Sanlam Lifestage Feedback Report
Quarter 2 2017

Employee Benefits

Sanlam

Insurance | Financial Planning | Retirement | Investments | Wealth

Contents

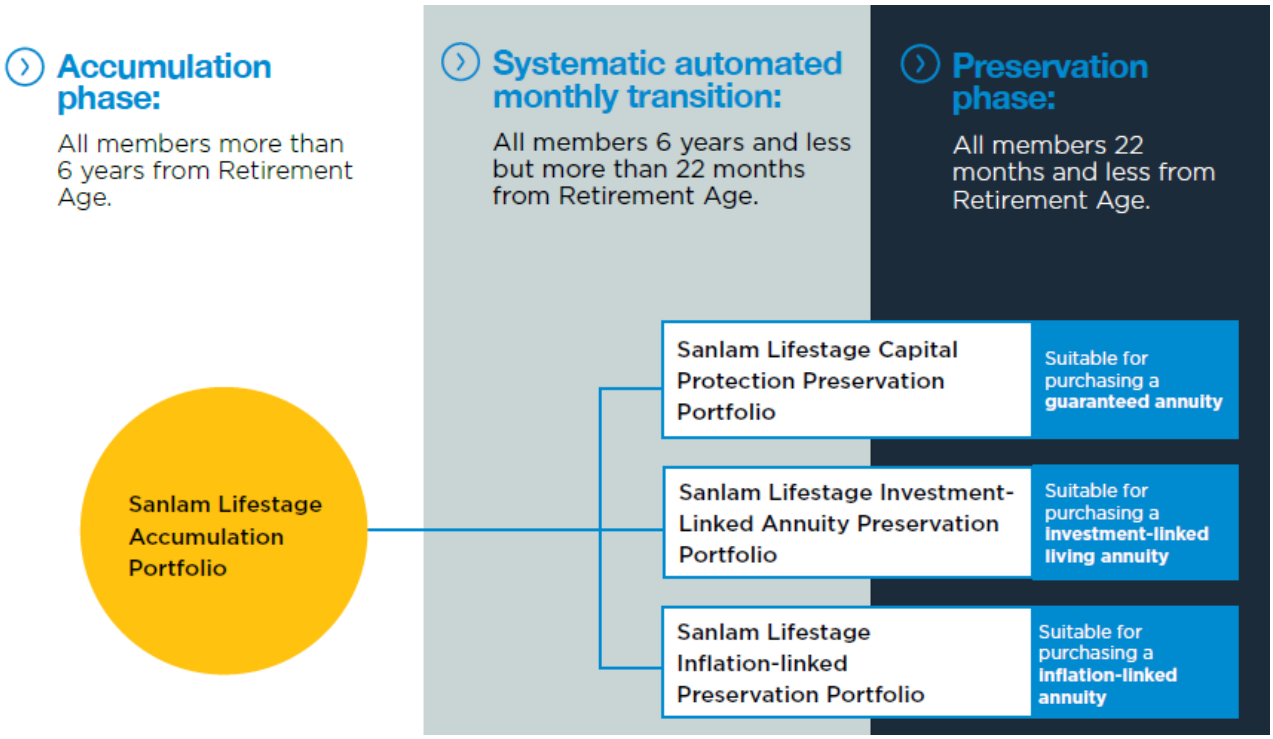
How does Sanlam Lifestage work?

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

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 2017

The 2nd quarter of 2017 was an eventful quarter with much focus on Geopolitical events as well as monetary policy decisions. The United States Federal Reserve Bank continued their rate hiking cycle raising the Federal Fund Rate 0.25%. UK Prime Minister Theresa May called a snap election to strengthen her governments hand in Brexit negotiations, however this backfired spectacularly and potentially casts doubt over Brexit. However the most important political event during the quarter was the French election which acted as a proxy for the battle between pro-Europe vs populist beliefs. The result of Emmanuel Macron winning was an important stabiliser to the region for now which combined with good economic growth data coming out of Europe led to a rally to global equity markets.

The MSCI World delivered 3.4% (USD) during the quarter. MSCI Emerging Markets (EM) also had a strong quarter delivering 5.5% (USD), which is indicative of the general strong risk-appetite occurring globally. This means that year to date Emerging Markets have returned 17.2% (USD). Global bonds as measured by the Barclay's Capital Global Aggregate delivered 2.6% (USD) assisted by benign global inflation numbers, while Emerging Markets delivered 2.5% (USD).

Locally, there has been a lot of focus on political events. Moody's became the latest rating agency to downgrade South Africa's foreign denominated debt post the reshuffle of the cabinet and firing of the Finance Minister. In addition the confirmation that the South African economy has entered into recession is the result of weak consumer and business confidence as well as an increase in the official unemployment rate to 27.7%. In addition State Owned Enterprises continue to be in the spotlight for all the wrong reasons, with the latest development that SAA has been bailed out to the tune of R2.2 billion.

All of this led to a greater risk-off sentiment locally. The All Share Index was down -0.4% (ZAR). This was primarily driven by the resources being down -6.1% (ZAR) off the back of the newly released Mining Charter which puts more pressure on mining houses and jobs. The All Bond Index (ALBI) returning 1.5% (ZAR) as foreign investors search for yield continues. Similarly listed property returned 0.9% (ZAR) during the quarter whilst cash during was up 1.9% (ZAR). The Rand strengthened against the US Dollar by 2.4% over the quarter off the back of the risk on trade globally into emerging markets.

The global and local pictures could not be more different at this stage. Globally economic growth continues to improve and future prospects remain strong, particularly in Europe. The US is likely to tighten monetary policy further, moving towards a more normalised environment for rates. This coupled with the economic growth means that Global bonds are likely to continue to deliver poor returns. From a valuation perspective Global Equities are beginning to get more expensive, particularly in the US. However on a relative basis they are still much cheaper than Global Bonds.

Domestically South Africa is in economic trouble. Projections last year were that the economy would grow over 1%, but recently this has been downgraded by most market commentators as well as the Reserve Bank. Unemployment is at record highs, with the only good news at this stage being that Inflation is coming down. However, with all the political uncertainty and lack of clear policies, it is difficult to see the current situation being resolved quickly.

