: I-Net Bridge

Chart 5: Naspers Share Price (ZAR)



Source: I-Net Bridge

Chart 6: R186 Government Bond Yield (%)



Source: I-Net Bridge

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