IMARA INVESTING IN AFRICA

Asset Management

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Fewer headwinds

International

Global markets have been experiencing heightened volatility lately due to tapering sound making by the Fed. Investors appear confused regarding the interpretation of on-going comments and guidance by the Fed on when exactly QE will come to an end or might be slowed. The accompanied rise in US treasury yields have been the main catalyst behind the sell-off in emerging market assets and corresponding currency weakness within these markets. In essence, this is a form of reversal of the carry trade that has kept emerging market currencies afloat for a long period of time due to low yields in developed markets.

Tapering of QE will raise expectations for rate hikes in developed markets, particularly in the US, which will cause capital flight out of emerging markets into developed markets in pursuit of yield. We are still of the opinion that tapering, if any, will be executed in an orderly fashion as the global economic recovery, which continues to gain momentum, remains fragile, particularly on the employment front.

New Bank of England (BOE) governor, Mark Carney, in his inaugural speech to business leaders recently stated that the bank could keep interest rates at record lows even if unemployment fell to below 7 % (currently 7.8%). He further stated that the BOE would relax liquidity requirements on banks once they met their capital target which would potentially provide approximately £90bn of additional credit to consumers in the real economy.

On the economic front, GDP in the Euro area expanded 0.30% in the second quarter of 2013 over the previous quarter, as reported by Eurostat, with Germany and France leading the recovery.

This is a marked change in fortunes compared to data from prior reporting periods. Growth in the USA remains on track with auto and home sales remaining buoyant. Weaker than expected home sales data in July reiterated that expansion is not rampant, which supports the argument for a measured approach in tapering of QE. Unemployment in the US dropped to 7.4% in July from 7.6% the previous month, which is still much higher than the 6% target set by the Fed. So, although trending down, and the economy steadily expanding, the rate of growth is certainly no reason for any inflationary concerns or a reason to start hiking rates any time soon, both in the US and other developed markets.

With tapering now largely discounted, in our view, there is scope for US bond yields to retrace some of their recent rise and for markets to stabilise in the near term. However, this is not a certainty with increased geopolitical risks in the Middle East as markets wait for more clarity on whether there will be a military strike on Syria.

From the tabulation it is clear that the major Western markets are relatively highly valued, whilst the Emerging markets reflect the fairly recent sell-off linked to the possibility of a contraction in global QE. This trend is likely to persist until market participants have a clearer idea of the timing and possible magnitude of stimulatory withdrawal.

SELECTIVE INTERNATIONAL P/E RATIOS

	26 June 2007	27 Sep 2007	29 Feb 2008	29 May 2008	26 June 2008	28 Nov 2008	26 Feb 2009	27 Oct 2009	23 March 2010	26 Aug 2010	27 Jan 2011	22 Feb 2012	27 Feb 2013	28 Aug 2013
US	19.6	22.7	15.5	16.4	15.9	11.0	11.3	19.8	20.8	15.1	17.5	15.1	17.2	**17.9**
Japan	22.5	19.5	14.9	16.8	16.4	10.8	13.7	30.2	31.4	16.0	15.9	17.1	15.6	**16. 2**
China											13.2	9.3	8.1	**7.2**
UK	12.0	11.3	10.7	10.6	9.6	8.0	7.5	11.9	12.3	13.6	15.5	10.5	13.9	**14.9**
Germany	15.1	13.5	12.0	13.8	12.7	11.2	9.3	23.6	18.5	14.1	15.5	10.9	11.7	**13.2**
Russia											10.1	6.5	6.0	**5.7**
Australia	14.9	15.8	13.3	14.6	13.9	10.7	10.7	17.3	17.3	13.8	15.3	13.2	18.4	**18.9**
Hong Kong	21.8	25.7	20.8	17.5	15.6	8.9	7.4	18.3	16.1	13.4	15.7	10.8	12.7	**10.8**
India											22.0	18.3	17.3	**12.9**
Singapore	14.8	13.3	10.3	9.6	8.9	5.1	5.6	18.8	18.4	15.1	13.6	8.3	12.1	**12.3**
South Korea	12.3	13.2	11.5	13.2	13.1	7.8	8.0	19.0	19.4	14.3	16.3	13.4	16.2	**14.8**
Brazil											14.3	11.8	13.9	**14.8**
South Africa	16.3	14.6	15.2	15.3	14.3	9.5	8.6	14.1	16.7	16.1	18.6	15.8	16.1	**16.5**

