SIX MONTHS DOWN, SIX TO GO

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The halfway mark of 2018 provides a good opportunity to take stock of returns from the main asset classes, the factors shaping them and the outlook for the months and years ahead.

An interesting place to start is remembering how bleak things were only a year ago. June 2017 was an eventful month for all the wrong reasons. Stats SA released first quarter GDP numbers that were unexpectedly negative. Since the economy also contracted in the fourth quarter of 2016, South Africa was in a technical recession, defined as two consecutive negative quarters. The recession was subsequently revised away although nobody realised it at the time. Moody's followed the other ratings agencies in downgrading South Africa to junk status after the earlier shock firing of Finance Minister Pravin Gordhan. A new draft mining charter was widely criticised and challenged in court by the industry. The BER/RMB Business Confidence Index slumped to its lowest level since the 2009 recession, with a reading of 29 index points (with 50 being the cut-off between net positive and net negative). The Public Protector controversially proposed that the clause in the Constitution on the SA Reserve Bank's mandate be changed. Politics in general were messy and uncertain.

The month of June 2017 was also a negative month for local equities with the FTSE/JSE All Share Index losing 3.4%. The index level at the end of June 2017 was the same than in June 2014. In other words, over this three-year period, dividends were the only source of return from local equities, the biggest asset class for most local investors. At the halfway mark of 2017, pessimism about markets and the local economy was therefore widespread and with good reason. And yet, starting with an incredible surge in July, the FTSE/JSE All Share jumped 20% in the following six months.

JSE IN THE RED IN 2018

June 2018 was a volatile but positive month for local equity, but the FTSE/JSE All Share Index remains in negative territory for the first six months of the year. One-year returns are back in double-digits and comfortably ahead of inflation (4.4% in May), helped by the low base from a year ago.

However, the lesson learnt from last year was that, faced with the negative returns from local equities in the first six months of 2018, one shouldn't become too despondent. Markets can turn around quickly and without warning, making it impossible to time.

The other important lesson from June 2017 is that, despite all the negativity on South Africa's political situation, state capture, midnight Cabinet reshuffles and junk status ratings, the rand rallied during the month. In fact, it appreciated around 15% in the preceding 12 months. In contrast, the rand has lost 16% since President Ramaphosa's swearing in as president in February. Clearly, the local currency is not driven primarily by local factors, but rather by the big global forces: expectations of US interest rates (and the direction of the US dollar), sentiment towards emerging markets and commodity prices. Remember that when the land reform debate heats up, the economy stumbles or the Springboks disappoint.

THE BIG GLOBAL DRIVERS

Looking at those three factors in turn, the US dollar has been strengthening since mid-April against the major currencies (euro, yen and pound), hammering emerging market currencies, including the rand. It is not always clear what drives such a sudden shift. Interest rates are rising in the US. In theory this should attract capital, but interest rates rose throughout 2017 and the dollar weakened. Over the past few months, the US economy has strengthened relative to other major economies and this has boosted perceptions of where interest rates will rise to in the future. At the same time, the European Central Bank (ECB) confirmed that they were not hiking before sometime in 2019. Also in the mix now is the potential for further escalation in the trade disputes between the US and the rest of the world. Higher import tariffs at American borders could lead to a stronger dollar, but it is not clear whether the President's tweets are a negotiating tactic or a permanent feature. Though 2017 saw the dollar decline, it appreciated strongly in the previous five years and is probably already in expensive territory. A stronger dollar from this point forward is not a given.

There was much excitement and trepidation when the US 10-year bond yield broke through 3%, but it fell back to below 3%, even as the Fed pushed ahead with hiking its short-term policy interest rate. The flattening US yield curve (higher short-term rates, but flat long-term rates) suggests that the bond market does not believe that the Fed will hike rates as much as commonly being forecasted by analysts. So the US dollar could lose this source of support sooner rather than later.

Sentiment towards emerging markets has definitely deteriorated, but this too is mostly linked to the dollar and the uncertainty created by Trump's trade war talk and not to changes in growth fundamentals in these economies. Turkey and Argentina have large current account and fiscal deficits as well as large foreign-currency denominated debts. They were always vulnerable to a stronger dollar. In contrast, South Africa's foreign currency debt levels are relatively modest. But there has been contagion to other emerging markets, including South Africa, as global investors often buy or sell emerging markets as a basket, rather than based on individual country considerations.

