IMARA INVESTING IN AFRICA

Asset Management

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Developed markets growth synchronising

International

The economic outlook for most developed markets continues to improve. The latest purchasing managers indices for Japan, Europe and the UK all jumped by a significant margin while that of certain emerging markets are still deteriorating.

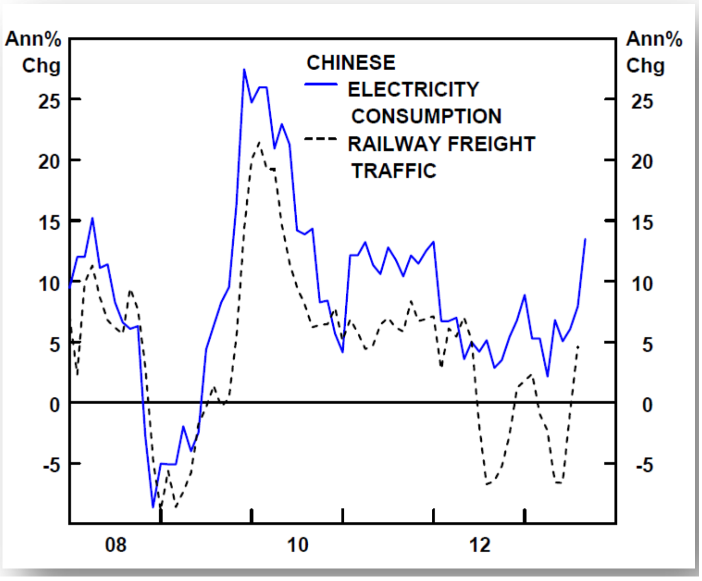
We anticipate that these contrarian trends will continue for a while. Structural reforms amongst some large emerging economies are underway to realign their economies to be less dependent on weaker currencies to drive growth, with the focus on a more inclusive consumer orientated model. Urbanisation will continue to be an important driver of growth in emerging markets, which to some extent should underpin those economies. .

Global manufacturing PMI increased by +0.8 to 51.7 in August. .This points to global GDP of 4% quarter on quarter in Q3.

Source: Deutsche Bank Research September 2013

From an investment point of view, the major current themes are monetary reflation and increased appetite for risk, given the more positive economic outlook. This could suggest multiple expansion and improved corporate profitability, particularly in developed markets. Historically, the end of the first phase in an equity bull market is multiple expansion ahead of a recovery in earnings. Given that 80% of global PMI's in August were trending upward and that corporate commentary has turned more bullish, we expect upward revisions in analysts' forecasts to follow suit. The Fed and other authorities remain extremely accommodative with stimulus if needed and we expect that the appetite for risky assets such as equities will remain robust. Emerging market equities also, despite having outperformed develop market indices over the past couple of years, could still do well as recent currency weaknesses should benefit corporate profits and reduce earnings multiples to more realistic levels. If global economic growth turns out better than expected, or forecasts are revised upwards, PE ratios could continue to expand as it will cause further steepening of yield curves indicating easier monetary policies relative to economic growth and potentially higher corporate profits.

A synchronised upturn in the global economy would limit investment returns in fixed interest investments as inflation should pick up in due course.



Anecdotal signs that China is still growing strongly with positive trends in electricity consumption and freight traffic.

