GLOBAL OUTLOOK **IMPROVING, SA STALLS**

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ABOUT **THE AUTHOR**

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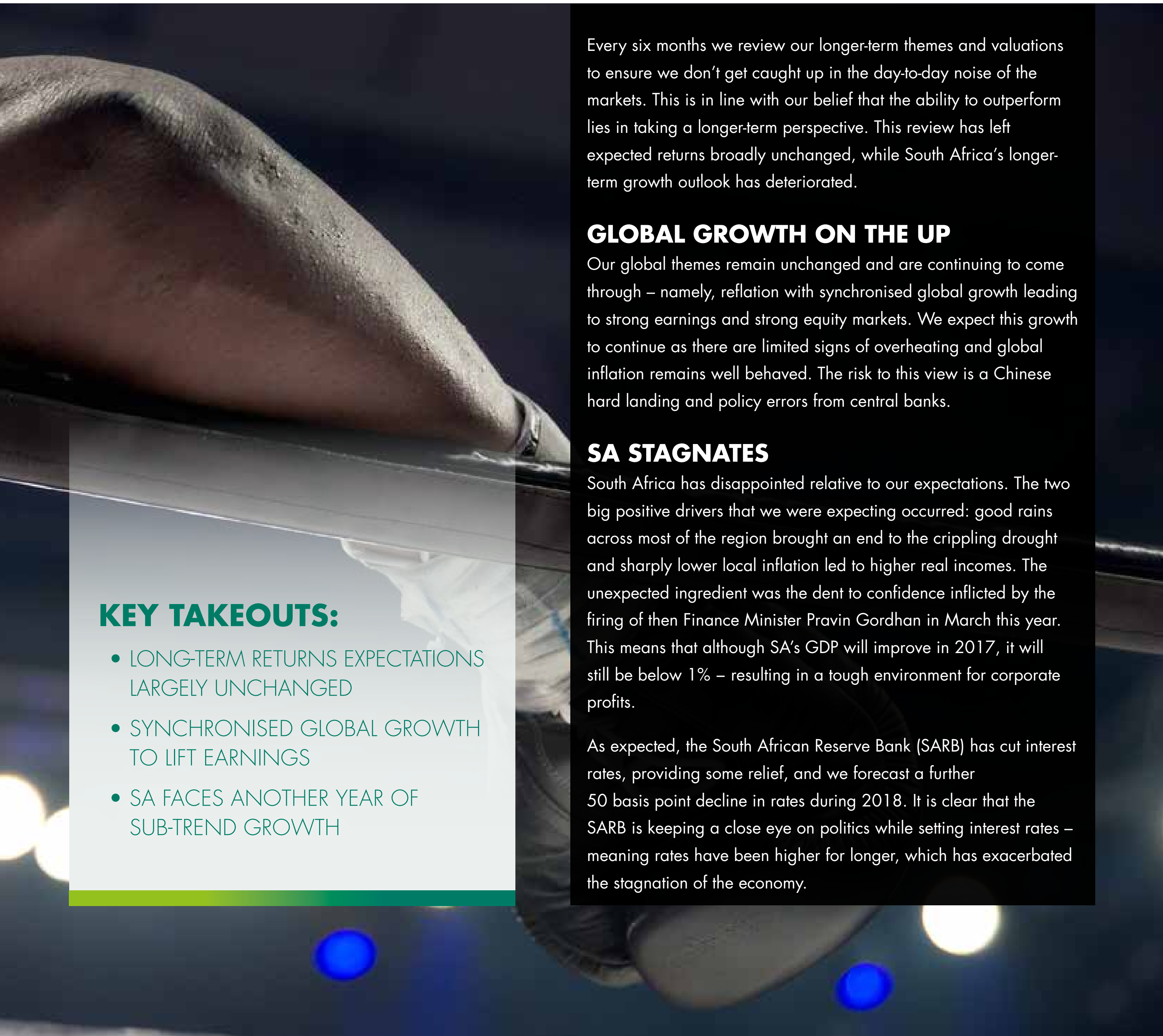

KEY TAKEOUTS:

- LONG-TERM RETURNS EXPECTATIONS LARGELY UNCHANGED
- SYNCHRONISED GLOBAL GROWTH TO LIFT EARNINGS
- SA FACES ANOTHER YEAR OF SUB-TREND GROWTH

Every six months we review our longer-term themes and valuations to ensure we don't get caught up in the day-to-day noise of the markets. This is in line with our belief that the ability to outperform lies in taking a longer-term perspective. This review has left expected returns broadly unchanged, while South Africa's longer-term growth outlook has deteriorated.

