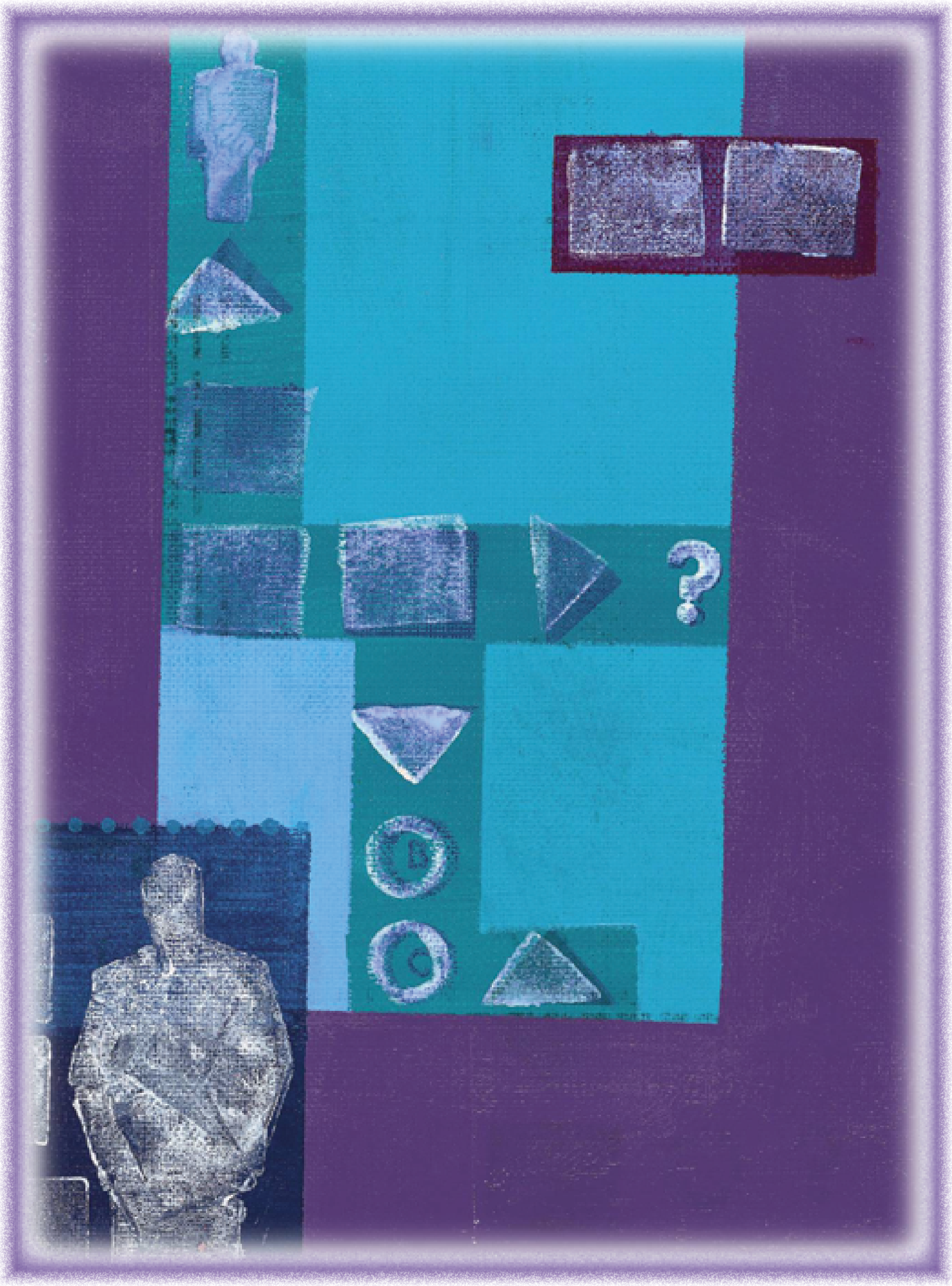
GTC

Formerly Grant Thornton Capital

Trendline

June 2013



Markets react to SA's weak outlook

A slew of economic data released in June 2013 showed South Africa as moving deeper into economic weakness following a slower than expected growth outlook while imports have continued to exceed exports. The trade deficit account has remained in negative territory for the past 17 months and the year to date deficit stands at R68.7bn, compared to the R46.2bn deficit for the first five months in 2012.

