Sanlam Lifestage Feedback Report
Quarter 2 2018

Sanlam

Employee Benefits

Insurance | Financial Planning | Retirement | Investments | Wealth

Contents

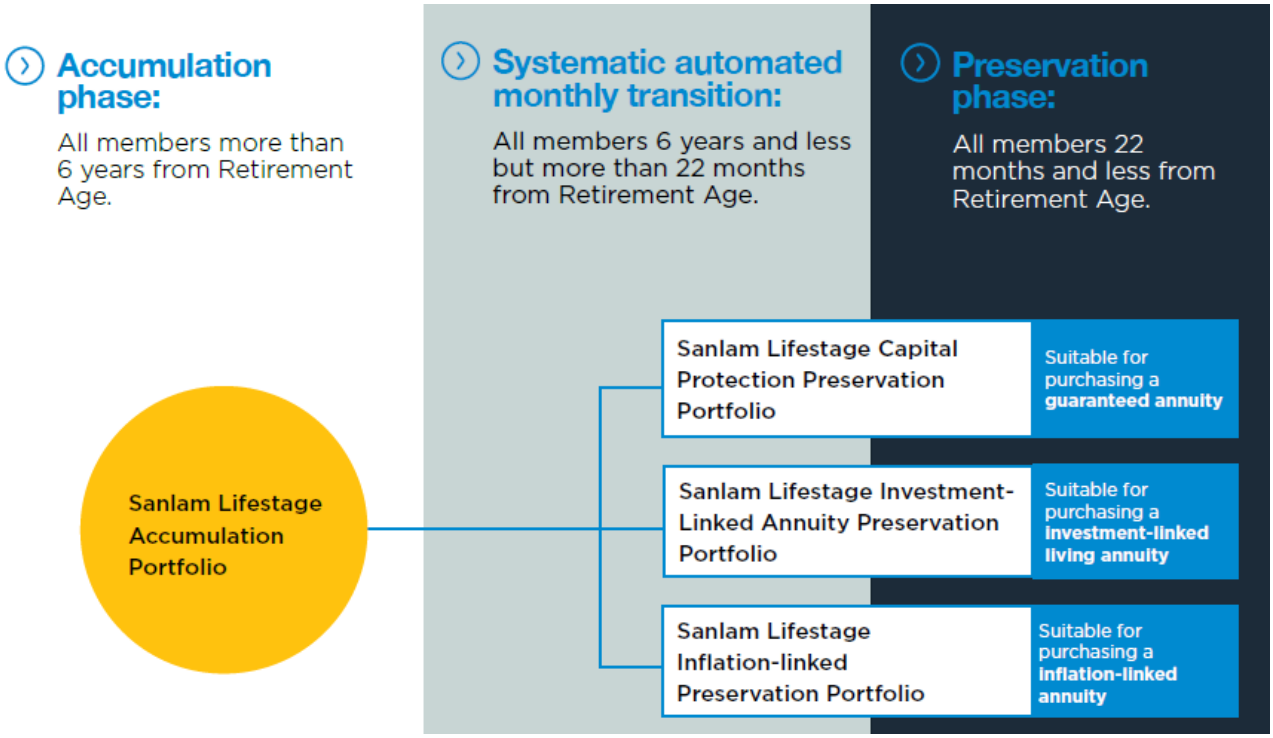
How does Sanlam Lifestage work?

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

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

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

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



The Capital Protection Preservation Portfolio is appropriate for a member wishing to purchase a guaranteed annuity at retirement, or who is uncertain on which annuitisation strategy they 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 2018

The global outlook continues to be positive for growth, with some deterioration in economic momentum as the winds of trade war, geopolitical risk, domestic political fractures, and debt-related risks loom, with financial markets already reflecting mounting vulnerabilities. The positive cyclical backdrop is expected to support earnings growth over the rest of the year. The risks to this outlook, however, are elevated, and include the mature stage of the economic and financial cycle and increased trade tensions. Among developed markets it is expected that falling unemployment and slowly building inflation drive central banks towards monetary tightening. Furthermore, heightened trade tensions are a threat to the positive global trend and tit-for-tat measures could derail the momentum of investment and trade. As such, the World Bank highlighted that global growth is set to slow over the next two years as central banks raise borrowing rates and fiscal stimulus starts to fade in countries such as the US and China.

Global equities made gains in a volatile quarter, as resilient economic and earnings data contended with an unsettling geopolitical backdrop. The MSCI World index delivered 1.73% in dollars while emerging market equities declined some 7.90% in dollars, as emerging market currencies depreciated on capital flight and an unwinding of the carry trade. This saw the rand depreciate some 13.55%. In bond markets, US 10-year Treasury yields rose significantly in April, and touched a seven-year high in May, before the risk-off investment environment led to the buying of safe-havens assets. Subsequently, The JP Morgan Global Aggregate index declined some 2.46% in dollars as bond yields pushed higher. Emerging market bonds had a difficult quarter and underperformed their developed market counterparts. As such, the JP Morgan EM index slumped 4.14% in dollars. Furthermore, the global property market rerated over the quarter, gaining some 5.43% in dollars.

