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Monthly Market and economic roundup – March 2018

Key points

- **ILB's were the pick of the month followed by nominal bonds while REIT's and equities did poorly**
- **Moody's affirmed SA's credit rating, rating outlook changed to stable, and the MPC cut the repo rate**
- **Inflation declined further to what is probably a cyclical low. It is likely to rise from here**

Asset class returns

The local bond market continued its strong run (+2.1%), recording its 4th consecutive month of positive returns as National Treasury announced the scaling back of its weekly nominal (-R900m) and ILB (-R300m) auctions.

Inflation-linked bonds, after lagging nominal bonds for most of the last two years, rebounded strongly (+4.4%) as the real policy (repo) rate declined after the SARB's repo rate cut and the inflation cycle has probably bottomed.

The domestic equity market did not benefit from the improved domestic economic outlook as global equity markets came under pressure and some of the bigger counters (Naspers in particular -11.6%) sold off.

Table 1 – SA Asset Class Returns – March 2018[1]

	1 month	YTD	6 month	12 month
Money market	0.56%	1.75%	3.57%	7.41%
Bonds	2.07%	8.05%	10.45%	16.23%
ILB	4.38%	4.15%	5.20%	7.68%
Property	-0.96%	-19.6%	-12.9%	-7.09%
Equities	-4.18%	-5.97%	1.03%	9.60%
Rand/USD$	-0.57%	4.38%	1.03%	13.07%

Source: *Bloomberg and Granate AM calculations*

Key market events

Moody's confirmed South Africa's investment grade credit rating at Baa3. In explaining its decision, Moody's points to the prospects of a gradual reversal of the previous deterioration of SA's institutions; improved growth performance and prospects; and the 2018 Budget that would stabilise and eventually reduce the debt burden.

The market was particularly encouraged by Moody's surprise decision to change the rating outlook from negative to stable reflecting "…a careful balance of risks. The new administration faces equally significant opportunities and challenges".

The SARB MPC met towards the end of the month and decided to cut the repo rate by 25 basis points to 6.5%. The rate cut was a close call (3 of the 7 members voted to keep it unchanged) and was accompanied by a hawkish statement which suggests that this might be the last rate cut this year.

Key economic data[2]

Inflation: CPI slowed in February to a year-on-year (y/y) rate of 4.0% (January: 4.4%), matching the previous cyclical low of March 2015. 9 of the major 12 categories recorded a y/y decline in inflation, with transport seeing the largest decline from 4.4% to 3.2% due to a cut in petrol price. The y/y increase in food and non-alcoholic beverages slowed further, registering its lowest rate (3.9%) since December 2013.

The stronger rand and weak demand suggests that inflation will remain low for a while. However, base effects and the 1% increase in VAT (which becomes effective on the 1st of April), means that inflation has probably bottomed in the 1st quarter.

Economic growth: The economy grew by a quarter-on-quarter annualised rate of 3.1% (1.9% y/y) in the 4th quarter, after recording an upwardly revised 2.3% growth rate in the 3rd quarter. The primary sector (mainly agriculture) remained strong, but encouragingly, both the secondary (manufacturing) and tertiary (trade) sectors, rebounded.

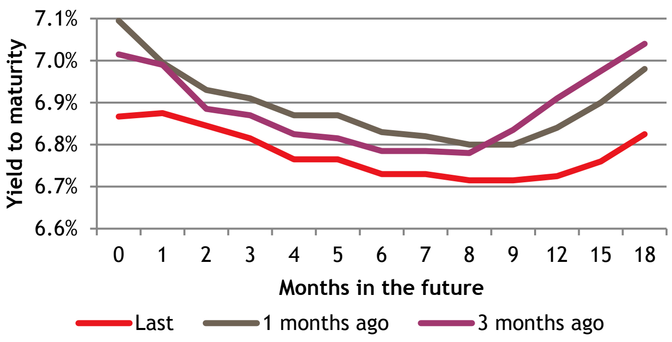
Q1 2018 data has been, on balance, encouraging. PMI's, business and consumer sentiment, and mining production have improved while manufacturing production and retail sales have softened, albeit from a strong performance in Q4 2017.

