Sanlam Lifestage Feedback Report
Quarter 3 2017

Employee Benefits

Insurance | Financial Planning | Retirement | Investments | Wealth

Contents

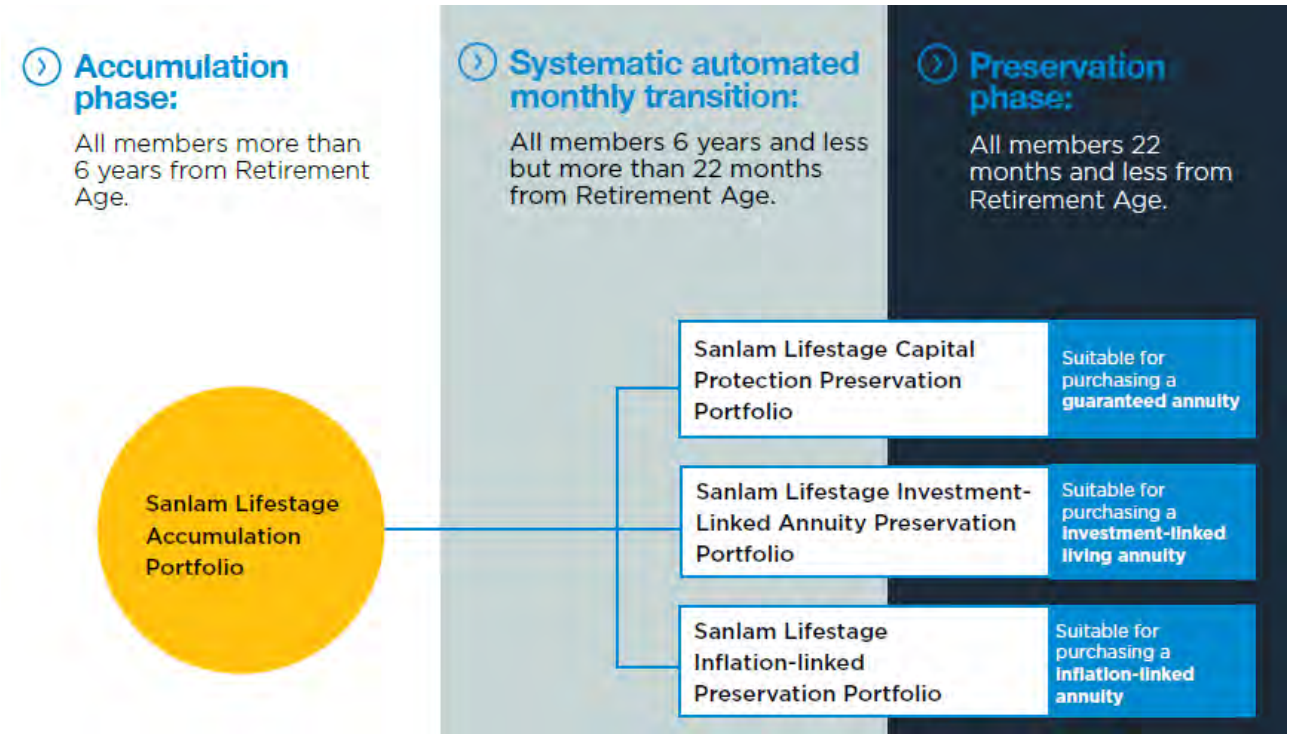
How does Sanlam Lifestage work?

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 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 September 2017

The 3rd quarter of 2017 was a good news story with a stable global expansion and benign inflation backed by positive earnings releases. Markets were supported by generally positive macroeconomic data. However, general sentiment was undimmed by increased political uncertainty amid rising tensions with North Korea and the ongoing failure of the Trump administration to realise its policy goals. Both economic data and forward-looking activity indicators deteriorated towards the end of the quarter. Yet, the market judged that any potential negative impact on growth would be temporary, as did the Fed in its statement following the latest FOMC meeting. The Fed confirmed that measures to reduce its balance sheet would begin in October, despite stubbornly weak inflation. The combination of lower unemployment and better wage data should support the case for shrinking the balance sheet and raising rates again December. There was a flurry of excitement at the end of the period in the currency and bond markets over President Trump's tax cut proposals and a more hawkish message from the Fed. Also, the possibility that the ECB could reduce its stimulus measures continued to be a focus for the market. The prospect of tighter monetary policy pushed up the euro for much of the period.

The MSCI world delivered 3.74% in dollar and 6.91% in rands during the quarter. MSCI emerging markets (EM) outperformed their developed market counterparts delivering 7.05% in dollars and 10.31% rands during the quarter against a backdrop of steady global growth and modest inflation proving supportive. While the late-June selloff in bonds continued in July, it came to a halt as growing expectations of a hawkish shift among central banks were reined in. Yields moved lower in August, precipitated by safe haven buying, before reversing course once more in September as risk appetite return. The US and North Korea tensions were a key driver behind the temporary rotation into safe haven assets during the quarter. As such, global bonds as measured by the JP Morgan Global Aggregate delivered 1.57% in dollars and 4.67% in rands, while Emerging Markets delivered 2.23% in dollars and some 5.35% in rands.

Despite the search for yield globally, South Africa finds itself neglected in the search for higher-risk investment destinations. South Africa emerged from recession in the 2nd quarter despite political turmoil, powered by a surge in agricultural production. In a surprise move in July, the MPC announced a 25 basis point cut in the repo rate as a result of material downward revisions to inflation estimates and the benign growth environment. A sharp decline in inflation failed to spur a more marked rally in bonds as investors fretted about the country's large revenue shortfall in its fiscus, the announcement of a R10 billion bail-out for SAA and the likelihood of a ratings downgrade before the end of the year. Furthermore, uncertainty about the outcome of the ANC presidential race has been a further source of concern, prompting investors to shy away from bonds. A perpetuation of the Zuma-legacy is largely seen as a "bad" political outcome that is likely to prompt a ratings downgrade to "junk" triggering capital flight as South Africa is excluded from global bond market indices. There is still a reasonable probability that ratings agencies could push out their sovereign review until after the national budget next year, once greater clarity regarding the fiscal deficit, sources of funding and the size of the contingent liabilities emerges.

The general risk-on environment over the quarter saw the All Share deliver 8.91% in rands. Resources buoyed market returns with the Resi-20 returning some 17.69% in rands, followed by Indi-25 with 8.16% in rands and the Fini-15 with 6.08% rands. The All Bond index delivered some 3.68% in rands underperforming SA listed property which yielded 5.73% in rands. Given the large rand-hedge component of the listed property sector, the asset class offered investors a partial hedge as the rand weakened against the dollar by 2.96% over the quarter. Due to the subdued inflation outlook and pedestrian inflation carry, domestic inflation-linked bonds yielded a 1.21% in rands, well short of nominal bond returns.

Global growth is improving at above-trend rates across the world, with inflation picking up supporting tighter monetary policy. Also, steady growth should provide support for risk assets in both developed and developing markets. One of the big risks looming on the horizon is the prospect of several major central banks tightening monetary policy in the coming months. The Bank of England hinted heavily that it would raise interest rates for the first time in a decade, while the Federal Reserve is planning to shrink its balance sheet and the European Central Bank is expected to trim its quantitative easing programme. Nonetheless, investors have been willing to ignore political ructions - including North Korea - and focus on the still-robust fundamentals, such as solid global economic growth and healthy corporate earnings. However, global political tensions will continue to dominate markets and may be associated to greater economic risks. Politics and geopolitics will continue to influence selected markets across the globe which should keep investors cautious.

After expanding by a strong 2.5% in the 2nd quarter, South Africa is unlikely to carry as much momentum in the 3rd quarter. This is largely driven by the private consumption ebbing and output from the mining sector contracting. Economic growth is unlikely to get much support from expanding credit. Private sector credit growth has stalled and it will most likely need lower interest rates to return to levels seen over the period 2012-2015. Also, sentiment indices indicate that investment will remain depressed. In the near term, however, the equity market could see some profit-taking ahead of the National Treasury's MTBPS in October, possible ratings downgrades in late November and the ANC's elective conference in December. With domestic economic fundamentals still weak, reflecting the absence of fixed-investment growth at a time when reinvestment demand should be increasing, interest rate sensitive stocks remain vulnerable to a sharp depreciation in the rand. Given the binary nature of investment decisions over the next few months, a neutral weighting is proposed across all of the fixed income sub-asset classes.

Portfolio Commentary – Quarter ending September 2017

Sanlam Lifestage Accumulation Portfolio

The portfolio outperformed its benchmark over the quarter.

Asset allocation was positive over the quarter. The overweight to foreign equity added value whilst the overweight position to foreign cash was the largest detractor.

Within manager selection, domestic equity manager selection was the largest detractor from performance. Naspers continued to rally hard over the quarter and most managers were underweight this stock which detracted significant performance. The Value Strategies managed by Investec and Satrix (Stable Dividend) performed particularly poorly over the quarter, whilst strong Contributions came from the Momentum strategies managed by Capricorn, Kaizen and Satrix. The enhanced SWIX structure also contributed well.

