STAR INVESTMENT PARTNERS

Quarterly Market Commentary.

Q4 2019

SA Market Overview

South African markets spent the past quarter being swayed by the same themes that investors have seen throughout the year. Fears over global growth stalling and uncertainty in the global political and economic climate ensured that investors remained wary of riskier assets such as South African securities. The firmly risk-averse tone from global investors was supported by severe country specific risks, as ESKOM reintroducing loadshedding to the day-to-day lives of South Africans and reporting of economic data unsupportive of the already strained government budget. Real economic growth on SA will be less than 1% for 2019 and forecasts are even less rosy for 2020.

On a positive note if you are an investor, the SA Reserve Bank has taken a logical stance in keeping interest rates high and in spite of lower inflation thus making South African interest bearing assets more attractive in the face of negative and near zero real yields from many sovereign assets.

The abovementioned factors culminated in SA equity assets delivering returns of +12.05% (in ZAR) for the ALSI and +10.34% for SA Fixed Income (ALBI) in 2019. The fourth quarter returns for the ALSI were up sharply +4.63% helping to lift an otherwise underwhelming risk adjusted equity market performance in 2019.

As a US$ investor in SA you would have experienced very volatile returns during the quarter as the Rand started at 15.22, strengthened to 14.56, weakened again to 15.09 after the MTBPS and then strengthened to end the quarter at R13.97/$1.

SA Budget Environment

In October 2019 Finance Minister Tito Mboweni delivered his inaugural Medium-Term Budget Policy Statement (MTBPS) to parliament. While he reiterated that the statement is not a platform to discuss specific financial reforms the overall tone of the statement was focussed on the need for immediate financial reforms in government and State-Owned Enterprises. The market seemed that the speech lacked substance, sending SA Inc securities into an initial downward spiral, with the ZAR performing especially badly after the speech but what turned out to be a knee-jerk reaction.

Investors will be waiting for the annual National Budget Speech on 20th February 2020 to see whether any specific reforms are implemented. Only concrete, date specific changes to future government spending and realistic revenue collection will help turn the tide of the mounting government debt spiral currently in play.

Ratings Agency Outlook

South African long-term government debt has long been rated as sub-investment-grade by both S&P and Fitch, with only Moody's still producing a rating that is only slightly above investment grade. This may change in the new year, as the last quarter saw all three ratings agencies placing a negative outlook on their ratings, implying that Moody's is likely to drop the rating below its current investment-grade level upon next review if real revenue and debt management is not implemented immediately.

Such downgrades would mean that S&P and Fitch would drop the rating even further below investment-grade, meanwhile Moody's would change their rating to sub-investment-grade, resulting in large amounts of foreign capital leaving the capital markets as foreign investors, such as global index tracking funds, being mandated to only invest in investment grade securities. Investors should however be cautious at this time as there is a wall of global high yield money seeking investments that could pick up the slack and cause these different foreign investors to enter our markets at higher yields.

Return of Load shedding

After experiencing no load shedding since March 2019, South Africans were once again plunged into darkness in December, with the worst bout of blackouts yet, causing ESKOM to unveil two new more extreme stages of load shedding, stage 5 & 6, which could result in some regions of SA experiencing load shedding of up to ten consecutive hours at a time.

This latest disruption to the power grid was due in part to two reasons; firstly, severe flooding in the Highveld, causing large amounts of coal reserves to become too wet to be used in electricity generation and secondly alleged sabotage, of the already constrained network, by high ranking ESKOM employees leading to the loss of 2000 MW of generation capacity, which amounts to roughly 5% of the country's total capacity.
Most logically and appropriately it was also stated by ESKOM COO, Jan Oberholzer, that the chief reason for the disruption was neglect and a lack of maintenance over the past twelve years of mismanagement.

USD/ZAR

The Quarter saw a strong Rand appreciation, with the currency pair ticking from R15.22 at the beginning of October, to end the year off just slightly above R13.97/$1, representing a gain of roughly 8% for the quarter. These gains came amid broad based Dollar weakness as most emerging market currencies also appreciated strongly against the Dollar, likely linked to the improving risk sentiment around the impending China/ US trade deal which is discussed later in this report.

It is important to note that this level of ZAR is close to fair value on a purchasing power parity basis, thus it is unlikely to see any further material gains for the currency. This is especially relevant when considering the plethora of domestic growth pressures already limiting Rand gains.

Inflation

Year on year inflation has surprised to the downside during the quarter, with the October print coming in well below expectations at 3.7% and the November print matching expectations at 3.6%. The low inflation was mostly attributable to a slowdown in the price increase of food & non-alcoholic beverages as well as price declines in transport, due to a drop in the fuel price in November.

Global Market Overview

What a year it has been for investors! Between January and September, almost all major asset classes performed extremely well, buoyed by dovish central bank policies and high government monetary and or fiscal stimulus. This resulted in the unusual case where the 20+ year US Treasury index was up over 20% YTD at September end, while the MSCI World index was also up 18%, a very unusual situation emerged where both safe haven & riskier assets posted strong returns.

The fourth quarter however certainly sided with the equity bulls, with global equity (MSCI ACWI) returning +9.18% in USD over the 3-month period, while global bonds (JPM GBI) were slightly negative.

What is important is to understand where these equity performances were coming from as is was not uniform in all markets. The below table shows the quarterly and yearly returns for various regional markets in US$

As at 31 December 2019	QTD	2019
US - S&P 500	9.1	31.5
Europe - EuroStoxx 50	9.3	14.0
UK - FTSE 100	10.4	22.0
MSCI Emerging Markets	11.9	18.9

UK General Election

After a tumultuous quarter of Brexit ups-and-downs, citizens of the UK braved cold December weather on their way to the polls for yet another general election. The aim of the snap election, called by Prime Minister Boris Johnson, was to break the parliamentary deadlock that has been limiting progress in BREXIT proceedings in the UK.