Emerging market equities surged ahead in 2017 (returning an astounding 37% in US dollars) but in the first half of the year, the MSCI Emerging Markets Index underperformed developed markets and fell in dollar and in local currency terms. The JSE has mirrored this trend.

Commodity price trends have also not been in South Africa's favour of late either. The dollar price of our main import – oil – has shot up over 19% this year. But the dollar prices of our main exports – gold, iron ore, platinum, palladium and gold – have all declined between 5% and 10%. Only coal prices, trending in sympathy with oil, moved in our favour. Commodity prices thus also weighed on the rand.

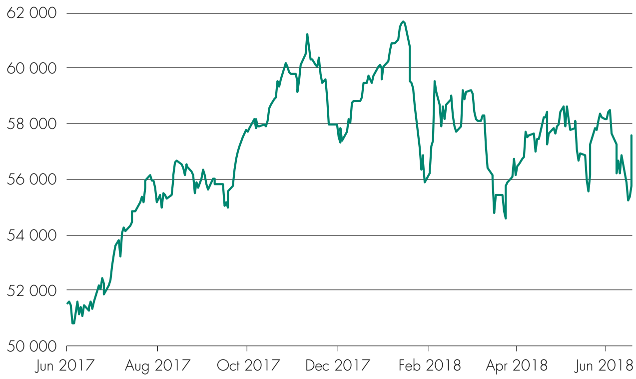
The US dollar return of global equity was disappointing against the backdrop of some strong corporate earnings reports driven by solid global growth and the US tax cuts. Geopolitics have come to the fore strongly this year. Trump's trade wars, his showdown with Iran and North Korea (and even his allies in the G7) and the Italian government merry-go-round have all weighed on markets. History shows that these events tend to be unimportant for long-term returns. What matters more are economic fundamentals, and these are still healthy for the time being. Global growth is solid and while the local economy is stuck in low gear, it should improve. The South African Reserve Bank's index of leading indicators slipped marginally in April but the overall trend still points to an improvement in local growth. And with the rand having pulled back sharply, local investors experienced a 10% rand return in global equity.

BEHAVIOUR MATTERS MORE

What matters the most for generating solid long-term returns, however, is often the behaviour of investors. Nothing destroys long-term returns as quickly as selling after equity prices have fallen a few percent, rushing money offshore after the rand hits a new record low or constantly trying to switch into the fund that is currently topping the performance tables. Markets are inherently volatile and returns tend to be lumpy and unpredictable, and so too is fund manager performance.

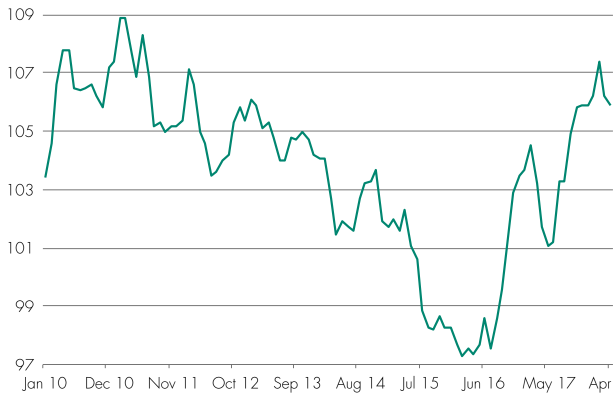
The sound approach is to do the homework upfront, set an appropriate strategy with the proper allocation to local and global assets, choose a manager with a proven and repeatable track record and then stick to the plan. Our information-rich modern world can lead to poor decision-making if investors overreact to market volatility and judge fund returns over inappropriately short periods. So while this is the halfway mark for the year, it is not the full-time whistle for investor returns. Successful investing requires lots of patience and discipline.

