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Trendline

Fourth Quarter 2016

Global: The gamble of global fiscal stimulus

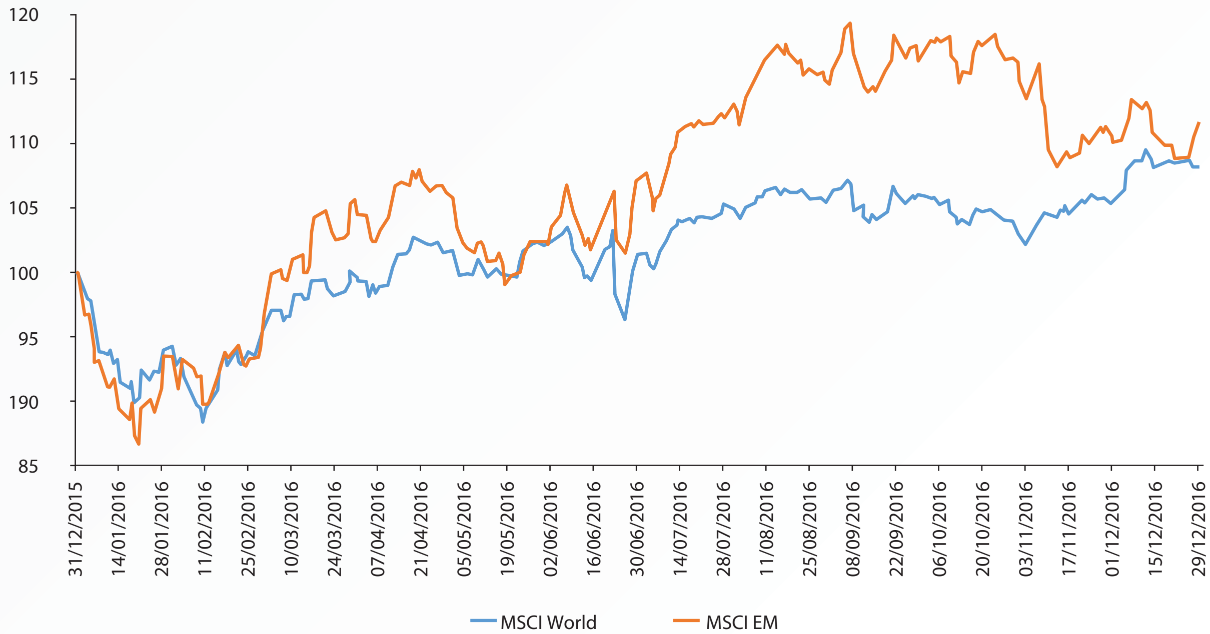
The year 2016 began with a shaky start with risk assets selling off across the board, oil declining to $28 a barrel and investor concerns focusing on the possibility of a significant Yuan devaluation. World trade remained pedestrian and in spite of liquidity being freely available, the world economic engine continued to chug along.

The one spark of hope remained: the United States where green shoots of economic recovery began to appear. The two shock political events of 2016, Brexit and the election of Donald Trump as US President were certainly the catalysts which helped bring about a change in the global economic outlook.

Thankfully the year ended on a more positive note for developed world equity markets, with the MSCI World Equity Index returning 8.15% y/y in total return terms whilst emerging markets returned 11.60%, despite displaying considerable volatility and a final quarter returning a negative return of -4.08% as measured by the MSCI Emerging Market Index.

This negative performance was largely as a result of rising bond yields, a strong Dollar and fears of protectionist trade measures being imposed by the newly elected Trump administration. However the events surrounding the surprising Brexit vote and the election of Donald Trump as US President will likely continue to echo throughout global stock markets for the duration of 2017.

MSCI World vs MSCI EM 2016



Source: GTC / Inet BFA

Global bond markets were almost exclusively driven by the political events surrounding the Brexit and Trump decisions. Upcoming elections in Europe also exerted influence. Despite the volatility the 10 year US Treasuries yield increased from 1.59% to 2.44% due to an expectation of tighter monetary policy in future. The European Central Bank confirmed that it was reducing the scale of its bond buy-back programme but carefully avoided any suggestion that this was tantamount to tapering.

In the US the victory of republican Donald Trump dominated markets as the prospect of a cut in taxes, an easing of regulatory requirements and a boost to infrastructure expenditure were seen as positive for domestic economic growth and resulted in the S&P 500 advancing 3.82%. Mid-cap and small-cap equities were the best performers with the Russell 2500 and the Russell 2000 gaining 6.1% and 8.8% respectively.

