



We have fallen upon evil times, and the world has waxed very old and wicked;

*Politics are very corrupt;
Children are no longer respectful to their parents."*

Inscription on a tablet from Constantinople, 3800 BC

Politics and economics make uneasy bed fellows. As alluded to in the above quote, politicians have been the subject of ridicule and debate since time immemorial – as have inter-generational tensions, it seems! At the extremes, there is no doubt that politics has a material bearing, but in our experience economic fundamentals are mostly dominant.

It has indeed been an eventful few months in South Africa – a new President, new Cabinet, a significantly stronger currency and lower bond yields – coupled with a renewed sense of optimism and confidence in consumers and corporates.

In our September 2017 quarterly, we referred to the Samuel Beckett play, "Waiting for Godot", in describing the national economic mood in South Africa – with the then pending outcomes from rating agency reviews and the ANC elective conference causing angst amongst investors. As things transpired, both events seemed to result in relatively "market friendly" outcomes, with the result that many domestic oriented assets rallied strongly towards the end of the year.

We maintain that in years to come, notwithstanding the frustration that many felt around politics, perception of corruption and low confidence levels in the economy, patient long-term investors will reflect favorably on 2016 and 2017. To list a few of the opportunities we believe investors were presented with:

- South African Banks were trading at subdued multiples for some time, with the major banks offering investors attractive opportunities. Most notably, the sell down of Barclays Africa by Barclays Plc at R132 in May 2017, valuing it on a PE of 7x, and dividend yield of 8%,
- Select Retailers, following prolonged stress in the consumer economy were trading at attractive valuations. With the precipitous fall in food inflation, typically the catalyst for improving consumer spend, their prospects for earnings was improving,
- Select industrial companies like Reunert - established brands, with a very strong balance sheet, trading on a 6.5% dividend yield and a very attractive PE multiple,
- Smaller cap food companies, trading for sustained periods of time at "through the cycle" PE multiples of around 8x,
- Longer duration Bonds and NCD's trading at real yields of over 5%,
- Bank Preference Shares trading at running dividend yields of over 10%, with the longer-term prospect of capital appreciation from these levels.

Ultimately, history will be the judge as to whether these prove to have been good investments.



Economic Environment

The global economy continues to steadily improve with growth rates heading towards the longer term average of 4%. As evidenced by the below charts, a notable feature of the global recovery has been the recovery of commodity exporter economies, off their recessionary levels of 2015. The current self-reinforcing growth environment remains constructive for commodity demand and has typically been an environment in which commodity currencies perform well.

Figure 3: Global real GDP growth back at its long-run (50y) average

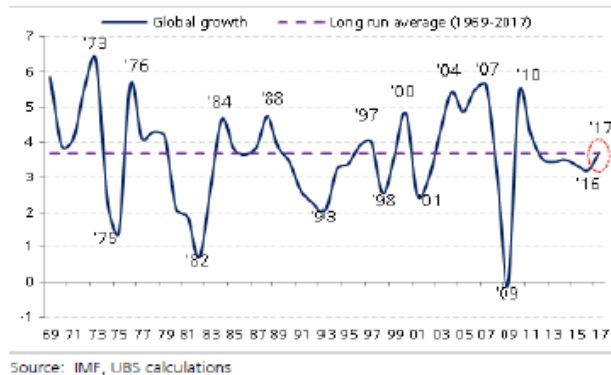
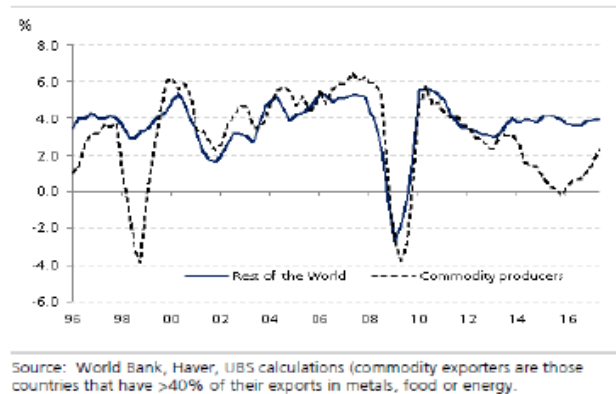


Figure 4: But most of the improvement seems to be coming from a narrow set of commodity exporters



We have been encouraged by the steady increase in global inflation, with developed economies' inflation rising towards 2% - this is certainly a more constructive environment for corporates to operate within, compared to the deflationary fears that were pervasive in the years following the global financial crisis. It is also interesting to note that inflation differentials between emerging and developed markets have narrowed materially over the last few decades, as evidenced in the graph below. Given that currencies tend to move in sync with inflation differentials over time, in theory this trend should result in a more benign currency environment.

