



June 2017

## A WORLD OF ACCELERATED CHANGE

South Africa continues to be precariously positioned given weak growth outcomes and rising political uncertainty.

Since the mid-1990s there was a clear correlation between South African and global growth. As the country opened and became integrated into the world economy, its fortunes were closely linked to the rest of the world. Recent data, however, now indicates that over the last 3 years, this correlation with the world economy is breaking down. At a high level, while global growth has recovered, South Africa's growth has pulled back. It is interesting to note that our neighbouring countries, in sub-Saharan Africa, is expected to grow above 5% over the next ten years.

South Africa's persistent challenges of poverty and unemployment continue to hold back our economic prospects. Political instability, low fixed investments and credit ratings downgrades have dented business and consumer confidence in South Africa. The situation has the most serious consequences for the poor who have no defence against the economic fallout of the country.

In turbulent times like these it is worth remembering that we are in period of profound political and economic change around the world. The shocking developments of the last 12 months continue to shift the ground under our feet. The new US president keeps on upsetting geopolitics, while the UK snap elections that has led to a "hung parliament" causes further uncertainty for the Brexit outcomes.

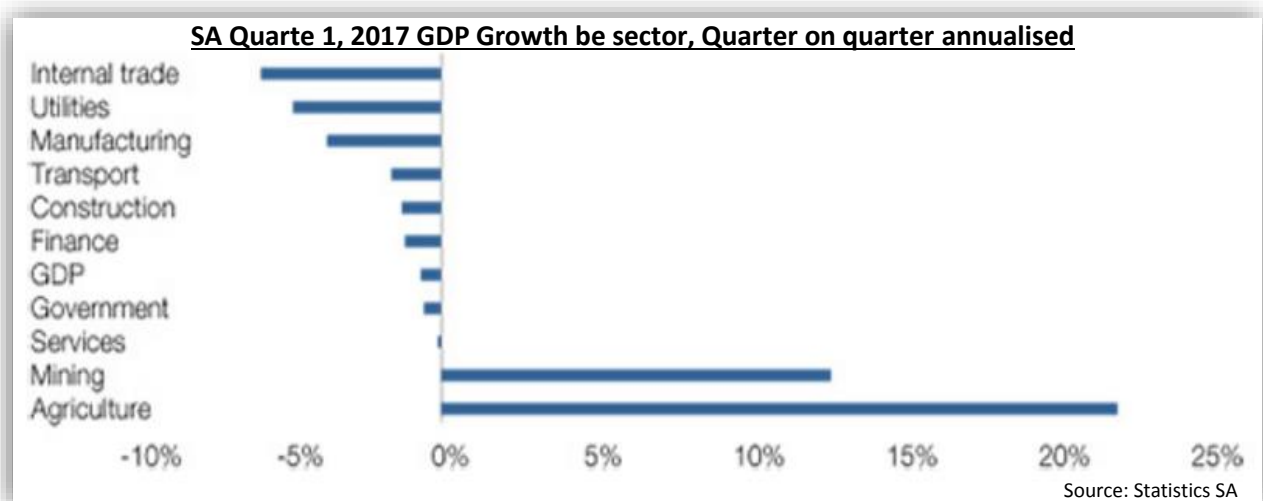
At Aspire, we continue to focus on building diversified portfolios that can withstand the economic shocks that seem to keep coming our way. We continue to be steadfast in our focus and commitment to deliver investment excellence for our clients.

## Domestic Market

Earlier this month, data released from Statistics South Africa showed South Africa's economy contracted by 0.7% in the first three months of 2017 after shrinking by 0.3% in the fourth quarter of last year, lagging market expectations of a quarter-on-quarter GDP expansion of 0.9%. It was the first time two consecutive quarters showed contraction — a definition of recession — since the second quarter of 2009.

Despite a healthy performance by the agriculture and the mining sectors, every other major sector contracted.

The chart below displays the quarter on quarter growth per sector.



Agriculture was very strong at 22% annualised – based on the record summer crops – while mining was also positive at 12.8%. However, all the other sectors were negative, with notable examples being manufacturing at -3.7% and electricity, which surprised at -4.8%, owing to impact from drought and water reticulation.

