Sanlam Lifestage Feedback Report
Quarter 1 2016
Sanlam Umbrella Fund

Sanlam

Employee Benefits

Insurance | Financial Planning | Retirement | Investments | Wealth

Contents

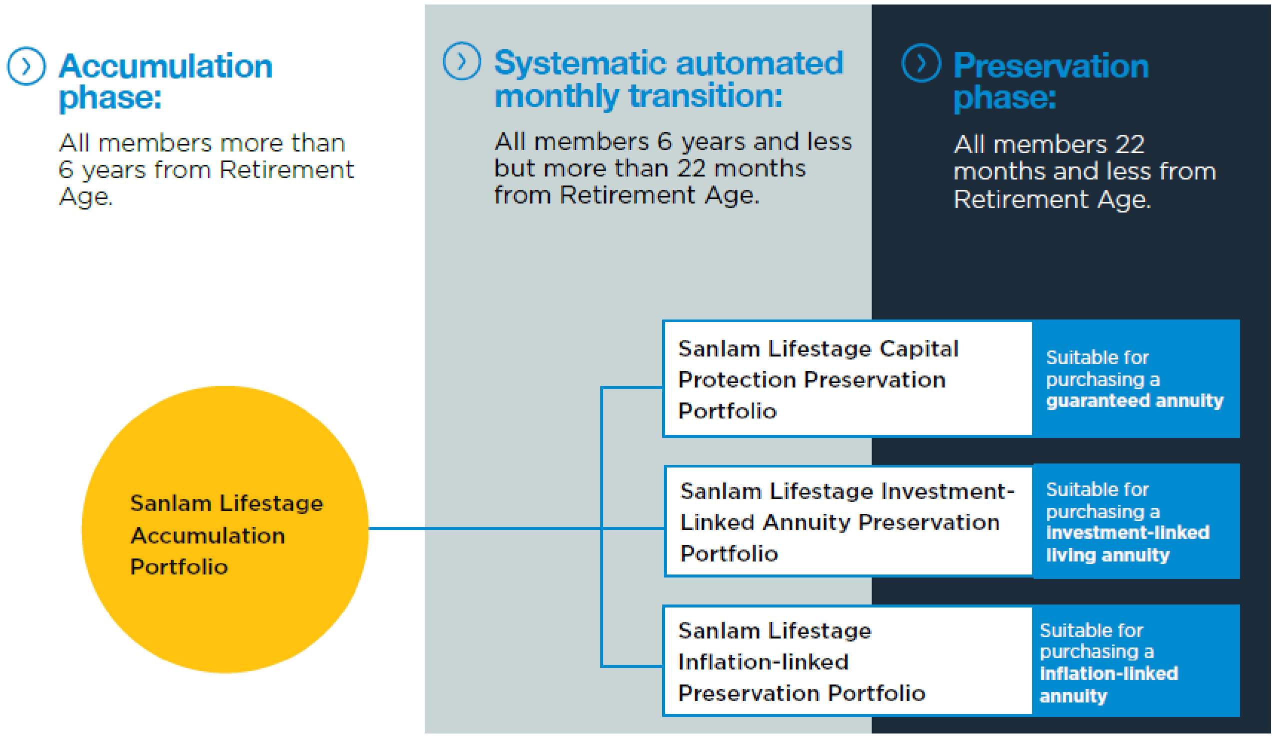
How does Sanlam Lifestage work?

Sanlam Lifestage aims to meet a member's retirement savings requirement in a single seamless investment solution, designed to adapt to the member's time remaining to retirement and income needs after retirement.

In terms of the lifestage approach, a member's savings are initially invested in a portfolio that places emphasis on long-term capital growth with some tolerance for short-term market volatility. As retirement approaches, a member's savings are automatically switched to a preservation portfolio. A preservation portfolio protects a member against the specific risks inherent in the purchase of the particular annuity the member is targeting to obtain an income in retirement.

As members may employ a range of different income strategies at retirement, 3 Sanlam Lifestage Preservation Portfolios are available, each designed to align capital to an income strategy for an almost seamless transition into retirement.

Transition from the accumulation phase to the preservation phase takes place by means of 50 monthly switches, starting 6 years prior to retirement, to reduce market timing risk. The transitioning switches that shift exposure from the Sanlam Lifestage Accumulation Portfolio to the Sanlam Lifestage preservation portfolios are calculated and implemented monthly based on members' actual ages. Members may plan to retire earlier than the normal retirement age determined by their employer, if this is allowed by their retirement fund. In such cases, planned retirement dates instead of normal retirement ages can be used to determine the timing of the transitioning process. This is done at no additional cost to the member.



The Capital Protection Preservation Portfolio is appropriate for a member wishing to purchase a guaranteed annuity at retirement, or who is uncertain on which annuitisation strategy they which to employ at retirement. The Inflation-linked Preservation Portfolio is appropriate for a member wanting to purchase an inflation-linked annuity at retirement, and the ILLA Preservation Portfolio for a member who plans to manage their income in retirement through an Investment-linked Living Annuity (ILLA).

Investment Portfolios offered in Sanlam Lifestage

Accumulation Portfolio

The Sanlam Lifestage Accumulation Portfolio aims to provide market-related capital growth to members who are more than six years from retirement and who need to grow their retirement savings.

The portfolio is a multi-managed portfolio which allocates its assets across equity, bond, property and cash sub-portfolios. In the case of each domestic sub-portfolio a core-satellite investment strategy is employed. The core is a low-cost index-tracking strategy, around which the satellite managers aim for active returns through the out-performance of their respective benchmarks.

The portfolio has an aggressive risk profile.

Preservation Portfolios

Capital Protection Preservation Portfolio

The Sanlam Lifestage Capital Protection Preservation Portfolio invests in the Sanlam Stable Bonus Portfolio. The portfolio aims to protect the invested capital. The Stable Bonus Portfolio provides investors with exposure to the financial markets, while protecting them against adverse market movements.

This is achieved by smoothing the returns over time and offering capital protection on the net contributions invested together with the vested bonuses in case of resignation, retirement, death, retrenchment or disability. A bonus is declared monthly in advance, which consists of a vesting and non-vesting component. Bonuses cannot be negative.

The portfolio has a conservative risk profile.

