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INVESTMENT REVIEW

JANUARY 2018

BRIDGE FUND MANAGERS

"Optimism is the faith that leads to achievement. Nothing can be done without hope and confidence."
Helen Keller

ECONOMIC OUTLOOK

The US economy grew by 2.6% in the final quarter of 2017 (chart 1). The rate of growth was lower than forecast as imports surged 4.6% on the back of strong demand from consumers. The economy grew 2.3% in 2017, an acceleration from 1.5% growth in 2016. Economists expect the US economy to expand by 3% in 2018 on the back of further increases in domestic demand following the significant reductions in corporate and personal taxes approved by Congress in December. Economists are not convinced the tax cuts will have a lasting impact on US economic growth but concede that growth will be boosted in 2018. The strong rally in the US stock market will also have a positive wealth effect and boost growth in 2018.

The European Central Bank (ECB) remains committed to slowly removing monetary stimulus from the euro-area following the conclusion of their policy meeting in January. A strong euro relative to the US dollar (chart 2) will place downward pressure on inflation, which is now forecast to remain below 2% until at least the end of 2020. The ECB will continue to purchase bonds totalling €30 billion a month until at least the end of September, while official interest rates are expected to remain at present levels until well after the end of the bond purchase programme. The stimulus measures have resulted in the region's strongest growth in a decade.

Index	January %	12m %	YTD %
Dow Jones	5.9	34.8	5.9
S&P 500	5.7	26.4	5.7
FTSE 100	-2.0	6.1	-2.0
EURO STOXX 50	3.1	14.5	3.1
Nikkei 225	1.5	21.3	1.5
Hang Seng	9.9	40.8	9.9
Australia	-0.3	8.3	-0.3

Source: I-Net Bridge

In South Africa, the Monetary Policy Committee (MPC) of the South African Reserve Bank voted to keep interest rates unchanged at their policy meeting in January. Despite a stronger rand exchange rate since the last meeting, the MPC felt risks to inflation remained to the upside, although they did acknowledge that the upward pressure had abated somewhat. The MPC highlighted the risks posed by the upcoming Budget speech and the decision by Moody's as key short-term risks for the rand which could have a material impact on inflation and inflation expectations over the forecast period.

Although consumer inflation increased to 4.7% in December, from 4.6% in November (chart 3), core inflation moderated further to 4.2% in December from 4.4% the previous month. The rand's recent strength has improved the outlook for consumer inflation in South Africa and is more than countering the sharp increase in the price of oil, which has risen to US$69/barrel. Early indications suggest that the outcome of the ANC's elective conference in December is having a positive impact on confidence levels. The latest PMI readings point to a gradual acceleration in economic activity in 2018.

MARKET OUTLOOK

US equity markets started 2018 in the same way they finished 2017 – rising sharply on the back of earnings momentum. The Dow Jones Industrial Average increased by 5.9% in January and is up almost 35% over the past 12 months (chart 4). Cheap money and an expectation of strong profit growth are fuelling investor enthusiasm for equities, despite elevated valuation levels. Once again, it's been the technology sector driving the bulk of the gains as industry heavyweights like Amazon and Facebook registered strong share price gains. The UK equity market bucked the global trend and declined by 2% on the back of a stronger pound exchange rate and renewed concerns regarding the impact of Brexit on economic activity and the prices of risky assets.

Global bond yields rose sharply in January (chart 5) on evidence inflationary pressures are building in the global economy. With the US economy at full employment and growth expected to accelerate in 2018, wages are likely to rise at the fastest pace in more than a decade. Investors also think the US Fed may be forced to raise official interests more than 3 times this year as inflation moves above 2%. Against this backdrop, global listed property markets continued to decline. Earnings momentum has also slowed following a period of increased new supply across most property types and in most geographies.

Index	January %	12m %	YTD %
All Share	0.1	16.1	0.1
Resources	3.2	9.9	3.2
Financials	-3.0	17.8	-3.0
Industrials	0.4	18.3	0.4
Property	-9.9	3.9	-9.9
Bond	1.9	10.8	1.9
Cash	0.6	7.5	0.6

Source: I-Net Bridge

The South African equity market gained just 0.1% in January as investors' attention was once again drawn to a report by Viceroy Research; this time focussed on Capitec. Capitec's share price declined by 27% in January, while PSG's share price also declined by 18% following the release of the report and this helped drag the Financials index down 3% during the month. The Resources sector advanced 3.2%, despite the stronger rand, as commodity prices continued to rise on the back of increased global economic activity. Naspers' share price declined by 2% in January, despite further price gains in Tencent in Hong Kong.

South African government bond yields continued fall on the back of a stronger rand and increased optimism regarding political developments in the country. The yield on government's benchmark R186 bond declined to 8.46% at the end of January. South Africa's listed property declined 9.9% in January (chart 6) as the large premiums to net asset value of the Resilient group of companies have now started to unwind. While the rest of the sector posted modest gains, the prices of Fortress B (-28.7%), Greenbay (-29.0%), NEPI Rockcastle (-24.7%) and Resilient itself (-23.0%) tumbled to 52-week lows.

