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Trendline

Third Quarter 2018

At a glance

Global equities continued to advance in Q3, largely driven by US equity markets. The MSCI World Equity Index returned 5% in total return terms. Other regions' performance was undermined by political and trade war considerations.

US equity markets dominated the world stage as economic growth indicators and actual company earnings exceeded expectations and overshadowed concerns surrounding a possible trade war with China.

Concerns over a potential Italian banking crisis, and possible contagion from the sell-off in emerging markets, resulted in the Eurozone markets delivering lacklustre performance. Brexit continued to loom over the UK market, with the FTSE All Share declining modestly by -0.8%. As expected the Bank of England raised interest rates marginally.

In Japan the re-election of Prime Minister Abe confirmed the medium term policy outlook for the economy, and this, coupled with a weaker Yen, saw strong equity gains with the Nikkei returning 5.9% for the quarter. Emerging market equities came under renewed selling pressure, both on the back of a considerably stronger US Dollar, as well as the imposition of punitive tariffs on a total of $250bn of Chinese goods. The MSCI Emerging Markets Index declined -1.1%.

South African equities delivered a dismal performance over the quarter as economic data continued to disappoint and political developments provided uncertainty. A risk-off attitude prevailed throughout the quarter.

US equities continued their improvement on the back of strong economic data, with Q2 annual GDP growth tabling at 4.1%, marginally below market expectations of 4.2%. This is the fastest rate of growth in four years, casting aside concerns raised after Q1's 2.2% reading.

A stronger Dollar has however raised concerns over the sustainability of continued earnings growth. The Fed raised interest rates by 0.25% to between 2% and 2.25%, and indicated another rate rise in December. In addition, three more are tabled for next year, and one in 2020. That was little changed from its June projections.

The Fed's projected hikes will put the benchmark overnight lending rate at 3.4% by 2020 - roughly half a percentage point above the Fed's estimated "neutral" rate of interest. Higher oil prices have created new worries for the US as higher energy prices usually result in inflationary pressures.

This could come at an inopportune moment as it might impact upon GDP growth, and as the Fed tightens monetary policy. US inflation remains elevated above the Fed's targeted 2% with markets already pricing in a further hike in December.

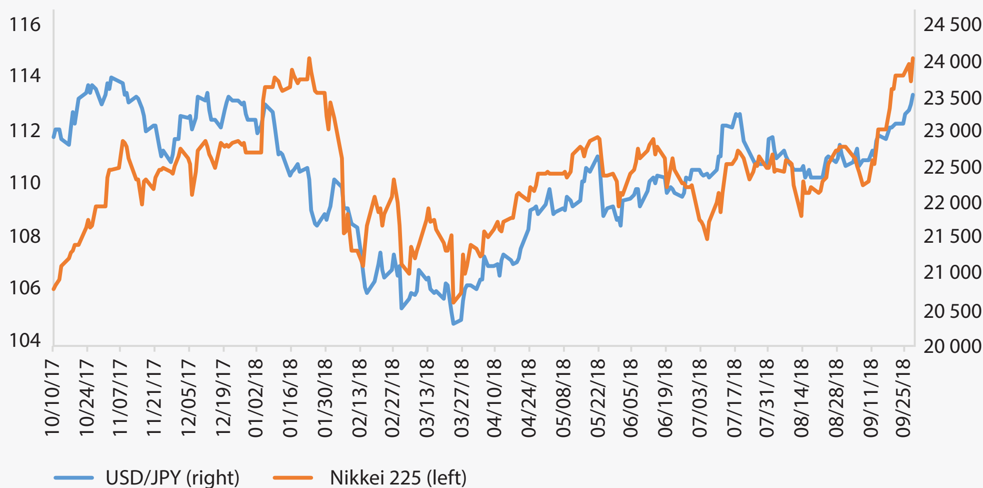
Looming US sanctions against Iran, and the unwillingness of the Organisation of the Petroleum Exporting Countries and top oil producer Russia to raise output to offset the loss of Iranian supply, have led prices higher.

Eurozone equities posted modest gains over the quarter, with the MSCI EMU Index returning 0.4%. Whilst financial counters delivered positive returns in Q3, European banks came under severe selling pressure amid concerns over their exposure to emerging market economies, especially Turkey.

An added concern related to the Italian budget. The motor industry was also the focus of attention as President Trump threatened to impose punitive tariffs against the industry. These concerns abated somewhat after Trump's meeting with EU President Junker. Economic data remained positive with Q2 GDP revised upward to 0.4% quarter-on-quarter.

The flash September PMI fell to a four month low of 54.2. The European Central Bank confirmed that interest rates would remain on hold for at least the summer of 2019.

