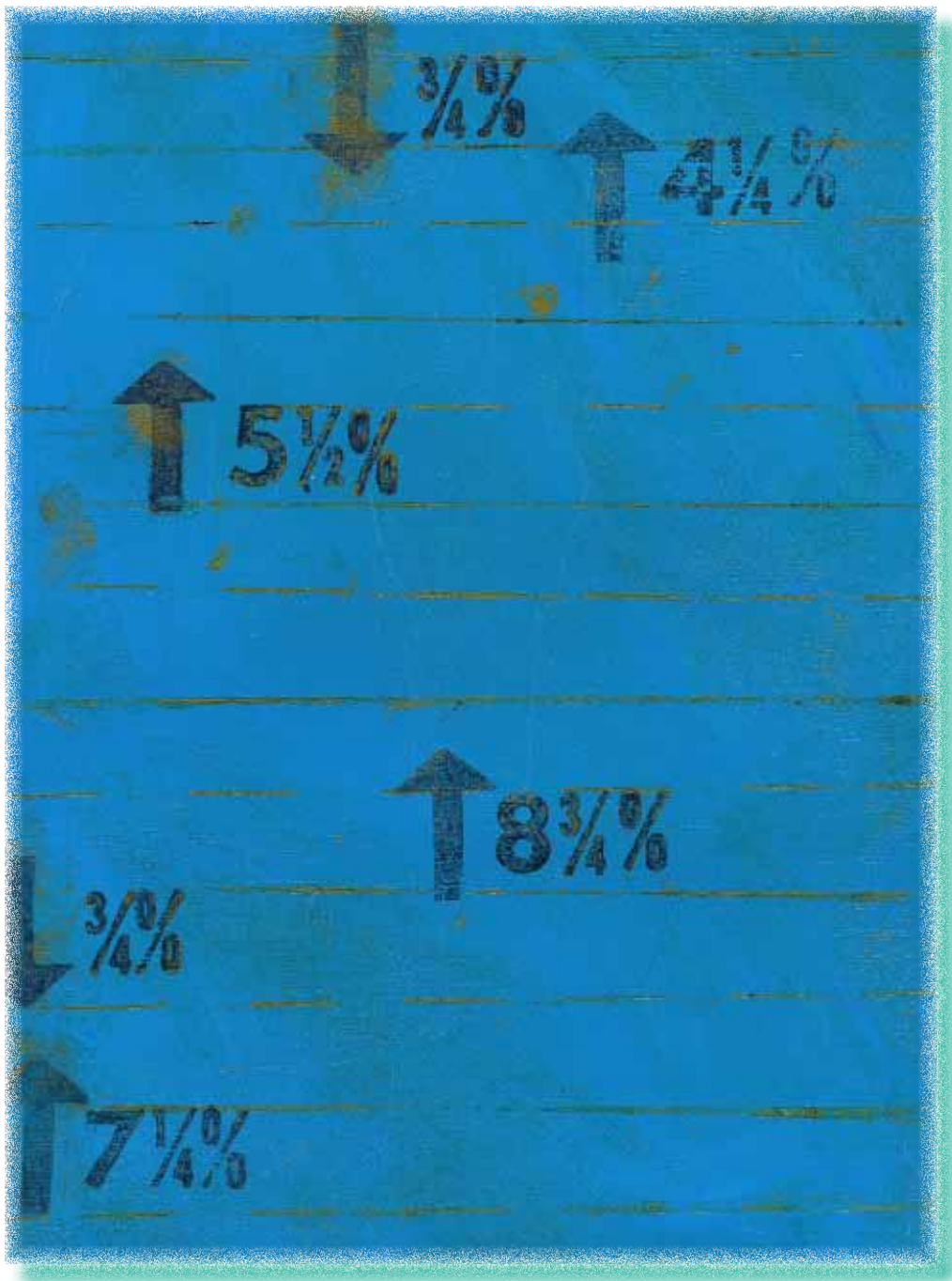


GTC

Formerly Grant Thornton Capital

# Trendline

For the quarter ended June 2014



# Equity markets resurgent

Both global and domestic stock markets overcame a brief and relatively mild sell off during the first half of April, surging into higher territory in the second quarter of 2014. An ongoing global economic recovery, diminishing concerns over Ukraine and Iraq, and stimulative monetary policy from central banks provided strong backdrop support to equity markets.

