A Market and Economic Update

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Contents

Newsflash 3
Economic Update 3
Rates 7
STANLIB Money Market Fund.. 7
STANLIB Enhanced Yield Fund.. 7
STANLIB Income Fund 7
STANLIB Extra Income Fund.. 7
STANLIB Flexible Income Fund 7
STANLIB Multi-Manager Absolute Income Fund.. 7

Newsflash

There will be no commentary from Paul Hansen for this week.

Economic Update

1. **The seasonally adjusted ABSA Purchasing Managers' Index (PMI) slipped back by 1.9 index points to 47.9 index points in June from 49.8 in May 2018 which brings the index back below the key 50-point mark.**
2. **Foreign portfolio investment flows into emerging markets have changed dramatically in recent months, hurt by a broadening range of factors.**
3. **US added an impressive 213 000 jobs in June 2018 but unemployment rose to 4% and wages were up only 2.7%y/y. Private sector has added jobs in each of the past 100 months.**
4. **Kenya's economy off to a good start in 2018 despite subdued credit growth.**

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1. **The seasonally adjusted ABSA Purchasing Managers' Index (PMI) slipped back by 1.9 index points to 47.9 index points in June from 49.8 in May 2018 which brings the index back below the key 50-point mark.**

   Among the PMI's sub-components in June, arguably, the most disappointing result of the survey was another marked decline in the index tracking expected business conditions in six months' time. The index declined for a fourth consecutive month to 55.7. This is a staggering 23.4 points below the multi-year record high level of 79.1 recorded in February this year and below the average level recorded in 2017 but still above the neutral 50-point mark. The new sales orders indexed declined by 2 points from 51.5 to 49.1 suggesting that exports decreased during the month. Purchasing Commitments stabilized in June and remained unchanged at to 45 index points. The employment index lost ground in June and shed 3.2 points to 46 from 49.2 in May. The inventories index edged lower in June after a 3 point improvement in May. The index has now been stuck below the neutral 50-point mark for just over a year. The business activity index moved lower for a second month in a row from 47.7 in May to 45.8 in June. The purchasing prices index increased substantially in June to 73.6 up from 65.5 in May. This was most likely as a result of the (on average) weaker rand exchange rate compared to May and the hefty fuel price increases over the recent months.

   Overall, this suggests that the sector is unlikely to stage a solid recovery in Q2 2018 after a contraction in output in Q1 2018. The latest decrease in the PMI reading is discouraging with several factors dampening optimism, in particular, the return of load shedding in recent weeks along with concerns about an intensification of the trade war between the US and the rest of the world.

   Finally, rising cost pressures may also be weighing down expectations based on the substantial increase in the purchasing price index. It is important to note though that the current level of the expected business conditions in six months' time index remains above the neutral 50-point mark meaning that respondents still expect conditions to improve from the current weak environment – just significantly less so than before.

2. **In 2017 emerging markets attracted more than $100 billion in foreign portfolio investment that was fairly evenly split between equities and debt (largely government bonds).** While this was not a record level of inflows, it was well in excess on the inflows recorded in 2015 and 2016 combined, helped by synchronized world growth, a relatively dovish approach to monetary policy normalisation by the Federal Reserve and subdued inflation in most parts of the world.

However, in 2017 this all changed, with emerging markets experiencing -$3.4 billion in net outflows of foreign portfolio investments during the first half of the year. Unsurprisingly, many emerging market currencies weakened appreciably in the first half of the year against a stronger Dollar, with the Rand the fourth weakest in the basket of EM currencies, after the Brazilian Real, Turkish Lira and Argentinian Peso.

This change in sentiment towards emerging markets appears to have intensified somewhat over the past six months as the list of global economic concerns have broadened. These concerns now include President Trump's approach to US trade policy, which appears to be firmly in favour of increased trade protection. This has already started to negatively impact the pace of growth in world trade. A sustained slowdown in global trade would weaken global growth, hurting many emerging economies that rely heavily on export earnings. Secondly, there has been a marked increase in the international oil price, which is pushing consumer inflation higher in many countries thereby potentially undermining key components of global economic activity. Thirdly, there is an expectation that global interest rates will continue to rise as the major central banks push ahead with their efforts to try and normalise monetary policy. This has been led by the United States, but on 14 June the ECB indicated their intention to stop QE by year-end and look to raise interest rates in 2019. A systematic increase in global interest rates will lead to higher debt servicing costs, and a further moderation in global liquidity. This is also likely to reflect in increased risk aversion, which could undermine the economic performance of vulnerable emerging economies.

