WARWICK Financial Maturity

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ASSET MANAGEMENT HouseView

This Month's Focus

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TWO GREAT BRANDS ONE ASSET MANAGEMENT TEAM

Adrian Meager, GM of Asset Management, would like to introduce his Head of Multi Asset, Brian Munro.

I started my career in the financial markets at Cadiz Securities where I specialised my research activities in risk management, portfolio construction and asset allocation. I played an integral role in developing a highly-rated research team between 2000 and 2012. Later, I joined Cadiz Asset Management as an investment strategist and assisted in asset allocation decisions for the multi-asset class funds before becoming the Head of Multi Assets at the end of 2015. I am primarily responsible for managing the Cadiz Balanced and Cadiz Stable fund.
Having been involved in financial markets for the last 18 years and responsible for clients' wealth, it has become clear to me that one needs a well-thought-out framework for investing. This framework, or set of beliefs, or philosophy, guides one's thinking when markets are turbulent.

It allows one to think and act clearly, taking advantage of opportunities when emotions in the market are running high.

What is equally important is a disciplined process when researching, buying and selling assets. The investment process should be integrally aligned to one's thinking. One tenet that is central to our investment process is risk management. As Warren Buffet says, "Rule No.1: Never lose money. Rule No.2: Never forget rule No.1". This belief underpins our objective, which is to protect and compound our client's wealth. Besides determining what we believe each asset is worth, we also focus on what could go wrong and the risks associated with that asset. For companies, we focus on various risks such as:

- Does the company have a strong balance sheet or is there excess financial leverage?
- Is there a capable management team?
- What regulatory, industry and other risks are the company exposed to?
- Are the earnings (profits) the company generates sustainable and how volatile are they?

Understanding what could go wrong and what could be a poor outcome helps us determine a price level that we would be willing to pay for that investment such that we are unlikely to lose our client's capital. Investing close to this price level gives us the margin-of-safety we need so that we protect our clients' money, but will give us a good return if our assessment of the business is correct.

Besides understanding the risks of each share we own in the portfolio, we also focus on managing the risks across the portfolio. Ensuring there is sufficient diversification across assets, sectors and asset classes is vital to fund management.

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This ensures the fund is not overly exposed to any one stock, sector or macro driver that could hurt the fund if something went wrong.

We simply don't know the future! Rather, building the fund with sound risk management principles, with a clear framework and being disciplined in how we implement our thinking should achieve our objective, which is to protect and compound our client's wealth over time.

International Market Overview

International markets produced a mixed bag during August, ending the month higher by 0.8%, after they lost around 1.5% during the second week. Notwithstanding the turmoil in emerging markets, volatility generally as measured by the Volatility Index (VIX), remained low. Developed markets thus, outperformed their emerging market counterparts, largely pushed by equity gains in the US, even with European markets ending the month of August softer. The ongoing tit-for-tat trade war between the United States (US) and China continued, as both parties once again failed to find common ground and the US committing to impose a further set of tariffs on $200bn worth of Chinese goods. Additionally, President Trump has also threatened to withdraw the US from the World Trade Organisation, if it doesn't, in his words, "shape up".

United States of America

Despite all the uncertainty caused by the political noise, US indices continued their upward trajectory and hit new highs for the month of August, largely fanned by strong corporate earnings, strong economic growth and tax cuts. The S&P 500 enjoyed its longest post-war bull market in US history, having beaten the 'dot-com' bubble of the nineties, ending the month higher by 3%. This strength was replicated by both the Dow, up by 2.2%, and the Nasdaq, up by 5.7%. Like the S&P 500, the Nasdaq not only had its best August performance since 2000, but also hit an all-time high. Economic data in the US continues to show the resilience of the market, as US consumer confidence surged to an almost 18-year high as measured by the Conference Board index, climbing to 133.4 as opposed to the July print of 127.9. The revised second quarter GDP number also came in higher at 4.2%, which has reflected the stronger investment in business than earlier forecast, together with a slight downward revision to consumer spending.

Europe

Unlike the US, markets in Europe closed on the back foot as ongoing concerns regarding the uncertain trade environment between the US and major economies persisted. Adding further negative sentiment to the markets was the continued uncertainty regarding Brexit. Economic data from the Eurozone showed that inflation had slowed to 2%, versus July's print of 2.1%. This appears to support the sentiment expressed by the European Central Bank (ECB), that the recent spike in inflation might only be a short-term one. Furthermore, unemployment in the Eurozone remained unchanged at its lowest rate since 2008, with the jobless rate coming in at 8.2%, in line with expectations, but down from the July print of 9.1%.

