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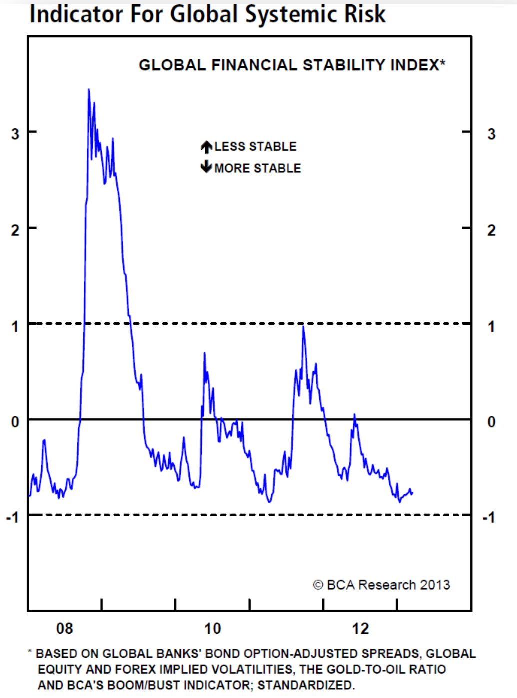
International

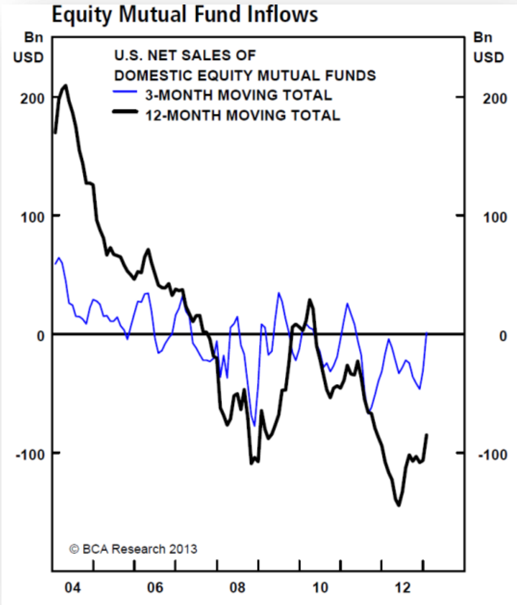
Steady as we go

The global economy appears to be moving into an environment of low growth, but with more systemic stability. Current underlying growth has not changed much with Europe remaining in recession, the US economy still strengthening and China rebounding. Prospects certainly appear more favourable now than 6 months ago and central bankers seem committed to avoiding flare-up's in systemic risk. The US is on track to keep rates low for a while in order to ensure a sustainable economic recovery. Housing and Jobs data in the US continue to improve which should have a positive impact on capital expenditure by US corporates. We, therefore, remain fairly bullish on equities given the positive growth assessment and expect a further contraction in equity risks premiums.



Source: BCA Research, March 22, 2013

Globally, systemic risk levels have continued to improve as indicated by this chart due to continued QE and less volatility in bond spreads and currency markets.



Source: BCA Research, March 22, 2013

Further positive factors supporting equities is renewed interest from retail investors buying more equities, having stopped cashing in their equity mutual funds; largely driven by the wealth effect due to increasing house prices and more job security. This chart shows that the turnaround is still very much in its infancy!

Stronger US economic growth will be accompanied by a stronger dollar and more investment inflows into the US, however, this eventually could hurt US profits and stock prices down the line but we think this risk is not imminent.

The table below, highlights, the upward trending forecast growth rates for a number of large economies, even in troubled Europe, from a low base, of course. An important factor in the survey is that the forecasts are from a fairly broadly based spectrum of economists and not just one or two.