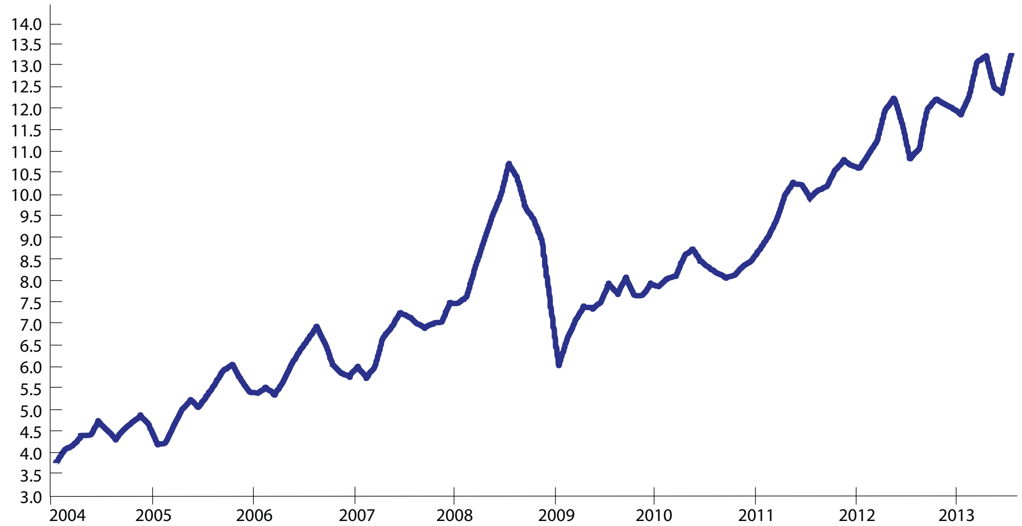
Although there has been a marginal increase in exports during May 2013, (0.8% month on month), the longer term trend has been far lower than the increase in imports. At the same time, the current account deficit hovers around 6% of GDP. The last time the current account was positive takes us 10 years back, to Q1 2003!

The news of the petrol price increase of R0.84/litre on 3 July 2013 was also a concern for consumers as the fuel price impacts goods and services across the spectrum. The estimated contribution to petrol inflation is 6.8% which implies about 0.04% to the monthly inflation rate.

Consumers, who are already feeling the pressure of higher imported prices will now need to increase their transport budget. The increase in short term, unsecured lending is evidence of consumers struggling to make ends meets.

The chart below shows the change in the petrol price between 2004 and 2013. The trend is upwards, but the impact of Rand weakness is shown during 2008, when the petrol price spiked to above R10/litre, before retreating to around R6/litre several months later, as the Rand strengthened.

Less than R4/litre less than 10 years ago!



Source: Stanlib

Market performances

The adage “Sell in May and go away” didn’t work for most of May 2013, but had you sold your equity exposure on 1 June 2013, you would have saved 5.7% (ALSI), as the market crashed through the 40 000 level to around 38 000. Although the market recovered some of its earlier losses, the impact was deep, leaving investors with a negative return for the month and quarter and barely positive for the 6 month period.

Equity market sectors behaved irrationally during the month of June, with resources falling a further 13% and financials and industrials declining around 3%. The resource sector recovery seems a distant promise, while financials and industrials lighten the burden.

