FUNDAMENTALS

THE NEWS MAGAZINE OF OLD MUTUAL INVESTMENT GROUP

JANUARY 2018

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2018 – A YEAR THAT WILL TAKE US **INTO UNCHARTED TERRITORY**

KHAYA **GOBODO** | MD OF ASSET MANAGEMENT

ABOUT **THE AUTHOR**

Khaya is responsible for the asset management division at the Old Mutual Investment Group. He has extensive experience working at large, sophisticated investment firms and, having previously built a boutique investment firm from the ground up, is well placed to unlock further value within our multi-boutique model.

Change is a challenge at the best of times and 2018 promises to be a year during which there will be change on many fronts. But with change comes the potential for new beginnings, vital learnings and, ultimately, progress and exciting new opportunities.

As George Bernard Shaw said, "Progress is impossible without change, and those who cannot change their minds cannot change anything." This quote is particularly relevant to the asset management industry where the most successful fund managers are required to have great conviction in their investment views – but also, importantly, to be open to new information that could potentially change their investment thesis.

Another characteristic that will determine who is best able to survive the changes and harness the opportunities that come with that change is resilience and, given the far-reaching nature of the changes that could well change the world as we know it, we will all be hard-pressed to step up to the plate on this count.

THE WORLD AS WE KNOW IT IS CHANGING

From economic policy entering unprecedented territory to a political shift from the centre to the right in the developed world, the world economy and political systems are going to look very different in the future – and it will be virtually impossible to predict the end game as it unfolds.

A seismic shift in the world's axis of power from the West to the East is also underway, with the centre of influence likely to reside in the East in the future, as the US's status as the post-war superpower is fast being eroded under Donald Trump's unpredictable leadership. But for investors adjusting to this new dispensation, it will not be a binary decision and we will need to be discerning about where and how to allocate capital in this world in transition. This is particularly true regarding how to evaluate emerging Asia against the traditional Western powerhouses.

At home, while December heralded a new era for the ANC, with Cyril Ramaphosa taking over the reins of the party, it's still unclear whether he will be able to carve out the deep-rooted change needed in the party and in the country's leadership if South Africa is to flourish again.

And we are not only going to be experiencing unprecedented change in global economic and political mores. 2018 promises to bring with it even faster, and more profound, technological change, with exponential advances in artificial intelligence (AI).

OLD MUTUAL'S HOMECOMING IS WELL TIMED

With all this change, companies will need to adapt quickly and Old Mutual has already begun its journey to position itself to its best advantage. This year will see the homecoming of Old Mutual from the UK to the African continent. This will allow us to be an independent and a focused business, better able to serve our broader stakeholder group – that is, our customers, employees, investors, partners and communities in the countries we operate.

History reveals plenty of evidence showing that companies that refocus and simplify as a result of an unbundling from a much larger diversified parent company are reinvigorated and have tended to do much better than their own history and their peers.

The good news is the Competition Tribunal has approved the acquisition of Old Mutual plc by the newly incorporated Old Mutual Limited, as was recommended by the Competition Commission – a significant step towards the listing of Old Mutual Limited as a standalone entity this year.

The move back to its roots couldn't come at a better time, with the Minister of Economic Development, Ebrahim Patel, welcoming Old Mutual's decision to make South Africa the primary base for all of its operations because of the investor confidence it will inject in the economy.

FRESH THINKING AND RESILIENCE POSITION OLD MUTUAL INVESTMENT GROUP WELL FOR CHANGE

Within the investment business, there has also been a leadership change that will, I believe, enable the Old Mutual Investment Group to take advantage of the broader societal and economic changes afoot in South Africa and the world and enable it to continue delivering the competitive returns our clients have come to expect of us.

Over the past decade and more, we have built a resilient multi-boutique investment business that is well resourced and designed for sustainability. The investment boutiques are led by high calibre investment professionals who have great skills and experience and thus are well positioned to navigate the financial market changes and pressures underway.

I have the privilege of becoming MD of our asset management business and I look forward to unlocking the real value of our boutique model, which I believe has not been fully appreciated up to now. Part of the key will be drawing on my experience working at large, sophisticated firms and my experience building a boutique investment firm from the ground up.

I have no doubt that the sum of these two – the proven quality of our investment business and some fresh thinking from a new leadership team – will put us in a strong position to take advantage of the economic, political, industry and technological shifts underway.

In the complex, ever-changing and uncertain world of investments, it's important to build resilient portfolios and our multi-asset class business, MacroSolutions, has a proven record of doing just that. Its range of multi-asset funds has dealt admirably with the uncertainty and nervousness surrounding the ANC conference and the Steinhoff explosion, with the boutique's core funds delivering compelling absolute returns and top quartile performance relative to peers.

At the end of the day, it is the returns we deliver to our clients that count – and in this respect I am pleased to say we are starting the year off on a promising note.