The largest falling sector was the trade sector at -5.9%, which was a result of the lower household consumption spending rate that came in at -2.3%.

### Another Ratings Downgrade

This month, we also saw Moody's (the last of the three major global credit rating agencies) downgrade South Africa's local and foreign currency rating after President Zuma's March 30th cabinet reshuffle. While Moody's one-notch downgrade of both the foreign and rand-denominated debt ratings leaves both still in Investment Grade, the agency retained the outlook on negative.

The rating agencies have warned against politically-motivated events detracting from the progress on growth-enhancing reform implementation and negatively impacting on the direction of government policy. Consequently, ongoing political friction raises the threat of further ratings downgrades in December, which could further hurt the economy.

Following a one notch downgrade to its lowest sovereign investment grade, Moody's also cut the ratings of most banks and companies including embattled power utility Eskom, further shaking confidence in Africa's most advanced economy.

## Domestic Market.... continued

### Reserve Bank leaves repo rate unchanged

On the 25<sup>th</sup> May, the South African Reserve Bank (“SARB”) kept the repo rate unchanged at 7%, which was in line with market expectations. The Reserve Bank last adjusted interest rates in March 2016, when they increased rates by 25bps.

The SARB noted it is concerned with the long-term prospects for inflation, which they forecast to test their upper target of 6%. The recent consensus amongst economists is that the widespread weakness in the domestic economy could spur a cut as early as July. The economy is just that weak!

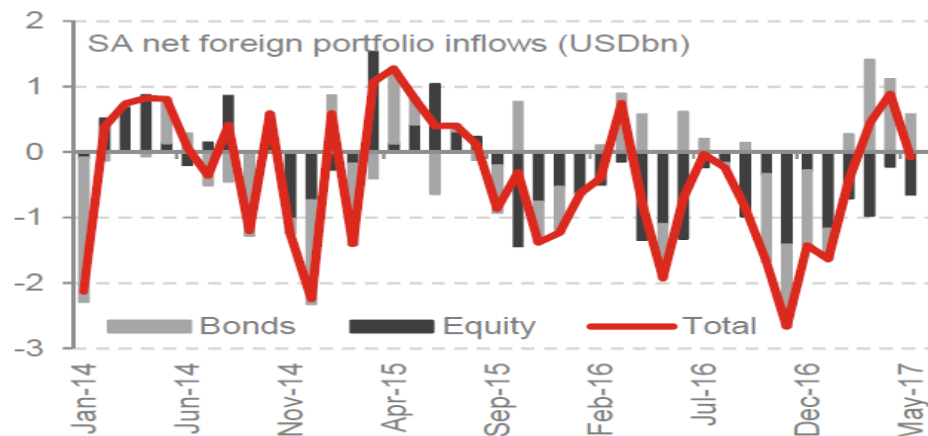
However, the challenge for the SARB is to balance SA’s significant reliance on foreign capital inflows to cover SA’s external imbalance. This reliance is a major factor that could limit the SARB’s ability to lower interest rates aggressively, in the short term.

### Currency

The rand has been largely range bound this quarter as it continues to defy reasonable expectations amidst the local political uncertainty.

The rand retreated from a two-and-a-half month high on Thursday at 12.6775 per dollar after the US central bank raised interest rates said it was prepared to continue tightening monetary policy.

Data on funds flowing into the economy suggests that the Emerging Markets asset class is still attracting investors. However recent developments in China (weaker data with higher frequency) and Brazil (political challenges) pose a real threat that political risks can sour the positive sentiment towards Emerging Markets.



Source: SARB, INET BFA, Momentum Investments

The SARB also raised concerns over higher funding costs and more difficult access to funding for domestic private sector fixed investment, following the sovereign credit ratings downgrade to junk status.

In response to questions about the ailing economy, Minister of Finance Malusi Gigaba said on Thursday 15 June, that Treasury was considering possibilities for further cuts in government spending and reallocation of funds to help boost growth and still remain within its fiscal target. These positive announcements from Treasury support the Rand’s strength.