The Economist poll of forecasters, March averages (previous month's, if changed)

	Real GDP %changed average			Consumer prices % change		Current account % of GDP	
	2013		2014	2013		2013	
Australia	2.8	(2.7)	3.1	2.6	(2.7)	-3.8	(-4.6)
Belgium	0.2	(0.1)	1.1	1.9		-0.7	(-0.1)
Britain	0.8	(0.9)	1.5	2.7	(2.5)	-2.5	(-2.7)
Canada	1.9		2.3	1.7	(1.6)	-3.5	(-3.1)
France	0.1		0.8	1.6	(1.5)	-1.7	
Germany	0.7		1.5	2.0	(1.9)	5.3	(5.8)
Italy	-1.1	(-1.0)	0.4	2.1	(2.0)	-07	(-09)
Japan	1.0		1.4	0.1	(-0.1)	0.9	(1.0)
Netherlands	-0.6	(-0.4)	0.7	2.3	(2.4)	8.5	(8.8)
Spain	-1.6		-0.1	2.3		-08	(-05)
Sweden	1.3	(1.4)	2.3	0.8	(0.9)	7.0	(6.7)
Switzerland	1.1	(1.3)	1.6	0.2	(0.3)	11.5	(11.1)
United States	2.0	(1.9)	2.6	1.8		-2.6	(-2.8)
Euro Area	-0.2	(0.1)	0.8	1.9		1.2	(1.1)
South Africa	2.8		n/a	4.8		-5.4	
South Africa (RMB forecast)	2.2		3.5	5.7		-5.8	

Sources: Bank of America, BNP Paribas, Citigroup, Commerzbank, Decision Economics, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, ING, JPMorgan Chase, KBC Bank, Morgan Stanley, RBC, RBS, Schroders, Scotia Capital, Société Générale, Standard Chartered, UBS

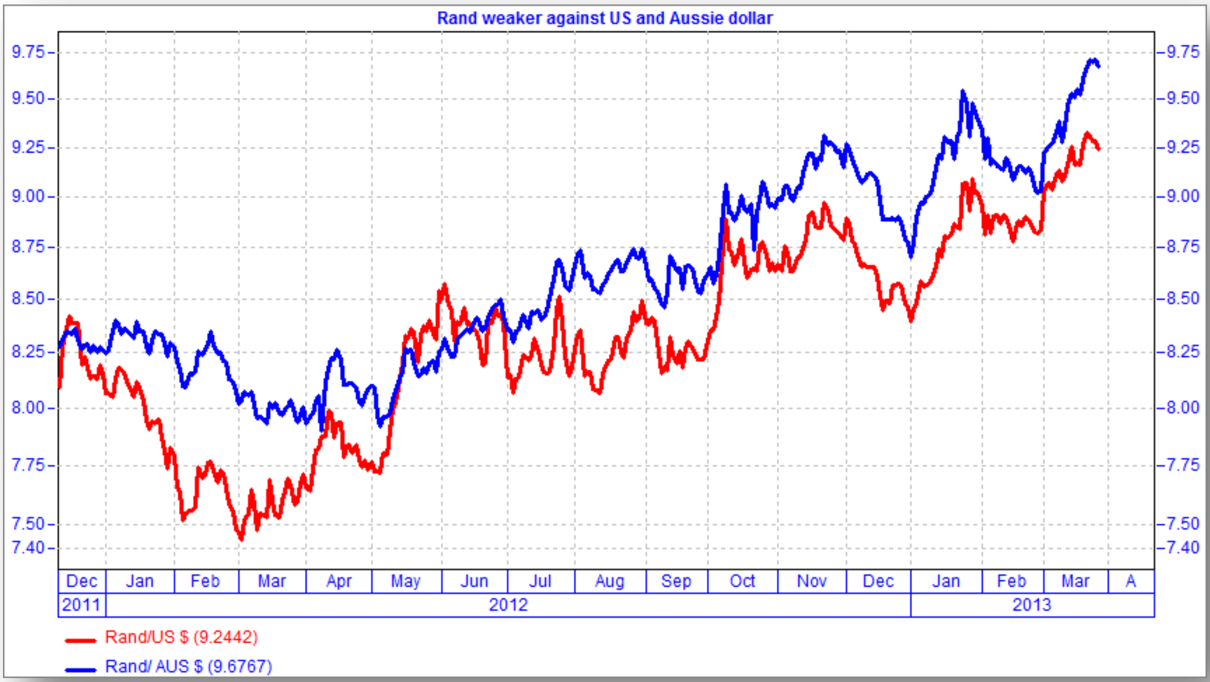
Source: Economist, 9th March 2013

Meanwhile in Europe, a decision by Cypriot banks to 'tax' deposit holders' money in excess of €100 000 in some banks, has largely been ignored by markets. Markets came off a bit after the announcement, but have since rebounded. Given the relative small size of that economy, we expect markets to continue to ignore the potential risk.