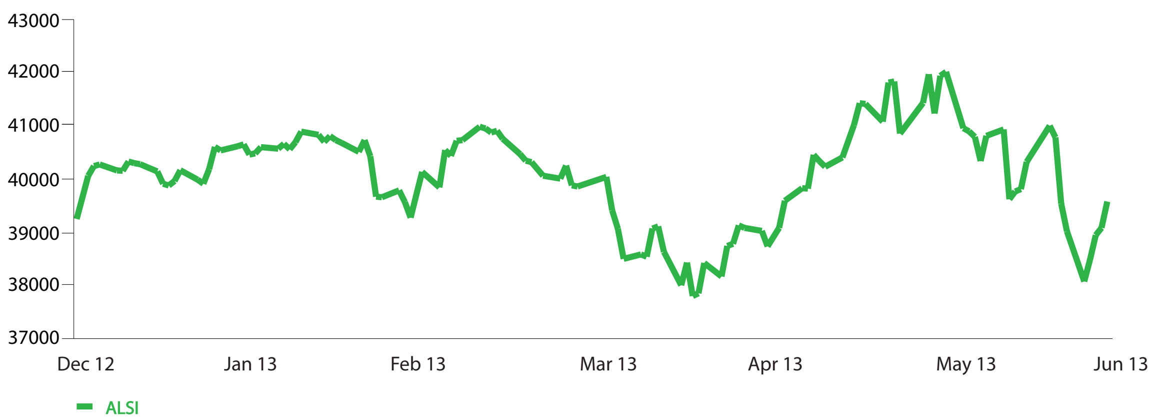
The sectors that performed poorly include gold mining (-19.8%), general mining (-15.2%) and platinum mining (-12.4%). The sectors that added to performance included fixed line telecommunications (+11.4%) and pharmaceuticals (+6.8%).

Market volatility has increased sharply, following a sell-off in the local bond and listed property sectors in May 2013. Although listed property achieved a modest recovery of 4.4% in June, the yields in the fixed income market continued to rise, which has led to massive capital losses for bond market investors, about 40% of which are foreigners.

These offshore investors looked to emerging markets for yield pick-up in the fixed income space as their own developed markets were only delivering around 1.5% annualised for 10 year investments. South Africa, meanwhile gave investors a yield of 8% (as at April 2012) for the same investment duration.

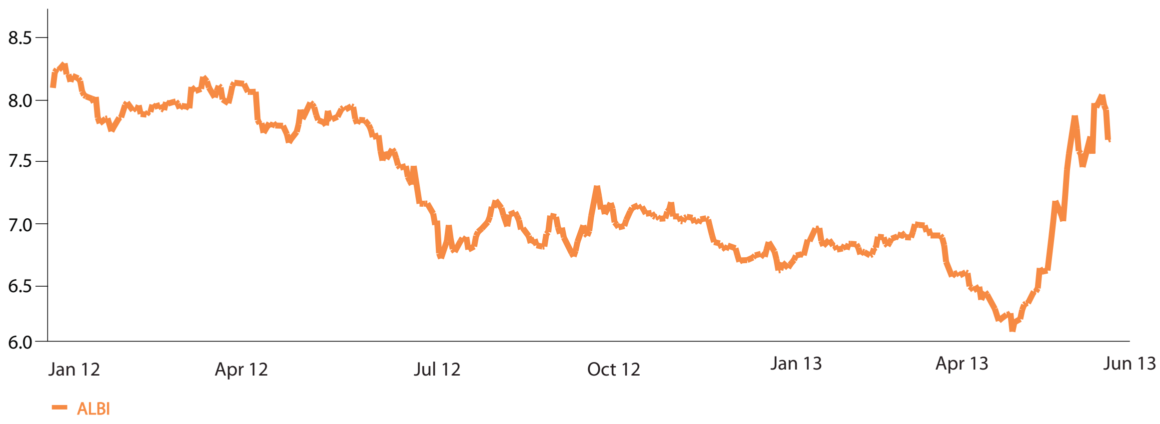
During the latter half of 2012, the Rand had weakened beyond R8/USD, and foreign investors were comfortable with the currency risk, given the level of additional yield. This year, the tables have been turned. These same investors have realised substantial losses from the increase in yield and Rand depreciation and have applied their “stop loss” trades to limit the extent of capital erosion.

Local equity performance - year to date June 2013



Source: GTC and I-Net

10 Year bond yields spike of 2% in six weeks



Source: GTC and I-Net

The result – 10 year bond yields have spiked from around 6.2% to over 8%, in the space of just 6 weeks. Local investors have now returned to the bond market as their threshold for investment (CPI+2%) has been reached, but their participation is limited to the extent of further weakness in bond prices. For this reason, these investors are marginally increasing their exposure which would allow them to also take advantage of further increases in bond yields through longer duration assets.

Local listed property suffered a similar fate in May 2013, when investors realised the extent to which the property market had increased and the risk associated with their exposure. The listed property sector sold off sharply on the back of a change in investor sentiment and currency weakness.