Despite this domestic bonds offer good value, with yields in excess of 9%. Foreigners have been net buyers of SA domestic bonds despite the downgrades and bad news because of the attractiveness of the high yields. If Inflation continues to fall, these yields are beginning to look even more attractive particularly in an environment not supportive of equity. We are negative on domestic equity as a result of the poor economic environment, particularly for SA only stocks. Rand Hedges could do better, but any Rand strength will hinder their returns. As a result we favour domestic bonds and property over domestic equity. Cash is providing better returns at present, but with the next move of the Reserve Bank likely to be a reduction in rates this will get slightly worse.

Geopolitical risks remain high, particularly with regards to North Korea and its missile testing program which recently successfully launched its first missile capable of reaching the US. This coupled with the prospect of further downgrades in SA mean that there are some potential high impact outcomes which could influence portfolios and we need to be aware of the risks of this.

Portfolio Commentary – Quarter ending June 2017

Sanlam Lifestage Accumulation Portfolio

The portfolio underperformed its benchmark over the quarter.

In terms of asset allocation the underweight to domestic equity added value as well as the overweight position to foreign equity and underweight position to foreign bonds.

The allocation to Africa performed extremely well over the quarter and was the largest contributor to performance.

Within manager selection, domestic equity manager selection was the largest detractor from performance. Naspers rallied particularly hard in April and May and most managers were underweight this stock which detracted significant performance. Managers that performed particularly poorly were the value strategies managed by Investec and ABSA as well as Fairtree, Coronation, Sentio and Capricorn. Strong positive contributions came from ABAX, Truffle, SIM, Kaizen and First Avenue.

Amongst other asset classes the manager selection was a positive contributor, particularly from the bond managers.

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.

Sanlam Lifestage ILLA Preservation Portfolio

The portfolio underperformed its benchmark over the quarter.

Asset allocation was flat over the quarter. The underweight to domestic equity detracted value, whilst the overweight position to foreign equity and underweight position to foreign bonds contributed.

Within manager selection, domestic equity manager selection was the largest detractor from performance. Naspers rallied particularly hard in April and May and most managers were underweight this stock which detracted significant performance. Managers that performed particularly poorly were the value strategies managed by Investec and ABSA as well as Fairtree, Coronation, Sentio and Capricorn. Strong positive contributions came from ABAX, Truffle, SIM, Kaizen and First Avenue.

Amongst other asset classes the manager selection was a positive contributor, particularly from the bond managers.

Fund Fact Sheets

Sanlam Lifestage

Mandate description

Sanlam Lifestage is the Fund's trustee approved default investment strategy and aims to meet each member's savings requirement by working towards a target date, which would be the Normal Retirement Age or the Planned Retirement Age (if different).

How Sanlam Lifestage works

The investment strategy consists of two phases and members are automatically switched from one phase to another as they near retirement. The two phases are:

- Accumulation phase
- Preservation phase

As retirement approaches, this target date strategy invests in an investment portfolio matching the member's postretirement needs or plans, but in the years prior to this greater emphasis is placed on achieving capital growth. Members with more than 6 years before reaching their Normal Retirement Age or Planned Retirement Age (if different) are fully invested in the Sanlam Lifestage Accumulation Portfolio which aims to achieve capital growth. Six years (72 months) before a member reaches his/her Normal Retirement Age or Planned Retirement Age (if different), the member is gradually switched from the Sanlam Lifestage Accumulation Portfolio to his/her selected Sanlam Lifestage preservation portfolio by means of 50 monthly switches.

Members with more than 6 years before reaching their Planned Retirement Age are fully invested in Sanlam Lifestage Accumulation Portfolio which aims to achieve capital growth.

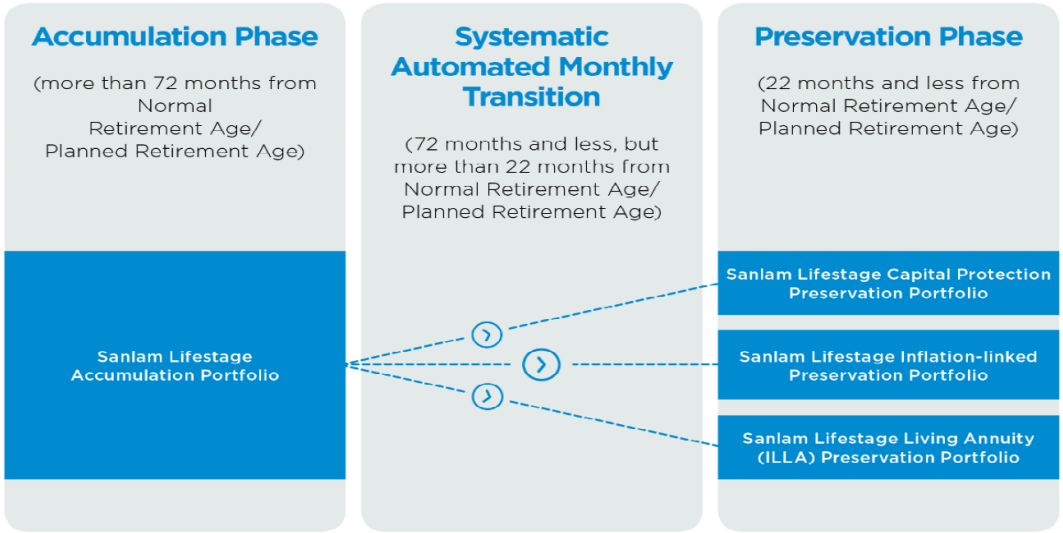
Six years (72 months) before a member reaches his/her Planned Retirement Age, the member is gradually switched from the Sanlam Lifestage Accumulation Portfolio to his/her selected Sanlam Lifestage preservation portfolio by means of 50 monthly switches.

Fund performance

Phase	1 month	3 months	1 year	3 years
Accumulation Portfolio	-2.1%	0.3%	2.0%	5.8%
Preservation Portfolios:				
Capital Protection	0.7%	1.9%	8.2%	10.6%
Inflation-Linked	-0.2%	0.6%	-0.8%	4.3%
Living annuity (ILLA)	-1.5%	0.5%	3.5%	7.1%

Please note:

Sanlam Lifestage investment reporting only commences from 1 August 2013, but the following longer term performance was achieved applicable to members previously invested in the Accumulation Phase of the Sanlam Umbrella Fund's discontinued Lifestage Programme, and whose investments were transitioned to Sanlam Lifestage during the month of July 2013.