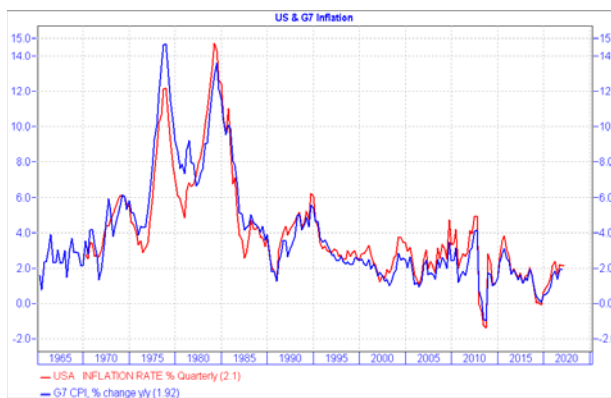
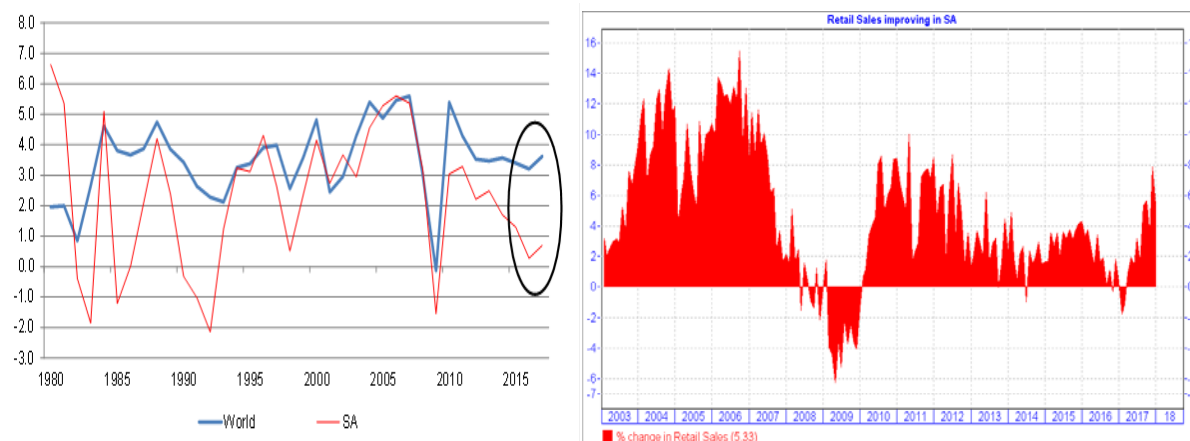


Figure 26: EM inflation (headline % YoY)



The South African economy has endured a difficult few years. As evidenced by the chart below, this has been the most significant dislocation in SA GDP growth relative to Global growth since the dark days of the late 80's and early 90's. Our view has been that much of the weakness can be explained by the Rand weakness from 2011 to 2015, exacerbated by the commodity downturn of 2015, the drought of 2015/16 in key maize growing areas leading to shortages, and a central bank increasing interest rates to offset these supply side inflationary issues.

