MARKET MATTERS

26 FEBRUARY – 2 MARCH 2018

A RED FEBRUARY

Dave Mohr & Izak Odendaal, Old Mutual Multi-Managers

Global markets ended February in the red, making it the worst calendar month since January 2016. The MSCI All Countries World Index, a broad benchmark of global equity markets, fell 4% in February in US dollars (it is still up 19% over one year though). From its most recent peak in late January to the bottom in early February, the index lost 9%. The US S&P500 Index lost 3.7% in February, not quite erasing January's strong gains and still up 17% over 12 months. It was the first negative month in 15 for the S&P500, an unusually long stretch of uninterrupted positive returns.

The MSCI Emerging Markets Index lost 4.6% in US dollars and 3.6% in local currency in February (implying some currency weakness against the dollar). However, the one-year return on the index is still 31%. China and Korea were the worst performers within the emerging markets universe in February, with both losing 6%. Russia, benefiting from a higher oil price over the past year and a ratings upgrade to investment grade status by S&P Global, saw a positive month on its equity market.

Equity markets also started March on a sour note after US President Donald Trump announced tariffs on steel and aluminium imports. This move is likely to be counterproductive at home, and has caused jitters abroad as investors fear a trade war if other countries retaliate.

GLOBAL GROWTH **BACKDROP STILL POSITIVE**

The February sell-off occurred despite a backdrop of strong global growth, in particular in the US and Europe where growth rates are in excess of 2.5%. The previous big corrections in global stocks – August 2015 and January 2016 – were driven by concerns over declining growth, tumbling oil prices, deflation and a hard landing in China. Today we seemingly have the opposite: the oil price is above $60 (bad news for motorists but good news for producers and their creditors), inflation is rising gradually and China's growth rate seems robust even as the authorities try to rein in excessive credit growth. The February Caixin Chinese Manufacturing Purchasing Managers' Index, the most up-to-date reading of the health of the Chinese economy, was in positive territory at 51.6 points, up from January.

Strong economic growth has resulted in good profit growth for listed companies, and profit expectations are still being upgraded (aided, of course, by corporate tax cuts in the US). The big fear of investors remains rising interest rates, and particularly that strong economic growth in the US, now fuelled even further by expansionary fiscal policy, could lead to the Federal Reserve accelerating the pace of hiking rates.

In the bi-annual testimony before Congress, new Fed Chair Jerome Powell noted his concern that the economy could overheat if the Fed did not continue hiking interest rates, pointing out that he believed that low unemployment would push up wages, leading to higher inflation. This view of the world (the 'Philips curve') still largely ignores the lack of bargaining power on the part of workers in a globalised economy with a global labour pool, further diminished by technology improvements and automation. Similarly, the pricing power of companies (the ability to pass on increases in input costs to end consumers) is limited by global competition. While inflation is picking up on a cyclical basis, driven by oil and base effects, a sustained rise in inflation well above the Fed's 2% target seems unlikely. The latest report on personal consumption expenditure - the Fed's preferred inflation measure - showed only a 1.7% rise (and 1.5% excluding food and fuel) in January.

A sustained rise in inflation is even more unlikely in Europe and Japan, where central banks are still engaging in quantitative easing and the first rate hikes appear months if not years away, despite faster economic growth. Powell also noted that there was no concern on the part of the Fed that market volatility would spill over into declining real economic activity. It therefore remains unlikely that the Fed will deviate substantially from its path of gradually increasing interest rates to a level that is slightly positive in real terms, without choking off economic growth.

LOCAL MARKETS CAUGHT BETWEEN GLOBAL **SELL-OFF AND POLITICAL OPTIMISM**

The local equity market in February was caught between the surge in optimism following the resignation of President Jacob Zuma and the swearing in of Cyril Ramaphosa as his successor on the one hand, and the turmoil on global markets on the other. Depending on the index, the local market was down between 1% and 2% in rand terms in February, but the declines of between 0.5% and 1.5% in US dollar terms compare favourably with the main global indices.

The FTSE/JSE All Share Index lost 1.9% in the month. The FTSE/JSE Capped SWIX Index, which limits the size of Naspers (and was adopted as our equity benchmark at the start of the month) lost 0.8%. Resources lost 4.8% and Industrials 3%, with both sectors more exposed to a stronger rand and weaker global markets. Financials were positive though, gaining 2.5% on the positive political developments. Within Financials, banks surged 9% and life insurers 4%, but listed property declined 9.9% (taking year-to-date losses to 18.8%) as corporate governance concerns weighed on the four shares in the Resilient stable. Resilient, NEPI Rockcastle, Fortress and Greenbay constituted 40% of the listed property benchmark before their sharp declines.

As can be expected from the political developments, investor-friendly Budget Speech, and improved ratings outlook, local bonds had a strong month. The All Bond Index returned 3.9% in February, lifting one year returns to 14%. The yield on the 10-year government bond yield declined from 8.6% since the start of the year, to 8.1% at the end of February, including a short spell below 8% for the first time since May 2015. Inflation-linked bonds returned 1.09% in February as real yields also declined.