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

The portfolio is currently positioned with an overweight to foreign assets, in particular to foreign equity, whilst being underweight foreign bonds and domestic equity. Foreign equity from a bottom up valuation perspective remains one of our favoured asset classes, and the Rand hedge protection seems prudent given that there are still many risks to the South African Rand, especially as we move closer to the ANC political conference in December.

We will be looking to start reducing our domestic bond position in the next quarter before the Medium term budget policy statement in anticipation of the risk of a downgrade.

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 performed in line with its benchmark over the quarter.

Asset allocation was positive over the quarter. The overweight to foreign equity added value whilst the overweight position to foreign cash and local cash was the largest detractor.

Within manager selection, domestic equity manager selection was the largest detractor from performance. Naspers continued to rally hard over the quarter and most managers were underweight this stock which detracted significant performance. The Value Strategies managed by Investec and Satrix (Stable Dividend) performed particularly poorly over the quarter, whilst strong Contributions came from the Momentum strategies managed by Capricorn, Kaizen and Satrix.

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.

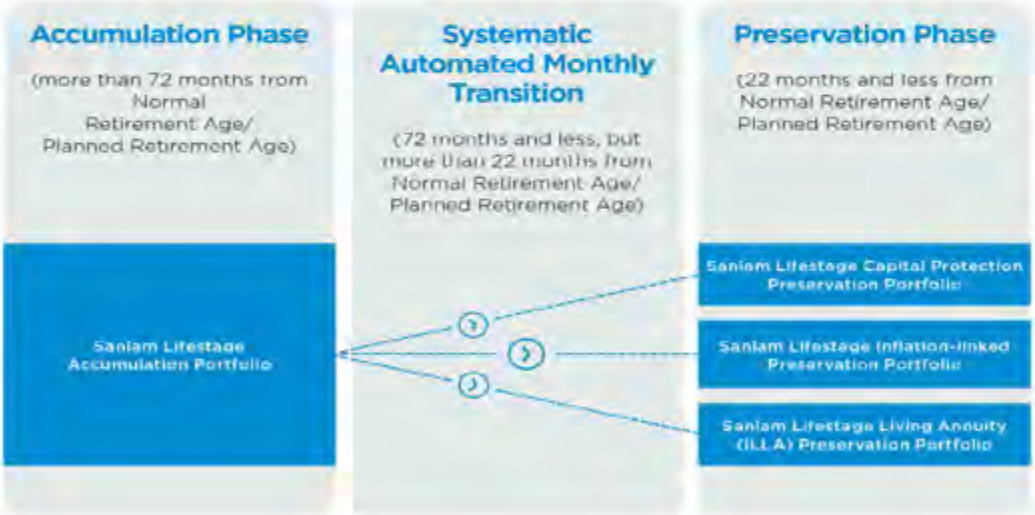
Six years (72 months) before a member reaches his/her Planned Retirement Age, the member is gradually switched from the Sanlam Lifestage Accumulation Portfolio to his/her selected Sanlam Lifestage preservation portfolio by means of 50 monthly switches.

Fund performance

Phase	1 month	3 months	1 year	3 years
Accumulation Portfolio	0.7%	6.5%	8.3%	7.7%
Preservation Portfolios:				
Capital Protection	0.7%	1.9%	7.8%	9.9%
Inflation-Linked	1.1%	1.1%	0.0%	4.3%
Living annuity (ILLA)	1.0%	4.9%	7.8%	6.4%

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-Sep-17
Fund Size	R 9,948 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	0.7%	0.4%
3 Months	6.5%	6.3%
6 Months	6.8%	6.9%
1 Year	8.3%	8.0%
3 Years	7.7%	9.0%
5 Years	n/a	n/a

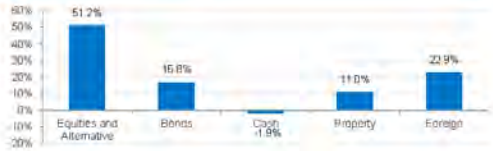
Top 10 holdings (% of Equities)

Share Name	% of Equities
Naspers	16.5%
British American Tobacco Plc	4.8%
MTN Group	3.3%
Standard Bank Group Limited	3.3%
Steinhoff Int Hldgs N.v	3.2%
Sasol Limited	2.7%
Anglo American	2.7%
Firstrand Limited	2.6%
Richemont	2.1%
Old Mutual	2.0%

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



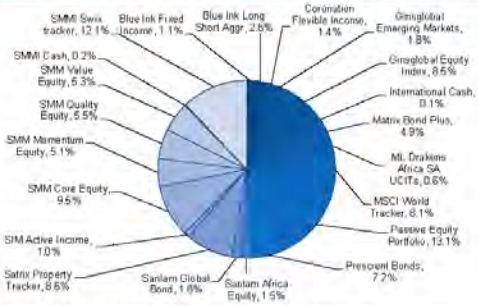
The benchmark reflects the fund's long-term strategic asset allocations. Fund asset allocations may be allowed to vary from the benchmark, depending on market conditions.

Foreign split

Equity sectoral exposure (%)

	Fund	Benchmark
Financials	21.4%	18.4%
Resources	15.3%	19.4%
Industrials	63.3%	62.2%

Fund manager breakdown



Please refer to the fund's equity manager investment for more information on the underlying equity managers within the portfolio.

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

% of negative months over the last 3 years	36.1%
Average capital loss in one month	-1.4%
Downside risk *	0.9%

* 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 as at the month-end, unless specifically indicated otherwise. Changes in currency rates of exchange may cause the value of your investment to increase. Past performance is not necessarily a guide to the future return. The value of investments and the income from them can vary (increase or decrease) and cannot be guaranteed. You may not get back the amount you invest. The product information provided is for the SANLAM UMBRELLA FUND as an investment summary. The product information should accompany a quotation and be considered in the context of the quotation. Information on guarantees cannot be provided in this document. Information on guarantees cannot be provided in this document. Information on rights, benefits and options cannot be provided in this document. The SANLAM UMBRELLA FUND is a flexible investment vehicle which can be used solely for employee benefit schemes. [illegible]

Sanlam Lifestage Capital Protection Preservation Portfolio

Period Ending	30-Sep-17
Fund Size (Book Value)	R 1674 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	3.9%
1 Year	7.6%
3 Years	9.9%
5 Years	n/a

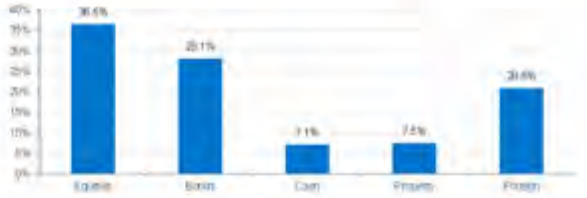
Top 10 equity holdings (% of Equities)

Share Name	% of Equities
Naspers N	21.4%
BTI Group	5.8%
MTN Group	4.3%
Stanbank	4.0%
FirstRand / RMBH	3.9%
Sasol	3.8%
Old Mutual	3.1%
Steinhoff (SNH)	3.0%
Barclays	2.3%
Anglos	2.3%

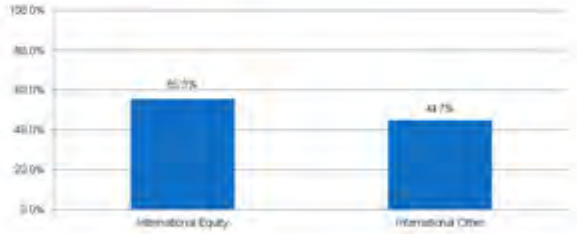
Benchmark

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



Foreign split



Equity sectoral exposure (%)

	Fund
Financials	20.4%
Resources	11.4%
Industrials	68.2%

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 5 years before retirement

Funding Level

October 2017: Fully funded

Sanlam Lifestage Living Annuity Preservation Portfolio

Period Ending	30-Sep-17
Fund Size	R 49 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

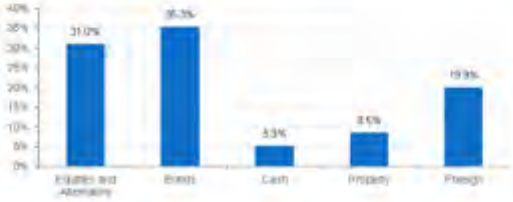
Fund performance (%)

	Fund	Benchmark
1 Month	1.0%	0.7%
3 Months	4.9%	4.9%
6 Months	5.5%	5.8%
1 Year	7.8%	6.7%
3 Years	8.4%	8.1%
5 Years	n/a	n/a

Top 10 equity holdings (% of Equities)

Share Name	% of Equities
Naspers	18.9%
British American Tobacco Plc	5.0%
MTN Group	3.6%
Standard Bank Group Limited	3.5%
Steinhoff Int Hldgs N.v	3.2%
Sasol Limited	3.1%
Firstrand Limited	2.9%
Anglo American	2.8%
Richemont	2.1%
Old Mutual	2.0%

