INVESTMENT REVIEW

JULY 2018

BRIDGE FUND MANAGERS

"Whoever is careless with the truth in small matters cannot be trusted with important matters."
Albert Einstein

ECONOMIC OUTLOOK

While US President Donald Trump called a ceasefire in his trade war with Europe, he has upped the ante in his stance towards China. Trump has now asked officials in Washington to increase tariffs from 10% to 25% on imported goods from China worth approximately $200 billion. The Chinese are likely to respond with similar tariffs on goods imported from the US and will continue to weaken the yuan against the US dollar. Since April this year, the yuan has depreciated by more than 10% against the US dollar and has depreciated in each of the last eight weeks (chart 1). The weaker yuan is one of the reasons President Trump and his advisors in Washington are planning to increase both the breadth and depth of tariffs on Chinese imports.

Outside the US, there has been a marked deterioration in business and consumer confidence as the threat of a global trade war escalates. Forecasts for economic growth in Europe and Asia have been cut for 2018 and 2019. Apart from the US Federal Reserve, which is expected to hike interest rates twice in 2018 and the Bank of England, which is expected to hike interest rates at the next policy meeting, central banks are expected to maintain an accommodative stance in monetary policy. An escalation in the global trade war may lead to higher global inflation and place upward pressure on short-term interest rates.

Index	July %	12m %	YTD %
Dow Jones	4.8	18.7	4.1
S&P 500	3.7	16.2	6.5
FTSE 100	1.5	5.1	0.8
EURO STOXX 50	3.9	5.0	2.9
Nikkei 225	1.1	13.2	-0.9
Hang Seng	-1.3	4.6	-4.5
Australia	1.2	10.3	3.2

Source: IRESS

In South Africa, the unemployment rate rose to 27.2% in the second quarter as a further 90,000 jobs were shed (chart 2). Although off its worst levels, unemployment in South Africa is expected to rise further in 2018 as business and consumer confidence continue to fall. Although President Cyril Ramaphosa has announced that the ANC would propose an amendment to the Constitution to clarify the conditions under which land can be expropriated without compensation, there is still significant uncertainty surrounding this issue, which is weighing on confidence in South Africa.

Despite the recent rand weakness and an increase in oil prices, South African consumer inflation continues to surprise to the downside. The lower-than-expected print in June (4.6% versus market expectations of 4.8%) was mainly due to subdued price increases in the quarterly rental inflation survey. Food inflation remains low at just 3.1% year-on-year while fuel prices rose 4.7% during the month and are up 16.3% year-on-year. Inflation is expected to accelerate for the remainder of the year, but remain below the upper end of the South African Reserve Bank's 3% to 6% targeted range.

MARKET OUTLOOK

A global equity market rally in July was marred by a sharp sell-off in technology shares towards the end of the month. Facebook's share price dropped almost 20% in a single day (chart 3) after the company missed revenue guidance and reported a slowdown in user growth. The company's forward guidance, suggesting things would get worse before they improve, also rattled investors. Away from technology, more than three quarters of the companies in the S&P 500 index that have reported earnings for the second quarter have beaten both revenue and earnings expectations. However, more companies have provided negative guidance for the third quarter, reflecting a slowdown in global growth as the trade war between the US and China escalates.

Global bond yields inched higher as the borrowing needs of governments continued to increase and central banks looked to reduce the size of their balance sheets following years of quantitative easing. The yield on 10-year US Treasuries rose 11 basis points in July and finished the month just below 3% (chart 4). Global listed property markets moved sideways in July despite higher global bond yields. Intu, owner of some of the largest shopping centres in the UK and Spain, announced a more than 10% reduction in net asset value, highlighting the difficulties facing mall landlords as online retailers gain market share.

Index	July %	12m %	YTD %
All Share	-0.2	7.2	-1.9
Resources	-1.4	23.7	13.4
Financials	4.7	10.1	-5.1
Industrials	-2.0	-0.3	-6.3
Property	-0.5	-13.6	-21.8
Bond	2.4	11.2	6.5
Cash	0.6	7.3	4.2

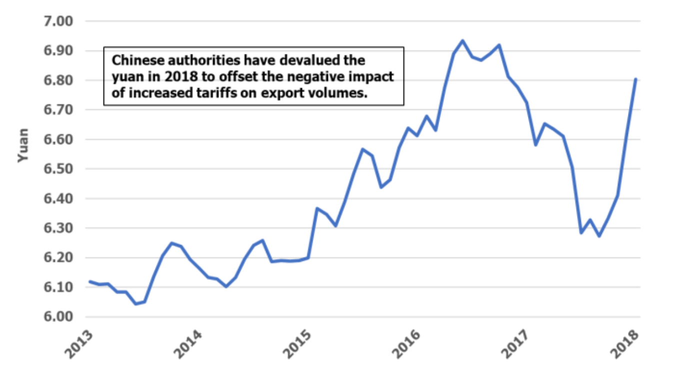
Source: IRESS

In South Africa, the FTSE/JSE All Share index declined by 0.2% on the back of a stronger rand and a 7% decline in the share price of index heavyweight Naspers. Naspers became a victim of the sell-off in technology stocks as the price of its largest investment, Tencent, declined by almost 10% in Hong Kong. Tencent's share price has now fallen more than 23% since the middle of March this year (chart 5). Financials were the best performing sector, following global markets higher. Both the life assurers (+8.6%) and banks (+7.7%) posted strong gains in July, while the mobile telecoms sector was up 7.9%.

