BELMONT
ASSET MANAGEMENT

MARKET COMMENTARY – MARCH 2018

MARKET REVIEW

While the overall global economic backdrop remained strong during the first quarter of 2018, most equity markets declined amid investor concerns about rising interest rates, inflation pressures and international trade tensions. The US initially announced tariffs on steel and aluminium imports. This was followed by the announcement of a 25% tariff on $60 billion worth of Chinese imports. China responded by announcing increased tariffs on $3 billion worth of US imports. Collectively the equities of developed markets underperformed those of emerging markets. The U.S. dollar declined against the yen, the euro and sterling.

INDEX	3 MTH TOTAL RETURN IN USD (%)	3 MTH TOTAL RETURN IN EUR (%)	3 MTH TOTAL RETURN IN GBP (%)
MSCI WORLD	-1.3	-3.6	-4.8
S&P 500 (US)	-0.8	-3.1	-4.3
FTSE EUROPE EX UK	-1.2	-3.5	-4.7
FTSE ALL SHARE(UK)	-3.4	-5.7	-6.9
TOPIX (JAPAN)	1.0	-1.4	-2.6
MSCI EMERGING MARKETS	1.4	-1.0	-2.2
MSCI ASIA EX JAPAN	0.7	-1.7	-2.9

The US

The S&P 500 Index fell by 0.8% in US dollars.

US equities had a strong start to the quarter, buoyed by strong economic data and corporate earnings and the confirmation of a major tax reform package. Gross Domestic Product (GDP) increased at an annual rate of 2.9% in the fourth quarter of 2017. Unemployment remained at 4.1%, a 17-year low.

However, the latter part of the quarter saw a marked increase in volatility. Investors reacted negatively to an elevated US inflation reading and the possibility that the Federal Reserve (Fed) might need to become more proactive in raising interest rates in order to keep upward price pressures under control. While the Fed did indeed raise rates by 0.25% in March, to a range of 1.5% to 1.75%, it did not alter its overall rate projection of three hikes for 2018. This eased some concerns, but the subsequent announcement of new international trade tariffs triggered a renewed bout of turbulence in March.

Europe

Eurozone

The FTSE Europe ex UK index fell by 3.5% in euros and by 1.2% in US dollars.

Eurozone GDP grew by 2.5% year-on-year in the fourth quarter, the fastest pace in a decade. The unemployment rate fell to 8.6% in January, the lowest level since December 2008. Annual inflation was 1.1% in February, below the European Central Bank's (ECB) target of 2%. ECB chairman Mario Draghi reiterated that interest rates would not rise until well past the end of the quantitative easing programme.

On the political front, Germany formed a new government after its inconclusive elections in September 2017. A coalition deal was agreed between Angela Merkel's CDU party and the SPD, ending five months of political deadlock. Italy's election yielded no overall winner. The anti-establishment Five Star Movement emerged as the largest single party. President Mattarella will now mediate talks to form a new government.

UK

The FTSE All Share index fell by 6.9% in sterling and by 3.4% in US dollars.

While UK economic growth remained sluggish it continued to surpass low expectations. The BoE maintained interest rates and stimulus over the quarter and said that inflation was expected to ease in the short-term but remain above the 2% target. They upheld their view that further interest rate rises would be necessary to tame inflation, although this would be a gradual move.

There was further progress with Brexit negotiations over the period. Prime Minister May rejected the EU's draft legal agreement which proposed keeping Northern Ireland in a customs union, effectively creating a new border in the Irish Sea. The UK and EU later agreed on a transition deal which would lead to a more orderly withdrawal of the UK.

Japan

The Topix index fell by 4.7% in yen but rose by 1.0% in US dollars.

Japan's economy grew an annualized 1.6% in the fourth quarter, the eighth consecutive quarter of growth. Increased hotel and infrastructure development ahead of the 2020 Olympic Games in Tokyo contributed to a 20% surge in tourism in 2017, which supported retail sales and domestic growth. In February, retail sales rose 1.6% from a year previously. Inflation continued to accelerate slowly. The Consumer Price Index advanced 1.5% in February from the previous year. In March, the Bank of Japan voted to keep its accommodative monetary policy unchanged.

While controversy surrounding the Moritomo Gakuen land sale has dented Prime Minister Abe's approval rating, the decision by the ruling Liberal Democratic Party to recommend the reappointment of Mr Kuroda for a second term as Governor of the Bank of Japan has eliminated one area of potential uncertainty and should ensure a stable policy environment.

Emerging Markets

The MSCI Emerging Markets Index rose by 1.4% in US dollars in spite of increased market volatility stemming from tensions over global trade. Investors were encouraged by steady economic growth in China and other developing countries, higher oil prices and a weaker dollar.

