Sanlam Lifestage Feedback Report
Quarter 2 2016
Sanlam Umbrella Fund

Employee Benefits

Insurance | Financial Planning | Retirement | Investments | Wealth

Contents

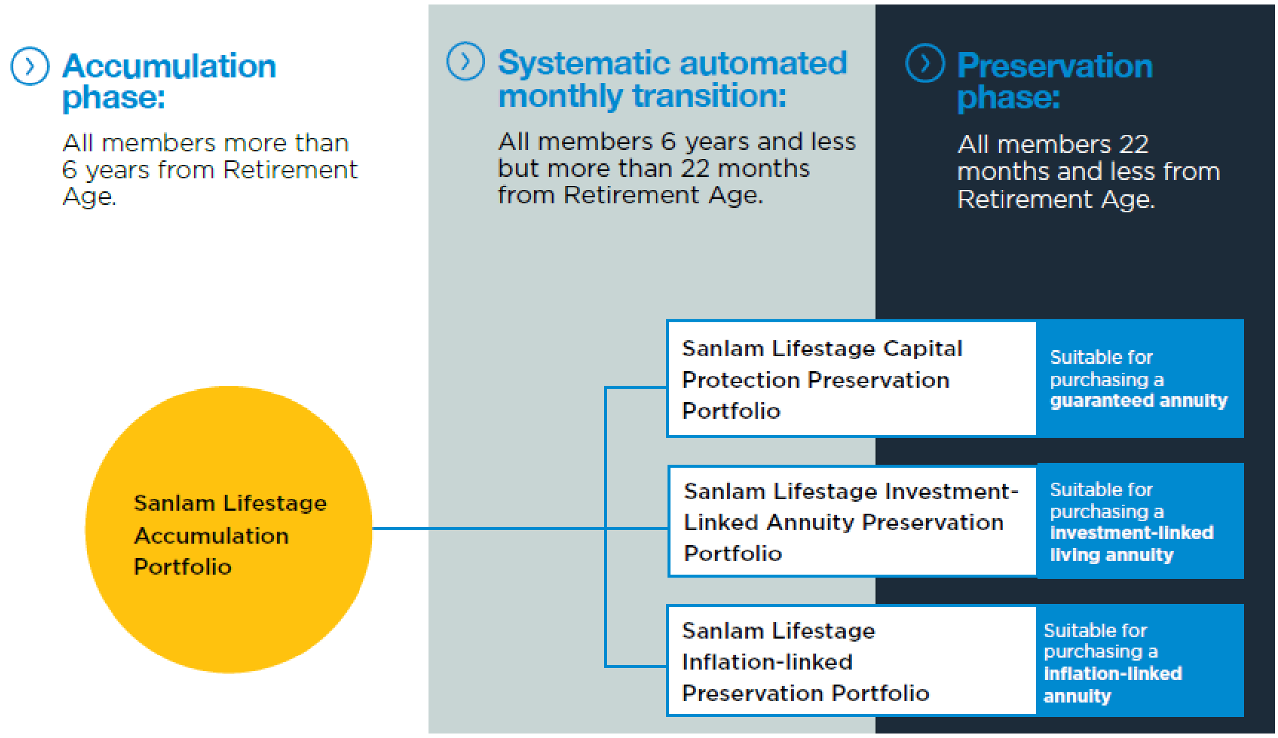
How does Sanlam Lifestage work?

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 June 2016

The second quarter of 2016 started positively with investors more willing to take on risk, primarily as a result of the dovish tone coming from the Federal Reserve regarding rate hikes in the US. There was also significant appreciation and stabilisation of the oil price at around $50 a barrel. A major concern throughout the quarter was the potential that the United Kingdom (UK) could leave the European Union. Against most expectations, the referendum resulted in a leave vote. As a result of this decision what began as a strong quarter ended flat with the equity markets giving back a lot their gains. The MSCI World returned 0.3% (USD) and MSCI Emerging Market Index slightly down -0.3%.

The Federal Reserve had begun the year with the belief that they would begin contractionary monetary policy. However, weak non-farm payroll numbers in May were disappointing and combined by the uncertainty caused by the UK referendum, rate hikes only look likely towards the end of the year if at all. The increased level of uncertainty in global markets has been favourable for bonds with the Barclay's Capital Global Aggregate 2.9% (USD).

South Africa managed to avert a ratings downgrade to Junk Status with Moody's remaining two notches above junk, albeit with a negative outlook. However, local financial markets were also not sheltered from global events. The All Share was up slightly 0.4% (ZAR). The financial sector suffered quite heavily down -6.1% (ZAR), while resources continued their strong performance delivering 6.5% (ZAR).