Markets in the UK ended the month lower by 4.1%, as business confidence slid to its lowest level since December 2017, as both trading prospects and optimism towards the broader economy declined as concerns deepened that Brexit would impact growth. This pessimism was reflected in the business confidence, which fell most in construction and consumer services, while remaining steady in manufacturing. There was an unexpected slowdown in manufacturing growth for August, the weakest in two years, as export orders contracted amid a weakening global economy. The IHS Markits Purchasing Managers' index fell to 52.8 in August versus the 53.8 for July, and below the 53.9 forecast by economists. The gauge for new orders fell below the 50-level for the first time since April 2016. The report also indicated that manufacturing production rose at its slowest pace in 17 months, as both input and output prices increased. There was a reported increase in the costs of electronics components, metals and energy which was passed through to consumers.

In Germany, the market ended weaker as the DAX 30 closed the month lower by 3.5% as Germany's unemployment rate extended its five-year decline, continuing to suggest that companies in Europe's largest economy remain confident in the outlook despite current risks. The number of out-of-work people fell by a seasonally adjusted 8, 000 in August to 2.33 million,

as the jobless rate held at a record low of 5.2%. Higher employment continues to boost wages, which, in turn, continues to contribute to an increase in general price pressures, while inflation remains stubbornly flat. It appears that the only concern now is how to fill the positions that are still open.

France's CAC 40 also closed the month lower by 1.9%, even as the economy showed signs of gaining steam as a gauge of private sector activity rose to a four-month high in August. The IHS Markit composite index of manufacturing and services climbed to 55.1 versus 54.4 for July, with consensus settling on 54.4. This was largely due to a greater domestic demand and a growth in expect orders, which are still below the historical average.

Asia

The continued uncertainty caused by the US/China tariff wars weighed on Asia, resulting in a generally mixed market. Asian markets had a generally better August, even as the trade war overhang continues to have an impact.

The Chinese markets recorded a poor performance for August, with both the Hang Seng and Shanghai Composite ending the month weaker. The Hang Seng, weaker for the fourth consecutive month, ended off by 2.43%, largely driven by the weakness in Tencent, which accounted for nearly half of the August slide in the Hang Seng. The Shanghai Composite Index ended down 5.3%, even as the economic data emerging from the Chinese markets slowed a slight increase as the PMI data for August moved up to 51.3 contrasted with the July print of 51.2. This measure has stayed above the 50-point mark, which indicates expansion for the 25th month in a row. The Nikkei again ended the month of August in the green, up by 1.4%, while benefitting from a relatively strong performance from the technology sector. Economic data showed that inflation failed to deliver an expected uptick in July, underlining the persistent weakness in consumer spending. This has forced the Bank of Japan to take a longer-term view of its goal of achieving a 2% inflation target. The Japanese economy showed a strong second quarter rebound, driven largely by capital investment, as companies turned to technology to cope with labour shortage. Continued positive data pointed to GDP increasing by 1.9% rather than an expected 1.4%, with business spending up by 1.3%, from the first quarter - the biggest increase since the fourth quarter 2016, and private consumption increasing by 0.7%, above the expected 0.2%.

Local Market Overview

Local Equities

The JSE All Share Index (ALSI) managed to finish the month of August in the green, despite the sharp sell-off towards month end. It was another volatile month for the local bourse and investor confidence was tested early on when ANC President Ramaphosa announced support for a constitutional amendment to allow expropriation of land without compensation. A few days later, the Turkish Lira went into free-fall, which put pressure on emerging market currencies such as the Rand. Despite all of this, the ALSI remained resilient and looked likely to end the month 5% stronger, before the precipitous fall of the MTN share price helped drag the index lower. The ALSI finished the month 2.34% stronger, and is up just 0.35% for the year.

On the local economic front, the South African Chamber of Commerce and Industry business confidence index ticked up to 94.7 from 93.7, while consumer inflation increased in line with expectations, up 5.1% from 4.6% recorded in the previous month.

In this lacklustre economic environment and where opportunities are not obvious, it is very important that we remain patient and adhere to our investment process and philosophy.

We continue to look for investment opportunities that meet our criteria of: quality business with sustainable competitive advantages; low financial risk; run by good management teams; and trading at an attractive price.