Sanlam Lifestage Accumulation Portfolio

Period Ending	30-Jun-17
Fund Size	R 9,244 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.
Scrip lending may be performed on the passive equity component.

Risk profile

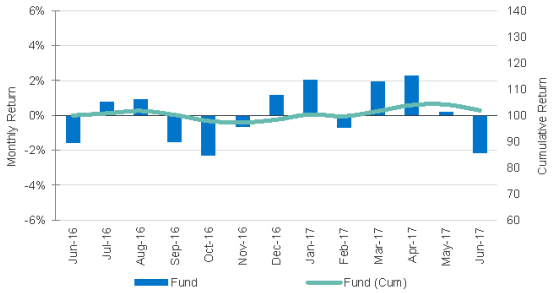
This portfolio has an moderate-aggressive risk profile

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	-2.1%	-2.2%
3 Months	0.3%	0.6%
6 Months	3.6%	3.4%
1 Year	2.0%	1.5%
3 Years	5.8%	7.2%
5 Years	n/a	n/a

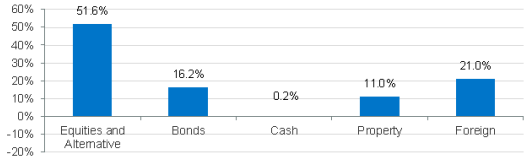
Top 10 holdings (% of Equities)

Share Name	% of Equities
Naspers	15.9%
British American Tobacco Plc	4.7%
Steinhoff Int Hldgs N.v	3.7%
Sasol Limited	3.0%
MTN Group	3.0%
Standard Bank Group Limited	3.0%
Firstrand Limited	2.8%
Bid Corporation Limited	2.0%
Anglo American	1.9%
Richemont	1.8%

Benchmark

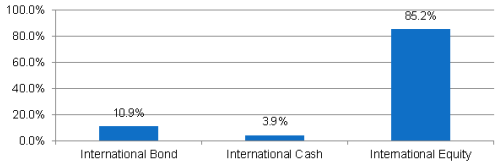
55%	SWIX (Shareholder Weighted Index)
10%	BEASSA Total Return All Bond Index
7.5%	FTSE/JSE SAPY Index
2.5%	Short Term Fixed Interest Index (STeFI)
5%	Barclays BESA Gov. Inflation-linked Index
15%	MSCI World (Developed Markets) Equity Index
5%	Barclays Global Aggregate Index

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.

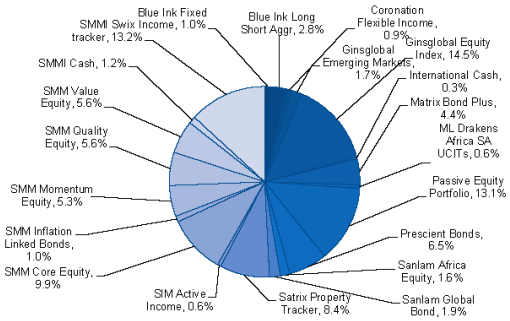
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	22.1%	19.3%
Resources	14.5%	17.8%
Industrials	63.4%	62.9%

Fund manager breakdown



Please refer to the "Local equity manager breakdown for SMMI portfolios" for a detailed outline of the underlying equity managers within this portfolio.

Risk analysis
(based on the last 3 years' monthly returns)

% of negative months over the last 3 years	38.9%
Average capital loss in one month	-1.4%
Downside risk *	0.9%

of the portfolio relative to CPI

Sanlam Lifestage Capital Protection Preservation Portfolio

Period Ending	30-Jun-17
Fund Size (Book Value)	R 1581 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. The portfolio offers 100% capital guarantee and partially vesting bonuses.

Risk profile

The portfolio has a conservative risk profile

Fees

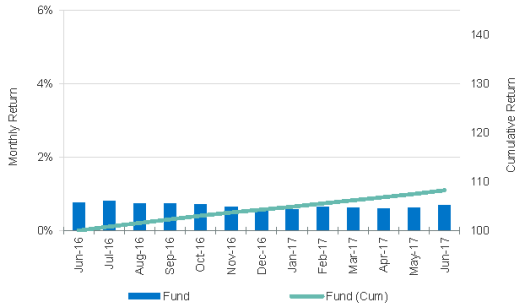
Sanlam's cost in relation to the investment plan is recouped by recovering the following fees:

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	0.7%
3 Months	1.9%
6 Months	3.8%
1 Year	8.2%
3 Years	10.6%
5 Years	n/a

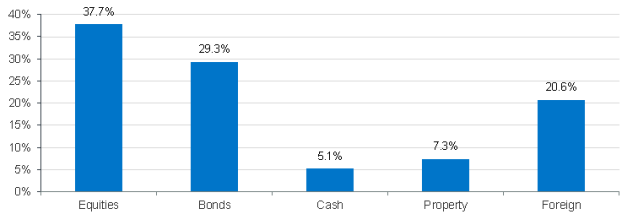
Top 10 equity holdings (% of Equities)

Share Name	% of Equities
Naspers N	20.3%
BTI Group	5.9%
Sasol	4.4%
MTN Group	4.3%
Stanbank	4.2%
FirstRand / RMBH	4.1%
Steinhoff (SNH)	3.6%
Old Mutual	3.3%
Barclays	2.5%
Anglos	2.0%

Benchmark

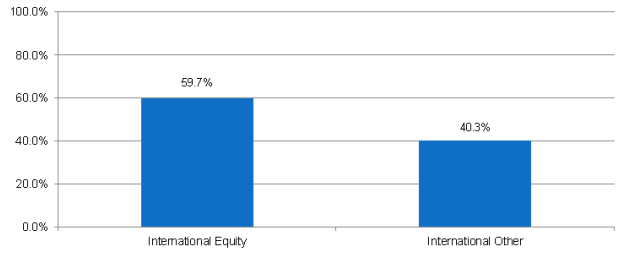
37.0%	SWIX (Shareholder Weighted Index)
25.5%	BEASSA Total Return All Bond Index
1.0%	STeFI + 2%
2.0%	IGOVI
12.5%	MSCI World Index (Dev. Markets)
5.0%	Barclays Global Aggregate Index
2.5%	US 3 month London InterBank Offered Rate (LIBOR) +2.5% (net of fees)
8.0%	STeFI Index
6.5%	BEASSA 7-12 years TRI 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	21.5%
Resources	12.5%
Industrials	66.0%