Asset class breakdown

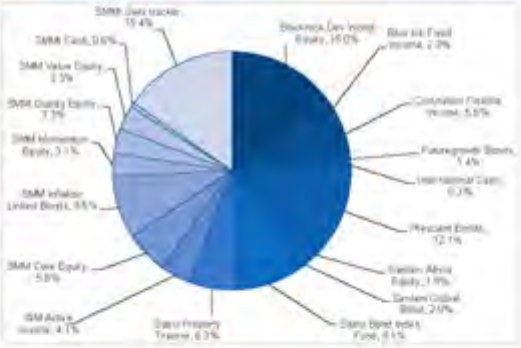


Foreign split

Equity sectoral exposure (%)

	Fund	Benchmark
Financials	21.7%	18.4%
Resources	13.9%	19.4%
Industrials	64.4%	62.2%

Fund manager breakdown



Sanlam Lifestage Inflation-linked Preservation Portfolio

Period Ending 30-Sep-17
Fund Size (Book Value) R1 million
Inception Date May-13

Benchmark Sanlam Asset Liability 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

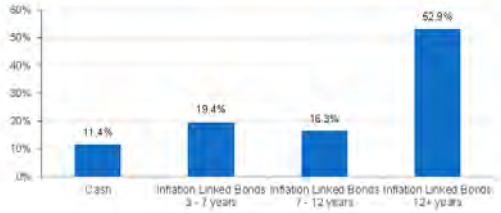
Investment Management Fees:
0.70% per annum.

Monthly and cumulative bonuses

Fund bonuses (%)

	Fund (gross of fees)	Benchmark
1 Month	1.1%	1.2%
3 Months	1.1%	0.8%
6 Months	1.7%	1.6%
1 Year	0.0%	-1.2%
3 Years	4.3%	4.0%
5 Years	n/a	n/a

Asset class breakdown



Local equity manager breakdown for SMMI portfolios

	Lifestage Accumulation	SMM 70 Portfolio	SMM 50 Portofio	SMM 30 Portfolio	ILLA Preservation
Domestic Equity					
Core Equity					
Fairtree Equity	1.9%	3.9%	2.7%	1.2%	1.2%
Truffe Equity	1.9%	3.9%	2.7%	1.2%	1.2%
ABAX Eqity	1.9%	3.9%	2.7%	1.2%	1.2%
Coronation Equity	2.5%	5.1%	3.5%	1.6%	1.5%
Sentio Equity	1.3%	2.6%	1.8%	0.8%	0.8%
Quality Equity					
First Avenue	1.9%	3.9%	2.7%	1.1%	1.2%
Steyn Equity	1.1%	2.2%	1.5%	0.6%	0.7%
Bataleur Equity	1.4%	2.8%	1.9%	0.8%	0.8%
Satrix Quality Index	1.1%	2.2%	1.5%	0.6%	0.7%
Momentum Equity					
Kaizen Thematic Equity	1.9%	3.9%	2.7%	1.1%	1.2%
Satrix Momentum	1.9%	4.0%	2.7%	1.1%	1.2%
Capricorn Equity	1.2%	2.5%	1.8%	0.7%	0.8%
Value Equity					
ABSA Select Equity	1.3%	2.7%	1.9%	0.8%	0.8%
Investec Value	1.3%	2.7%	1.8%	0.7%	0.8%
SIM General Equity	1.6%	3.3%	2.3%	0.9%	1.0%
Satrix Stable Dividend	1.0%	2.1%	1.5%	0.6%	0.6%
Total	**25.3%**	**51.7%**	**35.6%**	**15.1%**	**15.5%**

Performance vs Benchmark

Performance to end September 2017

Sanlam Lifestage	1 Month	3 Months	6 Months	1 Year	3 Year
Accumulation Portfolio	0.71%	6.45%	6.78%	8.33%	7.74%
Benchmark	0.39%	6.28%	6.89%	7.99%	8.99%
Capital Protection Preservation*	0.66%	1.89%	3.85%	7.79%	9.85%
Inflation-Linked Preservation Portfolio	1.09%	1.05%	1.69%	-0.01%	4.28%
Benchmark	1.20%	0.82%	1.59%	-1.17%	3.96%
ILLA Preservation Portfolio	1.01%	4.94%	5.50%	7.80%	8.43%
Benchmark	0.66%	4.92%	5.78%	6.74%	8.14%

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

Performance Attribution

Multi-Managed Portfolios:

3 months ending September 2017	Active Return	Tactical Asset Allocation	Manager Selection
Sanlam Lifestage Accumulation	0.17%	0.08%	0.09%
Sanlam Lifestage ILLA Preservation	0.02%	0.26%	-0.23%

The Sanlam Lifestage Accumulation portfolio outperformed its benchmark for the quarter ending 30th September having returned 6.45% giving an outperformance of 0.17%.

Drivers of the outperformance came both from asset allocation and manager selection relative to the benchmark where each contributed 0.08% and 0.09% respectively to performance.

On the asset allocation front the overall positive performance of the global allocations were buoyed by the depreciation of the rand over the quarter as the local political uncertainty continues. The other asset classes that added to the performance of the fund were SA Inflation Linked bonds and SA Cash.

Manager selection in local equities unfortunately detracted even though returns were up by 6.45%, the others to lag were the managers in SA Bonds and International Equity. The biggest contribution to performance came from the SA equity managers that contributed 3.71% to the portfolio where Cadiz Equity was the top performer followed by the SMMI Multi Managed Equity portfolio and the two passive components that grabbed the market beta as it went upward. Other notable manager performances came from the SMMI Property fund that returned 7.03% over the quarter which was 1.29% above its benchmark, and the GinsGlobal Emerging market fund that returned 11.08%.

The Sanlam Lifestage ILLA Preservation portfolio has outperformed its benchmark over the quarter ending 30 September 2017.

Asset allocation was the primary driver of outperformance with the portfolio's overweight to offshore equity contributing to performance given the relative Rand depreciation as well as strong global markets.

SA cash was a detractor to performance relative to the recent rally in the domestic equities market on the back of strong emerging markets over the period. The portfolio returned 6.83% within in the equity component of the portfolio relative to the 2.40% returned from cash within the fund. Within manager selection the largest contributor to total return came from passive domestic equity and globally from the Blackrock world index contributing 1.16% and 1.04% respectively.

Economics

September 2017

Executive summary

Risk assets outperformed their defensive counterparts in Q3 as above-trend synchronised global growth underpinned commodity prices, earnings were revised higher and business and consumer sentiment improved markedly. Despite asset class valuation concerns raised by the Fed following some USD11.5trillion in central bank monetary stimulus since 2008, strong gains in purchasing manager indices offset fears of an imminent collapse in share prices given still wide margins of safety. With inflation still benign both globally and in the US, a more moderate tightening in interest rates is priced in by the market than that shown in the Fed's dot-plot estimates. The well communicated roll-off of the Fed's balance sheet did result in a back-up in bond yields, but the gradualism of the increase was insufficient to warrant any material repricing of risk. Emerging market equities were the best performing of the broad asset classes, followed by domestic and developed market equities.

Emerging details about Trump's proposed tax reform plan was also generally well received by the market although horse-trading is still needed before a final agreement is reached by Congress. A 3rd term win for Angela Merkel buoyed sentiment and risk assets in Europe even as the anti-European AfD gained seats in parliament. Further gains by the populists in Austria's election and Catalonia's push for independence were a timely reminder of the political risks inherent in Europe, since Italian elections loom large in 2018.

Risks to the global outlook include a sharp rebound in inflation coupled with an aggressive tightening in monetary policy. Such an outcome would almost certainly hurt Wall Street more than Main Street given that all asset prices are stretched by historical standards. Correlations between asset classes would rise limiting investors' ability to diversify risk. The push towards increased protectionism in the US and Europe is expected to slow growth in trade, raise wages and imported inflation as tariffs and countervailing duties are increased, forcing governments to increase spending. Increased issuance of debt would almost certainly raise rates further, accelerating a market correction. The risk of war between the US and North Korea remains an extreme event risk that would destabilise markets globally, potentially sucking in Japan, China and Russia into a conflict. Trump's visit to Asia in November has been preceded by a steady military build-up in the region.