ECONOMIC DATA **MOSTLY STILL POSITIVE**

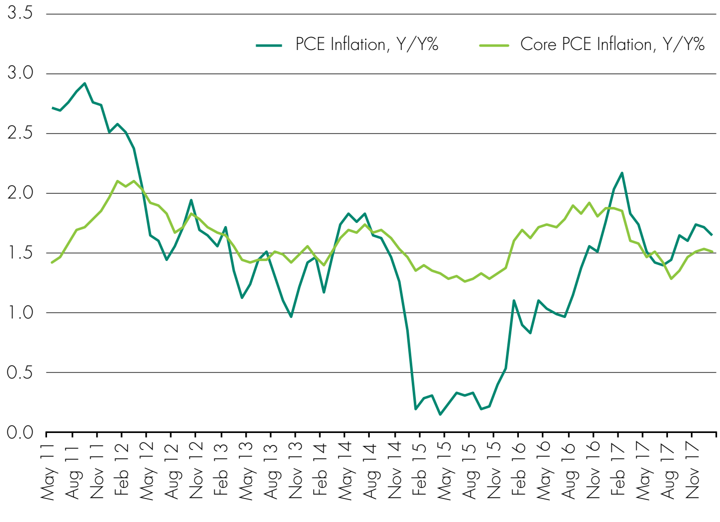
Economic data from last week continue to point to a stronger domestic economy, but it is uneven across sectors. The Absa/BER Manufacturing PMI, one of the timeliest cyclical indicators of the local economy, moved above the neutral 50 level in February. It seems to be finally catching up with its global counterparts, with strong growth in manufacturing the norm. The sub-index measuring expected business conditions in six months' time increased to 79.1 points, the highest level since 2001 and almost 30 index points above the November level. The new sales orders sub-index also exceeded the inventory sub-index, suggesting that firms will have to ramp up output to meet demand.

Credit growth has weakened further, supporting the case for the Reserve Bank to cut interest rates. Growth in total loans and advances slowed to below 5%, with corporate borrowing growth slowing further, while household borrowing remains subdued. As the economy recovers and confidence levels improve, the risk appetite of both banks and borrowers should also rise, leading to higher borrowing. Households in particular have scope to borrow more as they have deleveraged (incomes have grown faster than outstanding debt) over the past decade.

South Africa posted a surprisingly large R27bn trade deficit in January, as import values surged above export values for the first time in a year. The stronger rand is probably starting to hurt export revenues, while it supports import growth. However, there are also signs of a stronger economy in the import numbers. South Africa relies heavily on overseas suppliers for machinery and other capital equipment, so the strong pick-up in these import items is a positive sign.

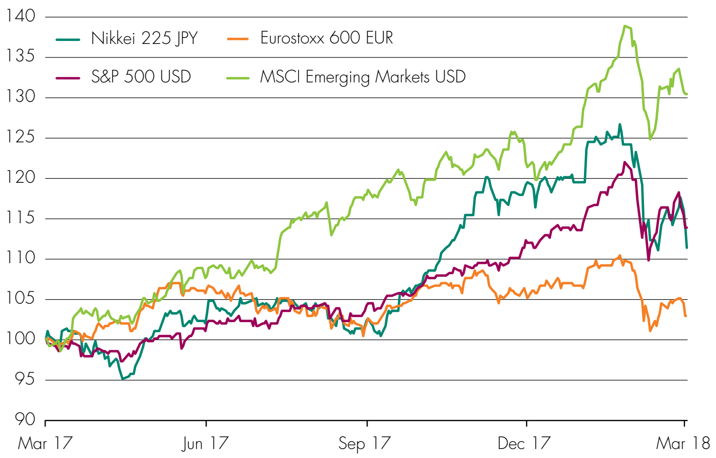
However, the improvement in consumer sentiment has not resulted in growth in the sales of new vehicles yet. New vehicle sales declined by 3.8% in February compared to a year ago, with passenger car sales flat. However, sales growth should rise during the course of the year as the strong rand suppresses vehicle inflation and replacement demand picks up. New vehicle sales boomed between 2004 and 2008, and these cars are now more than a decade old.

