Seed Market Overview

28 February 2019

Local Market

On the 29th of March, Moody's will announce the results of its review of South Africa's sovereign debt ratings. Moody's is the only major ratings agency that has not already downgraded South Africa's sovereign debt to junk. Currently, Moody's has South Africa's rating at Baa3, one notch above sub-investment grade. The outcome of the review might be any of the following:

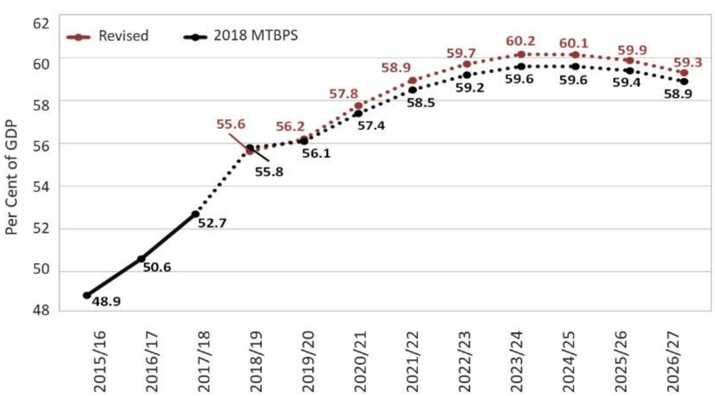
1) Keep the rating the same with a stable outlook (i.e. no downgrade likely in the next 12-18 months)
2) Change the outlook to negative (i.e. possible downgrade within 12-18 months)
3) Place S.A. on a ratings watch (i.e. review for a downgrade within 3 months)
4) Downgrade

A cut to South Africa's credit rating would see government bonds ejected from the World Government Bond Index with estimated outflows from the bond market of between $ 8bn and $ 10bn. However, it seems unlikely that South Africa will be downgraded or receive a negative outlook on the 29th, although a postponed downgrade would still remain a possibility.

Moody's rating methodology focuses on economic, institutional and fiscal strength, as well as the susceptibility to event risk. After Finance Minister Tito Mboweni's maiden budget, Moody's highlighted further fiscal deterioration, as illustrated in **Chart 1** (below), as a credit negative. However, with their methodology not considering specific debt thresholds, and with South Africa having a favourable debt structure, the probability of a ratings action has diminished until later in the year, or in 2020.

Uncertainty on the ratings action, the upcoming election and problems at state-owned enterprises continue to impact investor sentiment. Some market analysts believe the uncertainty adds as much as 10 to 12 basis points to bond prices. In February, the All Bond Index lost 0.4%. The local bond market responded positively to the budget speech, but the gains were not enough to offset the pre-budget losses. The Rand gave up on some of its January gains, while the FTSE/JSE All Share Index fared better, gaining 3.4% on the back of strong gains in Richemont, Naspers and BHP Billiton.

Chart 1: Gross Debt-to-GDP Outlook Showing Further Deterioration



Source: National Treasury (28/02/2019)

Global Market

Global equities rallied for a second consecutive month. The market was more positive on the prospects of a resolution to the U.S./China trade tension and the Brexit stalemate. The MSCI All Country World Index gained 2.7% with developed markets outperforming emerging market peers. The S&P 500 gained 3.1% as investors were appeased by the good earnings results for Q4 2018, and also the news of a delay in tariff implementation on Chinese goods.

The MSCI World Index (developed markets) rose 3.0%, while the MSCI Emerging Market Index delivered a muted 0.2% gain. Emerging markets experienced mixed fortunes during the month, with key markets like Brazil, India and Russia weaker. The Chinese market, on the other hand, had a very good month, recording strong gains. The MSCI China A Shares Index rose 15.3%, while the CSI 300 (Shanghai-Shenzhen Composite) gained 14.9%.