Japan Nikkei 225 vs USD/Yen



Source: GTC/FactSet

The UK's FTSE All-Share declined 0.8% as the outlook for global growth eased and the prospect of a no deal Brexit loomed over the entire economy. Many of the companies listed on the LSE have an emerging market component and the escalating trade war between the US and China resulted in a risk-off sentiment prevailing. The Brexit saga weighed heavily on the share price of many domestic UK companies and was also reflected in the currency which continued to depreciate. In spite of a somewhat gloomy economic outlook the Bank of England raised interest rates by 25 bps to 0.75%.

Speculation surrounded the Bank of Japan's policy meeting, which resulted in increased volatility in the bond market. However, no significant changes were forthcoming and with a stronger Yen as a backdrop, Japanese equity markets rallied 3.68% (MSCI Japan) over the quarter, despite the manufacturing sector recording its slowest growth in 20 months in July.

Emerging markets bore the scars of investor confidence erosion on the back of the Turkish currency crisis and Argentina's debt concerns. Chinese equity markets fell -7.03% (MSCI China 50) over the quarter, as a second round of tariffs of $200bn were tabled by the US, which saw China threatening retaliation and moving to provide fiscal stimulus and an easing of credit. Bloomberg Economics' initial estimate is that US tariffs will take 0.5% off China's GDP growth, and the cost will be around 0.9% a year when the 25% tariff on the latest round of goods takes effect.

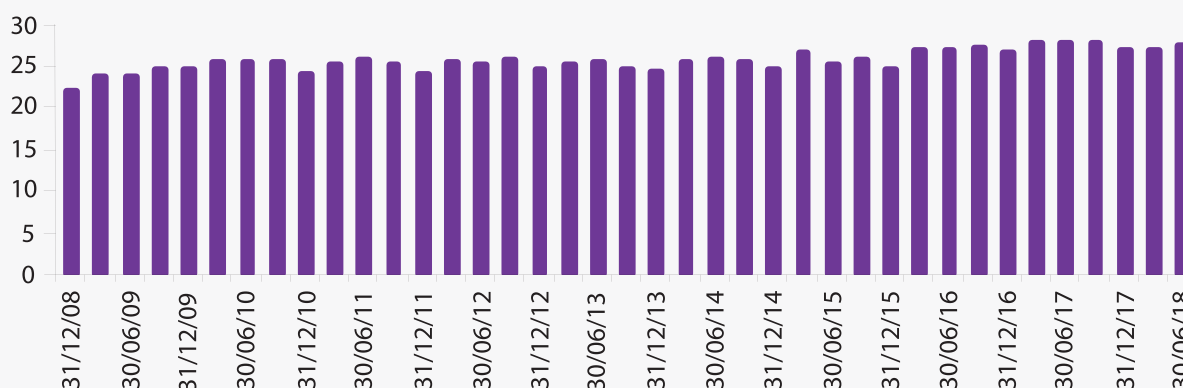
The Chinese economy is displaying further signs of weakness, with data showing investment slumped to a record low in the first seven months of the year and retail sales slowed. Output at factories and workshops expanded 6% year-on-year in July, in line with June's reading, but short of the 6.3% forecast in a Bloomberg News survey. Retail sales rose 8.8% in July, down from 9% in June, and also missing estimates of 9.1%. Fixed-asset investment expanded just 5.5% in January-July, the slowest pace on record.

Domestic - Destination SA

Locally, the JSE ALSI declined -2.17% as concerns around EM markets led to an outflow of capital and the Rand came under further pressure, declining 3.14% over the quarter. Despite Financials (+4.20%) and Resources (4.60%) both being up, this failed to offset the negative impact of Industrials, which declined 7.82%.

Macro-economic data remained unsupportive with the unemployment rate increasing by 0.5% to 27.2% in Q2 2018. The number of discouraged job seekers rose to 2.9 million people. Manufacturing lost 55 000 jobs year-on-year, with basic metals and food production the main constituents.

South Africa - Unemployment rate (%)



Source: GTC/FactSet

The official unemployment rate increased by 0.5% to 27.2% in the second quarter of 2018, up from 26.7% in the first three months of the year. The increase in the unemployment rate was due to a decline of 90 000 people in employment, as well as an increase of 102 000 people who became unemployed. Additionally the number of discouraged job seekers rose to 2.9 million people.

The headline CPI annual inflation rate in August 2018 was 4.9%. This rate was 0.2% lower than the corresponding annual rate of 5.1% in July 2018. On average, prices decreased by 0.1% between July 2018 and August 2018. Consensus was for a rise to 5.2%. Rising fuel prices have raised concerns around the ability of the Reserve Bank to keep rates on hold amidst the backdrop of a technical recession and rising rates in the US.

Despite retail trade sales increasing 1.3% year-on-year in July, there is a definite slowdown as consumers come under increasing pressure with July's increase being the smallest gain since April.

South Africa's manufacturing output expanded in July as food and motor vehicle outputs rose. Stats said manufacturing output rose by 2.9% year-on-year in July, following a revised 0.6% expansion in June. Analysts polled by Reuters had expected a 1.1% year -on-year increase in July.

