CEO’s corner

Sanlam has a rich heritage having been founded in South Africa almost 100 years ago in 1918. As CEO of Sanlam’s Swazi subsidiary I stand in solidarity with our South African colleagues who celebrate August as woman’s month saying ‘’ Wathinta abafazi wathinta imbokodo’. A global example is Hillary Clinton, who is making history as the first woman nominated to contest the presidency of the United States of America.

Many Swazi women contribute to our national economic development. In particular the many women who are part of stokvels, savings and cooperative schemes. We applaud their culture of savings and thank them for the many instances their savings have been used to educate our nation’s children thereby both moulding our future potential clients and from a young age teaching them the importance of savings and investments.

newsletter

Swaziland

According to the Central Bank of Swaziland report dated 21st July 2016 together with the Monetary Policy Consultative Committee (MPCC), held a meeting to consider the appropriate monetary policy stance for the Bank.

Considering the international, regional and domestic economic conditions, and pursuing its price and financial stability mandate, the Bank decided to keep the bank rate unchanged at 7.0 per cent. The underlying reason to keep the bank rate unchanged was the moderation in inflationary pressures. The inflation rate fell from a high of 8.5 per cent in April 2016 to 8.0 per cent in May 2016 before further falling to 7.5 per cent in June 2016.

The report further goes on state that the inflation projections for the rest of 2016 have been moderately revised upwards by 0.64 per cent, to average 7.7 per cent. These forecasts are moderating due to the expected improvement in drought conditions. However, over the forecast period (2016-2018), food inflation is expected to remain elevated. Moreover, South Africa, the country to which the Lilangeni is pegged has kept the discount rate unchanged at 7 per cent.

The Central Bank noted that credit to the private sector grew by 10 per cent in May 2016 compared to May 2015. This is higher than the 9.3 per cent recorded in March 2016, compared to March 2015. The increase in credit was mainly supported by credit to Households which grew by 21.6 per cent while credit to Business declined by 9.0 per cent. The decline in credit to Business reflects a slowdown in economic activity as well as the adverse effects of the drought situation in the country.

Gross Official Reserves remain under pressure from the fiscal challenges faced. The current reserves are enough to cover over 4 months of imports of goods and services. This is above the recommended 3 months but lower than the regional target of 6 months. The Bank will continue to monitor the developments that will influence the movements of inflation and reassures that it will act appropriately if there are significant changes to the inflation outlook.

Review – SA Capital Markets

After posting steady performances in both April and May, the local equity market took a hammering at the end of June as the shock Brexit vote sent global markets into a tailspin. The quarter's +0.4% return for the FTSE/JSE All Share Index disguises substantial discrepancies in returns across the market. Of the major equity sectors, SA Resources extended its lead over the rest of the market with a positive return of 6.4%, SA Industrials rose 0.5% while SA Financials lost 4.3% over the quarter as companies with UK exposures weighed on the index.

Two common themes were observed amongst the winners and the losers in the market. The underperformers were largely those stocks exposed to the impact of Brexit namely Investec (-17.3%), Old Mutual (-6.2%) and Netcare (-13.6%). Many of the gainers are companies involved in restructuring and/or disposing of their noncore assets. Notable examples of such are Anglo American (+22.1%), Altron (+17%), Bidvest (+21%) and Pick n Pay Holdings (+3.7%).

Review – SA Economy

The second quarter of 2016 was not short of surprises.

In South Africa, the quarter kicked off with the President unexpectedly addressing the nation to apologise for his handling of the Nkandla ruling by the Public Protector. A month later the Minister of Finance released a media statement to address the rumours that his arrest was imminent. Unemployment edged to 26.7%, the highest since 2008, and SA business confidence fell to a new all-time low, hurt by poor performances in sectors such as manufacturing and retail. Still, SA narrowly avoided a downgrade to junk status by Standard & Poor's, but the agency maintained its negative outlook. Days later data showed that SA GDP contracted by an annualised 1.2% in the first quarter of 2016, keeping the country uncertain about the ratings agencies stance.

Outlook – SA Capital Markets

Equity markets have recovered following the Brexit vote however, investors do not believe the dust has settled and there will likely be a protracted period of uncertainty. In the recovery defensive stocks continue to outperform. Many stocks and sectors remain well down on pre-Brexit levels.