Inflation-linked Preservation Portfolio

The Sanlam Lifestage Inflation-linked Preservation Portfolio aims to provide members nearing retirement with the ability to buy a post-retirement income that will grow in line with inflation after retirement. As such, the investment portfolio may fluctuate when interest rates rise or fall, as it aims to match the movement in purchasing prices of inflation-linked annuities rather than protect or maximise growth of capital in the short term.

The Sanlam Lifestage Inflation-linked Preservation Portfolio invests in a long-duration bond portfolio, the Sanlam Employee Benefit Inflation Annuity Tracker portfolio, where the benchmark for this portfolio is the SALI Real. The SALI Real has been developed by Sanlam to track the cost of purchasing an inflation-linked annuity.

The portfolio has a conservative risk profile.

Living Annuity (ILLA) Preservation Portfolio

The Sanlam Lifestage Living Annuity Preservation Portfolio aims to provide moderate market growth. This portfolio is suitable for members who want to invest in an investment-linked living annuity at retirement. The Sanlam Lifestage Living Annuity Preservation Portfolio allocates its assets across equity, bond, property and cash sub-portfolios.

In the case of each domestic sub-portfolio a core-satellite investment strategy is employed. The core-satellite is a low-cost index-tracking strategy, around which the satellite managers aim for active returns through the outperformance of their respective benchmarks.

This portfolio has a moderate risk profile.

Product Commentary – Quarter ending March 2016

Global markets begun the year poorly with there being a generally negative sentiment in the market. This was primarily as a result of weak economic data from China and the volatile oil price creating an uncertain environment. As a result global equity markets did not perform particularly well during the first quarter, but did rally significantly towards the end of the quarter with more dovish statements from the US Federal Reserve and as a result the MSCI World Index returned -0.3% (USD). However, the MSCI Emerging Market Index returned 5.7% (USD) mostly as a result of Dollar weakness. The general risk-off behaviour in the markets decreased the yield on global bonds with the Barclays Capital Global Aggregate Govt Index returning 7.2% (USD).

Locally, equity markets performed well, with the All Share Index returning 3.9% (ZAR). This has been driven by the strong resurgence of the resources sector with a return of 13.2% (ZAR). The deprecation of the rand in the latter part of 2015 and the drought affecting the agricultural sector has resulted in significant inflationary pressure in South Africa with inflation breaching the 3 to 6 percent target. This has forced the SARB to raise rates by 0.75% during 2016. This has had a positive effect on the bond market with the All Bond index returning 6.6%. Inflation linked bonds returned 2.2%. South African listed properties provided a strong return of 10.1% (ZAR). The rand also managed to appreciate 5.3% against the dollar in the first quarter of 2016.

The world's economy continues to find itself in a fragile state, with low growth (The IMF continues to downgrade growth estimates) and deflationary pressures in many parts of the globe. Hence why regions such the European Union have increased their Quantitative Easing (QE) programs recently. The US on the other hand remains in a rate hiking cycle which diverges from much of the rest of the world. The US Federal Reserve though has already reduced its expected number of interest rate increases during 2016 from 4 down to 2 during the first quarter alone. This confirms what we wrote at the beginning of the year that this interest rate hiking cycle that the US is going into will be a very shallow, slow and careful one.

The South African economy continues to be under significant pressure with the prospect of a ratings downgrade still looming. The Budget Speech in February appeared to provide the ratings agencies with some of what they wanted to hear in the short term, however, there continued to be concerns about structural problems in the economy that have resulted in persistently poor growth. In addition rating agencies are sceptical about the government's commitment to ensuring the targets set are met given governments track record over the recent past in this regard. Heavy political turmoil also ensures that the economy takes a back seat in the short term as issues surrounding the President continue to take central stage.

Foreign equity remains our favoured asset class from a fundamental perspective and Global bonds remain expensive but are good insurance against very negative events. Domestic property is very expensive as is domestic equity, with domestic companies likely to struggle to grow earnings within South Africa. Bonds look attractive but could suffer if South Africa is downgraded to junk status. The increase in interest rates means that cash is finally offering a real yield and this asset class is starting to look more attractive especially when considering the volatility inherent in other asset classes.

Portfolio Commentary – Quarter ending March 2016

Sanlam Lifestage Accumulation Portfolio

The portfolio underperformed its benchmark over the quarter.

Asset allocation contributed negatively to returns. Within asset allocation, we were overweight foreign equity and foreign in total which detracted value due to the appreciation of the Rand, as did our underweight to domestic equity. The overweight to SA Bonds added value as did the underweight to foreign bonds.

Manager selection added value, driven by the good performance of the domestic equity managers. Denker in particular had a good quarter as the value style performed well. Coronation and Kaizen also managed to beat the benchmark over the quarter with only First Avenue underperforming as their bias towards quality stocks which performed well in 2015 performed poorly in the Resource rally.

There were a number of changes to the fund during the quarter. After the Rand went through R16/US$ in the middle of January we reduced foreign exposure substantially as we felt the Rand was oversold. This benefitted the fund through the remainder of the quarter as the Rand strengthened significantly from that position. We still retain a small overweight to foreign given the risks. In addition exposure to domestic equity was increased towards the end of January and exposure to cash was increased through the quarter as cash yields became more attractive. The Fund remains underweight domestic equity and overweight bonds. As bond yields continue to compress we are likely to reduce this overweight particularly given the risk of the downgrade. SA equity market remains expensive in our view and cash looks more attractive given the risks to the global economy.

Sanlam Lifestage Capital Protection Preservation Portfolio

The Sanlam Capital Protection Preservation Portfolio continues to be a safe haven for our members during these volatile markets. The smoothing and guarantees offered by this portfolio means that there is no need for Lifestage members to panic. The stable and predictable monthly bonuses reduces the temptation to make emotional decisions during uncertain times, such as switching to more conservative investment options and thereby locking in losses when markets are down.

Sanlam Lifestage Inflation Linked Preservation Portfolio

The portfolio aims to closely match movements in its benchmark index, the SALI Real by investing in inflation-linked bonds. This index tracks the changes in the cost of an inflation linked annuity caused by changes in real interest rates. The portfolio therefore aims to preserve a member's ability to purchase an inflation linked annuity. During the first quarter of 2016, the portfolio return was 2.10% compared to benchmark of 2.29%.

Sanlam Lifestage ILLA Preservation Portfolio

The portfolio underperformed its benchmark over the quarter.