MARKETS TO BENEFIT FROM **STRONGER GLOBAL GROWTH AND SUBDUED INFLATION**

RIAN **LE ROUX** | STRATEGIST

ABOUT **THE AUTHOR**

As Sake Economist of the Year, Rian's insight into and forecasts of how macroeconomic developments impact financial markets inform our top-down views.

As we enter 2018, looking back at all the events, concerns and market moves in 2017 makes for interesting reading, as the year certainly had no lack of surprises.

As 2017 kicked off, the global economy was entering its eighth consecutive year of recovery. Even though it had been sub-par in strength compared with past periods of global expansion, there were growing concerns over the performance of the world economy in 2017 – especially against the background of the US Federal Reserve (Fed) clearly signalling its intention to tighten monetary policy further over the course of the year, the threat to global trade from the Trump administration, concerns over the outlook for emerging markets emanating from Fed tightening and possibly renewed strength of the US dollar, and the risk of a surge in wage growth in the US as the unemployment rate dropped to cyclical lows. In the event, the worst fears over global growth not only failed to materialise, but global growth actually accelerated and broadened, turning into the best year for the global economy since 2014 and, even more importantly, growth projections for 2018 are now equally rosy.

Importantly, the feared negative impacts from further US Fed tightening and the possibility of a stronger US dollar failed to materialise, as did the Trump administration's threats to global trade. In fact, the US dollar weakened over the course of 2017, easing pressures on the developing world in general, while the Fed's tightening also failed to cause wider damage, as sustained downside surprises in US inflation, despite an ever-tightening labour market, kept Fed rate hikes within already well-signalled expectations (three 25 basis point hikes effected in 2017). With global monetary policy settings thus remaining very supportive amidst a general lack of inflation pressures, the developing world became a magnet for capital flows, supporting overall economic conditions and allowing them to join the global expansion on a more sure-footed basis.

INFLATION NO LONGER A MAJOR THREAT

Apart from upside global growth surprises and a lack of outright policy shocks, the sustained deflationary nature of the world economy, despite it being in its eighth year of recovery, was perhaps one of the key macroeconomic surprises of 2017. Key here was the almost unbelievable lack of upward pressure on wage growth in the US, despite unemployment rates plummeting to multi-decade lows. The broad conclusion of both analysts and policymakers seems to be that the intensity of global deflationary forces, including on wage growth, have not only been grossly underestimated, but may well turn out to be a more structural phenomenon than was previously thought. So, even though inflation is expected to rise cyclically in 2018, inflation is not seen as a major threat, thus adding to the more upbeat view on the world economy in 2018.

GEOPOLITICAL TENSIONS REMAIN A CONCERN

Geopolitics was certainly also not a sleeping giant in 2017 either. Tension on the Korean peninsula ratcheted up dramatically and remains a threat as we enter 2018, although trade tensions between the US and China appeared to have thawed as the year progressed.

The global environment described above – namely, stronger and broader growth, low inflation and predictable policy normalisation by the US Fed – kept markets on a roll, with equity markets across the globe performing generally very well, despite perennial concerns over a host of issues.

BETTER GROWTH, MODERATE INFLATION, RISING MARKETS

Looking into 2018, consensus views call for an even better growth year in 2018 (albeit only moderately better than in 2017), a moderate rise in global inflation (although not enough to trigger a more aggressive policy response from what is currently expected to be another year of very gradual policy normalisation) and another year of good performance from investment markets. While it is difficult to argue with this broad view, we are sure that 2018 will see its own share of concerns. Indeed, we would list the key factors to watch for a possible derailment of the good global economic and market outlook for 2018 to be the risk of a stronger rise in wage growth in the US and/or a stronger rise in US inflation – both of which could cause the US Fed to tighten more aggressively and triggering a renewed rally of the US dollar. Another concern would be that the Trump administration turns its focus back to what it sees as an unfair global trade dispensation towards the US, an outcome that could have very negative consequences for the world economy. While geopolitical shocks are largely unpredictable, the tensions on the Korean peninsula need to be monitored closely too.

Data sourced from FactSet

KEY TAKEOUTS:

- 2017 SURPRISES WITH STRONGER GROWTH AND LOW INFLATION
- FADING INFLATION RISKS BUOY GLOBAL ECONOMIC OUTLOOK FOR 2018
- GLOBAL MONETARY POLICY SUPPORTS EMERGING MARKETS
- RISKS: AGGRESSIVE FED TIGHTENING, A RISING US DOLLAR AND TRUMP

IMPROVED POLITICAL BACKDROP **MAKES FOR A BETTER ECONOMIC OUTLOOK**

JOHANN **ELS** | CHIEF ECONOMIST

ABOUT **THE AUTHOR**

As Head of Economic Research, Johann is responsible for all local and global macroeconomic research. Specific focus areas include the rand, inflation, interest rates and fiscal matters.

Within a broad negative trend, induced by pessimistic political sentiment over the past year and longer, the South African economy experienced large swings during the last few months of 2017.

