Sanlam

Investments

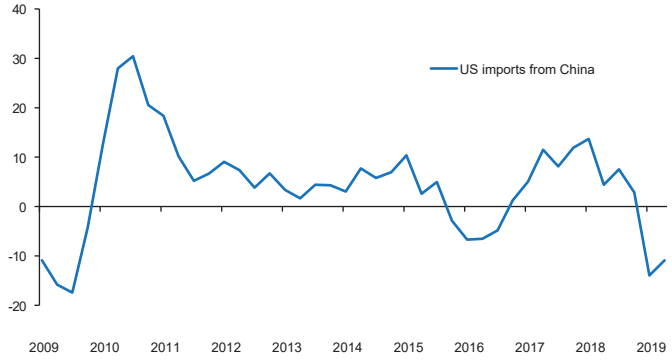
INVESTMENT STRATEGY

Q3 | 2019

THE ECONOMY

- Global industrial production remains stagnant.
- Chinese GDP growth slows to 6.2%.
- US imports from China are down 15%; Chinese imports from the US are down 30% y/y.
- The 'Benn Act' makes it likely that the Brexit deadline will be pushed out to 31 Jan 2020.
- US unemployment edges higher to 3.7%.
- The drone attack in Saudi Arabia leads to the largest intraday spike in the oil price on record.
- Q2 data releases show SA GDP has grown by 3.1% seasonally adjusted and annualised.
- Fixed investment spending in SA increases 6.1% annualised.
- SA company profits grow by a meagre 4.8% y/y.
- SA unemployment climbs to 29%.
- SA core inflation eases to 4.3%.
- Considering purchasing power parity, the Rand should be trading at US$13.35.

US IMPORTS FROM CHINA HAVE PLUMMETED

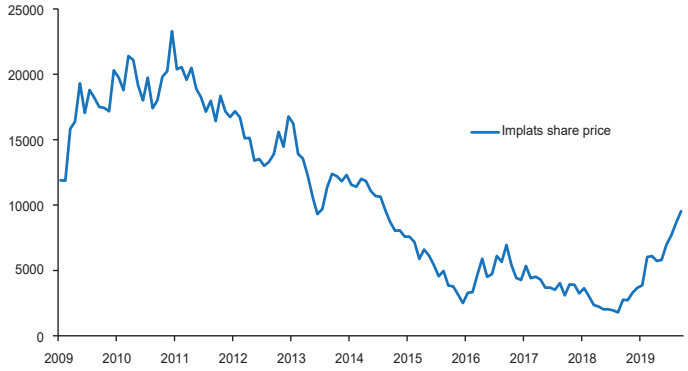


Source: Bloomberg | Sept 2019

EQUITIES

- Naspers lists its offshore assets in Amsterdam under the name Prosus.
- The current dividend yield of the ALSI, excluding Naspers and Prosus, is the highest since 2008.
- Uber, the company with the largest losses preceding its IPO, lists.
- PepsiCo offers to buy Pioneer Foods at a hefty premium.
- The ALSI is down 4.6% and the SWIX 4.3% for the quarter.
- Impala Platinum is up 37%.
- Sasol is down 28% for the quarter after the delay in publishing its results.
- The MSCI World Index returns 0.5% in Dollars, led by Japan.
- Emerging markets decline 4.25% for the quarter.
- Listed property is down 4.4% for the quarter.