GLOBAL GROWTH ON THE UP

Our global themes remain unchanged and are continuing to come through – namely, reflation with synchronised global growth leading to strong earnings and strong equity markets. We expect this growth to continue as there are limited signs of overheating and global inflation remains well behaved. The risk to this view is a Chinese hard landing and policy errors from central banks.

SA STAGNATES

South Africa has disappointed relative to our expectations. The two big positive drivers that we were expecting occurred: good rains across most of the region brought an end to the crippling drought and sharply lower local inflation led to higher real incomes. The unexpected ingredient was the dent to confidence inflicted by the firing of then Finance Minister Pravin Gordhan in March this year. This means that although SA's GDP will improve in 2017, it will still be below 1% – resulting in a tough environment for corporate profits.

As expected, the South African Reserve Bank (SARB) has cut interest rates, providing some relief, and we forecast a further 50 basis point decline in rates during 2018. It is clear that the SARB is keeping a close eye on politics while setting interest rates – meaning rates have been higher for longer, which has exacerbated the stagnation of the economy.

Looking forward, political uncertainty will keep investment on the sidelines and mean another year of sub-trend growth. This makes the ruling party's December policy conference a critical crossroads, with potential binary outcomes. We expect the ANC to muddle through, but have used a bar-bell strategy to build our portfolios to manage the risk of unknowable outcomes.

Due to good news internationally and disappointing SA news, we maintain our preference for offshore equity over SA equity. With global interest rates expected to rise and monetary stimulus programmes expected to be wound down, we still find global cash and bonds unattractive. Within SA, we still get good real returns on fixed income assets and lower cash yields should push some investors off the side-lines where they sit with high cash holdings. We think that locally listed property will deliver a decent real return.

Within the different asset classes, our return expectations are as follows:

SOUTH AFRICA

SA EQUITIES

We have reduced our expected real return to 4.5% a year over the next five years, down from 5%. This is due to lower trend growth and a hostile profit environment impacting long-term earnings growth expectations. However, local shares have gone nowhere, which means pockets of value are appearing and we are opportunistically taking advantage of specific weakness and better valuations.

SA PROPERTY

This sector also faces headwinds from a tough economy, but long-term leases and escalations mean that dividends are secure. The locally orientated companies should also benefit from a falling cost of capital (on the back of interest rate cuts). With SA-focused funds yielding 8%, our models show a good real return from property of 5.5% a year.

SA BONDS

Bonds have performed well and, due to our high political risk, offer some of the best real yields in the world. Lower inflation and lower rates are good news from bonds, but we are becoming more cautious over the longer term and have revised our view from being slightly positive to sellers.

SA CASH

Cash has been a tough hurdle to beat, delivering good returns over the past three years. We think rates are too high and, as the economy is on its knees, the SARB will cut rates. This will reduce the available return from cash.

INTERNATIONAL

GLOBAL EQUITY

Strong earnings growth has been good for global equity and we expect continued synchronised growth. However, a lot of the good news is already in the price and it will be more difficult to deliver returns going forward as the bull market matures. This feeds into our long-held theme of a low return world. Our outlook for this asset class over the next five years remains unchanged, and we maintain that global equity offers the best option for real returns.

GLOBAL BONDS

Global bonds are still expensive and the pressure from reducing monetary policy liquidity in the market leaves us bearish.

GLOBAL CASH

Artificially low real returns will normalise. While it is still too early, global cash will start looking more attractive as interest rates rise.

LONG-TERM ASSET ALLOCATION VIEW (JUNE 2017)

	Real Return (p.a.)	View	Comment
SA		**–**	**Good carry and the rand is cheap**
Equity	4.5%	Neutral	Key risk is earnings delivery as economy battles
Property	5.5%	+	Local plays offering good yield
Bonds	3.0%	–	Longer-term risk via credit ratings
Cash	1.5%	Neutral	Local rates have peaked
Global*		**+**	**Offshore diversification attractive**
Equity	5.0%	+	Best option for real returns
Bonds	-1.0%	–	Record low yields = low returns
Cash	-1.0%	–	Cash is trash

* The international return expectations above are in US dollar terms; any rand depreciation will add to returns in rands.

Note: These are long-term real returns expected over the next five years, as at the end of June 2017.