The more concerning factor is the way this was handled by Europe and the risk is that a dangerous precedent has been set.

South Africa

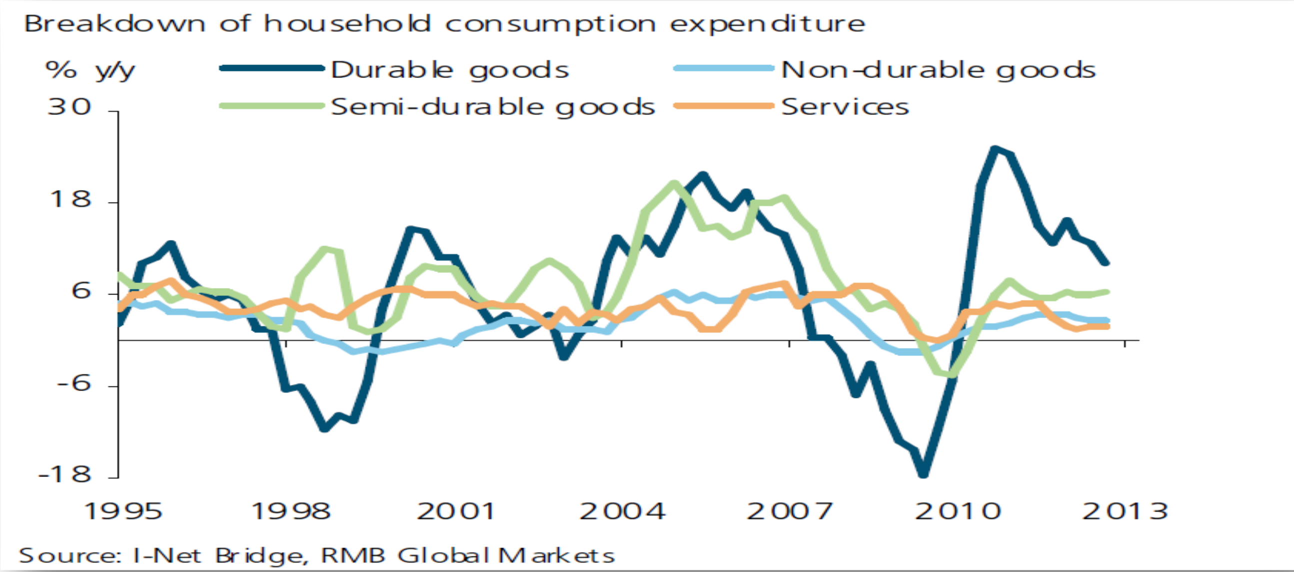
Locally, the big story has been a substantially weaker Rand against the dollar, moving from 8.40 to the dollar to currently 9.27 since the beginning of the year; a 10% drop. More importantly, the rand has weakened against other high yielding commodity currencies, indicating substantially negative sentiment and deteriorating fundamentals, particularly on the political and labour fronts. Also, investors remain on high alert regarding foreign inflows that are funding the current account deficit. With global first world economies improving, we could experience an outflow of funds and a further weakening of the rand. This will force the SARB to increase rates, as inflation would rise, which could derail our fragile growth trajectory.