The risk-off sentiment on global markets as well as the avoidance of the downgrade benefitted South African bonds with the All Bond Index returning 4.4% (ZAR). This was also driven by the fact that investors continue to look for yield in a global environment that is currently deprived of it. This is especially true when considering that several developed nations' bonds are offering negative yields. Inflation linked bonds returned 4.7%. Cash returned 1.8%, however South African listed property was down -0.4% (ZAR). The rand also slightly weakened losing 0.5%.

The result of the UK referendum has large implications for the global economy and monetary policy. As an example, prior to the referendum the US Federal Reserve was fairly intent on increasing interest rates at some time during 2016. This has however fallen by the wayside as the world tries to come to grips with the full implications.

As a result it appears that interest rates are likely to remain lower for longer and the potential exists that instead of an increase in interest rates by the US Federal Reserve there is a slim chance we might see an interest rate decrease. Global bonds certainly seem to be favouring this potential outcome as yields on global treasuries have fallen significantly since the referendum.

It could also lead to greater monetary stimulus from central banks, with further Quantitative Easing policies such as further bond buy back policies, further negative interest rates or even a "Helicopter drop", where central banks attempt to get extra cash directly into consumer's hands through tax cuts and other mechanisms.

All of this means that developed market currencies are likely to remain weak, which could mean a period of strength for emerging market currencies, although this does carry a lot of risk. In addition emerging market bonds become more attractive due to the high yields. With an extremely low/negative yield environment in the developed world, the carry trade comes back into play. Already foreigners have been putting significant inflows into the South African equity and bond markets since the Referendum result.

One could also make a case for saying that further monetary stimulus will benefit risk assets, but this needs to be cautioned with the price currently being paid for these risk assets which are at all-time highs in many parts of the world.

Portfolio Commentary – Quarter ending June 2016

Sanlam Lifestage Accumulation Portfolio

The portfolio underperformed its benchmark slightly over the quarter.

Asset allocation was a detractor over the quarter. The overweight to foreign assets (in particular foreign equity and (Africa) detracted value, particularly with the Rand strengthening towards the end of the quarter. Whilst the underweight to domestic equity and overweight to domestic bonds added value during the quarter.

Manager selection added value, driven by the good performance of the domestic equity managers. Kaizen in particular had a great quarter, with their position in gold adding significant value, whilst First Avenue also outperformed the benchmark strongly. Coronation and Denker underperformed the benchmark, but not by significant margins. The domestic bond managers also outperformed their benchmarks and added value.

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 second quarter of 2016, the portfolio return was 4.6% compared to benchmark of 4.8%.

Sanlam Lifestage ILLA Preservation Portfolio

The portfolio underperformed its benchmark slightly over the quarter.

Asset allocation was a contributor over the quarter. The overweight to foreign assets (in particular overweight foreign equity and underweight foreign bonds) detracted value, particularly with the Rand strengthening towards the end of the quarter. Whilst the underweight to domestic equity, underweight to domestic property and overweight to domestic bonds added value during the quarter.

Manager selection was a detractor, despite the good performance of the domestic equity managers. Kaizen in particular had a great quarter, with their position in gold adding significant value, whilst First Avenue also outperformed the benchmark strongly. Coronation and Denker underperformed the benchmark, but not by significant margins. The largest detractor was the active foreign equity manager who underperformed the MSCI during the quarter.

Fund Factsheets

Sanlam Lifestage Accumulation Portfolio

Period Ending	30-Jun-16
Fund Size	R 6,881 million
Inception Date	Jul-13

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

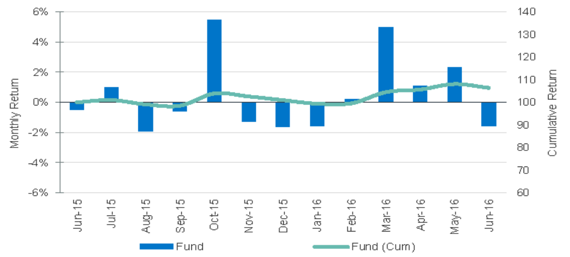
This portfolio has an moderate-aggressive risk profile

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 (%)

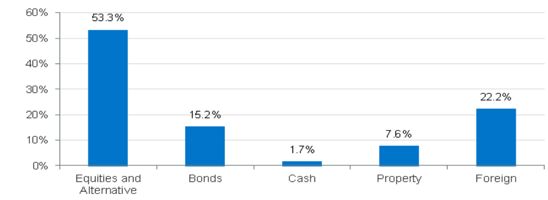
	Fund	Benchmark
1 Month	-1.6%	-1.3%
3 Months	1.8%	1.9%
6 Months	5.4%	6.1%
1 Year	6.4%	8.9%
3 Years	13.6%	14.9%
5 Years	n/a	n/a