Back to the South African economy, the second quarter was a reporting season with many companies struggling to show real growth in earnings. In fact, it's only companies exposed to consumers (semi and non-durable retailers, fast food) that have been able to grow earnings in real terms. Having said this it does seem like the worst is behind us as mining productivity recovers and the effects of the drought dissipate into 2017.

The good news is that we are probably close to the end of rising interest rates; in particular as further increases from the Fed this year seem highly unlikely. Inflation will peak in the fourth quarter of 2016.

Outlook – SA Economy

The monetary policy committee (MPC) at the South African Reserve Bank (SARB) decided to keep the policy interest rate unchanged at 7.0% at the conclusion of the meeting held in May 2016. Inflation moderated a bit in the second quarter, but is still outside the upper limit (6%) of the bank's target range. On the positive side, South Africa avoided a sovereign credit rating downgrade for now - the risk for a downgrade now shifts to December. The rand followed the ebb and flow of markets and was little changed over the quarter to close at R14.78/$

There is still a mist of uncertainty of what local elections in the month of August may hold but it is concerning to see violent protests, which took place in previous months in Pretoria regarding the ANC's candidate for mayor.

Global Review – Capital Markets

In dollar terms, the MSCI World Index and MSCI Emerging Markets Index posted returns of +1.2% and +0.8% respectively for the second quarter. Global bonds, as measured by the Barclays Capital Aggregate Bond Index, rose +2.9%. The rand strengthened to R14.78/$, representing a welcome appreciation from the R15.49 level seen at the start of the year. Within the global universe, we are of the opinion that on a relative basis global equities remain attractive and have become even more attractive post Brexit. The dividend yield of developed market equities is at 2.8%. This is higher than the average dividend yield of the past thirty years. International property holding are on average dividend yield of 5.5% and are attractively valued especially relative to offshore cash and bonds

Global Review – Economy

The outcome of the UK referendum on 24 June, with the UK voting to leave the European Union after 43 years of membership, sent shock waves through global markets, which had clearly priced in a triumph of the 'Remain' camp. European stocks were especially hard hit and the British pound slumped by 12% within a few hours of the news, to its lowest level in 31 years. Soon after the Brexit vote, key rating agencies downgraded their UK sovereign rating, the Bank of England announced it was ready to pump more than £250 billion of liquidity if required, while the European Central Bank indicated it was ready to provide further liquidity.
The duration of the Brexit process is uncertain. A prolonged process could result in lingering global uncertainty and hurt confidence and global growth prospects. In the US, high-frequency releases have pointed towards a slight

pick-up of momentum after the economy expanded by 1.1% in the first quarter of 2016. Retail sales growth has risen, while the residential real estate market has shown further gains

Global Outlook – Equity Markets

Looking ahead, it is expected that equity markets, especially in Europe and the UK, will remain comparatively volatile until there is greater clarity regarding the course and timing of the UK's withdrawal from the European Union. This uncertainty has already offered up some very enticing long-term opportunities and is likely to offer some more in the next few months. Investors who are able to remain aloof to this volatility and stay focused on the long term are likely to be richly rewarded.

Global Outlook – Economy

In June emerging market currencies strengthened relative to the USD whilst the pound fell 8.3%. Banks were the hardest hit; even US banks being down 9% (likelihood of a US rate hike postponed) whilst emerging market banks generally did well. A few examples include Barclays (-30%), Bank of America (-11.5%), Yes Bank in India (+6.6%). (% in the above paragraph are for the month June in US$)

The Brexit vote has increased uncertainty about both the UK and Europe (possible referendums in France and Italy?) and this uncertainty will keep both growth and interest rates in developed markets very low. Needless to say, this has made emerging markets more attractive and as per above, this can be seen in June when for the first time in many years emerging market currencies appreciated against the USD during a period of a financial shock. Even politically challenging emerging markets now seem more stable than developed markets!

Global investors are starting to contrast the low growth in developed markets to that of emerging markets and are slowly beginning to move capital back to emerging markets.

