MelvilleDouglas
A Member of Standard Bank Group

Melville Douglas

High Alpha Fund

Fund Review

2018 continues to be disappointing for SA equity investors. The quarter to September as down 1.3%, and the 12 month rolling performance of the ALSI more than halving from 7.2% at the end of August to 3.3% at the end of September. The JSE's three and five year returns are well below historical averages. Emerging markets remained under pressure, spooked by events in Turkey, Brazil and Argentina. A stronger US dollar, reduced US dollar liquidity and a higher oil price have added to the pressure for emerging markets. The fund was flat over the quarter, 1.3% ahead of the benchmark. The resource counters continued to help the performance of the fund while the SA facing counters had a tough period given the lack of performance from the local economy where we continue to see downward earnings revisions. As always, we remain diversified in the fund and focus on companies that have defensive earnings qualities and robust balance sheets.

Market Overview

Despite the concerns about oscillating trade tensions between USA and China, September was a better month for emerging markets compared to August's indiscriminate sell-off. The central banks in key EMs raised interest rates, whilst the SARB opted to leave rates unchanged. The decision was a close call though, with three members of the seven-member committee voting for a rate hike. In its meeting the SARB revised its inflation forecast upward and sees inflation moving away from the target midpoint but remaining within the 3.0% – 6.0% target band until 4Q2020. Our interest rate view has now changed, and we see the SARB keeping rates on hold at 6.50% for the remainder of the year but the risks for further rate hikes in 2019 have increased.

Increased trade tensions between the US and China have put a damper on global trade and the higher oil price is slowly eating into consumers disposable income in SA and abroad. Brexit is looming, with uncertainty continuing to weigh on confidence levels and economic activity. Italy's budget announcement will have the bond vigilantes circling. The rand has made up some loss ground against the major developed market currencies after the significant sell off in August – broadly in line with other EM currencies.

We believe that tightening global financial conditions, the US trade standoff and domestic politics ahead of general elections could weigh heavy on our capital markets and the rand in the near term. Although we are starting to see some valuation underpin, we are still cautious and will remain defensively positioned.

Looking Ahead

The divergence in growth between the US and the rest of the world continues to widen. Disappointing growth outside the US is one reason, but a stronger dollar and a decline in US dollar global liquidity are also to blame. Economic growth and investment returns outside the US have disappointed this year. The liquidity screws have been slowly tightened and global trade has softened. Consumer spending has remained robust in developed economies where strong growth in employment and income have provided an important underpin.

Quarterly Commentary as at 30 September 2018

A stronger dollar and trade uncertainties have prevented any acceleration in investment spending outside of the US. Political risks remain elevated as well: Italy poses ongoing concerns in Europe, BREXIT negotiations will heat up, and trade policy is not fully resolved. Eurozone growth is reasonable but will need to be very robust to cope.

SA is stuck in a low-confidence cycle and a recession, which complicate the outlook; but it has all the required basics to enable a cyclical recovery, even without lower interest rates. While most investors are watching for a catalyst to improve confidence and lead to an economic recovery, it is more likely that there will be a slow and stealthy recover. At some point an accumulation of factors will have combined to lift things and we'll be out of recession.