FLEXIPORTFOLIO

PERFORMANCE REPORT

1 NOVEMBER 2017

SOUTH AFRICAN ECONOMIC REVIEW

October was largely dominated by Finance Minister Gigaba's incredibly disappointing mid-term budget statement. The lack of fiscal consolidation and inadequate resolutions to address the problems within state-owned entities leads us to believe that there is a high chance we will see a ratings downgrade by at least one of the ratings agencies this November. This is, of course, not an ideal situation for the South African Reserve Bank (SARB), who we believed was on course to continue cutting interest rates this month. The SARB will now have to assess the impact a possible downgrade will have on the rand and, thereafter, the second round effects a weaker rand will have on inflation.

REASONS TO BE CAUTIOUS

This, of course, makes us wonder whether the SARB will in fact cut interest rates at all in this cycle. We initially had four rate cuts in our forecast for this cycle, but are now faced with the risk that the SARB may not have any room for further cuts. There are three key reasons for our shift in policy stance.

First is the notably more hawkish tone that SARB had in their latest monetary policy review, which they published in the beginning of October. The bank was rather frank about the need to target inflation of 4.5%, instead of the 6% ceiling of their 3%-6% inflation target band. This view is based on global inflation trends. The average inflation rate in emerging markets is currently between 3% and 4%, with Brazil, India and Russia registering inflation of 2.5%, 3.3% and 3%, respectively. According to the Reserve Bank, having inflation running at the top end of the range undermines the competitiveness of South Africa. This is why the SARB finds it prudent to anchor inflation and expectations closer to the mid-point of the target range. In addition to the new stance on inflation targeting, SARB specifically pointed out that it believes that the "neutral" real repo rate – when real GDP growth is at its trend rate without inflation accelerating – is 1.5%. With our current average inflation forecast of 4.7% for 2018, a neutral repo rate of 1.5% implies an actual repo rate of 6.2% (currently 6.75%). This then, in our view, only gives the SARB scope for two more rate cuts, and not three.

The second reason for us rethinking our interest rate forecast for 2018 is the possibility of an imminent ratings downgrade following the disappointing mid-term budget. Over and above our expectation of inflation remaining below the SARB's 6% ceiling for the duration of next year, another key reason we expected rate cuts was that we anticipated continued tight fiscal policy, which would take the pressure off the SARB and allow for rate cuts. The mid-term budget lacked evident of tight fiscal policy and, in fact, had an alarming debt outlook, due to the larger fiscal deficit expected in the later years. Without tight fiscal policy, it becomes rather difficult for the SARB to continue easing, as both loose monetary policy and fiscal policy are ingredients for spiralling inflation.

The third factor impacting our interest rate forecasts is GDP growth. Given the expectation of some improvement in growth, it takes the pressure off the Reserve Bank to continue easing. While monetary policy in itself cannot stimulate growth, in an environment where fiscal policy is tight, lower rates provides relief to the consumer who is faced with ever an increasing tax burden. Lower rates can also provide the foundation for businesses to source cheaper credit in order to re-invest in their existing businesses or find new opportunities that will drive growth. Recent data releases are starting to point to another 2.5% GDP expansion for the third quarter. If the fourth quarter prints growth of 1%, which is not far-fetched at all, full-year growth could be 0.9% – against our forecast of 0.8% and the SARB's of 0.7%. While it is too early to tell whether the improvement is meaningful, it is very likely that outside of another confidence shock going forward, growth for 2018 may be a better than the 1.2% that the market is expecting – which is really the only reason for us not being completely bearish on our view of South Africa. However, this silver lining does mean that the Reserve Bank will not be under pressure to ease policy – as would have been the case if we were to have a growth shock.

While we have notably shifted our rate cut expectations, we are cognisant of how a positive political outcome, following the ANC's December elective conference, could alter the direction of the SARB's policy stance – as a positive outcome will likely lead to renewed confidence and a stronger rand, which will bode well for inflation. At best, we can only hope for less political uncertainty going forward, but for now we continue to be prudent in our assessment of the local economy.