In October, the shocking Medium-Term Budget Policy Statement (MTBPS) that effectively put paid to fiscal consolidation led to Standard & Poor's (S&P) downgrading South Africa's local government bonds to sub-investment grade. While Moody's kept its investment grade rating unchanged, it placed South Africa on credit watch – meaning a downgrade decision within three months could still lead to SA's expulsion from Citigroup's World Government Bond Index, an outcome that could trigger large-scale capital outflows and a severe hit on the rand.

In November, the worst fears faded a bit, causing the rand to retrace quite sharply to around R13.50/US$ by early December – from above the R14.50/US$ level at one point

after the MTBPS. Similarly, bond yields eased back to below 9.20% (from a post-MTBPS level of around 9.50%), although still well above the 8.5% before the medium-term budget review. Better growth numbers and some retracement from the bad MTBPS seemed to be the major reasons behind these moves.

MARKETS POSITIVE ON NEW ANC LEADERSHIP

Then came the widely anticipated ANC elective conference in December. Despite some delays and worries around the voting process, markets took heart in the election of Cyril Ramaphosa as party president. Even before the conference, markets began to partly price in the election of Mr Ramaphosa. The rand moved from R13.50/US$ early in December to R13.22/US$ on the eve of the conference and then to R12.71/US$ by the end of the conference. The currency strengthened further to R12.38/US$ at the end of 2017.

Despite continued uncertainty around the ability of Mr Ramaphosa to unite the ANC behind him – the top six leaders and the National Executive Committee (NEC) seem fairly evenly split between backers of the new ANC president and those that supported his opponent – markets seem to think that he will be able to gradually bring the NEC around and that the SA economy will benefit from his leadership.

STRONG POLITICAL HEADWINDS REMAIN

While we agree that the ANC's elective conference was probably a divide between "bad politics" and "better politics" and will likely lead to, at the very least, a temporary improvement in confidence, we are also mindful of the many challenges that still abound.

Clearly, the new ANC president presents a break with the past, as Mr Ramaphosa has strong business experience and was heavily involved in the creation of the acclaimed National Development Plan (NDP). Thus, it is more likely now that the ANC will return to its more pragmatic policies. Within such an environment – coupled with likely sustained improvement in business and consumer confidence – we do expect better economic growth for 2018. There might even be some upside to our already above-consensus 1.5% GDP growth forecast for 2018. This is a decent uplift from the 0.3% GDP growth in 2016 and the expected 0.9% growth in 2017.

However, we remain cautious of becoming too optimistic. Although he is now the leader of the governing party, Mr Ramaphosa is not yet president of the country as President Zuma's term lasts until the 2019 elections – unless the new ANC leadership decides to replace President Zuma with Mr Ramaphosa. Crucially, the February 2018 Budget also needs to follow through in terms of strong fiscal consolidation. It thus remains a risk that Moody's might still downgrade SA's local currency bonds to non-investment grade.

However, should politics continue to improve and if the Budget marks a return to fiscal consolidation, Moody's might be willing to postpone a downgrade and the rand could hold on to its gains. Under such circumstances, inflation is likely to remain low – and possibly lower than the South African Reserve Bank (SARB)'s forecast. Our own inflation forecast of 4.8% average for 2018 – already below consensus – could turn out to be conservative. This, combined with tighter fiscal policy, could lead to circumstances where the SARB could consider restarting its cutting cycle.

Thus, while there are still many uncertainties, it seems reasonably clear that the improved political backdrop provides for a slightly more positive outlook for 2018 than before.

Data sourced from StatsSA, National Treasury, FactSet

KEY TAKEOUTS:

- MARKETS POSITIVE ON RAMAPHOSA, DESPITE UNITY FEARS
- STRONGER GROWTH EXPECTED IN 2018
- FEBRUARY BUDGET PIVOTAL FOR RATINGS OUTCOME

MARKET CELEBRATIONS **MASK THE DEPTH OF SA'S MACROECONOMIC ILLS**

WIKUS **FURSTENBERG** | PORTFOLIO MANAGER AT FUTUREGROWTH

ABOUT **THE AUTHOR**

Wikus manages a range of institutional and retail fixed income portfolios at Futuregrowth Asset Management, which include income, core bond and flexible interest rate funds. He also heads up the Futuregrowth Interest Rate team.

For the local bond market, the fourth quarter of 2017 was dominated by two events. The first was the disastrous Medium-Term Budget Policy Statement (MTBPS) in October, which served as the catalyst for a sharp rise in bond yields. A significant widening of the budget deficit, which implies a weakening of South Africa's creditworthiness, fed rising investor concern about possible multiple sovereign credit downgrades. This concern manifested itself in some aggressive bond selling, by both local and foreign investors. As a result, the yield of the benchmark R186 (maturity 2026) increased sharply from the September close of 8.55% to a weakest closing level of 9.47% around mid-November.