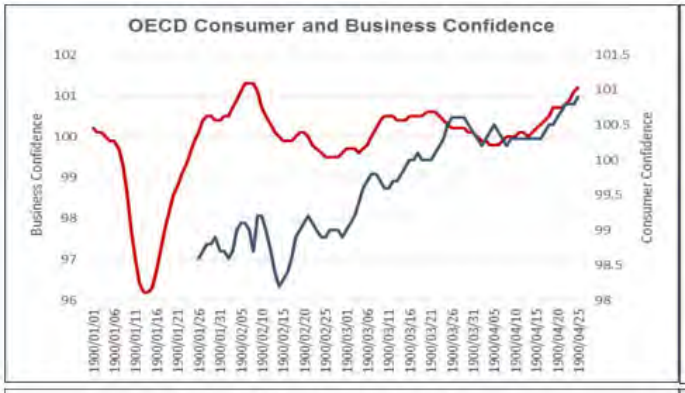
The headwinds facing the domestic economy are largely political and economic in nature with the ANC's succession race and potential ratings downgrades the most prominent. Legislative uncertainty remains a constraint on private sector gross fixed capital formation, with consumption at risk from rising administered prices (Eskom's 2018 tariff hike) and further redistributive tax increases. In light of these risks, a tactical overweight position is held in risk assets, both domestically and internationally.

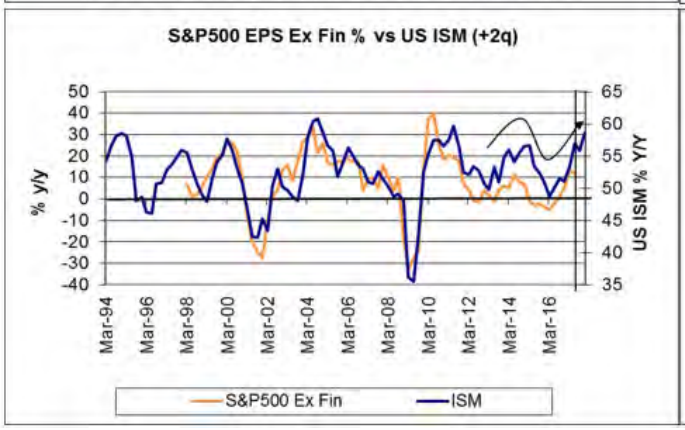
Highlights

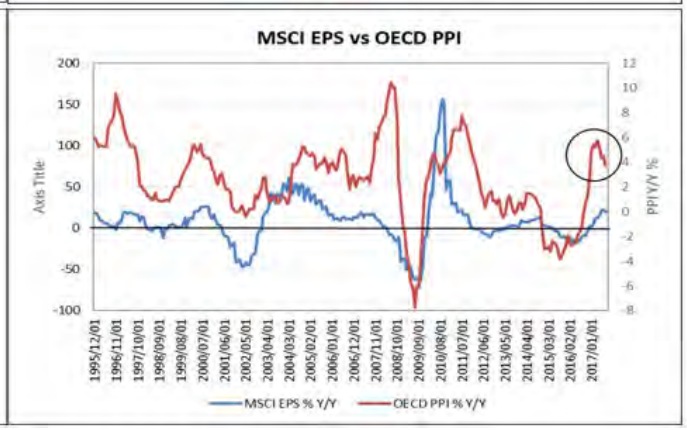
- US Fed signals balance sheet run-off from October
- FOMC divided on inflation
- Trump's tax plan favours corporates and the wealthy
- Germany's Merkel wins another term but coalition talks difficult
- China's 19th National Party Congress to decide future policy
- Japanese go to polls in October. No change to policy expected yet
- SARB pauses on rates amid poor economic fundamentals
- National Revenue Fund tapped to bail out SAA
- MTBPS an important test for Gigaba

Global Equities

Global equities rallied some 5.3% in USDs and 6.9% in rands in Q3 as Trump's proposed tax reform plan, synchronised global growth and strong consumer and business sentiment underpinned risk assets. The broad-based gains in purchasing manager indices (PMI) were supportive of earnings growth momentum, helping to offset concerns about stretched equity market valuations. Given the backdrop of expected central bank monetary tightening, equity markets are at risk of a sharp back-up in yields triggering a market derating, or worse, a market crash. The divergence between the Fed's dot-plot and the market's expectation of future interest rates increases could serve as a catalyst for a correction, if a "Hawk" replaces Janet Yellen at the helm of the Fed. With MSCI World trailing earnings growing at 20% and emerging market earnings at 22.3%, a modest market derating is expected to be offset by the buoyancy in earnings. Similarly, although OECD producer price inflation is slowing at around 4% year on year, the leads and lags between producer inflation and earnings growth offer investors some degree of comfort that the earnings cycle still has further to go.







FOMC Dot-Plot

Emerging market equities were the biggest beneficiaries of the better growth outlook and higher commodity prices, rallying some 7.1% in USD's and 10.3% in rands. Although relative valuations are still attractive, emerging markets are nonetheless expensive relative to their own history and also vulnerable to capital flight risks from rising bond yields. The positives, however, include supportive commodity prices given broad-based synchronised growth, economic reform momentum, improving cash flows and better underlying economic fundamentals, all of which could underpin higher absolute valuations. In terms of our valuation matrices, developed market equities are expected to outperform their emerging market counterparts in the year ahead. Given the expected dispersion in returns and the belief that central bank tightening will be gradual and well communicated to the market, we retain an overweight position in developed market equities and a near-term overweight in emerging market equities.

Total Return Matrix - MSCI World

MSCI Valuation Matrix - Consensus vs Top-Down Earnings

Current P/E 21.04	10-Yr Exit P/E								LT Exit P/E				
Expected Earnings Growth %	15.5	16.0	16.5	17.0	17.5	18.0	19.0	19.5	20.0	20.5	21.0	21.5	22.0
8.0	-18.0	-15.4	-12.9	-10.3	-7.7	-5.2	0.0	2.5	5.1	7.7	10.2	12.8	15.4
8.5	-17.6	-15.1	-12.5	-9.9	-7.3	-4.8	0.4	3.0	5.6	8.1	10.7	13.3	15.9
9.0	-17.3	-14.7	-12.1	-9.5	-6.9	-4.3	0.9	3.4	6.0	8.6	11.2	13.8	16.4
9.5	-16.9	-14.3	-11.7	-9.1	-6.5	-3.9	1.3	3.9	6.5	9.1	11.7	14.3	16.9
10.0	-16.5	-13.9	-11.3	-8.7	-6.1	-3.5	1.8	4.4	7.0	9.6	12.2	14.8	17.4
10.5	-16.2	-13.5	-10.9	-8.3	-5.7	-3.0	2.2	4.8	7.5	10.1	12.7	15.3	18.0
11.0	-15.8	-13.2	-10.5	-7.9	-5.2	-2.6	2.7	5.3	7.9	10.6	13.2	15.9	18.5
17.0	-11.4	-8.6	-5.8	-3.0	-0.3	2.5	8.1	10.9	13.6	16.4	19.2	22.0	24.8
17.5	-11.0	-8.2	-5.4	-2.6	0.2	3.0	8.5	11.3	14.1	16.9	19.7	22.5	25.3
18.0	-10.6	-7.8	-5.0	-2.2	0.6	3.4	9.0	11.8	14.6	17.4	20.2	23.0	25.8
18.5	-10.3	-7.5	-4.6	-1.8	1.0	3.8	9.4	12.3	15.1	17.9	20.7	23.5	26.3
19.0	-9.9	-7.1	-4.3	-1.4	1.4	4.2	9.9	12.7	15.5	18.4	21.2	24.0	26.9
19.5	-9.5	-6.7	-3.9	-1.0	1.8	4.7	10.3	13.2	16.0	18.9	21.7	24.5	27.4

Bloomberg Consensus 2-year avg

Bloomberg Consensus 12 months

Total Return Matrix - MSCI EM

MSCI EM's Valuation Matrix - Consensus vs Top-Down Earnings

Current P/E 15.79	10-Yr Exit P/E							LT Exit P/E			
Expected Earnings Growth %	10.5	11.0	11.5	12.0	12.5	13.0	13.5	14.0	14.5	15.0	15.5
10.0	-24.4	-21.0	-17.5	-14.0	-10.5	-7.0	-3.5	-0.1	3.4	6.9	10.4
10.5	-24.1	-20.6	-17.1	-13.6	-10.1	-6.6	-3.1	0.4	3.9	7.4	10.9
11.0	-23.8	-20.3	-16.7	-13.2	-9.7	-6.2	-2.7	0.8	4.4	7.9	11.4
11.5	-23.4	-19.9	-16.4	-12.8	-9.3	-5.8	-2.3	1.3	4.8	8.3	11.9
12.0	-23.1	-19.6	-16.0	-12.5	-8.9	-5.4	-1.8	1.7	5.3	8.8	12.4
12.5	-22.8	-19.2	-15.6	-12.1	-8.5	-5.0	-1.4	2.2	5.7	9.3	12.9
13.0	-22.4	-18.9	-15.3	-11.7	-8.1	-4.5	-1.0	2.6	6.2	9.8	13.3
13.5	-22.1	-18.5	-14.9	-11.3	-7.7	-4.1	-0.5	3.1	6.6	10.2	13.8
14.0	-21.8	-18.2	-14.6	-10.9	-7.3	-3.7	-0.1	3.5	7.1	10.7	14.3
14.5	-21.4	-17.8	-14.2	-10.6	-6.9	-3.3	0.3	3.9	7.6	11.2	14.8
15.0	-21.1	-17.5	-13.8	-10.2	-6.5	-2.9	0.7	4.4	8.0	11.7	15.3
15.5	-20.8	-17.1	-13.5	-9.8	-6.1	-2.5	1.2	4.8	8.5	12.1	15.8
16.0	-20.4	-16.8	-13.1	-9.4	-5.8	-2.1	1.6	5.3	8.9	12.6	16.3
16.5	-20.1	-16.4	-12.7	-9.0	-5.4	-1.7	2.0	5.7	9.4	13.1	16.8
17.0	-19.8	-16.1	-12.4	-8.7	-5.0	-1.3	2.5	6.2	9.9	13.6	17.3

Bloomberg Consensus Avg 2-year

Bloomberg Consensus 12 month

Despite the positive economic news-flow over the past quarter, it was Trump's tax reform plan that stole the show in September. While the plan faces headwinds within his own Republican Party from "deficit hawks" who want tax changes to be budget neutral and the "cutters" who are willing to have large near-term deficits to ensure the tax plan pays for itself over the longer term through accelerated growth, there are the Democrats who will try to prevent passage of the bill until after the mid-term elections in November 2018. Our base case view is that compromises will ensure passage of the tax bill with implementation in Q1 or Q2 of 2018. GDP growth could gain an extra 0.5% next year from the proposed tax changes.