Statistics presented at the Naamsa Automotive Conference showed that the industry contributes 7.7% of SA's GDP, which is larger than the mining sector. The motoring industry also accounts for 14% of all exports, with 600 000 vehicles made locally in 2017 for foreign markets at a value of R165bn. Our domestic market remains a heavyweight with 564 000 new vehicles purchased last year, which is 45% of sales for the entire African continent.

South African business confidence fell marginally in the third quarter. The Rand Merchant Bank (RMB) business confidence index compiled by the Bureau for Economic Research fell to 38 points in Q3, from 39 points in Q2, dropping further below the 50-mark that separates net positive and negative readings.

Consumer confidence in South Africa increased to 38 Index Points in the third quarter of 2018, from 22 Index Points in the second quarter of 2018.

Consumer Confidence in South Africa averaged 1.68 Index Points from 1982 until 2018, reaching an all-time high of 38 Index Points in the third quarter of 2018, and a record low of -33 Index Points in the second quarter of 1985.

Resources Minister Gwede Mantashe said South Africa's new mining charter will require holders of mining rights to raise the level of black ownership to at least 30% from 26% within five years. Mantashe said at least 20% of the 30% stake of black ownership would be in the hands of business people, with the other 10% being granted free to communities and qualifying employees.

The IMF is concerned about the rapid increase in SA public debt, which has doubled as a share of GDP over the past decade, to 53% in 2017, and is set to continue climbing. The fund suggested the government implement a more realistic expenditure ceiling or add a debt ceiling to curb the debt trajectory. Though the fund expects economic growth to pick up and average about 1.8% over the medium term, this mostly cyclical recovery will not impact unemployment and inequality.

President Cyril Ramaphosa announced measures to kick-start the economy. There is no big number to the plan and it is difficult to determine exactly how much money the state will pump into the economy in an effort to jump-start growth. Rather the plan centres around the re-prioritisation of existing budgets.

R50bn is one number mentioned. This is the amount in the existing budget presented to parliament in February, which will be shifted around in this financial year. R400bn is another. That is the amount which will be re-prioritised in the existing three-year budget cycle and spent on investment in infrastructure.

Ramaphosa's drive to raise foreign capital in the region of $100bn has borne fruit. China pledged to invest $14.7bn in South Africa in order to strengthen economic ties and increase trade. In addition, Eskom secured a $2.5bn long term facility from the China Development Bank while Transnet secured a $300m loan.

Unquestionably the patience of local investors is being sorely tested over the apparent lack of any real domestic market momentum. However, bear in mind that the underlying GTC portfolio valuations remain positive and ultimately these will reflect in equity prices. Indeed our economy is only sputtering along but events are underway which hopefully will bear fruit in the not too distant future.

Bear in mind too that approximately 25% of GTC's portfolios are invested offshore, bringing a comforting element of diversification into the mix.

While markets remain volatile, the importance of employing a diversified investment solution cannot be overemphasised. Markets go through cycles and while it is easy to get caught up in the negative sentiment, investors should be reminded of the well advocated advice of not attempting to time the market, but rather focusing on time in the market.

GTC Fund performances - September 2018

Client portfolios	1Year %	3Year* %	5Year* %	7Year* %	10Year* %
GTC EB Conservative	5.05	6.42	5.83	6.93	7.06
CPI +1%	6.11	6.22	6.34	6.43	6.16
GTC EB Moderate	3.97	5.95	6.09	8.41	9.01
CPI +3%	8.11	8.23	8.34	8.43	8.16
GTC EB High Equity	2.92	6.20	6.65	9.57	10.03
CPI +5%	10.11	10.23	10.34	10.44	10.16
GTC EB Market Plus	3.15	5.88	7.05	10.92	10.46
Composite Benchmark	3.84	6.27	7.94	11.53	9.79
FTSE/JSE All Share Index (ALSI)^	1.79	5.09	6.39	11.11	10.45
FTSE/JSE Shareholder Weighted Index (SWIX)^	-0.65	4.01	6.45	11.26	10.82
BEASSA All Bond Index (ALBI)^	5.55	6.07	5.57	6.32	6.95
Cash (SteFi)^	5.74	5.78	5.24	4.84	5.25
MSCI World Index (R)^	14.78	11.08	13.42	18.36	10.84

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

The **GTC Conservative Fund** was ahead of its inflation adjusted target over longer term periods. Equity markets remain the key driver of performance.

The **GTC Moderate Fund** was ahead of its inflation adjusted target over longer term periods. Equity markets remain the key driver of performance.

The **GTC High Equity Fund** (previously Aggressive) lagged its inflation adjusted target as equity markets detracted over the short and medium term.

The **GTC Market Plus Fund** was ahead of its target over the long term and lagged over the short term. Our manager blend has a component of protection which we feel is prudent in the current environment.

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