# INVESTMENT REVIEW

SEPTEMBER 2018

BRIDGE FUND MANAGERS

"Wisdom is not a product of schooling but of the lifelong attempt to acquire it."
*Albert Einstein*

## ECONOMIC OUTLOOK

The US Federal Reserve (the Fed) raised official interests for the third time this year (chart 1), following the conclusion of their policy meeting in September. The Fed remains committed to a gradual increase in interest rates despite further upgrades to the outlook for the US economy in 2019. The Fed is expected to raise interest rates by a further 0.25% in 2018 and 0.75% in 2019, which would take the Federal Funds rate to 3.25% by the end of 2019. They also removed the word "accommodative" from the description of their current policy stance and are of the view that the US economy is strong enough to remove the stimulus that has been in place since the global financial crisis. US President Donald Trump broke with tradition and openly criticised the Fed's decision.

In Europe, policymakers have temporarily shifted their attention away from Brexit towards Italy after the country's new populist coalition government announced plans to up spending in 2019, thereby tripling the size of Italy's budget deficit. Investors responded by selling Italian assets, while European Union ministers criticised the decision given the current state of Italy's finances. At 131%, the country has the second highest debt to GDP ratio in Europe, behind Greece. Italian politicians have since committed to reducing the country's budget deficits from 2020 but insist next year's spending is needed to kickstart the flagging economy.

| Index | September % | 12m % | YTD % |
|---|---|---|---|
| Dow Jones | 2.0 | 20.8 | 8.8 |
| S&P 500 | 0.6 | 17.9 | 10.6 |
| FTSE 100 | 1.0 | 1.9 | -2.3 |
| EURO STOXX 50 | 0.3 | -2.9 | -0.6 |
| Nikkei 225 | 5.5 | 18.5 | 6.0 |
| Hang Seng | -0.4 | 0.9 | -7.1 |
| Australia | -1.6 | 10.1 | 2.6 |

*Source: IRESS*

In South Africa, the Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) opted to keep interest rates unchanged following the conclusion of their policy meeting in September. Three members of the committee voted to increase the repo rate by 0.25%. Following recent rand weakness and a significant increase in the price of oil (chart 2), the MPC's tone was more hawkish. However, the SARB's forecasts for inflation in the medium-term remain within the targeted range of 3% to 6%, but the risks are clearly to the upside. The MPC did acknowledge that growth in SA remained weak and was keeping inflation lower.

During September, South African President Cyril Ramaphosa announced a stimulus and recovery package which included reprioritising spending within the current budgetary framework and seeking private sector partnerships. While the measures introduced are unlikely to change the outlook for 2018, they are likely to have some impact in 2019 and 2020. Amongst Ramaphosa's proposals are the creation of an infrastructure fund based on the Indian model, easing visa requirements to boost tourism and the appointment of a 10-person advisory panel to help resolve issues around land expropriation without compensation.

## MARKET OUTLOOK

US equity markets pushed higher in September and the S&P 500 has now gained more than 10% in 2018. It was a more mixed picture elsewhere in the world, with developed markets generally registering small gains and developing markets small losses during September. An escalation in the trade war between the US and China has seen investors rotate out of emerging markets, while rising bond yields in the US are attracting money at the expense of more risky assets. Japan is one of the few equity markets outside the US to deliver excellent returns for investors in 2018. The Nikkei 225 index rose 5.5% in September and has gained 18.5% in the past 12 months (chart 3) on the back of strong foreign buying and an improvement in the outlook for Japanese corporate profits.

US bond yields spiked sharply in September and have continued rising in the first week of October. Global inflation is expected to accelerate because of the magnitude of the tariff increases announced by the US, while Chinese and Japanese investors have been reducing their exposure to US bonds. The yield on 10-year US Treasuries has increased to 3.2% (chart 4). Against a backdrop of sharply rising bond yields, global listed property stocks fell more than 2% in September. Together with other interest rate sensitive sectors, listed property prices are expected to come under pressure as US interest rates and bond yields normalise.

| Index | September % | 12m % | YTD % |
|---|---|---|---|
| All Share | -4.2 | 3.3 | -3.8 |
| Resources | 1.0 | 26.9 | 21.0 |
| Financials | -2.0 | 8.1 | -6.8 |
| Industrials | -7.7 | -7.7 | -11.8 |
| Property | -2.6 | -15.7 | -22.2 |
| Bond | 0.3 | 7.1 | 4.8 |
| Cash | 0.6 | 7.3 | 5.4 |

*Source: IRESS*

In South Africa, the FTSE/JSE All Share index declined 4.2% as the rand strengthened (chart 5) and investors rotated out of emerging markets during September. SA Industrials were down 7.7% during the month as Aspen's share price tumbled more than 40% (chart 6) after a disappointing results announcement and expectations that trading conditions will remain extremely challenging for the company. A weak trading statement from Netcare (down 17.5%), which also impacted Mediclinic (down 15.9%) and the resignation of CEO David Kneale at Clicks (down 13.8%) also contributed to the poor showing by SA Industrials.