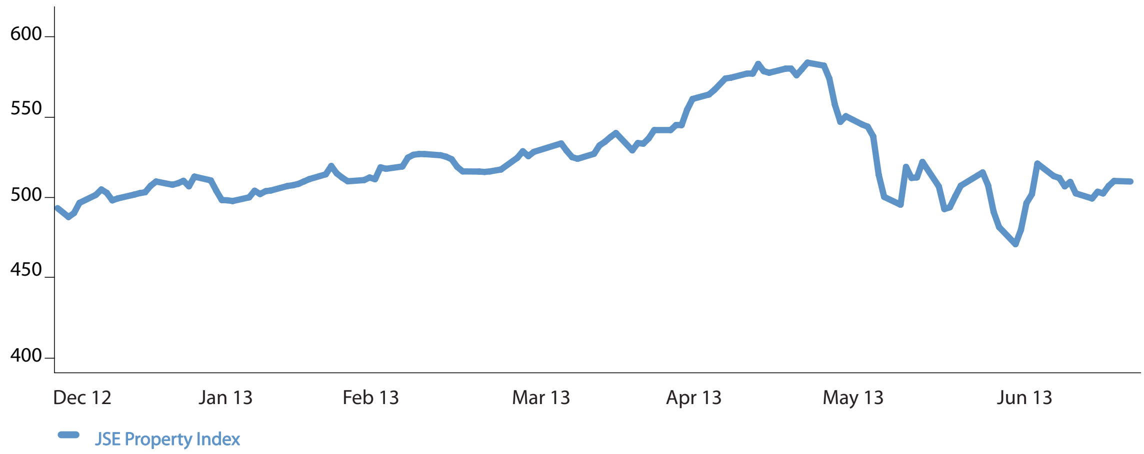
Over the past few years, listed property has been a key source of return for balanced portfolios, but the level at which these shares were trading implied an increased risk to capital loss. In 2012 alone, the listed property sector added over 35%, but a recent change of country risk premium, caught investors on the back foot and led to a loss of over 11% in the month of May.

The main driver of property performance in recent years has been the rental yields that have been achieved by good quality property businesses. This same principle was applied to the lesser quality graded properties which increased the relative value of these businesses. As expected, the vacancy levels in the larger regional shopping centres has reduced as international brands have entered our market and are eagerly seeking quality locations.

At the other end of the property spectrum the neighbourhood shopping centres have experienced high vacancy levels as these centres represent the small business environment supported by an anchor tenant, usually a supermarket. These destinations are less attractive to bigger businesses and foot traffic is reducing, which has caused the increase in vacancies. The listed property market remains expensive relative to investments in other yield based assets.

In the office market, triple A grade offices in Sandton CBD are in short supply, which in part explains the continuous construction of new buildings with increased floor space. Tenants are also looking for new-age offices that incorporate environment factors such as natural light, natural heating and cooling, building constructions with environmental friendly products. Property businesses with these types of properties have justifiably been ahead of the curve and deserve the premium rentals achieved.

JSE Property Index



Source: GTC and I-Net

Further down the line the B and C grade offices are plentiful due to the migration to Sandton and other new city CBD's. All businesses have visions of strong brands and business image which is the attraction to developed business nodes. Unfortunately, this has had a negative impact on rental yields in other areas and vacancy levels have increased. Some property companies have decided to sell properties with low occupation levels, in order to boost their overall occupation numbers.

Investments into the property sector should therefore be based on facts and figures of specific property businesses rather than blind investment faith in the index.

The volatility of the Rand

In recent months, the Rand has weakened beyond the levels of the 4 year low (R10.24/USD), climbing to R10.36/USD in June 2013. The panic driven depreciation was a result of foreign investors exiting South Africa in favour of less volatile emerging markets.

The main issues facing South Africa at this time include the continued threat of wild cat strikes, unreasonable wage demands, restrictive labour laws, political uncertainty, volatility of the Rand, increasing current account deficit, dependency on imported products, low export growth, and a declining consumer spending trend. Although this list is not exhaustive, these remain the key issues of impartial foreign investors.