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

Sanlam Umbrella Pension Fund	8.30%
Sanlam Umbrella Provident Fund	9.47%

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

Funding Level

July 2017: 97.41% funded

Sanlam Lifestage Living Annuity Preservation Portfolio

Period Ending	30-Jun-17
Fund Size	R 60 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

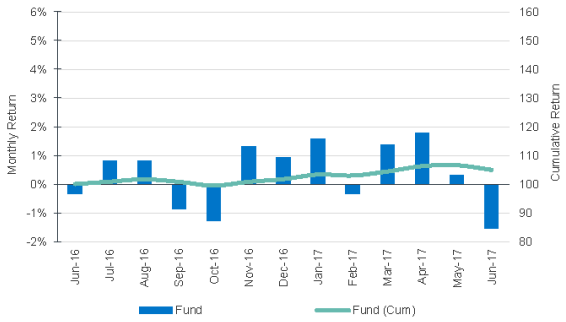
The portfolio has a moderate risk profile.

Fees

Investment Management Fees:
0.80% per annum.

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

Monthly and cumulative returns



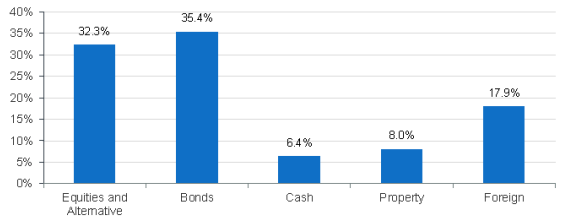
Fund performance (%)

	Fund	Benchmark
1 Month	-1.5%	-1.6%
3 Months	0.5%	0.8%
6 Months	3.2%	3.0%
1 Year	3.5%	2.2%
3 Years	7.1%	6.9%
5 Years	n/a	n/a

Top 10 equity holdings (% of Equities)

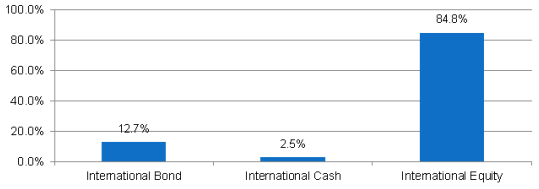
Share Name	% of Equities
Naspers	18.1%
British American Tobacco Plc	4.9%
Steinhoff Int Hldgs N.v	3.8%
MTN Group	3.4%
Sasol Limited	3.4%
Standard Bank Group Limited	3.3%
Firstrand Limited	3.0%
Bid Corporation Limited	2.1%
Anglo American	2.0%
Sanlam	1.9%

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.

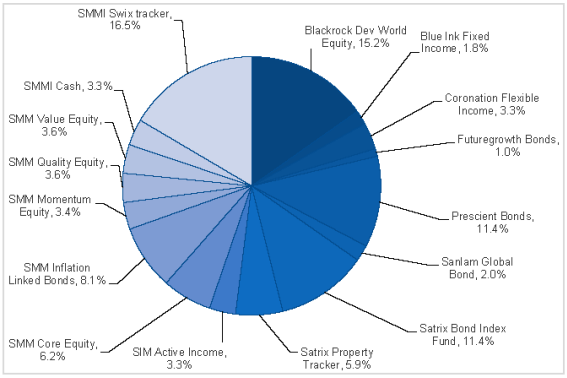
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	22.3%	19.3%
Resources	13.1%	17.8%
Industrials	64.6%	62.9%

Fund manager breakdown



Please refer to the "Local equity manager breakdown for SMMI portfolios" for a detailed outline of the underlying equity managers within this portfolio.

Sanlam Lifestage Inflation-linked Preservation Portfolio

Period Ending 30-Jun-17
Fund Size (Book Value) R1 million
Inception Date May-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.

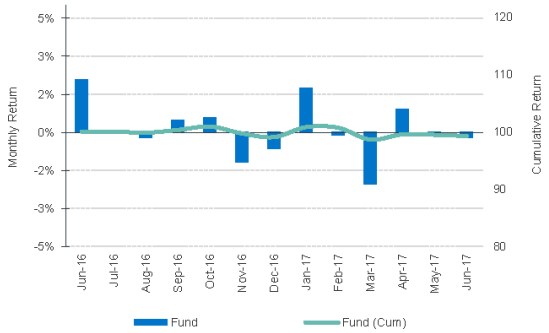
Risk profile

This fund has a conservative risk profile

Fees

Investment Management Fees:
0.70% per annum.

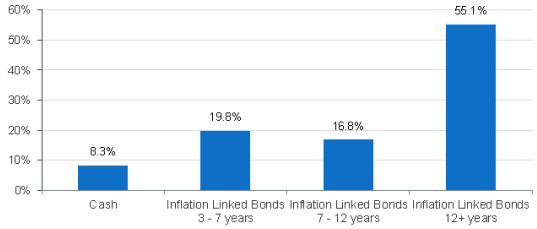
Monthly and cumulative bonuses



Fund bonuses (%)

	Fund (gross of fees)	Benchmark
1 Month	-0.2%	-0.3%
3 Months	0.6%	0.8%
6 Months	0.2%	0.0%
1 Year	-0.8%	-1.7%
3 Years	4.3%	4.1%
5 Years	n/a	n/a

