BELMONT
ASSET MANAGEMENT

MARKET COMMENTARY – DECEMBER 2017

MARKET REVIEW

It was another good quarter for world equity markets amid strong corporate earnings growth and improving world economic data. Investors also responded positively to the announcement of a $1.5 trillion tax cut in the US and to the re-election of Prime Minister Shinzo Abe in Japan.

INDEX	3 MTH TOTAL RETURN IN USD (%)	3 MTH TOTAL RETURN IN EUR (%)	3 MTH TOTAL RETURN IN GBP (%)
MSCI WORLD	5.6	4.0	4.8
S&P 500 (US)	6.6	5.0	5.8
FTSE EUROPE EX UK	1.2	-0.4	0.4
FTSE ALL SHARE(UK)	5.8	4.2	5.0
TOPIX (JAPAN)	8.6	6.9	7.7
MSCI EMERGING MARKETS	7.5	5.8	6.6
MSCI ASIA EX JAPAN	8.3	6.6	7.4

The US

The S&P 500 Index rose by 6.6% in US dollars. US equities had a good year, remarkable not only for their strong returns but also for their unusual lack of volatility. US equities delivered positive returns in every single month of 2017. They rose both in anticipation of and following the announcement of the tax cuts. They were also supported by generally positive macroeconomic data.

The passing of meaningful tax policy legislation was a key Trump election campaign promise and the bill was finally agreed by Congress late in 2017. While there are features of the plan designed to benefit individual taxpayers, the cornerstone of the legislation is corporate tax reform. The corporate tax rate was lowered from 35% to 21%, which should boost after-tax earnings for US companies.

Annualised third-quarter gross domestic product (GDP) growth of 3.0% was better than expected and unemployment fell to the lowest level since 2000. The Fed also raised its growth forecasts for 2018 to 2.5% from 2.1%. As had been widely expected, the US Federal Reserve (Fed) increased its key interest rate by a further 0.25% in December.

Europe

Eurozone

The FTSE Europe ex UK index fell by 0.4% in euros but rose by 1.2% in US dollars. Eurozone equities had a very good start to the year, as business confidence improved and political risk faded. The euro's strong rally in 2017 explains much of the subsequent drag on European equities in local currency terms.

Amid generally favourable economic data, the European Central Bank (ECB) announced in October that quantitative easing would be extended to September 2018 but that the pace of purchases would be reduced from €60 billion per month to €30 billion.

In Germany, coalition talks collapsed between Angela Merkel's CDU/CSU and the liberal FDP and the Greens. However, the centre-left SPD agreed to talks with the CDU in an effort to resolve the impasse. In Spain, Catalonia held a regional election which failed to resolve the independence issue. Separatist parties retained a slim majority overall but Ciudadanos, who favour the union with Spain, emerged as the largest single party.

UK

The FTSE All Share index rose by 5.0% in sterling and by 5.8% in US dollars. Investors were encouraged by the completion of the first phase of the Brexit negotiations in December, even though many challenges remain. Despite a sluggish economy, the Bank of England (BoE) raised interest rates for the first time since November 2007, from a record low of 0.25% to 0.50%. Annual consumer price inflation reached 3.1% in November, breaching the BoE's upper target. The BoE said that any further rate rises were likely to be very gradual and would remain highly dependent on the outcome of the Brexit negotiations.

Japan

The Topix index rose by 8.7% in yen and by 8.6% in US dollars. Japanese equity markets were strong, driven partly by the reassurance of political stability following a favourable election result. Shinzo Abe was re-elected with a large majority on behalf of the Liberal Democratic Party in a snap election, which boosted confidence that there should be few changes to his economic policies.

Investors also responded positively to company earnings, which rose by 16% year-on-year in the third quarter, and to encouraging economic data. The unemployment rate declined to 2.7%, inflation data unexpectedly improved and industrial production and retail sales were comfortably ahead of forecasts. The Bank of Japan's quarterly Tankan survey recorded the strongest sentiment among large manufacturing companies for more than 11 years.

At its latest meeting, the Bank of Japan (BoJ) maintained interest rates and existing levels of stimulus. The BoJ re-iterated its expectation for a moderate expansion in growth, as well as an increase in inflation towards its 2% target.

Emerging Markets

The MSCI Emerging Markets Index rose by 7.5% in US dollars.

China: The MSCI China IMI Index rose by 7.0% in US dollars. Third quarter GDP growth was stable at 6.8%. At the 19th Communist Party Congress in October, emphasis was placed on focussing on the quality of growth and addressing structural risk. China sold $2 billion of bonds, its first sale of U.S. dollar-denominated debt in 13 years.

