FLEXIPORTFOLIO
PERFORMANCE REPORT

1 JULY 2017

SOUTH AFRICAN ECONOMIC REVIEW

It was another exciting month in South Africa! Amid all the political noise – including #Guptaleaks, ANC NEC meeting, talk about a judicial commission of inquiry into state capture, ongoing Eskom and SAA issues and the Constitutional Court ruling, which allowed the Speaker of Parliament to decide whether the upcoming motion of no confidence vote could be held in secret – the rand was remarkably stable.

In economic news, the first quarter GDP data shocked, with the economy unexpectedly recording negative growth. The consensus forecast was for +1.0% annualised growth, but the actual number came in as -0.7%. This was one of the biggest surprises – actual versus expected – in my 30 years as an economist. This, of course, meant that the economy is now in recession, as the last quarter of 2016 also recorded negative GDP growth. But an even bigger shock awaited in the detail of the GDP numbers – the broad-based nature of the contraction was totally unexpected. Eight of the ten sectors in the economy recorded declines in the first quarter! Only positive growth numbers were recorded in agriculture and mining.

Weak growth – albeit a bit better than the 0.3% measured in 2016 - were already expected for 2017, but many analysts have subsequently revised GDP forecasts even lower. We now expect growth for 2017 of around 0.7% versus our previous forecast of just above 1%. The weak first quarter was also reflected in real growth in household consumption spending, which declined 2.3% at an annualised pace. Even though this will probably not be an extended or very deep recession, we are firmly stuck in a (very) low growth environment. Sustained weak or sub-par growth – as we discuss frequently–has serious consequences for fiscal sustainability and thus credit ratings.

More widely expected was the news that Fitch and S&P kept SA's ratings unchanged at the levels of the early April downgrades. Also, the Moody's downgrade of SA's foreign and local currency ratings by one notch from Baa2 to Baa3 (but still investment grade) was widely expected and had little market impact. The comments made by all three agencies still imply that if political uncertainty, policy uncertainty and lack of serious economic reform persist then there is significant risk of full downgrades of SA's local currency rating to sub-investment grade.

Inflation has surprised many analysts – printing lower than expected over the last few months. Already down from 7% in February last year (and more recently December 2016's 6.7%) to the 5.4% recorded in May, we expect a further decline to about 4.6% by July. Apart from the sharp decrease in the petrol price in July, lower food inflation and continued slowing in consumer goods inflation numbers contribute to our expectation of inflation remaining around, or slightly below, 5% for the next 18 months or so. Core inflation (i.e. headline inflation excluding food, non-alcoholic beverages, fuel and energy) has also surprised – easing from 5.9% in December 2016 to 4.8% currently.

Lower inflation, combined with a very weak economy and a tighter fiscal stance, creates an environment within which the Reserve Bank could potentially set out on an easing rate cycle. There is currently a window of opportunity to cut interest rates, namely while the global economy is still supportive of local economic conditions through the sharply reduced funding need on the current account, with the deficit having improved from around -6% in 2012/2013/2014 to -2.1% in the first quarter of this year.

Clearly politics, policy uncertainty and potential further downgrades do pose a risk to the currency (and thus inflation) but this window of opportunity might not be open for long as we are likely to reach the peak in global growth within the next year or two. While two or three interest cuts of 25 basis points each will not have a huge impact, on the margin they will certainly support confidence. We expect one rate cut later this year and two next year, but we are worried that the Reserve Bank might be running the risk of a policy error if they delay the start of the cutting cycle for too long.

MARKET PERFORMANCE INCLUDING DIVIDENDS

	LAST MONTH (%)	YEAR TO DATE (%)	1 YEAR (% P.A.)	3 YEARS (% P.A.)	5 YEARS (% P.A.)	8 YEARS (% P.A.)	10 YEARS (% P.A.)
JSE All Share	-3.5	3.4	1.7	3.4	12.2	14.5	9.3
JSE Fin & Ind	-3.6	5.7	1.9	7.4	16.9	19.7	13.7
JSE All Gold	-9.5	-10.2	-47.9	-4.7	-11.3	-6.6	-5.8
All Bond	-0.9	4.0	7.9	7.1	6.6	8.6	8.3
Total Cash	0.6	3.4	7.5	6.1	5.5	5.5	6.5
ALSI 40	-3.6	4.9	1.6	2.5	12.2	14.1	8.9
INDI 25	-4.2	10.8	1.7	8.2	19.6	22.2	16.5

RETIREMENT ANNUITIES TO 01/07/2017 (REFER NOTES)