As expected, the Federal Open Market Committee raised interest rates in December on the back of a continued improvement in the economy with non-farm payrolls displaying rising employment numbers which resulted in the unemployment rate declining to 4.6% in November. It is evident from Trump's pre-election manifesto that far more reliance will be placed on fiscal rather than monetary policy in order to promote economic growth.

The Eurozone continued to reflect improved economic conditions with the MSCI EMU index returning a healthy 8.1%. There was a distinct shift away from bond related investments towards value areas which are seen benefitting from rising bond yields. This resulted in the Financial sector being the best performer as rising interest rates were seen to be conducive to improved bank profits. Commodity shares, particularly energy related ones, also performed well with the OPEC oil cut back programme providing the stimulus.

The European Central Bank extended its quantitative easing programme to December 2017 but reduced its monthly bond repurchases to 60 billion Euros from the previous 80 billion. Unemployment declined to 9.8% with annual inflation rising from 0.5% in October to 0.6% in November. Economic growth remained pedestrian with GDP for Q3 coming in at 0.3%.

As the dust around the Brexit decision began to settle, statistics showed that the UK economy grew at a better than expected 0.6% in Q3. This was to an extent as a result of sterling weakness but the encouraging factor is that consumer spending remained resilient in spite of higher energy prices as well as the prospect of further imported inflation.

Sterling fell sharply early in October but regained some ground when the Bank of England revised upwards its GDP growth projections. The decision by the U.K's Chancellor of the Exchequer Philip Hammond to officially abandon his predecessor's promise to run a balanced budget reflected a move towards a more fiscal rather than monetary approach to economic stimulus. He has left the option open to extend the deficit funding programme.

A more positive reaction to the prophets of doom following the Brexit decision resulted in the FTSE All-Share returning 3.9% over the period. Bond yields rose as the sell-off in developed gilt markets gathered momentum resulting in a distinct steepening of the yield curve. The prospect of higher interest rates resulted in Financials performing particularly well. The possibility of higher oil prices as a result of the proposed OPEC production cuts and more encouraging economic data coming out of China saw the resources sector delivering a strong performance.

The Japanese stock market was the star performer over the quarter improving month on month to return 15.0% overall. This was largely due to a disconnect in bond yields between the US and Japan where the impact of potential increases in US rates were significantly muted because of the Bank of Japan's ongoing commitment to manage the yield curve via its bond repurchase programme. This resulted in a widening in the interest rate differential between the two nations and saw the Yen fall sharply.

Whilst the outcome of the US election influenced Japanese market sentiment the key sectors attracting investors remained unchanged. The major beneficiaries of a rising interest rate environment continued to attract attention with banks, insurance companies and securities companies attracting the most attention.

The Chinese markets continued to display weakness partly as a result of the potential further increase in US interest rates but also as a result of increased curbs being placed on property speculation as well as an overall tightening in credit availability.

Capital outflows continued unabated in spite of further Yuan depreciation as foreign exchange reserves held by the Peoples Bank of China declined by almost $70 billion in November resulting in depreciation of 2.2% from the previous month. The Yuan declined -3.9% over the quarter versus the Dollar. In Hong Kong market sentiment weakened as curbs to reduce property development speculation were not well received by investors.

Domestic: Rating agencies relief

The uncertainties surrounding potential change in US trade and foreign policy impacted emerging markets significantly with the fear of a protectionist policy being implemented by the Trump administration weighing heavily.