Asset class breakdown



Local equity manager breakdown for SMMI portfolios

	Lifestage Accumulation	SMM 70 Portfolio	SMM 50 Portoflio	SMM 30 Portfolio	ILLA Preservation
Domestic Equity					
Core Equity					
Fairtree Equity	2.0%	4.2%	2.9%	1.4%	1.2%
Truffe Equity	2.0%	4.1%	2.9%	1.3%	1.2%
ABAX Eqity	2.0%	4.1%	2.9%	1.3%	1.2%
Coronation Equity	2.6%	5.5%	3.8%	1.8%	1.6%
Sentio Equity	1.3%	2.7%	1.9%	0.9%	0.8%
Quality Equity					
First Avenue	2.0%	4.1%	2.9%	1.3%	1.3%
Steyn Equity	1.1%	2.3%	1.6%	0.8%	0.7%
Bataleur Equity	1.4%	3.0%	2.1%	1.0%	0.9%
Satrix Quality Index	1.1%	2.3%	1.6%	0.8%	0.7%
Momentum Equity					
Kaizen Thematic Equity	2.0%	4.1%	2.8%	1.4%	1.2%
Satrix Momentum	2.0%	4.2%	2.9%	1.4%	1.3%
Capricorn Equity	1.3%	2.7%	1.8%	0.9%	0.8%
Value Equity					
ABSA Select Equity	1.4%	2.9%	2.0%	0.9%	0.9%
Investec Value	1.4%	3.0%	2.0%	1.0%	0.9%
SIM General Equity	1.7%	3.5%	2.4%	1.1%	1.1%
Satrix Stable Dividend	1.1%	2.3%	1.6%	0.8%	0.7%
Total	**26.2%**	**54.9%**	**38.0%**	**17.9%**	**16.7%**

Performance vs Benchmark

Performance to end June 2017

Sanlam Lifestage	1 Month	3 Months	6 Months	1 Year	3 Year
Accumulation Portfolio	-2.13%	0.31%	3.63%	1.96%	5.83%
Benchmark	-2.23%	0.57%	3.42%	1.52%	7.25%
Capital Protection Preservation*	0.69%	1.93%	3.79%	8.15%	10.60%
Inflation-Linked Preservation Portfolio	-0.22%	0.63%	0.18%	-0.77%	4.32%
Benchmark	-0.34%	0.76%	0.00%	-1.73%	4.06%
ILLA Preservation Portfolio	-1.53%	0.53%	3.17%	3.50%	7.14%
Benchmark	-1.55%	0.82%	3.01%	2.21%	6.93%

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

Performance Attribution

Multi-Managed Portfolios:

3 months ending June 2017	Active Return	Tactical Asset Allocation	Manager Selection
Sanlam Lifestage Accumulation	-0.26%	-0.01%	-0.25%
Sanlam Lifestage ILLA Preservation	-0.29%	0.03%	-0.32%

The Sanlam Lifestage Accumulation portfolio has underperformed its benchmark over the quarter on the back of a continued low return environment. The main detractors to the performance unfortunately came from both manager selection and asset allocation that returned -0.25% and -0.01% respectively. Looking at the manager selection side, the funds that came under the most pressure were the SIM Institutional Equity fund, Kaizen Thematic Equity which returned a combined -0.46%, followed by the SMMI Property fund, SMMI Government and Bank Inflation linked fund, GinsGlobal Equity fund and the Blue Ink hedge funds. On the asset allocation side the detractors came from SA Equity by -0.3%, SA Bonds by -0.02%, SA Cash by -0.03% and international cash by -0.08% with the rand having also strengthened.

The Sanlam Lifestage ILLA Preservation portfolio has underperformed its benchmark over the quarter on the back of a continued low return environment. The main detractor to the performance of the came from manager selection that returned -0.32% while asset allocation offset a bit of the negative performance with a positive return of 0.03%. Looking at the manager selection side, the fund that came under the most pressure was the Equity managers that returned -0.30%, followed by the SMMI Property fund, SMMI Government and Bank Inflation linked fund, Blackrock World Index and the Blue Ink hedge funds. On the asset allocation side the detractors came from SA Equity by -0.1%, SA Property by -0.01% and international cash by -0.05% with the rand having also strengthened.

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 2017

Executive summary

Risk assets outperformed their defensive counterparts in Q2 as upward revisions to global growth reinforced market expectations that the earnings cycle still had legs. A slight easing in global bond yields, despite a Fed rate hike and hawkish comments from the ECB, allayed investor concerns that equity market valuations had become overly stretched. Emerging market equities were the best performing of the broad asset classes even as political risks in Brazil detracted from returns. In contrast, domestic asset classes bucked the trend with equities underperforming their fixed income counterparts. The gazetting of the Mining Charter, negative first quarter GDP growth (QQSAA), policy uncertainty ahead of the ANC's policy conference and a sharp sell-off in gold and platinum stocks, outweighed the negative effects of sovereign ratings downgrades by S&P Ratings, Fitch and Moody's. Cash was king, outperforming all of the broad domestic asset classes.

Highlights

- FOMC raises rates on "transitory" inflation
- ECB turns hawkish, but tapering is off the table for now
- Macron wins majority in French Parliamentary vote; reforms to gain traction
- IMF revises global growth higher for 2017
- SA heads into technical recession
- Mining Charter fails to ignite investment enthusiasm
- S&P Ratings, Fitch and Moody's downgrade SA sovereign debt
- SA Public Protector takes aim at constitutional mandate of the SARB
- ANC Policy Conference fails to add clarity to policy debate; populism still at the core

Global Equities

Global equities yielded a satisfactory 3.38% in USDs in Q2 as the Fed's forward guidance on rate hikes and leading indicators of earnings growth underpinned equity markets. Even a tech stock selloff in June and hawkish comments from the ECB failed to stem the market's advance. While the Fed's June rate hike was largely expected given the Bank's forward guidance, surprisingly hawkish comments from the ECB on tapering its QE programme unnerved markets late in the quarter. The ECB indicated that since the balance of risks to growth and the inflation outlook were largely balanced, no further rate cuts were expected in the current cycle. Market participants are now expecting the ECB to taper its QE programme over a nine month period, starting in January 2018, with a rise in rates only expected towards the end of the year.

Emerging market equities fared somewhat better over the quarter, yielding 5.47% in USDs as capital flight risks were pushed out further in time and the IMF revised global growth higher. In rand terms, global and emerging market equities returned a more muted 0.9% and 2.9% respectively, due to a 2.5% appreciation in the rand/USD exchange rate. The buoyancy in emerging market $-returns must be seen against the backdrop of a sharp selloff in Brazilian stocks in May following graft allegations against the President. Despite the selloff, the general underpin for emerging markets suggests that investors remain optimistic about the outlook for global growth and the earnings outlook for emerging markets. While PMI indices were volatile over the quarter, fueling concerns of a possible slowdown in earnings growth in the coming months, upward revisions to the June PMI's post the quarter end helped equity markets rally strongly in the first half of July. The back-up in bond yields in late June also reversed direction in July, as pedestrian inflation reinforced the view that a rise in bond yields would only be gradual. High equity market valuations were therefore likely to persist over the medium term.