In essence, the tax proposals include a move away from a worldwide tax system to a territorial system whereby foreign earnings are taxed at a lower rate than domestic earnings. Although a specific tax rate was not proposed, a one-time tax of some 5% for illiquid assets and a tax of say 10% on cash is a possibility that could encourage some USD 2.6trillion in foreign earnings to be brought back to the US. While the Trump plan is for future foreign earnings to be exempt from tax, a 12% tax rate could be a compromise solution. The flaw in the plan is that if not amended, the tax could incentivize companies in technology and pharmaceuticals to place their earnings from intellectual property in tax havens. Rather, it might make more sense to set a minimum tax rate for international earnings and credit companies for whatever taxes they pay abroad. The current system does allow for this but the rate is high and the liability is deferred until the money is repatriated back to the US.

The Trump plan proposes reducing the corporate tax rate from 35% to 20% and allowing companies to fully expense capital investments once incurred for a period of five years. The current system allows for investment to be depreciated over a 10-year period rather than within the year it is incurred. While Trump has stated that a 20% corporate tax rate is a red line, a compromise could be to reduce corporate taxes to 25%. With respect to removing the deductibility of net interest expenses, a compromise may be to limit the deductibility of interest. Furthermore, a reduced tax rate was proposed for owner-businesses that are taxed at their personal income tax rates up to a maximum of 39.6% (so-called pass-through income). The tax rate will reduce to 25% providing a meaningful windfall for small businesses.

On the personal income tax front, the Trump proposal is for the number of tax brackets to be reduced from 7 to 3 with an unspecified tax to be levied on the wealthy. In order to ensure that the wealthy do not benefit disproportionately, as is the case with Trump's current proposals, an unchanged tax rate of 39.6% may be agreed to. Still to be negotiated are the income levels at which the rates would apply. With respect to estate duty, Trump's proposal is for the tax to be eliminated. This move would primarily benefit top earners, so a partial elimination of the tax is a possible compromise outcome. The White House plan also proposes doubling the standard deduction to $12,000 for individuals and $24,000 for households, with a child tax credit for higher income families also proposed. In the case of state and local taxes which are currently fully deductible, a partial elimination of the deduction may be agreed to as a means of moving towards budget neutrality. Finally, the absolute minimum tax threshold is expected to remain unchanged. The table below highlights the various permutations of the tax code, from Trump's campaign promises, to the House blueprint and the "Big Six" Republican plan. Also included is the Sanlam Investments multi-manager projection of what a compromise solution could look like.

On net, the proposed tax plan should be beneficial for equity markets, with smaller companies likely to be the biggest beneficiaries of a corporate tax cut. Shareholders would also benefit from higher distributions and the payment of special dividends arising from the repatriation of offshore cash.

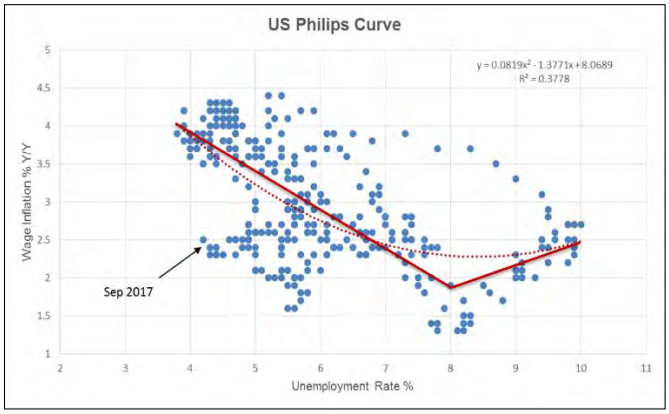
Individual Taxes	Current	House Blueprint	Republican "Big Six"	SMMI
Brackets	7	3	3 or 4	4
	39.6%, 35%, 33%, 28%, 25%, 15%, 10%	35%, 25%, 12%	39.6% (optional), 35%, 25%, 12%	39.6%, 35%, 25%, 12%
Top capital gains rate	23.80%	16.50%		23.80%
Standard Deduction	$ 12600	$ 24000	$ 12000 or $ 24000 & "child credit tax"	$ 12000 or $ 24000
Estate Tax	Max. 40%	Eliminate	Eliminate	Partial Elimination
State & Local tax deduction	Fully deductible		Eliminate	Partial Elimination
Pass-Through income	Varies with brackets		25%	25%
Alternative min. tax	26 or 28%		Eliminate	26 or 28%

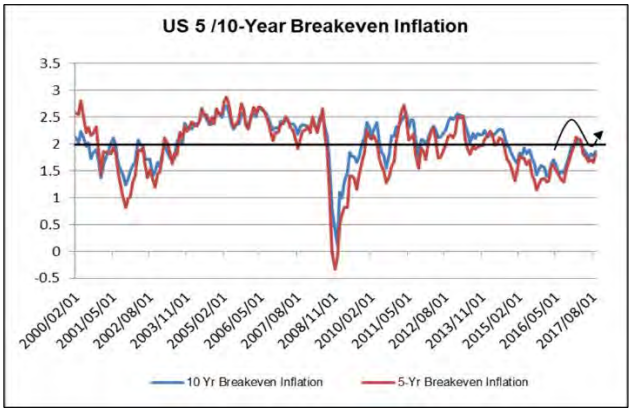
Corporate Taxes	Current	House Blueprint	Republican "Big Six"	SMMI
Corporate tax rate	35%	20%	20%	25%
Corporate expensing	Net interest expenses are deductible. Capital investments are deductable/depreciated over a 10 year period	No deductibility of interest. Full investment expensing	Limited deductability of interest. Full investment expensing for at least 5 years	Limited deductibility of interest. Full investment expensing
Foreign profits	35%	0%	Territorial system	Territorial system. Foreign earnings taxed at around 12% rate
Repatriation		One-time 10% tax on untaxed foreign profits: 8.75% on cash and 3.5% on reinvested earnings	One-time tax with a lower rate for illiquid assets	One-time tax with a lower rate for illiquid assets (5% vs 10% for cash)
Alternative min. tax	20%		Eliminate	20%

Global Bonds

Global bonds gained some 1.6% in USDs and 4.7% in rands in Q3 shrugging off concerns that above-trend growth would filter through into higher inflation. Although inflation has been benign in advanced economies and slowing in many emerging economies, an expected closing of the output gap (reflecting capacity/slack) and declining unemployment is likely to feed through into higher consumer prices over time. The recent increase in US wages suggests that the Philips curve relationship between unemployment and wage inflation will re-establish itself at a lower natural rate of unemployment. While technology platforms have constrained wage growth, the asymmetric profile of the Philips curve is a clear warning that wage inflation could rebound sharply. Our base case view is that the "new normal" continues, however, with interest rates failing to rise to pre-crisis levels because of a global glut of savings due to ageing populations saving a larger proportion of their incomes. Furthermore, corporate balance

sheets also flush, having benefitted from stagnant wage growth in recent years. Demand for credit is therefore expected to remain muted capping interest rates at lower levels.

