MARKET PERFORMANCE AND ECONOMIC UPDATE

Quarter 2 of 2017

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Market overview

Global markets experienced positive returns and lower volatility over the quarter. Receding political risk in Europe, increased global economic activity and overall positive economic data out the larger developed countries provided the support for the mild global recovery seen over the quarter.

US Fed raises interest rates

In June, the US Fed raised interest rates by 0.25% for the second time this year. Although recent weak inflation data may have caused the Fed to remain dovish, it is confident of a recovery in the economy, believing the weak inflation data is due to temporary factors. US equity markets were relatively unresponsive to the rate hike, ending the month flat. The rate hike and comments suggesting tightening monetary policy from other major developed market Central Banks saw the dollar weakened against major developed market currencies.

Chinese debt downgraded

In May, ratings agency Moody's downgraded Chinese sovereign debt by one notch. They cited the likely erosion of China's fiscus in the near future amid an environment of rising Chinese debt and slowing potential growth. Additionally, S&P ratings agency maintained a negative outlook on Chinese debt and cautioned of a possible downgrade in the coming months.

European Union economic update

The European Central Bank (ECB) elected to leave interest rates unchanged over the quarter. Comments by the European Central Bank's (ECB's) President Mario Draghi, suggested a possible end to the bank's accommodative monetary policy stance within the next few months. The comments were fuelled by improved inflation and economic growth figures emerging from Europe recently, coupled with dissipating political uncertainty. The sentiment drove a selloff in European bonds and equities and saw a strengthening of the euro and pound against the dollar.

Emerging equity markets continue to outperform

Emerging market (EM) equities have outperformed developed market (DM) equities for the sixth straight month this year, amassing 18.6% year-to-date (in US dollars) and they have largely recovered since the US elections last year.

Commodities

In May, OPEC extended the current production cut agreement of 1.8 million barrels a day for a further nine months as the current agreement was due to end in June 2017. The announcement saw oil prices decline -2.2% in May as markets felt that a greater cut in production was needed. The current production cut has not reduced global oil inventories as much as expected. This as a surge in US Shale production has been offsetting a large portion of the production cut by OPEC. The oil price declined -4.2% in June, -8.9% for the quarter and -14.2% year-to-date.

Gold and platinum were down by -0.6% and -2.5% for the quarter but year-to-date are up 7.9% and 2.6% respectively.

South Africa

The country has experienced two consecutive quarters of contracting GDP growth, technically entering recessionary conditions. Figures released by Stats SA showed a 0.7% quarter on-quarter decline for 2017 Q1, with a 0.3% decline in 2016 Q4. Growth projections for the next three years have been cut by the South African Reserve Bank (SARB), with 1% expected in 2017, down from 1.2%.

In June, Moody's downgraded South Africa's sovereign credit rating with a negative outlook, it now sits at one notch above sub-investment grade status while S&P Global and Fitch have reaffirmed South Africa's rating at sub-investment grade status.

The SARB kept interest rates unchanged at 7%, which was in line with market consensus, while the tone of the monetary policy meeting (MPC) meeting was less dovish than expected. Inflation is expected to average around 5.7% for 2017 and 5.4% next year, suggesting the increased probability of an interest rate cut in the remaining part of this year and next year.

Inflation increased slightly from 5.3% in April to 5.4% in May but remains within the 6% target of the South African Reserve Bank.

Market performance as at end of June 2017

Global equities and global bonds returned 4.5% (MSCI ACWI) and 2.9% (Citi WGBI) while emerging market equities (MSCI EM) returned 6.4% to outperform their developed counterparts over the quarter (all in US dollars).

Local equity and bond markets underperformed cash and inflation for the month, returning -3.5% and -0.9% respectively. Local equities were hurt by continuing political uncertainty, foreign investor sales, lower commodity prices and a stronger rand over the quarter.

On a month-to-date and year-to-date basis, local equity markets have seen a net capital outflow of R20.3 billion and R70.9 billion respectively.

A revision of South Africa's Mining Charter heightened uncertainty in financial markets in June. This resulted in a selloff of mining stocks, particularly gold mining stocks, which returned -9.5% in June. The selloff, weak iron ore and oil prices were contributing factors to resources losing -7.0% over the quarter. Industrials was the best performing super sector, returning 2.2% for the quarter. Naspers was the main driver, delivering 9.9% over the quarter. Financials was down -2.1% in June and ended the quarter flat.

The top three performing sectors over the quarter were Consumer Services (5.3%), Health (1.4%) and Consumer Goods (0.6%). At the bottom were Construction (-11.5%), Basic Materials (-7.0%) and Chemicals (-6.6%). Large Caps (0.9%) outperformed both Small Caps (-7.7%) and Mid Caps (-8.4%) for the quarter.

The strong demand for local bonds from foreign investors as seen in the past few months slowed in June due to negative sentiment from increased political turmoil. Despite the credit downgrades and ongoing political turmoil, local bonds have gained 7.9% over the one year period.

The rand depreciated against the euro (-4.3%) and sterling (-2.1%) over the quarter. Over the same period the rand gained 2.6% against the US dollar, due to dollar weakness.

Asset class returns in rand terms for the period ending 30 June 2017:

Asset classes	Index	1 month	3 months	1 year	3 years (per year)	5 years (per year)
Local equities	FTSE/JSE All Share Index	-3.5%	-0.4%	1.7%	3.4%	12.2%
Listed properties	SA Property Index (SAPI)	0.3%	0.9%	2.8%	13.2%	13.8%
Local bonds	All Bond Index (ALBI)	-0.9%	1.5%	7.9%	7.1%	6.6%
Inflation-linked bonds	Inflation-Linked Bond Index	-0.20%	0.90%	-0.50%	4.50%	7.20%
Local cash	STeFI Overnight	0.6%	1.7%	7.0%	6.3%	5.8%
Global equities	MSCI All Countries World Index	-0.1%	2.1%	6.8%	13.0%	22.1%
Global bonds	Citi WGBI	-0.8%	0.5%	-14.2%	6.1%	9.7%

** The returns for the global asset classes have been converted from dollars to rands.*

Sources: INET BFA, DataStream, Bloomberg