Asset allocation contributed negatively to returns. Within asset allocation, we were overweight foreign equity and foreign in total which detracted value due to the appreciation of the Rand, as did our underweight to domestic equity. The overweight to SA Bonds added value as did the underweight to foreign bonds.

Manager selection added value, driven by the good performance of the domestic equity managers. Denker in particular had a good quarter as the value style performed well. Coronation and Kaizen also managed to beat the benchmark over the quarter with only First Avenue underperforming as their bias towards quality stocks which performed well in 2015 performed poorly in the Resource rally.

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Fund Fact Sheets

Sanlam Lifestage Accumulation Portfolio

Period Ending	31-Mar-16
Fund Size	R 6,722 million
Inception Date	Jul-13

Benchmark
55% FTSE / JSE Shareholder Weighted Index
4% BEASSA Total Return Index
10% FTSE/JSE SAPY Index
11% Short Term Fixed Interest Index (STeFI)
20% MSCI World (Developed Markets) Equity Index

Fund objective

The fund is an aggressive portfolio displaying high levels of volatility over the short term and is aiming to provide market related growth.

Risk profile

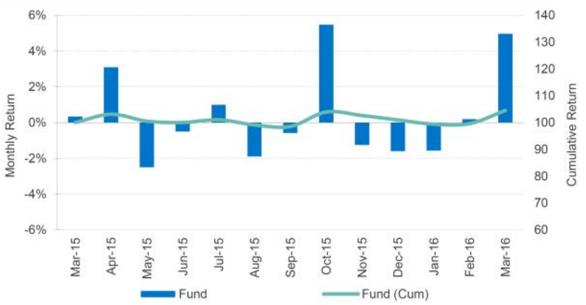
This portfolio has an moderate-aggressive risk profile

Fees

1.00% per annum for the first R50m
0.90% per annum on the portion of assets between R50m - R100m
0.775% per annum on the portion of assets between R100m – R300m
0.70% per annum on the portion of assets between R300m – R500m
0.65% per annum on the portion above R500m

All Sub-funds invested in Sanlam Lifestage Accumulation Portfolio are charged the highest investment management fee applicable to the first tranche of assets, and Sub-funds with greater than R50 million assets are separately rebated any savings due to the sliding investment management fee scale on a monthly basis.The underlying investment managers may be incentivised on a performance fee basis.

Monthly and cumulative returns



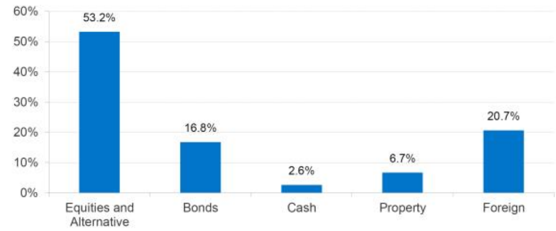
Fund performance (%)

	Fund	Benchmark
1 Month	5.0%	5.3%
3 Months	3.5%	4.1%
6 Months	6.1%	7.2%
1 Year	4.5%	6.3%
3 Years	n/a	n/a
5 Years	n/a	n/a

Top 10 holdings (% of Equities)

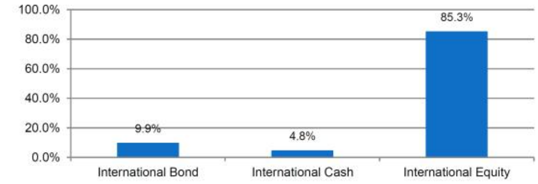
Share Name	% of Equities
Naspers	12.8%
British American Tobacco Plc	5.5%
Steinhoff Int Hldgs N.v	5.3%
MTN Group	4.3%
Sasol Limited	3.7%
Standard Bank Group Limited	3.6%
SABMiller Plc	3.5%
Old Mutual	3.2%
Firstrand Limited	3.0%
Woolworths Holdings Limited	2.3%

Asset class breakdown



The benchmark reflects the fund's long-term strategic asset allocations. Fund asset allocations may be allowed to vary from the benchmark, depending on market conditions.

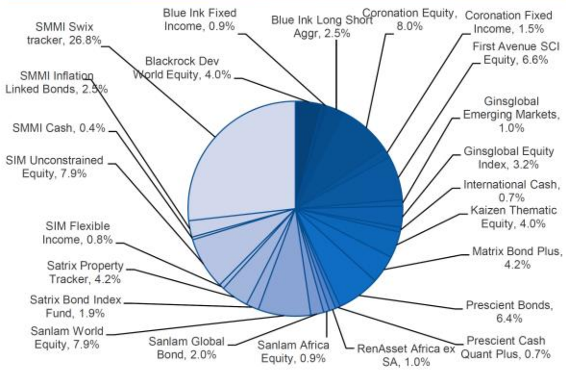
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	21.8%	17.4%
Resources	10.5%	14.4%
Industrials	67.7%	68.2%

Fund manager breakdown



Risk analysis

(based on the last 3 years' monthly returns)

% of negative months over the last 3 years	27.8%
Average capital loss in one month	-1.2%
Downside risk *	0.8%

* Downside risk is measured as the standard deviation of the underperformance of the portfolio relative to CPI

Note: Performance figures are gross of investment management fees, but are net of any performance fees (if applicable). For portfolios in the Smoothed Bonus Range ,the returns are gross of investment management fees, but are net of any guarantee premiums. Performance figures for periods greater than 12 months are annualised. All data shown is at the month-end, unless specifically indicated differently. Changes in currency rates of exchange may cause the value of your investment to fluctuate. Past performance is not necessarily a guide to the future returns. The value of investments and the income from them may increase or decrease and are not guaranteed. You may not get back the amount you invest. The product information sheets are prepared for the SANLAM UMBRELLA FUND by its investment consultants. The product information sheets are prepared in good faith and the information, data and opinions contained in the product information sheets are based on source information considered reliable. However, no guarantee, explicit or otherwise are provided that the information and data contained therein are correct and comprehensive. The SANLAM UMBRELLA FUND and the investment consultants cannot be held liable for any loss, expense and/or damage following from the use of the product information sheets.

Sanlam Lifestage Capital Protection Preservation Portfolio

Period Ending	31-Mar-16
Fund Size (Book Value)	R 1 117 million
Inception Date	Aug-13

Benchmark

42.0% SWIX (Shareholder Weighted Index)
25.5% BEASSA Total Return All Bond Index
1.0% STeFI + 2%
2.0% Barclays BESA Gov. Inflation-linked Index
7.5% MSCI World Index (Dev. Markets)
5.0% Barclays Global Aggregate Index
2.5% HFRI Fund of Funds Composite Index
8.0% STeFI Index
6.5% BEASSA 7-12 years TRI plus 1.0% p.a.