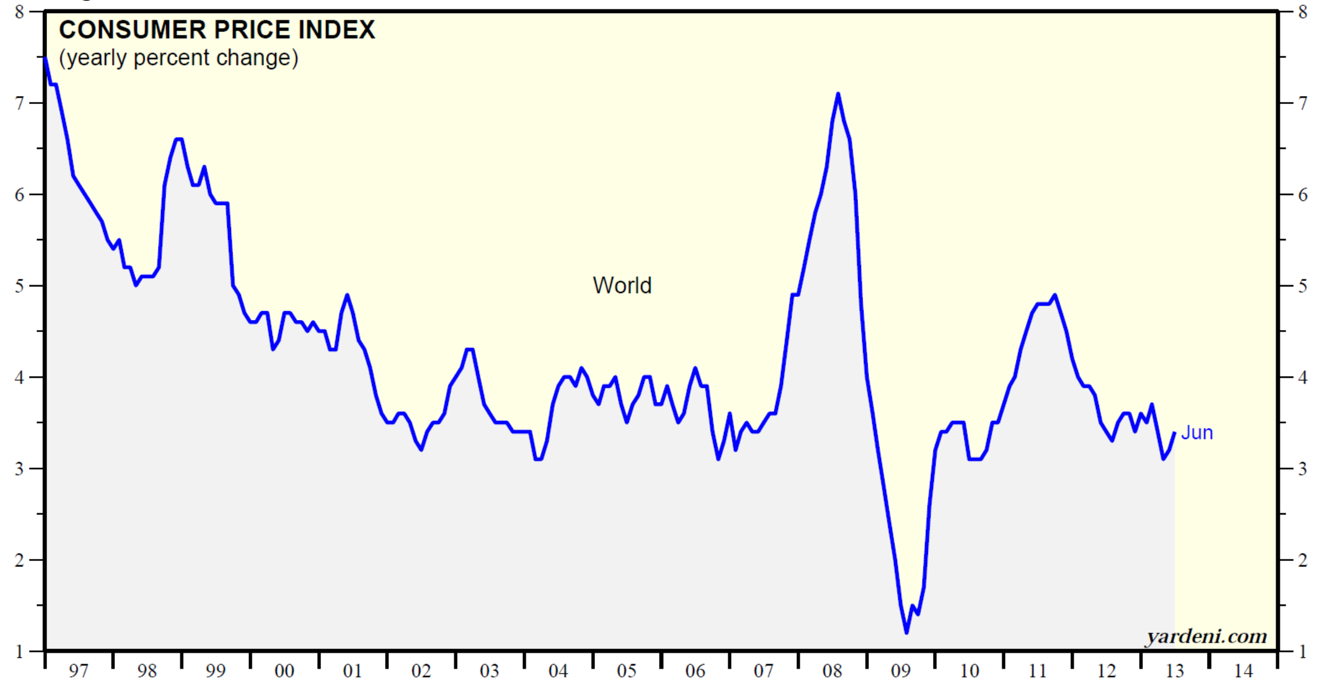
Source: BCA Research, 20th September 2013

Defying the sceptics, the Chinese economy continues to surprise on the upside with a strong recovery witnessed in electricity consumption and railway freight traffic. We expect the economy to sustain growth of around 7% due to the fact that only 50% of the population are urbanised. Furthermore, the Chinese government has been gradually easing monetary policy in order to assist with the supply side reforms.

In the US, data continues to show a broadening of the economic recovery but also that unemployment remains at unacceptable levels at just over 7% given the Fed's target of 6.5% levels – hence the Fed's decision to postpone tapering of its QE programme which we expected, as mentioned in previous communiqués. Growth in private credit extension also remains weak which is largely a function of job growth despite the Fed's efforts of providing "cheap money". It's therefore likely that some form of stimulus will remain for a while – it is also likely that the Fed will not "guide" the market on when QE will be slowed, but rather just quietly do so when it deems fit - so as not to upset or surprise investment markets.

