momentum Securities | S P REID

Global ETF Portfolio - Multiple

June 2016

Investment objective

This is a global diversification portfolio aimed at a long-term sustainable capital growth, with a limited element of capital protection. Investors are placed in an S&P 500 index tracker fund which exposes the investor to a broad range of large-cap US listed companies, and allows the investor to diversify internationally and seek long-term growth. The investor is also exposed to the MSCI Europe ETF which offers exposure to a broad range of large, medium and small cap stocks within the developed market countries within Europe. There is further exposure to the MSCI Pacific ETF which offers the investor comprehensive access to large, medium and small cap stocks in Australia, Hong Kong, Japan, New Zealand and Singapore.

Investment profile

- For entry-level investors seeking international exposure
- Investors who have a longer investment term (in excess of 5 years)
- Value-based investors with a high-risk tolerance, seeking an internationally diversified managed portfolio
- Main objective: Capital growth
- Investors comfortable with inherent volatility of equities, as well as the volatility of international currencies

Risk profile

- ☐ Low
- ☐ Low-Medium
- ☐ Medium
- ☐ Medium-High
- ■ High

Portfolio information

Inception date	1 June 2015
Benchmark average	MSCI World Index
Investment manager	Momentum SP Reid Securities
Administrator/custodian	Momentum SP Reid Securities
Administration fee	0.5% (annual)
Minimum lump sum	$ 80 000
Redemption period	5 business days

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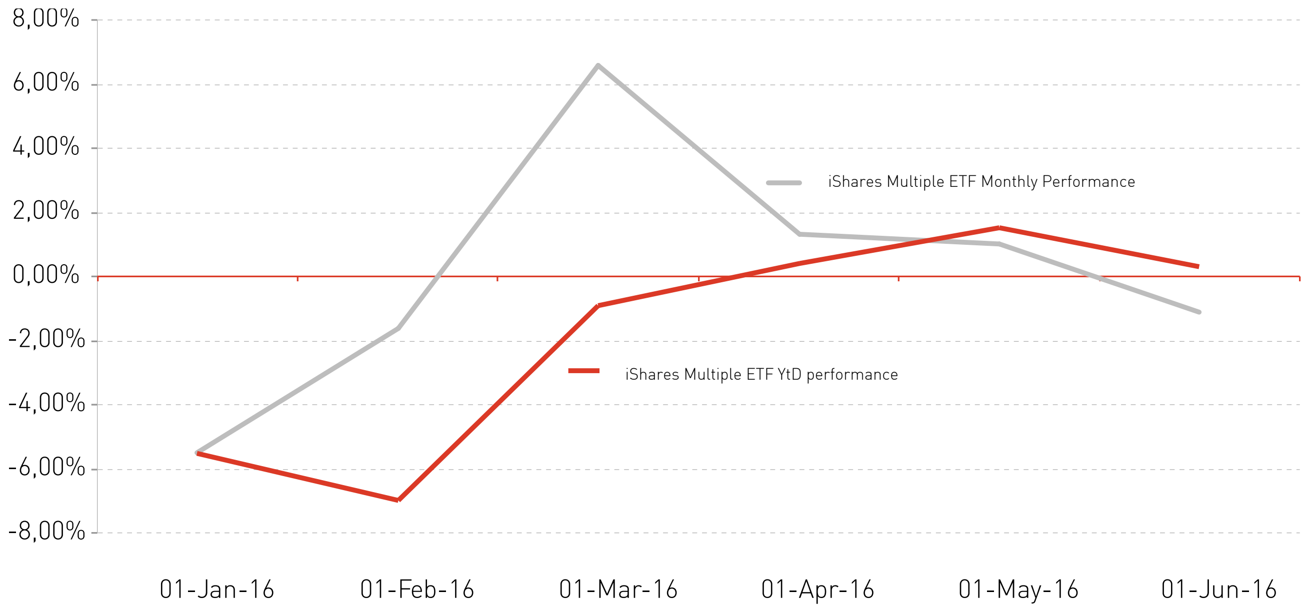
Performance in USD



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Economic and market snapshot for June 2016

Global economic developments

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Head of Macro Research and
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Economist

United States (US)