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	6.3	19.6	20.1	9.0	13.0	13.9	9.7
JSE Fin & Ind	6.0	19.5	19.4	10.4	17.0	18.6	14.0
JSE Resources	7.1	20.4	23.1	-3.0	-2.3	0.4	-1.7
ALSI 40	6.6	23.0	22.9	8.9	13.0	13.7	9.4
All Bond	-2.3	5.4	5.0	5.6	6.0	8.4	8.0
Cash	0.6	6.3	7.6	7.1	6.4	6.3	7.2

DO GREAT THINGS

OLDMUTUAL

RETIREMENT ANNUITIES TO 01/11/2017 (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	20.1	14.5	14.5	14.4	11.0	11.0	17.5	12.6	12.6	9.5	9.3	9.3	6.4	6.4	6.4	5.1
2 Years	10.4	8.2	5.3	8.9	7.7	6.2	9.4	7.0	4.4	9.2	9.2	9.2	6.4	6.2	6.2	5.6
3 Years	8.1	8.0	7.8	7.8	7.9	8.1	7.4	7.6	8.2	9.5	9.7	10.1	6.1	6.0	5.8	5.3
5 Years	9.3	9.8	12.3	8.9	9.3	11.0	8.5	9.0	10.7	10.9	11.1	12.3	5.6	5.5	5.0	5.5
8 Years	11.5	11.4	11.9	10.4	10.3	10.5	10.2	10.1	10.3	11.4	11.4	11.1	5.1	5.0	4.8	5.2
10 Years	11.3	10.9	7.5	10.2	9.8	7.9	10.1	9.7	7.2	11.1	11.0	10.3	5.1	5.2	5.5	6.0
15 Years	12.2	12.2	13.2	10.8	10.7	11.5	11.0	11.0	12.0	11.6	11.6	11.7	5.4	5.4	5.7	5.7
20 Years	12.3	12.4	12.2	10.8	10.9	10.9	-	-	-	11.4	11.3	10.9	5.6	5.6	6.2	6.2
25 Years	12.3	12.5	13.4	10.9	11.1	11.8	-	-	-	11.4	11.4	11.8	6.4	6.5	7.8	6.6
INTERIM RATES										9.50% p.a. (0.759% p.m.)			0.526% p.m.			

ENDOWMENTS/LIFE PORTFOLIOS TO 01/11/2017 (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	15.7	11.0	11.0	12.3	9.3	9.3	13.9	9.8	9.8	8.0	7.8	7.8	3.7	3.7	3.7	5.1
2 Years	7.6	5.8	3.3	7.3	6.2	4.8	7.1	5.0	2.7	7.7	7.7	7.7	3.7	3.6	3.6	5.6
3 Years	5.9	6.0	6.1	6.4	6.5	6.6	5.5	5.7	6.4	8.0	8.2	8.6	3.6	3.5	3.4	5.3
5 Years	7.7	8.2	11.0	7.4	7.9	9.6	6.9	7.3	9.4	9.4	9.6	10.8	3.2	3.2	2.8	5.5
8 Years	10.3	10.3	11.2	9.0	8.9	9.1	8.9	8.8	9.3	9.9	9.9	9.7	2.9	2.9	2.7	5.2
10 Years	10.3	9.8	6.6	8.7	8.4	6.6	8.8	8.5	6.3	9.6	9.6	9.0	3.0	3.1	3.5	6.0
15 Years	11.2	11.1	12.1	9.3	9.3	10.2	9.7	9.7	10.9	10.3	10.3	10.5	3.4	3.5	4.0	5.7
20 Years	11.2	11.3	11.2	9.5	9.6	9.7	-	-	-	10.2	10.2	10.0	4.0	4.0	5.0	6.2
25 Years	11.2	11.4	12.3	9.6	9.8	10.5	-	-	-	10.4	10.4	10.8	4.9	4.9	6.3	6.6
INTERIM RATES										8.00% p.a. (0.643% p.m.)			0.308% 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)	27 (3)	14 (0)	25 (0)	0 (0)	27 (27)	0 (0)	26 (3)	14 (0)	25 (0)	0 (0)	27 (27)
Ordinary Shares	100 (26)	65 (31)	75 (28)	66 (24)	100 (85)	73 (58)	100 (26)	67 (31)	75 (28)	66 (24)	100 (85)	73 (58)
Property	0	7	10	7	0	0	0	6	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	14.5	Media
2.	British American Tobacco	5.6	Consumer Goods
3.	Sasol	4.3	Oil & Gas
4.	Steinhoff International Holdings	3.6	Personal & Household Goods
5.	Standard Bank	3.3	Banks
6.	Barclays Africa	3.1	Banks
7.	Old Mutual	2.9	Financials
8.	MTN	2.7	Telecommunications
9.	Aspen Pharmacare Holdings Limited	2.4	Pharmaceuticals
10.	Remgro	2.4	Financials