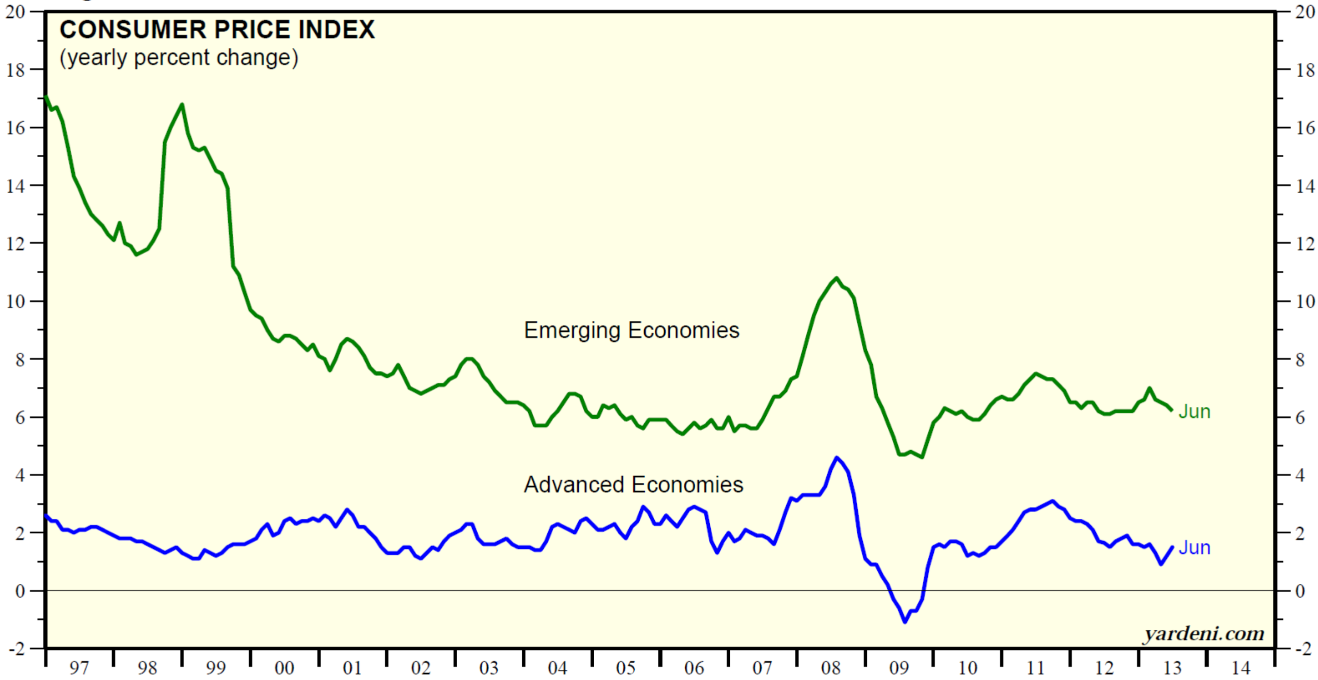
There are some risks to our positive outlook though. Given the more positive outlook on growth, if inflation did unexpectedly turn upwards, it would send severe shockwaves through the entire financial system, both to policymakers and investors which could make bonds and equities vulnerable to a sell-off, less so for equities, but a sell-off nevertheless. So far, there are no signs of inflationary pressures yet, as the recovery in broad consumer expenditure and appetite for credit remains anaemic in both developed and emerging economies. Another risk is that as equity multiples have expanded handsomely, there could be a risk of contraction if the inflection point of earnings revisions is not reached, or if reported results disappoint which might suggest that the recovery in global growth is faltering. But, so far so good, with things looking positive for equities going forward despite very good returns year to date in 2013.

Figure 1.



Source: International Monetary Fund (IMF).