Investment Strategy

Domestic (SA)	Position	Rationale
Local equities	Underweight	We retained our underweight position. Even though SA equities are fairly priced using a bottom-up valuation of the individual companies, we continue to prefer global developed market (DM) equities instead. SA equities continue to trade at a substantial premium to other emerging markets (EMs) on both a price-to-earnings and a price-to-book basis.
Local Bonds (SA)	Overweight	In January we increased our overweight position, specifically when the 10-year bond traded at 9.6%, offering among the highest local currency real yields in EMs. Since January our long bonds have rallied and we reduced the size of our overweight. The real yield on offer remains attractive, though, especially when compared to DM 10-year sovereign bond yields, which are at record low levels.
Inflation-linked bonds	Overweight	We retained our overweight position, which we implemented in December. Ten-year inflation-linked bonds then traded at real yields of 2.3%. The default risk on inflation-linked bonds is low as the government is in control of the rand printing presses. These bonds have now strengthened to 1.75%, but still trade above our current long-run assumption of fair value, which is 1.5%.
SA listed Property	Neutral	We retained our neutral position in listed property. We prefer international listed property companies, which we believe are cheaper.

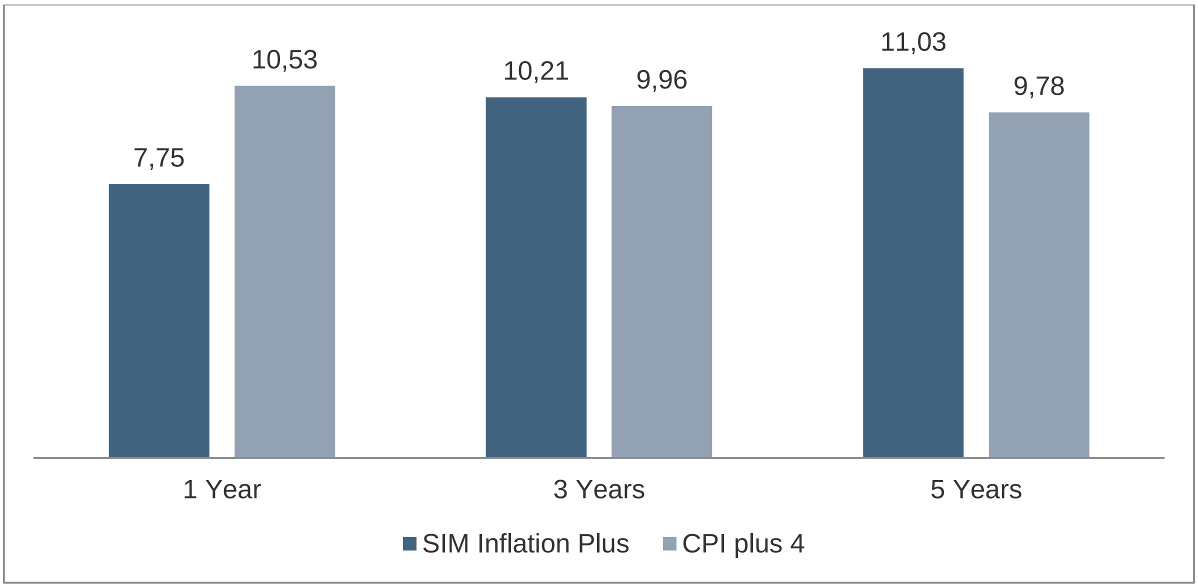
International (Global)	Position	Rationale
Global equities	Overweight	We retained our overweight position and think global equities are even more attractive after Brexit. The dividend yield of developed market (DM) equities is 2.8%; only in 2008 were dividend yields substantially higher than current levels. We continue to prefer Europe and the UK to the rest of the developed world. European companies trade at a lower price to book valuation and higher dividend yields than most other developed markets.
Global bonds	Underweight	The real yield on offer from DM bonds remains unattractive relative to riskier assets. We retained our underweight position in favour of international listed property. We also remain concerned about the long-run impact of quantitative easing on bond yields.
Global Property	Overweight	We retained our overweight position via listed REITs. Our portfolio currently consists of nine companies that have properties in the USA, Europe and Australasia. The average dividend yield of the portfolio is 5.5%.

Fund Performance

2nd Quarter 2016

SIM Inflation Plus Fund

This is a multi-asset low equity fund which aims to deliver smooth, positive real returns (adjusted for the effects of inflation) targeting CPI +4% over a rolling 3 year period. Equity exposure is limited to 40%. This actively managed fund is a combination of investments in equity, bonds, money market instruments and listed property both locally and abroad. It can invest 25% offshore. This fund uses derivatives to protect capital.

