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Monthly Market and Economic Roundup – April 2018

Key points

- **Listed property had a strong month, but remains a significant laggard on a 12-month basis**
- **US Treasuries sold off and EM's remained relatively resilient, but a flattening US yield curve could become a problem for risky assets**
- **Inflation surprised on the downside in April, but (mild) pressures are starting to build**

Asset class returns

The local bond market gave back a small part of its recent gains losing 0.7% in April as global bond yields rose, the rand lost 5% against the US$, and the oil price rose by 8.2%.

After–a-particularly bad start to the year, the listed property sector rebounded strongly (+7.7%) in April to outperform all other domestic asset classes as some of the sector heavyweights recovered.

Inflation-linked bonds continue their uncharacteristically volatile run, performing worse than any other sector in April after recording the best performance in March. Inflation-linked bonds remain the only asset class to return negative real returns over the last 5 years.

The domestic equity market bucked the global trend, outperforming most major markets, driven predominantly by rand hedge and commodity stocks.

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

	1 month	YTD	6 month	12 month
Money market	0.62%	1.74%	2.39%	7.47%
Bonds	-0.70%	5.34%	7.30%	13.75%
ILB	-2.62%	2.75%	1.38%	3.63%
Property	7.68%	-3.9%	-13.4%	-0.45%
Equities	5.40%	-0.99%	-0.90%	11.45%
Rand/USD$	-4.98%	-4.89%	-0.63%	7.30%

Source: *Bloomberg and Granate AM calculations*

Key market events

After many months of local events moving domestic markets, global events dominated in April. In particular, US Treasuries sold off, with the yield on the 10yr bond rising by 21bp, breaching the 3% mark for the first time in over 4 years. The selloff was driven by further evidence of rising wages and increasing oil prices which led to concerns that the US Federal Reserve might be inclined to raise its lending rate 4 more times before the end of the year as inflation expectations rise above 2%. While emerging market bonds held up relatively well in April (+0.7%) appetite for risky assets will soften as the US yield curve flattens and growth slows later in the year.

Key economic data[2]

Inflation: CPI slowed further in March to a year-on-year (y/y) rate of 3.8% (February: 4.0%), its lowest rate since February 2011. The outcome was 0.3% lower than market expectations, the largest "forecast error" in the current inflation down-cycle. The largest contributors to the decline in the y/y rate of inflation were a further slowdown in food (3.5%) and fuel (2.9%) prices.

While demand-pull inflation remains subdued, upward pressure will start building over the next few months. The fading favorable base effects and significant increases in fuel prices (which by July could contribute 0.75% to inflation from 0.1% in March) together with an increase in several indirect taxes mean that inflation will increase.

Economic growth: Manufacturing production declined in February by a seasonally adjusted (S/A) m/m rate of 2.4% while mining production increased by 0.9%. Their 3-month annualized growth rates were 0.8% and -9.2%, respectively, suggesting that both sectors have grown at a substantially slower pace than the first two months of the previous quarter.

While Retail sales growth accelerated in February the annualised quarterly increase shows a significantly lower contribution to GDP in 1Q18. Overall, available data suggests that growth in 1Q18 has slowed from the previous quarter.

[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

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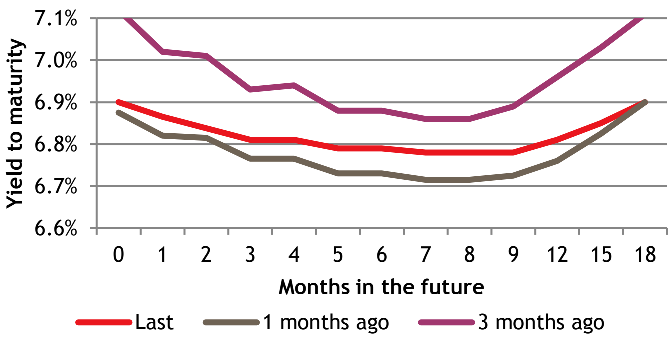
Income Assets Performance and Outlook

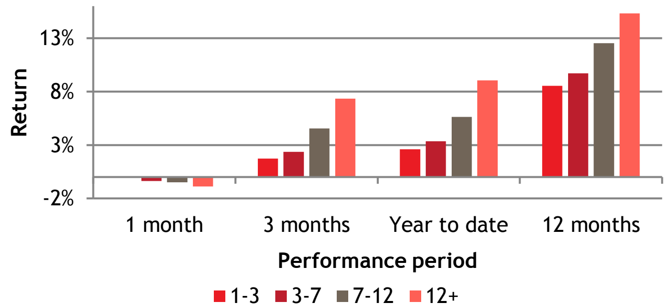
Figure 1- Market expectations of path of repo rate



Money market – Despite the lower than expected domestic inflation in April the market is pricing in a lower probability of further rate cuts this year than it did a month ago.

A weaker currency, higher international oil prices (which in rand increased by 13.2% in April), rising global policy rates, and an MPC that is increasingly focusing on an inflation target of 4.5% suggest that, barring a significant improvement in the inflation outlook (with a focus on wage settlements), the SARB will keep the repo rate at 6.5% for the foreseeable future.

Figure 2 - Bond market sector returns

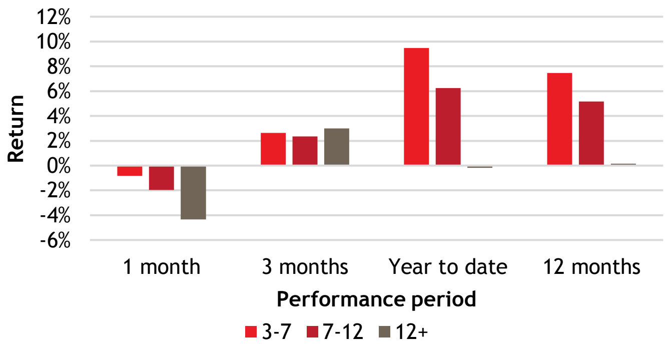


Nominal bonds - The bond rally stalled in April after a spectacular run over the previous 4 months.