Source: FT 27/08/2013 P/E's relate to a sample of stocks that cover at least 75% of each markets capitalisation

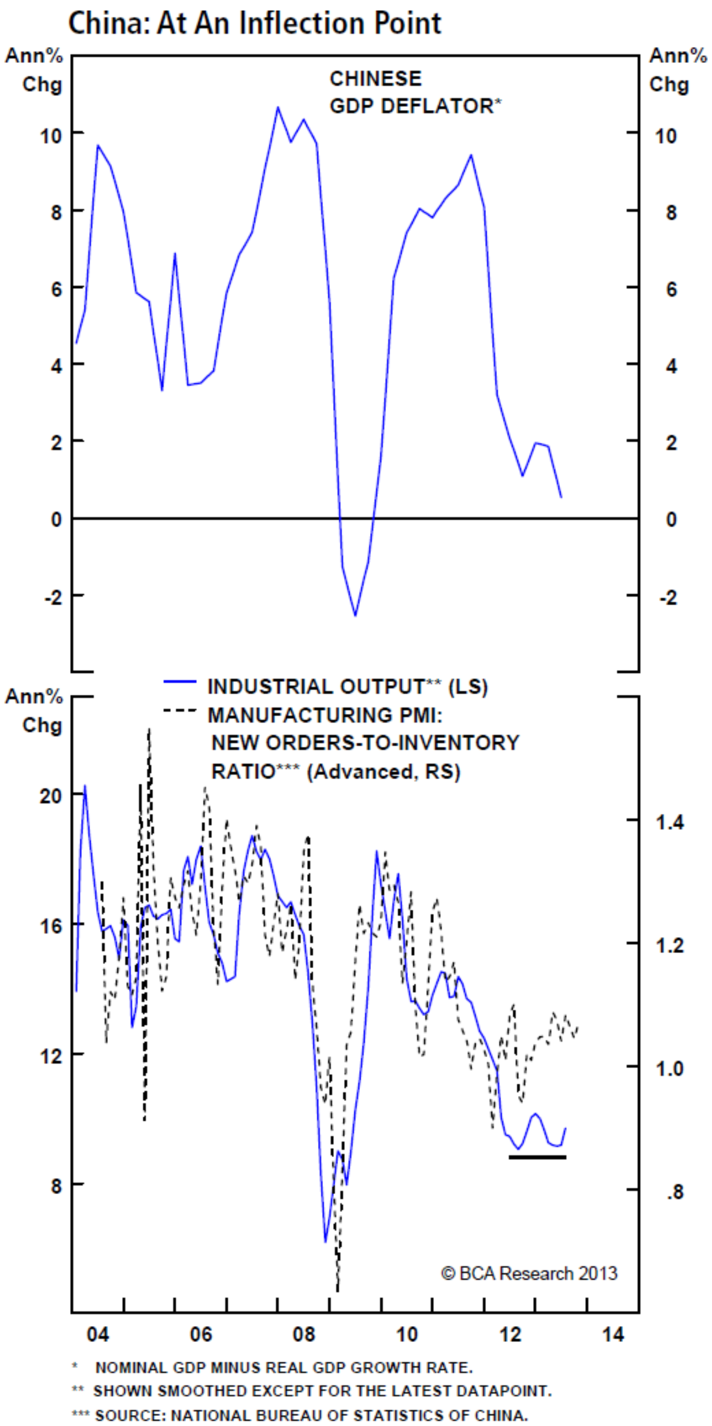
REAL GDP GROWTH FORECASTS (%)