	PERFORMANCE PROFITS									SMOOTHED BONUS			STABLE FUND			CPI
	Equity %			Balanced %			Select %			%			%			
Period	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	%
1 Year	-0.2	0.9	0.9	2.2	3.2	3.2	0.4	1.6	1.6	7.8	8.0	8.0	6.4	6.4	6.4	5.1
2 Years	0.8	1.0	1.1	3.2	3.7	3.9	1.1	1.4	1.4	8.3	8.7	9.0	6.2	6.1	6.0	5.7
3 Years	1.8	2.3	3.5	4.1	4.7	5.7	2.3	3.0	4.5	9.1	9.5	10.3	6.0	5.9	5.6	5.4
5 Years	6.6	8.1	11.9	7.3	8.4	10.9	6.2	7.4	10.5	10.9	11.2	12.2	5.4	5.3	4.8	5.6
8 Years	9.8	10.8	12.6	9.4	10.0	11.0	8.7	9.5	10.8	11.3	11.2	10.9	4.9	4.9	4.8	5.4
10 Years	9.7	9.5	7.1	9.2	9.2	7.7	8.7	8.7	7.1	10.9	10.9	10.5	5.1	5.1	5.5	6.0
15 Years	11.4	11.6	11.8	10.3	10.4	10.4	10.3	10.6	11.2	11.6	11.6	11.4	5.4	5.4	5.7	5.5
20 Years	11.6	11.5	10.9	10.4	10.4	10.0	-	-	-	11.3	11.3	10.8	5.6	5.7	6.4	5.7
25 Years	11.8	11.7	12.1	10.7	10.6	11.0	-	-	-	11.4	11.4	11.9	6.5	6.6	8.0	6.3
INTERIM RATES										9.50% p.a. (0.759% p.m.)			0.525% p.m.			

ENDOWMENTS/LIFE PORTFOLIOS TO 01/07/2017 (REFER NOTES)

	PERFORMANCE PROFITS									SMOOTHED BONUS			STABLE FUND			CPI
	Equity %			Balanced %			Select %			%			%			
Period	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	%
1 Year	-2.5	-0.6	-0.6	1.4	2.2	2.2	-1.1	0.5	0.5	6.3	6.5	6.5	3.7	3.7	3.7	5.1
2 Years	-1.0	-0.3	-0.1	2.2	2.8	3.0	-0.2	0.3	0.2	6.8	7.2	7.5	3.6	3.6	3.5	5.7
3 Years	0.4	1.1	2.5	3.2	3.7	4.7	1.0	1.8	3.1	7.6	8.0	8.8	3.5	3.4	3.3	5.4
5 Years	5.4	7.0	10.9	6.1	7.1	9.5	5.0	6.2	9.2	9.4	9.7	10.7	3.1	3.1	2.7	5.6
8 Years	8.9	9.9	11.9	8.1	8.6	9.5	7.7	8.4	9.8	9.8	9.8	9.5	2.8	2.8	2.8	5.4
10 Years	8.8	8.7	6.4	7.9	7.9	6.4	7.7	7.7	6.2	9.5	9.5	9.1	3.0	3.1	3.6	6.0
15 Years	10.5	10.6	10.6	8.9	9.0	9.2	9.2	9.4	10.1	10.3	10.3	10.3	3.5	3.5	4.1	5.5
20 Years	10.6	10.5	9.9	9.2	9.1	8.8	-	-	-	10.2	10.2	9.9	4.0	4.1	5.2	5.7
25 Years	10.8	10.7	11.0	9.4	9.4	9.8	-	-	-	10.4	10.4	10.8	4.9	5.0	6.4	6.3
INTERIM RATES										8.00% p.a. (0.643% p.m.)			0.307% p.m.			

GUARANTEED CAPITAL FUND (CURRENT AFTER-TAX RATE)		4.70% p.a. (0.383% p.m.)
EQUIVALENT RETURN	at the tax rate of 18%	5.73% p.a. (0.466% p.m.)
	at the tax rate of 41%	7.97% p.a. (0.641% p.m.)

