INVESTMENT REVIEW

MAY 2017

BRIDGE FUND MANAGERS

"Learning is not compulsory. Neither is survival."
W. Edwards Deming

ECONOMIC OUTLOOK

Based on current quotes for Federal funds futures, the market is assigning a 90% probability that the US Federal Reserve (the Fed) will raise official interest rates by 0.25% when they meet in June. Since December 2008, when the Federal Open Market Committee cut interest rates to an historic low of 0.25%, the Fed has only raised interest rates on three occasions (chart 1). The last of those increases happened in March this year following an increase in inflation towards 2% and further improvements in the US labour market. Although inflation has moderated somewhat since then and the US economy is expanding at a more subdued pace, various Fed spokespeople have reiterated their commitment to normalising interest rates, which should result in a June interest rate hike.

Prime Minister Theresa May's decision to call a snap election in the UK may be backfiring on her ruling Conservative Party. The snap election was called at a time when her party enjoyed a healthy lead over the Labour Party in opinion polls and was expected to strengthen the Conservative Party's position in Parliament ahead of the Brexit negotiations. Latest polling suggests the large lead has dwindled significantly, to the extent the Conservative Party may lose its majority in Parliament. This would necessitate the formation of a coalition government and greatly weaken the Conservative Party's position during the Brexit negotiations.

Index	May %	12m %	YTD %
Dow Jones	0.7	21.2	7.5
S&P 500	1.4	17.5	8.7
FTSE 100	4.4	20.7	5.3
EURO STOXX 50	1.0	19.2	10.0
Nikkei 225	2.4	14.0	0.3
Hang Seng	4.2	23.3	16.6
Australia	-3.1	5.8	0.7

Source: I-Net Bridge

In South Africa, consumer inflation dropped to 5.3% in April, from 6.1% in March (chart 2). Analysts surveyed by Bloomberg had expected inflation to moderate to 5.6%. The sharp drop in inflation and the positive outcome relative to analysts' expectations was mainly the result of slower food inflation. Food prices were unchanged from the previous month and year-on-year food price inflation slowed to 6.7% in April from 8.7% in March. Lower petrol and diesel prices helped transport inflation slow to 4.6% year-on-year in April. Core inflation, which strips out food and energy, moderated to 4.8% in April, from 4.9% in March and is expected to remain low in the face of weak economic growth.

Despite the significant moderation in consumer inflation, the Monetary Policy Committee (MPC) of the South African Reserve Bank left interest rates unchanged following their May policy meeting. The decision was widely expected by economists, given heightened levels of political uncertainty in South Africa following President Jacob Zuma's most recent cabinet reshuffle that resulted in the axing of Finance Minister Pravin Gordhan and his deputy, Mcebisi Jonas. Although one MPC member voted to cut interest rates, the other five members all voted to leave interest rates unchanged.

MARKET OUTLOOK

With most of the S&P 500 having now reported first quarter results, the blended earnings growth rate is expected to fall just short of 14%. This represents the highest level of growth since the third quarter of 2011. A more stable US dollar, together with a recovery in oil prices and stronger economic growth outside the US, contributed to the strong year-on-year increase in earnings for America's large multi-national businesses in the first quarter. US equity markets continued rising to record levels on the back of this stronger growth as well as the continued accommodative monetary stance of the Fed and other central banks. Hong Kong's Hang Seng index gained 4.2% during May as the price of Tencent Holdings surged 10% following better-than-expected results (chart 3).

Global bond yields continued to fall in May (chart 4) as most US economic indicators suggested that economic growth in the world's largest economy had slowed. This will allow the Fed to be more circumspect as it looks to normalise interest rates. Economists are forecasting two more interest rate hikes in the US this year, including the widely expected move in June. The GPR 250 REIT index declined by 0.1% in US dollars during May as the positive impact of lower bond yields was offset by increased uncertainty for large mall owners like Simon Property Group. So far this year, global listed property markets have gained an average of just 1.5%.

Index	May %	12m %	YTD %
All Share	-0.4	2.2	7.1
Resources	-4.1	2.5	-1.5
Financials	-1.3	2.7	1.1
Industrials	1.4	2.5	13.7
Property	0.1	3.7	2.0
Bond	1.0	13.4	5.0
Cash	0.6	7.6	3.1

Source: I-Net Bridge

South Africa's equity market failed to follow global markets higher during May (chart 5). Lower commodity prices meant the Resources sector was firmly on the back foot for most of the month. Domestically-focussed sectors like Banks and Retailers were also under pressure on the back of increased political uncertainty and the threat of further credit rating downgrades later this year. Losses on the JSE would have been larger were it not for a 7% increase in the share price of Naspers. Following President Jacob Zuma's cabinet reshuffle in March, South Africa's equity market has underperformed its emerging market peer group, as well as most developed markets.

South African government bond yields continued to fall in May, despite increased political uncertainty and the threat of further credit rating downgrades. The yield on government's benchmark R186 bond yield declined to 8.58% at the end of May, from 8.69% at the end of April (chart 6). South Africa's listed property sector gained just 0.1% in May, despite lower bond yields. Investors are becomingly increasingly concerned about the impact lower economic growth will have on vacancy rates and rental reversions on expiring leases. The current one-year forward yield on the sector is 7.0%.