The local equity market fared better than the broad emerging market basket during the second quarter. The ALSI gained 4.54% in rands. A strong quarter for Resource and Industrial shares helped the local market post positive returns. As such, in rands, the Resi20 index and Indi25 index delivered 21.73% and 5.29% respectively. The Fini15 bucked the trend, delivering -6.63% for the quarter. Foreigners were net sellers of the local bond market to the tune of R68.1 billion for the quarter, as investors remain concerned about the recurring theme related to the reversal of ‘easy money’. The SA 10-year yield pushed 85 bps higher and settled at 9.04% at month end. As such, the ALBI delivered -3.78% in rands. Inflation-linked bonds underperformed their sovereign counterparts, delivering -4.99% in rands. Furthermore, the local listed property market came under pressure as bond yields pushed higher. As such, the SAPY index delivered -2.19% in rands. Furthermore, local cash returned 1.76% for the quarter.

Portfolio Commentary – Quarter ending June 2018

Sanlam Lifestage Accumulation and ILLA Preservation Portfolios

The Sanlam Lifestage Accumulation Portfolio outperformed its benchmark over a 3 month period, having returned 3.61% relative to the benchmark's 2.77% return. Outperformance is attributed to Asset Allocation while Manager Selection gave a slight negative number.

The Sanlam Lifestage ILLA Portfolio outperformed its benchmark over a 3 month period, having returned 1.90% relative to the benchmark's 0.94%. Outperformance is attributed to both Asset Allocation and Manager Selection.

Trade war fears and ongoing Emerging Market contagion were the dominant themes across markets in the second quarter, with Emerging Market equities particularly hit hard.

In terms of Asset Allocation underweight positions in Local Equities and SA Inflation linked Bonds as well as being overweight International Equities and International Cash contributed to performance as the local currency depreciated. Unfortunately the overweight position in property and being underweight International Bonds detracted from performance. Local Property though, returned a negative figure for the quarter at the back of issues surrounding the Resilient group of companies that contributed about 80% of the property sector decline.

Manager Selection in Local Equities, Local Property and Local Bonds contributed positively to performance. The performances of the mangers in the mentioned buckets went well as they outperformed their benchmarks with the Equity and Bonds portion having to weather the storm from the "Ramaphoria" trade unwinding as the realisation that the problems in the country would take longer to fix became apparent.

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 benchmark for the portfolio is the SALI index. The index is created by Sanlam to match the purchase price of an inflation linked annuity. The portfolio closely matches the performance of the benchmark over the long term. This is to ensure that clients will be able to purchase an annuity that is linked to inflation upon retirement.

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.

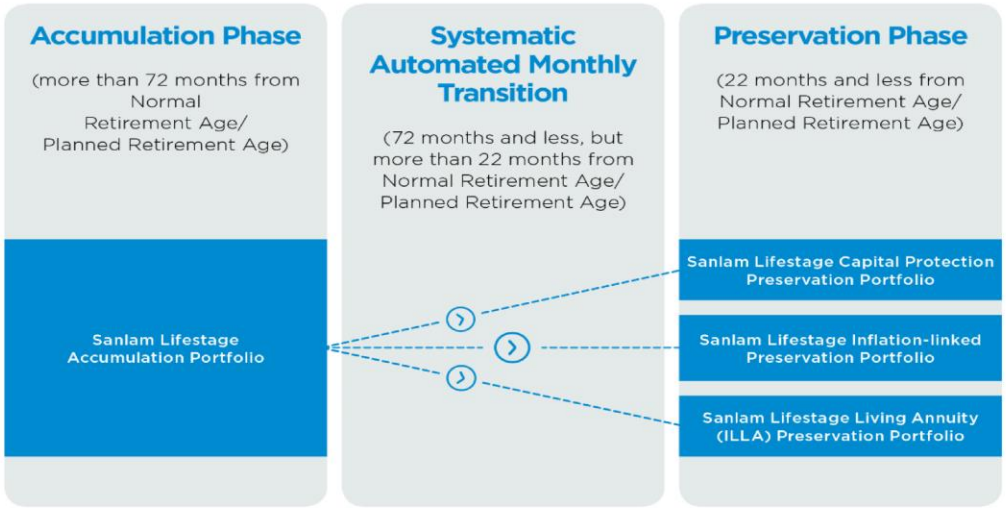
Six years (72 months) before a member reaches his/her Planned Retirement Age, the member is gradually switched from the Sanlam Lifestage Accumulation Portfolio to his/her selected Sanlam Lifestage preservation portfolio by means of 50 monthly switches.

Fund performance

Phase	1 month	3 months	1 year	3 years
Accumulation Portfolio	2.3%	3.6%	9.1%	5.8%
Preservation Portfolios:				
Capital Protection	0.6%	1.8%	8.3%	8.6%
Inflation-Linked	-1.9%	-5.1%	0.6%	2.9%
Living annuity (ILLA)	1.3%	1.9%	8.5%	7.0%

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.



