

"Reality leaves a lot to the imagination."  
John Lennon

## ECONOMIC OUTLOOK

European politics are once again dominating headlines. In Italy, a rise in populism has culminated in the first populist coalition government in a founding European Union member. Giuseppe Conte will be sworn in as prime minister and will preside over a cabinet in which members of the anti-establishment Five Star Movement and the far-right League movement hold most of the key positions. The formation of a coalition government at the eleventh hour has allayed fears that Italy was headed for snap elections that could have seen increased support for anti-EU parties and threatened the country's ongoing participation in the eurozone. In Spain, Prime Minister Mariano Rajoy was forced out of office following a no-confidence vote in parliament.

In the United States, unemployment fell to 3.8%, the lowest level since 1969 (chart 1). The economy added a further 223,000 jobs in May, while consumer confidence, personal income and construction spending continued to rise. The Trump administration's tax cuts are clearly having a positive impact on economic activity, despite the increased geopolitical risks in Europe, the Middle East and North Korea. President Donald Trump announced that the US will levy higher tariffs on aluminium and steel imports from the EU, Mexico and Canada. There was an almost immediate response from Mexico and the EU to "impose rebalancing measures".

Index	May %	12m %	YTD %
Dow Jones	1.4	18.9	-0.2
S&P 500	2.4	14.4	2.0
FTSE 100	2.2	2.1	-0.1
EURO STOXX 50	-2.5	-1.5	-0.8
Nikkei 225	-1.2	13.0	-2.5
Hang Seng	-1.1	18.7	1.8
Australia	0.9	6.3	-0.7

Source: IRESS

In South Africa, the Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) unanimously decided to leave interest rates unchanged following the conclusion of their May policy meeting. The tone of the statement following the meeting suggested that inflation risks had increased, following a sharp spike in the oil price (chart 2) and a period of rand weakness. The MPC was also worried that further monetary tightening in the US would lead to lower capital flows into South Africa and cause further depreciation in the value of the rand. There appears little chance of a further interest rate cut this year.

South Africa's consumer inflation rate accelerated to 4.5% in April (chart 3), up from 3.8% in March. The increase was in line with the SARB's expectations and includes a relatively moderate pass-through from the higher VAT rate and sugar tax. Inflation is expected to continue accelerating in 2018 as the full impact of the increase in VAT is felt and the higher oil price and weaker rand translate into higher petrol and diesel prices. Consumer inflation is expected to remain within the SARB's targeted range and to average 4.9% in 2018 and 5.2% in 2020. This should result in interest rates remaining lower for longer.

## MARKET OUTLOOK

The increase in geopolitical risk, particularly in Europe, weighed on equity market returns during May. European equities were sold off in the wake of Italy's ongoing failure to form a new government and the growing threat of populist and anti-EU parties within the country. In 2018, very few major equity markets have been able to generate positive returns for investors, although the tech-heavy S&P 500 (US) and Hang Seng (Hong Kong) indices are up slightly since the start of the year. Although the gains and/or losses experienced by equity investors this year are small, the intraday and intramonth volatility has increased significantly, reflecting investor concerns about the pace of monetary tightening in the US and increased geopolitical risks.

Global bond yields dropped sharply in the second half of May as concerns about the political situation in Italy and the eurozone sent investors scrambling for safe-haven assets. However, bond yields in many of Europe's periphery nations spiked sharply, with the yield on Italian 10-year bonds rising from 1.65% at the end of April to 3.0% at the end of May (chart 4). Lower global bond yields provided a tailwind for listed property markets in the US (+3.7%) and Australia (+3.0%), while the increase in geopolitical risks weighed on listed property prices in Europe (-4.1%) and most of Asia (+0.1%).

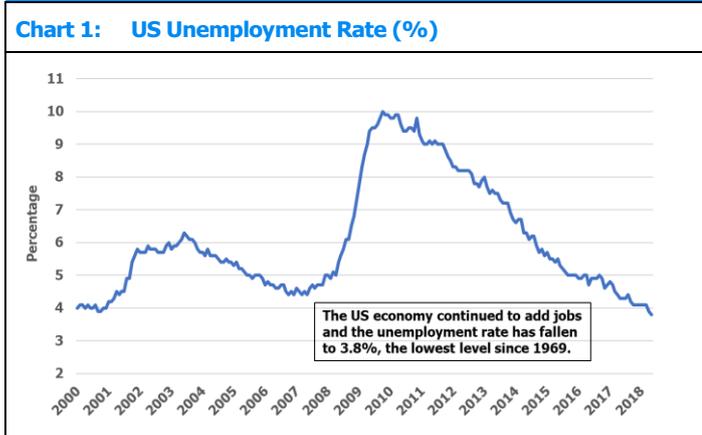
Index	May %	12m %	YTD %
All Share	-3.5	8.0	-4.4
Resources	3.9	30.0	8.6
Financials	-6.3	11.4	-6.7
Industrials	-5.1	-1.1	-8.2
Property	-5.9	-6.5	-18.6
Bond	-2.0	10.4	5.2
Cash	0.6	7.4	3.0