In the U.S. the S&P and Dow indices forged ahead despite a disastrous first quarter which showed the economy actually contracted by 2.9%. This was the worst quarter since 2009 and was largely attributable to extreme weather conditions particularly along the East Coast.

As a result, the Federal Reserve cut its economic growth forecast for 2014 to a range of 2.1-2.3 %. U.S. consumer price inflation (CPI) rose to 2.1% in May and by the end of June it had risen at the fastest monthly rate in more than a year. The authorities appear positive on the outlook for the U.S. economy and seem relatively unconcerned about inflationary pressures for the moment.

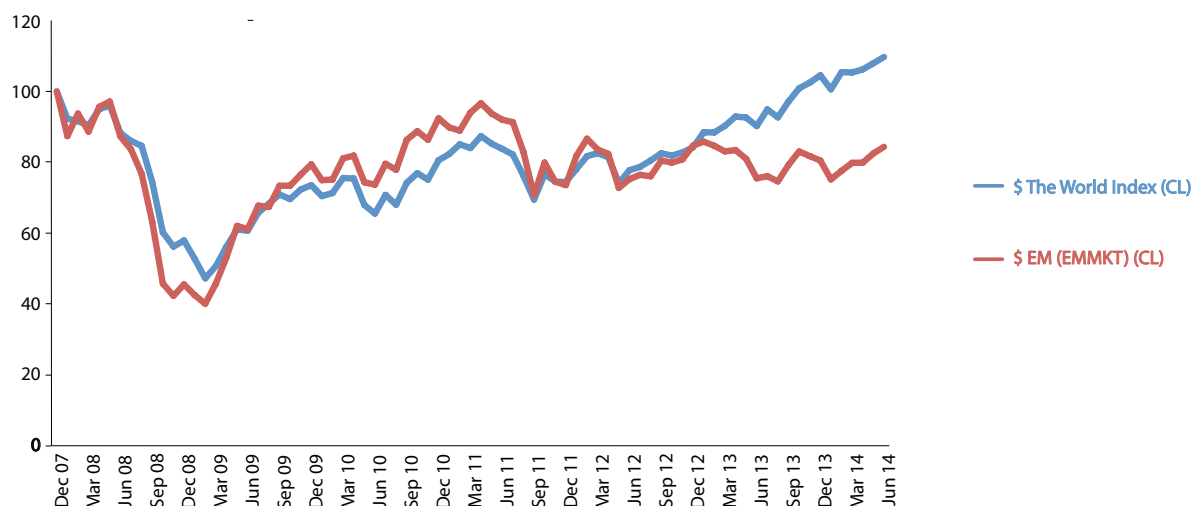
Earlier in the year the new Governor of the U.S. Federal Reserve uttered some hawkish statements suggesting that interest rates might rise sooner than expected. The result was an immediate sell off in global markets.

However, in her first public address she adopted a far more dovish approach which saw markets immediately reverse the trend, climbing to new highs. Throughout the quarter the Federal Reserve maintained its tapering programme, reducing its monthly bond repurchases by an additional \$10 billion. Federal Reserve Chair Janet Yellen continues to advocate a policy of near zero interest rates expressing her concern over jobs growth.

The unemployment rate was 6.1% in May, down from 6.3% in April, significantly below the stated Fed target rate of 6.5% set under prior Fed chairman, Ben Bernanke. The Federal Reserve Open Market Committee (FOMC) now predicts that the continued improvement in the economy will allow it to gradually increase real interest rates from the current near zero to 1.2% by year end 2015, to 2.4% by 2016 and stabilising thereafter in the region of 3.75%.

The European Central Bank (ECB) provided a substantial boost for markets in early June when ECB President Mario Draghi announced a range of major changes. The benchmark interest rate was cut from 0.25% to 0.15%, a negative deposit rate was introduced and cheap four-year loans were made available to assist lending to small businesses.

## MSCI World vs MSCI Emerging



Source: GTC/I-Net

Should inflation continue at the current ultra-low levels (inflation for May and June was just 0.5%) Draghi hinted that the ECB may institute an asset buying programme, not dissimilar to the Fed's quantitative easing. These announcements led to substantial inflows into a host of global stock markets especially those offering higher real returns.