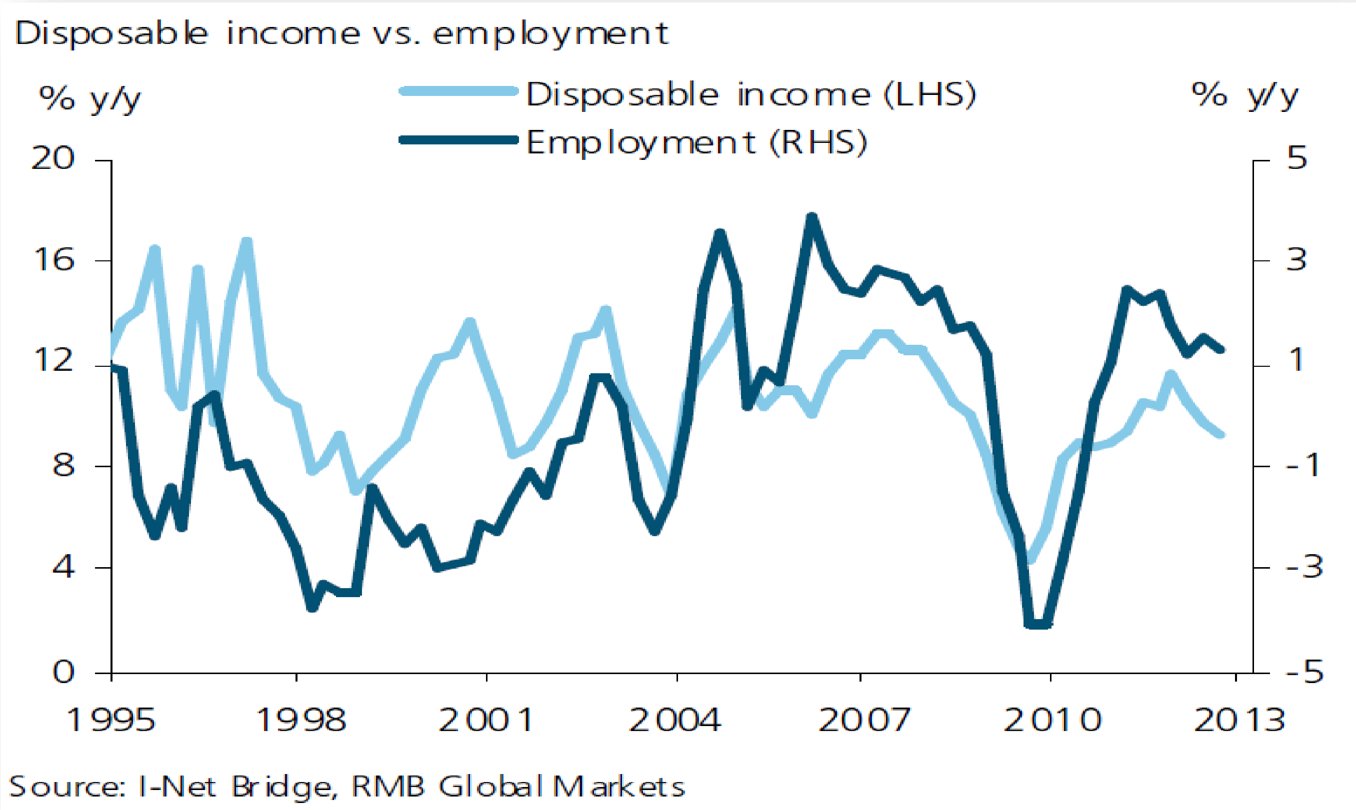
Source: I-Net Bridge

The weaker rand, on the other hand, should provide welcome relieve to the manufacturing sector despite prevailing cost pressures but will negatively impact retailers and consumers.

Recent results from retail stocks have failed to meet expectations, suggesting the consumer is under pressure due to high levels of debt and inflationary pressures. The charts below from RMB, 19 February 2013, indicate that household expenditure on durable goods is declining sharply and that disposable income and employment data is deteriorating. We however expect that the next round of wage increase negotiations will be settled at levels above inflation (particularly in the public sector), which should avoid spending on semi durables and non-durables falling off a cliff.