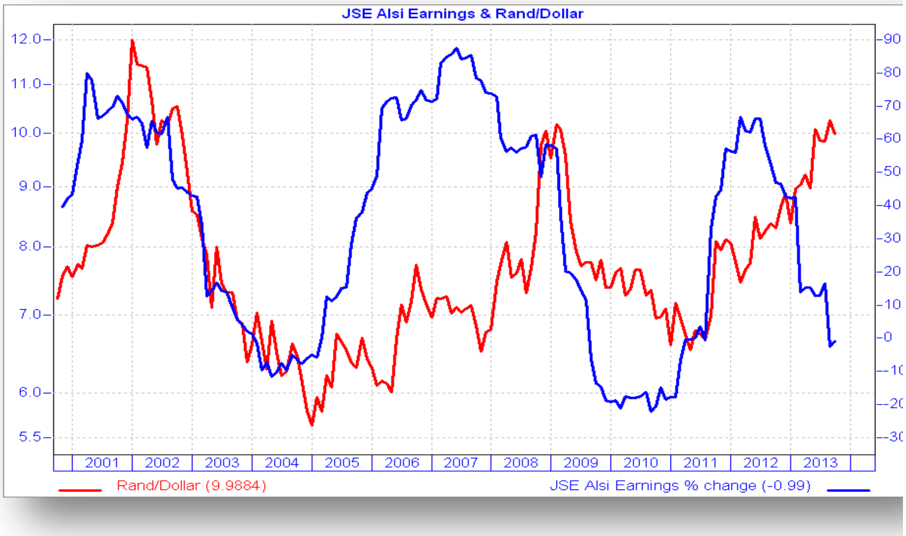
Figure 2.



Source: IMF.

IMARA INVESTING IN AFRICA

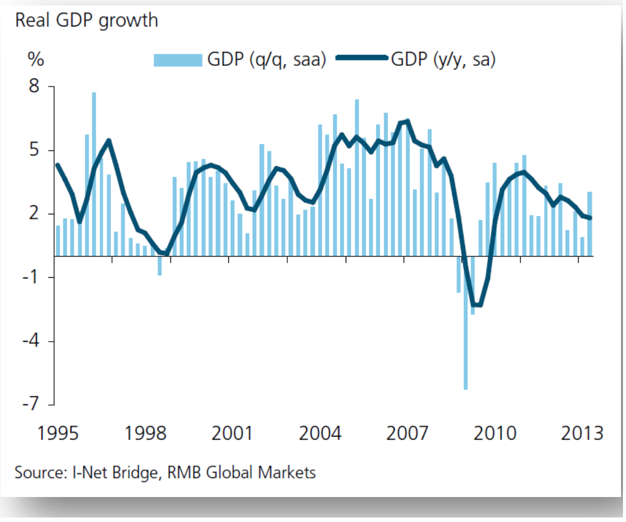
South Africa



The rand has remained relatively weak against the dollar reaching a low of R10.38 against the greenback towards the end of August - in line with most emerging market currencies due to US tapering concerns. The currency regained some ground in September reaching R9.57 against the dollar but has subsequently weakened again and was trading at R10.06 at the time of writing. We expect volatility to continue in the near term as markets await more clarification on the looming US debt ceiling and tapering by the Fed – a stop or reversal would be catastrophic.