	Economist Intelligence Unit 22 August 2013		Deutsche Bank 14 August 2013		The Economist poll of forecaster 10 August 2013 (previous month's, if change)		RMB Marketing Research 23 August 2013	
	2013^E	2014^E	2013^E	2014^E	2013^E	2014^E	2013^E	2014^E
World	2.9	3.6	2.8	3.8				
US	1.6	2.6	1.6	3.2	1.7(1.9)	2.7(2.8)		
Japan	1.7	2.1	2.0	0.6	2.0(1.8)	1.7(1.6)		
Euro area	-0.5	0.7	-0.6	1.0	-0.6	0.8		
Germany			0.1	1.5	0.3	1.5		
UK			1.4	2.1	1.0	1.7(1.6)		
India			5.0	6.0				
China	7.5	7.3	7.6	8.5				
Eastern Europe	1.9	3.1						
Asia & Australasia (excl. Japan)	5.6	5.8						
Australia					2.5	2.9(2.8)		
Latin America	2.7	3.5						
Middle East & North Africa	2.9	4.0						
Sub-Saharan Africa [b]	3.9	4.8						
South Africa							1.8	2.8
World inflation (%;av)	3.1	3.4						
World trade growth (%)	3.7	5.2						

E: Estimate
b: Refers to Angola, Kenya, Nigeria and South Africa

Do economic GDP forecasts support somewhat elevated equity markets?

An interesting fact is that across the range of forecasts, economists expect growth in 2014 to be significantly better than this year's estimate. Although one should not be sanguine about economic predictions in general, markets only partially reflect the better times that may lie ahead. As with the divergence in forecasts, so go the markets expectations—continue to expect volatility!



Source: BCA Research 16 August 2013

In China, economic policy remains at an infliction point, with Premier Li Keqiang focusing on supply side reforms in place of demand stimulation. Some important reform measures undertaken so far include lower taxes and liberalization of the financial system as well as providing greater market access to the private sector. Importantly, the People's Bank of China has aggressively been promoting credit growth to small and medium sized businesses by injecting liquidity into the banking system.

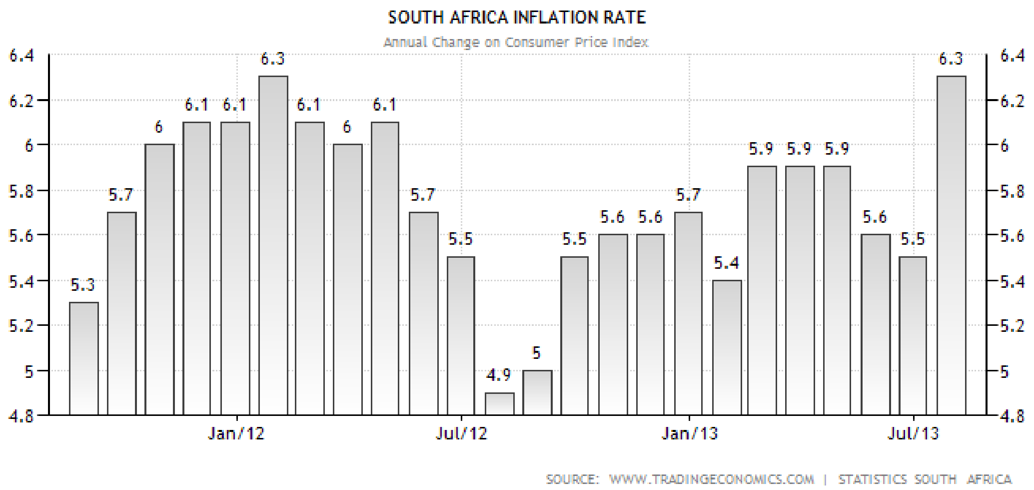
Despite the focus on changing the economy to a more consumption driven model, it is likely that capital spending will remain at high levels with the national savings rate at 50% of GDP and employment growth not picking up meaningfully yet. Continuing urbanisation (50% rural) and a minimum target growth rate of 7% by authorities, further supports this thesis.

This chart indicates that growth in China is slowing and there is an increased risk of deflation. Industrial output also, although recovering, remains sluggish. However, we maintain our view that there is enough strength in the economy to see it through.