Top 10 holdings (% of Equities)

Share Name	% of Equities
Naspers	13.7%
British American Tobacco Plc	5.9%
Steinhoff Int Hldgs N.v	4.7%
MTN Group	4.0%
Standard Bank Group Limited	3.4%
Sasol Limited	3.3%
Old Mutual	3.3%
Aspen Healthcare Holdings	2.7%
Firstrand Limited	2.7%
SABMiller Plc	2.5%

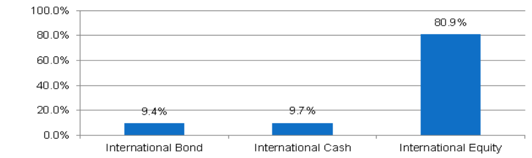
Benchmark
55% FTSE / JSE Shareholder Weighted Index
4% BEASSA Total Return Index
10% FTSE/JSE SAPY Index
11% Short Term Fixed Interest Index (STeFI)
20% MSCI World (Developed Markets) Equity Index

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.

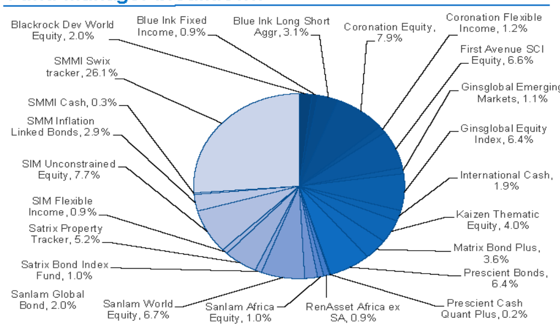
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	21.3%	16.5%
Resources	11.2%	15.8%
Industrials	67.5%	67.8%

Fund manager breakdown



Risk analysis

(based on the last 3 years' monthly returns)

% of negative months over the last 3 years	30.6%
Average capital loss in one month	-1.3%
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	30-Jun-16
Fund Size (Book Value)	R 1 180 million
Inception Date	Aug-13

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.

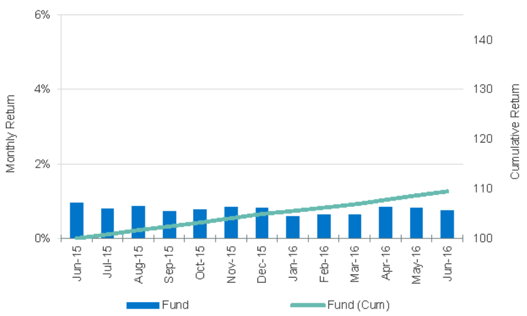
Risk profile

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.)

Monthly and cumulative bonuses



Fund bonuses (%)

	Fund (gross of fees)
1 Month	0.8%
3 Months	2.4%
6 Months	4.3%
1 Year	9.4%
3 Years	n/a
5 Years	n/a

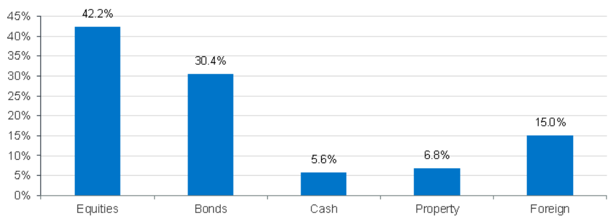
Top 10 equity holdings (% of Equities)

Share Name	% of Equities
Naspers N	15.4%
BTI Group	5.7%
MTN Group	4.5%
Steinhoff (SNH)	4.4%
ATTACQ Limited	4.3%
Old Mutual	3.7%
Sasol	3.6%
FirstRand / RMBH	3.2%
Stanbank	3.1%
Remgro	2.5%

Benchmark

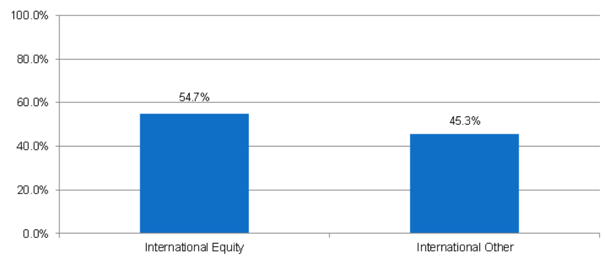
42.0%	SWIX (Shareholder Weighted Index)
25.5%	BEASSA Total Return All Bond Index
1.0%	STeFI + 2%
2.0%	Barclays BESA Gov. Inflation-linked Index
7.5%	MSCI World Index (Dev. Markets)
5.0%	Barclays Global Aggregate Index
2.5%	HFRI Fund of Funds Composite Index
8.0%	STeFI Index
6.5%	BEASSA 7-12 years TRI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