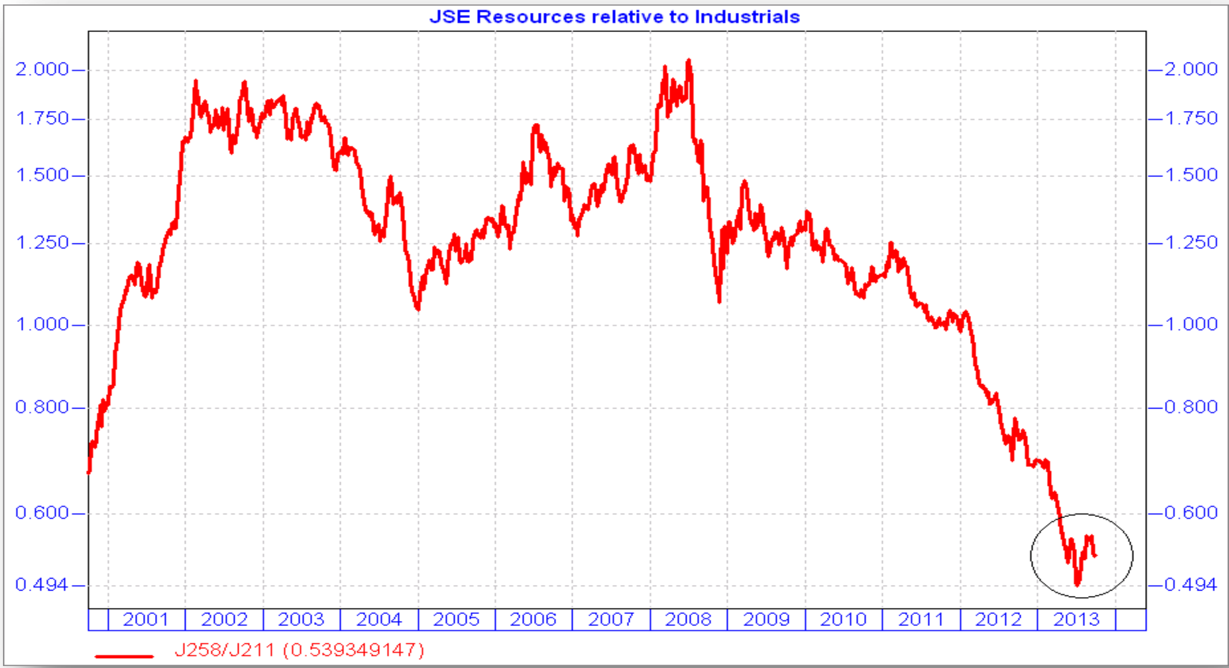
The rand has weakened 19% year to date against the dollar.
History tells us that stronger global growth should ultimately be positive for the rand as exports will increase and risk aversion typically decreases. Global leading indicators are improving steadily, including Europe, our biggest trading partner. So, although weakening again, the rand is certainly not a one way bet! As can be seen in the above chart, the All Share index appears to be discounting upward revisions in earnings due to the weak rand.

The JSE has delivered a solid return of 13% year to date supported by very good reported earnings by banks and industrial counters. The market reached another record high of 43752 in September following a weaker rand and a recovery in commodity prices. The market appears fully valued on a current multiple of 18x and dividend yield of 2.8%. We expect the weak rand to provide a fillip to rand hedge shares (about 2/3rds of the JSE's market capitalisation) in the coming months and expect upward revisions in earnings forecasts to be forthcoming which will reduce the market PE to more reasonable levels. Despite the market's high rating, we expect overall earnings growth of approximately 16% from financials and industrial counters for the next year which we view as a reasonably conservative potential return from this market segment over this period – we expect no further rerating in the market. Capital outflow due to foreign selling remains the single largest threat to our market due to the potential reverse in the carry trade as investors chase potentially higher yields in developed markets. Foreign ownership of the JSE remains uncomfortably high.