Eurozone GDP growth for the first quarter was way below expectations at a miserly 0.2%. Germany led the way with growth of 0.8%, France was flat and Italy contracted 0.1%. The Eurozone composite purchasing managers index (PMI) hit a three year high of 54.0 in April but eased back to 53.5 in May and 52.8 in June. This slowdown in growth resulted in the ECB introducing the above mentioned substantial stimulus measures. In the U.K. the FTSE All Share fell 1.3% in June but nevertheless managed to move 2.2% over the quarter.

The strength of Sterling has continued to impact on profits of many U.K. companies with international exposure and as a result U.K. industrials had a poor quarter. The U.K. economy continues to perform strongly driven by growth in household spending and more recently by business investment. The pick-up in household spending is reflected in the latest consumer confidence survey which in May reached

levels not seen since 2005. Data released in June showed the unemployment rate down to a current level of 6.6%.

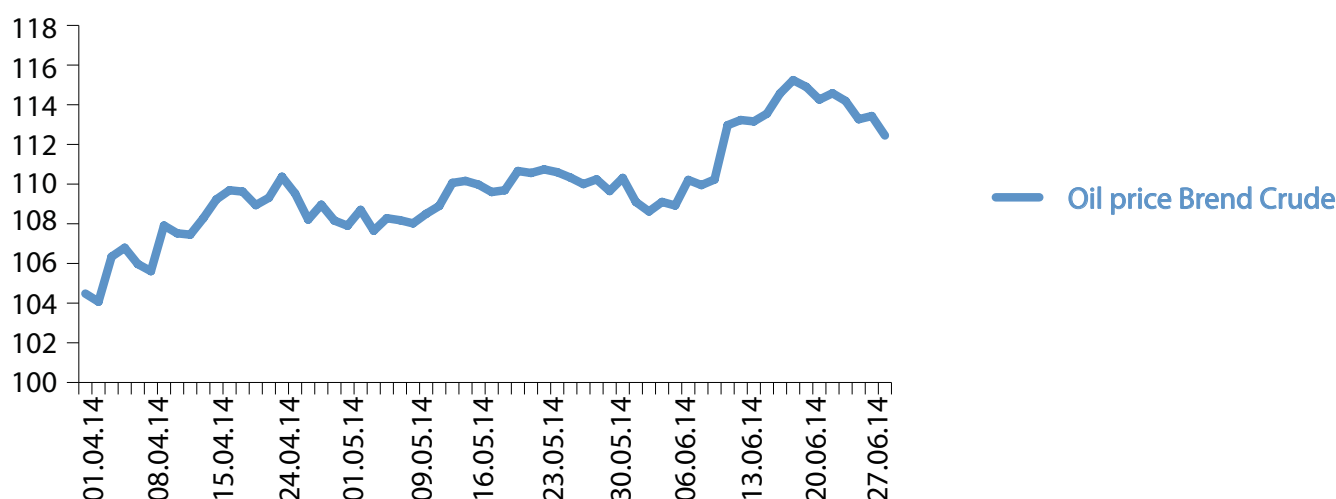
### Geopolitical tensions

The second quarter produced its fair share of geopolitical news highlighted by the ongoing crisis in Ukraine and the battle between rebel and government forces for control of Iraq. Although neither situation had a long lasting or material effect on stock markets over the quarter, it raises concern on how armed conflict and other geo-political concerns tend to impact financial markets.

History shows that geo-political events often have a dramatic but short lived impact and introduce considerable volatility to markets. The spill over from the Syrian crisis into northern Iraq has seen swathes of the northern part of the country captured by the rebels. Immediate reaction saw the oil price spike above \$114 a barrel before receding towards \$110 a barrel as it became evident that Iraqi oil supplies would be unaffected.

It was hoped that the U.S. led move to a democracy following on the defeat of Saddam Hussein would lead to more inclusive government. Unfortunately the Shia majority latched onto the power base at the expense of the Sunni minority which provided the basis for the current uprising.

### Oil price Brent Crude \$



Source: Morningstar/GTC

Whilst the Ukrainian situation remains fluid, newly elected President Petro Poroshenko has taken some positive steps to help resolve the crisis in the eastern part of his country. His offer of greater local autonomy to the region coupled with albeit the seemingly reluctant support of Russian President Putin, seems to be bringing calm to the situation. Ongoing diplomacy appears to be the order of the day despite periodic flare ups of rebel activity.