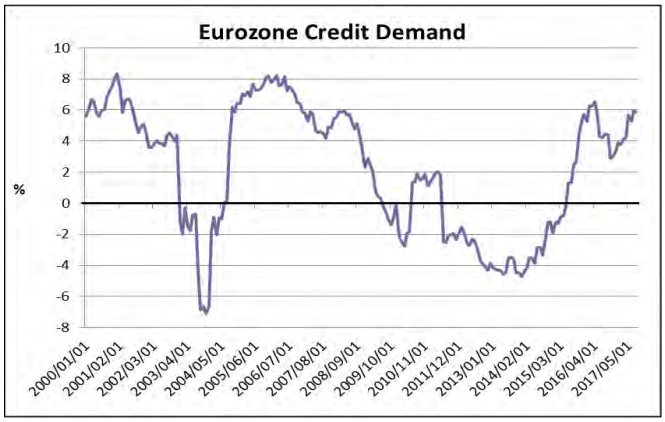




The reaffirmation of the Fed's well communicated intention of running down its USD 4.5trillion balance sheet, commencing in October, barely added upward pressure to yields over the quarter. The yield on the JP Morgan Global Aggregate Total Return Index increased from 1.89% to 1.91% highlighting benign inflation expectations. A modest rise in US break-even inflation to around 1.9%, in part due to a 16.4% rise in the oil price courtesy of the US hurricane season, further supported the reflation trade. The search for yield globally supported emerging market bonds that gained some 2.2% in USD's and 5.4% in rands as spreads narrowed to 317 basis points from 334 the previous quarter. Global corporate bonds fared somewhat better than their sovereign counterparts as spreads came in further on the improved global economic outlook. The BarCap Global Corporate Bond Index returned some 2.3% in USDs and 5.4% in rands. Global listed property also benefitted from the gains in bonds to yield some 1.8% in USD's and 4.9% in rands. In a world of low asset class returns, a 4% dividend yield on developed market listed property supports a neutral weighting in this asset class.

One of the consequences of central bank asset purchases has been the mispricing of risk premia and market volatility, thereby distorting the term premium across the yield curve and boosting asset prices. With the Fed the first to exit QE, reduced Fed demand for Treasuries and Agency mortgage backed securities (MBS), coupled with increased net supply in 2018, will result in bond yields rising, term premiums normalizing and yield curves steepening. Central banks will, however, still be net purchasers of assets in 2018, but at a slower rate. As a consequence, investors will need to digest a larger share of bond issuance globally. But the effects of exiting QE will differ across regions. In Europe, fiscally weak economies such as Italy and Portugal will face higher borrowing costs when the ECB begins tapering its QE programme. The ECB is widely expected to begin tapering early in 2018 since inflation expectations have risen in recent months. While this may be due to hawkish comments from Mario Draghi, inflation is still benign with Euro strength capping gains in imported inflation. A consequence of ECB tapering is that corporate credit demand will decline since asset purchases in Europe included investment grade corporate bonds. The result has been a more aggressive compression in European spreads relative to those in the US and Asia (ex Japan). With further spread compression unlikely, given the late stage of the economic cycle, underweight positions are retained in both sovereign and corporate bonds. Furthermore, since the ECB is expected to tighten interest rates only late in 2018, core European bonds are likely to be anchored at low levels, while peripheral bond yields will rise on political developments and QE tapering.

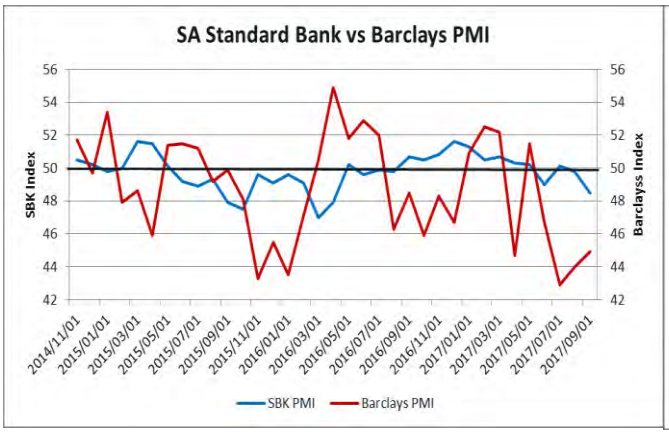
Japan's yield curve targeting and negative interest rate policy is expected to remain unchanged despite early elections called for in October. While we believe Abe will retain power, a change in policy is only likely once BoJ Kuroda's term ends in April 2018. If Kuroda's term is extended for a further 5 years, some tweaking of the current policy is likely. This could entail moving away from negative interest rates and targeting a higher 10-year bond yield, possibly at around 0.5%. The justification for such a move would to preserve the interest incomes of the aged and reduce the systemic risk to the financial system from negative interest rates.

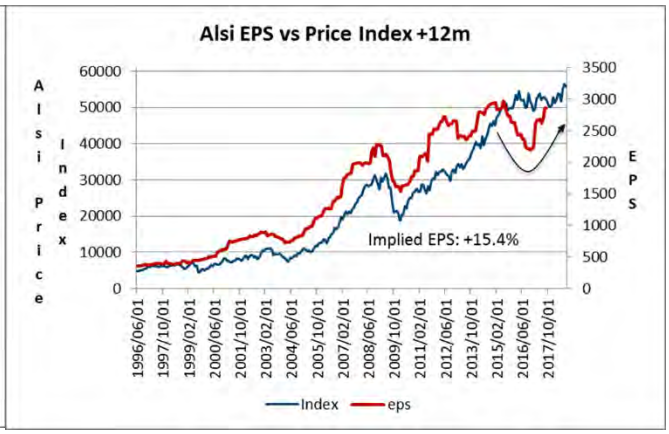


The biggest longer term risk to the bond market is likely to come from increased fiscal deficits in the US, Europe, Japan and China. A deficit funded US tax code, further gains by populists in Europe, accelerated credit induced growth in China following the 19th Congress of the People, and Japan's desire to increase the VAT rate to fund social welfare benefits could bring about increased issuance in the years ahead. The recent gains by populists in German and Austrian elections and Catalonia's push for independence have been timely reminders that the anti-globalisation lobby remains a risk to growth in global trade. With increased protectionism high on their agendas, increased fiscal spend may be needed to offset the slowdown in growth.

SA Equities

SA equities tracked their emerging and developed market counterparts higher in Q3 underpinned by an 11.4% increase in $-metals prices. The All Share Index rallied some 8.9% in rands even as foreigners took flight to the tune of R18.3bn. Fed rate guidance signalling interest rate hikes in December and a further 3 increases in 2018, coupled with heightened political risk, served as the catalyst for the foreign sales. The rally in metals prices and a 3% depreciation in the rand/USD exchange rate buoyed resource counters with the Resi-10 surging 17.7%. Returns from industrials and financials were more muted with the Indi-25 gaining 8.2% and the Fini-15 some 6.1%. Gold stocks rallied 9.9% on a higher gold price, whereas platinum stocks lagged on a softer platinum price gaining a pedestrian 1.9%. Persistently weak PMI indices, signalling an economy battling to gain traction, were largely shrugged off by the market. Despite the poor economic fundamentals, we remain constructive on this asset class given the backdrop of buoyant global growth, rising commodity prices and a sharp rebound in earnings per share. While political and economic uncertainty is elevated ahead of the ANC's succession race and possible ratings downgrades, the equity market remains a hedge against a negative outcome given its concentrated exposure to foreign income. It is in light of these risks that equities are tactically upweighted to overweight over the coming quarter. In the second half of the investment horizon, equities are downweighted given expectations that returns will be front-loaded and that fixed income assets classes will offer more attractive returns following their expected repricing. Further support for equities has been the closing of the gap between implied earnings growth and bottom-up consensus estimates.





Following the sharp rally in domestic equities in Q3, valuations deteriorated somewhat with the forward multiple rising to 14.9X earnings, ahead of the 13.7X mean. Price gains and downward revisions to bottom-up consensus earnings estimates accounted for the slide in valuations. If the All Share Index is reconstituted to exclude some of the large rand-hedge counters (NPN, CFR, BTI, GLN), the forward multiple declines to 12.6X earnings, suggesting that SA Inc shares are fairly priced. Given the stage of the country's economic cycle, our investment compass suggests that interest rate sensitive stocks like banks, financials and listed property should lead market returns, ably assisted by commodity counters that are benefiting from the global reflation trade (see Appendix B). While resources are fairly valued, financials are attractively priced, lending further support to our sector rotation. In the near term, however, the risk of rand depreciation is expected to weigh on interest rate sensitive sectors. In terms of style betas, growth stocks are still favoured domestically, whereas globally, momentum and value are expected to drive returns.