GLOBAL ECONOMIC OVERVIEW

October saw a continuation of the recent global trends that we have labelled as "Goldilocks" – not too hot to cause (runaway) inflation and not too cold to cause a recession. In practice, this means we saw continued strong growth, but little evidence of that growth leading to higher inflation (yet).

Recent data releases across the US, Eurozone, Japan and China (together comprising 60% of global GDP) were mostly in line with these trends. Third quarter GDP data show strong growth across these countries and regions. On a seasonally adjusted annualised basis, growth of 3.0% was recorded in the US, 2.4% in the Eurozone and 6.5% in China, while 1.3% is estimated for Japan. Heading into the last quarter of the year, most forward looking indicators, such as confidence surveys, indicate a continuation of the recent growth trends.

Meanwhile, inflation rates remain generally subdued and below target. Core PCE (personal consumption expenditure) inflation in the US of 1.3% remains below the Federal Reserve Board (Fed) target of 2%. Similarly, core inflation in the Eurozone is at 0.9% (versus 2% target), at 0.2% in Japan and headline inflation in China is 1.6%.

In this environment, central banks are ready to continue on the path of policy normalisation. The latest statement by the US Fed's Federal Open Market Committee (FOMC) policymaking body highlighted the fact that economic activity is now classified as "solid" – versus "rising modestly" as per the previous statement. Core inflation is still (and rightly so, in my mind) labelled as "soft". The Fed is expected to hike rates again in December and three or four more times in 2018. At the same time, as reported previously, the Fed has started on a slow and measured process of running down its US$4.5 trillion balance sheet.

The Bank of England (BoE) recently hiked interest rates in the UK for the first time in 10 years, on the back of inflation being outside of their target range. However, significant (Brexit-related) risks to the UK economy led the BoE to warn that "any future increases in the Bank Rate would be expected to be at a gradual pace and to a limited extent."

While inflation globally is low and in many cases below target, we do expect higher inflation numbers to become more evident during the course of the next six to 12 months. This is, of course, as a result of strong growth, but also because low inflation in the recent past was as a result of declining food and fuel prices (thanks to positive supply shocks). These have since eased markedly and food and fuel prices are now rising. Thus, higher measured inflation is likely during the first half of next year as base effects impact on the year-on-year inflation data.

The conditions for strong equity market performance thus remain in place. As highlighted in last month's report, these include:

1. The growing confidence that the global economic recovery not only remains on track, but is spreading around the world;
2. Investors seeing central banks' willingness to push on with policy normalisation as a sign of policymakers' growing confidence that the global recovery is becoming self-sustaining, thus requiring less monetary support;
3. Evidence that tax reform and fiscal stimulus in the US is back on the agenda, with the release of the House of Representatives' tax proposals.

