Sanlam

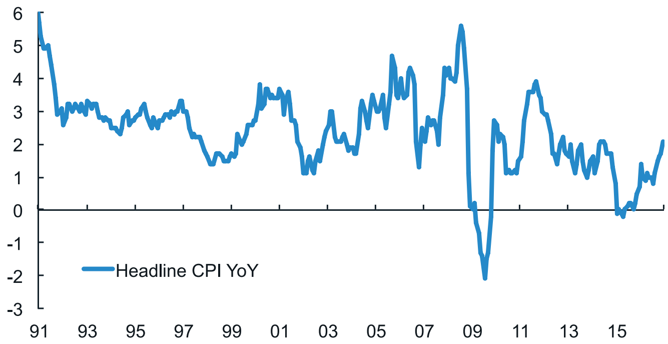
investment strategy

Q4 | 2016

✚ THE ECONOMY

- SA headline consumer inflation accelerates to 6.6% yoy.
- Headline consumer inflation is climbing globally. Oil has been a big driver of the recent fall and ascent.
- Eurozone unemployment unexpectedly declines to the lowest level in seven years.
- German GDP grows 0.2% in Q3 compared to 1.7% a year ago.
- Business conditions as measured by the Ifo Business Climate Survey is at its highest level since 2012.
- SA unemploment rises to 27.1%, the highest since 2003.
- S&P downgrades SA local debt by one notch to BBB, two notches above junk.
- SA ekes out GDP growth of 0.2% in Q3.
- SA current account deficit widens to 4.1% in Q3.
- National Treasuy indicates in the MTBS that it aims for R28bn more revenue in 2017/18.

US inflation steps up with oil prices

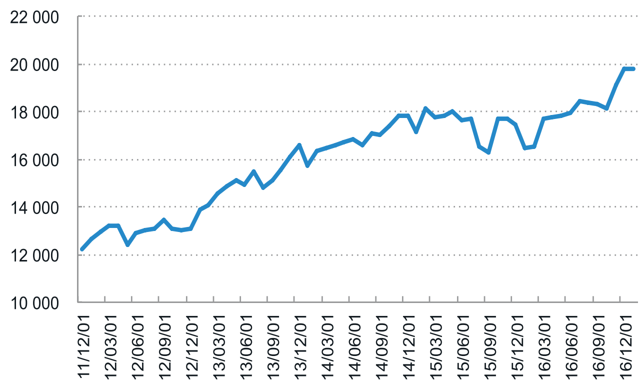


Source: Bloomberg | Dec 2016

✚ EQUITIES

- AB InBev completes its merger with SABMiller.
- The top share on the JSE, Naspers, delivers a poor -15% for the quarter.
- FTSE/JSE launches the new Capped SWIX All Share and Capped SWIX Top 40 indices.
- The Dow, S&P and Nasdaq all hit new records after the ECB's stimulus program announcement.
- Europe's main stocks retreat on worries over troubled Italian bank Monte dei Paschi di Siena.
- The aggregated market cap of Google and Apple is now larger than all European and Japanese banks combined.
- The ALSI loses 2.1% during the quarter on a total return basis, with Industrials under pressure due to rand strength vs. major European currencies.
- The SWIX is down 3.2%, with Healthcare, Tobacco, Retailers and Precious Metals underperforming and General Miners, Banks and Property stocks outperforming.
- The MSCI World Index ($) returns 2.0% on a total return basis.
- After an exceptional Q3, emerging markets lose 4.1% in Q4.