Fund objective

The Portfolio offers investors stable, smoothed returns with a partial guarantee on benefit payments. A bonus, which consists of a vesting and non-vesting component is declared monthly in advance. Bonuses cannot be negative.

Risk profile

The portfolio has a conservative risk profile

Fees

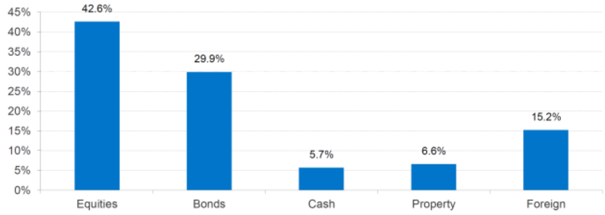
Sanlam's cost in relation to the investment plan is recouped by recovering the following fees:

Investment Management Fees:
0.425% per annum

Guarantee Premium:
A guarantee premium of 0.90% per annum

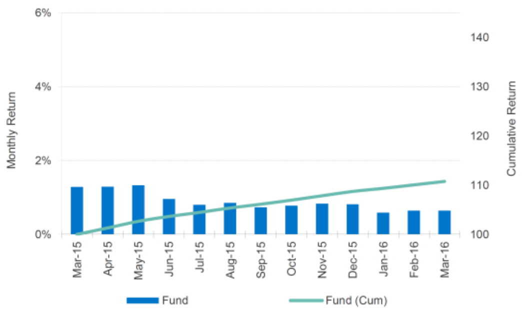
Annual Performance Linked Fee:
The investment manager may be incentivised with performance fees (capped at 0.30% p.a.)

Asset class breakdown

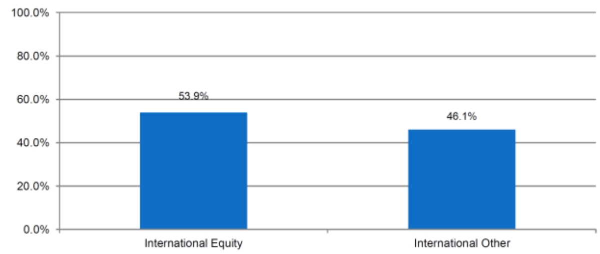


The benchmark reflects the fund's long-term strategic asset allocations. Fund asset allocations may be allowed to vary from the benchmark, depending on market conditions.

Monthly and cumulative bonuses



Foreign split



Fund bonuses (%)

	Fund (gross of fees)
1 Month	0.6%
3 Months	1.8%
6 Months	4.3%
1 Year	10.7%
3 Years	n/a
5 Years	n/a

Equity sectoral exposure (%)

	Fund
Financials	18.9%
Resources	10.9%
Industrials	70.2%

Top 10 equity holdings (% of Equities)

Share Name	% of Equities
Naspers N	14.0%
Steinhoff (SNH)	5.2%
BTI Group	5.2%
ATTACQ Limited	4.5%
SAB	4.4%
MTN Group	4.2%
Sasol	4.0%
Old Mutual	3.6%
FirstRand / RMBH	3.3%
Stanbank	2.8%

The Non - Vested bonuses as a proportion of the total Sanlam Stable Bonus Portfolio holdings:

Sanlam Umbrella Pension Fund	6.72%
Sanlam Umbrella Provident Fund	8.94%

** Only impacts Sanlam Lifestage members opting for this preservation strategy in the last 6 years before retirement.*

Note: Performance figures are gross of investment management fees, but are net of any performance fees (if applicable). For portfolios in the Smoothed Bonus Range ,the returns are gross of investment management fees, but are net of any guarantee premiums. Performance figures for periods greater than 12 months are annualised. All data shown is at the month-end, unless specifically indicated differently. Changes in currency rates of exchange may cause the value of your investment to fluctuate. Past performance is not necessarily a guide to the future returns. The value of investments and the income from them may increase or decrease and are not guaranteed. You may not get back the amount you invest. The product information sheets are prepared for the SANLAM UMBRELLA FUND by its investment consultants. The product information sheets are prepared in good faith and the information, data and opinions contained in the product information sheets are based on source information considered reliable. However, no guarantee, explicit or otherwise are provided that the information and data contained therein are correct and comprehensive. The SANLAM UMBRELLA FUND and the investment consultants cannot be held liable for any loss, expense and/or damage following from the use of the product information sheets.

Sanlam Lifestage Inflation-linked Preservation Portfolio

Period Ending 31-Mar-16
Fund Size (Book Value) R2 million
Inception Date Aug-13

Fund objective

The portfolio aims to closely match movements in its benchmark index, the SALI Real. This index tracks the changes in the cost of an inflation linked annuity caused by changes in real interest rates. The portfolio therefore aims to preserve a member's ability to purchase an inflation linked annuity.

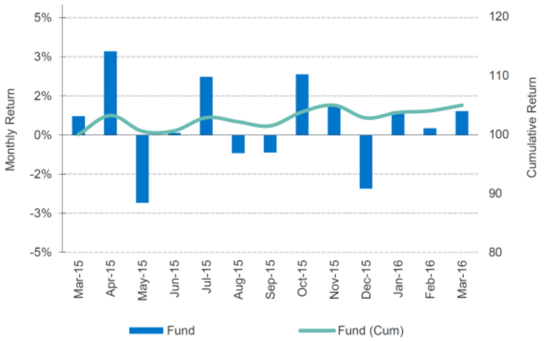
Risk profile

This fund has a conservative risk profile

Fees

Investment Management Fees:
0.70% per annum.