The second event was S&P Global Ratings' announcement on 24 November of its decision to downgrade South Africa's local currency sovereign credit rating to the sub-investment level of BB+. Moody's, on the other hand, opted to wait until after the ANC elective conference in December and the delivery of the 2018/2019 National Budget in February 2018 before resolving their ratings review (currently Baa3 with a negative outlook). The single downgrade from S&P resulted in the exclusion of South Africa from the Barclays Global Aggregate Index, but not from the Citigroup World Government Bond Index. Exclusion from the latter requires a sub-investment grade local currency rating from both rating agencies. Rand and bond strengthening immediately following these announcements suggests that some investors expected a downgrade from both ratings agencies. The exclusion from both indices would have resulted in a sizeable forced sale by foreign bond investors.

KEY TAKEOUTS:

- RELIEF RALLY FOR BONDS AND CURRENCY POST ANC CONFERENCE
- INFLATION-LINKED BONDS SUFFER AS CPI DROPS
- LACK OF FISCAL TIGHTENING WILL LIMIT MONETARY POLICY EASING

A TURNING POINT FOR THE ECONOMY

Local currency and bond market sentiment received a significant boost following the ANC conference where Mr Ramaphosa was elected as the party's new leader. Investors were quick to conclude that this outcome could prove to be a major turning point for the country. The rand strengthened against the US dollar to levels last recorded in the fourth quarter of 2015. Bonds moved in tandem and the yield of the R186 decreased sharply to close the quarter at 8.59%

In light of the above, the fourth quarter of 2017 turned out to be a very strong period for nominal bonds and particularly so for long duration bonds. The JSE All Bond Index ended its fourth-quarter rollercoaster ride with a decent return of 2.2% after reaching an intra-quarter low of -4.3%. Cash rendered a return of 1.8% for the same three-month period.

The post-ANC elective conference relief rally was strong enough to push the All Bond Index return for the calendar year to 10.2%, well above that of cash (7.5%). However, 2017 was not a good year for inflation-linked bonds. The sharp drop in inflation and rising real yields kept this market on the back foot. As a result, the JSE Inflation-linked Government Bond Index only managed to eke out a return of 2.8% for the year.

CURRENT CEILING ON GLOBAL BONDS TO LIFT

The modest global economic recovery sets the scene for limited inflationary pressure and a steady monetary tightening cycle for the few economies that are in a position to normalise policy. In our view, the US Federal Reserve (Fed) is in a position to lift policy rates at its next meeting, but this will be part of a gradual normalisation of policy. Our view remains that global bond markets are not appropriately priced, leaving some room for rising yields. Although the Fed is adamant that the unwinding of its balance sheet will be done in an interest-rate neutral way, we believe that the steady unwind will still contribute to the lifting of the current ceiling on global bond rates over time.

LIMITED SCOPE FOR SIGNIFICANTLY LOWER REPO RATE

Locally, the downward trend in inflation is expected to slowly turn. Although we do not expect the rate of inflation to accelerate at break-neck speed, a slightly higher future rate of increase does support the steady accumulation of inflation-linked bonds into bouts of market weakness. We are in agreement with the current cautious monetary policy stance of the South African Reserve Bank (SARB). The external trade imbalance, albeit improving, is still too big to allow for a significantly lower real repo rate, especially when considered against the background of possible large-scale foreign selling of local currency bonds. The lack of fiscal consolidation also makes it more difficult to ease monetary policy.