RESOURCES - After a poor month of July, resources have made a strong comeback, ticking up by 5.83% in August. This was mostly driven by a weaker Rand, as commodity prices dipped 1.94% in US Dollar terms, rising by approximately 10% over the period in Rand terms. Precious metals continue to face pressure, with platinum slipping 6.06% and gold losing 1.88% in USD. Gold reached its lowest level for the year in August, stooping to USD1174.16 in the middle of the month. Despite iron ore's rise of 14.3% in ZAR over the period, it did little to boost Kumba Iron Ore's performance, with the counter losing 3.79% for the month. Mineral Resources Minister Gwede Mantashe has managed to boost confidence in the mining sector after suggesting the withdrawal of the Draft Bill to amend the Mineral and Petroleum Resources Development Act. We will keep a keen eye on any developments within the sector which may present promising opportunities.

INDUSTRIALS - The INDI25 added 2.07% for the month, buoyed by most of the Rand hedge shares as the local currency came under significant pressure. Bidcorp and Bidvest were the top performers, gaining 19% and 15.32% respectively. Retailers had a mixed month, while healthcare and pharmaceuticals enjoyed strong gains. Tiger Brands and MTN were the worst performers, dropping 18.21% and 22.28%. A worse-than-expected trading statement by the food producer, resulted in massive selling pressure on the share. MTN released a SENS statement on the penultimate day of the month, informing investors that the Nigerian Central Bank had alleged that MTN improperly repatriated funds from the country between 2007 and 2015, and was ordering the company to refund the USD8.1bn. This news sent the share price plummeting some 20% on the day. We believe this is a desperate attempt by the Nigerian government to try and fund a forex shortfall, and MTN has strongly refuted these allegations. We may see this uncertainty weigh on the share price in the shorter term, but believe the share is offering value at current levels. During the month, we rotated out of Advtech and topped up Mediclinic, MTN and Woolworths, which we believe are offering better value.

FINANCIALS - Financials ended the month slightly softer, with the FINI15 down 0.26%. Life insurers, Sanlam and Discovery, both performed well, adding 3.93% and 3.06% respectively. There were mixed performances from the banks, with Capitec, FirstRand and Nedbank all ending in the green, while Absa and Standard Bank struggled, falling 5.43% and 8.59%. Property counter NEPI Rockcastle, and investment holding company Reinet, were the top performers for the month, adding 14.75% and 12.19% as the weaker Rand boosted their share prices. At current levels, we think financials are trading at about fair value to slightly above fair value, and are comfortable with our current weighting.

LISTED PROPERTY - Despite it being a trying month for emerging markets, the local listed property market managed to deliver a positive return of 2.15% as measured by the Property Total Return Index. Returns were once again mixed, but counters in the Resilient stable regained some traction and counters with offshore exposure moved higher on the back of positive distribution growth.