A more cautious mood amongst US Federal Open Market Committee (FOMC) members

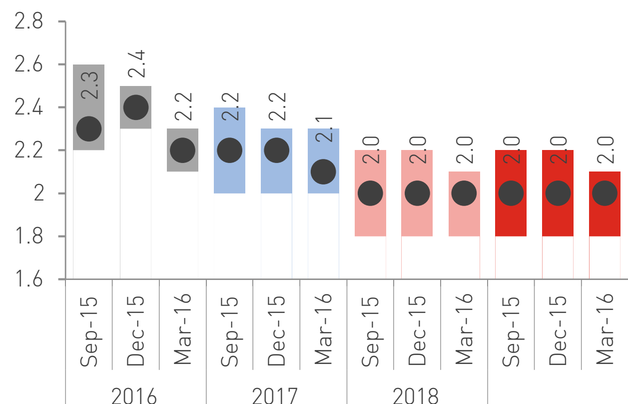
A dismal payrolls print for the month of May (38 000 jobs added versus a consensus expectation for a 162 000 gain) led to a significant repricing of interest rate hike expectations in the futures market in the run up to the June 2016 meeting. Although the FOMC acknowledged the slower pace of improvement in the US labour market, it noted that general economic activity had picked up.

The Citigroup Economic Surprise Index has turned less negative over recent weeks as the extent of downside surprises in US economic activity lessened. Although real GDP growth only expanded at an upwardly-revised rate of 0.8% q/q in seasonally-adjusted annualised (saar) terms in 1Q16, growth forecasts for the second quarter of the year look healthier. The Atlanta Federal Reserve (Fed) NowCast (a model predicting GDP growth based on high-frequency data releases) indicates that growth could have expanded at 2.7% q/q saar in 2Q16 (above the Blue Chip consensus of 2.5%). Higher growth will most likely be driven by robust consumption expenditure, which is estimated to have expanded by around 3% in 2Q16 based on realised retail sales figures to date.

The Fed's monetary policy statement was received as having a dovish overtone. The number of committee members only seeing one rate hike in 2016 went up from 1 to 6 (out of 17 members) relative to the March round of forecasting. Though the median forecast remains for two rate hikes before the year is up, the poor labour print for May has most likely dented perceptions of strength in the US labour market and the outlook for overall economic activity.

Although a tighter labour market, a gradual acceleration in inflation and firmer economic activity could, in our view, see the Fed raising rates before year end, the committee is likely to closely monitor any negative spillover effects on the domestic economy related to the UK's decision to exit the European Union (EU). External risks are likely to ensure a gradual pace of rate tightening in the US.

Chart 1: Fed's long-run growth estimates steady at 2.0%



Source: Federal Reserve, Momentum Investments, dot = mid-point of central range

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Eurozone

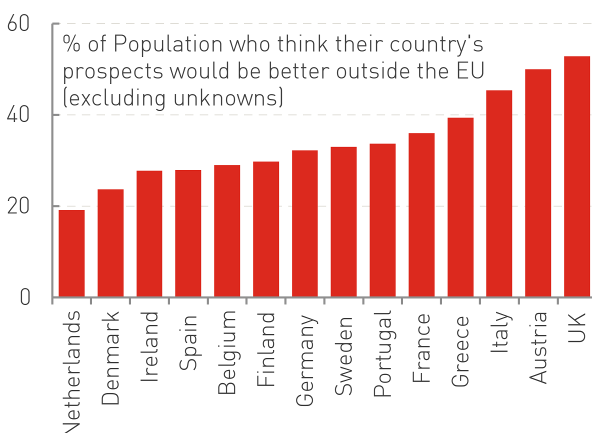
Concerns rise over growing support for Eurosceptic parties

The United Kingdom's (UK) vote to leave the EU has raised alarm bells over the growing calls for referendums to be held in other EU member countries.

According to Capital Economics, the most Eurosceptic countries surveyed in an Ipsos poll are Italy, France and Sweden. The European Commission (EC) Eurobarometer carried out in November 2015 suggested that Austria had the strongest anti-EU views, with 41% of the respondents holding a negative view of the EU. This was followed by 37% of the respondents in Greece, 27% in Germany and 25% in France.