China: The MSCI China IMI Index rose by 1.9% in US dollars. Although Chinese equities were volatile towards the end of the quarter, they recorded a positive return. Macroeconomic data was more resilient than expected. GDP growth for 2017 accelerated to 6.9% year-on-year, well above the government's target of 6.5%. Strong industrial growth, higher exports and a resilient property market were all core drivers of economic growth.

Russia: The MSCI Russia IMI Index rose by 9.3% in US dollars as oil prices rose, Russia's central bank cut interest rates and the country's debt was upgraded to investment grade by ratings agency Standard & Poors. Vladimir Putin won a six-year term as Russian President with over 76% of the vote. This victory extended his expected time in office to almost 25 years.

Brazil: The MSCI Brazil IMI Index rose by 11.6% in US dollars as former president Luiz Inácio Lula da Silva saw his criminal conviction upheld, increasing the chances of the left-wing candidate being prohibited from participating in October's presidential elections. Its central bank cut the benchmark interest rate to a record low and signalled the possibly of another cut as inflation remained muted.

India: The MSCI India IMI Index fell by 8.0% in US dollars amid concerns about a reported fraud at a state bank and weak performance from the ruling Bharatiya Janata Party in state by-elections. Indian equities lagged despite signs that economic growth was picking up again. India's economy advanced a better-than-expected 7.2% for the last quarter of 2017, following slower growth in the previous six months.

South Africa: The MSCI South Africa IMI Index fell by 3.5% in US dollars. South African GDP surprised on the upside in the last quarter, posting a 3.1% gain quarter-on-quarter and a 1.3% gain for the year 2017, which was ahead of the Reserve Bank's expectations. Positive trends in the agricultural and manufacturing sectors contributed mainly to the GDP growth, while lower precious metals production due to a sustained low platinum price weighed negatively.

It is encouraging to note that improvements in business and consumer confidence since the election of Cyril Ramaphosa have resulted in upward revisions of growth expectations for 2018 from both the World Bank (1.4%) and the Reserve Bank (1.7%). Recognising the urgent need for growth, Mr Ramaphosa has hit the ground running in his first few months as president, acting decisively to strengthen government institutions by replacing many incompetent and corrupt ministers and leaders. These actions together with the recent sentiment boost would have no doubt played a role in Moody's decision not to downgrade South Africa's debt to junk status.

The rand had a strong quarter against the dollar, gaining 4.4% on the back of greater political certainty. The euro similarly lost 1.9% to the rand while sterling's decline versus the rand was more demure at 0.8%. This rand strength could help to explain the steady deceleration in the consumer price index (CPI), which increased by 3.8% over the previous year in March. This in turn motivated the Reserve Bank to vote for only the second cut in the prime interest rate in six years, to 6.5%.

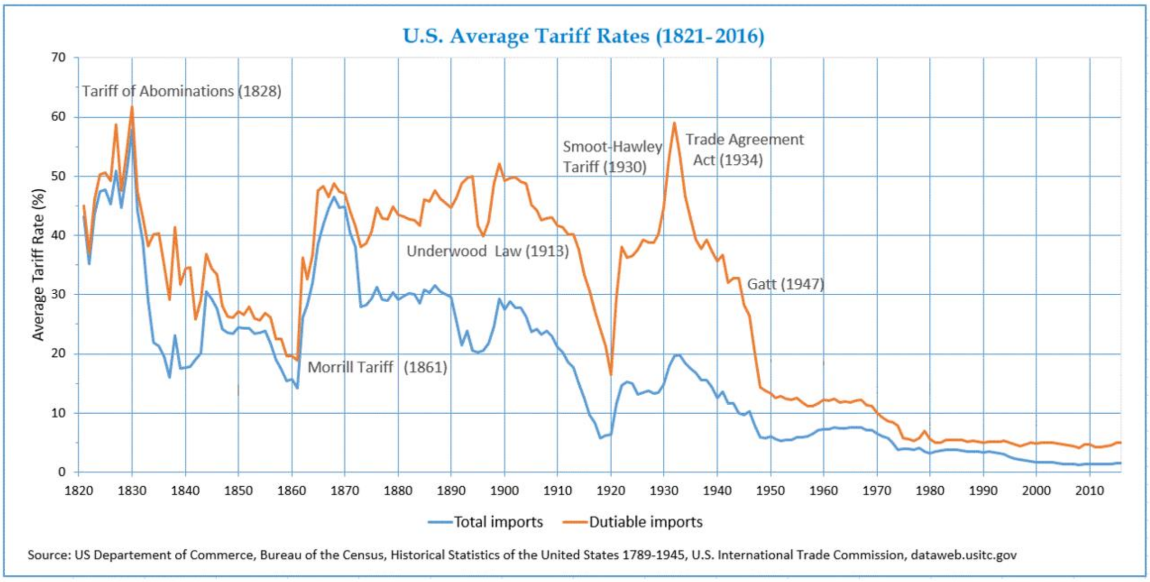
The JSE: In the wake of the Steinhoff scandal, the JSE witnessed further share price crashes from companies such as those in the Resilient property stable as well as EOH technologies. There appears to be greater scrutiny on corporate governance and fraud and this can only be a positive for the JSE in the long run. Naspers and British American Tobacco were hit particularly hard in the quarter, while local retail shares such as Shoprite and Mr Price rode the wave of what has now been dubbed "Ramaphoria".