Monthly and cumulative bonuses

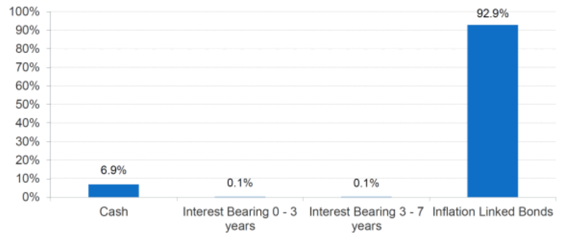


Fund bonuses (%)

	Fund (gross of fees)	Benchmark
1 Month	0.9%	1.0%
3 Months	2.1%	2.3%
6 Months	3.5%	3.4%
1 Year	5.0%	5.1%
3 Years	n/a	n/a
5 Years	n/a	n/a

Benchmark Sanlam Asset Liabilty Index Real (inflation linked)

Asset class breakdown



Sanlam Lifestage Living Annuity Preservation Portfolio

Period Ending	31-Mar-16
Fund Size	R 39 million
Inception Date	Oct-13

Benchmark	40% FTSE / JSE Shareholder Weighted Index
	20% BEASSA Total Return Index
	13% Short Term Fixed Interest Index (STeFI)
	10% FTSE/JSE SAPY Index
	17% Barclays BESA Gov. Inflation-linked Index

Fund objective

The relatively high equity allocation of the Fund should occasionally result in high volatility but also a high rate of growth compared to funds with a moderate risk profile.

Risk profile

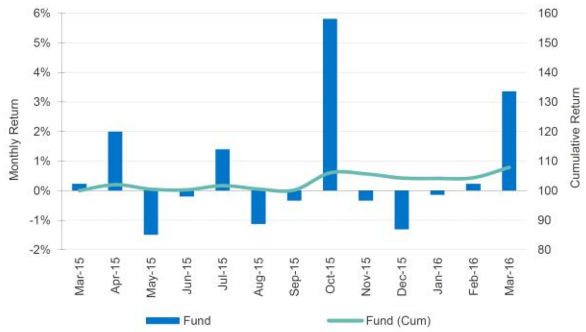
The portfolio has a moderate risk profile.

Fees

Investment Management Fees:
0.80% per annum.

The underlying investment managers may be incentivised on a performance fee basis.

Monthly and cumulative returns



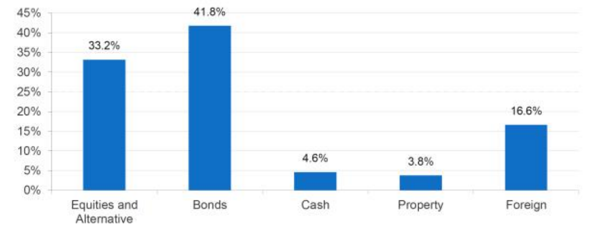
Fund performance (%)

	Fund	Benchmark
1 Month	3.4%	3.9%
3 Months	3.4%	3.9%
6 Months	6.1%	5.5%
1 Year	6.3%	5.8%
3 Years	n/a	n/a
5 Years	n/a	n/a

Top 10 equity holdings (% of Equities)

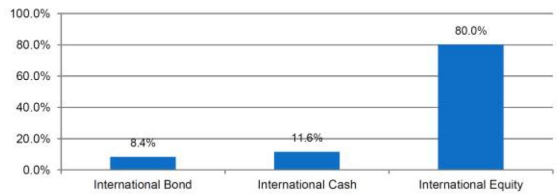
Share Name	% of Equities
Naspers	12.8%
British American Tobacco Plc	5.4%
Steinhoff Int Hldgs N.v	5.4%
MTN Group	4.3%
Sasol Limited	3.7%
Standard Bank Group Limited	3.6%
SABMiller Plc	3.5%
Old Mutual	3.2%
Firstrand Limited	3.0%
Woolworths Holdings Limited	2.3%

Asset class breakdown



The benchmark reflects the fund's long-term strategic asset allocations. Fund asset allocations may be allowed to vary from the benchmark, depending on market conditions.

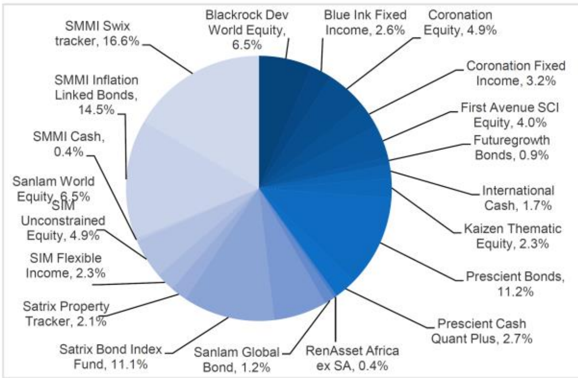
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	22.0%	17.4%
Resources	10.4%	14.4%
Industrials	67.6%	68.2%

Fund manager breakdown



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Performance vs Benchmark

Performance to end March 2016

Sanlam Lifestage	1 Month	3 Months	6 Months	1 Year	3 Year
Accumulation Portfolio	4.9%	3.5%	6.1%	4.5%	n/a
Benchmark	5.3%	4.1%	7.2%	5.3%	n/a
Capital Protection Preservation*	0.6%	1.8%	4.3%	10.7%	15.3%
Inflation-Linked Preservation Portfolio	0.9%	2.1%	3.5%	5.0%	n/a
Benchmark	1.0%	2.3%	3.4%	5.1%	n/a
ILLA Preservation Portfolio	3.3%	3.4%	6.1%	6.3%	n/a
Benchmark	3.9%	3.9%	5.5%	5.8%	n/a

** The Capital Protection Preservation Portfolio does not have an explicit benchmark.*

Performance Attribution

Multi-Managed Portfolios:

3 months ending March 2016	Active Return	Tactical Asset Allocation	Manager Selection
Sanlam Lifestage Accumulation	-0.54%	-0.51%	-0.04%
Sanlam Lifestage ILLA Preservation	-0.50%	-0.67%	0.17%

The Sanlam Lifestage Accumulation portfolio underperformed its benchmark during the quarter ending 31 March 2016.

Asset allocation detracted value in February and March with SA property, SA cash, SA hedge funds and International equity detracting most value among the assets. Allocation to SA bonds and International bonds contributed positively to performance.

The Manager Selection contribution to return was basically flat, with Coronation and SIM Equity being the biggest contributors to the overall positive contribution from SA Equities. Prescient and Investec bond managers contributed to the SA bonds positive returns while Sanlam Universal Equity and Blackrock World Index detracted the most value.

The Sanlam Lifestage Living Annuity Preservation Portfolio underperformed its composite benchmark over the quarter ending 31 March 2016. Asset allocation was the biggest detractor to performance specifically in February and March, while manager selection contributed positively over the quarter.