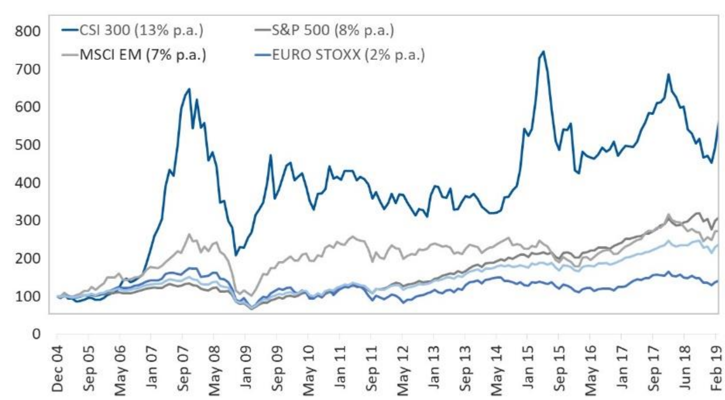
The weight of trade wars and deleveraging in China eased during the month. Positive talks between U.S. and China paved the way for the U.S. to suspend a pledge to increase tariffs on $ 200bn worth of Chinese imports. Furthermore, China revealed a shift in focus from the nation's debt pile towards shoring up growth, with signs that the two-year deleveraging drive is over.

The Chinese equity market has traditionally been a volatile, but rewarding, market. **Chart 2** (below) illustrates the growth of the CSI 300 Index relative to other major indices since January 2005. The CSI 300 Index outperformed the MSCI World by 6.8% per annum, but with significantly more volatility. On a risk adjusted basis, the Chinese market performed better.

The Chinese market is attractive, with investors wanting to share in China's economic growth story. Fundamentals are favourable, with valuations indicating that the market is still fairly cheap compared to global equities.

There is a potential for a massive outperformance, and also underperformance, as illustrated in **Chart 2** (below).

Chart 2: Global Market Index Annualised Returns (USD Jan 2005 – Feb 2019)



Source: Morningstar Direct (28/02/2019)

Asset Class (ZAR)	MTD	YTD	1 Year	3 Years	5 Years	10 Years
Local Equity	3.4%	6.3%	-0.9%	7.3%	6.6%	15.0%
Local Property	-5.7%	3.0%	-5.2%	-0.6%	6.9%	12.9%
Local Bonds	-0.4%	2.4%	4.2%	10.4%	8.4%	8.5%
Local Cash	0.5%	1.1%	6.6%	6.9%	6.4%	6.1%
Global Equity	8.8%	8.3%	18.1%	7.7%	12.2%	16.6%
Global Property	5.8%	8.2%	36.7%	3.0%	13.1%	20.2%
Global Bonds	5.0%	-1.8%	18.1%	-3.2%	6.2%	6.0%
Global Cash	6.2%	-1.9%	21.7%	-3.2%	6.4%	4.0%

Compiled by Seed Investment Consultants (Pty) Ltd, a licensed Financial Services Provider (2346). Data and illustrations reflect market data as at 28 February 2019.
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Seed Local Review

Equity

The JSE All Share's solid 3.4% return in February means that local equities are now up 10.8% over the last three months. Resources (8.0%) outperformed as Platinum Group Metal miners surged, while Financials (-2.1%) lagged. The Industrials sector (4.1%) also performed well, as many rand-hedged counters benefitted from a weaker rand. Despite the partial recovery over the last 3 months, and only moderate growth in underlying earnings, our models are still showing reasonable value. We are maintaining our equity allocations at levels close to benchmark.

Property

The S.A. Property Index gave up 5.7% in February, as the sector remains under seige from various external factors. The high debt levels and liquidity problems within the Edcon group, a major tenant in many retail REIT portfolios, remains the chief concern. Furthermore, Delta Property's share price declined sharply on news that government is delaying the renewal of its leases. In current conditions, a property portfolio with a very attractive one year forward yield of 14.4% can be constructed, although the growth on this yield will be lower than inflation. Our valuation models continue to indicate a maximum weighting, despite the risks of expected distributions not materialising.

Bonds

The ALBI returned -0.44% this month, but remains the top performing local asset class over 3 years (+10.4%) and 5 years (+8.4%). The benchmark R186 bond (8.8 years to maturity) currently yields 8.69%, while the 10 year rate is at 9.06%. The relationship between nominal and inflation-linked yields puts estimated inflation at 5.5%. Our valuation model indicates that bonds are fairly valued, but practically we continue to take duration risk in the Property sector in our funds.