CHART 1: US PERSONAL CONSUMPTION EXPENDITURE PRICES



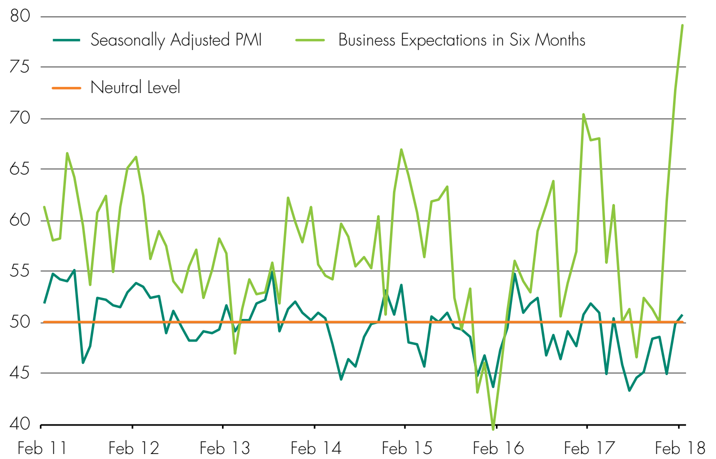
Source: Datastream

CHART 2: GLOBAL EQUITY INDICES OVER THE PAST YEAR, REBASED TO 100



Source: Datastream

CHART 3: ABSA/BER MANUFACTURING PURCHASING MANAGERS' INDEX



Source: Bureau for Economic Research

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 090.0	-2.38%	-1.32%	-0.62%	13.03%
United States	S&P 500	US$	2 691.0	-2.04%	-0.85%	0.64%	12.97%
Europe	MSCI Europe	US$	1 753.0	-2.56%	-1.41%	-2.45%	15.10%
Britain	FTSE 100	US$	9 756.0	-3.60%	-1.97%	-6.20%	7.68%
Germany	DAX	US$	1 387.0	-4.28%	-3.21%	-5.96%	20.29%
Japan	Nikkei 225	US$	200.3	-2.19%	-3.15%	-0.85%	17.70%
Emerging Markets	MSCI Emerging Markets	US$	1 192.0	-1.97%	-0.25%	2.94%	27.35%
Brazil	MSCI Brazil	US$	2 293.0	-2.67%	-0.17%	13.35%	21.32%
China	MSCI China	US$	93.3	-2.62%	0.20%	5.49%	44.38%
India	MSCI India	US$	585.9	-1.06%	-0.52%	-4.11%	18.85%
South Africa	MSCI South Africa	US$	612.0	-4.23%	-1.29%	1.16%	26.97%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	57 745.0	-1.65%	-0.99%	-2.96%	11.28%
All Share	All Share (Total Return)	Rand	8 210.0	-1.63%	-0.99%	-2.84%	14.58%
TOP 40/Large Caps	Top 40	Rand	7 211.0	-1.76%	-1.08%	-3.18%	16.61%
Mid Caps	Mid Cap	Rand	16 901.0	-0.94%	-0.21%	-0.44%	4.66%
Small Companies	Small Cap	Rand	21 020.0	0.29%	-0.07%	-0.01%	-1.78%
Resources	Resource 20	Rand	2 195.3	-1.40%	-2.60%	-3.98%	11.08%
Industrials	Industrial 25	Rand	14 475.0	-2.21%	-0.97%	-4.24%	16.23%
Financials	Financial 15	Rand	9 990.0	-0.95%	0.23%	2.92%	26.22%
Listed Property	SA Listed Property	Rand	2 021.9	0.31%	1.09%	-17.94%	-5.21%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	959.1	0.02%	0.00%	1.16%	8.19%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	618.5	-1.38%	-0.64%	5.24%	13.09%
Government Bonds	BESA GOVI	Rand	616.2	-1.25%	-0.56%	5.10%	13.13%
Corporate Bonds	SB JSE Credit Indices	Rand	129.0	-0.15%	-0.07%	2.26%	-12.31%
Inflation Linked Bonds	BESA CILI	Rand	250.2	-1.06%	-0.74%	-0.96%	0.18%
Cash	STEFI Composite	Rand	387.6	0.14%	0.04%	1.23%	7.48%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	64.5	-4.19%	-0.75%	-3.72%	17.29%
Gold	Gold Spot	US$	1 323.0	-0.38%	0.38%	2.00%	7.13%
Platinum	Platinum Spot	US$	964.0	-3.12%	-1.63%	3.66%	-2.43%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	11.93	-3.15%	-1.10%	3.81%	10.27%
ZAR/Pound	ZAR/GBP	Rand	16.46	-1.94%	-1.40%	1.70%	-1.94%
ZAR/Euro	ZAR/EUR	Rand	14.69	-3.27%	-2.04%	1.16%	-5.92%
Dollar/Euro	USD/EUR	US$	1.23	0.00%	-0.89%	-2.36%	-14.63%
Dollar/Pound	USD/GBP	US$	1.38	1.23%	0.00%	-2.17%	-10.87%
Dollar/Yen	USD/JPY	US$	0.01	-1.08%	-0.90%	-6.15%	-8.01%

Source: I-Net, figures as at 2 March 2018

OLDMUTUAL

HELPLINE +27 21 524 4430 | **FACSIMILE** +27 21 441 1199 | **EMAIL** ommmclientquery@ommm.co.za | **INTERNET** www.ommultimanagers.co.za

ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Standard Bank PMI
- Fourth quarter GDP growth

US

- ISM non-manufacturing index
- Non-farm payrolls and unemployment

EUROPE

- Eurozone retail sales
- European Central Bank interest rate decision

CHINA

- Trade balance
- Inflation

HELPLINE +27 21 524 4430 | **FACSIMILE** +27 21 441 1199 | **EMAIL** ommmclientquery@ommm.co.za | **INTERNET** www.ommultimanagers.co.za

Old Mutual Multi Managers ("OM m|m") is a business unit of Old Mutual Life Assurance Company (South Africa) Limited ("OMLACSA"), a licenced Financial Services Provider, Reg. No: 1999/004643/06. OM m|m is authorised to provide financial services on the OMLACSA license, FSP 703.