The release of the June FOMC minutes highlighted the Committee's view that inflation's recent weakness was "transitory". The combination of strong payrolls data, an unemployment rate well below the Fed's full employment rate, and a lack-lustre wage picture continued to divide the FOMC on their expectations for inflation. The bulk of the Committee was still in the "transitory" camp when it came to recent inflation weakness, but soft (and broad-based) wage gains suggested that inflation could be slow to pick up. The June FOMC minutes raised the concern that a steep Philips curve could re-emerge if the unemployment rate fell significantly below equilibrium, which could then pose an appreciable upside risk to inflation or give rise to imbalances that eventually lead to a significant downturn. Yellen notably did not tie the balance sheet reduction decision to short-run inflation developments. Rather, she stressed that the balance sheet would reach "normal" levels by around 2022 and that the Fed's balance sheet would not be used as an active monetary policy tool, except if there was a "material deterioration" in the economic outlook that warranted a sizeable reduction in the fed funds rate.

Our base case view is that global growth will remain buoyant over the next 12 months, but could start to slow in the second half of 2018, potentially setting the scene for a slowdown in 2019. Ironically, the collapse in oil prices in late 2014 was both the main reason for the deterioration in global growth as well as its subsequent recovery. Plunging oil prices led to a decline in capital spending in the energy sector and associated industries, with the economic fall-out more pronounced in emerging markets such as Russia and Brazil. The result was a global manufacturing recession and a pronounced slump in international trade. Since financial conditions in most countries have improved substantially since the start of the New Year, thanks to rising equity prices, lower bond yields and narrowing credit spreads, these positive wealth effects are expected to feed through into higher capital and consumption expenditure over the next six to nine months.

A number of "virtuous cycles" should amplify the effects of easier financial conditions globally. In the US, a tight labour market should lead to faster wage growth, helping to spur consumption expenditure. Strong consumption expenditure, in turn, will also encourage firms to expand capacity, translating into more investment spending. Risks to this view include a more aggressive Fed tightening in rates as wage inflation rises more quickly than the FOMC expects. At this point in the economic cycle, it appears as though inflation is still well contained given a moderation in the reflation trade. Furthermore, since corporate profits as a percentage of GDP are slowing, it is only a matter of time before the unemployment rate begins to increase again. Since these trends are typically longer-term trends, growth could slow beyond our 12-month investment horizon. Base effects in 2018 could also contribute to a slowdown in 2019 if Trump's tax reform plan and fiscal expenditure programme are implemented in early 2018.

The Eurozone economy has continued to gain traction in 2017 with growth tracking close to 2% this year. Political developments in the Netherlands, France and Italy have also contributed to the more positive investment outlook for the region, with anti-European political parties losing out to the pro-EU camp. As a consequence, the economic reform agenda has retaken centre stage with France expected to lead the charge following Emmanuel Macron's parliamentary majority. With PMI's trading at levels consistent with above-trend growth and confidence indicators pointing to an improvement in business and consumer confidence, growth is expected to surprise on the upside. Furthermore, with corporate balance sheets in the euro area improving and credit growth accelerating, a rebound in business investment is expected. The fact that the ECB has no intention of raising rates anytime soon will only serve to help matters further. As inflation expectations begin to recover, however, short-term real interest rates will fall leading to a virtuous cycle of stronger growth and even higher inflation expectations. At this stage of the economic cycle, however, the ECB will no doubt stand ready to raise interest rates, potentially capping growth in the subsequent years.

The Japanese economy managed to grow by an annualized 1% in Q1 2017, marking the fifth consecutive quarter of positive sequential growth, the longest streak in 11 years. Exports have recovered, with both the manufacturing and non-manufacturing PMI's near multi-year highs, pointing to growth exceeding potential GDP this year. Recent gains in the Tankan Survey are also supportive of this view with broad based improvements seen in Q2.

The Chinese economy managed to hold onto its above-target growth rate of 6.5% through the first half of this year, growing a robust 6.9% in Q2 2017. Real-time measures of industrial activity such as railway freight volumes, excavator

sales, and electricity production are rising at a reasonable clip helping to underpin growth. Furthermore, higher producer price inflation is helping fuel a rebound in industrial profits, which should support business capital spending in the medium term. Exports have accelerated thanks to a weaker currency and stronger global growth, while retail sales have continued to expand ahead of expectations. Consistent with the improvement in China's PMI's has been a sharp rebound in industrial production. China's focus on managing systemic risks in its banking system, in particular the role of shadow banks, and the enactment of financial sector reforms could however weigh on growth in the second half of the year, and in 2018/19. Already money supply growth has trailed historical levels, highlighting the tightening in monetary policy since the start of the year. Increased regulation of the Internet and the introduction of controls on on-line gaming, coupled with ongoing restrictions on property ownership in large cities, could be further catalysts for more muted growth going forward.

Since the earnings yield differential between global equities and bonds still favour an overweight equity position, an overweight position in both developed and emerging market equities is retained. For the earnings cycle to extend into 2018, producer price inflation would need to remain buoyant, helping to underpin the reflation trade and equity market returns. Sanlam Multi Manager's Investment Compass (see figure below) highlights the positioning of the large global economies, barring China, in the recovery/reflation quadrant which has historically been supportive of global equities. This offshore bias towards global equities is further reinforced by deteriorating domestic economic fundamentals (SA is in a technical recession), policy uncertainty that is expected to persist at least until the ANC's elective conference in December and the promulgation of business unfriendly legislation that will continue to drive away new fixed-investment expenditure by both domestic and foreign investors. A case in point is the recently gazetted Mining Charter (subsequently suspended) that is riddled with populist empowerment targets and preferential treatment of BEE shareholders that has made the sector uninvestable and subject to legal challenge by the Chamber of Mines. Given the risk of further ratings downgrades to sub-investment grade before the end of the year, the result of fiscal slippage and rising contingent liabilities, expectations of rand weakness will support offshore risk assets. This view is further reinforced by the carry trade which is expected to result in USD appreciation as the Fed continues to tighten interest rates.