South African bond yields were largely unchanged during September and the yield on government's benchmark R186 bond managed to finish the month below 9%. The weaker rand and higher oil price are likely to place upward pressure on SA bond yields in the short-term. South Africa's listed property sector was down 2.6% in September as the outlook for short-term distribution growth continued to deteriorate. Numerous companies have warned that trading conditions have been deteriorating throughout the year, resulting in lower market rentals and higher vacancy rates, not all of which was captured in current valuations.

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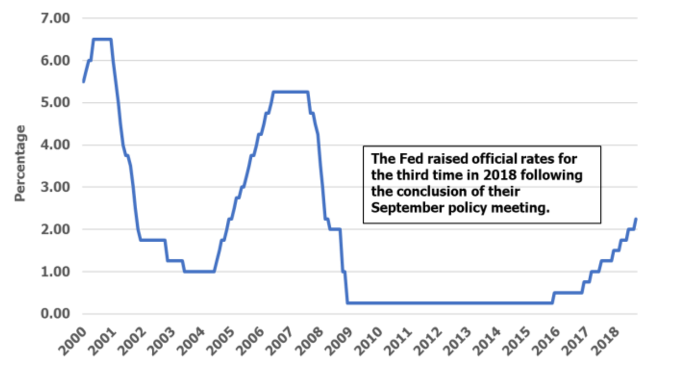
## CHARTS

### Chart 1: US Federal Funds Rate (%)

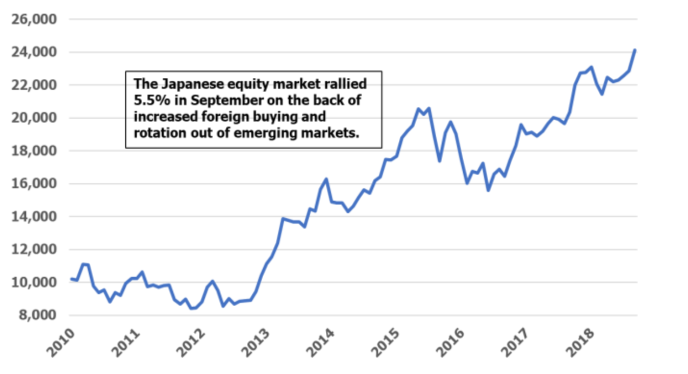



*Source: IRESS*

### Chart 2: Oil Price (US$/barrel)

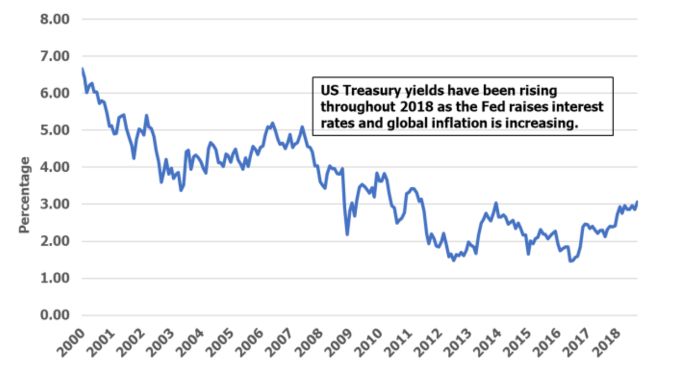

*Source: IRESS*

### Chart 3: Nikkei 225 Index




*Source: IRESS*

### Chart 4: US 10-year Treasury Yield (%)

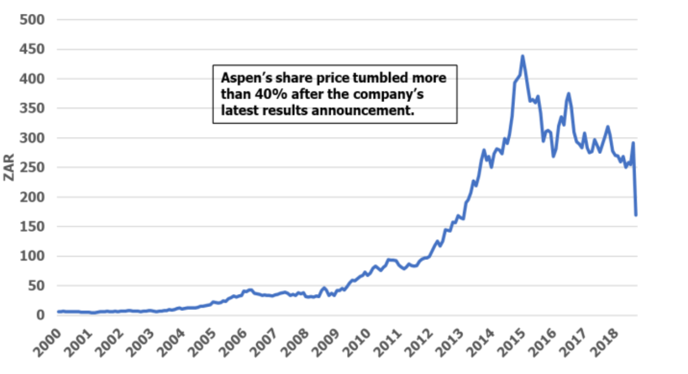



*Source: IRESS*

### Chart 5: ZAR/USD Exchange Rate (ZAR)


*Source: IRESS*

### Chart 6: Aspen Share Price (ZAR)




*Source: IRESS*

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