Current P/E: 20.05	Total Return Matrix - SA Equities (Alsi)																
	FTSE/JSE Valuation Matrix - Consensus vs Top-Down Earnings																
Expected Earnings Growth %	Exit P/E																
	13.5	14.0	14.5	15.0	15.5	16.0	16.5	17.0	17.5	18.0	18.5	19.0	19.5	20	20.5	21	
5.0	-26.5	-23.8	-21.2	-18.6	-16.0	-13.4	-10.8	-8.1	-5.5	-2.9	-0.3	2.3	5.0	7.6	10.2	12.8	
5.5	-26.1	-23.5	-20.9	-18.2	-15.6	-13.0	-10.3	-7.7	-5.1	-2.4	0.2	2.8	5.4	8.1	10.7	13.3	
6.0	-25.8	-23.1	-20.5	-17.9	-15.2	-12.6	-9.9	-7.3	-4.6	-2.0	0.6	3.3	5.9	8.6	11.2	13.9	
6.5	-25.5	-22.8	-20.1	-17.5	-14.8	-12.2	-9.5	-6.9	-4.2	-1.5	1.1	3.8	6.4	9.1	11.7	14.4	
7.0	-25.1	-22.5	-19.8	-17.1	-14.4	-11.8	-9.1	-6.4	-3.8	-1.1	1.6	4.2	6.9	9.6	12.2	14.9	
7.5	-24.8	-22.1	-19.4	-16.7	-14.1	-11.4	-8.7	-6.0	-3.3	-0.7	2.0	4.7	7.4	10.1	12.8	15.4	
8.0	-24.4	-21.8	-19.1	-16.4	-13.7	-11.0	-8.3	-5.6	-2.9	-0.2	2.5	5.2	7.9	10.6	13.3	16.0	
8.5	-24.1	-21.4	-18.7	-16.0	-13.3	-10.6	-7.9	-5.2	-2.5	0.2	3.0	5.7	8.4	11.1	13.8	16.5	
9.0	-23.8	-21.1	-18.3	-15.6	-12.9	-10.2	-7.5	-4.7	-2.0	0.7	3.4	6.1	8.9	11.6	14.3	17.0	
9.5	-23.4	-20.7	-18.0	-15.2	-12.5	-9.8	-7.0	-4.3	-1.6	1.1	3.9	6.6	9.3	12.1	14.8	17.5	
10.0	-23.1	-20.4	-17.6	-14.9	-12.1	-9.4	-6.6	-3.9	-1.1	1.6	4.3	7.1	9.8	12.6	15.3	18.1	← I-Net Consensus 24m Est
10.5	-22.8	-20.0	-17.3	-14.5	-11.7	-9.0	-6.2	-3.5	-0.7	2.0	4.8	7.6	10.3	13.1	15.8	18.6	
11.0	-22.4	-19.7	-16.9	-14.1	-11.4	-8.6	-5.8	-3.0	-0.3	2.5	5.3	8.0	10.8	13.6	16.3	19.1	
11.5	-22.1	-19.3	-16.5	-13.7	-11.0	-8.2	-5.4	-2.6	0.2	2.9	5.7	8.5	11.3	14.1	16.8	19.6	← I-Net Consensus 12m Est
12.0	-21.8	-19.0	-16.2	-13.4	-10.6	-7.8	-5.0	-2.2	0.6	3.4	6.2	9.0	11.8	14.6	17.4	20.2	
12.5	-21.4	-18.6	-15.8	-13.0	-10.2	-7.4	-4.6	-1.8	1.0	3.8	6.6	9.5	12.3	15.1	17.9	20.7	
13.0	-21.1	-18.3	-15.4	-12.6	-9.8	-7.0	-4.2	-1.3	1.5	4.3	7.1	9.9	12.7	15.6	18.4	21.2	
13.5	-20.7	-17.9	-15.1	-12.2	-9.4	-6.6	-3.8	-0.9	1.9	4.7	7.6	10.4	13.2	16.1	18.9	21.7	
14.0	-20.4	-17.6	-14.7	-11.9	-9.0	-6.2	-3.3	-0.5	2.3	5.2	8.0	10.9	13.7	16.6	19.4	22.2	

SA Bonds

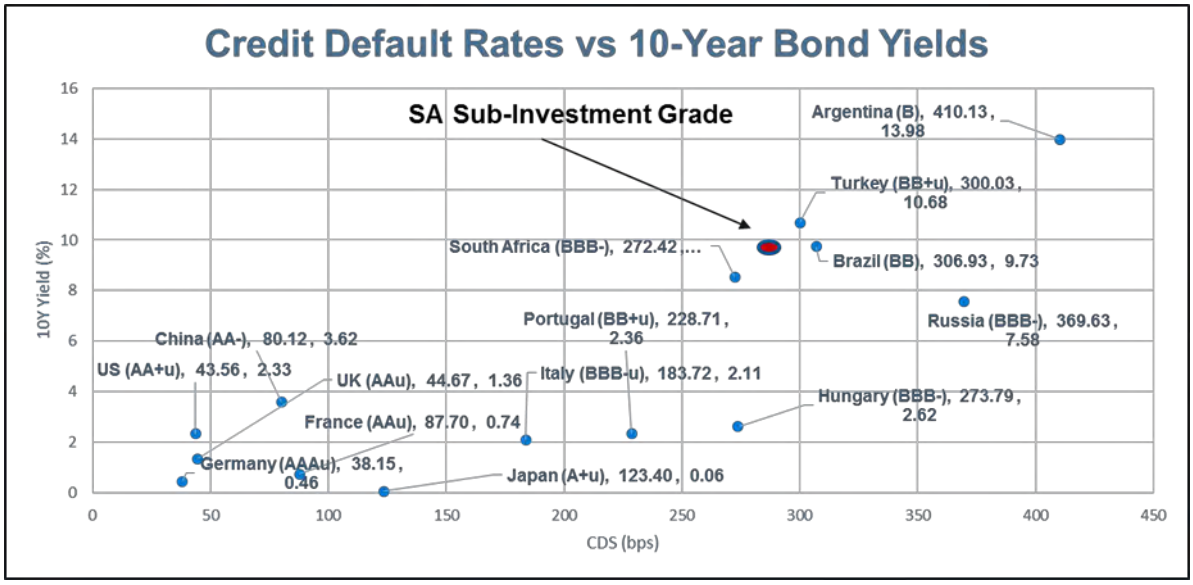
SA bonds gained some 3.7% in rands in Q3 even as rand depreciation, revenue shortfalls and political uncertainty ahead of the ANC's elective conference all weighed on sentiment. Even with Finance Minister Malusi Gigaba's Medium Term Budget Policy Statement (MTBPS) looming large in October, coupled with the risk of ratings downgrades in November, yields on the All Bond Index eased somewhat to 9.32% from 9.49% the previous quarter. While the ratings agencies could still push out their sovereign risk assessment to March 2018 following the release of the National Budget, what is clear is that the uncertainties in the bond market will persist over the coming quarters. These uncertainties, particularly as they relate to the direction of the rand/USD exchange rate could help underpin demand for inflation-linked bonds, albeit in H2 of our investment horizon. Coupled with the removal of the VAT exemption on petrol (March 2018), Eskom's proposed tariff hike (July 2018) and rising food inflation (H2 2018), the inflation carry along with capital appreciation offers investors a hedge against a negative inflation outcome. With the inflation carry muted over the quarter, inflation-linked bonds yielded a pedestrian 1.2%, well short of the return from cash.

While the bond market benefitted from net foreign inflows totalling R23.6 billion and better than expected inflation data, all eyes will be on the National Energy Regulator (Nersa's) expected electricity tariff determination to be announced in December. Eskom has applied for a 20% tariff hike for direct users and a 27% increase for municipalities. A 20% increase will change the inflation trajectory in the second half of 2018 when the tariff hikes are included in the July CPI figure. A further headwind for the inflation outlook is the removal of the VAT exemption on petrol that will come into effect on 1 March 2018. Both the inclusion of VAT on petrol and the Nersa tariff hike are expected to raise inflation to around 5.3% in the second half of 2018, limiting the scope for further rate cuts in the current cycle.

The bailout of SAA to the tune of R5.3 billion in September, following Standard and Chartered and Citigroup's refusal to roll over debt totalling some R4 billion, was also largely shrugged off by the market. The funding of the repayments, including R1.2 billion in working capital for SAA from the National Revenue Fund will, however, need to be added to the 2017/18 expenditure estimate to be announced in the MTBPS. But SAA is not out of the woods yet, with some R3billion in repayments due at the end of October. The local lenders could, however, roll over the debt if certain conditions are met, the most important being the appointment of a chief restructuring officer. While no detailed tax proposals are expected to be announced in the MTBPS, revenue adjustments in 2018/19 will include the removal of the VAT exemption on petrol (R18 billion in revenue), the reduction in medical tax credits (R21 billion in revenue) and a reduction in contingency reserves from R20 billion to R10 billion, suggesting no additional personal income tax or VAT rate hikes would be necessary. With elections looming in 2019, government will be careful of alienating the electorate especially since allegations of state capture have been so widely publicised. There is, however, still scope for adjusting fiscal drag by some R15 billion, which would limit the fiscal deficit to around 3.7% of GDP

In the 2017/18 fiscal year, the revenue shortfall and expenditure increases attributed to SAA, will likely result in a 0.7% increase in the fiscal deficit from the February estimate, to some 4.2% of GDP. In the outlying years of the MTBPS (2020/21), the Treasury will need to constrain the deficit at 3% of GDP in order to prevent further ratings downgrades. With respect to the net debt to GDP ratio, an increase of some 1.1% is expected to around 54% of GDP, with a one-year delay in debt stabilisation proposed for 2021/22. But it will be changes to the Contingent Liabilities that will be the biggest challenge since SAA will require at least an additional R12 to R15 billion in assistance over the next few years. With other SOE's also in need of government support, it seems unlikely that further assistance to these entities will be budget neutral. Since government appears unlikely to sell its 39% Telkom stake, dividends from SOEs will not close the funding gap, suggesting an increase in Contingent Liabilities is inevitable. Although a case can be made to reintroduce prescribed investments on retirement funds to close the funding gap, opposition from trade unions is expected to put a brake on this proposal, at least until after the 2019 elections.