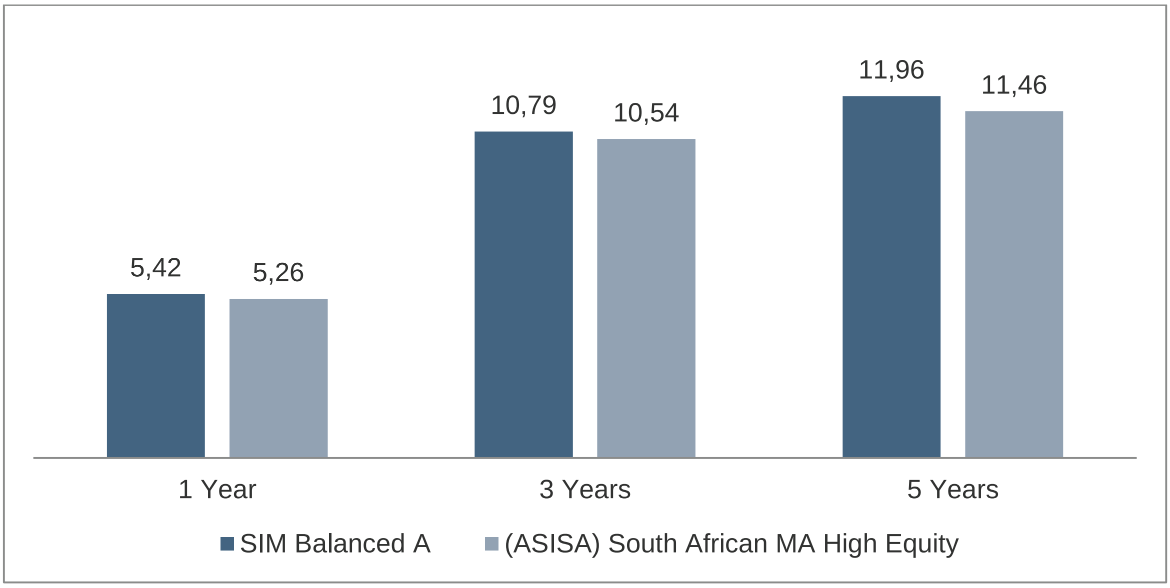


Fund Commentary

Over the last two years, the local equity market is up only 4%. Volatility has been high over this period, an indication of the uncertainty on macro drivers such as the timing of the next US Fed rate hike, Brexit impact, Chinese GDP growth, downgrading of SA's debt and general soft economic conditions in SA. Looking at the current pricing level of the market, we believe that not all of the above risks have been adequately priced in. The upshot for our value-based investment philosophy is that this type of environment provides us with more stock picking opportunities. As such, we have taken some profits in the Resources names and switched our holding in SABMiller into more attractively valued stocks such as Netcare and Nampak. In this environment, we believe that managing the portfolio with a long-term value creation mind-set will pay dividends to investors. We will maintain our disciplined approach of investing in those stocks which offer both a discount to our estimate of fair value and the required margin of safety.

SIM Balanced Fund

This is a medium-risk portfolio that aims to deliver income and capital growth over the medium term. This portfolio is designed to minimise volatility and aims to cultivate as smooth a ride as possible. There is some exposure to risky asset classes (such as equities) necessary to grow capital over the medium to long term. This fund holds a large weighting in JSE shares with a maximum equity exposure of 75%. Capital exposure will also include investments in money market instruments, bonds, listed property and up to 25% in offshore assets. The preservation of real capital is of primary importance in achieving this objective.