INVESTMENT ENVIRONMENT AND OUTLOOK: *Are trade war fears misplaced?*

While Donald Trump's tariff hikes have triggered trade war fears, it is difficult at this stage to know how far a retaliatory cycle of tariff increases would go. This is because he appears to be using tariff increases or threats thereof as a negotiating tactic to reverse unfair trade practices in the USA's trading partners. We suspect it is just a negotiating tactic because it is almost certain that Trump and his team of economic advisors are aware of the Smoot-Hawley Tariff Act of 1930 which raised tariffs on over 20 000 US imported goods. The consensus of economists is that the Act exacerbated the great depression of 1929-1933 although the legendary monetarist Milton Friedman believes that tight monetary policy played a greater role. Either way, it appears as if Trump's negotiating tactics may be working. Quoting from Investec Wealth and Investment's note of 11 April:

"Say what you like about Trump, but he can be effective! Yesterday China's leader Xi Jinping pledged a "new phase of opening up" in a keynote address to the Boao Forum for Asia. Effectively he has promised to open his nation's banking and manufacturing sectors to increased imports and lower foreign ownership levels on manufacturing companies, effectively signalling an effort to defuse a burgeoning trade war. Trump yesterday praised Jinping's "kind words" on the subject. One wonders how long it would have taken to get China to agree to such shifts in policy if the USA and its western trading partners had adopted a policy of gentle/quiet diplomacy with China on this issue."

Noting the above, if Trump's sabre-rattling on tariffs continues to succeed it is quite likely that he will ultimately persuade other countries to **lower** their trade barriers in line with the US rather than **raising** them in retaliation. This would be a win-win for global trade but only time will tell whether good sense prevails. If not, and should the cycle of retaliatory tariff increases continue, they would have to rise a long way and broaden greatly in application to abort the current US economic recovery. This is because the average US tariff is still very low (see chart) and exports are only about 12% of US GDP. It is also worth noting that China holds $1.2 trillion in US Treasury Bills which must give the US some leverage too.

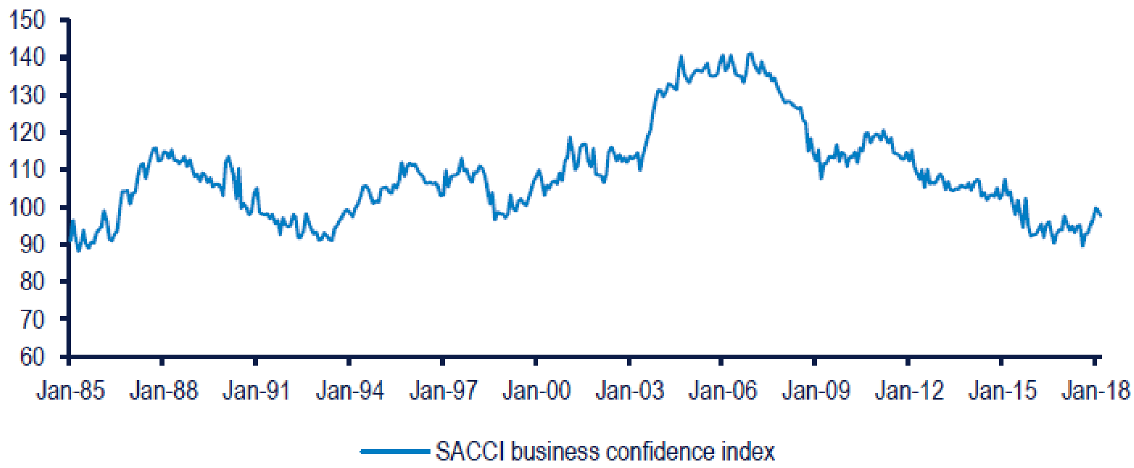


We conclude that on the balance of probabilities investors are overreacting to the trade war threat and this, along with fears of rising interest rates, has depressed prices and improved the valuations of certain shares significantly during the quarter.