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
Financials	19.0%
Resources	10.9%
Industrials	70.1%

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 Living Annuity Preservation Portfolio

Period Ending	30-Jun-16
Fund Size	R 38 million
Inception Date	Oct-13

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

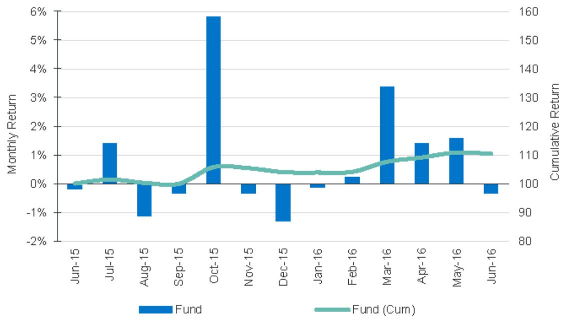
The portfolio has a moderate risk profile.

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	-0.3%	0.0%
3 Months	2.6%	2.7%
6 Months	6.2%	6.8%
1 Year	8.9%	8.9%
3 Years	n/a	n/a
5 Years	n/a	n/a

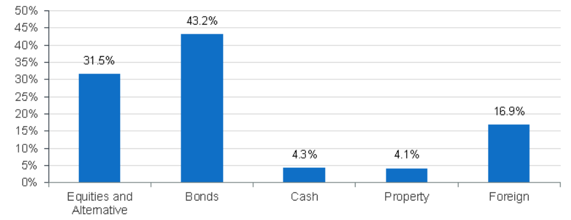
Top 10 equity holdings (% of Equities)

Share Name	% of Equities
Naspers	13.6%
British American Tobacco Plc	5.9%
Steinhoff Int Hldgs N.v	4.7%
MTN Group	4.0%
Standard Bank Group Limited	3.4%
Sasol Limited	3.3%
Old Mutual	3.3%
Aspen Healthcare Holdings	2.7%
Firstrand Limited	2.7%
SABMiller Plc	2.5%

Benchmark

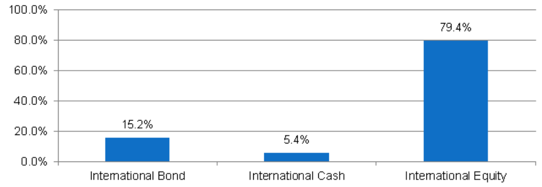
40% FTSE / JSE Shareholder Weighted Index
20% BEASSA Total Return Index
13% Short Term Fixed Interest Index (STeFI)
10% FTSE/JSE SAPY Index
17% Barclays BESA Gov. Inflation-linked Index

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.

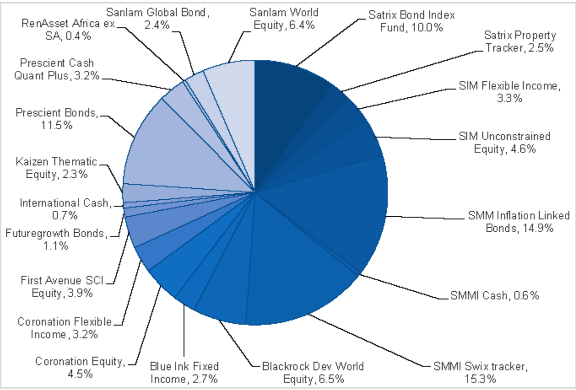
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	21.5%	16.2%
Resources	10.7%	15.1%
Industrials	67.8%	68.7%

Fund manager breakdown



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Sanlam Lifestage Inflation-linked Preservation Portfolio

Period Ending	30-Jun-16
Fund Size (Book Value)	R2 million
Inception Date	Aug-13

Benchmark Sanlam Asset Liabilty Index Real (inflation linked)

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.

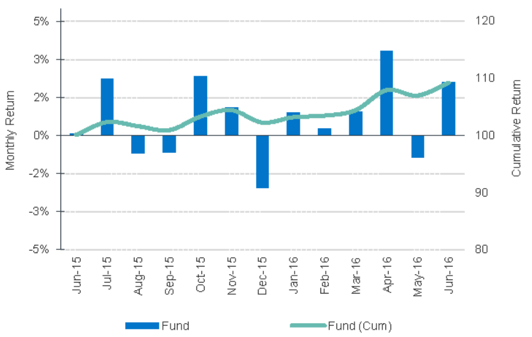
Risk profile

This fund has a conservative risk profile

Fees

Investment Management Fees:
0.70% per annum.