SA GDP has materially lagged Global GDP – early signs of improvement



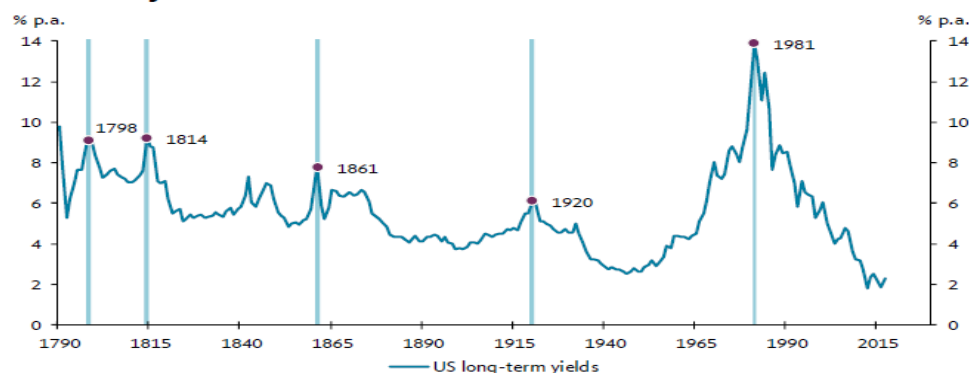
During 2016 and 2017, we saw a reversal of many of these headwinds, leading to declining inflation, the long overdue start of an interest rate easing cycle, and some encouraging signs of an improving retail sales environment. Recent data releases point to a changing dynamic in South Africa - an improvement in retail sales (chart above), coupled with a positive surprise in GDP growth rates in the final quarter of 2017, demonstrate there are increasingly signs of life in the SA economy. What is interesting about these improvements, is that they have occurred before the euphoria of the ANC Elective conference towards the end of December – perhaps politics and economics are not as closely linked as many surmise?

Global Markets

There have been some seismic developments under way in global markets – the US Dollar has been weakening and Bond yields have been rising – the antithesis of what has been the norm for several years. The US 10 year government bond yield is now nearing 3%, mostly for the constructive reasons mentioned above – economic growth, increasing consumer demand resulting in moderately higher inflation leading to rising bond yields. Nothing sinister, and part of a normal cyclical recovery.

The chart below provides some perspective on bond yields – long run charts are fraught with risk, but nonetheless make for interesting viewing. The recent increase in US Bond Yields is barely evident, but it does highlight the extraordinary tail wind that “bond proxy” type investments, such as defensive industrials and property companies, have enjoyed over the last few decades. Lower yields have enabled investors to justify paying ever increasing multiples for a predictable earnings stream - any sustainable change in yields will have a material bearing on the prospects for many of these investments.

Historical evolution of US long-term yields, i.e. 10-year benchmark Treasuries – annual averages*



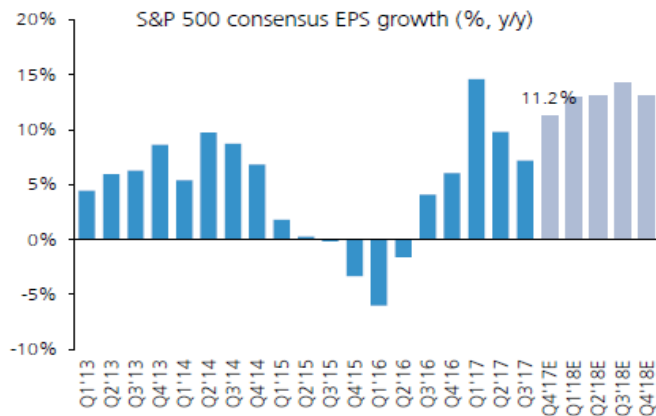
Source: Datastream, Julius Baer

* 2017 = 2.53%; 2016 = 1.84%; 2015 = 2.13%; 2014 = 2.53%

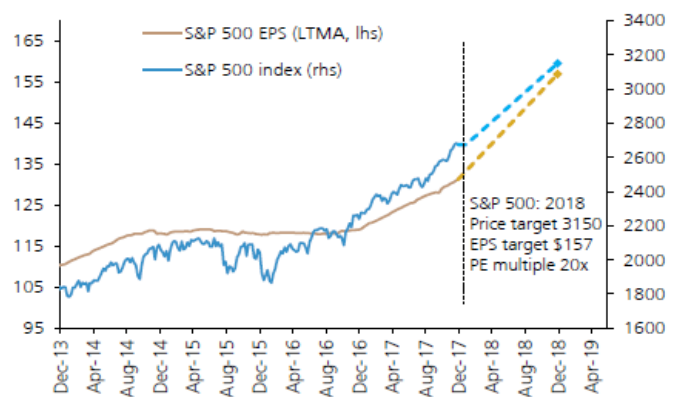


On the 2nd of December 2017 the US Senate approved amendments to the Tax Cuts and Jobs Act of 2017. The major elements of these amendments comprise changes to personal, estate and corporate taxes including the slashing of the corporate tax rate to 21% from 35%. As a result, the earnings estimates for many US focused companies shifted by up to 7% instantaneously.