To an outsider, South Africa looks less attractive as an investment destination than other emerging markets that have shown significant economic growth and have a stable investment environment. This is the main reason for not attracting Foreign Direct Investment (FDI) where businesses develop manufacturing plants and factories through long term investments. What is being seen now is flows into the financial markets, rather than FDI. These flows can leave the country overnight, resulting in a depressed Rand as foreigners sell Rands in favour of other currencies at any cost.

The sell-off experienced in recent weeks is a fraction of the investments made over the past year, so if the trend continues, it is possible that the Rand will weaken further.

The graph below shows the trading pattern of the Rand (daily) since the beginning of 2013 with each day represented by a vertical blue bar. The length of the bar illustrates the trading levels achieved for that day. For most of the period, the trading spread between high and low per day was less than 20 cents but towards the end of May and in June, the spread increased to as much as 35 cents (almost twice the volatility). This signifies the extent to which South Africa is beholden to foreign investors for the stability of our currency.

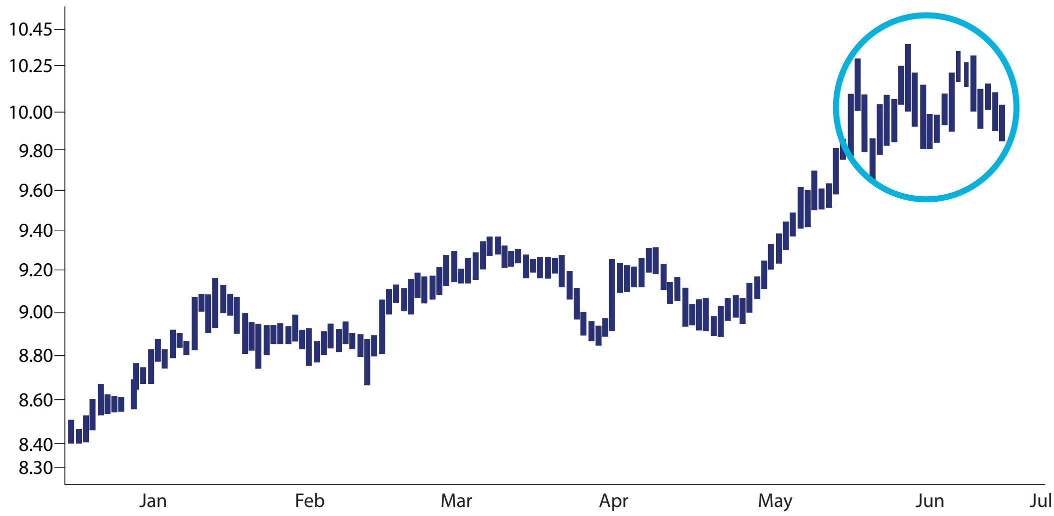
South Africa requires a catalyst to stimulate growth in manufacturing, while imports must decrease, exports must increase and we need to attract more FDI. Labour regulation and productivity levels are also factors that push investors to other emerging markets, which need to be addressed quickly and decisively to attract investment capital. For example, BMW South Africa has committed to vehicle manufacturing by increasing their local capacity for export vehicles. We hope other manufacturers follow their lead.

South Africa is growing as a consumer driven society, which has resulted in an increase in imported products. In 2008, local manufacturing was a key contributor to the retail market but since the equity market correction, retail sales have continued to grow month on month, while manufacturing has lagged this retail trend, not even reaching the high of 2008. Surprisingly, manufacturing has capacity to increase production, but consumers have preferred the imported option.

This dependency on imported products is likely to contribute to long term Rand weakness as will the impact of foreign ownership of financial instruments which require dividends and coupons to be paid in foreign currency to offshore investors. This is already seen in the 40% foreign ownership of existing JSE listed companies.

The current level of the Rand has however contributed to lower imports in May and marginally higher exports.

The Rand against the US Dollar - year to date 2013



Source: GTC and I-Net

GTC fund performances

The **GTC Fixed Income Fund** has continued to deliver strong returns relative to cash and managed to outperform the short end of the bond market. The manager has increased duration in the fund to benefit from the improving yields, which have contributed to performance. The manager has also increased exposure to credit instruments which offer higher yields than the government equivalents.

Although cash rates have remained low, the market has anticipated a further interest rate cut, which could result in short term rates moving lower. A low interest rate environment could be the stimulus required to get the local economy active again, but reduces the income earned on cash investments.