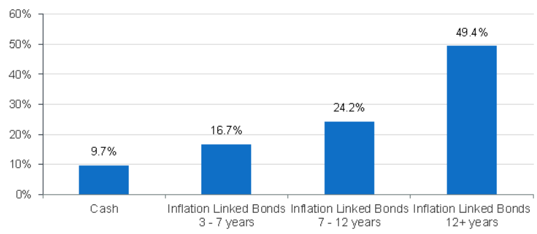
Monthly and cumulative bonuses



Fund bonuses (%)

	Fund (gross of fees)	Benchmark
1 Month	2.1%	2.3%
3 Months	4.6%	4.8%
6 Months	6.8%	7.2%
1 Year	9.2%	9.2%
3 Years	9.3%	9.5%
5 Years	n/a	n/a

Asset class breakdown



Performance vs Benchmark

Performance to end June 2016

Sanlam Lifestage	1 Month	3 Months	6 Months	1 Year	3 Year
Accumulation Portfolio	-1.6%	1.8%	5.4%	6.4%	13.5%
Benchmark	-1.3%	1.9%	6.1%	8.9%	14.9%
Capital Protection Preservation*	0.8%	2.4%	4.3%	9.4%	14.6%
Inflation-Linked Preservation Portfolio	2.1%	4.6%	6.8%	9.2%	9.3%
Benchmark	2.3%	4.8%	7.2%	9.3%	9.5%
ILLA Preservation Portfolio	-0.3%	2.6%	6.2%	8.9%	n/a
Benchmark	0.0%	2.7%	6.8%	8.9%	n/a

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

Performance Attribution

Multi-Managed Portfolios:

3 months ending June 2016	Active Return	Tactical Asset Allocation	Manager Selection
Sanlam Lifestage Accumulation	-0.11%	-0.02%	-0.10%
Sanlam Lifestage ILLA Preservation	-0.07%	0.05%	-0.11%

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

Asset allocation detracted value in April and June with SA cash, SA hedge funds, International equity and bonds detracting most value among the assets. Allocation to SA equities, SA bonds, and International cash and an underweight position in SA property contributed to performance.

Manager selection also detracted from performance with the biggest detractors being international equity managers. SA equity managers and bond managers contributed 0.8% and 0.53% to performance with Stocks such as Naspers, BAT, MTN and Aspen contributing to the equity performance while Steinhoff, Standard bank, Sasol, Old Mutual and Firstrand detracted performance.

The Sanlam Lifestage Living Annuity (ILLA) Preservation Portfolio underperformed its benchmark during the second quarter of 2016 with the composite benchmark returning 2.71% versus the portfolio's 2.64%.

Asset allocation contributed to performance due to allocation to SA equities which gained from equity manager selection. Other asset allocation contributors was an underweight position in property and an overweight position in SA bonds as well as an allocation to SA cash.

Manager selection detracted value especially on international asset managers potentially at the back of a stronger rand. SA equities contributed to performance with 0.65% of which 0.31% was contributed by the passive equity portfolio. Other performance contributions came from SA ILB's as well as SA cash.

Overweight positions in stocks such as Naspers, BAT, MTN, Aspen and an underweight in SABMiller contributed to the SA equity performance while overweight in Steinhoff Standard bank, Sasol, Old mutual and FirstRand detracted from performance over the quarter.

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

June 2016

Executive summary

The risk-off trade dominated asset class returns in Q2 as concerns about a Brexit vote and downward revisions to global growth weighed on equities. Uncertainty about the timing of a US rate hike added to the volatility in equity markets with developed market equities marginally outperforming their emerging market counterparts. The notable exception was African listed equities that outperformed all of the broad asset classes, yielding a stunning 10.6% in rands. The rally was in all likelihood due to valuation considerations following the sharp sell-off in recent years. Investors' flight to safety coupled with the search for yield saw emerging market bonds gain some 6.5% in rands, well ahead of their developed market counterparts, as currency risks abated. With the exception of emerging market bonds, SA fixed income asset classes outperformed their foreign equivalents as the country's investment grade rating was reaffirmed. Domestic listed property brought up the rear, derating relative to the 10-year bond yield from overvalued levels.