Double-digit growth expectations ahead of the tax boost



Upside to price target driven by earnings growth



Source: UBS

The ClucasGray “Alpha Thesis”, a key part of our investment process, considers that the key drivers of a share price are:

1. Real growth in earnings, dividends and cash flows; and
2. Change in the rating or PE multiple

Whilst this is not the only component to the investment process, the “Alpha Thesis” aims to gain comfort around the valuation of all investment decisions. We believe that investing in long term structural earnings outperformers at an appropriate multiple is the best way to enjoy superior returns. The methodology can be used to consider individual equity investments as well as the valuations and earnings prospects at an index level.

The charts above and the table below illustrate a couple of points around this thesis. Firstly, the consensus for earnings growth from S&P 500 companies appears to be robust and this has been given an additional boost from the tax cuts. As illustrated by the chart on the right, earnings growth is a key component to equity performance over time. Secondly, a supportive earnings backdrop is important in an environment where valuations are now fully priced. The upgrade to earnings has meant that valuations have moderated and, in our view, the prospects for reasonable returns from global markets exists. The table below depicts an environment where global equities are still attractive relative to alternative asset classes

9 March 2018: Index Summary	SPOT	EXIT PE	Return - 3 year CAGR	12 Month PE	FY2 PE	3 YR EPS CAGR	FY1 DY
Msci World	2 149,3	17,50	11,7%	16,41	15,08	13,2%	2,45%
S&P 500 Index	2 786,6	18,00	9,9%	17,82	16,15	15,5%	1,91%
Euro 500	255,4	16,00	13,0%	14,82	13,64	18,0%	3,59%
Nasdaq Index	7 560,8	22,00	10,3%	22,99	19,79	24,1%	1,03%
Msci Em	1 207,2	14,00	13,8%	12,90	11,58	15,7%	2,66%
Topix Index (Tokyo)	1 741,3	15,00	9,1%	14,23	13,64	4,9%	1,99%
Msci Ac Asia X Japan	733,8	14,00	11,1%	13,37	12,05	11,7%	2,51%

Conclusions

Economic Conclusions

The global economy continues to improve with decent growth and mild inflation expected for key global economies. The current environment should allow central banks to commence an exit process from a very accommodative monetary policy position, albeit that central banks in different regions will move at different speeds. We expect that the US FED will continue on a gradual tightening path during 2018. We should not be dismissive about the fact that rising yields could have potentially disruptive effects on markets in the near term and may have implications for over-indebted economies and companies in the longer term.

South Africa has lagged the global recovery noticeably and we are hopeful that key domestic economic trends, being lower inflation, lower interest rates and an improvement in the consumer economy, will still play out and result in better growth. The global backdrop remains constructive for commodity demand which has typically been supportive for a more stable environment for commodity currencies. We are mindful that the rand strength will have an impact on the earnings profile of certain companies and certain domestic companies now require a significant improvement in the level of earnings to deliver reasonable returns.

Asset Allocation Conclusions

An improving global economic cycle remains supportive of earnings growth and despite the fact that valuations are more fully priced, equities remain attractive relative to alternative asset classes. More specifically:

- Global equity valuations have moderated and appear to offer decent returns from current levels.
- Global non-equity assets (bonds & cash) remain unattractive and we are not convinced that they can produce real returns from the perspective of a Rand investor as they typically require a weakening Rand.
- Domestic equity ratings have moved up considerably, however they should benefit from the improvement in the domestic economic cycle and from an improving global environment. We see attractive opportunities in select companies.
- Domestic preference shares offer good real returns.
- Domestic fixed income yields have compressed, however specific property and fixed income assets still remain attractive.

Appropriate diversification remains as important as ever, and our analysis indicates that the prospects to earn reasonable real returns in select asset classes and underlying securities exists.