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

Sanlam Lifestage Accumulation Portfolio

Period Ending	30-Jun-18
Fund Size	R 10,950 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

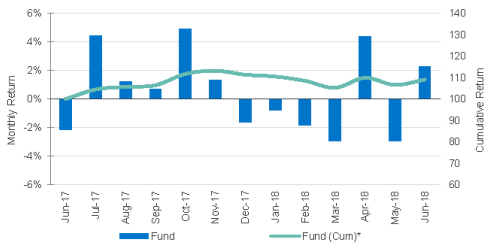
This portfolio has an moderate-aggressive risk profile

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 this 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



*Based on 1 year returns

Fund performance (%)

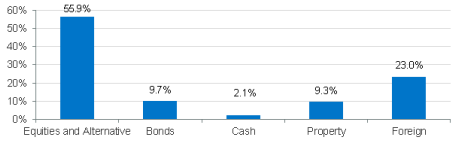
	Fund	Benchmark
1 Month	2.3%	2.1%
3 Months	3.6%	2.8%
6 Months	-2.1%	-2.1%
1 Year	9.1%	9.7%
3 Years	5.8%	6.6%
5 Years	10.2%	11.1%

Top 10 holdings (% of Equities)

Share Name	% of Equities
Naspers	19.2%
Standard Bank Group Limited	4.6%
Sasol Limited	4.4%
British American Tobacco Plc	4.2%
Firstrand Limited	3.3%
Anglo American	2.9%
MTN Group	2.5%
BHP Billiton Plc	2.3%
Sanlam	2.0%
Shoprite Holdings Limited	1.7%

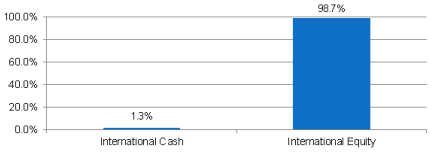
Benchmark	27.5%	SWIX (Shareholder Weighted Index)
	27.5%	Capped SWIX (Shareholder Weighted Index)
	10%	BEASSA Total Return All Bond Index
	7.5%	FTSE/JSE SAPY Index
	2.5%	Short Term Fixed Interest Index (STeFI)
	5%	Barclays BESA Gov. Inflation-linked Index
	15%	MSCI World (Developed Markets) Equity Index
	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.

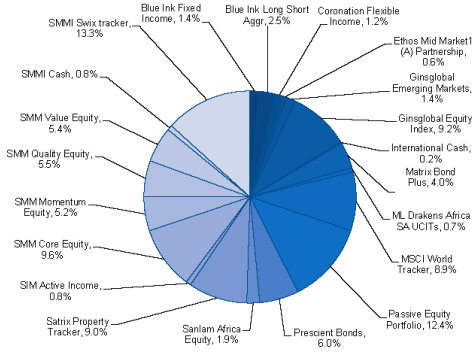
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	24.7%	23.1%
Resources	14.9%	11.4%
Industrials	60.4%	65.5%

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	44.4%
Average capital loss in one month	-1.6%
Downside risk *	3.8%

of the portfolio relative to CPI

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

Sanlam Lifestage Living Annuity Preservation Portfolio

Period Ending	30-Jun-18
Fund Size	R 54 million
Inception Date	Oct-13

Benchmark

17.5%	Capped SWIX (Shareholder Weighted Index)
17.5%	SWIX Index
20.0%	BEASSA Total Return Index
7.5%	Short Term Fixed Interest Index (STeFI)
10.0%	MSCI World Equity Index
5.0%	Barclays Global Aggregate Index
5.0%	SAPY Property Index
17.5%	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

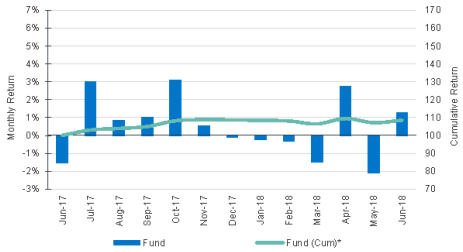
The portfolio has a moderate risk profile.

Fees

Investment Management Fees:
0.80% per annum.

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

Monthly and cumulative returns



*Based on 1 year returns

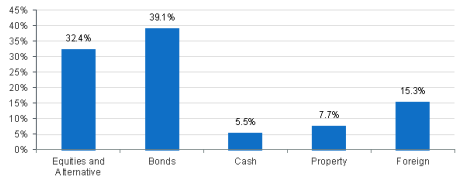
Fund performance (%)

	Fund	Benchmark
1 Month	1.3%	1.1%
3 Months	1.9%	0.9%
6 Months	-0.2%	-0.8%
1 Year	8.5%	8.3%
3 Years	7.0%	6.4%
5 Years	n/a	n/a

Top 10 equity holdings (% of Equities)

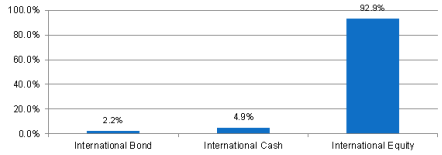
Share Name	% of Equities
Naspers	21.9%
Sasol Limited	4.7%
Standard Bank Group Limited	4.7%
British American Tobacco Plc	4.1%
Firstrand Limited	3.5%
Anglo American	3.0%
MTN Group	2.9%
BHP Billiton Plc	2.3%
Sanlam	2.1%
Shoprite Holdings Limited	1.8%

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.

