

ASSET MANAGEMENT House View



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International Market Overview

Like a record stuck on repeat, the fourth quarter of 2019 was characterised by the usual suspects, namely i) the trade tensions between the US and China which continue to raise fears of a global slowdown, ii) the uncertainty of a no-deal Brexit and iii) the drive to impeach President Trump. All these issues notwithstanding, US markets in general hit record highs during the month of December as well as pulling along the rest of the world on its coattails.

United States of America

S&P 500 higher by 8.53% (28.88% for the year), and the Nasdaq up 12.17% for the quarter and 35.23% for the year. Once again, we saw the US Federal Reserve (The Fed), cut rates by 0.25% at the end of October, the third cut for the year. This was caveated by Fed Chair, Jerome Powell, who hinted that the Fed's market-stimulating rate cuts won't re-occur unless there is a worsening in the economic outlook. Though the

US markets ended 2019 on the front foot, with the Dow Jones up 6.02% for the quarter (22.34% for the year), the

Fed acknowledged the challenges facing the global economy, it noted that the US was still doing comparatively well. The economic data released during the quarter was a mixed bag, as we saw muted GDP growth of 1.9% which was higher than the expected lower consensus number of 1.6% as well as a contractionary reading in the ISM's Chicago Business monitor (the second consecutive print below 50, as well as the lowest since December 2015), while manufacturing output had shrunk for the second quarter, indicating that it is in a recession. November's consumer confidence index dipped to 125.5, its fourth consecutive monthly decline. However, *IHS Markit's* flash purchasing managers

index (PMI) showed that US November manufacturing output accelerated to its fastest pace in seven months, while services activity also picked up more than expected, indicating the continued resilience of the US economy, despite the ongoing trade war and other headwinds. A revised estimate of GDP growth showed an increase of 2.1% in the third quarter of 2019, driven by consumer spending. Consumer confidence dipped again in December (its fifth consecutive decline) coming in at 126.5 as opposed to consensus of 128.2, while the ISM manufacturing index also slid to 47.2 vs the previous reading of 48.1. This marks the fifth straight month of contraction, as well as being the softest reading since 2009.

Europe

European markets followed the US markets stronger as

they ended the quarter on a firmer footing, with the FTSE 100 up by 1.81% for the quarter and 12.1% for the year, the DAX better by 6.61% (25.5% for the year), and the CAC40 up 5.29% for the quarter, and 26.37% for the year. Unlike its US counterpart, the ECB continues to keep rates at ultra-low levels (same as the Bank of Japan), even as the data continued to show sluggish growth in the EU block, with third quarter growth coming in at 0.2%, with the global trade wars weighing on sentiment.

On the European economic

front, the latest *OECD* data pointed to the fact that exports and imports fell across all major European economies on the back of the US-China trade war, Brexit uncertainty and the industrial downturn in the EU's largest economy, Germany. This was mitigated to a degree by economic news in November that the EU's largest economy, Germany, had narrowly avoided a recession. Data also indicate that exports from the EU contracted by 1.8% quarter-on-quarter in the third quarter 2019, with imports having fallen by 0.4% quarter-on-quarter. The EU now forecasts real GDP growth of 1.1% (down from a previous estimate of 1.2%) and inflation of 1.2% this year. To provide some context, the US economy, which is also slowing, is

forecast to grow at twice that rate (+2.2%). The EU continued to warn of the potential for a protracted period of subdued growth and low inflation in the context of high uncertainty, as the factors mentioned above continue to have an impact on nearly every sector of the economy in the Eurozone.

The UK market remained volatile as PM Boris Johnson was forced into seeking a Brexit extension from the EU, culminating in the UK going to the polls on the 12th December as MP's backed his call for an election following the months of Brexit deadlock. He emerged victorious, confirming that the UK would be leaving the EU on the 31st January 2020.

Asia

Asian markets shrugged off the escalating trade tensions between China and the United

States as a resolution seemed to become closer to reality, as well as the protests in Hong Kong, as the Nikkei ended the quarter firmer by 8.74% (18.2% for the year), and both the Hang Seng and the Shanghai Composite were stronger by 8.04%, and 4.99% for the quarter and 9.07% and 22.3% for the year respectively. Like its European counterpart, the

Bank of Japan decided to keep policy rates unchanged.

China's manufacturing activity for October surprised on the upside, as per the Caixin/Markit manufacturing PMI survey which showed that activity had expanded more than expected, coming in at 51.7. This was mitigated, however, by the readings of the more closely watched official October PMI data. This reading generally polls a large proportion of big businesses and state-owned enterprises, and it indicated that key manufacturing activity in

China shrank for the sixth straight month, dropping to a worse-than-expected 49.3 from September's 49.8 (a reading of above 50 indicates expansion and below 50 indicates contraction). This reinforces the view that the Chinese manufacturing sector continues to struggle under a slowing domestic economy, while the long-running trade war is also impacting. This reversed in November as China's factory activity returned to growth as the November PMI print bounced back to 50.2 - its highest level since March.