Cash

Annual inflation is now at a very low 4.0%, down markedly from January's 4.5% and at the lower end of the SARB's target band. Minister Mboweni's budget speech was sensible but brutally honest, and markets were not surprised that the S.A. Debt-to-GDP ratio could peak at 60% over the next 4 years. Cash currently delivers a very attractive 3.2% real yield. We appreciate the optionality in cash, but recognise that several other asset classes offer more value at the moment. As a result, we remain neutral.

Seed Global Review

Currency

The rand weakened in February, alongside most Emerging Market currencies, in a reversal of January's strength. The ZAR closed at R 14.09/$ from a R 13.25/$ starting point, and has continued to weaken further into March. The USD strengthened as the intensity of the U.S./China trade conflict seems to abate. At month end, the ZAR was 4% under valued against the trade weighted basket of currencies on a purchasing power parity basis. Significantly, the ZAR is 23% undervalued versus the USD using the same methodology.

Equity

Global markets built on January's rally during February, with the MSCI ACWI up 2.7% and the S&P500 gaining +3.2%. Emerging Markets lagged, with the exception of the MSCI China A Onshore index which delivered an excellent 15.3% on signs that China's drive towards deleveraging might be over. The U.S./China trade war might come closer to resolution as the U.S. suspended further tariff increases for now. We maintain our global equity ranking at overweight, but continue to favour allocation to high quality stocks.

Fixed Income

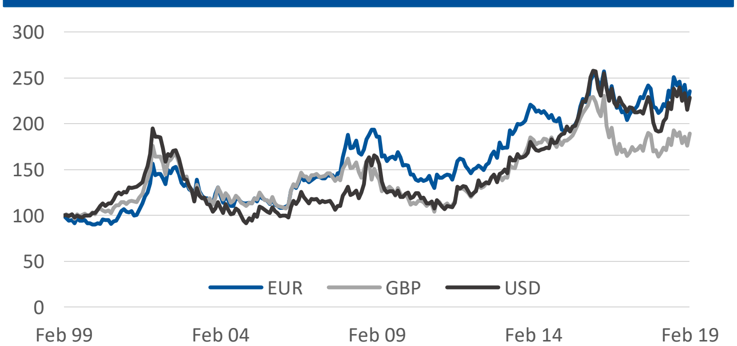
The yield on the U.S. 10 year treasury bond increased from 2.63% to 2.72% this month. However, US bond yields remain depressed, with inflation expectations kept in check by a low oil price and weak growth in other developed markets. The Fed, which has taken a more dovish stance since January, is expected to keep rates unchanged for all of 2019. BCA Research opines that the Fed will stay on hold for around 6 months to ease market jitters, but will then raise rates 2 or 3 times during the remainder of 2019 to curb inflation.

Alternative

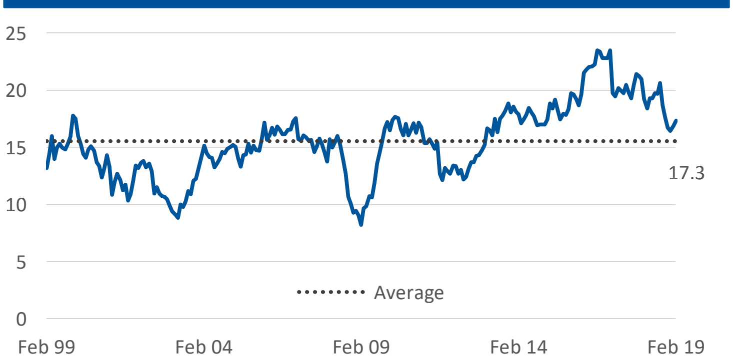
Other asset classes that can be considered include structured notes, private equity, direct real estate, commodities, and hedge funds and can provide investors with uncorrelated returns. However, as interest rates are slowly but surely rising, these alternative investments do become less attractive. These assets can perform a useful role in multi asset portfolios, as they help provide more consistent returns.

ZAR vs USD

Currencies vs ZAR (rebased to 100)



ALSI vs PE Ratio



SA Government 10 Year Bond Yield