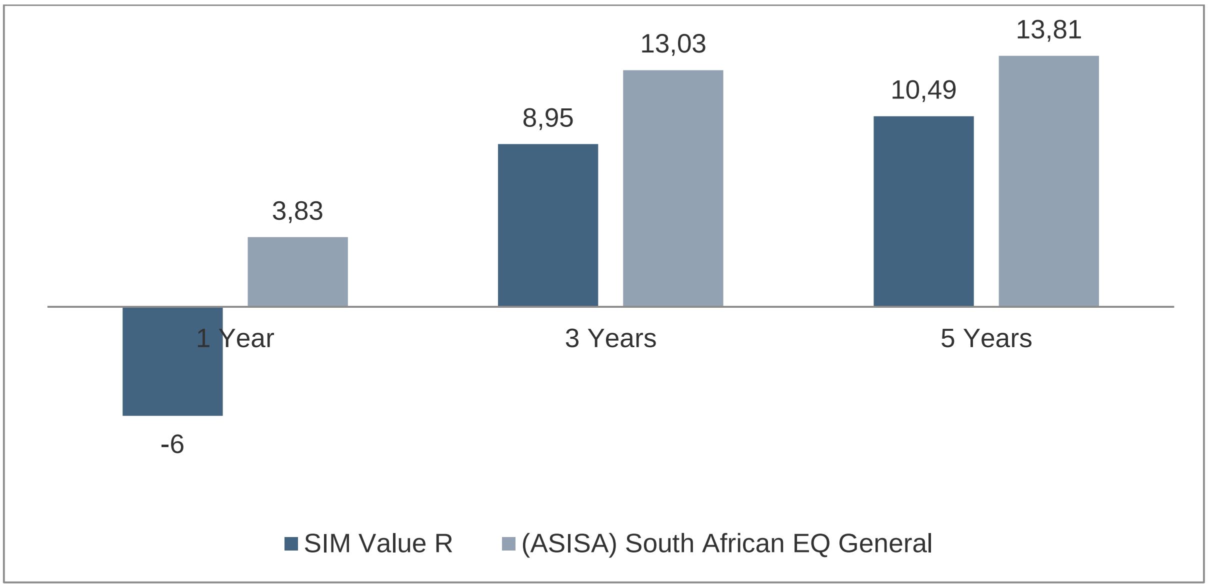


Fund Commentary

The rating agencies have recently confirmed South Africa's investment grade rating. Their ratings are a reflection of the ability of the country to service its foreign debt. Even so, the yield difference (spread) between the South African 10-year USD sovereign bonds and the USA 10-year sovereign bond is still at about 3%, which is 0.5% higher than where it traded on average in 2014 and 2015, before the surprise dismissal of the Minister of Finance by the President in December 2015. This 3% spread is also high relative to other investment grade countries and is a reflection of the increased sovereign risk premium attached to South Africa by foreign investors, despite the views of the rating agencies. When we make asset allocation decisions we consider the real return on offer from assets relative to their own long-run historical real returns. In addition to this we have to overlay the medium-term macro-economic framework and make suitable Sanlam Investment Management Balanced Fund June 2016 (Fund Fact Sheet) have to overlay the medium-term macro-economic framework and make suitable adjustments. For example, the world is currently still recovering from the 2008 financial crises and the developed world's central banks have all engaged in quantitative easing. We similarly consider the real returns available from South African assets relative to their own history. However, it is also useful to view these real returns relative to assets in similar commodity based emerging markets. With several of these countries, such as Brazil and Russia, there are similar concerns with regards to the political stability in the countries.

SIM Value Fund

This is an aggressively managed pure equity fund diversified across all sectors of the JSE. It offers a reasonable level of current income and the potential for long term outperformance. The portfolio aims to deliver capital growth over the long term (greater than 5 years) also substantially outperform the markets. The portfolio is diversified across all major asset classes with significant exposure to equities, and may include offshore equities. The fund managers only invest in shares which are undervalued and are very aware of downside risks. A maximum of 25% offshore assets may be held. There may be some capital volatility in the short term, although higher returns may be expected from five years or beyond.



Fund Commentary

The quarter was dominated by the British referendum, which will likely result in the end of Britain's 43-year membership of the EU. In spite of the knee-jerk sell off of equities, the FTSE 100 is up 4.4% in June and over 6% in Q2 2016. Even if one had perfect foresight of the referendum results (the bookies indicated Brexit had a 10% chance), not many forecasters would have predicted that equity markets would be higher just one week later. The impact on the South African economy will be fairly muted as the UK accounts for just over 3% of our exports. There are, however, several listed companies in South Africa with significant operations in the UK that were hit by the shock result. The worst of these were the property stocks (like Capco and Intu, which were down 17% and 12% respectively in the 2nd quarter) followed by financial stocks such as Investec (-17%).

Out & About

This quarter saw Sanlam Swaziland participating in a number of events. The team took part in the annual Mahamba Gorge Hiking. This year’s event attracted ± 5000 people who all enjoyed hiking the beautiful Mahamba Gorge.

Sanlam Team

Sanlam's Mpumelelo Ngcamphalala

Sanlam stand at Mahamba Gorge

**This newsletter is not for distribution outside Swaziland.*