CHART 1: FTSE/JSE ALL SHARE INDEX OVER THE PAST YEAR



Source: Thomson Reuters Datastream

CHART 2: SA RESERVE BANK COMPOSITE LEADING ECONOMIC INDICATOR



Source: SARB

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 080.0	-1.65%	-0.62%	-1.09%	8.33%
United States	S&P 500	US$	2 716.0	-1.42%	0.41%	1.57%	12.23%
Europe	MSCI Europe	US$	1 676.0	-2.50%	-2.39%	-6.73%	0.18%
Britain	FTSE 100	US$	9 960.0	-2.27%	-2.42%	-4.24%	4.17%
Germany	DAX	US$	1 330.0	-4.11%	-4.59%	-5.96%	2.15%
Japan	Nikkei 225	US$	201.9	-1.39%	-1.05%	-0.10%	12.17%
Emerging Markets	MSCI Emerging Markets	US$	1 047.0	-3.77%	-6.60%	-9.59%	3.25%
Brazil	MSCI Brazil	US$	1 627.0	-0.43%	-9.56%	-19.57%	-3.84%
China	MSCI China	US$	84.4	-5.68%	-7.65%	-4.66%	15.80%
India	MSCI India	US$	550.3	-3.95%	-3.11%	-9.93%	3.25%
South Africa	MSCI South Africa	US$	479.0	-5.15%	-9.45%	-20.83%	-1.64%

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	57 611.0	1.33%	2.59%	-3.18%	12.18%
All Share	All Share (Total Return)	Rand	8 306.0	1.37%	2.78%	-1.70%	15.59%
TOP 40/Large Caps	Top 40	Rand	7 409.0	1.81%	3.61%	-0.52%	17.29%
Mid Caps	Mid Cap	Rand	15 188.0	-1.45%	-2.14%	-10.53%	4.64%
Small Companies	Small Cap	Rand	19 820.0	-0.05%	-3.31%	-5.72%	0.87%
Resources	Resource 20	Rand	2 709.2	3.89%	6.40%	18.50%	45.00%
Industrials	Industrial 25	Rand	14 524.0	1.37%	4.88%	-3.92%	9.57%
Financials	Financial 15	Rand	8 966.0	-0.07%	-2.84%	-7.63%	16.88%
Listed Property	SA Listed Property	Rand	1 937.4	0.56%	-3.47%	-21.37%	-9.89%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global Government Bonds	Citi Group WGBI	US$	938.8	0.16%	-0.12%	-0.98%	1.22%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Bond	BESA ALBI	Rand	611.1	0.32%	-1.19%	3.99%	9.67%
Government Bonds	BESA GOVI	Rand	606.5	0.35%	-1.31%	3.45%	9.09%
Corporate Bonds	SB JSE Credit Indices	Rand	113.9	0.25%	-4.52%	-9.72%	-18.22%
Inflation Linked Bonds	BESA CILI	Rand	251.2	-0.21%	-2.02%	-0.54%	1.60%
Cash	STEFI Composite	Rand	396.6	0.13%	0.55%	3.56%	7.35%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	77.7	2.65%	-0.36%	16.00%	61.92%
Gold	Gold Spot	US$	1 253.0	-1.34%	-3.98%	-3.39%	0.56%
Platinum	Platinum Spot	US$	850.0	-3.08%	-6.90%	-8.60%	-7.81%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.77	-2.38%	-7.76%	-10.08%	-5.65%
ZAR/Pound	ZAR/GBP	Rand	18.01	-1.05%	-6.22%	-7.05%	-6.11%
ZAR/Euro	ZAR/EUR	Rand	15.93	-1.69%	-6.77%	-6.71%	-6.65%
Dollar/Euro	USD/EUR	US$	1.16	0.86%	0.78%	3.53%	-1.72%
Dollar/Pound	USD/GBP	US$	1.31	1.44%	1.70%	3.23%	-0.60%
Dollar/Yen	USD/JPY	US$	0.01	0.45%	1.54%	-1.92%	-1.66%

Source: I-Net, figures as at 29 June 2018

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ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- Absa Manufacturing Purchasing Managers' Index
- Naamsa new vehicle sales

US

- ISM manufacturing and services indices
- Vehicle sales
- Minutes of the June Federal Reserve monetary policy meeting
- Unemployment and non-farm payrolls

EUROPE

- Eurozone retail sales

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