

"The aim of education is the knowledge, not of facts, but of values."
William S. Burroughs

ECONOMIC OUTLOOK

The US Federal Reserve (the Fed) decided to leave interest rates unchanged following the conclusion of their policy meeting in August. In a statement that followed the meeting, the Fed emphasised that the labour market continued to strengthen, and that economic activity had been rising at a strong rate. Household spending and business fixed investment had also accelerated since their last meeting. At the same time, inflation remains close to the Fed's target of 2% (chart 1) and inflation expectations remain subdued despite the buoyant economy. The Fed concluded that further gradual increases in official interest rates would be consistent with sustainable economic expansion, strong labour market conditions and inflation near 2% over the medium term.

Brexit negotiations between the UK and the European Union have been moving slowly, with the EU's chief Brexit negotiator, Michel Barnier, saying that he strongly opposes key parts of the UK's proposals for a future trade deal. Negotiators have also made little progress in resolving the issue of the border between Northern Ireland and the Republic of Ireland. While some politicians and trade unions are calling for a new public vote on leaving the European Union, both the ruling party and major opposition party remain committed to Brexit. UK economic growth has stalled on the back of Brexit uncertainty.

Index	August %	12m %	YTD %
Dow Jones	2.6	21.0	6.7
S&P 500	3.3	19.7	9.9
FTSE 100	-4.1	0.0	-3.3
EURO STOXX 50	-3.7	1.8	-0.9
Nikkei 225	1.4	16.4	0.4
Hang Seng	-2.4	-0.3	-6.8
Australia	1.0	11.3	4.2

Source: IRESS

In South Africa, economic activity contracted by 0.7% in the second quarter of 2018, following a downwardly revised 2.6% contraction in the first quarter (chart 2). Technically, South Africa is now in recession. The weakness in the second quarter was broad-based, reflecting the deterioration in consumer and business confidence as the debate around land expropriation intensified and the global backdrop for emerging markets deteriorated. Economists had forecast the economy to grow by approximately 0.5% in the second quarter, but a 29.2% contraction in the agricultural sector and a 0.5% contraction in government services were negative surprises.

Although a sharp bounce in economic growth is anticipated in the third quarter, due mainly to a recovery in agricultural production, growth for the full year is now likely to come in below 1%. The headwinds facing the South African economy, including policy uncertainty, a deterioration in the terms of trade and a less forgiving global backdrop are likely to persist in the short-term. Lower expected economic growth and a shift to more populist policies, like subsidising fuel, have raised the risk of Moody's downgrading South Africa's sovereign credit rating to below investment grade.

MARKET OUTLOOK

US equity markets moved higher in August following an impressive second quarter earnings season. Both the S&P 500 and Nasdaq indices finished the month at record levels (chart 3). According to FactSet, 80% of the S&P 500 constituents beat earnings estimates in the second quarter, with a blended earnings growth rate of 25%, the highest level since the third quarter of 2010. At the start of the reporting season, analysts had expected growth across the S&P 500 constituents of 20%. There are very few equity markets outside the US that have generated positive returns for investors in 2018. President Donald Trump's trade war with China has clouded the outlook for global economic growth and undermined investor confidence in non-US equity markets.

Global bond yields fell in August as investors' appetite for risky assets, other than US equities, waned. Investors have been rotating out of emerging market equities, bonds and currencies and into the sovereign bonds of developed countries like the US and Germany. The yield on 10-year US Treasuries had declined to 2.86% by the end of August. Falling global bond yields helped underpin the prices of global listed property stocks in August. The GPR250 REIT index added a further 1.9% in August, driven primarily by gains in US REITs, following a strong second quarter results season. The index is now up 3.4% in 2018 (chart 4).

Index	August %	12m %	YTD %
All Share	2.3	6.9	0.3
Resources	5.6	24.2	19.8
Financials	0.3	8.2	-4.9
Industrials	1.9	-0.4	-4.5
Property	2.1	-12.4	-20.1
Bond	-1.9	8.0	4.5
Cash	0.6	7.3	4.8

Source: IRESS

In South Africa, the FTSE/JSE All Share index gained 2.3% as the rand weakened sharply (chart 5) and the Resources sector rallied 5.6%. MTN's share price tumbled more than 20% in August after the Nigerian authorities ordered MTN and 4 banks to return US\$8.1 billion they claim was illegally repatriated by the company between 2007 and 2015. Amongst the heavyweight rand hedges, Bidcorp was up 19% following satisfactory results, Mondi gained 14.5% and Richemont added 13.3%. Away from the rand hedges, investors suffered large capital losses in August as foreign investors continued to sell South African equities.

South African bond yields rose almost 40 basis points as investor sentiment towards emerging markets continued to deteriorate. The yield on government's R186 bond yield rose to 8.97% at the end of August and has subsequently risen a further 30 basis points to 9.27% (chart 5). South Africa's listed property sector gained 2.1% in August on the back of a 14.8% increase in the price of NEPI Rockcastle (chart 6). The current one-year forward yield on the sector is 8.9%, which is lower than the yield on longer-dated government bonds. Weaker domestic property fundamentals will result in lower income growth from the sector in 2019 and 2020.

CHARTS

<p>Chart 1: US Core Inflation (%)</p> <p>Source: IRESS</p>	<p>Chart 2: SA GDP Growth (%)</p> <p>Source: IRESS</p>
<p>Chart 3: S&P 500 Index</p> <p>Source: IRESS</p>	<p>Chart 4: GPR 250 REIT Index</p> <p>Source: Global Property Research</p>
<p>Chart 5: ZAR/USD Exchange Rate (ZAR)</p> <p>Source: IRESS</p>	<p>Chart 6: NEPI Rockcastle Share Price (ZAR)</p> <p>Source: IRESS</p>

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