SOUTH AFRICA: *Business confidence has improved but is still depressed*

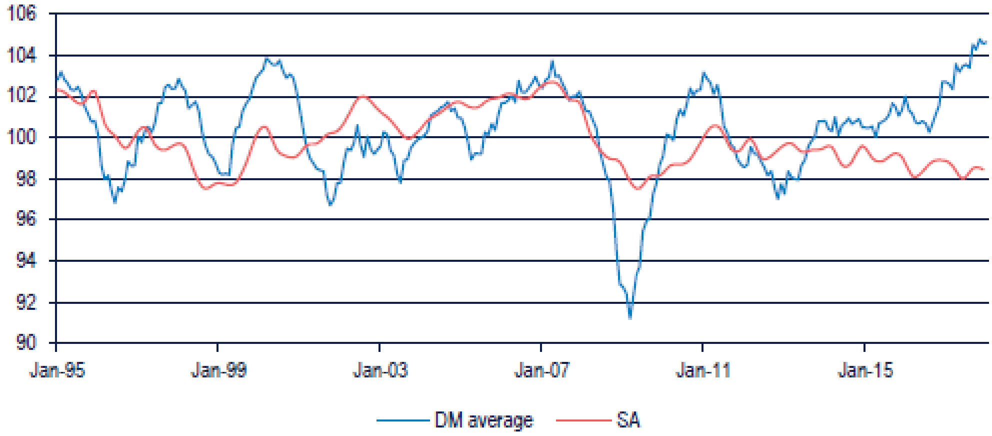
While the election of Cyril Ramaphosa as President was generally welcomed by both foreign and local investors, from a long-term perspective business confidence is still at pre-1994 levels which at the time reflected the uncertainty of SA's transition to a new democracy (see chart 1):

Chart 1: SA Chamber of Commerce and Industry (SACCI) Business Confidence Index



There is therefore scope for further gains in business confidence and economic growth from current depressed levels but a healthy global economy is also required since manufacturing confidence in emerging markets such as South Africa tends to follow that of developed markets (DM) (see chart 2):

Chart 2: OECD Manufacturing Confidence Indices



We conclude that further improvements in SA confidence and economic growth may be expected which is supportive for domestic equities.

STRATEGY: *Stay fully invested but cautious and highly selective*

The sharp correction in global equities last quarter has restored certain sectors and shares to good long-term value although the US bellwether S&P 500 index remains on the expensive side overall. Consumer defensives such as brewers and tobacco are value stand-outs along with other large high quality multinationals whose share prices have succumbed to fears of a global trade war. Our attention is focused very selectively on acquiring such shares for portfolios which are either underweight or do not hold them at all. This also applies to onshore portfolios where such shares are dual-listed on the JSE. In addition, certain domestic sectors such as banks continue to offer good long-term value despite their recent run-up and should be fully represented in portfolios.

INDICES BY SECTOR

		Sector	2017 **31-Mar**	**30-Jun**	**29-Sep**	**29-Dec**	2018 **29-Mar**	3 Months **% Chg**	*6 months* **% Chg**	*9 months* **% Chg**	*12 months* **% Chg**
J235	1	Construction	24	21	21	22	24	9.1%	14.3%	14.3%	1.7%
J537	2	General Retailers	7 144	6 384	6 556	8017	8575	7.0%	30.8%	34.3%	20.0%
J273	3	Electronics	15 016	14 267	12 894	12186	12865	5.6%	-0.2%	-9.8%	-14.3%
J835	4	Banks	7 135	7 176	7570	9619	9808	2.0%	29.6%	36.7%	37.5%
J272	5	General Industrials	171	174	176	203	202	-0.5%	14.8%	16.1%	18.1%
J857	6	Life Assurance	36 408	35 707	37029	43992	43545	-1.0%	17.6%	22.0%	19.6%
J353	7	Beverages	229	230	211	231	220	-4.8%	4.3%	-4.3%	-3.9%
J580	8	Financial	40 261	40 046	41264	47450	44820	-5.5%	8.6%	11.9%	11.3%
J177	9	Mining	23 557	21 835	25982	27351	25386	-7.2%	-2.3%	16.3%	7.8%
J203	10	**All Share Index**	**52 458**	**52 163**	**55 580**	**59505**	**54865**	-7.8%	-1.3%	5.2%	4.6%
J200	11	**Top 40**	**45 561**	**45 994**	**49 376**	**52533**	**48180**	-8.3%	-2.4%	4.8%	5.7%
J357	12	Food Producers	10 182	9 294	9142	10807	9785	-9.5%	7.0%	5.3%	-3.9%
J211	13	Industrial 25	69 001	71 312	75 729	79085	71103	-10.1%	-6.1%	-0.3%	3.0%
J150	14	Gold Mining	1 381	1 185	1 325	1304	1105	-15.3%	-16.6%	-6.8%	-20.0%

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