IMPALA PLATINUM'S STRONG RECOVERY CONTINUES

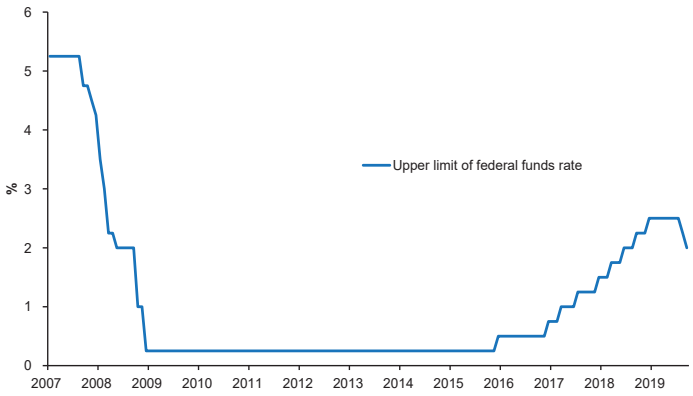


Source: IRess | Sept 2019

FIXED INCOME

- The Fed cuts interest rates to 1.75-2.0%.
- The ECB cuts the interest rate on deposits to -0.5%.
- The Reserve Bank of India cuts its policy rate twice – to 5.15% currently.
- The PboC cuts reserve requirements and lending rates.
- The US 10-year bond yield drops from to 2.0% to 1.66% during the quarter.
- The German 10-year bond touches an all-time low.
- The US yield curve inversion (10-year vs. overnight rate) persists.
- Global negative-yielding debt stands at $14 trillion.
- The SA yield curve does not react much to the bond auction spike.
- The market is pricing in one more 25bps rate cut over the next 12 months.
- Fitch changes SA's rating outlook from stable to negative.
- SA nominal and inflation-linked bonds return 0.78% and 0.25% respectively during the quarter.

THE FED CUTS INTEREST RATES BY 25BPS



Source: IRess | Sept 2019

Market view of the **SIM Balanced Fund**

We have consistently expressed our expectation that global equities are likely to continue offering better returns than global bonds, but that for both asset classes these returns are likely to be disappointing relative to long-term historical returns. As long as bond yields remain low (and they have yet again hit new lows in the past quarter), the negative real returns on offer from bonds are likely to keep high equity valuations in place and earnings growth will set the tone for returns. When doubt develops over earnings growth, equities will suffer a loss, but unless the earnings decline then materialises, the asset class is likely to bounce back with the resilience of an All Black rugby team.

So we continue to hold our bias for growth assets, but as the global economy slows down and more questions are being asked about equity earnings, we realise that there is a rising risk. And unlike the betting man's one-way bet, we try to mitigate the risk through three approaches. One is a more defensively positioned growth portfolio, another is the inclusion of protective strategies to offset portions of large losses that equities might suffer, and the last is a diversification of growth strategies invested in.

During the quarter our real asset fund celebrated its one-year anniversary and it did so in style. Over the year until end September it provided a 13% positive return in US Dollar and outperformed the MSCI World Index by about 11%. In the previous quarter we conveyed our excitement about the new team managing our emerging market fund and in the short term our emerging market exposure has done very well. Our portable alpha foreign exposure also continues to add value consistently. The other components of our foreign growth assets were under more pressure over the last quarter and detracted from the performances of the three components mentioned above. However, over the last year, which included a meaningful market correction and recovery, our foreign growth assets in total did outperform the MSCI World Index by about 2.5%.

We continue to be wary of pricing in global bond markets, where yields have yet again fallen to record lows and where it is becoming increasingly difficult to find any way of generating positive real returns over any period in the foreseeable future.

Applying a rugby analogy to the local market, SA assets represent the Fijian team. They seem impressive in terms of physical stature, but can't always convert it to dominant on-field performance. All local asset classes seemingly remain priced for better than historical returns. However, all are faced with risks that explain why investors are demanding such higher returns. Bonds face the potential risk of a debt trap, which could in the longer run/worst case see pressure on the asset class. Equities have been plagued by earnings pressure, especially on the locally-derived portion of earnings, so the seemingly attractive pricing level keeps getting eroded by the slowing real earnings of the FINDI stocks (excluding Naspers). Similarly, properties have suffered from high vacancies and negative resets in rental contracts that come up for renewal. And with an economy that just can't get traction, there is a risk that this softness could remain – keeping the pressure on equity earnings and property vacancies alike.

In the last two quarters we slightly reduced our exposure to traditional growth assets. However, the continued high exposure to growth assets continued to present a headwind, since both equities and property underperformed fixed-interest assets. This was to some extent offset by our star 'impact player' when some of the money taken from growth assets was redeployed in AT1 instruments.

And representing our try scorers in the latest match, the most notable contributors to performance included a good performance from our local equities, a positive contribution from the protective derivative structures held against the local equity market, and a near fully-protected Naspers position that expired with good gains during the quarter.

In summary, our portfolio remains positioned for an expansive running game. On a wet field made soggy by a damp economy, it might not be as effective as one with a stronger pack of forwards (read fixed-interest assets), but the impact off the bench (read protective structures) have been chosen such that it could change the nature of the portfolio somewhat in a prolonged wet game on a heavy field.