South African bond yields bucked the global trend and declined by approximately 25 basis points as the rand strengthened against the US dollar. The yield on government's benchmark R186 bond declined to 8.58% at the end of July, from 8.84% at the end of June. South Africa's listed property sector failed to benefit from the decline in bond yields and posted a modest loss in July. Resilient's share price declined by a further 8.1% in July and is now down more than 60% since the start of the year (chart 6). The one-year forward yield on the SA Listed Property (SAPY) index is now 8.9%, above the yield on government's R186 bond.

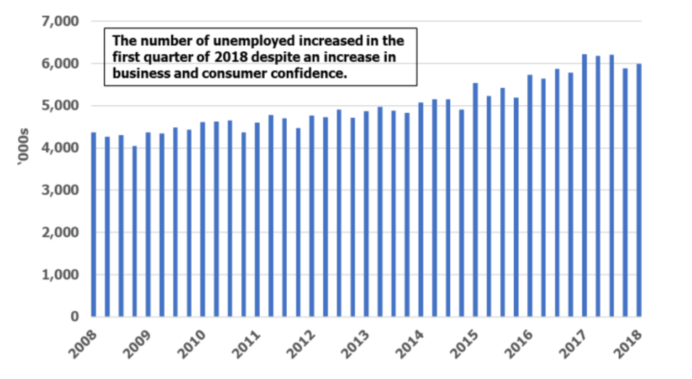
CHARTS

Chart 1: Yuan/US$ Exchange Rate



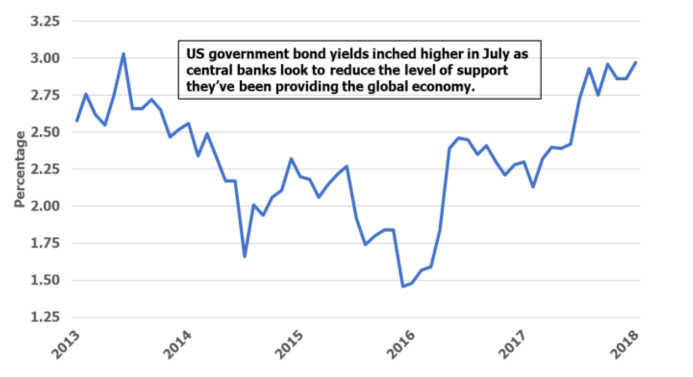
Source: IRESS

Chart 2: SA Unemployed ('000s)



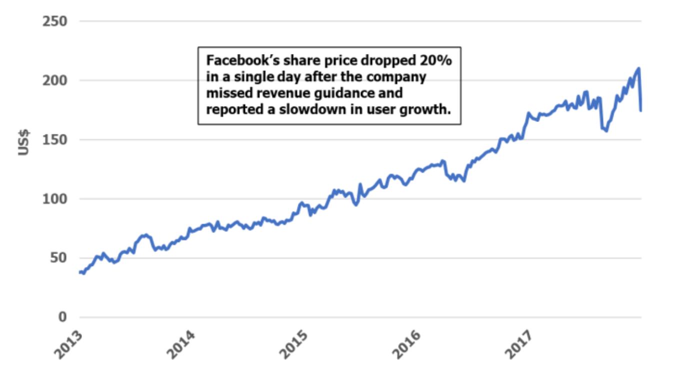
Source: IRESS

Chart 3: US 10-year Treasury Yield (%)



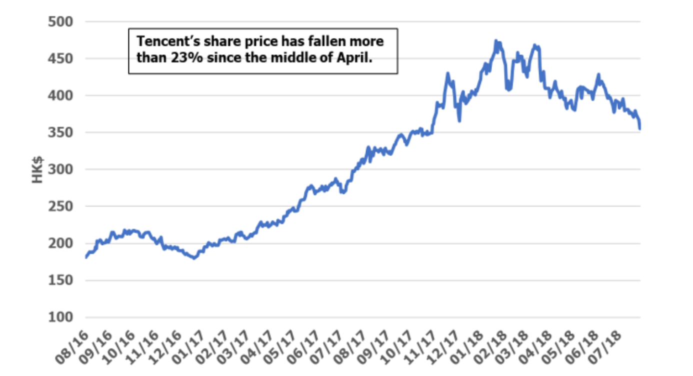
Source: IRESS

Chart 4: Facebook Share Price (US$)



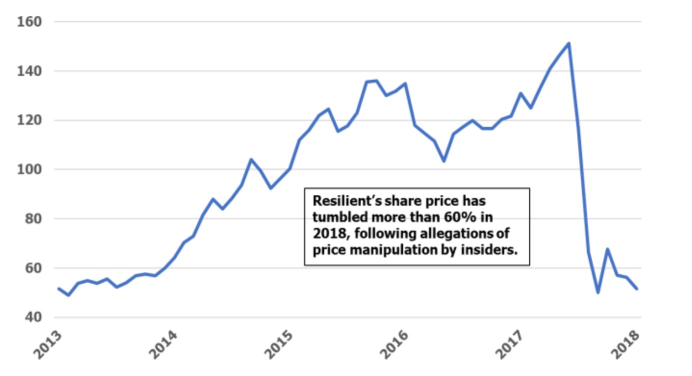
Source: FactSet

Chart 5: Tencent Share Price (HK$)



Source: FactSet

Chart 6: Resilient Share Price (ZAR)



Source: IRESS

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