The result of the December election was emphatic, with the conservative party gaining 48 seats and labour losing 60 seats. This result has been a strong step toward the Conservative Government goal of formally leaving the EU by the 31 January 2020 extended deadline, starting an 11-month period of negotiations on formal trade agreement with the EU.

Global markets reacted generally positively to the election result as Brexit uncertainty lowered, with Sterling priced securities struggling as the UK currency gained but fears that UK based companies may suffer from a poor EU trade deal persisted.

Trump Impeachment

On December 18, after months of preparation and testimony, the Democratic Party controlled US House of Representatives, commonly known as Congress, voted along party lines to impeach US President Donald Trump. It is important to note that impeachment itself does not remove the president from office, impeachment is merely the act of bringing charges against a government official. The decision of whether the president should be removed from office is to be heard and decided in front of the Senate, which is controlled by the Republican Party (GOP).

The articles of impeachment were largely based on a phone call between President Trump & Ukrainian President Volodymyr Zelensky, where President Trump allegedly attempted to obtain a quid-pro-quo (military aid) from the Ukrainians pertaining to that country investigating on his behalf, his political rival and potential 2020 Democratic Party presidential hopeful Joe Biden.

Congress saw this as proof of Trump soliciting a foreign agent to interfere in the 2020 election, thus he is charged with abuse of power. The second article of impeachment is the obstruction of Congress that pertains to President Trump allegedly ordering his officials to ignore congressional subpoena's.

While it is not yet clear when the Senate trial will begin, to most observers it seems unlikely at best that a Republican controlled Senate would remove a sitting Republican President from office while he is seeking re-election.

US China Trade Deal

The US-Sino trade war has been one of the biggest drivers of uncertainty during 2019, to such a point that a more conciliatory tone from one or other of the parties would send markets up across the globe. It came as good news to the global markets then that on December 15th, 2019 the two countries reached a limited agreement and agreed to halt implementing new tariffs that were due to be implemented on that day.

The two countries are currently fleshing out a "phase-one" trade deal, which is set to be signed at the White House on January 15th. President Trump further stated that he would shortly be making a trip to Beijing to discuss a further "phase-two" deal. While exact details of the document are not yet known, markets reacted positively, with most major indices posting strong gains after the news.

It remains to be seen whether this is the start of a permanent end to the trade war or if President Trump is merely giving in to the pressures that this trade war has placed on the US economy in a year that he is seeking Presidential re-election.

Middle East Tensions

The Middle East has long been a hotbed for global tensions, but the recent tensions between Washington and Tehran has escalated to a point that cannot be ignored.
Since the US withdrew from the 2015 Iran nuclear agreement in late 2018, they have imposed strict sanctions on Iran, focussing specifically on their oil & banking industries, thus putting an economic stranglehold on the oil dependant nation. Iran has responded by strengthening its influence in the region, essentially producing a puppet government in Iraq. Iran has further repeatedly violated the caps imposed on their stockpiles of refined uranium in an attempt to get European nations to circumvent the US sanctions. This combined with various attacks in the region that have been linked to Tehran has driven the US to consider military action.

The US authorized an airstrike on a base controlled by Iran-backed Hezbollah rebels in Iraq, with Iran responding in kind by attacking Iraqi military bases that are strategic points to the US, this resulted in the death of a US civilian contractor, further driving tensions between the two countries.

The tensions between these countries poses a great geopolitical threat, which could be the driving force behind global risk in the foreseeable future.

Post quarter end the Trump ordered the killing of the most senior Iranian military person in an attempt to bring these tensions to a head. Iranian forces have subsequently and mistakenly shot down a Ukrainian passenger jet killing over 170 international and Iranian citizens onboard and causing a global and local outrage thus weakening Iran's negotiating position going forward.

Asset Class Performance (ZAR)

As at 31 December 2019	QTD	YTD	1 Year	3 Years*	5 Years*
Global Equity – MSCI ACWI	0.69	23.43	23.43	13.48	13.11
Global Property - FTSE EPRA Nareit DR	(6.31)	20.64	20.64	9.77	11.01
Global Bond - JPM GBI Global Traded	(8.26)	3.06	3.06	4.78	6.11
Global Cash - ICE LIBOR 1 Month	(7.33)	(0.52)	(0.52)	2.56	5.12
SA Equity - FTSE/JSE All Share	4.63	12.05	12.05	7.42	5.99
SA Property - FTSE/JSE SA Listed Prop	0.58	1.92	1.92	(3.72)	1.21
SA Bond - Beassa ALBI	1.73	10.32	10.32	9.41	7.75
SA Cash - STeFI Call Deposit	1.60	6.64	6.64	6.70	6.55

Asset Class Performance (USD)

As at 31 December 2019	QTD	YTD	1 Year	3 Years*	5 Years*
Global Equity – MSCI ACWI	9.18	26.98	26.98	12.64	8.90
Global Property - FTSE EPRA Nareit DR	1.58	24.11	24.11	8.96	6.88
Global Bond - JPM GBI Global Traded	(0.52)	6.02	6.02	4.01	2.16
Global Cash - ICE LIBOR 1 Month	0.48	2.34	2.34	1.80	1.21
SA Equity - FTSE/JSE All Share	13.46	15.26	15.26	6.63	2.04
SA Property - FTSE/JSE SA Listed Prop	9.06	4.85	4.85	(4.44)	(2.56)
SA Bond - Beassa ALBI	10.31	13.49	13.49	8.60	3.74
SA Cash - STeFI Call Deposit	10.17	9.70	9.70	5.91	2.58