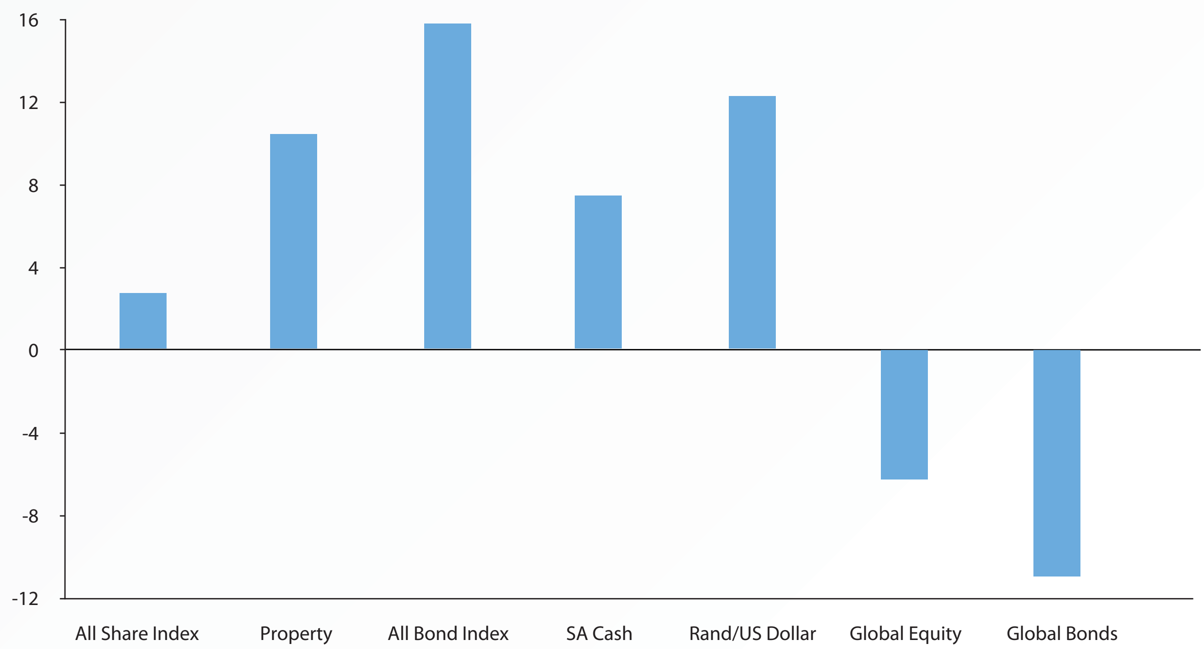
The South African equity market was hamstrung awaiting the outcome from the three major rating agencies with a distinct fear that SA's sovereign debt would be downgraded to junk status.

Fortunately South Africa managed to avoid this potential calamity with Standard and Poor's, which is the most relevant rating agency, deciding to affirm the long term foreign currency debt rating at 'BBB-' with a negative outlook. Rising risks have resulted in the agency's decision to lower the long term local currency debt rating from 'BBB+' to 'BBB' a rating that is still two notches above sub-investment grade.

SA will have to keep a careful eye on its balance of payments and fiscal deficits and move closer towards political stability if it wants to hold on to its investment grade credit rating in 2017. This is because the ratings agencies will have to resolve their negative outlook on the country's credit rating within 12 months by either changing it to stable or downgrading it.

While the ratings agencies decision means that SA has managed to keep its investment grade rating with all three major rating agencies, it also means the country is now on notice for a downgrade by all three.

Asset class returns % 2016 (ZAR)



Source: GTC / Inet BFA

The JSE/ALSI gained 0.88% and 0.97% in total return terms over December. Overall JSE equity performance can best be described as pedestrian for 2016 having returned a paltry total return of 2.6%. The FINI was the best performer gaining 3.23% with the INDI25 coming in at a positive 1.80%. Following on a stellar performance from Steinhoff the Household Goods sector gained 9.53%.

The General Mining sector came under significant selling pressure losing 6.91%, the main contributors being Anglo American which was down 7.97% followed by BHP Billiton down 6.50%. Platinum and Precious Metals did not avoid the sell-off losing 5.12% with Lonmin contributing a negative 11.70% and Anglo Plats 8.51%. Star performers for the year are Kumba and Assore with the former gaining 285.92% and the latter 281.51%. Indeed spectacular performance, although admittedly from an overly depressed base. Property gained 4.24% while the ALSI's 30 day volatility indicator was up at 15.51 from the previous month's 13.37. Foreigners were net sellers of R5.69 billion worth of equities.

The All Bond Index staged a mild recovery from the sell-off of the previous month returning 1.57%. The 12+ maturity sector gained 1.76% with the 7-12 year bucket returning 1.45%. Foreigners disposed of R6.61 billion of bonds during the month. Interestingly y/y both the ALBI and cash outperformed the ALSI with the ALBI returning 15.45% and cash 7.37% whilst the ALSI returned 2.63%.

The headline CPI annual inflation rate in November 2016 was 6.6%. This rate was 0.2% higher than the corresponding annual rate of 6.4% in October 2016. On average prices increased by 0.3% between October 2016 and November 2016. Prices of food and non-alcoholic beverages climbed 11.6% from a year earlier while fuel costs rose 5.6%. The annual percentage change in the PPI for final manufactured goods was 6.9% in November 2016.

In October, retail sales unexpectedly fell for the first time this year, suggesting the South African Reserve Bank might continue to hold off raising interest rates in January to take pressure off the economy. The SACCI Business Confidence Index (BCI) improved by another 0.9 index points from October 2016 to 93.9 in November 2016. The BCI increased by 3.6 index points from the exceptionally low level of 90.3 registered in September 2016.