Asset allocation to SA property, SA Cash, International cash and International equity detracted the most value, while positive contribution to performance was added from SA bonds, international bonds and SA inflation linked bonds.

Manager selection positive contribution came from the Denker fund and Kaizen Thematic, while the Satrix Bond Index and Prescient bond added most positive on bond allocation. The largest value detractors were international equity managers with Blackrock World Index and Sanlam Universal Eq detracting the most from performance.

Please refer to the portfolio commentary for insight into performance of the Sanlam Capital Protection and Inflation-Linked Preservation Portfolios. These portfolios do not provide comparable information to the above due to the unique nature of their structure and mandate.

Economics

March 2016

Executive summary

The first quarter of the year was marked by downgrades to global economic growth, the adoption of negative interest rate policies, a soft oil price and rising default risks in the banking and oil sectors. While January and February favoured defensive asset classes, March saw a reversal in trend with risk assets rallying strongly as the Fed signalled a moderation in its interest rate tightening cycle and the ECB extended its QE programme. While global economic growth was at risk of stalling early on in the first quarter of 2016, March/April data releases have been generally more upbeat, reducing the likelihood of a global recession. Growth is nonetheless still uneven with Japan most at risk from sliding back into recession. As a consequence, the likelihood of more unconventional monetary policy measures being adopted, is growing. China also appears to be stabilising, helping to underpin commodity prices that have made encouraging gains since the beginning of the year.

With global bonds and property having outperformed their equity counterparts in Q1, the gradual re-inflation of the US economy has resulted in inflation-adjusted yields on the benchmark 10-year US treasury declining sharply to levels considered overbought. Furthermore, with one third of outstanding global bonds trading at negative nominal yields (mostly European and Japanese bonds), exposure to risk assets remains our preferred offshore strategy.

On the domestic front, nominal SA bonds rallied strongly post the "Nenegate" saga and are still yielding attractive expected real yields based on inflation projections over the next 3 years. Given the risk of a ratings downgrade and a gradual tightening in US interest rates, we retain a neutral weighting in bonds looking to overweight bonds post a ratings downgrade. The biggest change to our asset allocation view is an overweight allocation to domestic cash given expectations of further MPC tightening. In the event of a ratings downgrade, interest rates are expected to increase by more than the base case view, making this asset class even more attractive on a risk-adjusted basis.

Following the strong rally in equities in March, valuations and expected returns deteriorated across both developed and emerging markets. Despite this deterioration, the tail risks of negative returns are still quite low, supporting an overweight allocation to offshore risk assets. In contrast, given the large tail risks of negative returns on the All Share Index, domestic equities have been downgraded to underweight following the strong gains in Q1.

Highlights

- Yellen dovish on US rates, cites uncertain global environment and inflation expectations
- ECB signals end to NIRP – Is a "helicopter drop" next?
- Japan downgrades economic outlook
- China's debt downgraded by Moody's
- Emerging markets rally on Yellen, commodities but risks remain
- SA MPC raises rates a further 25 basis points in March
- SA sub-investment grade rating likely from Standard & Poor's, Fitch

Global Equities

Risk assets underperformed their defensive counterparts in Q1 as global growth concerns persisted, the low oil price raised fears of default risks in the oil and banking sectors and a Chinese hard landing seemed inevitable as the country transitioned from an infrastructural export driven growth model to a consumer driven economy. The MSCI World Index declined some 0.9% in USDs and 5.8% in rands, while emerging markets fared much better yielding 5.4% in USDs and 0.1% in rands. Most of the losses occurred in January and February with strong gains in March helping to partially reverse some of the losses. The change in sentiment was due to the Federal Reserve Bank signalling a moderation in its forward-looking interest rate projections and the ECB extending its QE programme. In March, the MSCI World Index gained 6.5% in USDs (-0.7% in rands), while emerging market equities surged an impressive 13.2% in USDs (5.5% in rands).

Gains in oil and commodity prices contributed to the more upbeat assessment of emerging markets given their attractive relative valuations and the release of better than expected Chinese economic data after quarter end. The FOMC's March decision to leave rates unchanged was premised on concerns that global economic prospects had led to increased market volatility and tighter financial conditions in the US. ZEW and PMI indices supported these concerns, highlighting the slowing momentum in global growth, particularly amongst emerging economies. Post quarter end, however, PMI data releases showed an improvement in the US, Eurozone and China, helping to underpin commodity prices. A rebound in Chinese export growth and a bottoming in the leading economic indicator also gave investors renewed optimism about the outlook for global growth.

Although conditions in the US labour market have improved considerably, subdued inflation expectations persisted, pushing out the timing of interest rate hikes. The FOMC revised down its expected number of interest rate increases this year from four to two, underpinning the demand for risk assets. Although the caveat of data dependency remains in place, the Fed emphasized that any future rate increases would likely be "gradual" and that "policy was not on a pre-set course" and would change because the "economy would surely evolve in unexpected ways". Yellen also said that the fed funds rate could be reduced to zero in the event of a shock to the financial system, highlighting that the Fed was open to pursuing unconventional monetary policy in the event that it was needed. Consistent with its more dovish tone, the Fed revised lower US GDP growth to 2.2% from 2.4%, while inflation was cut to 1.2% from 1.6%. From the FOMC's dot-plot it is clear that markets are far less dovish than the Fed as to the path of interest rate increases, suggesting the risk of market disappointments remains elevated.

In light of the pedestrian growth outlook for the Eurozone coupled with deflationary risks, the ECB announced an expansion of its QE programme to Euro 80bn from Euro 60bn per month. The ECB said that although growth momentum had been weaker than anticipated at the start of the year, the economic recovery would "proceed at a moderate pace." Recent gains in the PMI is largely supportive of this view, although longer-term growth indicators point to sluggish growth late in 2016 or early 2017. The deposit rate was also reduced to -0.4% from -0.3% and the refinancing rate was cut to zero from 0.05%. Corporate bonds were included in the purchase programme for the first time, while four new rounds of ultra-cheap four-year loans to banks were also to be extended for on-lending into designated sectors. Draghi also signalled that no further rate cuts were likely, suggesting QE in its current form has come to an end.

Japan's government also downgraded its assessment of the current economic climate for the first time in five months but maintained its overall view that the economy was still on a "moderate recovery" path. Weakness was seen in the economy with household spending slumping due to lower average incomes. While the government revised down its views on private consumption, corporate profits and business sentiment, it upgraded its assessment of capital investment and exports. In the near term, sluggish growth in Asian emerging economies, caused by China's recent economic slowdown, have been a drag on overall export growth. A recovery in Chinese import demand will, however, serve as a catalyst for a recovery in exports and industrial production, both of which are weighing on growth.

