AUTUS

wealth care specialists

QUARTERLY ECONOMIC COMMENTARY

Q1 | 2017

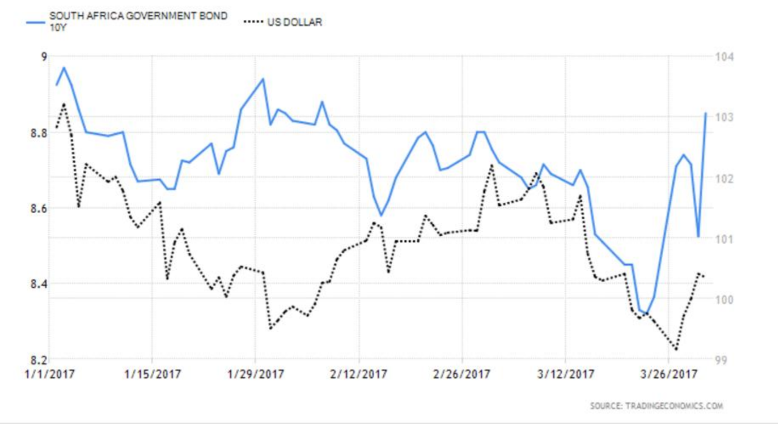
AUTUS BCI INCOME PLUS FUND

Quarterly Commentary - Autus BCI Income Plus Fund

While 2016 was marked as the year to forget, the first quarter of 2017 is fast shaping-up as the one to remember! We commenced the New Year with the hope this would be a better year than last. Economic factors such as increased agricultural output (thanks to higher rainfall after the severe drought), a stable oil price, strengthening currency amongst others implied the possibility that inflation could be on a slow decline and that interest rates had peaked. With the prospect of an interest rate decline, much needed support would be given to the ailing consumer and economy which only managed to grow by 0.6% in 2016. Globally, the US economic engine continued to power ahead in 2016 with quarter on quarter growth of 2.1% recorded for the fourth quarter and 1.6% for 2016. The “Trump factor” injected optimism in the US that greater spending on infrastructure, broad tax cuts and reduced healthcare spending would enhance the prospects for strong economic growth. Encouragingly, the European economy maintained its ability to post growth albeit at a very modest 0.4% in Q4 and 1.7% for the year due to improved consumption expenditure and fixed investment. Brexit hit UK also managed to post positive GDP growth of 1.8% in 2016.

Unfortunately, on the 27th of March President Zuma recalled Finance Minister Gordhan from an international roadshow and began a political reaction that culminated in a cabinet re-shuffle announced at midnight on the 30th of March. Ratings agency Standard and Poor’s swiftly followed this by reducing the country credit rating to junk.

As shown in the accompanying graph, the market reaction to these events was immediate and strong, with the Rand gapping to 13.80 and the yield on the South African benchmark R186 bond pushing to about 9.00%. Shocking as these moves were, it is lucky that the events took place during global risk on period. In fact, the market impact was less drastic when compared to Nenegate at the end of 2015. The Rand is still stronger than where it was at the end of 2016 and bonds are still stronger than where they started the year. Perhaps it is South Africa’s good fortune that these events took place whilst the financial world is in positively disposed to emerging markets.



As for fixed income investments, well, a rating down grade is a little like an interest rate hike as South African debt costs are likely to rise in the future. Ironically this is good for investors because the yield earned on fixed income will drift upwards over time, increasing the accrual of income for investors. Because of the short duration of the fund, the negative impact of recent events has been avoided. For risk averse investors, flexible income funds could be the safer option to avoid anticipated increased volatility.

For the quarter under review, the portfolio yield stood at 9.54%, the duration was 0.39 years and a return 1.9%. For the 12 month to end March 2017 the portfolio return was 7.7%. We remain jaundiced about the outlook for the rest of the year. Our initial thesis has been overturned by political events and the impact that these could have on the economy. Our current focus is therefore to manage risk to enhanced the income in the portfolio while preserving capital.

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