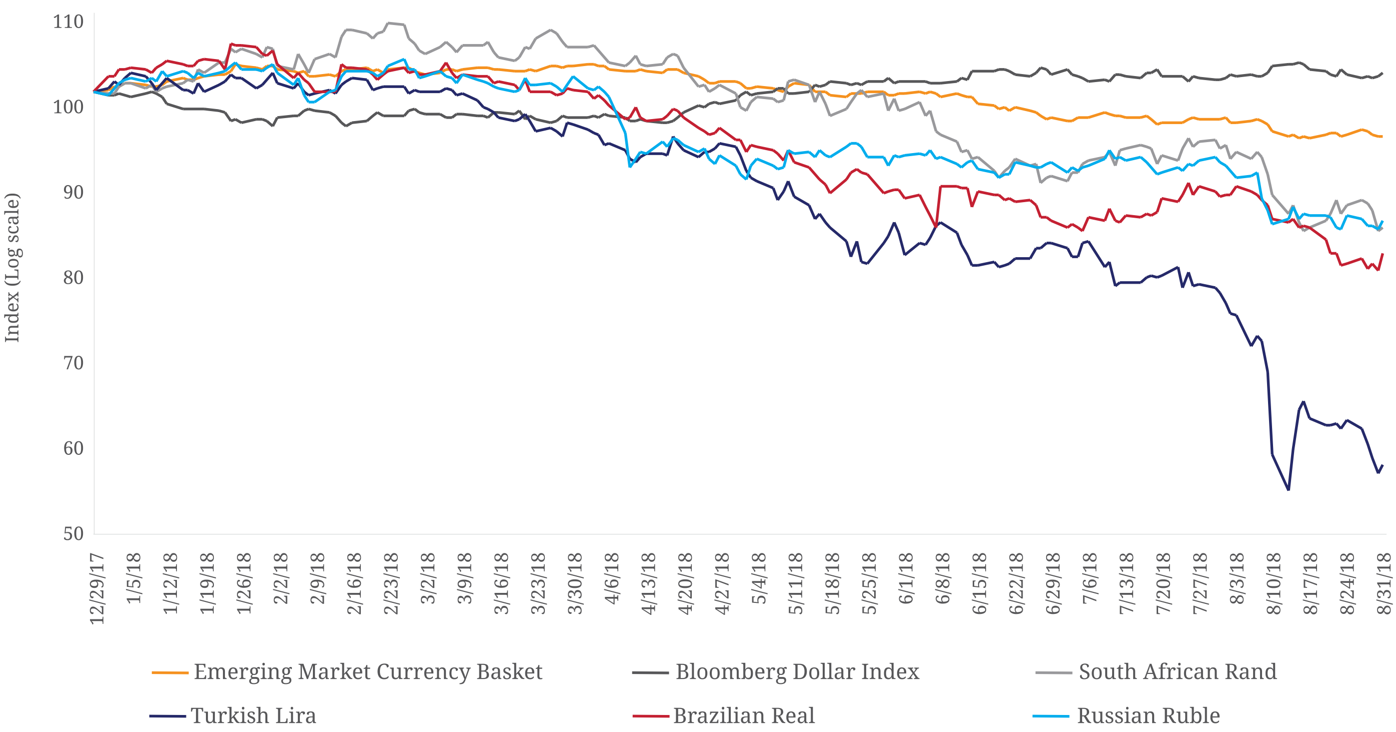
Property fundamentals remain weak in a low-growth environment, with very few signs of recovery in the retail sector. The office sector remains a laggard as oversupply increases. Stocks with their focus in offshore markets are, however, now starting to show some recovery in their share price action.

The near-term outlook remains volatile, but distribution yields are expected to stabilize somewhat for the remainder of the year.

We maintain a diversified mix of property counters in our portfolios. The investment strategy remains focussed in shares that fall within defined quality and liquidity parameters.

LOCAL CURRENCY- The Rand struggled over the month, losing 9.6% against the US Dollar. This was, in part, due to contagion after the Turkish Lira plummeted more than 25% in August after increased fears over Turkish President Recep Tayyip Erdogan and US President Donald Trump locking horns. Over the period, the MSCI Emerging Markets Currency Index dropped approximately 2% in USD. Emerging market capital flows have also been slowing, dropping approximately 11.5% since the beginning of the year according to the Bloomberg Emerging Markets Capital Flow Index. Against other major currencies, the Rand lost 8.54% against the British Pound Sterling, 8.85% against the Euro, and 10.25% against the Japanese Yen.

Chart 1: Emerging Market Currencies against the USD, Source: BLOOMBERG



Local Fixed Income

The month of August turned out to be a positive month for developed markets, as risk-off sentiment drove bond yields firmer. The German 10-year generic yield was down 12 basis points to end the month at 0.33%. The comparative bond in the US also declined 10 basis points, to end at 2.86% while its French counterpart closed the month at 0.68%.

Foreigners turned firmly into net sellers of our local bonds with outflows of R19.7bn for the month of August. The sell-off occurred across the curve with the R186 benchmark bond losing 1.46% for the period. The All Bond index, in turn, was down 1.87%.

Inflation-linked bonds had a quiet month as sufficient demand for this asset class contained any volatility in real yields.

No rate changes are expected in the near term, but the rate hiking cycle is anticipated to commence during the course of next year. This notwithstanding the hawkish tone of Reserve Bank Governor Lesetja Kganyago while delivering the most recent Monetary Policy Committee statement after the decision by the Committee to maintain an unchanged repo rate at 6.5%.

Market Review

Our fixed income outlook for the coming month is detailed as follows:

- Economic growth remains low with most economic indicators showing little signs of robust recovery.
- Currency volatility will continue to be fueled by political and international factors.
- Inflationary pressures caused by higher fuel prices and taxation increases remain a threat, but not sufficiently so to drive yields significantly higher.
- Liquidity is strong with institutional cash portfolio holdings at high levels.
- Short-term technical trends remain positive, while long-term trends are neutral for now.
- Local sentiment is turning negative and remains prone to political risks.

We continue to see value in the longer end of the bond curve with corporate bond issues still offering value in the short-to-medium part of the curve.