The Japanese stock market fell in April before racking up two consecutive months of gains to finish the second quarter up 5.1%. Economic data continued to be mixed following April's sales tax hike from 5% to 8%.

The latest inflation data in June was positive but there were some clear signs that inflation has peaked and will decline slightly from here. The outlook for the economy going forward remains subdued.

Emerging markets rebounded over the quarter and the MSCI Emerging Markets index outperformed the MSCI World index. Emerging Asia was the strongest region led by gains in India. Optimism about the country's growth and reform prospects following the decisive election victory of Narendra Modi boosted stock prices.

China lagged its peers but nevertheless equities posted strong gains over the quarter on the back of various stimulatory measures taken by the authorities to boost growth in the world's second largest economy.

Among the series of mini stimulus measures, the government increased investment in railways from RMB 700 billion to RMB 800 billion while the central bank cut the reserve requirement ratios for county level rural banks. Economic data slowly improved and the June PMI number of 53.1 against May's number of 50.7 is indicative of growth and would suggest that the target growth rate of 7.5% in GDP is still attainable.

#### Local economic woes

Over the quarter the domestic market continued to be plagued by ongoing labour unrest which is having a serious impact on economic growth. Not only is it affecting economic growth but more seriously it is making the country's ability to borrow abroad not only more costly but also more and more difficult. South Africa has reached the stage where our sovereign debt is now only one notch above junk status and this in itself often precludes many would be investors from participating in our global bond offerings.

A series of events developed over the quarter which impacted significantly on the economy but which in the main were as a result of a carryover from Q1 where the Gross Domestic Product (GDP) actually contracted by 0.6%. Two successive quarters of negative growth indicate that the economy is in fact in recession.

To add to concerns around economic growth, Consumer Price Inflation (CPI) continued to increase from 6.0% in April to 6.6% in May almost certainly heralding the likelihood of an interest rate hike at the July meeting of the Reserve Bank's Monetary Policy Committee.

Earlier in the year Gill Marcus, the Governor of the Reserve Bank, indicated that in the current rising interest rate cycle adjustments to the bank rate might be made less frequently but might be of greater magnitude. The main drivers of this latest increase were food, transport and insurance. Core inflation edged up from 5.3% to 5.5%, the fastest increase in this more stable measure of inflation indicating that underlying price pressures are intensifying.

Certain trends are appearing which are cause for some concern. Food prices have increased sharply over the past six months and in spite of agricultural commodity prices, particularly maize, declining food prices remain stubbornly high. Prices of imported goods, over which in many instances we have no control, have continued to rise adding fuel to the fire.

Oil imports are of particular significance in this regard as transport costs feed directly into the price of consumables. The weak and somewhat vulnerable Rand remains a key risk to the future inflation outlook.

# Market commentary

April saw a widening in the trade deficit to a mammoth R13.026 billion (consensus was R11 billion) which was exacerbated by the prolonged AMCU strike in the platinum sector as well as a substantial slowdown in motor vehicle exports also as a result of strike action. The 24.7% decline in mining output for Q1 was the biggest quarterly contraction since 1967.

The Purchasing Managers Index (PMI) for May declined to 44.3, a level last seen in August 2009 giving an indication of just how severe the pull back in the economy has been.

Taking all these factors into account it is no surprise that the Rand has come under significant pressure which would in the normal course of events translate into a significant improvement in Rand earnings from our exports.