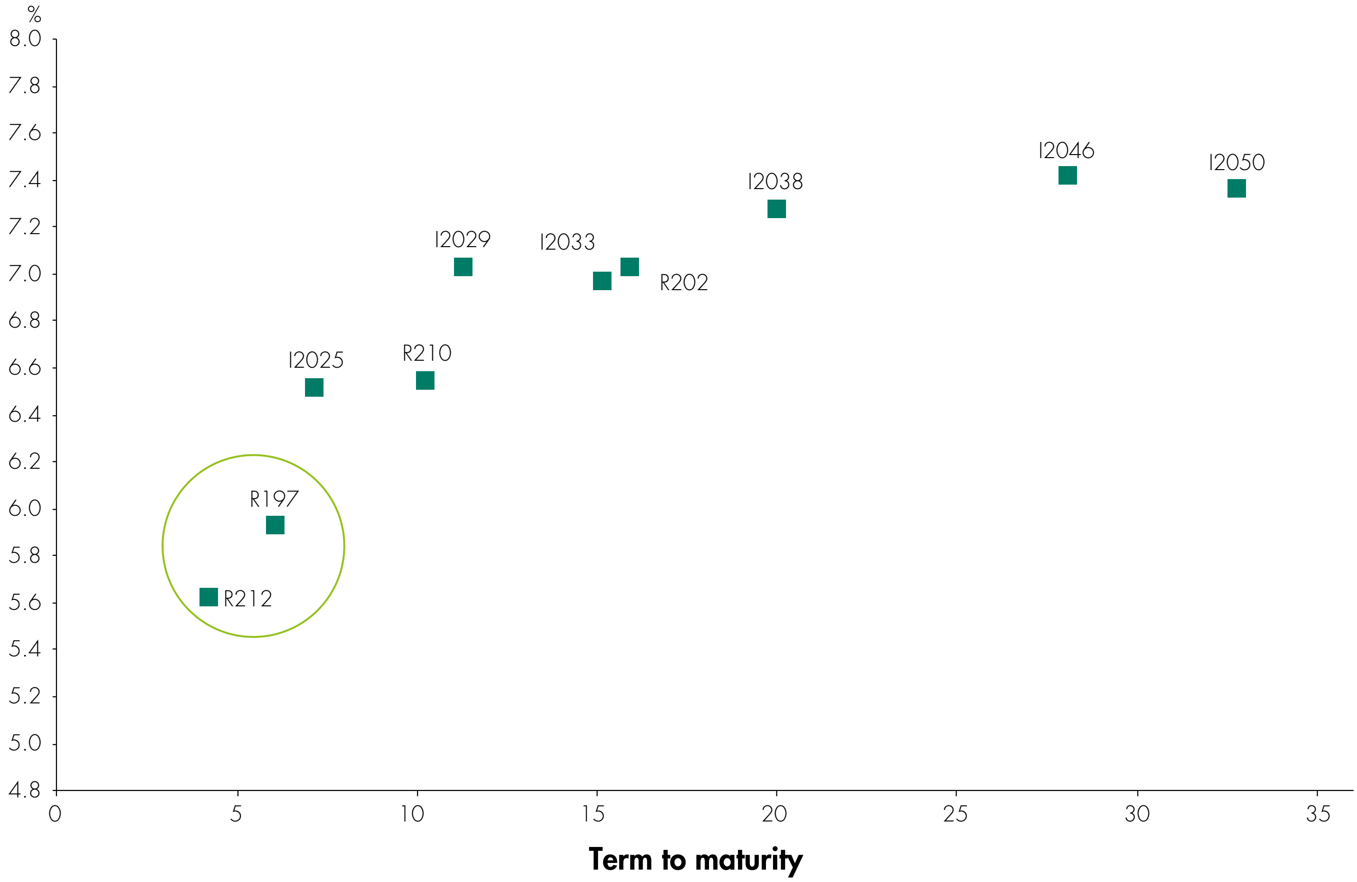
From a fundamental perspective, our main concern with regard to the bond market remains the strong link between the low local economic growth backdrop and tax revenue collection. Persistent sub-trend economic growth and macro policy uncertainty have negative implications for fiscal consolidation, eventually leading to sovereign credit ratings downgrades. The confirmation of these concerns with the tabling of the MTBPS does not imply that the theme has played out in full. As things stand, we expect Moody's to resolve its ratings review with a downgrade to sub-investment by the end of the first quarter of 2018. On the political front, the changes to the governing party's political leadership are welcomed with caution. The structural nature and extent of the country's macroeconomic ills require significant policy adjustment and time to be resolved. For now, we fear that markets have gotten ahead of themselves with unrealistic expectations.

Negative ratings momentum in the medium to longer term, caused mainly by sustained sub-trend economic growth and uncertainty about the fiscal outlook, does not match foreign investors' continued aggressive accumulation of local currency bonds. This mismatch presents a potentially lethal mix for the local bond market. Considering this, we shall continue to approach the market with extreme caution. However, we used bouts of market weakness post the MTBPS to reduce the size of the defensive position. This was simply based on the fact that market valuation after the post-MTBPS correction had improved significantly. Following the strong relief rally late in December, this no longer remains the case.

A SLOW, CONSIDERED ACCUMULATION OF INFLATION PROTECTION

We have no reason to be particularly concerned about the near-term inflation outlook. That said, real yields have risen significantly from cyclical lows, in response to lower inflation. This is reflected in poor 2017 inflation-linked bond returns. Our slow accumulation of inflation-linked bonds is therefore a value trade, with one eye on the fact that inflation may start rearing a lazy head in months to come. Considering our muted inflation view, stock selection is of utmost importance. For this reason, we still prefer low duration inflation-linked bonds with a low inflation breakeven rate (R212 and R197). In other words, we are buying better valued inflation accrual with the lowest possible capital risk.

Market inflation breakeven rates (yield difference between nominal and inflation-linked bonds with similar term to maturity)



Source: Bloomberg, Futuregrowth

Unless otherwise indicated, performance figures in the article are sourced from Futuregrowth and I-Net Bridge (Pty) Ltd.

AS THE JSE CONTINUES TO LAG GLOBAL MARKETS, **WHERE TO NOW FOR INVESTORS?**

DAVID **COOK** | BOUTIQUE HEAD AND PORTFOLIO MANAGER

ABOUT **THE AUTHOR**

David is a founding member of Old Mutual Titan, the global equity boutique within the Old Mutual Investment Group. In co-managing their global equity portfolio, his responsibilities include the bottom-up fundamental valuation of emerging and developed market equities.