Local Market Overview

Local Equities

Resources

Resources ended the year on the front foot, with precious metals leading the charge. The JSE Resources Index gained 13.46% over the fourth quarter, bringing its full year return to an impressive 25.32%. Despite issues at its Lake Charles Chemicals Project earlier in the year, Sasol gained 19.92% over the quarter, with stronger oil prices (+8.59% in USD) helping to ease the pain. Gold ended the year at USD1517.27, up 3.04% over the quarter and 18.31% over the year. This helped prop-up gold counters like Sibanye Gold and Gold Fields, up 71.07% and 25.95% respectively over the quarter. Platinum counters continued their meteoric rise over the period, with Impala Platinum and Anglo American Platinum gaining 50.63% and 43.19%, respectively.

Industrials

After falling 2.3% in Q3, the INDI25 Index essentially moved sideways in Q4, gaining a paltry 0.06% in the last three months of 2019. Despite the muted performance from the index, there were some strong gains in a few of the constituent companies over the quarter. The top five industrial stock performers within the INDI25 were: Aspen Pharmacare, which surged 32.5% thanks to the company using the proceeds from asset sales to pay down some debt, Mediclinic International gained 25%, Clicks saw its share price increase 19% due to another strong financial performance for the year, Mr. Price (+15%), followed by British American Tobacco which gained 13% over the quarter. The top laggards in the index which offset this performance were Telkom (-50%), Anheuser-Busch InBev (-18%), MTN (-15%), and the retailers Woolworths (-13%) and Truworths (-9%). Woolworths had a stellar Q3 in which it gained 14.6%, but those returns evaporated in Q4 as a trading update upset investors and hurt the counter. Despite the poor economic conditions in the country, the INDI25 Index managed to gain a pleasing 11% over the 2019 calendar year.

Financials

The Fini15 index was up 1.7% over the final quarter, but down 4.3% for the year. Capitec had another good quarter, returning 12.3% with the rest of the local banks not faring as well, with Standard bank down 3.7%, Nedbank -5.5% and Absa -2.3%. Firststrand was the only one of the local banks to have a positive return over the quarter at 1%. The insurers had a better quarter, with Discovery returning +5.8% and Sanlam +6.1% the best performers. For the calendar year, Capitec was the standout performer with a +29.4% return, on the back of another year of strong results and earnings growth at 20%. The other local banks and insurers had a tough year, with Discovery being the main detractor contributing a negative 24.5% return, followed by Nedbank (-22%), Redefine Properties (-21.8%) and Old Mutual down 12.2%. The financial index lagged the JSE over the year, which returned +8.2%.

Listed Property

The property index gained 0.72% in the fourth quarter of 2019. The standout performers in the quarter were Stenprop (+26%), Sirius Real Estate (+18.5%) and Stor-Age Property REIT (+13%). The laggards in the quarter that offset this performance were Fortress B REIT (-17%) and Fortress A REIT (-7%). The persistent low growth environment has hampered the fundamentals of the property counters. The retail sector is still under pressure, with declining footfall due to the rise of online shopping affecting net rental income received from the property counters. The office sector is not faring much better due to low business confidence. With the low growth environment forecast to persist in the short-term, this sector is expected to continue to struggle. We maintain a diversified mix of property counters in our portfolios. The investment strategy remains focused on shares that fall within defined quality and liquidity parameters. For the calendar year 2019, the Property Index gained a meager 1.9%.



Local currency

The South African rand ended the year on a high note, strengthening by 8.13% over the quarter, with a positive change of 2.63% over the year. Despite the faltering local economy, the rand remained resilient as US geopolitics put pressure on the USD, with uncertainty surrounding trade talks with China. The South African Reserve Bank left rates unchanged at 6.50%, helping to avoid negative pressure on the ZAR if rates were cut. Against other major currencies over the period, the rand appreciated by 5.12% against the EUR and 8.61% against the JPY, while remaining unchanged against the GBP.

Local Fixed Income

Market Review

Fundamentally, South Africa's economic growth remains under pressure. Analysts continue to revise their 2020 economic growth forecasts downwards. We share their concerns. Eskom and other parastatals are a significant risk to the country's fiscus. Hard choices and expenditure cuts are needed to improve the country's fiscal position. Nevertheless, we expect increased issuance by National Treasury, in both nominals and inflation-linked bonds to fund the country's expenses as tax revenue growth remains sub-par.

There is a very high probability that South Africa's sovereign credit rating will be downgraded to sub-investment grade by Moody's. This should see South African bonds being excluded from the FTSE World Government Bond Index which could see further selling of SAGBs.

Notably, although South Africa's fundamentals are poor, South African bonds are cheap and have the steepest yield curve globally. The 10-year bond offers an attractive 9% yield, which is a 4.5% real yield (above inflation). With the potential for increased supply and further selling pressure, we remain cautious and require a high-margin-of safety when buying bonds to be compensated for these inherent risks.



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