## INTERNATIONAL MARKETS

The global macro-economic backdrop remains supportive with global GDP growth approaching its pre-financial crisis trend of 3.5%p.a. This is a result of synchronous growth amongst the global major economies.

Recently released data show that the Eurozone economy has had a good quarter with a robust expansion of 0.5% over the previous quarter in Q1. While the official breakdown of the components have not yet been released, economists suggest solid consumption and buoyant export growth are likely behind the result. Overall, domestic demand is riding the tailwinds of an improved labour market, a less-tight fiscal stance and ultra-loose monetary policy.

On top of the positive incoming data, the Eurozone is clearing political hurdles. Following a turbulent campaign race, centrist Emmanuel Macron beat right-wing Marine Le Pen in the presidential runoff vote on 7 May, ensuring that the region's second-largest economy remains in pro-European hands. In Italy, election risks have shifted into next year, while Angela Merkel's CDU/CSU is the clear front-runner in early polls for Germany's upcoming vote.

Early in the second quarter, the UK Prime Minister called a snap general election, in attempt to consolidate power before those negotiations. However, the UK witnessed an upset the likes of which hasn't been seen in that country in a generation — or two. Jeremy Corbyn's Labour Party won overwhelming voter support to obliterate Theresa May's majority, resulting in a hung Parliament. Reports are now emerging that attribute Corbyn's remarkable, and unexpected, surge to the 18- to 24-year-old segment of the population.

Corbyn's team tailored their message to the young and relied less on old-school campaigning than on a sophisticated social media campaign that addressed the local and national concerns of young voters.

Markets are looking positive in the USA, with the Wall Street's volatility index, which measures implied volatility of stocks and is often seen as investors' fear gauge, fell below 10, near a decade-low touched in May, in another sign of investors' confidence that markets will be stable at least for the time being.

Moody's downgrade of China from Aa3 to A1 (still comfortably within investment grade) was the first in nearly 30 years. Moody's highlighted concerns over China's challenge with rising financial risks resulting from credit-fuelled stimulus in previous years.

### Interest Rates and Inflation

The Federal Reserve raised interest rates on 14 June for the second time in three months and said it would begin cutting its holdings of bonds and other securities this year, signalling its confidence in a growing U.S. economy and strengthening job market.

Interest rates were raised by a quarter percentage point to a target range of 1.00-1.25% and the Fed forecast one more rise in 2017.

The Fed also gave a first clear outline on its plan to reduce its \$4.2 trillion portfolio of Treasury bonds and mortgage-backed securities, most of which were purchased in the wake of the 2007-2009 financial crisis and recession.

The UK Sterling surged to its highest in a week against the euro on Thursday, 15 June, after as many as three members of the Bank of England's ("BoE") policy committee surprised financial markets by voting for a rise in interest rates.

The split votes come at a time when the BoE has blamed a rise in inflation far above its 2 percent target on a weak pound and was taken as a warning that officials could seek to defend the currency, if need be. Markets are keenly watching and waiting for the outcome of this vote.

## Sticking to fundamentals in a world of accelerated change

At Aspire, we continue to focus on managing the long-term wealth of our clients. In our portfolio construction process, we look for sectors and funds with return profiles that are not dependent on or exposed to the same factors. We do this to reduce concentrated exposure to any single risk event.

Our investment team continues to carefully monitor our clients' investments for long term growth. We are committed to ensuring that our strong, skilled investment teams, robust business processes and risk-aware approach to managing your money will provide you with peace of mind as we navigate these challenging times.

## MARKET INDICATORS

ECONOMIC INDICATORS		LATEST DATA	PREVIOUS YEAR
<b>Exchange Rates</b> (source: South Africa Reserve Bank)			
Rand/US \$	15 June 2017	12.7054	15.2860
Rand/UK Pound	15 June 2017	16.1416	21.6871
Rand/Euro	15 June 2017	14.27072	17.1433
<b>Commodity Prices</b>			
Gold Price (US\$)	15 June 2017	1 252.84	1 291.45
WTI Crude Oil (US\$)	15 June 2017	44.54	50.89
<b>Interest Rates</b>			
Prime Overdraft	15 June 2017	10.50%	10.50%

Source: South African Reserve Bank