It can be argued that some desynchronisation of global growth was to be expected in 2018/2019 as business cycles are seldom perfectly correlated across countries and regions for an extended period. Furthermore, it is not a surprise that the major central banks have become increasingly anxious to try and normalise monetary policy. However, the escalation of the "global trade war" in an environment of growing risk aversion appears to be exacerbating the pace of desynchronization, undermining business confidence in key economic regions, most notably the European Union and the more vulnerable emerging economies.

More positively, many emerging market currencies are now under-valued, and could attract renewed foreign investment if the current concerns about the performance of the world economy improve. It does, however, feel like this would be a relatively short-term respite.

3. In June 2018, the **US unemployment rate rose to 4.0%, up from 3.8% in May.** This was fractionally worse than market expectations, which was for the unemployment rate to remain unchanged at 3.8%. This month US unemployment rate was pushed higher by a pick-up in the labour market participation rate, which rose to 62.9% from 62.7% in May. Overall, the participation rate remains extremely low on a trend basis for a variety of reasons, but needs to be watched for any signs of a sustained increase as this would start to adjust wage growth expectations.

   Non-farm payrolls rose by a solid 213 000 jobs in June 2018, which was above market expectations for an increase of 195 000 (Bloomberg). Over the past 6 months, job gains have averaged a remarkable 215 000 per month. The level of US employment is an impressive 10.0 million above the peak prior to the global financial market crisis. During the financial market crisis the US lost a total of 8.7 million jobs. Consequently, the **US has created well over 18 million jobs since the financial crisis ended.** The payroll data for April and May 2018 was revised up by a combined 37 000 jobs.

   The private sector gained 202 000 jobs in June 2018, after gaining a revised 239 000 jobs in May 2018. The private sector had gained employment in each of the past 100 months at an average of 193 000 jobs a month and is at a record high, comfortably surpassing the previous peak in January 2008.

In May 2018, average hourly earnings for all employees on private nonfarm payrolls rose by 5 cents to $26.98. **Over the year, average hourly earnings have increased by 72 cents, or 2.7%.** The growth in US wages remains very modest given the low unemployment rate, record number of job openings and ongoing rate of monthly job gains. However, wage is expected to continue to trend higher, leading to a sustained upward bias in consumer inflation and interest rates. In that regard it is interesting to see that the number of job openings now exceeds the number of people that are unemployed. It will also be important to watch the labour market participation rate. A meaningful increase in participation would argue for wages to continue to rise at a fairly gradual pace

Overall, the latest US labour market report is fairly robust despite the rise in the unemployment rate. The strengths in the report include the overall gain in employment, the strong upward revision to the previous two months job gains, and the impressive gain in manufacturing employment (including metal products). Furthermore, job openings were recorded at a record high of 6.7 million in April 2018 (data lags). The disappointments in the report included the increase in the unemployment rate and the lack of acceleration in wages. The trend growth in jobs gains coupled with solid business activity data, strong confidence indicators, as well as Trump's fiscal stimulus package, should encourage the Federal Reserve to continue to hike interest rates. Especially since the US inflation rate is now up at 2.8%. Consequently, we still expect the US Federal Funds Target Rate to increase two more times in 2018, and by 25bps on each occasion, with the next rise taking pace in September 2018.

4. **Kenya's economy started of the year on a good note with a reading of 5.7% y/y in Q1 2018 from 5.3% y/y in Q4 2017 and 4.8% y/y** in Q1 2018.

   Agriculture grew at its fastest rate in almost two years at 5.2% well above fourth quarter's figure of 1.4%. The sector has recovered from a drought which started in 2016. There have been good rains in the region recently and because agriculture is such big contributor to overall GDP (25.4%) and employment it is expected to be a meaningful driver of growth this year.

   Manufacturing picked up in line with PMI data and accelerated to 2.3% after contracting by -0.4% in the previous quarter. This was the highest rate of expansion in manufacturing since the third quarter of 2016. The latest PMI reading of 55.4 suggests that expansion should continue in the sector after it contracted in the second half of 2017 from the election impasse.

   Construction has slowed somewhat but is still robust at 7.2% driven by infrastructure investment. It was largely expected as major projects in the country are close to completion. In the fourth quarter of 2017 growth was 10.9%.

   Surprisingly **finance and insurance activity continued to pick up and accelerated to 2.6% from 2.3% in the final quarter of 2017**. However it is worth noting that the sector was robust and growing above 8% before the interest rate cap regulation which stipulates maximum and minimum lending and deposit rates that banks can charge. Credit extension to the private sector has been subdued ever since.