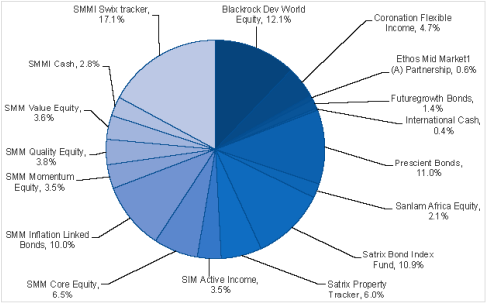
Foreign split



Equity sectoral exposure (%)

	Fund	Benchmark
Financials	24.5%	23.1%
Resources	13.5%	11.4%
Industrials	62.0%	65.5%

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	44.4%
Average capital loss in one month	-0.7%
Downside risk *	2.4%

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

Sanlam Lifestage Inflation-linked Preservation Portfolio

Period Ending	30-Jun-18
Fund Size	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.

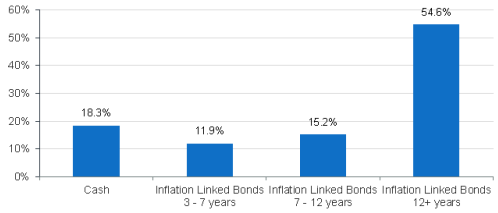
Risk profile

This fund has a conservative risk profile

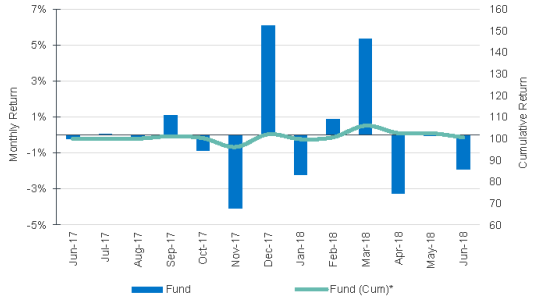
Fees

Investment Management Fees:
0.70% per annum.

Asset class breakdown



Monthly and cumulative returns



*Based on 1 year returns

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

% of negative months over the last 3 years	50.0%
Average capital loss in one month	-1.2%
Downside risk *	3.9%

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

Fund performance (%)

	Fund	Benchmark
1 Month	-1.9%	-2.5%
3 Months	-5.1%	-6.0%
6 Months	-1.4%	-1.8%
1 Year	0.6%	-0.2%
3 Years	2.9%	2.3%
5 Years	5.4%	5.2%

Sanlam Lifestage Capital Protection Preservation Portfolio

Period Ending	30-Jun-18
Fund Size (Book Value)	2012 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.

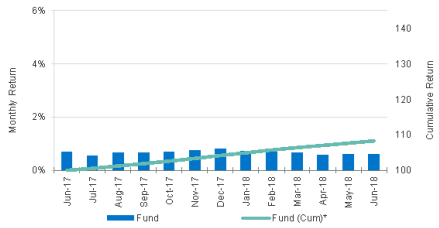
Risk profile

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



*Based on 1 year returns

Fund bonuses (%)

	Fund (gross of fees)
1 Month	0.6%
3 Months	1.8%
6 Months	3.9%
1 Year	8.3%
3 Years	8.6%
5 Years	n/a

Top 10 equity holdings (% of Equities)

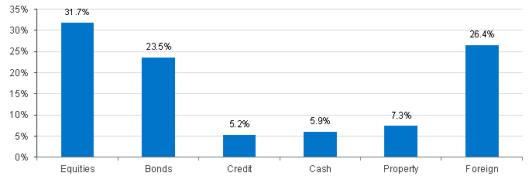
Share Name	% of Equities
Naspers N	18.0%
Sasol	5.6%
BTI Group	4.8%
FirstRand / RMBH	4.8%
Stanbank	4.8%
MTN Group	3.7%
Anglos	3.1%
Barclays	2.8%
Consol Holdings	2.4%
Old Mutual (OMU)	2.2%

Benchmark

16.0%	*SWIX (Shareholder Weighted Index)
16.0%	*Capped SWIX (Shareholder Weighted Index)
25.5%	BEASSA Total Return All Bond Index
1.0%	STeFI + 2%
2.0%	IGOVI
17.5%	**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.

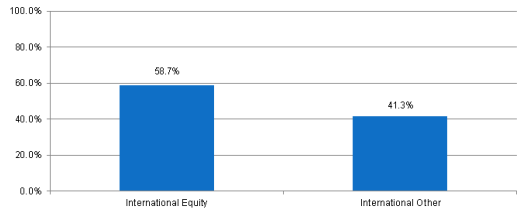
** Transitioning from 100% SWIX to above benchmark by June 2018*
*** Transitioning from 12.5% foreign equity to 17.5% by June 2018*

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	23.3%
Resources	14.0%
Industrials	62.7%

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.*

Risk analysis

(based on the last 3 years' monthly returns)

% of negative months over the last 3 years	0.0%
Average capital loss in one month	0.0%
Downside risk *	0.5%