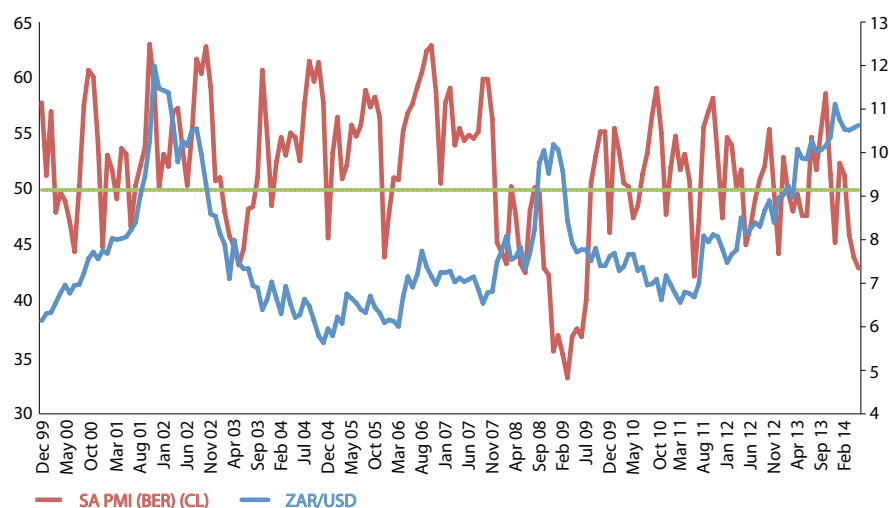
Unfortunately this has not materialised as the potential boost in exports has been overshadowed by an erratic electricity supply, ongoing labour unrest and a reduced world demand for our mineral exports. The Eurozone, which continues to be one of our major trading partners, has until recently displayed anaemic growth which has meant weak demand for our exports.

The current economic difficulties being faced by South Africa are being directly reflected in the current account of our balance of payments. We rely heavily on foreign investment flows to help balance the books and continued labour unrest will certainly in the end deter some would be investors resulting in an even weaker currency.

The AMCU strike in the platinum industry after having played havoc with the economy was finally brought to an end on the 24th June, having lasted for five months. There was nationwide relief.

However, there was a sting in the tail as some of the internationally recognised rating agencies felt it incumbent in the light of unfolding economic events to downgrade our sovereign debt rating. Fitch retained our overall rating at BBB but altered its outlook for the economy from stable to negative. Standard & Poor's downgraded their rating to BBB minus with a negative outlook.

**SA PMI (lhs) vs ZAR/USD (rhs)**



Source: GTC/I-Net

The effect of these downgrades will be an increased cost of borrowing from the global bond investors. Indicative of the perceived outlook for the South African economy Fitch also revised their 2014 GDP forecast down to 1.7% and Standard & Poor's to 1.9% from a previous 2.7%.

Having seen the devastation caused by the five month long AMCU platinum miners' strike and the earlier motor industry strike, the announcement by the National Union of Metalworkers (NUMSA), that they intend embarking on an indefinite strike for higher wages commencing 1st July could not have come at a worse time. Should this strike prove to be prolonged the possibility of further rating agency downgrades appears inevitable.

In spite of the South African economy facing increasing headwinds the local equity market continued to soar to ever greater heights driven by a surfeit of global liquidity and the ever relentless search for yield. S.A. equities have moved in tandem with global markets as low volatility and S.A.'s large dual-listed equity component attracted considerable foreign interest .

The SWIX outperformed all domestic asset classes over the quarter. Inflation linked bonds outperformed both local bonds and cash. Platinum and gold prices continued to rise as production stoppages underpinned platinum while geo-political events in Ukraine and Iraq supported the gold price.

### The BRICS country ratings compared

		S&P		Moody's		Fitch	Average	TE Score
<b>China</b>	<b>AA-</b>	Stable	Aa3	Stable	A+	Stable	78.82	Stable
<b>South Africa</b>	<b>BBB-</b>	Stable	Baa1	Negative	BBB	Negative	57.44	Negative
<b>Russia</b>	<b>BBB-</b>	Negative	Baa1	Stable	BBB	Negative	54.81	Stable
<b>Brazil</b>	<b>BBB-</b>	Stable	Baa2	Stable	BBB	Stable	50.73	Stable
<b>India</b>	<b>BBB-</b>	Negative	Baa3	Stable	BBB	Stable	47.12	Negative