Russia: The MSCI Russia IMI Index rose by 3.8% in US dollars. The extension of the agreement to reduce oil production reduces pro-inflationary risks over the next year. In recognition of this, the Bank of Russia cut its key interest rate by 50 basis points to 7.75%.

Brazil: The MSCI Brazil IMI Index fell by 1.9% in US dollars. Investor sentiment deteriorated as top government officials and lawmakers pushed back a potential vote on a pension reform bill seen as crucial in helping to fix the country's fiscal woes. The central bank cut its key interest rate to a historic low of 7% and the real weakened by 5% against the U.S. dollar.

India: The MSCI India IMI Index rose by 13.4% in US dollars. Indian equities performed well amid signs of accelerating economic growth and following the announcement of the government's plans for a significant recapitalisation of state-controlled banks.

South Africa

South Africans had plenty to cheer about over the festive season last year. While GDP growth remained positive at 2% over the previous quarter, largely driven by a recovering agricultural sector, the election of Cyril Ramaphosa as ANC president took centre stage and resulted in an immediate boost in the Rand and non Rand-hedged JSE shares.

In his first few weeks as ANC president, Mr. Ramaphosa vowed to strengthen the ANC by putting an end to corruption and by redistributing land to more productive use. Although there remain question marks around his support base at an executive level and by extension his capacity to execute policy, Mr Ramaphosa's election has already contributed to renewing trust in the South African economy.

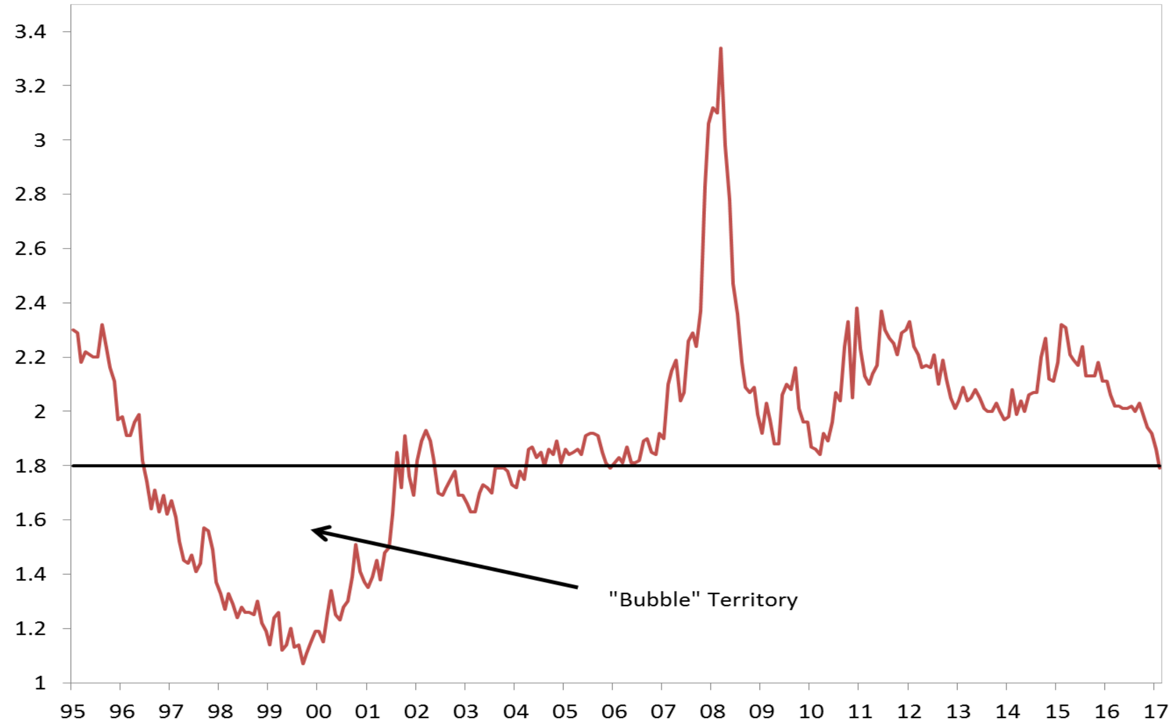
The Rand gained 8.6% against the US Dollar, 7.1% against the Euro and 7.1% against Sterling during the fourth quarter. The stronger Rand was in spite of President Jacob Zuma's announcement of providing free tertiary education, which will add further strain to the fiscus. The overall strength however resulted in an improved outlook for interest rates, although the higher petrol price will weigh negatively in the short-term on any of the Reserve Bank's decisions.