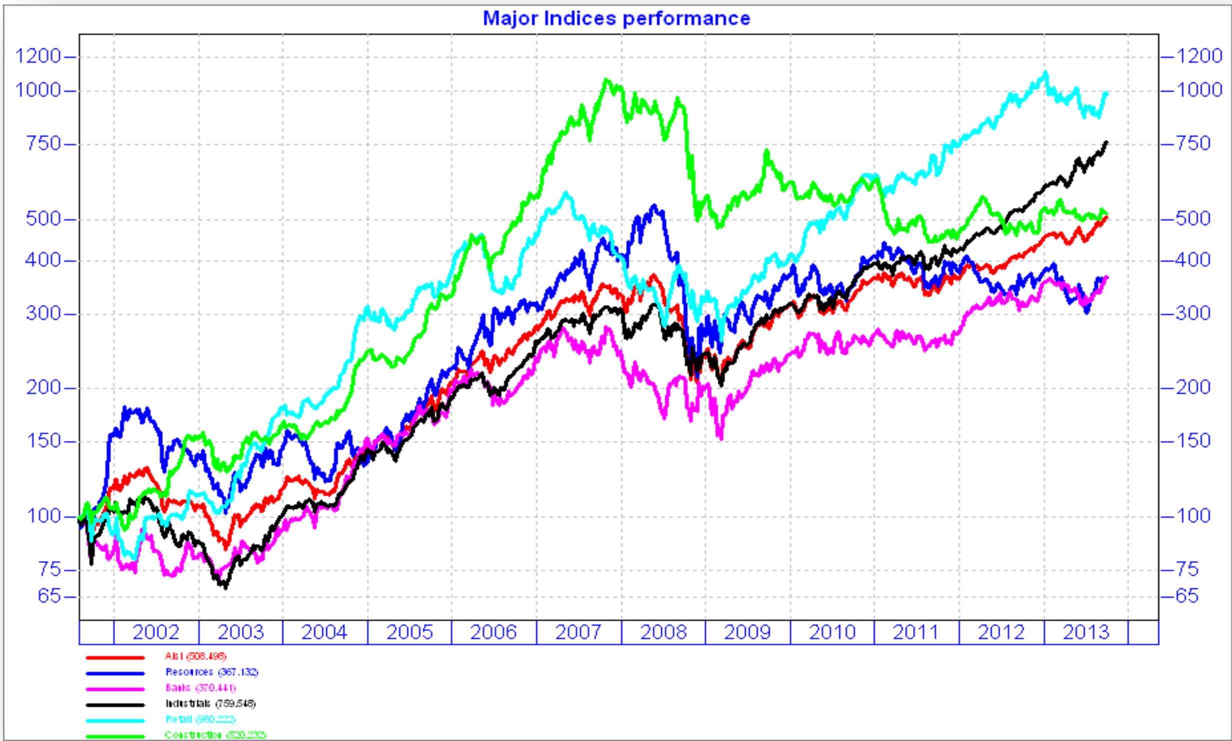


Local GDP growth forecasts have been steadily declining and consensus currently stands at 1-8% to 2.0% for 2013 mainly due to slowing household expenditure and stalling fixed investment by government. For this reason, despite the weakening rand, we remain fairly optimistic on the inflation outlook and for local interest rates not to start moving up before the second half of 2014(at best), but this will be dependent on the magnitude of potential weakness in the rand.

Source: RMB Global Research, 19th September 2013



Given the improvement in the global economic outlook and the weaker rand, logic dictates that one should be overweight resource counters. As can be seen in the chart above, sector rotation out of industrials into resources started in July this year, but has slowed somewhat. We remain cautious whether this trend will be reinforced in the short term. But on a longer term view, we believe given the global backdrop that exposure to this sector should at least be maintained and depending on the rate of global recovery, be increased in due course.



In conclusion:

- The economic outlook for most developed markets continues to improve whilst growth in most emerging markets are slowing as structural reforms are underway.
- Major current themes include monetary reflation and increased appetite for risk given the positive economic outlook – this should underpin current equity valuations.
- The Fed and other authorities remain extremely accommodative in the event of the global recovery losing momentum.
- The Chinese economy continues to surprise on the upside with a strong recovery witnessed in electricity consumption and railway freight traffic.
- There are some risks to our positive outlook though. Given the more positive outlook on growth, if inflation did unexpectedly turn upwards, it would send severe shockwaves through the entire financial system, both to policymakers and investors which could make bonds and equities vulnerable to a sell-off.
- The rand has remained relatively weak reaching a low of R10.38 against the dollar and has weakened 19% year to date.
- Global leading indicators are improving steadily, including Europe, our biggest trading partner. So, although the rand remains weak, it certainly is not a one way bet!
- The market appears fully valued on a current multiple of 18x and dividend yield of 2.8%.
- However, we expect the weak rand to provide a fillip to rand hedge shares (about 2/3rds of the JSE's market capitalisation) in the coming months and expect upward revisions in earnings to be forthcoming which will reduce the market PE to more reasonable levels.
- Local GDP growth forecasts have been steadily declining and consensus currently stands at 1-8% to 2.0% for 2013 mainly due to slowing household expenditure and stalling fixed investment by government.
- Given the better economic backdrop, sector rotation into commodity based counters should gain more traction over the medium to long term.

Sincerely

Chris

Chris Botha

Dave

Dave Eliot