   Wholesale and retail trade picked up somewhat to 6.3% from 6.2% in the two preceding quarters. The sector has held up quite well considering that supply of credit has fallen sharply and stayed low.

   Tourism activity has encouragingly reached its highest levels in 6 years. The recovery in tourism since the Westgate Mall attacks has been slow but steady with confidence being regained amongst tourists. However it has to be deliberated as how much of a drag the strong Kenyan Shilling has been on tourism as the currency is overvalued which makes visiting Kenya relatively expensive.

Growth is expected to accelerate to 5.1% supported by the agricultural sector and infrastructure investment as well as tourism (one of larger foreign exchange earners). However the interest rate cap and strong currency are a drag on overall growth. Budget and current account deficits have remained stubbornly wide in the country and fiscal consolidation could further hold the economy back.

Please follow our regular economic updates on twitter ***@lingskevin***

Kevin Lings, Laura Jones & Kganya Kgare

(STANLIB Economics Team)

Rates

These rates are expressed in nominal and effective terms and should be used for indication purposes ONLY.

STANLIB Money Market Fund	
Nominal:	6.44%
Effective:	6.63%

STANLIB is required to quote an effective rate which is based upon a seven-day rolling average yield for Money Market Portfolios. The above quoted yield is calculated using an annualised seven-day rolling average as at 06 July 2018. This seven- day rolling average yield may marginally differ from the actual daily distribution and should not be used for interest calculation purposes. We however, are most happy to supply you with the daily distribution rate on request, one day in arrears. The price of each participatory interest (unit) is aimed at a constant value. The total return to the investor is primarily made up of interest received but, may also include any gain or loss made on any particular instrument. In most cases this will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of reducing the capital value of the portfolio.

STANLIB Enhanced Yield Fund	
Effective Yield:	7.80%

STANLIB is required to quote a current yield for Income Portfolios. This is an effective yield. The above quoted yield will vary from day to day and is a current yield as at 29 June 2018. The net (after fees) yield on the portfolio will be published daily in the major newspapers together with the "all-in" NAV price (includes the accrual for dividends and interest). This yield is a snapshot yield that reflects the weighted average running yield of all the underlying holdings of the portfolio. Monthly distributions will consist of dividends and interest. Interest will also be exempt from tax to the extent that investors are able to make use of the applicable interest exemption as currently allowed by the Income Tax Act. The portfolio's underlying investments will determine the split between dividends and interest.

STANLIB Income Fund	
Effective Yield:	8.29%
STANLIB Extra Income Fund	
Effective Yield:	7.73%
STANLIB Flexible Income Fund	
Effective Yield:	6.09%
STANLIB Multi-Manager Absolute Income Fund	
Effective Yield:	7.40%

Collective Investment Schemes in Securities (CIS) are generally medium to long term investments. The value of participatory interests may go down as well as up and past performance is not necessarily a guide to the future. A schedule of fees and charges and maximum commissions is available on request from the company/scheme. CIS can engage in borrowing and scrip lending. Commission and incentives may be paid and if so, would be included in the overall costs." The above quoted yield will vary from day to day and is a current yield as at 06 July 2018.

For the STANLIB Extra Income Fund, Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. The historical yield over the last 12 months is reported for the STANLIB Multi-Manager Absolute Income Fund.

Disclaimer

The price of each unit of a domestic money market portfolio is aimed at a constant value. The total return to the investor is primarily made up of interest received but, may also include any gain or loss made on any particular instrument. In most cases this will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of reducing the capital value of the portfolio. Collective Investment Schemes in Securities (CIS) are generally medium to long term investments. The value of participatory interests may go down as well as up and past performance is not necessarily a guide to the future. An investment in the participations of a CIS in securities is not the same as a deposit with a banking institution. CIS are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from STANLIB Collective Investments (RF) (Pty) Ltd (the Manager). Commission and incentives may be paid and if so, would be included in the overall costs. A fund of funds is a portfolio that invests in portfolios of collective investment schemes, which levy their own charges, which could result in a higher fee structure for these portfolios. Forward pricing is used. Fluctuations or movements in exchange rates may cause the value of underlying international investments to go up or down. TER is the annualised percent of the average Net Asset Value of the portfolio incurred as charges, levies and fees. A higher TER ratio does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER cannot be regarded as an indication of future TERs. Portfolios are valued on a daily basis at 15h00. Investments and repurchases will receive the price of the same day if received prior to 15h00. Liberty is a full member of the Association for Savings and Investments of South Africa. The Manager is a member of the Liberty Group of Companies.

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