[1] Money market - STEFI composite; Bonds- ALBI; ILB - CILI; Property - JSE SA Listed Property index; Equities – JSE All Share Index

[2] Comments on economic data released over the last calendar month

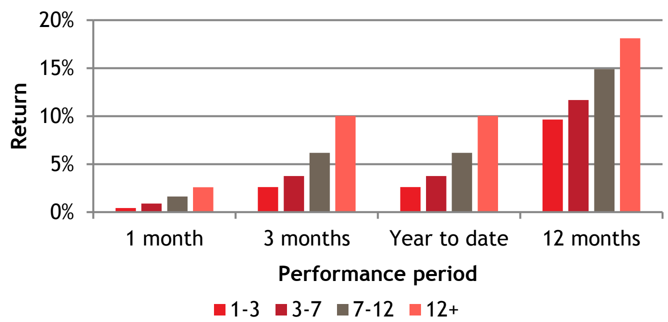
Income Assets Performance and Outlook

Figure 1- Market expectations of path of repo rate



Money market – The MPC's decision was widely expected and priced in. Prior to the meeting the market was pricing in two 25bp rate cuts. However, given the hawkish MPC statement and the focus on the middle of the inflation target band (4.5%) being where the SARB wants inflation expectations to settle, the market is now pricing in "only" a 60% chance of a further 25bp rate cut. With underlying data suggesting a more dovish MPC statement it is difficult to see what it will take for further rate cuts – maybe a favorable outcome in the public-sector wage negotiations.

Figure 2 - Bond market sector returns

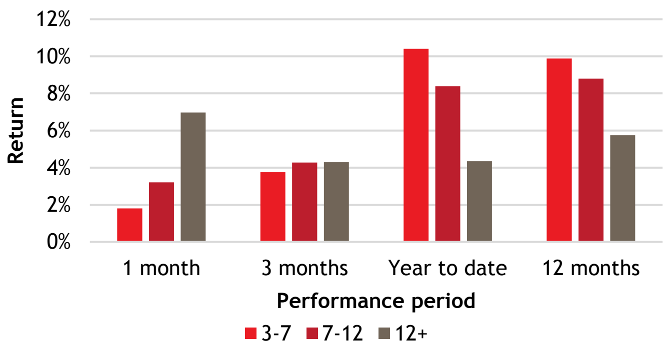


Nominal bonds - The bond rally continued in March with the yield curve bull flattening further after a short-lived pause earlier in the month.

The yield on the 1-3 sector of the yield curve ended the month slightly higher, but still managed a positive return (0.43%) while the yield on the 12+ sector of the yield curve fell by 20bp to return 2.6%.

At current levels, our bond valuation models suggest that the local bond market is offering no risk compensation.

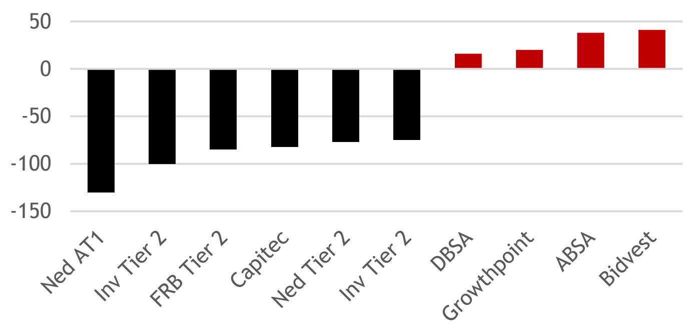
Figure 3 - Inflation-linked bond market sector returns



Inflation-linked bonds (ILB) - The asset class had its second best monthly performance in over 6 years as National Treasury cut the size of the monthly auction by a 1/3rd and the falling policy rate combined to make the asset class more attractive.

As with the nominal curve, but to a greater extent, the ILB curve flattened. The yield on the I2050 (longest) declined by 39bp to return 9.7% compared with the yield on the R212 (shortest) which fell by 15bp to return 1.2%.