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

Funding Level

July 2018: 99.41% funded

Performance vs Benchmark

Performance to end of June 2018

Sanlam Lifestage	1 Month	3 Months	1 Year	3 Year	5 Year
Accumulation Portfolio	2.30%	3.61%	9.10%	5.77%	10.24%
Benchmark	2.08%	2.77%	9.72%	6.64%	11.09%
Capital Protection Preservation*	0.59%	1.77%	8.30%	8.63%	12.02%
Inflation-Linked Preservation Portfolio	-1.89%	-5.11%	0.58%	2.90%	N/A
Benchmark	-2.51%	-6.01%	-0.20%	2.32%	N/A
ILLA Preservation Portfolio	1.27%	1.90%	8.53%	6.95%	5.43%
Benchmark	1.07%	0.94%	8.28%	6.41%	5.21%

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

Performance Attribution

Multi-Managed Portfolios:

3 months ending June 2018	Active Return	Tactical Asset Allocation	Manager Selection
Sanlam Lifestage Accumulation	0.84%	0.87%	-0.04%
Sanlam Lifestage ILLA Preservation	0.96%	0.70%	0.26%

Economics

July 2018

Executive summary

Trade war fears and ongoing emerging market contagion were the dominant themes across markets in the second quarter, with emerging market equities particularly hard hit. Even safe-haven assets failed to yield positive USD returns, with only global listed property ending the quarter in the black. Rand-based investments underperformed their global counterparts as capital flight resulted in a 13.6% depreciation in the rand/USD exchange rate. The domestic bond market saw foreign outflows totalling a staggering R68.1 billion, a far cry from the equity outflows totalling some R8.6 billion. The domestic equity market bucked the generally weaker trend, highlighting its defensive properties in times of Rand weakness. While valuations generally still favour offshore risk assets, geopolitical uncertainty, increased protectionism and a tightening in financial conditions support more risk mitigation in the year ahead. As a consequence, overweights to risky assets have been scaled back, whereas the underweights to safe-havens have been reduced. On the domestic front, risk-adjusted returns favour broad-based diversification across all asset classes, with on-weight allocations proposed for both risky and defensive asset classes.

Highlights

- Trade war fears intensify as China and the EU respond to US tariffs
- China cuts required reserve ratio in response to US tariffs
- Fed minutes highlight trade policy risks and yield curve fears
- US immediate expensing provision in tax code drives capital investment
- Italy's League and Five Star Movement form coalition government. Parties reach fiscal deal that could cost some Euro100bn
- ECB signals end to QE by December 2018; rates to rise in the second half of 2019
- SA Mining Charter stuck on free-carry interest for employees and communities
- ANC does about-turn on tribal land expropriation
- SA GDP disappoints, declining 2.2% QQSAA (quarter on quarter, seasonally adjusted annualised)

Global Equities

Global equities eaked out a positive return in the second quarter as trade war concerns offset the benefits of favourable US tax breaks for both corporates and consumers. The release of hawkish FOMC statements further dampened sentiment as a higher path of interest rate increases triggered capital flight from emerging markets, driving currencies and equity markets lower. The capital outflows resulted in the JP Morgan Emerging Market Currency Index depreciating by some 9% over the quarter. Political uncertainty in Italy also took some of the gloss off returns as anti-establishment parties, the Five Star Movement and the League, formed a coalition government putting it on a collision course with the EU on reigning in its fiscal deficit. The MSCI World Index gained a pedestrian 1.1% in USDs and 16.9% in rands, whereas emerging market equities fell a sharp 8.7% in USDs. In rands, however, emerging market equities gained some 5.7%, courtesy of a 13.6% depreciation in the rand/USD exchange rate.

While Trump's proposed tariffs on Chinese imports totalling USD34 billion (effective 6 July) was well publicized, the quantum of the affected goods is still small in the context of the broader economies, helping to temper market concerns. Even the addition of a further USD16 billion of Chinese imports is unlikely to change sentiment much. China's commensurate tit-for-tat response that targeted imports of US agricultural goods, soybeans and motor vehicles followed earlier tariff increases on US pork, fruit, wine and steel piping in response to US tariffs on Chinese steel (25%) and aluminium (10%). The risk to markets now is that Trump extends the tariff list to a further USD200 billion of Chinese imports, subject to a 10% tariff, effective 30 August. Such a move would likely elevate the current trade dispute into a full-blown trade war with

negative implications for risk assets. In the event that China responds with higher tariffs or non-tariff barriers such as increasing red tape on US companies doing business in China or encouraging a nationwide boycott of US goods, the US could levy further tariffs on Chinese goods totalling another USD200 billion. Collectively, the tariffs on Chinese goods could increase to over USD500 billion, almost the same amount that the US imported in 2017. The escalation in trade tensions has also brought the EU, Canada and Mexico into the fray, with retaliatory tariffs on US goods totalling some USD19.3 billion thus far. The EU imposed tariffs of up to 25% on US motor cycles, denim and bourbon in July, opening the EU to retaliatory tariffs of 20% on its motor vehicle exports.

Although it may be too early to gauge the effects of the current trade impasse on the real economy, rising tariffs are expected to result in higher input costs along the supply chain with businesses either passing on the higher costs to consumers or absorbing some or all of the additional cost pressures. On net, aggregate demand is likely to be negatively affected, with corporate profits also coming under pressure. While the trade impasse is expected to gather momentum and slow the rate of global growth, US tax reforms are expected to partially insulate the US from the slowdown in trade in 2018 and 2019. Emerging markets are likely to be the most vulnerable, with further currency depreciation and capital flight expected, at least in the near term. The fact that June PMI export indices for both the US and China only eased slightly, serves to highlight only the start of the trade war, with further fallout expected over the coming months.