KEY TAKEOUTS:

- SA EQUITIES ARE CHEAP, BUT EARNINGS OUTLOOK IS POOR
- GLOBAL STOCKS ARE EXPENSIVE, BUT EARNINGS LOOK PROMISING
- ACTIVE, DEFENSIVE PORTFOLIOS NEED TO WITHSTAND A POTENTIAL SELL-OFF

Over the past five years, local markets have returned just above 12% a year, which is comparable to the JSE's long-term average. However, when taking into account that over this period, the South African rand has weakened by almost 50% against the US dollar, the FTSE/JSE All Share Index's hard currency return – in real comparable terms – is just over 4% a year over the five years, and this is after the recent bounce in performance on the back of Cyril Ramaphosa winning the ANC presidency in December.

SA STOCKS DISAPPOINT

When considering that the US S&P 500 Index and US Dow Jones Industrial 30 Index have both returned more than 15% a year in US dollar terms, or approximately 24% a year in rands over the past five years, the JSE's continued weak performance in US dollar terms has left much to be desired by local investors hoping to keep up with global markets.

The JSE has been a weak performer over the past three to five years, particularly if you exclude the performance of the big multinational industrials – such as Naspers, Richemont and British American Tobacco – whose earnings are derived largely from overseas operations.

While one may view this relatively weak performance as a signal to buy, the local market is currently still reasonably expensive in absolute terms and, even after the Cyril Ramaphosa ANC win, the environment does not instil confidence among investors. Furthermore, when looking to forecast returns, it is important to consider the absolute return in terms of expected earnings growth and the factors that could impact this growth. Factors include fiscal and monetary policy changes, as well as future market volatility that could arise as a result. Currently, these factors do not paint a particularly positive picture for domestic equities going forward.

NAVIGATING GLOBAL MARKETS NEEDS AN ACTIVE APPROACH

Within global equities, the opposite problem currently exists: markets are looking relatively expensive, particularly in the US. While Europe and Japan perhaps offer slightly more value, along with some emerging markets, I wouldn't go as far as to call any of these cheap. The outlook in these markets, however, is generally far more promising in comparison to that of South Africa right now. This means we have South African equities at reasonable valuations, but with a relatively poor outlook for earnings, while global stocks currently carry high valuations with a decent outlook for earnings.

In terms of current positioning, my preference is for a higher allocation to global, but with a cautious approach in navigating such an expensive market. As an active manager, our aim is to build portfolios that can withstand a market sell-off and be able to generate alpha under different market conditions.

While a positive outcome from the December ANC elective conference will help the domestic market, will it be enough to turn things around, given how weak South Africa's current fiscal situation is? My other concern is that global investors are very much "risk-on" at the moment and all but ignoring any potential risks in the investment landscape. If and when this optimistic mindset changes to one of pessimism, as it duly does in time, then riskier markets like SA could be in for a difficult time in terms of valuations and rand weakness.

In the current environment, investors would be best served with a globally diverse portfolio of high quality and reasonably priced assets, and with a manager who is very active and more defensive in their approach, rather than one who is simply trying to mimic a market index. This would mean seeking a portfolio that includes companies with more defensive earnings profiles, such as consumer staples or tobacco businesses, as well as companies that offer significant potential for value growth.

WHAT FULLY VALUED GLOBAL **EQUITY MARKETS WILL MEAN FOR PRIVATE EQUITY**

PAUL **BOYNTON |** CEO: OLD MUTUAL ALTERNATIVE INVESTMENTS

ABOUT **THE AUTHOR**

Paul's entire career has been in investment and capital markets. He is responsible for the teams that originate and manage Old Mutual's investments in infrastructure, private equity, impact investment (housing and schools) and mezzanine debt.

Cast your minds back to December 2006, when Bloomberg canvassed the views of 12 senior equity analysts at Wall Street's largest investment banks and brokerages for their thoughts on the year ahead. Each and every analyst was upbeat and bullish. They said traders were experiencing "Goldilocks" conditions, neither too hot or too cold, but just right, with volatility levels at 12-year lows. Their natural conclusion was that 2007 would be another good year in the markets. Yet just seven months later it began going horribly wrong as markets started to tank sharply.
And after two more years, almost unthinkably, both Lehman Brothers and Bear Stearns would be out of business and

other venerable Wall Street institutions, including the mighty Merrill Lynch, were ignominiously forced into accepting rescue packages in the wake of one of the worst Wall Street crashes since the Great Depression.

And so we tread carefully when it comes to stock market predictions. But daring to look ahead in 2018 and beyond, we support the views of respected international fund manager Jeremy Grantham.

SEEKING A SAFE HAVEN

In a note from last year, Grantham discusses the possibility of a market correction but only over the medium term. He points out that the company price earnings ratio could begin to come under pressure from either lower company profit margins or rising inflation, or possibly both. But he was not discussing an immediate correction in 2018.