Risks around the extent of central bank policy tightening remain. Markets have become very complacent about the extent and pace of central bank tightening. In the face of an acceleration in inflation, even if only modest, markets might be surprised if the US Fed only continues on their well-signalled rate path.

We remain positive on the outlook for the world economy – expecting growth of 3.2% both this year and next – compared with the 2.6% in 2016. There are currently no serious headwinds in sight that could derail this outlook.

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	6.7	22.8	29.5	18.1	23.6	19.3	13.1
JP Morgan	4.3	8.9	4.9	9.8	10.0	9.4	11.3
S&P 500	7.2	20.9	29.7	20.3	26.9	23.2	16.0
FTSE 100	5.5	20.6	27.8	10.9	15.9	14.2	8.4
Nikkei Index	12.2	22.2	22.5	19.2	23.0	15.5	11.2
Rand/Dollar	4.7	3.4	4.9	8.6	10.2	7.7	8.0

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	35.6	26.0	26.0	30.6	22.6	22.6	29.5	19.0	19.0	25.1	16.5	16.5
2 Years	18.2	16.2	12.0	15.7	14.1	10.2	13.4	12.1	9.0	11.2	10.3	7.5
3 Years	15.8	16.0	15.8	14.0	14.3	14.5	12.8	13.4	14.4	10.9	11.7	12.8
5 Years	15.9	16.9	18.9	14.5	15.5	17.8	13.7	14.7	16.4	12.3	13.1	15.2
8 Years	16.9	16.7	15.0	15.9	15.7	14.2	14.9	14.7	13.2	13.9	13.7	12.5
10 Years	14.7	14.0	8.1	13.8	13.1	7.4	13.1	12.6	8.8	12.3	11.8	8.1
15 Years	11.6	11.3	8.8	10.6	10.4	7.6	11.1	10.8	8.4	10.2	9.9	7.4

GEOGRAPHICAL SPREAD

	EQUITY PORTION %			BOND PORTION %		
	Fund	MSCI	Difference	Fund	Benchmark[7]	Difference
United States	42.7	52.1	-9.4	36.1	38.8	-2.7
Japan	4.1	7.9	-3.8	2.9	16.7	-13.8
Europe ex UK	18.8	15.9	2.9	33.0	28.5	4.5
United Kingdom	6.6	5.8	0.8	8.5	5.5	3.0
SE Asia & Canada	10.2	12.1	-1.9	14.5	8.4	6.1
South Africa	14.5	0.0	14.5	0.0	0.2	-0.2
Other	3.1	6.2	-3.0	4.9	1.8	3.1
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	3.0	0.0	1.5	0.1	0.2	0.6
Consumer Discretionary	8.9	11.9	4.5	0.4	0.7	2.0
Consumer Staples	6.1	8.7	3.0	0.3	0.5	1.3
Energy	4.2	6.3	2.1	0.2	0.3	0.9
Financials	16.8	18.7	8.4	0.8	1.3	3.7
Healthcare	10.8	10.9	5.4	0.5	0.8	2.4
Industrials	10.9	10.8	5.5	0.5	0.8	2.4
Information Technology	15.0	18.2	7.5	0.7	1.2	3.3
Materials	4.8	5.4	2.4	0.2	0.4	1.1
Other	0.5	0.0	0.3	0.0	0.0	0.1
Telecoms Services	1.5	3.1	0.7	0.1	0.1	0.3
Utilities	1.4	3.1	0.7	0.1	0.1	0.3
SA Rand Hedge	14.5	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. Comcast Corporation	Consumer Discretionary
4. Apple Inc	Information Technology
5. Alphabet Inc	Information Technology
6. Moody S Corporation	Financials
7. Fiat Chrysler Automobiles	Consumer Discretionary
8. Keyence Corporation	Information Technology
9. Bank of America Corporation	Financials
10. Mettler Toledo International	Healthcare

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.