While the immediate expensing provision in the US tax code drove capital investment amongst S&P500 companies to their fastest rate in seven years in the first quarter, contacts with businesses by Fed district presidents flagged declining business confidence from trade policy uncertainty as a risk to investment spending going forward. A rebound in investment spending due to Trump's tax reforms had been seen as an important catalyst for extending the business cycle and subsequently the bull market in equities. Comments from the likes of Harley Davidson that they would consider expanding investment in international plants as a means of side-stepping tariffs, highlights the risks to investment spending and the growth cycle. Tesla recently signed an agreement with China to set up an electric vehicle assembly plant, further highlighting the risk to new US investment. Nonetheless, the US's end game appears to be attracting investment back to the US, ensuring the sustainability of industries considered strategic to the US's security interests and the need to tackle the problem of intellectual property theft by China. Furthermore, by banning sensitive technology exports to China, the US hopes to thwart China's "Made in China 2025" initiative to dominate in new technologies.

Although the current trade impasse was of concern to the Fed, it did not feature prominently in its outlook for growth, with the latest FOMC minutes characterising US growth as very strong, with inflation expected to remain within the 2% target range on a sustained basis. The flattening in the yield curve did, however, receive some attention in the minutes with a number of participants thinking it important to continuously monitor the slope of the yield curve, given the regularity that an inverted yield curve has signalled a pending US recession.

Despite all the concerns raised above, PMI indices and leading indicators of economic activity are still constructive, suggesting global growth will exceed trend this year and grow in line with trend in 2019. With global growth expected to moderate, due to trade wars and a tightening in financial conditions, earnings growth will also slow, suggesting some risk mitigation in 2019 as the late-cycle recovery wanes. From a valuation perspective, the MSCI World Index is trading on a multiple of some 18.5X earnings, marginally ahead of the 10-year average but well behind the long-term mean of some 21X earnings. Given the relationship between earnings-per-share and the price index, a market correction was due, given that expected earnings 12-months out were already discounted in the price. However, consensus earnings expectations two to three years out point to further price gains, although these are likely to be more modest than in previous years. A similar case can be made for emerging market equities, where price gains in 2017 had run well ahead of 12-month consensus earnings expectations. Following the sell-off in emerging market equities since the beginning of the year, in part due to anxiety about US rate hikes and trade policy, valuations have improved with the trailing multiple of 13.4X earnings in line with the 10-year mean, but below the long-term average of 15X earnings. Using longer-term normalised earnings in our valuation matrices, both developed and emerging market equities are likely to deliver double-digit returns in the year ahead, with emerging market equities now expected to outperform their developed market counterparts, at least towards the back-end of the investment horizon (12 months). An overweight bias is therefore still retained in global equities although the magnitude of the tilt has been moderated to take account of trade policy uncertainty and geopolitical risks.

Global Bonds

Global bonds declined by some 2.5% in USDs in the second quarter as an increase in yields to 2.22% and a depreciation in benchmark constituent currencies dragged returns lower. Emerging market bonds were the biggest underperformers, as currency depreciation of some 9.0% and a widening in spreads from some 343 basis points to around 408 basis points hurt returns. The JP Morgan Emerging Markets Bond Index declined by 4.1% in USDs even as investors switched out of risk assets into more defensive asset classes. Global corporate bonds were not spared either with the Barclays Global Corporate Bond Index declining some 2.4% in USDs as spreads widened on an increase in risk aversion.

Global inflation-linkers underperformed their nominal counterparts in the second quarter, declining by 3.3% in USDs as real yields increased slightly from -0.77% to -0.65%. The derating was somewhat surprising given rising inflationary concerns linked to higher import tariffs and higher oil prices. Coupled with historically low unemployment rates, particularly in the US, inflationary pressures are likely to intensify in the months ahead. Although the Fed is more sanguine about the inflation outlook, expecting core inflation to hold marginally above the 2% level over the coming two years as rates are normalized and growth slows, the New York Fed's measure of underlying inflation points to an acceleration in core inflation over the next 18 months. This is at odds with market expectations as reflected in breakeven inflation rates. The tightening in financial conditions arising from the Fed's interest rate normalization is expected to be a headwind for risk assets, with a further flattening, if not inversion, in the yield curve a distinct possibility. Financial conditions in the Eurozone are also expected to tighten, albeit at a slower pace, as the ECB exits QE in December and raises rates in the second half of 2019. China, for its part, is expected to continue cutting the required reserve ratio as a means of stimulating domestic consumption and as a back-stop to the economic fallout from a trade war. Our base case view is that US long bond yields are likely to be anchored around the mid-3% level as growth slows and short-term rates rise, informing our current underweight position in this asset class. However, a closing of the underweight position is expected towards the backend of our investment horizon (12 months).