Economic prospects are being displaced with political concerns. Despite respondents in the Netherlands being the least optimistic about their country's chances outside of the EU (less than 25% of respondents in the Netherlands and Denmark were optimistic on their respective countries prospects existing outside of the EU - see chart 2), opinion polls suggest that Eurosceptic parties in the region could capture 57% of the vote.

Chart 2: Voting on economic prospects outside of the EU



Source: Capital Economics, Momentum Investments

An upcoming referendum in Italy on constitutional reform in October 2016, followed by elections in the Netherlands in March 2017, French presidential elections in April 2017 and German elections later in the year suggest that political risk will play a major role in preventing a sharper acceleration in growth in the region in upcoming quarters.

Anaemic growth has suppressed price pressures further, with headline inflation printing at a negative 0.1% in May 2016. With downside risks to growth having intensified following the Brexit decision, we expect a further response from both fiscal and monetary authorities.

United Kingdom

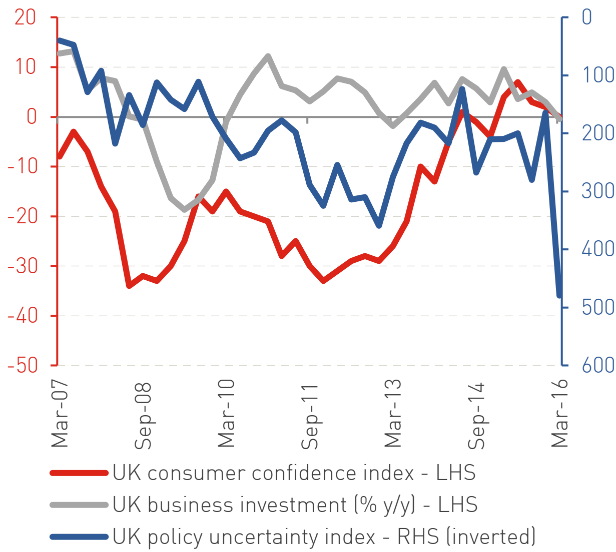
Britain votes to leave the European Union

Although Scotland, Northern Ireland and London voted in aggregate to stay within the EU, these votes were insufficient to offset a significant "leave" vote from Wales and pockets of England, resulting in the "leave" vote obtaining 51.9% of the final tallied votes.

The UK will likely remain inside the EU for at least two years (and possibly even longer) as the UK irons out its future trading relationship with the remainder of the EU and the rest of the world. Political and economic uncertainty is likely to linger for some time, leading to a weaker GBP.

As a result, UK businesses are likely to hold off investment and hiring, hence curbing growth (see chart 3). UK consumers are likely to feel the pinch as hiring intentions suffer and as inflation ratchets higher.

Chart 3: Uncertainty has dampened confidence



Source: Bloomberg, Momentum Investments

The Organisation for Economic Co-operation and Development (OECD) estimates that under Brexit UK GDP will be 3% below the level it would have been if the UK stayed in the European Union. It notes that every country in the EU would suffer a 1% growth decline. The OECD further estimates that financial shocks, as well as weaker European demand, could lower the level of GDP in the BRICS (Brazil, Russia, India, China, South Africa) nations and other non- OECD economies by more than 0.5% by 2018 as Brexit stirs global uncertainty among investors, businesses and consumers, resulting in negative consequences for global growth and the flow of global capital around the world.

UK trend growth is also likely to be negatively impacted as supply-side challenges (including a reduction in the size of the labour force through a possible lowering of net migration inflows) impact longer-term growth. The OECD suggests that UK GDP could be over 5% lower by 2030 than otherwise if the exit had not occurred.