Highlights

- Brexit "Yes" vote surprises markets despite polls
- IMF revises global growth lower
- Can Brexit contagion be contained?
- Fed uncertainty on rates fuels risk-on, risk-off trade
- Italy to defy EU on bank "bail-ins"
- Japan wins voter support for more stimulus
- SA gets sovereign ratings reprieve
- Money market rates moderate on inflation and growth expectations

Global Equities

Global equities gained a pedestrian 0.3% in USDs and 0.8% in rands as uncertainty about the timing of a Fed rate hike persisted and concerns about a "Brexit" vote weighed on sentiment. Both hawkish and dovish FOMC statements over the quarter only served to fuel the risk-on risk-off trade, with the latter gaining the upper hand. In the most recent FOMC minutes, the Fed indicated it was losing confidence in the need to raise rates as the sharp slowdown in May non-farm payrolls data pointed to slowing momentum in the job market. Furthermore, the uncertainty that a "Brexit" vote would bring to the global financial system and concerns about economic stability in China also weighed on the Fed's decision to leave rates unchanged. With inflation expectations also continuing to trend lower, the Fed was cautious of fuelling a further slowdown in global growth. The IMF did not help either, weighing in with successive downgrades to global growth expectations. Although emerging market assets rallied strongly in June as currency risks abated, the gains were insufficient to offset the losses in the previous months. As a consequence, emerging market equities declined some 0.3% in USDs but gained a negligible 0.1% in rands. In contrast, the S&P Africa ex SA Index bucked the trend, rallying an impressive 10.1% in USDs and 10.6% in rands. The rally was in all likelihood valuation-driven following years of losses.

Although markets initially reacted negatively to the UK's yes-vote on 23 July, markets bounced back to pre-Brexit levels in July. Theresa May was appointed as the new UK Prime Minister, with a cabinet reshuffle taking place the following day. The appointment of "leave" campaigners to the foreign ministry and the "Brexit" ministry was no doubt an attempt to unite the Conservative Party and show its commitment to implementing the will of the people. But the journey out of the EU will be a difficult one with Britain unlikely to retain access to the single market area without capitulating to the funding and settlement of immigrants. Also the issue of corporate pass porting may not be resolved in Britain's favour, resulting in the flight of banks and insurers from the UK. In the run-up to the "EU exit" vote, expected in December 2018, the UK is likely to cut interest rates by 50 basis points at the August MPC meeting, expand QE further and possibly reduce the corporate tax rate by some 5% as a means of stimulating growth.

The Brexit vote has raised concerns in the EU that anti-European political parties may also be emboldened to follow the UK's lead and attempt a break-away from the EU. The most likely candidate at this point is Italy, which faces the headwind of bank failures due to non-performing loans (NPLs) and a constitutional vote in October which could unseat Matteo Renzi. Since banks are saddled with NPLs of some Euro 360 billion, a government bailout is needed in order to recapitalise the banks. However, new Eurozone banking rules that came into effect this year make it mandatory for creditors to "bail-in" the banks before government funding can be used. Since retail investors hold some Euro 200 billion in bank bonds, the political backlash from a "bail-in" would almost certainly bring the Five Star Movement, an anti EU political party, into power. In the event that Italy were to exit the EU, for which there is no legal precedent, the Eurozone experiment would likely end in failure. It is in light of these risks that we believe a compromise agreement will be reached between Italy and the EU with respect to a bank bailout.

While UK economic growth will almost certainly be negatively affected by the decision to leave the EU, fed fund futures are again pricing in a higher probability of a Fed rate hike by December, following a surge in June non-farm payroll data, better than expected industrial production and retail sales data and a positive start to the Q2 earnings reporting season, especially amongst US banks. Chinese data also surprised on the upside with retail sales, industrial production and foreign direct investment all beating the street. Despite strong growth in aggregate financing, the surge in the country's total debt to GDP ratio, coupled with default risks, poses a headwind for growth. Although Japan has been plagued by a strong Yen despite QQE, the LDP's win in recent Upper House elections has given Japanese Prime Minister Shinzo Abe a mandate to introduce an additional stimulus package in order to reinflate the economy. While further monetary and fiscal stimulus is expected in the near term, the government has ruled out using deficit bonds to fund the stimulus programme opting rather to use longer-term construction bonds. This is likely to be financed by the Central Bank, the so-called helicopter drop of money. The funding (USD 95 billion) will be used to bring forward the construction of Maglev Train (Shanghai Transrapid) and other high-speed train lines and improve facilities at ports for tourist cruise ships.