Source: Economists.co.za

# GTC fund performances

Investment portfolios	3Mth	6Mth	12Mth	2Year*	3Year*	4Year*	5Year*
<b>GTC Fixed Income B</b>	1.47%	2.44%	4.46%	4.56%	4.99%	5.41%	5.97%
<b>GTC Wealth Accumulator FOF B</b>	4.64%	7.89%	22.27%	16.04%	12.33%	14.21%	15.47%
<b>GTC Capital Plus FOF B</b>	3.77%	6.02%	13.17%	11.33%	9.14%	8.87%	9.33%
<b>FTSE/JSE All Share Index (ALSI)^</b>	6.78%	10.95%	30.81%	24.89%	18.85%	19.83%	19.86%
<b>FTSE/JSE Shareholder Weighted Index (SWIX)^</b>	6.31%	10.98%	29.95%	24.38%	19.98%	20.62%	20.40%
<b>BEASA All Bond Index (ALBI 1-3 year)^</b>	1.40%	1.74%	4.08%	3.51%	5.27%	5.51%	5.77%
<b>Cash (SteFi)^</b>	1.04%	1.99%	3.85%	3.78%	3.89%	4.07%	4.45%
<b>GTC Conservative Absolute Growth (R)</b>	2.58%	3.69%	12.33%	24.17%	19.93%	15.57%	12.58%
<b>GTC CAG's Composite Benchmark (R)^</b>	2.16%	3.98%	16.54%	19.25%	18.83%	13.93%	11.01%
<b>R/\$ Exchange rate</b>	0.32%	1.28%	7.44%	13.22%	15.79%	8.49%	6.11%
<b>GTC Global Conservative Absolute Growth (\$)</b>	1.88%	3.22%	10.63%	9.03%	4.24%	7.28%	6.28%
<b>GTC Global CAG's Composite benchmark (\$)^</b>	1.83%	2.67%	8.46%	5.30%	2.60%	5.00%	4.60%

\* Annualised

^Benchmark returns include 1,5% fees

The [GTC Fixed Income Fund](#) has delivered outperformance against the Cash (SteFi) and Bond (ALBI 1-3 year) benchmarks over most periods. Interest bearing returns remain suppressed below inflation as a result of the loose monetary policy adopted by central banks both locally and globally.

The [GTC Wealth Accumulator FoF](#) continues to participate in the strong positive returns delivered by the equity market while maintaining a defensive position should the markets sell off. The cost of protection within the Prescient Protected Equity portion will reduce over the coming months benefitting the Fund further. The local equity market has been the top performing asset class over 2014.

The [GTC Capital Plus FoF](#) has achieved healthy outperformance of its inflation relative target (CPI+3%) over the past year. The significant absolute return exposure ensures that the Fund captures upside equity return while focusing on avoiding losses over 12 month periods.

The [GTC Conservative Absolute Growth Fund](#) (USD and Rand classes) continues to deliver outperformance against its benchmark over almost all of the analysis periods displayed. The Rand weakened marginally over the past 3 months due to concerns surrounding strike action and the potential ramifications on South Africa's current account. This resulted in a slight positive impact for local investors with exposure to offshore markets.



# Contact us

**Head - Consulting Services**

Jeff Morgan-Hill  
T +27 (0) 11 322-4804  
E [jmhill@gtc.co.za](mailto:jmhill@gtc.co.za)

**Head - Investment Analytics**

Clive Eggers  
T +27 (0) 11 322-4844  
E [ceggers@gtc.co.za](mailto:ceggers@gtc.co.za)

**Head - Healthcare**

Jill Larken  
T +27 (0) 21 322713 8504  
E [jlarken@gtc.co.za](mailto:jlarken@gtc.co.za)

**Head - New Business Development**

Roger Schärge  
T +27 (0) 11 322-4507  
E [rscharges@gtc.co.za](mailto:rscharges@gtc.co.za)

**Executive - Private Client Wealth Management**

Jenny Williams  
T +27 (0) 11 322-4532  
E [jwilliams@gtc.co.za](mailto:jwilliams@gtc.co.za)

**Executive - Employee Benefits Consulting**

Toy Otto  
T +27 (0) 11 322-4644  
E [totto@gtc.co.za](mailto:totto@gtc.co.za)

**Chief Operating Officer**

Farhadh Dildar  
T +27 (0) 11 322-4821  
E [fdildar@gtc.co.za](mailto:fdildar@gtc.co.za)

**Chief Executive Officer**

Gary Mockler  
T +27 (0) 11 322-4512  
E [gmockler@gtc.co.za](mailto:gmockler@gtc.co.za)

**Compliance Officer**

Dale Nussey  
T +27 (0) 11 322-4828  
E [gmockler@gtc.co.za](mailto:gmockler@gtc.co.za)

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