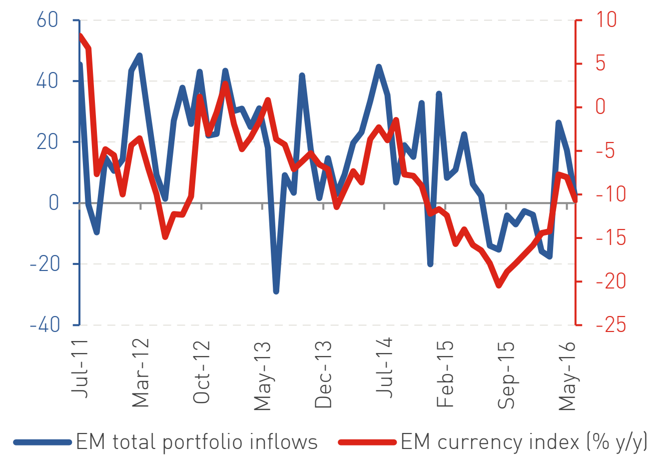
During the period of elevated uncertainty under the Brexit reality, the safe-haven assets will likely be US Treasuries, the US dollar, the Japanese yen, the Swiss franc and gold. A rising risk-off tendency puts all perceived risky assets under pressure – including equities, the euro, British pound, commodity prices, as well as emerging market (EM) currencies and assets.

Emerging markets (EM)

The dust should eventually settle in EM following the initial reaction to Brexit

The initial shock of the Brexit vote has triggered a flight to safety. As such, capital inflows into emerging markets are likely to have dipped further over June following soft May data (see chart 4).

Chart 4: Reduction in positive EM sentiment



Source: Bloomberg, Momentum Investments

Aside from capital flows, diverse growth outcomes across emerging markets have further been driven by relative sensitivity to a muted commodity price environment, the pace of structural reform momentum, the level of US dollar-denominated debt and the availability of policy buffers.

A negative terms-of-trade (export prices relative to import prices) shock has driven a sharp slowdown in domestic demand in net commodity-exporting emerging markets, while commodity-importing EMs have been far more resilient. Weaker growth in the former has led to larger external imbalances, an extension of government budget deficits, higher debt levels and elevated debt burdens. This has left more net commodity-exporting nations in a poorer credit standing and with limited policy buffers to protect growth.

Nonetheless, growth in retail sales and exports in the weaker-performing regions appear to be bottoming out. Better weather conditions should enable a mild recovery in drought-inflicted Sub-Saharan Africa next year, while a stabilisation in the oil

price should aid a gradual improvement across the Middle East and North Africa. Growth is expected to recover off a low base in Latin America, Emerging Europe and Central Asia as domestic challenges abate in 2017. Meanwhile, further policy accommodation and economic reform are likely to drive a stabilisation in Emerging Asia over the same time period.

Local economic developments

May's inflation print surprises positively, but headline figure set to rise into 4Q16

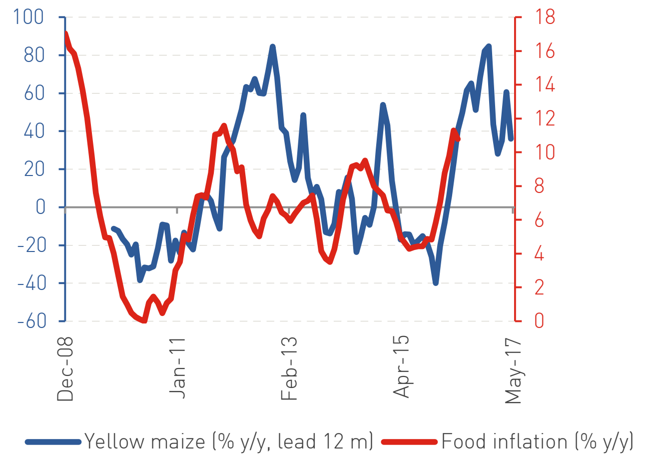
Headline inflation dropped to 6.1% in May in year-on-year terms, undershooting our own (6.3%) and the Bloomberg consensus (6.4%) forecast.

The momentum in food price inflation slowed, increasing by a mere 0.2% m/m. This is significantly lower than the average 2% m/m increase experienced over the previous four months. As a result, food inflation dipped to 10.8% in May from 11.3% in April in year-on-year terms. The largest contributor to the overall rise in food inflation remains prices of bread and cereals, followed by fruit and vegetables.

A recent reversal in maize prices bodes well for food inflation further down the line. Leading the rand value of yellow maize prices (% y/y) by twelve months suggests an improvement in the food inflation trajectory in 2017 (see chart 5). This downward move has already been partly captured at the producer price inflation (PPI) level, where PPI crop inflation reversed sharply from 44.3% y/y in February to 27.3% y/y in April.