The **GTC Wealth Accumulator Fund of Funds** has performed in excess of inflation over the past year but market volatility and sector specific exposures have limited the overall return. The managers have chosen to increase their weighting to resource based companies as these shares have been trading at opportunistic levels for some time.

The global slowdown and reduced demand in both developed and emerging markets have contributed to the lacklustre performance of resource shares which has negatively impacted local equity performance. Industrial and financial shares performed above expectations which have also increased the risk of these sectors reversing previous gains in the short term. In May, the industrial and financial sectors underperformed the resource sector.

The **GTC Capital Plus Fund of Funds** has continued to achieve a rolling 12 month positive return, despite the volatility experienced in most asset classes this quarter. The fund has exposures to multiple conservative strategies including equity downside protection, growth and income based investments. Over the quarter, equities led the performance charge, which resulted in the fund achieving the inflation adjusted performance objective. The managers continue to evaluate the various asset classes to reduce risk and increase relative performance.

The **GTC Conservative Absolute Growth Fund** (Rand and USD classes) performed exceptionally well over the past 12 months as global markets continued to attract investor capital. The fund also benefited from diversified asset class exposures as the market rewarded investment in all exposures. Developed markets have also outperformed emerging markets, further enhancing returns. Within the Rand based fund, the largest contributor was the impact of the Rand weakness, which added close to 20% of performance to the 1 year return.

Investment portfolios	3Mth	6Mth	12Mth	2Year*	3Year*	4Year*	5Year*
GTC Fixed Income B	1.41%	2.24%	4.67%	5.25%	5.73%	6.36%	7.63%
GTC Wealth Accumulator FOF B	-1.80%	0.36%	10.13%	7.68%	11.65%	13.83%	12.26%
GTC Capital Plus FOF B	0.58%	2.18%	9.53%	7.18%	7.48%	8.39%	8.74%
FTSE/JSE All Share Index (ALSI)^	-0.60%	1.49%	19.24%	13.28%	16.38%	17.27%	6.94%
FTSE/JSE Shareholder Weighted Index (SWIX)^	0.34%	1.57%	19.04%	15.28%	17.66%	18.13%	9.59%
BEASA All Bond Index (ALBI 1-3 year)^	-0.03%	0.54%	2.93%	5.87%	5.99%	6.20%	7.91%
Cash (SteFi)^	0.88%	1.76%	3.71%	3.91%	4.15%	4.59%	5.59%
GTC Conservative Absolute Growth (R)	13.18%	23.34%	37.25%	23.92%	16.68%	12.65%	4.13%
GTC CAG's Composite Benchmark (R)^	6.92%	17.05%	25.15%	20.57%	13.25%	9.99%	4.58%
R/$ Exchange rate	6.96%	16.47%	19.32%	20.20%	8.84%	5.78%	4.38%
GTC Global Conservative Absolute Growth ($)	-2.90%	0.25%	7.45%	1.18%	6.19%	5.22%	-0.78%
GTC Global CAG's Composite benchmark ($)^	-1.52%	-0.85%	2.23%	-0.21%	3.87%	3.66%	0.67%

* Annualised ^Benchmark returns include 1,5% fees Not all fund class returns are shown. Class B refers to indirect investments

Further information

Contact us

Head of Private Client Wealth Management
Jenny Williams
T +27 (0) 11 322-4532
E jwilliams@gtc.co.za

Head of Investment Analytics
Laven Chetty
T +27 (0) 11 322-4844
E lchetty@gtc.co.za

Head of Strategic Partners
Jeff Morgan-Hill
T +27 (0) 11 322-4804
E jmhill@gt.co.za

Head of Employee Benefits Consulting
Toy Otto
T +27 (0) 11 322-4644
E totto@gtc.co.za

Chief Operating Officer
Farhadh Dildar
T +27 (0) 11 322-4821
E fdildar@gtc.co.za

Chief Executive Officer
Gary Mockler
T +27 (0) 11 322-4512
E gmockler@gtc.co.za

Head of New Business Development
Roger Schärger
T +27 (0) 11 322-4507
E rscharges@gtc.co.za

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www.gtc.co.za