Source: IRESS

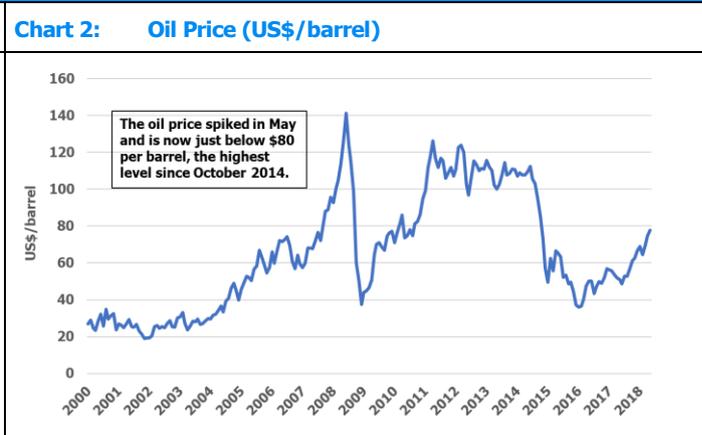
South Africa's equity market fell 3.5% in May as investment sentiment towards emerging markets continued to sour in the face of mounting geopolitical risks. Although the resources sector gained 3.9% on the back of higher commodity prices, South Africa's general retailers (-12.6%), general industrials (-12.0%) and food producers (-11.1%) were particularly hard hit following several weaker-than-expected earnings reports. Massmart's share price tumbled 28.9% (chart 5) after the company missed analyst estimates and its own guidance and warned that trading conditions remained extremely challenging.

The combination of a weaker rand (to the US dollar) and lower investor appetite for emerging markets pushed the yields on South African bonds higher. The yield on government's benchmark R186 bond increased to 8.54% from 8.16% at the end of April (chart 6). South Africa's listed property sector declined by 5.9% in May, on the back of higher bond yields and a more hawkish stance by the MPC following their policy meeting in May. The one-year forward yield on South Africa's listed property sector has now increased to 8.2% and, despite the uncertainty surrounding the Resilient group of companies, is offering investors good long-term value.

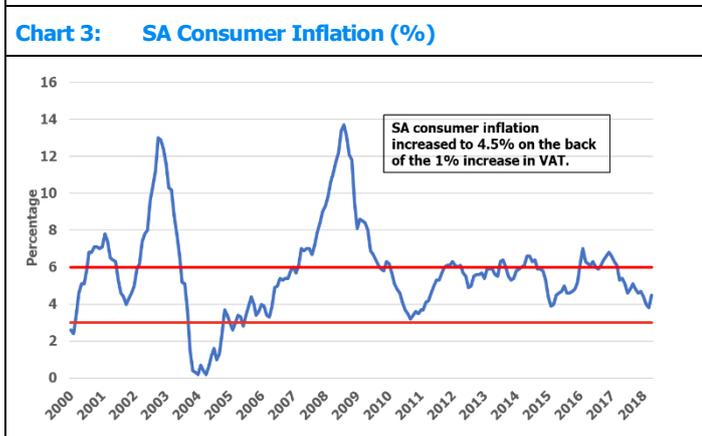
## CHARTS



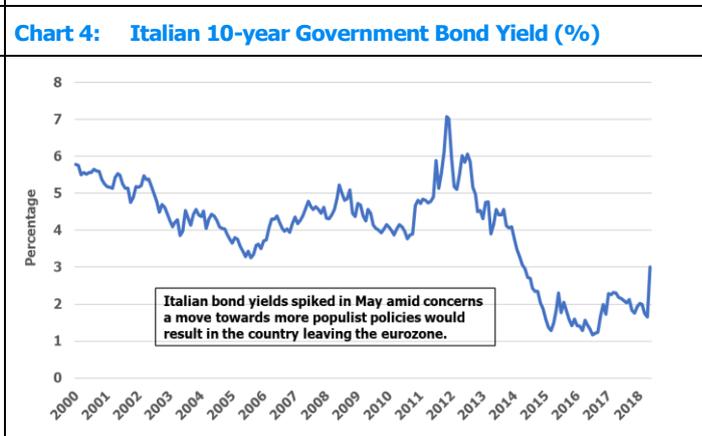
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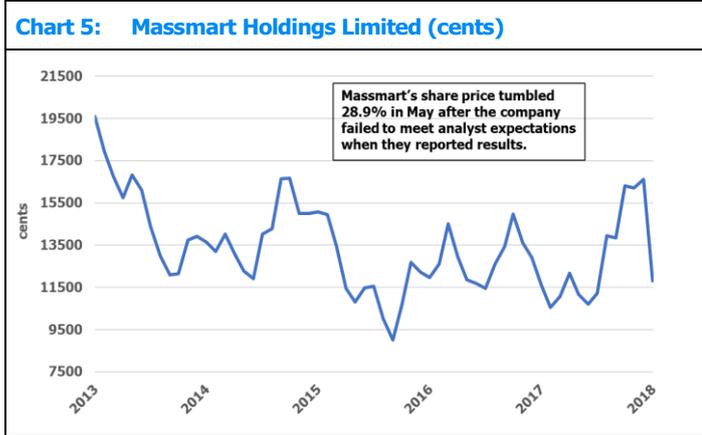
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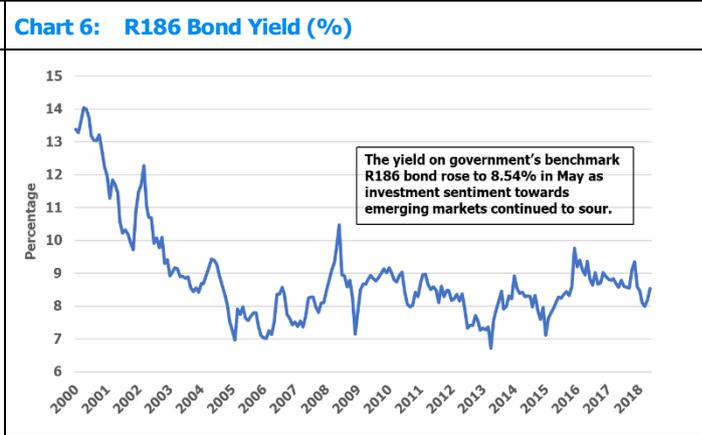
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