PORTFOLIO ASSET SPLIT

	RETIREMENT ANNUITIES						ENDOWMENTS/LIFE					
	PP Equity %	PP Balanced %	PP Select %	Smoothed Bonus %	WW Equity %	WW Balanced %	PP Equity %	PP Balanced %	PP Select %	Smoothed Bonus %	WW Equity %	WW Balanced %
Interest-bearing	0 (0)	28 (2)	16 (0)	25 (0)	0 (0)	26 (26)	0 (0)	28 (2)	16 (0)	25 (0)	0 (0)	26 (26)
Ordinary Shares	100 (25)	64 (31)	74 (28)	66 (24)	100 (86)	74 (60)	100 (25)	64 (31)	74 (28)	66 (24)	100 (86)	74 (60)
Property	0	7	10	7	0	0	0	7	10	7	0	0
Other	0	1	0	2	0	0	0	1	0	2	0	0

Figures in brackets — international portion of sector weighting

TOP EQUITY HOLDINGS (SA)

NAME		% SPLIT	SECTOR
1.	Naspers Ltd	14.7	Media
2.	British American Tobacco	5.1	Consumer Goods
3.	Steinhoff International Holdings	4.2	Industrials
4.	Sasol	4.2	Oil & Gas
5.	Standard Bank	3.1	Banks
6.	Barclays Africa	3.0	Banks
7.	Old Mutual	2.9	Life Insurance
8.	Remgro	2.6	Industrials
9.	MTN	2.6	Telecommunications
10.	Aspen Pharmacare Holdings Ltd	2.3	Pharmaceuticals

GLOBAL ECONOMIC OVERVIEW

While the US Federal Reserve (Fed) is still on course to hike rates for a third time this year in the months to come, questions are being raised about whether the central bank is perhaps too bullish on the number of the rate increases it wishes to undertake through 2018.

One fundamental factor behind this view is the recent weakness in inflation data. The core personal consumption expenditure (PCE) deflator, the Fed's preferred measure of inflation, came in at 1.4% in May, well below the Fed's preferred target level of 2%. This follows a decline in 10-year inflation expectations implied by the bond markets from 2.1% in January to about 1.7% last month. The recent fall in oil prices adds further downside risk to inflation, raising more concerns about the Fed's hawkish stance.

To add to the weaker inflation picture, consumer demand has been ensuring a slower trend over the last few months as US retail sales and vehicle sales came in weaker than expected, along with a slowdown in consumer expectations of better growth in the next two years. Notwithstanding the weak round of real economy and inflation data coming from the US recently, the tight labour market still warrants further policy normalisation. Still, absent clear signs of overheating in the economy and the growing concerns over policy error, the Fed will be likely to continue carefully assessing both the downside and upside risks in interest rate decisions.

The European Central Bank (ECB) rattled markets, as ECB president, Mario Draghi, in a press conference, said that the reflation of the European economy creates room to pull back unconventional stimulatory measures. Although Draghi did emphasise the need to maintain a considerable degree of accommodation until inflation was on a more durable footing, the comments were seen as more hawkish, causing bond yields around the world to surge and strengthening the Euro.

Draghi's growing confidence in the economy could imply a reduction in due course of the monthly €60bn bond-buying programme. An announcement on this is now generally expected by September. However, interest rate increases are only likely much later – and only well after the pace of quantitative support (bond buying) has begun to slow. One key obstacle in the way of policy normalisation is the Eurozone's annual inflation rate, which, at 1.3%, still remains stubbornly below the ECB's target of 2%.

The potential for tighter policy in Europe and a cautious Fed has undermined the US dollar, which has been softening for some time now. In fact, by late June, the trade-weighted dollar had lost all its post-election gains. The softer dollar has lent considerable support to emerging markets through both stable emerging market currencies and higher commodity prices.

Emerging market economies continue to benefit from improved external factors, such as the firm global growth momentum, which has supported a surge in exports, the key driver behind the strong first quarter growth numbers experienced within emerging markets, particularly in Asia. Although in Asia, the China risk remains, improved global demand, particularly from Europe, should balance a slowdown in China and not undermine the recovery in emerging markets.

This sets the global economy on course for a solid end to the second quarter.

GLOBAL MARKET PERFORMANCES IN RAND TERMS

	LAST MONTH (%)	YEAR TO DATE (%)	1 YEAR (% P.A.)	3 YEARS (% P.A.)	5 YEARS (% P.A.)	8 YEARS (% P.A.)	10 YEARS (% P.A.)
MSCI World	-0.2	6.4	6.3	13.4	23.1	20.9	11.2
JP Morgan	-0.9	-0.3	-14.5	6.7	9.9	10.0	10.5
S&P 500	0.0	4.8	5.5	17.5	26.0	24.6	13.9
FTSE 100	-2.5	5.4	1.6	4.4	16.0	16.2	6.8
Nikkei Index	-0.3	4.2	5.1	13.6	20.4	16.3	8.5
Rand/Dollar	-0.6	-4.2	-10.5	7.2	9.9	8.0	6.4