Core inflation (excluding food, beverages, petrol and energy) declined to 5.5% y/y in May from 5.7% in February, despite clear indications of rand-related price pressure in recent months. We expect core inflation to track marginally higher over upcoming months, but to remain below the upper band of the 3% - 6% inflation target range.

Chart 5: Maize prices stabilising and turning lower



Source: Stats SA, Global Insight, Momentum Investments

We expect inflation pressures to build towards year end on the back of higher food prices and pass-through from previously unfavourable currency movements. Potential currency shocks and wage cost pressures provide significant upside risks to the inflation trajectory, which is expected to remain outside the target band in upcoming quarters.

Moreover, inflation expectations (businesses and trade unions in particular) remain stubbornly high, posing a threat to second-round inflation pressures.

In addition, a still-elevated current account deficit and recent comments by the SA Reserve Bank (SARB) suggesting that monetary policy remains highly accommodative, suggest that a further 25 basis point hike later this year is still likely. The SARB is unlikely to hike rates more aggressively against the backdrop of subdued growth expectations and depressed confidence levels pointing to a shallow growth recovery.

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Financial market performance

Global markets

World equity markets were down 0.6% at the end of June 2016, led weaker by losses (-1.1%) in the MSCI Developed Markets Index, which more than offset gains in the emerging market composite.

The Eurostoxx 50 Index and the Nikkei 225 Index were amongst the worst performers in the developed market composite. European stocks lost 6.1% following the UK's vote to quit the EU. Meanwhile, Japanese shares plummeted 9.5% on the back of a firmer yen. The yen strengthened around 6% against the US dollar over the past month as investors increasingly sought out safe-haven assets in the current risk-off climate.

The MSCI Emerging Markets Index fared better, posting gains of around 4.0% in June 2016. After declining by nearly 11% in the previous month, the MSCI Emerging Markets Latin America Index bounced back in June, increasing by 11.4%. This was followed by a moderate 3.3% uptick in the MSCI Emerging Markets Europe, Middle East and Africa (EMEA) Index and a 2.8% rise in the MSCI Emerging Markets Asia Index.

Local markets

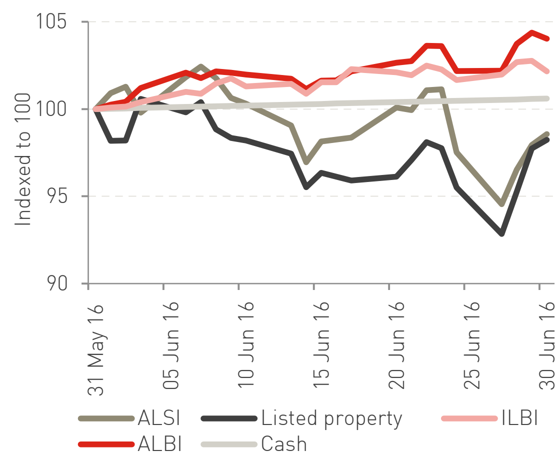
Local equities followed the slump in global markets. The FTSE/JSE ALSI fell by 3.0% in June 2016, with losses fairly broad-based across the underlying indices. The FTSE/JSE Industrials Index, which includes many of SA's large dual-listed firms that was negatively impacted by the Brexit fallout, lost 3.5%. This was followed by a 2.5% drop in the FTSE/JSE Resources Index and a 2.1% decline in the FTSE/JSE Financials Index.

Mid-caps outperformed small-caps over the month. The FTSE/JSE Mid-cap Index ended the month 3.2% higher, while the FTSE/JSE Small-caps Index traded largely sideways.

The ALBI gained 4% over the same time period, as the SA ten-year bond yield rallied by 54 basis points. Meanwhile, listed property performance fizzled out, increasing by a mere 1.2%. Inflation-linked bonds rose 2.2%, while SA cash gained 0.6% over the month.

Emerging market currencies ended the month firmer. The SA rand posted the second-largest monthly gain among a basket of EM currencies, second only to the stellar 12.4% appreciation of the Brazilian real against the US dollar. The rand gained 6.8% against the US dollar and a firmer 7.2% against the euro, given the euro's relative losses against the US dollar in the current risk-off environment.

Chart 6: Local asset class returns



Source: Bloomberg, Momentum Investments

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