Against the backdrop then of increased monetary and fiscal stimulus in the UK, Japan and the Eurozone in coming months, the added liquidity is expected to underpin risk assets. Post the 2008 recession, risk assets have been buoyed by QE stimulus rather than inflation expectations as has historically been the case. In addition, expectations of a turning point in the US earnings cycle is also likely to underpin equities over the coming quarters. Although developed market equity valuations are somewhat stretched relative to their 10-year mean, relative to their longer-term mean, the equity market is still fairly valued. Similarly, emerging market equities are also fairly valued, supporting an overweight position in both developed and emerging market equities. Since emerging market currencies are generally trading at a discount to their purchasing power parity values and the carry trade still favouring the search for yield, these factors are expected to partially insulate emerging markets against macro-economic risks.

Global Bonds

Global bonds benefitted from the flight to safety ahead of the Brexit vote, a slowdown in global growth and uncertainty about a Fed funds rate hike. Global bonds rallied some 2.7% in USDs and 3.2% in rands as inflation expectations moderated. Lower inflation expectations, as reflected in break-even rates, pushed the yield on the JP Morgan Global Aggregate Bond Index down to 1.27% from 1.59% the previous quarter. Emerging market bonds faired much better as investors went in search of yield. The JP Morgan Emerging Market Bond Index rallied 6.0% in USDs and 6.5% in rands as spreads narrowed to 376 basis points from 400 basis points at the end of Q1. Global inflation-linked bonds lagged their nominal counterparts, yielding a more subdued 1.7% in USDs even as real yields pushed lower to -0.67% from -0.41%. Global corporate bonds also underperformed their nominal sovereign counterparts, yielding 2.1% in USDs as spreads widened on the uptick in risk aversion.

Although global bonds are overbought, expectations of additional quantitative easing in the UK, Eurozone and Japan will likely cap bond yields over the medium term. While trends in the US bond market will affect pricing of bonds globally, declines in US break-even inflation rates suggest inflation expectations are well anchored at historically low levels. With real bond yields trading in negative territory, especially in Europe and Japan, pension and endownment funds are having to place increasing amounts of assets on risk in order to meet contractual obligations to fund pensions. This suggests that over the longer term, bond yields will need to rise in order to avert a potential collapse in life assurers. Since emerging markets offer more attractive absolute bond yields relative to their developed market counterparts, a neutral weighting is retained in emerging market bonds. Even though currency risk remains a concern in the event that the US raises rates sooner rather than later, our base case view is that emerging market currencies are trading below their fair value providing a cushion against an unexpected normalisation in US rates.

Global property benefitted from the lower yields in the bond market, rallying some 3.7% in USDs (4.1% in rands). With global property trading on a 1.58X price-to-book ratio, somewhat ahead of the 1.43X mean, we retain a neutral weighting in this asset class in the near term, looking to underweight property on early signs of a Fed rate hike.

SA Equities

SA equities tracked the performance of their emerging market counterparts in Q2 as the implications of a "Brexit" vote weighed on sentiment, given the historical trade ties between SA and the UK. The All Share Index eaked out a gain of 0.4% in rands but yielded 0% in USDs given a small depreciation in the rand. Despite the disappointing rand returns, foreigners were net buyers of equities, totalling a staggering R47.6 billion. This suggests that although foreigners were net buyers of emerging market assets, including SA, domestic investors were selling down their equity exposure. Since the market sell-off came well ahead of the Brexit vote and after the sovereign ratings reprieve by S&P Global Ratings and Fitch Ratings, a switch out of equities into bonds in all likelihood accounted for the weak market returns. At the sectoral level, financials came under selling pressure with the Fini-15 down 6.1%, while the Indi-25 gained a pedestrian 0.4% and the Resi-10 a welcome 6.5%. Gold counters, in turn, rallied strongly, gaining some 16.4%, underpinned by demand for safe-haven assets and a strong rally in the metal's USD price. While disappointing Q1 GDP data may have contributed to the negative sentiment in the market, a weak Q1 reading was largely priced into the market.

Following the Q1 GDP report, estimates for growth were revised lower with the IMF forecasting growth of only 0.1% this year and some 1.1% in 2017. This will add to the previous 2 years of negative GDP per capita growth, a key consideration for ratings agencies when assessing an investment or sub-investment grade score. Although retail sales and manufacturing production data beat the consensus in May, mining production continued to contract on a year-on-year basis. Despite the pedestrian GDP growth outlook, the top-down measure of earnings growth - the gross operating surplus - has shown an improvement since Q4 2015, a trend that continued in Q1 2016. Not only have earnings bottomed out, but margins have also improved, shown as the difference between the gross operating surplus and employee compensation. Expectations of a better earnings environment are also reflected in the gains seen in the Barclay's PMI index.

