Quarterly Commentary as at 31 March2018

Melville Douglas

Dynamic Strategy Fund

Quarterly Commentary

After a strong year in 2017, the first quarter of 2018 was disappointing for equity investors, especially locally given the significant improvement in the political arena and the fact that SA managed to avoid another credit rating downgrade. Equity markets globally were weak, and the JSE was no exception. The JSE was down 6% for the quarter, slightly worse than global equity which was down 5% in rand terms. SA's industrials were affected by the sharp fall in the price of Naspers (down 16% for the quarter) as its main underlying investment, Chinese IT company Tencent, tracked global IT shares lower. The fund's portfolio was underweight Naspers, and therefore did better than the market, but was nevertheless down for the quarter. The rand strengthened 4% against the US dollar in the quarter, undermining the rand return from the global equity holdings. The fund's best performing asset class for the quarter was SA bonds, where we increased the allocation and the duration of the holdings as the improving domestic situation became clearer. We increased the allocation to SA equity in the quarter as well.

The global volatility that began in January has not abated, and markets have not been able to recover January highs. Underlying economic fundamentals and corporate earnings remain robust but new risks have emerged. It was predictably the case that 2018 would prove more volatile than 2017 as the tension between rising inflation and easy monetary policy started to bite. In addition, markets now have additional pressures to deal with in the form of trade and tariff fights and geopolitical issues. History does not suggest that a tariff approach to trade issues has beneficial outcomes. For now, the economic impacts of the currently published US-China trade measures will be mild, but it remains to be seen whether the argument develops into something worse. Since the US has a vested interest in China's success (US companies benefit enormously from access to China's domestic markets – GM sells more cars in China than in the US, for example) we expect common sense to prevail, but the political dimension of the current disputes may push politicians into implementing economically damaging measures. The headwinds facing equity markets are stronger than they were, and so we expect volatility to remain elevated. In SA, fortunately, there has been plenty of good news, including an interest rate cut. President Ramaphosa has moved swiftly to show commitment to improved governance (a significant cabinet reshuffle and board changes at state owned companies), and fiscal sustainability (the budget was a vast improvement and included a challenging increase in the rate of VAT). The changes were favourably noted by Moody's, which completed its sovereign credit rating review by improving the outlook. Its assessment of the risks noted specifically land reform and the redrafting of the Mining Charter. For investors, a much-improved outlook domestically is balanced with a less certain global backdrop. Valuation and robust business models remain the key.