Of course, major equity markets are still on a bull run that has lasted for nine years, with the FTSE 100 closing 2017 at record levels and the Dow Jones Index also closing the year near its peak, having previously hit new highs no fewer than 71 times. However, towards the end of last year we noted greater share price volatility affecting certain stocks after trading updates led to dramatic – and arguably disproportionate – price falls as investors took fright. If we are reaching the point where individual stocks are fully valued, these are more likely to be vulnerable to changes in investor sentiment.

On the horizon is US political uncertainty as President Trump's White House struggles to turn rhetoric into concrete policies and laws. There are also the ongoing political and economic repercussions of Brexit, the war cries from North Korea and the responses from Asian and Western leaders, as well as the increased flexing of muscles in the Middle East to factor in too.

If markets are set for a period of volatility and price revaluations at some point this year or in 2019, private equity (PE) will be a major beneficiary as investors seek safer havens. Recent research on PE exits from the African Private Equity and Venture Capital Association (AVCA) covering 2007 to 2016 found that PE houses globally had a record year for exits in 2016, as they took advantage of favourable pricing. Given the amount of dry powder around at the moment, we foresee any stock market volatility next year leading to advantageous PE buying opportunities.

By its very nature, PE is a longer-term financial commitment, usually of five to seven years or more, which enables our industry to deal with the economic and industry cycles, including swings and downturns that are inevitably part of any investing programme.

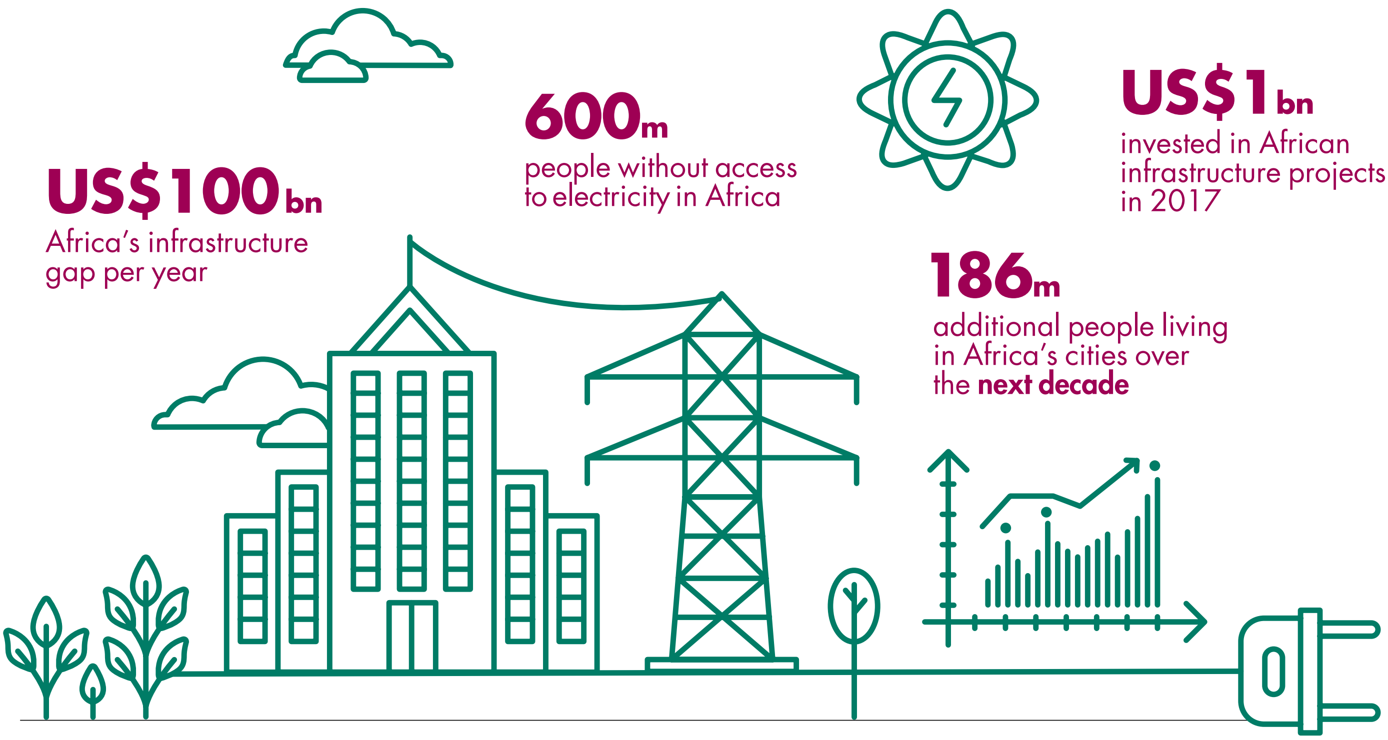
AFRICA UNDER CONSTRUCTION

We believe that large, well-managed African infrastructure projects (power, ports, roads, large housing developments) will continue to attract global investors' funds as they offer steady and reliable returns for those prepared to take a long-term view. African demand for capital is clear, estimated at around US$100 billion a year for infrastructure projects alone. Without it, Africa simply can't compete effectively in a global market.