Summary Market Performance: 28 February 2018

DOMESTIC MARKET	SPOT	1 Month	Quarter	YTD	1Y	3Y	5Y
JSE All Share	58 325	-2,0	-2,4	-2,0	14,0	3,0	8,0
JSE Top 40	51 383	-2,3	-3,5	-2,2	16,4	2,9	7,8
JSE Resi TR	2 254	-4,9	-2,5	-1,4	16,7	-4,7	-3,2
JSE Fini TR	9 967	5,1	12,7	2,7	29,1	7,3	14,8
JSE Indi TR	14 617	-3,5	-7,8	-3,3	18,5	7,1	15,4
Property TR	2 000	-9,9	-15,4	-18,8	-6,1	0,7	8,0

GLOBAL MARKETS (Local Currency)		Month	Quarter	YTD	1Y	3Y	5Y
MSCI WORLD INDEX TR	5 983	-4,1	2,3	0,9	17,4	8,2	10,7
S&P 500	5 308	-3,7	3,0	1,8	17,1	11,1	14,7
Nasdaq	7 273	-1,9	5,8	5,4	24,8	13,6	18,1
Euro Stoxx 50	6 931	-4,6	-3,4	-1,7	6,2	1,1	8,4
Nikkei TR	34 351	-4,4	-2,7	-3,0	17,6	7,5	15,8
FTSE 100	6 175	-3,4	-0,5	-5,3	3,4	5,4	6,6
MSCI Emerging	539	-4,6	7,0	3,3	30,5	9,0	5,0

Exchange Rates		Month	Quarter	YTD	1Y	3Y	5Y
ZAR/\$	11,80	0,5	13,9	4,7	10,2	-0,4	-5,5
ZAR/€	16,23	3,4	12,5	2,9	0,1	3,4	-3,5
ZAR/£	14,38	2,2	11,9	3,2	-3,6	-3,3	-4,1
ZAR/AUS \$	9,15	4,1	11,8	5,3	8,9	-0,2	0,1
ZAR/BRL	3,64	2,1	13,1	3,0	13,8	3,8	4,4
\$/€	1,38	3,0	-1,7	-1,8	-11,1	3,8	1,9
\$/£	1,22	1,8	-2,4	-1,6	-15,3	-2,9	1,4
\$/CHF	1,06	1,4	-4,1	-3,2	-6,5	-0,3	0,2

COMMODITY PRICES		Month	Quarter	YTD	1Y	3Y	5Y
Oil (Brent)	64,7	-5,6	4,7	-2,1	14,5	-5,0	-6,6
Copper (3 month LME)	6 931,0	-2,6	2,5	-4,4	16,0	5,5	-2,4
Platinum	983,5	-1,9	4,3	5,7	-4,0	-6,1	-9,1
Iron Ore	75,6	5,6	10,0	6,8	-18,2	5,6	-12,9

Bond Prices	2018-02-28	2018-01-31	2017-12-29	2017-08-31	2017-02-28
RSA 10 YEAR	8,12	8,45	8,59	8,56	8,79
US 10 Year	2,86	2,71	2,41	2,12	2,39
German 10 Year	0,66	0,70	0,43	0,36	0,21
UK 10 Year	1,50	1,51	1,19	1,03	1,15

Disclaimer

"ClucasGray (Pty) Ltd is an authorised financial services provider (FSP 21117). Collective Investment Schemes in Securities (CIS) should be considered as medium to long-term investments. The value may go up as well as down and past performance is not necessarily a guide to future performance. CIS's are traded at the ruling price and can engage in scrip lending and borrowing. Performance has been calculated using net NAV to NAV numbers with income reinvested. There is no guarantee in respect of capital or returns in a portfolio. The Manager retains full legal responsibility for any third-party-named portfolio. Where foreign securities are included in a portfolio there may be potential constraints on liquidity and the repatriation of funds, macroeconomic risks, political risks, foreign exchange risks, tax risks, settlement risks; and potential limitations on the availability of market information. The investor acknowledges the inherent risk associated with the selected investments and that there are no guarantees. Prescient Management Company (RF) (Pty) Ltd is registered and approved under the Collective Investment Schemes Control Act (No.45 of 2002). For any additional information such as fund prices, fees, brochures, minimum disclosure documents and application forms please go to www.clucasgray.co.za