Global Bonds

Global bonds underperformed global equities in Q2, yielding some 2.65% in USDs and 0.19% in rands. The yield on the JP Morgan Global Aggregate Total Return index decreased from 1.94% to 1.89% as subdued inflation offset a Fed rate hike and the ECB's hawkish comments on QE tapering. Emerging market bonds fared slightly worse than their developed market counterparts, returning 2.4% in USDs and -0.06% in rands. Following the repricing of bond risk in June, the risk of emerging market capital flight increased as yields on Eurozone bonds turned positive from negative across a broader front. Global corporate bonds were the best performing of the fixed income assets classes, yielding some 3.5% in USDs as spreads came in on positive economic growth momentum. Global listed property lagged the corporate bond market in Q2, rallying some 3.0% in USDs and 0.5% in rands. A sector rerating pushed the price-to-book ratio up to 1.51X, somewhat ahead of the 1.43X mean. Since dividend yields are around the 4% level, high relative to yields on developed market bonds, the sector could rerate further in the near term. Over the longer term, however, we remain cautious of global listed property since real estate prices are trading at levels well ahead of those in 2007, before the Great Recession. As a consequence, a correction in real estate prices could be a catalyst for a sell-off across all asset classes at some stage in the investment cycle.

Notwithstanding the appreciation in the Euro following the ECB's stated intention to begin tapering its QE programme, the fact that European unemployment is still at levels well in excess of those in the US and the region's own natural rate of unemployment, suggests the US has far more scope to raise rates than the Eurozone over the forecast period. As a consequence, the carry trade is expected to favour the USD over the coming year notwithstanding Trump's inertia in getting his reforms through Congress. With bond yields expected to trend higher as the global economy reinflates, we retain an underweight bias in this asset class, despite still benign inflation numbers. In the US, 5-year and 10-year break-even inflation has fallen to around 1.7%, similar to the trend seen in the 5-year/5-year forward break-even rate. Similarly, with core PCE inflation at around 1.4%, well behind the 2% targeted by the US Fed, only a gradual increase in US treasury yields is expected over the investment horizon. Nonetheless, a high modified duration in global bond indices and the risk of a sharp increase in US wage inflation informs our underweight bias in bonds. Our concerns reflect those of the Fed in that if unemployment drops materially below the natural rate of unemployment, wages could rebound sharply, forcing long bond yields to reprice.

SA Equities

SA equities disappointed over the quarter, declining some 0.39% in rands, eclipsing only global inflation-linkers that returned -0.41%. Foreigners were net sellers of domestic equities totalling some R31.2 billion, marginally less than the R38.6bn in Q1. At the sectoral level resources were the losers with the Resi-10 declining some 6.1%, while industrials gained 3.4% (Indi-25) and financials a muted 0.28% (Fini-15). The catalysts for the sell-off included the gazetting of the Mining Charter, negative first-quarter GDP growth (QQSAA) and policy uncertainty ahead of the ANC's policy conference. The fallout from the Mining Charter saw gold and platinum stocks coming in for a beating, down 12.3% and 14.7% respectively. Naspers, the Alsi's largest share by market capitalisation, also detracted from overall market returns in June following a sell-off in the Nasdaq's FANG's (Facebook, Apple, Netflix and Google), which spilled over into Tencent, Nasper's largest holding.

The release of Q1 GDP figures, indicating that the South African economy had contracted for a second quarter running, a so-called technical recession, also served to take the gloss off equities during the month as concerns surfaced about the earnings outlook for listed companies. These concerns are also reflected in weak PMI data, a top-down indicator of earnings growth. Since implied earnings growth priced into the equity market is also well in excess of both top-down and bottom-up consensus earnings estimates, the risk of a market correction has increased in the near term. It is worth noting, however, that the high trailing multiple for the Alsi is due to stretched valuations on rand-hedge industrial counters (NPN, CFR, BTI), which if stripped out of the index, produces a far more attractive valuation. By way of example, the rolling P/E for the market is around 16X earnings, but if the major rand-hedge counters are excluded from the index, the rolling multiple improves to some 12.3X earnings, somewhat below the historical mean. This suggests that SA Inc shares are attractively priced, reflecting no doubt the weak fundamentals for the domestic economy. While confidence indices and PMI indices point to weak economic growth over the remainder of the year, the Reserve Bank's leading economic indicator points to a recovery in domestic growth. From a tactical point of view, domestic equities are upweighted to neutral in Q4 amid expectations of rand weakness due to a sub-investment grade ratings downgrade.

The latest rendition of the Mining Charter, gazetted in June, is seen as negative for growth and investment in the sector, given the onerous targets that mining companies are now forced to meet. The charter contained some startling new clauses. One was the need for all mining companies to have a 30% black empowerment shareholding within 12 months, up from 26% previously, irrespective of whether they previously had black empowerment partners who had sold their stakes. The "once empowered, always empowered" principle was ignored in the latest version of the charter as well as the submissions made by the Chamber of Mines. Other new requirements were that new mining rights holders would have to pay 1% of turnover to their black shareholders, on top of any dividends enjoyed by all shareholders, and that 8% of these black empowerment shares would be held on behalf of communities in a new agency called the Mining Transformation and Development Agency. This agency would also receive 2% of mining companies' payrolls as part of the 5% of payrolls that would be allocated for skills development. There was little clarity on the governance of this new agency raising fears it is intended to be another source of largesse for crony enrichment. The new charter also required 70% of all mining companies' spending to be on locally manufactured goods, of which 21% had to be from black-owned companies. Foreign-owned companies were also required to pay 1% of their turnover to the new agency. The charter is expected to be challenged on several legal grounds including lack of consultation with the Chamber of Mines (representing 90% of the industry by value), the fact that the reviewed mining charter was not law but a nonbinding guideline or statement of policy. Any argument elevating the status of the charter would arguably not pass constitutional muster and would be considered *ultra vires* (beyond our legal power). The preferential treatment of certain shareholders would also fall foul of the Companies Act.