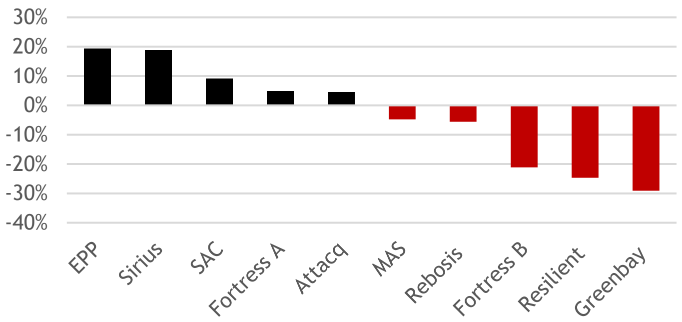
Figure 4 - Corporate Bond moves



Corporate Bonds – This month saw notable credit spread narrowing in Tier 2 sub debt across most of the banks. Nedbank held a Tier 2 sub debt auction during the month which priced 70bps tighter than the same auction 10 months earlier. The pickup of buying a Tier 2 bank bond over a senior bank bond has declined over the recent months.

There was marginal credit spread widening among certain corporates.

Figure 5 - Property stocks: best and worst in March



Source for all figures: Bloomberg, JSE and Granate AM calculations

Listed property (SAPY) – had another poor month (-0.96%) underperforming all other asset classes but equities.

Resilient's group of companies' underperformance was the main driver behind the SAPY performance despite the announcement by Resilient and Fortress of plans to restructure the Siyakah Trust. French Mall operator Klepierre offered to acquire Hammerson for £4.9bn in an attempt to break up the UK property firm's agreed acquisition of Intu. Hammerson's board rejected the deal. The share price rallied by 24% on the announcement.

Table 2 - Selected markets returns (to end March 2018)

Global markets	1 Month	3 Months	YTD	12 Months
MSCI Global Equity (USD)	-2.5%	-1.8%	-1.8%	11.2%
MSCI Global Equity	-2.6%	-2.7%	-2.7%	7.7%
MSCI Emerging Market (USD)	-2.2%	0.9%	0.9%	20.3%
MSCI Emerging Market	-2.2%	0.2%	0.2%	18.0%
S&P 500	-2.5%	-0.8%	-0.8%	14.1%
Nasdaq *	-2.9%	2.3%	2.3%	19.8%
Bloomberg European 500 *	-2.2%	-4.2%	-4.2%	-1.3%
Nikkei 225	-3.4%	-6.3%	-6.4%	12.2%
Global Bonds (Local currency)	1.1%	0.3%	0.3%	1.6%
EM Bonds (Local currency)	0.8%	3.0%	2.5%	7.9%
Commodity prices (%)	**1 Month**	**3 Months**	**YTD**	**12 Months**
Brent Oil spot (USD/barrel)	7.4%	3.6%	3.6%	34.0%
Platinum spot (USD/oz)	-5.2%	0.2%	0.2%	-2.4%
Gold spot (USD/oz)	0.5%	1.7%	1.7%	5.7%
Copper spot (USD/tonne)	-3.1%	-7.3%	-7.3%	13.5%

SA equity sectors (%)	1 Month	3 Months	YTD	12 Months
FTSE: All Share	-4.2%	-6.0%	-6.0%	8.8%
FTSE: Top 40-TOPI	-4.3%	-6.3%	-6.3%	10.4%
FTSE: Resource 20	-1.3%	-2.7%	-2.7%	13.9%
FTSE: Industrial 25	-5.6%	-8.7%	-8.7%	5.9%
FTSE: Financial 15	-3.7%	-1.1%	-1.1%	21.5%
Currencies	**1 Month**	**3 Months**	**YTD**	**12 Months**
ZAR per USD	-0.4%	4.6%	4.6%	10.2%
ZAR per EUR	-1.2%	2.0%	2.0%	-3.6%
ZAR per GBP	-2.2%	0.7%	0.7%	-2.3%
USD per EUR	-0.9%	-2.4%	-2.4%	-12.5%
JPY per USD	0.2%	5.9%	5.9%	4.3%
USD per GBP	-1.8%	-3.6%	-3.6%	-11.3%

Source: Bloomberg, JSE, Citibank and Granate AM calculations * Excluding Dividends

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