For example, currently the cost of moving goods through African ports is about three to four times more expensive than in Europe. What's more, the road access rate in Africa is well below global norms, and only a quarter of the roads in sub-Saharan Africa are currently paved, which means slower freight deliveries as well as more frequent vehicle breakdowns and delays. These factors lead to high transportation costs, which can add up to 75% to the price of goods in parts of Africa.

With such clear demand for new African infrastructure investment, we see transport and power as particularly exciting sectors in the coming years, given that modern, connected economies need power in every home. There are still around 600 million people in sub-Saharan Africa without access to electricity today.

Another factor that augurs well for African economies is the rise of the middle class, with disposable income to spend on the consumer goods and lifestyle experiences that are common to developed nations. You may be aware that Africa is the world's



fastest urbanising region. According to research, there will be an additional 187 million Africans living in cities over the next decade, and by 2045, an average of 24 million additional people are projected to live in cities each year. This number is larger than China or India's urban population growth. Such enormous growth clearly requires considerable funding in terms of delivering new housing, transport and other services to these fast-expanding conurbations.

WE BELIEVE THAT LARGE, WELLMANAGED AFRICAN INFRASTRUCTURE PROJECTS (POWER, PORTS, ROADS, LARGE HOUSING DEVELOPMENTS) WILL CONTINUE TO ATTRACT GLOBAL INVESTORS' FUNDS AS THEY OFFER STEADY AND RELIABLE RETURNS FOR THOSE PREPARED TO TAKE A LONG-TERM VIEW

THE RIGHT TEAM

If public equity markets start to come off peak, investors, whether from Africa or overseas, will be reassured that there are plenty of high quality PE African infrastructure projects that could continue to deliver double-digit returns over the longer term.

The best projects are identified by the most experienced investment teams. These are teams who have built strong partnerships with companies and advisers across Africa, and whose local knowledge and contacts can filter out inferior projects before anyone's capital is risked. These are our investment teams, whose ethos is to leave absolutely nothing to chance, with no proverbial stone unturned.

We respect the ability of stock markets to move rapidly in unanticipated directions. And if there is a correction at some point in the next 12 to 18 months, well-managed PE offers a safer home for investors looking for growth in uncertain times.

US$2.4 BILLION RAISED BY PRIVATE EQUITY FOR INFRASTRUCTURE BETWEEN 2011-2016

Source: www.avca-africa.org/media/1701/avca-africa-infrastructure-report-april-2017.pdf

MARKET INDICATORS AS AT 31 DECEMBER 2017

	DY %	P/E Ratio	1 Month %*	12 Months %*
FTSE/JSE All Share Index	2.8	21.2	-0.3	21.0
FTSE/JSE Resources Index	3.1	14.9	-0.5	17.9
FTSE/JSE Industrial Index	2.4	17.7	-4.1	22.5
FTSE/JSE Financial Index	4.2	18.0	8.4	20.6
FTSE/JSE SA Quoted Property Index	5.8	17.3	4.2	17.2
ALBI BEASSA Bond Index			5.7	10.2
STeFI Money Market Index			0.6	7.5
MSCI World Index (R)			-8.0	11.4
MSCI World Index ($)			1.4	23.1

*Total return index percentage change

Economic Indicators		Latest Data	Previous Year
Exchange Rates			
Rand/US$	December-17	12.38	13.69
Rand/UK Pound	December-17	16.74	16.70
Rand/Euro	December-17	14.86	14.44
Rand/Aus$	December-17	9.68	9.89
Commodity Prices			
Gold Price ($)	December-17	1296.7	1150.6
Gold Price (R)	December-17	16019.3	15863.3
Oil Price ($)	December-17	66.5	56.8
Interest Rates			
Prime Overdraft	December-17	10.3%	10.5%
3-Month NCD Rate	December-17	7.2%	7.4%
R186 Long-bond Yield	December-17	8.6%	8.9%
Inflation			
CPI (y-o-y)	November-17	4.6%	6.6%
Real Economy			
GDP Growth (y-o-y)	September-17	1.0%	0.6%
HCE Growth (y-o-y)	September-17	1.7%	0.8%
(Household Consumption Expenditure)			
GFCF Growth (y-o-y)	September-17	1.3%	-5.4%
(Gross Fixed Capital Formation)			
Manufacturing Production (y-o-y) (seasonally adjusted)	October-17	1.1%	-1.2%
Balance of Payments			
Trade Balance (cumulative 12-month)	January-00	$13.0	-$1.7
Current Account (% of GDP)	September-17	-2.3%	-3.8%
Forex Reserves (incl. gold)	November-17	$684.8	$658.5

Sources: JSE, Iris, I-Net

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