While much has been said about the waning effectiveness of QE to support growth and reinflate the Japanese economy, we believe there are other unconventional measures that could be adopted in the event that growth fails to gain traction in the quarters ahead. These include a “helicopter drop” of cash, which would entail the central bank printing money and the proceeds being used to buy up of government debt. Since monetizing debt creates a liability with no fixed maturity and no interest payment, the net present value of the liability will be zero. Alternative policy responses include increasing fiscal spend and/or the reducing taxes through refund offsets.

Against the backdrop then of sub-par economic growth, the US Fed is expected to normalise interest rates at a slower pace, given the risk of destabilising emerging markets, currency markets and commodity prices. USD strength has also been cited by the Fed as a concern for corporate profitability, which runs the risk of reversing some of the recent gains seen in the labour market. The recent slowdown in JOLT job openings data is supportive of this concern, as is the decline in corporate profitability as a percentage of GDP. Nonetheless, we expect inflationary pressures to build in the second half of 2016, fuelling a monetary policy response from the Fed. With core inflation running at 2.3% year/year, services inflation (excluding energy) at 3.1% and core PCE inflation at 1.7%, there are clear signs that inflation has bottomed. Wage growth at 2.3% year/year has also historically been associated with a higher fed funds rate, lending further support for a slight tightening in US interest rates later in the year.

Since bonds yields are expected to trend higher in this environment, risk assets are still expected to make further gains over the next 12 to 18 months, given that trailing earnings are coming off a low base and interest rates will still be low by historical standards. Trailing earnings on the MSCI World Index declined some 11.6% in the year to end March, whereas emerging markets declined some 9.8%, albeit it well off their earlier lows. Similarly, earnings multiples for the two indices to end March were 19.7X and 13.9X respectively, up from 18.5X and 12.3X the month before. Although equity market prices typically lead earnings by around 9 to 12 months, consensus earnings estimates point to higher earnings than those currently implied by the market. As a consequence, earnings over the next few years are expected to be supportive of prices notwithstanding full valuations.

Following the rally in both developed and emerging market equities in March, valuations deteriorated with total returns being revised lower. Notwithstanding the downward revisions, the tail risks of negative returns are still well contained, suggesting that markets will be able to withstand earnings disappointments and/or a market derating. Our valuation matrices suggest that developed markets will outperform their emerging market counterparts in the year ahead with the former likely to deliver low double digit returns and the latter high single digit returns. As a consequence, we retain an overweight bias to developed market equities and a neutral weighting towards emerging market equities.

Global Bonds

Global bonds benefitted from the subdued growth outlook and persistence of disinflationary pressures in Q1. The search for yield and demand for safe-haven assets saw global bonds return some 5.7% in USDs and 0.4% in rands as the yield on the JP Morgan Global Aggregate Total Return Index declined from 2.07% to 1.59%. Emerging market bonds, in turn, returned a slightly better 5.9% in USDs and 0.6% in rands as spreads compressed from 410 basis points to 400 basis points. Even Moody's downgrading of Chinese government debt to Aa3 "negative" from "stable", failed to halt the rally in emerging market bonds. The downgrade was due to the large stock of contingent sovereign liabilities of state-owned corporations, local governments and the debt of China's big "policy" banks. Further contributing factors included uncertainty over authorities' capacity to implement economic reforms and the recent sharp drop in the country’s foreign exchange reserves.

Since inflation-adjusted yields on the benchmark 10-year US treasury have declined sharply in recent months, global bonds are once again in overbought territory, supporting an underweight position in this asset class. Furthermore, with one-third of outstanding global bonds trading at negative nominal yields (mostly European and Japanese bonds), exposure to risk assets remains our preferred offshore strategy.

Global corporate bonds underperformed their sovereign counterparts despite a slight compression in investment grade spreads from 1.72% to 1.64%. The BarCap Global Corporate Bond index yielded 4.6% in USDs, with high yield credit returning a more subdued 4.1% in USDs. The recovery in the oil price to back over USD40/barrel towards quarter end saw high yield credit return a pleasing 5% in March as default risk associated with lending to shale and oil producers eased. Concerns remain, however, that the quality of the high yield book has deteriorated, suggesting risks in this space remain high for investors.

Global inflation-linked bonds lagged their sovereign counterparts in Q1 yielding some 4.7% in USDs and -0.5% in rands as breakeven inflation rates pushed higher across the yield curve. US 5-year and 10-year breakeven inflation increased to 1.6%, while the 5-year/5-year forward breakeven inflation rate increased to 1.7%. As a consequence, the real yield on the BarCap Global Inflation Linked Bond Index declined to -0.41% from -0.05% the previous quarter.

Global listed property yielded some 5.5% in USDs and 0.2% in rands in Q1 buoyed by a 9.7% (USD) surge in March. The sector benefitted from lower bond yields and investors' search for yield. With property trading at a premium to the historical price-to-book ratio but at a discount to the 18.6X historical earnings multiple, a neutral weighting is retained given the sector's attractive dividend yield and investors' need for diversification across a broad range of asset classes.

SA Equities

SA equities tracked their emerging market counterparts higher in Q1, gaining some 3.9% in rands and 9.3% in USDs, ahead of the MSCI Emerging Market Index. Similar to the trend in emerging market equities, the gains came in March with the Alsi rallying 6.4% in rands. It is worth noting that over the quarter, foreigners remained net sellers of domestic equities totalling a substantial R22bn. Despite the equity outflows, inflows into the bond market, USD weakness and gains in precious metals prices helped underpin the rand. Resource counters benefitted from the gains in commodity prices with resources gaining some 18.1% in rands, outperforming the broader market sectors. Platinum and gold counters surged some 74.6% and 92.8% respectively as precious metals found favour in an environment of low or negative interest rates.

While resources were the dominant theme over the quarter, SA Inc counters rallied strongly in March with the Fini-15 returning some 12.4%, well ahead of the Resi-10 (4.7%) and the Indi-25 (4.7%). The rally came about despite a further 25 basis point increase in the repo rate and ongoing downward revisions to domestic economic growth. Given concerns about the health of the consumer on the back of rising interest rates, escalating food prices, a 9.4% increase in electricity tariffs and high levels of household indebtedness, general retailers contracted 1.4% over the quarter, while banking and non-life stocks gained some 13.0% and 27.0% respectively.