The yield curve flattened, longer dated bonds still benefiting from the lower supply while the short end starts to price out further repo rate cuts.

Despite the back-up in yields over the month, the market remains slightly expensive suggesting that, with little coupon flows in May, investors will be reluctant to enter the market at current levels.

Figure 3 - Inflation-linked bond market sector returns

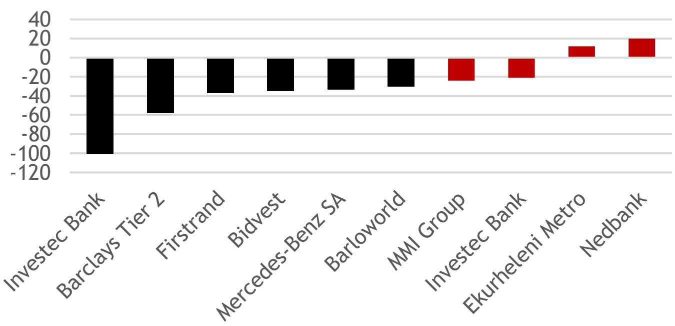


Inflation-linked bonds (ILB) – returned to their familiar position as the worst performing domestic asset class.

Recent yield lows in March were clearly overdone, particularly at the long end of the curve, and the strong message from the SARB that it is willing to keep real policy rates higher than they have been for a while resulted in a correction in real yields.

The ILB curve steepened again (the spread between the 2022 and 2050 bonds) by 10 basis points.

Figure 4 - Corporate Bond moves



Corporate Bonds -yield spreads narrowed further during April in both the banking and corporate sectors. Consumer and business confidence indicators are picking up and there is strong investor demand for companies which benefit from this.

There were very well supported corporate auctions in the primary market during the month of April which were more than 3 times oversubscribed.

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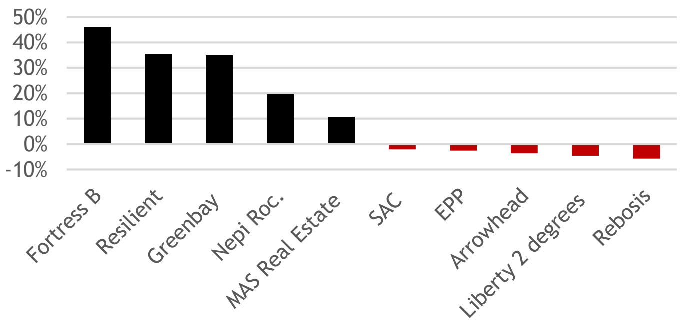
Figure 5 - Property stocks: best and worst in April



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

Listed property (SAPY) – rebounded (7.68%) after a poor 1st quarter, outperforming all other domestic asset classes.

Resilient's group of companies was the main driver behind the SAPY performance after it was cleared of the damning allegations by the independent investigator. The FSB/JSE Investigation into share price manipulation is ongoing.

French Mall operator Klepierre withdrew it's £4.9bn offer to acquire Hammerson after the board rejected the deal. Furthermore, Hammerson's board is now recommending that its shareholders vote against the Intu Transaction.

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

Global markets	1 Month	3 Months	YTD	12 Months
MSCI Global Equity (USD)	1.0%	-5.8%	-0.8%	11.1%
MSCI Global Equity	1.8%	-4.6%	-1.0%	8.7%
MSCI Emerging Market (USD)	-0.4%	-6.7%	0.5%	19.1%
MSCI Emerging Market	1.2%	-4.7%	1.4%	18.0%
S&P 500	0.4%	-5.7%	-0.4%	13.3%
Nasdaq *	0.0%	-4.5%	2.4%	16.8%
Bloomberg European 500 *	3.7%	-2.7%	-0.7%	0.1%
Nikkei 225	6.2%	-2.7%	-0.6%	19.3%
Global Bonds (Local currency)	-0.5%	0.6%	-0.2%	0.6%

Commodity prices (%)	1 Month	3 Months	YTD	12 Months
Brent Oil spot (USD/barrel)	8.2%	10.0%	12.0%	47.2%
Platinum spot (USD/oz)	-3.0%	-9.3%	-2.8%	-4.4%
Gold spot (USD/oz)	-0.8%	-1.7%	1.0%	3.7%
Copper spot (USD/tonne)	1.4%	-3.4%	-6.1%	18.6%

SA equity sectors (%)	1 Month	3 Months	YTD	12 Months
FTSE: All Share	5.4%	-1.1%	-0.9%	11.4%
FTSE: Top 40-TOPI	5.8%	-1.3%	-0.9%	12.3%
FTSE: Resource 20	9.4%	2.0%	6.5%	21.6%
FTSE: Industrial 25	5.8%	-3.8%	-3.5%	6.7%
FTSE: Financial 15	3.0%	5.0%	1.9%	24.2%

Currencies	1 Month	3 Months	YTD	12 Months
ZAR per USD	-5.0%	-4.0%	-0.6%	7.3%
ZAR per EUR	-3.2%	-1.4%	-1.3%	-3.2%
ZAR per GBP	-3.3%	-1.3%	-2.6%	0.9%
USD per EUR	1.8%	2.7%	-0.6%	-9.8%
JPY per USD	-2.7%	-0.5%	3.1%	2.0%
USD per GBP	1.9%	2.8%	-1.8%	-5.9%

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

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