Dow Jones reaches for the 20 000 level

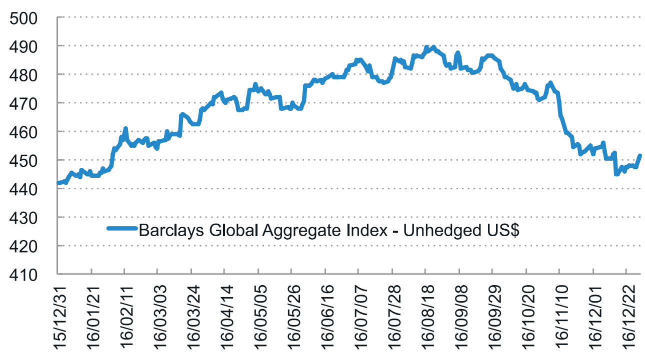


Source: I-Net | Dec 2016

✚ FIXED INCOME

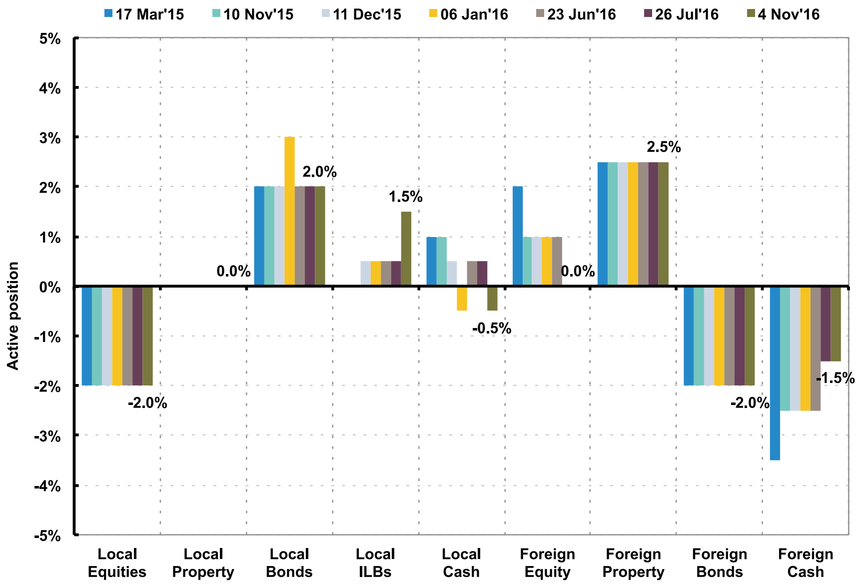
- Investors sell almost $5bn of bonds in Asia's local-currency debt in the week following Trump's victory.
- The Bloomberg Barclays Global Aggregate Total Return Index loses 4% in Nov, the biggest retreat since 1990.
- The US 30-year bond yield climbs from 2.3% in October to 3.2% in mid-December, expecting fiscal stimulus under Trump.
- The Fed raises the federal funds target rate to 0.50-0.75%. Three more hikes are expected in 2017.
- The ECB announces it will extend its stimulus programme.
- Japan too will continue its stimulus programme.
- After a strong Q3, SA nominal bonds gain a mere 0.35% during Q4.
- SA inflation-linked bonds return -0.9% vs. the 1.9% from cash.
- Local listed property returns 1.3% for the quarter.

Global bonds sell off post US elections



Source: I-Net | Dec 2016

SIM ASSET ALLOCATION



During Q4 2016:

We increased our overweight in SA inflation-linked bonds (ILBs) from 0.5% to 1.5%, from SA cash. SA ILBs are attractive relative to developed market ILBs: in the US the 10-year ILBs are at 0% and in Germany at -1.0%. Over the next six months we expect a nominal return of about 3% from the SA 10-year ILBs, lower than cash, but we do make investments with a 5- to 10-year horizon.

Source: Sanlam Investments (Dec 2016)

DOMESTIC	POSITION	RATIONALE
Local equities	Underweight	We retained our underweight position. The historical price to earnings (PE) ratio of SA equities is above 20. The earnings of resources companies are expected to recover and if this materializes it should bring the PE to below 15 by year-end, which is still above our estimate of a fair PE of 12 to 13, given our long-run real required return of 7% for SA equities.
Local bonds	Overweight	We retained our overweight in SA long bonds. They are still offering among the highest local currency real yields in emerging markets. This is particularly attractive given the low real returns available in equity and global bond markets.
Inflation-linked bonds	Overweight	We retained our overweight position. In the last quarter of 2016 the 10-year inflation-linked bond yield weakened to above 2%, an attractive real yield and on par with the long-run real return of conventional 10-year long bonds, but with considerable less risk. SA inflation-linked bonds are also attractive relative to developed market (DM) inflation-linked bonds.
Local listed property	Neutral	We believe JSE-listed properties are slightly expensive at a current dividend yield of 6.2%, but retained our neutral position for geographic diversification and its higher yield in a yield-starved environment. Approximately 40% of JSE-listed property companies' earnings are now from outside SA.

INTERNATIONAL	POSITION	RATIONALE
Global equities	Neutral	We retained our neutral position as real returns from competing assets were not attractive, but we are reconsidering this in the light of rising global bond yields. Global equity markets have rallied since the election of Donald Trump and the US market is currently expensive on a current rolled PE of 20 and a price to book ratio of 2.8.
Global bonds and cash	Underweight	We retained our underweight position. At a yield of 2.4% US long bonds offer a positive real return relative to our long-run inflation assumption of 2%, but we are concerned about long-run global inflation and now require an attractive premium above 2%.
Global property	Overweight	We retained our overweight position via listed REITs. Our portfolio currently consists of nine companies that have properties in the USA, UK, Europe and Australasia. The average dividend yield of the portfolio is 6.0%. Rising bond yields do mean the cost of funding would increase over the longer run, but we also expect some earnings growth from these companies.