Mining production decreased by 2.9% year-on-year in October 2016. The main negative contributors were: PGMs, Manganese, "other" non-metallic minerals and Gold. Iron ore and coal were significant positive contributors. Manufacturing production decreased by 2.7% in October 2016 compared with October 2015. Seasonally adjusted manufacturing production decreased by 1.9% in October 2016 compared with September 2016. This followed month-on-month changes of 1.3% in September 2016 and -1.0% in August 2016.

The Rand's Achilles' heel the current-account deficit is narrowing as subdued demand constrains imports. The shortfall shrank to 3.1% of gross domestic product in the second quarter from 5.3% the previous three months.

Inflation is slowing. The South African Reserve Bank sees the rise in consumer prices averaging 5.8% in 2017 down from a seven year high of 7% in February, which means that the yield on South African assets will remain attractive even as US interest rates rise.

The SA economy has endured several severe economic shocks in the past few years: a labour shock; a commodities shock, an electricity shock, and on top of everything, the worst drought in 100 years. At last however, there is a sense among economists that the business cycle is bottoming out and that SA will enjoy relatively better growth and lower inflation in 2017 and hopefully even an interest rate cut in the second half if the promised rains come. A summer with good rains is essential for increasing food supply and tempering food inflation which has been the driving force behind the CPI target breach for much of this year.

What does 2017 hold for the local equity market? Certainly a more positive outlook remains in spite of many unknowns both political and economic. On the positive side agricultural production seems set to improve helping to ease food price inflation, an improving Chinese economy together with rising commodity prices should benefit the mining industry and Donald Trump's infrastructure plans should also assist in this regard. 2016 has indeed been a difficult year for SA Equities but at last there appears to be some light at the end of the tunnel. Certainly patience will be rewarded!

GTC Fund performances - December 2016

Client Portfolios	1Year %	2Year* %	3Year* %	4Year* %	5Year* %
GTC High Equity - Provident	2.68	4.77	5.36	9.01	9.80
GTC High Equity - Inflation Target - CPI+5%	11.62	10.69	10.73	10.63	10.62
GTC High Equity - Pension	2.55	4.69	5.34	8.89	9.63
GTC High Equity - Inflation Target - CPI+5%	11.62	10.69	10.73	10.63	10.62
GTC Moderate - Provident	3.16	4.37	4.87	7.88	8.58
GTC Moderate - Inflation Target - CPI+3%	9.62	8.69	8.73	8.62	8.62
GTC Moderate - Pension	3.17	4.36	4.86	7.85	8.56
GTC Moderate - Inflation Target - CPI+3%	9.62	8.69	8.73	8.62	8.62
GTC Conservative - Provident	4.22	4.94	4.97	6.20	6.80
GTC Conservative - Inflation Target - CPI+1%	7.61	6.69	6.73	6.62	6.62
GTC Conservative - Pension	4.36	5.03	5.07	6.45	7.02
GTC Conservative - Inflation Target - CPI+1%	7.61	6.69	6.73	6.62	6.62
GTC EB Market Plus - Pension	1.32	4.82	5.06	9.86	11.39
GTC EB Market Plus - Benchmark	1.94	4.73	6.94	10.32	12.08
GTC EB Market Plus - Provident	1.55	3.67	5.06	9.87	11.39
GTC EB Market Plus - Benchmark	1.94	4.73	6.94	10.32	12.08
FTSE/JSE All Share Index (ALSI)^	1.10	2.33	4.58	8.16	11.31
FSTE/JSE Shareholder Weighted Index (SWIX)^	2.58	2.33	5.99	9.09	12.49
BEASA All Bond Index (ALBI)^	13.75	3.75	5.32	3.74	5.77
Cash (SteFi)^	5.83	5.35	5.01	4.66	4.52
MSCI World Index (R)^	-8.48	8.56	9.69	18.83	18.22

*Annualised
GTC Performances are shown net of all fees
^Benchmark returns include 1.5% fees

The **GTC Market Plus Funds** are lagging their targets on the back of equity market weakness. Within our manager blend, exposure to attractive and depressed materials exposure has detracted in the short term.

The **GTC High Equity Funds** (previously Aggressive) are lagging their inflation targets over the short term as detraction from equity markets impacts performance. Our manager blend has a component of protection which we feel is prudent in the current environment.

The **GTC Moderate Funds** are performing in line to their inflation adjusted targets over longer term periods. Equity markets remain the key driver of performance.

The **GTC Conservative Funds** are performing in line to their inflation adjusted targets over longer term periods. Equity markets remain the key driver of performance.

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