WORLDWIDE FUNDS: PERFORMANCE IN RAND TERMS – REFER NOTES

	WW EQUITY %						WW BALANCED %					
	Retirement Annuities			Endowments/Life			Retirement Annuities			Endowments/Life		
Period	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.	M.P.	A.P.	S.P.
1 Year	10.2	7.5	7.8	8.0	5.7	6.4	5.0	0.8	5.7	3.4	-0.4	4.4
2 Years	6.4	7.4	7.4	5.3	6.5	6.8	2.9	4.6	6.5	1.9	3.6	5.5
3 Years	8.2	8.7	9.8	7.4	7.9	9.2	6.3	7.0	9.1	5.2	6.0	8.2
5 Years	12.5	14.0	17.9	11.7	13.1	17.1	10.7	11.9	15.4	9.7	10.9	14.6
8 Years	14.5	14.9	14.8	13.8	14.3	14.1	12.8	13.1	13.0	12.0	12.4	12.4
10 Years	12.3	11.9	6.4	11.6	11.2	5.7	11.1	10.9	7.3	10.5	10.2	6.7
15 Years	10.1	9.8	6.8	9.3	9.0	5.5	9.8	9.6	6.6	9.0	8.8	5.7

GEOGRAPHICAL SPREAD

	EQUITY PORTION %			BOND PORTION %		
	Fund	MSCI	Difference	Fund	Benchmark[7]	Difference
United States	43.5	52.6	-9.1	33.0	38.7	-5.8
Japan	3.7	7.7	-4.0	3.9	17.2	-13.3
Europe ex UK	19.0	15.8	3.1	34.6	28.2	6.4
United Kingdom	6.1	5.8	0.3	9.1	5.5	3.6
SE Asia & Canada	9.6	11.9	-2.3	17.3	8.4	8.9
South Africa	14.7	0.0	14.7	0.0	0.2	-0.2
Other	3.4	6.1	-2.7	2.2	1.7	0.4
Total	**100.0**	**100.0**	**0.0**	**100.0**	**100.0**	**0.0**

EQUITY SECTOR SPREAD

	Fund	MSCI	US	JAPAN	UK	Europe ex UK
Cash	3.8	0.0	1.9	0.2	0.3	0.8
Consumer Discretionary	8.6	12.1	4.4	0.4	0.6	1.9
Consumer Staples	6.3	9.3	3.2	0.3	0.5	1.4
Energy	4.0	6.1	2.0	0.2	0.3	0.9
Financials	15.8	18.6	8.1	0.7	1.1	3.5
Healthcare	11.1	11.4	5.7	0.5	0.8	2.5
Industrials	12.0	10.9	6.1	0.5	0.9	2.7
Information Technology	14.0	16.9	7.1	0.6	1.0	3.1
Materials	4.8	5.1	2.5	0.2	0.3	1.1
Other	0.3	0.0	0.2	0.0	0.0	0.1
Telecoms Services	1.5	3.2	0.8	0.1	0.1	0.3
Utilities	1.5	3.1	0.8	0.1	0.1	0.3
SA Rand Hedge	14.7	0.0	0.0	0.0	0.0	0.0

TOP EQUITY HOLDINGS (GLOBAL)

NAME		SECTOR
1.	JPMorgan Chase & Co	Financials
2.	Oracle Corporation	Information Technology
3.	Alphabet Inc	Information Technology
4.	Moody S Corporation	Financials
5.	Owens Corning	Industrials
6.	Apple Inc	Information Technology
7.	Fiat Chrysler Automobiles	Consumer Discretionary
8.	Wells Fargo & Co	Financials
9.	DS Smith Plc	Industrials
10.	Bank of America	Financials

NOTES

1. The performance figures in the tables represent the returns earned on premiums allocated. The returns on premiums actually paid will be lower than this because they take the policy specific charges into account.

2. All returns are quoted net of investment fund charges and tax.

3. The Smoothed Bonus declaration is made up of a vesting bonus and a claim bonus. The vesting bonus portion of the total bonus cannot be removed on death or maturity of the policy. The claim bonus portion is not guaranteed and could be adjusted should investment conditions dictate.

4. M.P. = monthly premium, A.P. = annual premium, S.P. = single premium.

5. The Flexi range of products was launched on 1 September 1984. Returns for the periods starting before this date apply to policies available before the introduction of the Flexi range of products.

6. The Property Portfolio and the OMD Top 40 Index Fund returns are available at any time.

7. The MSCI World Index is the benchmark for the Worldwide Equity portion. The benchmark figures for the Worldwide Bond portion consist of 70% JP Morgan Bond Index and 30% Barclays Capital Global Bond Index.