While it's still early days for Shinzo Abe and his QE Programme in Japan, initial signs seem positive. That economy grew at a 2.4% annual rate in the second quarter, after growing at a 3.6% rate in the first quarter. This additional growth shows up in other measures as well. The employment to population ratio, the percentage of adults who are working, increased by 0.6 percentage points between the last quarter of 2012 and the second quarter of 2013. Furthermore, low interest rates translate into a low interest burden. Japan's net interest payments on its debt last year were under 0.9% of GDP and would have been even lower if the money refunded from the central bank for interest it received on its bond holdings were deducted.

So, overall, there are more green shoots emerging in Europe and the US economy continues to expand at a moderate pace. QE, or some form of economic measures in China are possible, given weaker than expected GDP growth and employment trends despite a planned change in economic policy. But the economy is far from collapsing! Global inflation remains subdued and therefore, we believe that a measured approach will be adopted by the authorities in terms of tapering of QE.

South Africa

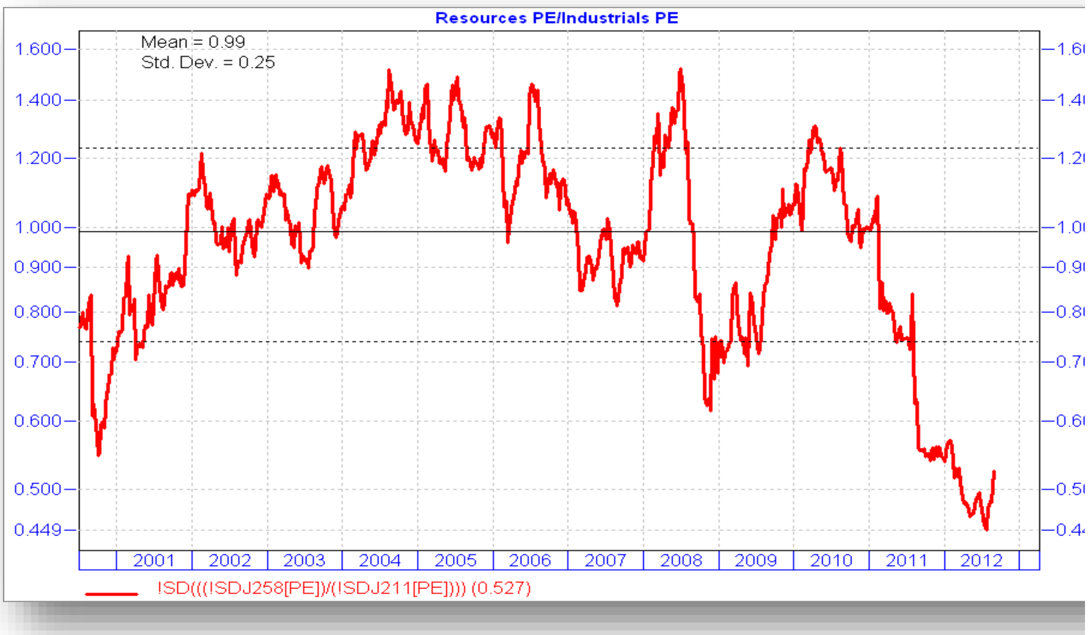


Uncertainty around QE in the US and conflict in the Middle East will dominate risk sentiment for now. Emerging market currencies are again under pressure with weakness in the Rand being further fuelled by pending labour unrest. The local currency weakened by 4% against the dollar since the beginning of August and was trading at R10.30 per dollar at the time of writing; posing an upside risk to local inflation. CPI as reported in July 2013 came in at 6.3%, above the upper target band set by the SARB. As discussed in previous issues of the Communiqué, we expect the SARB to allow some drift above the upper band due to a slowdown in GDP. This is partially evidenced by a slowdown in consumer expenditure, illustrated in the rather disappointing recent results from SA retailers, on the credit side in particular.