With both the Barclays manufacturing PMI and the Standard Bank PMI (a measure of overall economic activity) remaining below the 50 breakeven level (signalling a contraction in economic activity), growth estimates for 2016 and 2017 were revised lower to some 0.6% and 1.2% respectively. At the National Income Accounting level, the decline in SA's gross operating surplus from slowing economic growth and margin compression from employee compensation, resulted in trailing earnings declining some 14.5% in the year to end March.

Despite the sharp decline in trailing earnings, top-down measures of expected earnings growth along with consensus earnings estimates suggest that earnings per share will recover in the year ahead. The dislocation between the real economy and earnings growth is due to the fact that almost 70% of the top 50 listed companies' earnings are in hard currencies, highlighting the lesser reliance of listed companies on the fortunes of the domestic economy. Furthermore, since the Alsi price index tends to lead earnings by around 12 months, the market is pricing in a recovery in earnings, albeit off a low base. With the market trading on a multiple of 21.5X earnings, the market appears to be extremely overbought. On a rolling basis, the diagnosis is no better with the Alsi trading on a 19.4X multiple, up from 17.1X the month before. The forward multiple of 16.2X is also stretched with rand-hedge industrials skewing the multiple to the upside. If the top 6 rand-hedge counters are stripped out of the index (BIL, NPN, MTN, CFR, SAB, BTI), the forward multiple declines to 12.6X earnings, slightly below the historical average. This suggests that SA Inc counters are fairly valued, supporting the notion that the year ahead will favour active stock pickers rather than passive index trackers. In the near term, rand strength will underpin domestic counters, whereas in latter half of the year, rand weakness will be supportive of rand-hedge counters. With the US Fed expected to lift rates then and with SA at risk of a ratings downgrade to sub-investment grade, the rand is expected to come under renewed pressure. Since the tail risks of negative returns are elevated in the event of earnings disappointments or a market derating, we underweight domestic equities.

SA Bonds

SA bonds tracked their emerging and developed market counterparts higher in Q1, shrugging off the sharp increase in inflation to 7% and a cumulative 75 basis point increase in the repo rate. The Albi returned some 6.6% in rands and 12.2% in USDs as the yield on the Albi declined from 10.1% to 9.53%. Notwithstanding the risk of a ratings downgrade later in the year, foreigners were net buyers of domestic bonds, totalling some R15.75bn. The net inflows of foreign exchange benefitted the currency, with the rand appreciating some 5.3% against the USD. At current yields, the Albi is expected to yield some 3.5% in real terms based on our projected inflation rate of some 6.1% over the coming 3 years. While this is an attractive expected real yield, the risk of a ratings downgrade limits our allocation to a neutral holding. While the fallout from a ratings downgrade is difficult to assess, the SARB estimates that short rates could rise some 80 basis points and long yields around 104 basis points in the event of a downgrade. It is important to note that a ratings downgrade of South Africa's foreign currency denominated debt will only affect around 10% of outstanding bond issuance, suggesting a more muted backup in rates. Furthermore, in the event that short rates rise over and above our base case estimate as a result of a downgrade, the long end of the curve is likely to be anchored as a flattening in the yield curve reflects the marked slowdown in economic growth.

SA corporate bonds underperformed their sovereign counterparts, yielding 5.6% in rands and 11.1% in USDs. Against the backdrop of slowing economic growth, contracting earnings growth and the risk of a ratings downgrade, spreads widened slightly from 1.85% to 1.87% partly offsetting the capital gain from the decline in yields.

Inflation-linked bonds underperformed their nominal sovereign counterparts in Q1, even as real yields declined from 1.98% to 1.90% the previous quarter. The BarCap Inflation Linked Bond Index gained a subdued 2.2% in rands and 7.6% in USDs as the muted inflation carry from the back-end of 2015 capped gains. In the months ahead, the inflation carry from rising food prices, electricity tariffs and petrol prices will provide an underpin for returns, informing our neutral weighting in this asset class. Even though 10-year break-even rates fell from 7.86% to 7.29%, we continue to favour nominal over inflation-linked bonds, given the view that expected inflation priced into the bond market is too high. Even though our own estimates of inflation point to a high of 7.2% in the fourth quarter of 2016, inflation is expected to decline to around 5.8% by Q4 2017. As a consequence, nominal bonds are expected to yield higher returns than their inflation-linked counterparts.

SA listed property surged in Q1, buoyed by the rally in nominal bonds. Given a rerating relative to the 10-year bond, listed property yielded some 10.1% in rands and 15.9% in USDs, the best performining of the broader asset classes. Although distributions growth continued to contract, the rate of contraction slowed, aiding returns from the sector. Even though listed property is attractive relative to domestic equities, we remain cautious of the sector given the risk of a ratings downgrade. Since returns are sensitive to an increase in bond yields and the fact that the sector is trading at a 30% premium to net asset value, we underweight listed property.

SA Cash

SA cash yielded 1.7% in Q1, lagging all of the domestic asset class returns. Following the 75 basis point increase in the repo rate over the quarter, money market rates eased across the curve, with the market pricing in the likelihood of a further 50 basis points of increases this year and a further 50 basis points in 2017. As a consequence, interest rates are expected to peak at around 8% in the current cycle, down from 8.75% at the end of December. The MPC's downward revisions to inflation, particularly in 2017, was a catalyst for the lower rates. The MPC revised lower its average inflation forecasts for 2016 to 6.6% from 6.8%, and for 2017, from 7% to 6.4%. Its growth estimates were also revised lower to 0.8% from 0.9% for 2016, and to 1.2% from 1.4% in 2017. The decision by the MPC to raise rates a further 25 basis points at the March meeting, following the 50 basis point increase in January, was not a unanimous one, with three members favouring a 25 basis point increase while the remaining three members voted for no change. In the final analysis, the MPC decided to raise the repo rate remaining cognisant of the continuing dilemma of a deteriorating inflation environment and a worsening growth outlook. With interest rates now up a cumulative 2% since the low of 5% in December 2013, the MPC is ahead of the US interest rate cycle, suggesting less pressure on the Reserve Bank to raise rates by more than 25 basis points at each of its policy setting meetings.

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