The JSE: On the back of a change in sentiment following the ANC's election of Cyril Ramaphosa, non Rand-hedged shares on the JSE witnessed a rally not unlike the recent "Trump rally" in the US. Financials were especially firm, increasing 17% over the previous quarter. Rand-hedged shares meanwhile retreated in line with the currency. Furthermore, the JSE witnessed its biggest corporate scandal ever as the price of Steinhoff shares crashed more than 90% due to alleged fraud. Fortunately, Belmont had no exposure to this company whatsoever.

INVESTMENT ENVIRONMENT AND OUTLOOK: *All rooms sea-facing in 2018*

With global growth set to reach 4% in 2018, the improved outlook to which we referred last quarter has become more entrenched and we like Investec's quote: "All rooms sea-facing in 2018". This implies demand for later cycle assets, commodities and emerging markets. Country specific policies such as US tax reform and infrastructural spending should enhance this supportive environment. The one potential major headwind remains higher interest rates through normalisation of monetary policies post the era of massive quantitative easing (QE). However all evidence is that with inflation showing no signs of life, US interest rates will rise slowly and reactively to good US data and therefore at this stage pose no threat to continued economic growth. The fundamentals for equity investments accordingly remain very positive. However valuations have become more expensive, e.g. US dividend yields have fallen, but are not yet in bubble territory such as 1999-2000 (see chart 1). On the balance of probabilities, the bull market remains intact.

Chart 1: Dividend yield of S&P 500 Index



SOUTH AFRICA: *Political developments favourable for once*

While South Africa is a general beneficiary of the currently favourable environment for commodities and emerging markets, the election of Cyril Ramaphosa as ANC president is an additional tailwind since apart from his other qualities he appears to be sensitive to the needs of foreign investors. While it is quite possible that in the interests of ANC unity Jacob Zuma will be allowed to complete his term as SA president, market confidence in the better domestic outlook has already improved. In December this manifested as stronger rand and bond prices, and a rerating of local interest-rate sensitive shares such as banks and retailers. We expect this trend to continue for the time being as long term value is still present in many non-rand hedges.

STRATEGY: *Complacency could become a risk, dance closer to the exits*

With international stock markets around record highs, much good news is already reflected in share prices. This includes the JSE, which has a large proportion of dual-listed international shares. Further rerating of the USA's benchmark S&P 500 share index would start taking valuations in terms of dividend yields into bubble territory (see chart 1 again) and causing what Jeremy Grantham of GMO refers to as a "melt up" as opposed to a "melt down" or crash. It is possible that complacency as a result of the benign global environment could lead to such a scenario. However, even if we gave such a scenario a high probability it would be unprofessional speculation to rely upon it. Accordingly our strategy both offshore and onshore is one of caution and funds will only be committed very selectively where good value still remains. Some selling may be done where good share price appreciation has led to overweight positions and excessive exposure.

Indices by Sector

	Sector	2016 31-Mar	01-Jul	30-Sep	30-Dec	2017 31-Mar	*3 months* % Chg	*6 months* % Chg	*9 months* % Chg	*12 months* % Chg
1	Gold Mining	1 978	2 448	2 115	1 357	1 381	1.8%	-34.7%	-43.6%	-30.2%
2	Mining	19 260	22 796	24 474	23 511	23 557	0.2%	-3.7%	3.3%	22.3%
3	Banks	6 675	6 457	7 056	7 755	7 135	-8.0%	1.1%	10.5%	6.9%
4	General Industrials	161	174	176	185	171	-7.6%	-2.8%	-1.7%	6.2%
5	Financial	42 386	40 584	40 419	41 478	40 261	-2.9%	-0.4%	-0.8%	-5.0%
6	Food Producers	8 430	9 297	9 755	9 795	10 182	4.0%	4.4%	9.5%	20.8%
7	Life Assurance	39 875	37 861	36 514	35 701	36 408	2.0%	-0.3%	-3.8%	-8.7%
8	**All Share Index**	**51 584**	**52 358**	**51 950**	**51 021**	**52 458**	2.8%	1.0%	0.2%	1.7%
9	Construction	20	18	21	21	24	12.4%	12.4%	28.3%	18.0%
10	Electronics	15 792	14 237	13 861	14 904	15 016	0.8%	8.3%	5.5%	-4.9%
11	**Top 40**	**45 485**	**46 016**	**45 426**	**44 261**	**45 561**	2.9%	0.3%	-1.0%	0.2%
12	General Retailers	7 739	7 624	6 904	7 030	7 144	1.6%	3.5%	-6.3%	-7.7%
12	Industrial 25	70 053	70 821	68 218	64 283	69 001	7.3%	1.1%	-2.6%	-1.5%
13	Beverages	302	286	267	244	229	-6.1%	-14.2%	-19.9%	-24.2%