AUTUS

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QUARTERLY ECONOMIC COMMENTARY

Q2 | 2017

AUTUS BCI BALANCED FUND

Quarterly Commentary - Autus BCI Balanced Fund

The second quarter of 2017 started on a positive note as signs of a recovering global economy emerged, spurring investor sentiment. The MSCI World Index, Eurostoxx 50 and Nikkei 225 all traded significantly higher during the month of April. Locally, the All Share Index (3.6%), Industrials Index (5.2%) and Financials Index (3.6%) also benefited from world markets trading stronger on healthy economic data. However, the recovery is not without its risks. The International Monetary Fund (IMF) warns about threats to growth posed by a possible shift towards inward-looking policy platforms, rising protectionism and increased geopolitical tensions.

Local bonds sold off at the end of the first week of April, following sovereign ratings downgrades to junk status by ratings agencies Standard and Poor's and Fitch. Despite negative ratings and ongoing political uncertainty, yields rallied and the rand strengthened, receiving support from the global carry trade. Fears arose over President Trump's ability to deliver on tax reforms and to push through regulatory changes. Investors worried that it may stall the introduction of growth-enhancing spending plans and legislation. A weaker US dollar culminated into further rand strength, putting pressure on commodity prices during the quarter. Resource shares were the biggest detractors, with the Resources Index ending the month of May lower by 4.1%.

The "sell in May and go away" phenomenon may not have materialised in 2017, but the month of June surely provided its own drama. The All Share Index fell by more than 5% in the first two weeks, absorbing almost all the YTD return, partly driven lower by weak domestic economic data and the release of the Mining Charter. The Mining Charter aims to increase permanent black ownership targets of all mines to 30% (up from 26%). The Resources Index sank even further following the announcement, but endured some relief as the mining companies applied to the high court in order to block the controversial Charter. This time around, none of the indices were spared the rod, the All Share Index down 3.49% for the month and ending the quarter in negative territory, down 0.39%.

Emmanuel Macron's victory over Marine le Pen's far-right political party in France suggest the protectionist wave in Europe may be receding. Despite the improved growth prospects for the Eurozone, unemployment and wage growth levels still haven't reached the desired levels and should continue holding back inflation pressures. The points to an ongoing cautions monetary policy stance by the ECB, whereas the BOE has indicated the intention to tighten policy in the near future. In contrast to the ECB, the rate of unemployment has fallen more convincingly in the US and, as expected, the Fed raised interest rates by 0.25% during middle of June.

From an asset allocation point of view, the only significant change was an increase in offshore cash brought on by the conversion of the Autus BCI Global Equity Fund towards the Autus BCI Global Equity Feeder Fund. The Fund is now fully invested offshore, up 5% from the previous quarter. Equity was reduced slightly to 62%, which is underweight relative to the equity mandate. Rand strength seemed to have countered the underweight exposure. However, stock selection more than made up for it. Active bets in Greenbay Properties (up 23.72% for the quarter), Bidcorp (15.22%), Capitec (9.01%) and Steinhoff (4.49%) all contributed in the Fund returning 1.38% for the quarter, more than double its benchmark at 0.62% and outperforming its peers by 1.45%. Anglo American, BHP Billiton and MTN are some of the significant counters that are no longer a part of the portfolio.

Looking ahead, we are of the view that global equities are likely to be driven by global economic and earnings growth trends. Local bonds are likely to benefit alongside emerging market bond markets in the current global hunt-for-yield environment. Following three years of negative real growth on the All Share Index, we believe that local equity valuations have improved meaningfully and are starting to look attractive.

This is something we keep a close eye on, as we are eagerly looking for opportunities to increase our equity exposure. However, to unlock strong SA equity returns we'll have to see a drastic change in confidence levels, hinging on more policy certainty and political change.

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