SA Bonds

SA bonds yielded some 1.5% in Q2 despite ratings downgrades from S&P Ratings, Fitch and Moody's, negative news flow following the release of the Mining Charter and uncertainty about the resolutions expected to be adopted at the ANC's policy conference. In spite of the uncertainty, foreigners were net buyers of bonds totalling some R17.2bn, up from the R15.7bn the previous quarter. Net foreign demand for bonds and a decline in break-even inflation helped to partially offset a repricing of risk domestically that saw yields on the All Bond Index rise from 9.38% to 9.49%. Since nominal bonds are yielding expected real returns in excess of 4%, well ahead of the 2.5% yielded by inflation-linkers, nominal bonds are expected to outperform their inflation-linked counterparts over the investment horizon, notwithstanding the political risks embedded in bonds towards the latter part of the year. Inflation-linkers lagged their nominal counterparts in Q2 as real yields rose from 2.3% to 2.5%. Despite the increase in real bond yields, inflation-linkers benefitted from the inflation carry earlier in the year to yield a positive return of 0.87% for the quarter. With the inflation carry expected to be less of a driver of returns in the coming months, an underweight position is retained in this asset class.

The political risks that are likely to weigh on bonds later in the year include the ANC succession race in December, the adoption of market unfriendly economic policies and the high probability of further ratings downgrades. The first milestone in Q4 is the Medium Term Budget Policy Statement (MTBPS) to be tabled in October, which will be closely watched by ratings agencies for any signs of fiscal slippage, commitments to increasing the country's contingent liabilities (government guarantees to SOE's), reforms of SOE's including announcements on the privatisation of non-core assets as was announced by the Minister of Finance in his 14-point strategic plan for growth. Proposed tax changes will also be under the microscope given the country's small tax base and already over-extended taxpayers.

The conclusion of the ANC's policy conference in early July contained a number of policy statements that will still need to be voted on at the December elective conference. Some of the more contentious proposals included moving control of the budget from the Treasury to the Presidency in order to align its role with developmental objectives. The Presidency would thus serve as the central driver of resource planning and co-ordination of state policy. The implication is that fiscal prudence will be found wanting and that fiscal spend and wasteful expenditure would add to the already high debt burden. Contingent liabilities would likely rise as SOE's receive additional funding with no conditions attached. In the context of the #Gupta-Leaks, this is tantamount to having 'the fox guarding the henhouse'.

A further proposal to emerge after the policy conference was the plan to fund the NHI plan via medical aid rebates currently afforded to members. By scrapping these rebates an estimated R20 billion per annum would be available for the NHI. What is missing from the White Paper on NHI is the implementation of the plan and the future role of private medical schemes.

Prescribed investments, whereby pension funds would be compelled to invest in government and parastatal bonds – while not part of the initial policy discussion documents – were included as part of the transformation committee's recommendations. This followed earlier comments by the Minister of Finance that the role of the PIC be reviewed. In the current environment of rampant corruption, the decision is viewed with extreme skepticism. A risk of prescription is that the definition of "developmental" investments could be politically motivated (read nuclear) rather than based on sound investment principles. The generally poor level of governance at SOE's would be a further concern, while investment returns would also likely be lower as a flood of money would chase too few projects. Since the Government Employees Pension Fund (Africa's largest pension fund) is a defined benefit fund, any shortfall in investment returns would ultimately be funded by the taxpayer.

The decision by the transformation committee to endorse the nationalization of the SARB relates more to the private ownership structure of the Bank as opposed to its constitutionally entrenched independence. However, by changing the ownership structure of the SARB, government would have the right to appoint compliant members to the Board, potentially undermining the independence of the institution. While the rand weakened materially following the Public Protector's recommendation to change the Bank's mandate, in reality there is unlikely to be any change to its constitutional mandate or its independence, only its share ownership structure and Board composition. The

nationalization proposal, in our view, appears to be nothing more than a smokescreen, hiding the growing factionalism within the ANC and disagreement amongst these factions over key economic questions. Control of the SARB seems to be sought by patronage factions in the ANC, given the misperception that once in the hands of the state, the Bank would be dictated to. The constitutional changes proposed by the Public Protector to change the Bank's mandate from targeting the rand and inflation has also now been withdrawn following the legal challenge from Parliament, the Treasury and the SARB. Also, the more contentious proposal that Parliament should have oversight of the SARB's policy decisions, effectively undermining its independence, has now also fallen away.

Due to the rise in bond yields over the quarter, SA listed property underperformed nominal bonds yielding some 0.91%. The sector rerated relative to bonds despite distributions declining slightly from the previous month. In year-on-year terms, however, distributions growth was still buoyant, helping to underpin demand for the sector. Given the change in the composition of the sector with around 45% of the sector's market capitalisation now dominated by rand-hedge stocks, listed property remains an attractive asset class, benefitting from sharply lower bond yields in the near term and the possibility of a weaker rand later in the year. From a tactical point of view, listed property is overweighted in the near term but reduced to neutral later in the year given the risk of a ratings downgrade. Risks to our upbeat assessment include persistently weak retail sales growth which could constrain rental escalations and a protracted blow-out in the bond market in the event of a downgrade. In a world of lower asset class returns, however, listed property remains an attractive investment option for South African investors. This view is also supported by the Sanlam Multi-Manager Investment Compass, which supports fixed income asset classes given the country's current stage of the economic cycle.

SA Cash

SA cash yielded 1.85% in Q2, the best performing of the broad asset classes barring emerging market equities. Expectations of slowing inflation and the release of negative Q1 GDP data helped offset the fallout from the sovereign ratings downgrades and the call by the Public Protector to change the constitutional mandate of the SARB. Even the ANC's policy conference proposal to nationalize the SARB failed to disrupt the money market. In fact, money market rates eased somewhat, with the longer-dated Fra's declining some 25 basis points to around 7%, the current level of the repo rate. While the SARB is expected to hold interest rates unchanged at the July MPC meeting, scope for a rate cut later in the year is increasing as a result of an expected slowdown in inflation to around the midpoint of the SARB's target range. With real interest rates expected to increase to around 2%, the rand carry trade is unlikely to be adversely affected by a rate cut. The MPC could, however, retain its cautious bias in the face of political risks which could trigger a depreciation in the rand. Given pedestrian economic growth, however, pressure will increase for the MPC to act on interest rates, sooner rather than later.

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Disclosure

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