In contrast to the top-down earnings estimates, the JSE's bottom-up consensus earnings estimates suggest earnings will rebound in excess of 30% over the coming 12 months, albeit off a low earnings base that contracted some 20% in the year to end June. Earnings implied by the market are even higher at 40% highlighting the risk of earnings disppointments in the year ahead. From a valuation perspective, the market is also expensive trading on a forward multiple of 16X earnings. However, if the top six rand-hedge counters are stripped out of the index, the forward multiple declines to 12.3X earnings, somewhat less than the historical mean of 13X earnings. This suggests that SA Inc shares are fairly valued, while their rand hedge counterparts are expensive. As a consequence, we retain a neutral weighting in domestic equities biased towards financials and domestic industrials.

SA Bonds

Domestic bonds rallied strongly in Q2, following the decision by S&P Global Ratings and Fitch Ratings to leave SA's sovereign rating unchanged, at investment grade. The reprieve may, however, be short-lived as a follow up review is scheduled for December. In order to avoid a downgrade then, a number of hurdles will need to be overcome. These include the transformation of SOEs, including board representation, measures to combat rising unemployment and weak economic growth, a freeze on public sector employment and a moderation in the wage bill, implementation of economic reforms including labour market reforms (strike balloting and minimum wage legislation), finalisation of the Minerals Bill and the avoidance of populist economic policies post the August local government elections. The October Medium Term Budget Policy Statement will also be an important milestone with ratings agencies looking for signs of fiscal prudence and realistic macro-economic assumptions.

SA bonds rallied some 4.4% in rands and 3.9% in USDs, as yields on the Albi declined from 9.53% to 9.25%. Lower inflation expectations and net foreign purchases of bonds, totalling some R6.25 billion, aided the gains in the bond market. In contrast, inflation-linked bonds yielded some 4.7% in rands as real yields on the BarCap SA Inflation Linked

Bond Index declined to 1.8% from 1.9%. While inflation expectations were revised lower over the quarter on downward revisions to food inflation, the higher modified duration of the index and the inflation carry underpinned inflation-linked returns. A preference for inflation-linkers over nominal bonds is retained in H2 as inflation accelerates from current levels. Corporate bond yields tracked their sovereign nominal counterparts lower in Q2, but a widening in spreads capped returns at some 4.1% in rands. The widening in spreads reflected the increase in risk aversion that weighed on equities over the quarter. Despite the sharp decline in bond yields, SA listed property stocks yielded a negative 0.9% in rands as the sector derated relative to bonds and distributions growth remained mired in negative territory.

Despite the year-to-date gains in the bond market, tailwinds between now and December include materially higher inflation and the December review by the rating agencies. Since inflation is expected to peak at around 7% in Q4, bond yields are likely to push higher, supporting a moderation in exposure to nominal bonds. Similarly, ahead of the ratings review in December, bond yields are expected to increase further as risk aversion intensifies. The magnitude of the back-up in yields is likely to be capped since USD-denominated debt constitutes around 10% of outstanding issuance and the fact that a downgrade is partially priced into credit default swaps. Since a downgrade remains our base case view, we envisage increasing exposure to bonds post the ratings review at somewhat higher yields. At yields in excess of 10%, nominal bonds will be overweighted. In contrast, exposure to inflation-linkers will provide a hedge against inflation risk, with returns benefitting from the inflation carry. Since listed property tends to track bond yields, we retain our underweight positon in property looking to upweight this asset class later in the year on higher bond yields.

SA Cash

SA cash yielded 1.8% in Q2, outperforming both local and foreign equities and domestic listed property. With growth and inflation having come in lower than expected in recent months, expectations of interest rate increases have moderated notwithstanding an expected acceleration in inflation in H2. Following the contraction in Q1 GDP by 1.2% QQSAA, growth expectations have also been revised lower over the coming two years, falling well short of SA's population growth. The implication is that unemployment will rise providing further challenges for the local economy. Money market rates have consequently moderated reflecting the market's view that the MPC will be more dovish when announcing its interest rate decision at the upcoming meeting in July. Money market rates are now expected to peak at around 7.75% in the current cycle, down from almost 8.5% the previous month. In contrast, SMMI expects rates to rise a further 25 basis points to 7.25% before year end, and a further 25 basis points in 2017 on a ratings downgrade. Real interest rates, in turn, are expected to increase from some 0.7% currently to around 1.7% in H2 2017. Although this is somewhat lower than historical real rates, it nonetheless reflects a normalization in interest rates in a "new normal" world.

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