Reported GDP growth for the second quarter was 3% q/q which was at the lower end of the expected range. Underlying growth remains well below trend growth with a large contraction in mining output the main contributor to the lowering trend. Manufacturing output performed better than expected assisted by the weakening rand. It's expected that GDP will average 1.8%-2.0% for 2013 and for interest rates to only potentially start moving up in the second quarter of next year at the earliest.

The JSE All Share reached another all-time high in August, spurred by higher commodity prices. Industrials and financials in general are underperforming the market as sector rotation into cyclical counters is gaining momentum. Some better economic news from Europe, Chinese restocking of Iron Ore and some very recent calmness around tapering, increased investors' appetite for riskier assets.

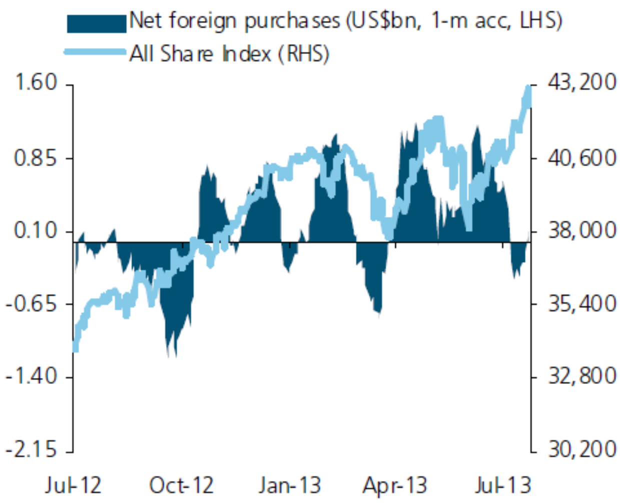
As can be seen in the following chart, resources, due in part to Rand weakness, have been rerating relative to industrials since July this year in terms of price/earnings ratio, as industrials now appear fully valued. We caution however that resource counters are likely to be volatile in the near term as prices will be data dependant on Chinese growth and a sustained recovery in the US and Europe together with an increased appetite for risky assets.



Foreign investment flows have been very volatile of late due to QE tapering concerns in the US and growing current account deficits within emerging markets. The JSE experienced a net outflow in foreign investment in July of R0.3bn after a fairly robust inflow of R6.9bn in June. Renewed appetite returned in August with net purchases of R3.4bn month to date. We, however, expect volatility to continue until more clarity is reached around potential conflict in the Middle East, QE tapering and the outcome of local wage negotiations.

Overall, despite many uncertainties, investment fundamentals have steadily been improving within all this turmoil. The headwinds around a recovery in European growth, the end of QE and a hard landing in the Chinese economy, have dissipated somewhat and weakness in equity markets will potentially be viewed as a buying opportunity.

Net foreign purchases vs. ALSI



Source: I-Net Bridge, RMB Global Markets

Source: RMB Global Markets Research
S A Chart Pack 20 August 2013

To conclude:

- Global markets have been experiencing heightened volatility lately due to tapering concerns by the Fed.
- The accompanied rise in US treasury yields have been the main catalyst behind the sell-off in emerging market assets and corresponding currency weakness within these markets.
- Growth in Europe is gaining momentum and the US continues to expand at a moderate but acceptable pace.
- Do economic GDP forecasts support somewhat elevated equity markets? - An interesting fact is that across the range of forecasts economists expect growth in 2014 to be significantly better than this year's estimate. Although one should not be sanguine about economic predictions in general, markets only partially reflect the better times that may lie ahead. As with the divergence in forecasts, so go the markets expectations—continue to expect volatility!
- In China, economic policy remains at an infliction point, with Premier Li Keqiang focusing on supply side reforms instead of demand stimulation.
- We expect stimulus in China to continue as manufacturing and employment remains weak.
- Locally, resource counters have been rerating relative to industrials since July this year, in terms of price/earnings ratio as industrials appear fully valued.
- Foreign investment flows have been very volatile of late due to tapering concerns in the US and growing current account deficits within emerging markets, not to forget SA.
- We expect volatility to continue in the near term until more clarity is reached around potential conflict in the Middle East, tapering of QE and the outcome of local wage negotiations.

Sincerely

Chris Botha **Dave Eliot**