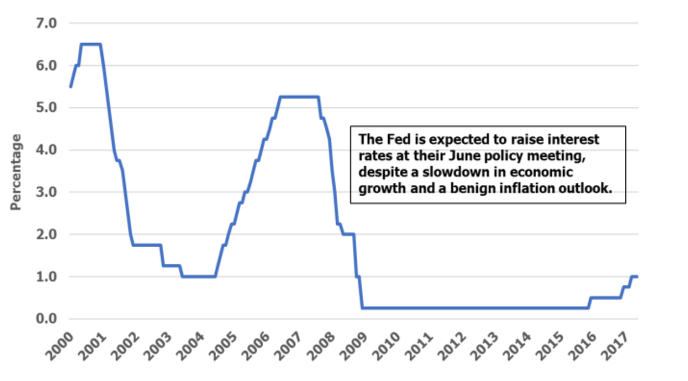
www.bridgefm.co.za

INVESTMENT REVIEW

MAY 2017

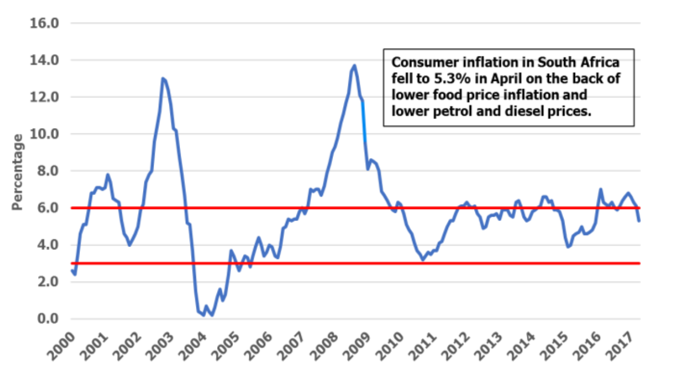
CHARTS

Chart 1: US Federal Funds Rate (%)



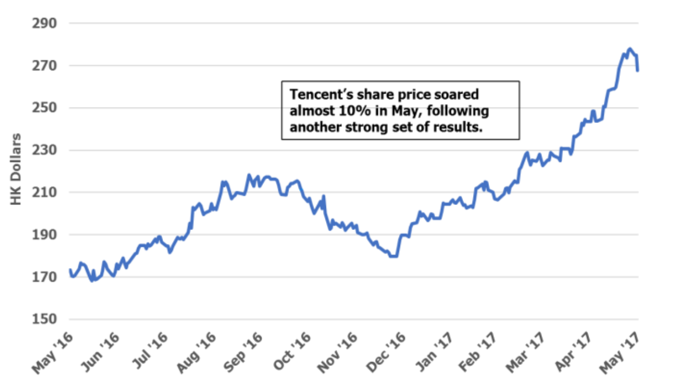
Source: I-Net Bridge

Chart 2: SA Consumer Inflation (%)



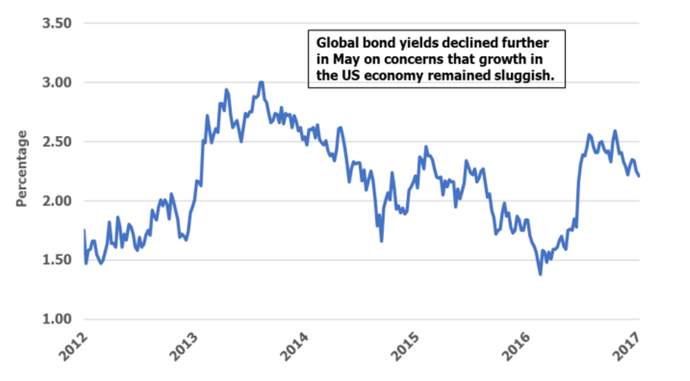
Source: I-Net Bridge

Chart 3: Tencent Holdings' Share Price (HKD)



Source: I-Net Bridge

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

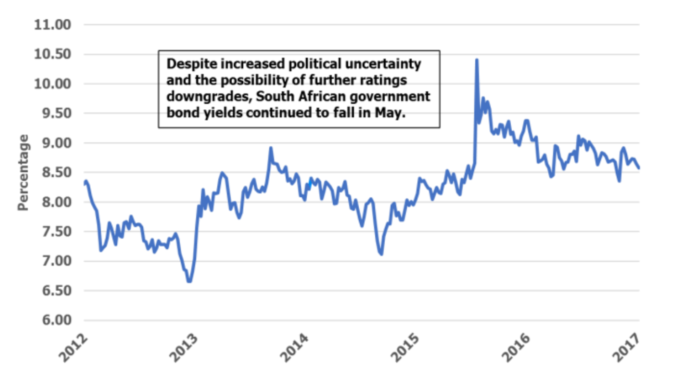


Source: I-Net Bridge

Chart 5: FTSE/JSE All Share Index

Source: I-Net Bridge

Chart 6: R186 Government Bond Yield (%)



Source: I-Net Bridge

Ian Anderson, CFA, CAIA
Chief Investment Officer