While the MTBPS could give some comfort to the ratings agencies, the issue of fiscal transparency will remain a material concern, given that Cabinet approved the relocation of the budgeting process from the Treasury to the President's Office. Amid concerns of state capture, including the Treasury, the reallocation of the budgeting process is seen as an attempt to reduce fiscal transparency, paving the way for connected individuals to bypass legal tender processes. Furthermore, the alleged weakening of the Treasury's governance, monitoring and compliance (GMC) unit's powers to decide on government department requests for tender deviations and extensions, must be another red flag. Given the backdrop of weak economic growth, decade high unemployment, fiscal slippage and weak governance at SOEs, a ratings downgrade is factored into our investment outlook. As a consequence, a repricing of risk is expected to result in a sub-investment grade rating of BB+ by both Fitch and S&P Global Ratings. South Africa's exclusion from world government bond indices will then likely push bond yields higher, raising the cost of capital for the country.

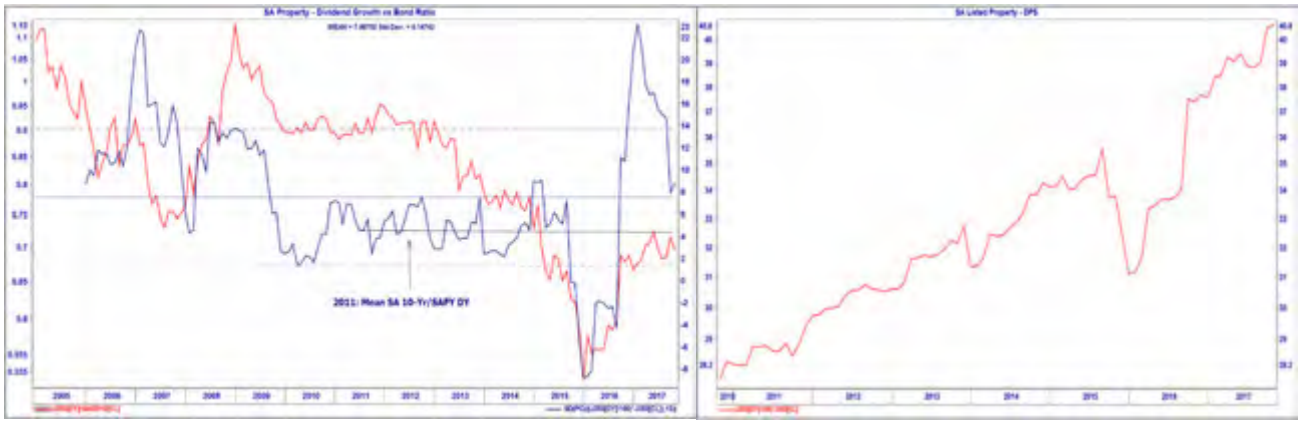


Prescribed investments, whereby pension funds would be compelled to invest in government and parastatal bonds – while not part of the initial policy discussion documents – were included as part of the transformation committee's recommendations. This followed earlier comments by the Minister of Finance 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.

Despite lower bond yields in Q3, the SA listed property sector derated relative to bonds, with returns buoyed by a 4.1% quarterly rise in distributions per share. The sector yielded some 5.7% in rands, outperforming both nominal and inflation-linked bonds. Given the large rand-hedge component of the listed property sector, the asset class offers investors a partial hedge against rand weakness. A neutral weighting is therefore retained in listed property, at least over the coming two quarters.



Current Yields	Expected Dividend Growth %	Total Return Matrix - SA Property (FTSE/JSE SA Listed Property) Exit Yield													
0.72	Prop / Bond Rel Yield	0.59	0.62	0.64	0.67	0.69	0.72	0.74	0.77	0.79	0.82	0.84	0.87	0.89	0.92
8.72	10 Year Bond Yield	9.22	9.22	9.22	9.22	9.22	9.22	9.22	9.22	9.22	9.22	9.22	9.22	9.22	9.22
6.24	Prop Yield	5.45	5.68	5.91	6.14	6.37	6.60	6.83	7.06	7.29	7.52	7.75	7.98	8.21	8.44
Target Yield Rel	-4.0	16.0	11.5	7.4	3.6	0.1	-3.2	-6.3	-9.1	-11.8	-14.3	-16.7	-18.9	-21.1	-23.0
	-3.0	17.2	12.7	8.5	4.7	1.1	-2.2	-5.3	-8.2	-10.9	-13.5	-15.8	-18.1	-20.2	-22.2
	-2.0	18.4	13.9	9.6	5.8	2.2	-1.2	-4.3	-7.3	-10.0	-12.6	-15.0	-17.3	-19.4	-21.4
	-1.0	19.6	15.0	10.8	6.8	3.2	-0.2	-3.4	-6.3	-9.1	-11.7	-14.1	-16.4	-18.6	-20.6
0.74	0.0	20.8	16.2	11.9	7.9	4.2	0.8	-2.4	-5.4	-8.2	-10.8	-13.2	-15.6	-17.8	-19.8
	1.0	22.0	17.3	13.0	9.0	5.3	1.8	-1.4	-4.4	-7.2	-9.9	-12.4	-14.7	-16.9	-19.0
	2.0	23.2	18.5	14.1	10.1	6.3	2.8	-0.4	-3.5	-6.3	-9.0	-11.5	-13.9	-16.1	-18.2
	3.0	24.5	19.7	15.2	11.2	7.4	3.8	0.6	-2.5	-5.4	-8.1	-10.6	-13.0	-15.3	-17.4
	4.0	25.7	20.8	16.4	12.2	8.4	4.8	1.5	-1.6	-4.5	-7.2	-9.8	-12.2	-14.5	-16.6
	5.0	26.9	22.0	17.5	13.3	9.5	5.9	2.5	-0.6	-3.6	-6.3	-8.9	-11.3	-13.7	-15.8
	6.0	28.1	23.1	18.6	14.4	10.5	6.9	3.5	0.3	-2.6	-5.4	-8.0	-10.5	-12.8	-15.0
	7.0	29.3	24.3	19.7	15.5	11.5	7.9	4.5	1.3	-1.7	-4.5	-7.2	-9.7	-12.0	-14.2
	8.0	30.5	25.5	20.8	16.6	12.6	8.9	5.4	2.2	-0.8	-3.6	-6.3	-8.8	-11.2	-13.4
	9.0	31.7	26.6	22.0	17.6	13.6	9.9	6.4	3.2	0.1	-2.7	-5.4	-8.0	-10.4	-12.6
	10.0	32.9	27.8	23.1	18.7	14.7	10.9	7.4	4.1	1.0	-1.9	-4.6	-7.1	-9.5	-11.8

SA Cash

SA cash yielded 1.8% in Q3, lagging the returns of all the broad domestic fixed-income asset classes barring inflation-linked bonds. Expectations that the MPC would again reduce interest rates by some 25 basis points in September failed to materialize given the Committee's concerns about heightened political uncertainty, weak economic growth and the risk of further ratings downgrades. The MPC assessed that inflation risks had increased due to the vulnerability of the rand and that upside surprises to growth in the US and the Eurozone would result in tighter monetary policy that could impact negatively on capital flows and the exchange rate.

The MPC revised up (by 0.1%) its inflation estimates for 2018 and 2019 to 5.0% and 5.3% respectively, although its electricity tariff hike assumption for 2018 was still a wishful 8%. The MPC stated that if the 20% tariff hike applied for was approved, inflation would increase by between 0.2% and 0.3% p.a. A lower turning point in the inflation cycle of 4.6% was still however expected in Q1 2018. Core inflation was similarly revised higher to 4.9% and 5% respectively for 2018 and 2019. Of some concern was the expected inflation of businesses and trade unions which remained uncomfortably close to the 6% upper limit of the target range over the coming 2 years. Lower inflation expectations among key price setters is an important element in reducing future inflation, thereby enabling lower nominal interest rates. It is worth noting that the decision was a split one, with 3 members calling for a cut and 3 calling for no-cut. In the end the Governor had the deciding vote, opting to leave rates unchanged.

Following the MPC's announcement, money market rates increased to reflect the expectation that no further rate cuts were likely in the current cycle, although short-dated rates (1X4 Fra's) were still pricing in a 25 basis point hike. This suggests that the money market is partially pricing in the likelihood of a ratings downgrade. In contrast, longer-dated Fra's are still holding below 7%, highlighting the uncertainty about future interest rate moves. Our base case view is that the next move in interest rates will be up as a sovereign downgrade is expected, probably only in March 2018.

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Disclosure