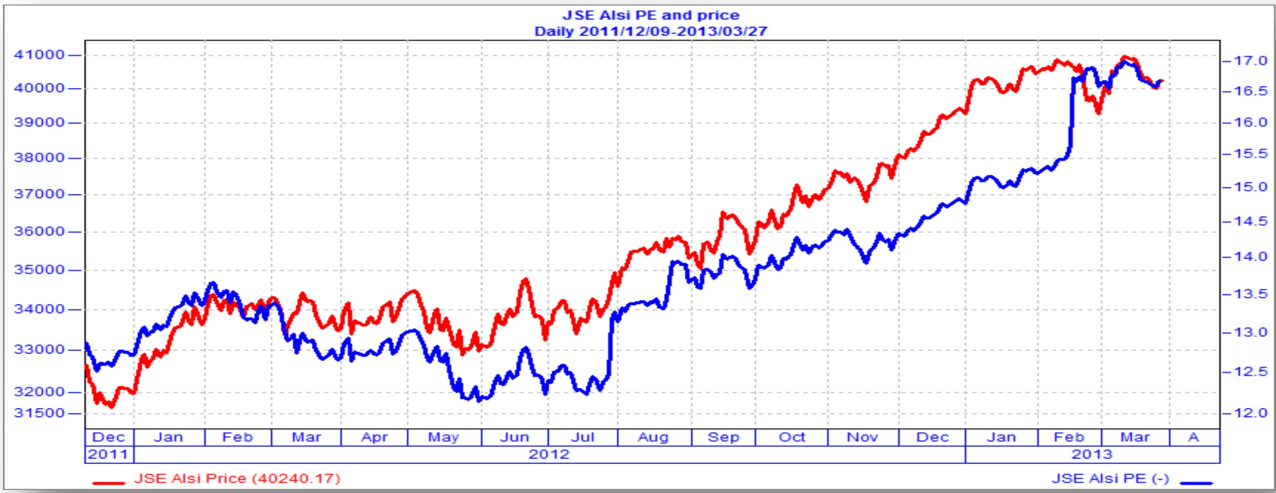


Source: Rand Merchant Bank, 19 March 2013



Source: Rand Merchant Bank, 19 March 2013

On the investment side, stocks have had a solid start to the year with the JSE All Share up 2.5% year to date. More importantly though, the market has seen a substantial 13% increase in its Price Earnings ratio, indicating a rerating in the market partly driven by an expectation of a recovery in earnings on the mining front and outperformance by large capitalisation rand hedge stocks. We anticipate no further material rerating as the market appears fully priced on a short term basis.



Source: I-Net Bridge

Rand weakness will help certain stocks on the earnings front and we expect some profit upgrades to come through in due course, on miners and certain rand hedges. Given the above, we do not envisage a sharp correction in our market and that we will post modest returns for the next quarter, largely driven by earnings. The main risks remain a blow out in Europe, slower growth in China and foreign disinvestment from emerging markets, with funds moving into developed markets. This could cause further rand weakness accompanied by more inflationary pressures

In conclusion

- The global economy is characterised by low growth but within a more stable environment.
- Authorities in Europe are committed to prevent a flare-up of systemic risk [despite Cyprus] and the Fed will continue to keep rates low for a while to ensure continued economic growth.
- Forecast growth rates for global economies, Europe included, are being revised upwards by a greater number of economists compared to a few months ago.
- We think the issue around banks in Cyprus "taxing" deposit holders will have little impact on markets, if the dangerous precedent that has been set does not flow over to other European countries. We expect Russia to not allow the Cypriot banks to fail.
- Locally, rand weakness against both the dollar and other commodity currencies indicates deteriorating fundamentals and a more negative view on politics and labour.
- A persistent current account deficit could cause further currency weakness and more inflationary pressures.
- Consumers remain under pressure with spending on durable goods in particular being impacted.
- We believe the market is "full" in the short term and that a further expansion in multiples is unlikely; but that the risk of a derating is also unlikely, given expected upward revisions in earnings due to rand weakness.
- Risks to our investment strategy remain a blow out in Europe, slower growth in China and foreign disinvestment.

Sincerely

Chris

Chris Botha

Dave

Dave Eliot

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