DIRECTORS
DP DU PLESSIS* (CHAIRMAN), SA BLADES*
MB LOGAN, DA POLKINGHORNE*, PS STEWART.
*NON EXECUTIVE

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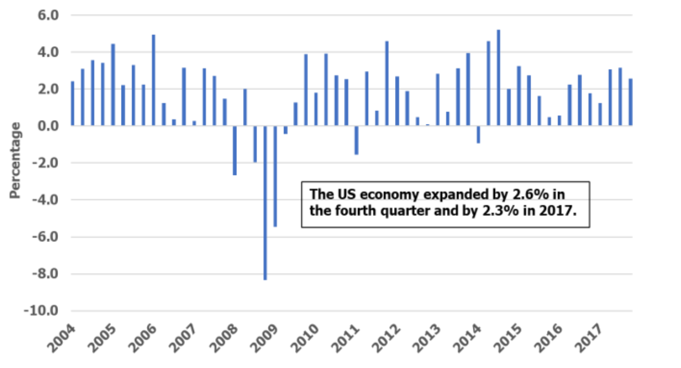
CHARTS

Chart 1: US GDP Growth (%)

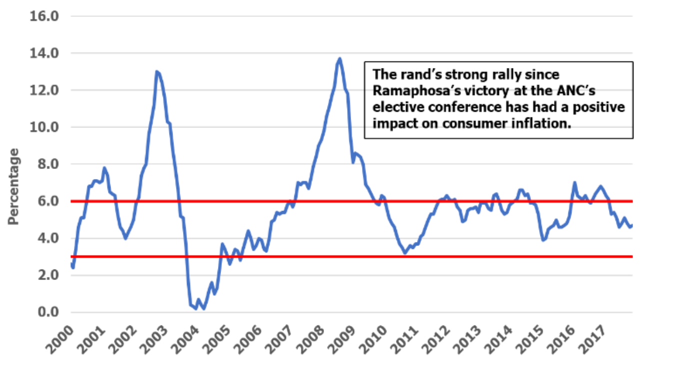


Source: I-Net Bridge

Chart 2: US$/Euro Exchange Rate (US$)

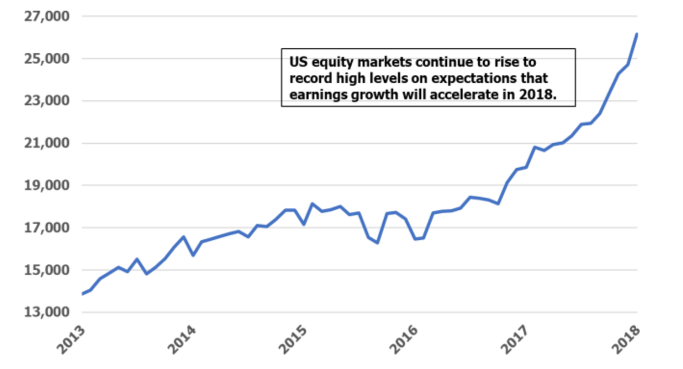
Source: I-Net Bridge

Chart 3: SA Consumer Inflation (%)



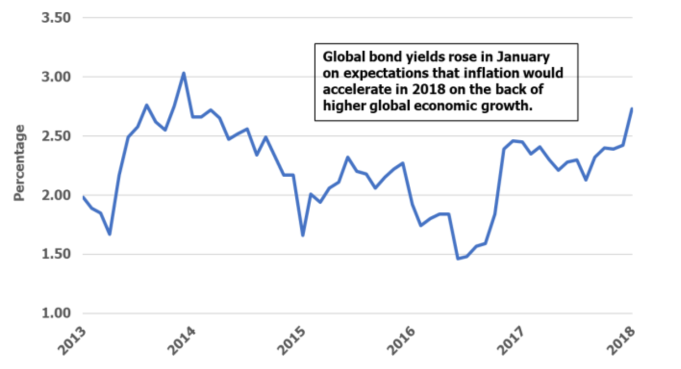
Source: I-Net Bridge

Chart 4: Dow Jones Industrial Average



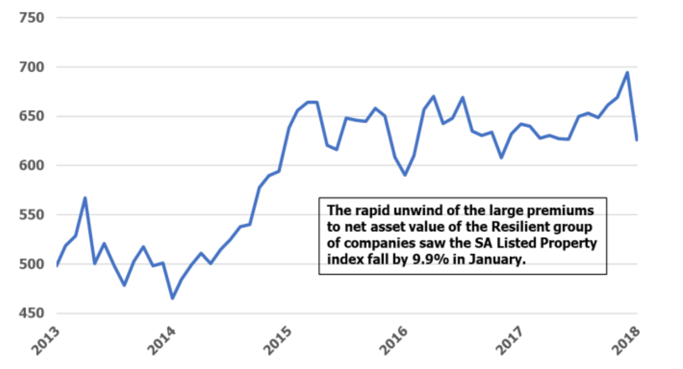
Source: I-Net Bridge

Chart 5: 10-Year US Treasury Yield (%)



Source: I-Net Bridge

Chart 6: FTSE/JSE SA Listed Property Index



Source: I-Net Bridge

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