Global listed property bucked the generally weaker trend in fixed income markets, with the EPRA/NAREIT Developed Market Property Index gaining some 5.4% in USDs and 22.0% in rands. The relative outperformance from listed property came about as a result of small rerating, with the price-to-book ratio increasing from 1.34X to 1.36X, still well below the mean of around 1.44X. With increased bond issuance expected from the Fed going forward, due to larger fiscal deficits and an unwinding of the Fed's balance sheet, rising bond yields are expected to be a headwind for the sector. Although our base case view is for long bond yields to move higher over the investment horizon, the valuation gap in global listed property along with yields in excess of 4% informs our neutral position in this asset class.

SA Equities

South African equities gained some 4.5% in rands in the second quarter, buoyed by resource stocks that rallied an impressive 21.7%. In USDs, however, the market tracked emerging markets lower, courtesy of a 7.6% depreciation in the rand/USD exchange rate. The All Share Index returned some -9.6% in USDs, marginally behind the emerging market composite index that was down some 8.7%. The rally in resource counters highlighted the geared effect of rand weakness on returns, despite declines in precious and flat industrial metals prices. Industrials (Indi-25) also benefitted from rand weakness, up some 5.3% in rands, whereas financials (Fini-15) bore the brunt of the weaker rand, down some 6.6%. The largest contributor to total returns was Naspers, up 20.5% on speculation that it would list in Hong Kong, potentially unlocking the discount to its Tencent holding. Naspers contributed some 3.5% to the Alsi's quarterly return, highlighting the importance of this stock in South African portfolios. Despite contagion across emerging markets in general, foreigners were net sellers of only some R8.6bn in equities over the quarter, with outflows of some R20.7bn in June representing a marked reversal from the inflows recorded in the prior two months.

Despite disappointing GDP growth figures for Quarter 1, down some 2.2% QQSAA, the year/year growth rate was still positive, increasing by some 0.8%. Given weak performances from mining, manufacturing, agriculture and trade, private sector consensus estimates have been revised lower for the year to around 1.5%, in line with our own estimate. The growth outlook for the second quarter does not appear to be much better either, following contractions in April in manufacturing production, mining production and retail trade on both a 3-month/3-month and month/month basis. With the Barclays PMI Index also declining in May and June, the sector is likely to remain under pressure in the second half of the year, whereas increases in the Standard Bank PMI points to some gains in the broader economy. The Standard Bank PMI tracks private

sector business trends across mining, manufacturing, services, construction and retail trade, based on data collected from a representative panel of around 400 companies. The generally more upbeat assessment of the domestic economy is in line with our own assessment of more buoyant growth in the second half of the year, providing some underpin for earnings growth. Expenditure side proxies used for household final consumption expenditure (motor car sales) and gross fixed capital formation (commercial vehicle sales) also suggest growth will slow in the second quarter before recovering in the third quarter, on a year/year basis.

Policy uncertainty relating to the Mining Charter and a possible constitutional amendment to property rights have been a headwind for fixed investment growth, which contracted by 3.2% QQSAA in the first quarter, despite upbeat readings in business and consumer confidence. Sticking points relating to the Mining Charter include the 10% free carry interest on new mining rights to qualifying employees and communities, while the uncertainty of land expropriation without compensation has stalled new investment in the agricultural sector. The President's recent about-turn on expropriating Ingonyama Trust land from King Goodwill Zwelithini has highlighted the inconsistency in the ANC's land policy as well as the political considerations behind the about turn on tribal land. That leaves commercial property mostly at risk, further serving to constrain new investment expenditure.

Despite the downside risks to economic growth in the year ahead, top-down equity market earnings estimates suggest earnings could grow some 10% over the coming year, in line with implied earnings growth priced into the All Share Index. The top-down estimates differ somewhat from the consensus bottom-up estimates of around 16% in year one and some 9% in year two, reflecting possibly the recent depreciation in the rand/USD exchange rate. While the trailing multiple of 19.7X earnings suggests the domestic equity market is expensive, the rolling multiple of the market is substantially lower at around 14.8X earnings, slightly less than the long-term mean. If a reconstituted index is used, which excludes large rand-hedge stocks (Naspers, Richemont, British American Tobacco and Glencore), the rolling multiple improves further to some 12.8X earnings. Forward multiples are similarly attractive with the forward price-to-earnings ratio for the All Share Index estimated at 12.8X earnings, whereas the reconstituted multiple is around 11.3X earnings, cheap relative to the long term mean. Possible explanations for the low market rating include downside risks to growth, policy uncertainty and the risk of further capital flight from emerging market contagion. While the equity market looks attractive on a valuation basis, risk-adjusted returns point to caution in overweighting equities. With the earnings yield differential between equities and bonds largely neutral, we retain an on-weight allocation to domestic equities.

SA Bonds

SA bonds fell foul of capital flight over the quarter as foreigners dumped some R68.1 billion in domestic bonds. As a consequence, the yield on the All Bond Index increased from some 8.62% to 9.44% dragging returns lower by some 3.8%. While inflation has been subdued for most of the past year, hovering around the 4.5% level, the outlook for inflation has deteriorated on the back of rand weakness, rising oil prices and expectations of increases in food inflation over the coming months. Further pricing pressures are possible from the second-round effects of the recent VAT rate hike and possible electricity tariff increases in excess of the 8% included in our estimates. The likelihood of increased bond issuance needed to refinance debt-strapped SOE's, recent public sector wage increases and early or voluntary retrenchments within the public sector, pose a further headwind for the bond market.

Higher debt levels will further fuel concerns about the country's debt sustainability, a concern again highlighted by ratings agency Moody's. In the event that debt levels continue to rise, including contingent liabilities, a further ratings downgrade to sub-investment grade seems likely, with negative implications for the rand, inflation and bond yields. Although SAA has shown a recent willingness to seek an equity partner, it seems unlikely that private investors would be willing to take a minority stake in the airline while being expected to provide the much-needed funding. This then potentially opens the door for the reintroduction of prescribed assets, a move that would almost certainly be rejected by the unions. That may then leave the Treasury with the only option but to increase debt levels and accept a ratings downgrade to "junk". A spike in bond yields would most likely attract domestic institutional investors back into the bond market, offering the potential for attractive returns. While a downgrade will push bond yields higher, South Africa's relatively small holding of foreign-currency denominated debt will likely cap yields at levels well below those of other BB+ rated economies.

Since government bonds currently yield a very attractive real return of 5% and an estimated 3.5% through-the-cycle, bonds are compensating investors for the risks discussed above. Relative to other competing

asset classes such as equities, the earnings yield differential is also attractive informing our neutral bias in this asset. At yields in excess of some 9.5% on the Albi, bonds are upweighted to overweight.

Inflation-linkers underperformed their nominal counterparts in the second quarter, declining by some 5.0% as real yields increased from 2.3% to 2.96%. Since the inflation carry has been benign for most of the past year, it is not surprising that inflation-linkers have yielded negative returns. With real yields meaningfully higher than the 2.5% we consider to represent fair value, the asset class is attractive at current yields. While the optimal timing of an increased allocation to inflation-linkers may be some months away, the asset class is upweighted to neutral at yields in excess of 3%. Since break-even inflation in excess of 6% exceeds our through-the-cycle inflation estimate, nominal bonds are still preferred relative to inflation-linkers.

SA listed property stocks came under further selling pressure over the quarter, with the SAPY Index declining by some 2.2%. A rise in bond yields offset the positive contributions from a small rerating in the sector and a 1.4% growth in distributions. With the property dividend-to-bond yield relative ratio at some 0.85X, the sector has experienced a material derating from some 0.65X since the start of the year. The trigger for the derating was allegations made against the Resilient Group of companies of market manipulation and insider trading. Although an independent investigation by former auditor-general Shauket Fakie had cleared the company of any wrong-doing, unanswered questions remained about share transactions conducted by a number of shelf companies.

Despite having partially cleaned up Resilient's shareholding structure by distributing its 15.5% shareholding in Fortress and consolidating its BEE trust into its own books, the company is still being investigated by both the JSE and the Financial Sector Conduct Authority for insider trading. Since the outcome of the investigation could still result in a material write-down in the company's value, the sector as a whole remains tainted. However, since the sector is trading at a discount relative to its historical dividend-to-bond yield relative ratio and its net asset value, a neutral weighting is maintained.

SA Cash

SA cash yielded 1.8% in the second quarter, outperforming all of the broad domestic fixed-income asset classes. Recent rand depreciation and successive petrol price increases have resulted in increases in projected money market rates, with the longer dated FRA's pricing in a cumulative 100 basis points of interest rate increases between now and the end of 2019. The path of interest rate increases anticipated by the market is however slightly more aggressive than the Reserve Bank's Quarterly Projection Model, which points to three increases of 25 basis points each between now and the end of 2019. In contrast with the FRA's that see interest rates holding steady in H1 2020, the Reserve Bank is penciling in two further increases in the repo rate in 2020. Despite the upside risks to inflation, our implied path of interest rate increases up to the end of 2020 is somewhat more conservative, with a cumulative 75 basis points of increases expected up to the end of 2020. The more conservative trajectory of increases is premised on a real repo rate of between 1.5% and 2%, as opposed to the SARB's 2% to 2.5%. Money markets are however expected to take their cue from the upcoming MPC meeting in July, when the committee is expected to revise upwards their projections for inflation over the coming years.

call us

Danie van Zyl
Sanlam Employee Benefits Investments
+27 (21) 950 2853
danie.vanzyl@sanlam.co.za

Bethuel Korase
Sanlam Employee Benefits Investments
+21 (21) 950 2536
Bethuel.korase@sanlam.co.za

Disclosure

Warnings and Disclaimer

Sanlam Life Insurance Ltd is an authorised financial services provider.

This survey is for the use of Sanlam and its clients only and may not be published externally without permission first obtained from Sanlam. While all reasonable attempts are made to ensure the accuracy of the information, neither Sanlam nor any of its subsidiaries makes any express or implied warranty as to the accuracy of the information. Past performance is not necessarily a guide to future returns. Investment returns can be positive or negative. The material is meant to provide general information only and not intended to constitute accounting, tax, investment, legal or other professional advice or services. This information should not be acted on without first obtaining appropriate professional advice. The use of this document and the information it contains is at your own risk and neither Sanlam nor any of its subsidiaries shall be responsible or liable for any loss, damage (direct or indirect) or expense of any nature whatsoever and howsoever arising.