Heidi Dreyer
Head of Corporate Sales

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Market Overview: July 2018

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Despite the escalation in trade tensions in July, improved global sentiment toward emerging markets and risk assets in general helped boost global equities, underpinned by continuing good company earnings reports. The South African rand and bonds benefitted as investors resumed their purchases of SA bonds, with local bonds among the best-performing EM government bond markets in July (in US$ terms). However, South African equities ended the month with a marginally negative return as the stronger rand weighed on the JSE's large global stocks. Global bonds, meanwhile, where impacted negatively by rising US interest rates. Overall, global growth remained broadly robust, but risks to that growth increased somewhat amid some signs of deceleration, with the US's brisk pace of expansion starting to diverge from the rest of the world.

In the US, the latest data showed the factors driving economic expansion remained solid, despite worsening sentiment surrounding the potential damage from the expanding US trade wars with China, the EU and others. US GDP growth for Q2 2018 was reported at 4.1% (q/q annualised), in line with estimates and underpinned by strong consumer and business spending. Unemployment was close to an 18-year low at 4.0%, while inflation remained around the US Federal Reserve's 2% target. In comments to Congress, Fed Chairman Jerome Powell reaffirmed the market's views of further, but gradual, interest rate hikes: two further increases of 25bps each are still expected this year.

Elsewhere, the Euro area's growth slowed to 2.1% (q/q annualised) in Q2 2018 from 2.5% the previous quarter, impacted by higher fuel prices and weaker consumer spending, while unemployment remained steady at 8.3%. The ECB's supportive monetary policy remained in place, with interest rates unchanged as expected. In the UK, while manufacturing was sluggish in Q2, consumer spending was on track for a rebound thanks partly to the summer heatwave, analysts said, which boosted the local economy. UK inflation was flat at 2.4% y/y in June, despite the highest petrol prices in four years. Finally, China's economy grew 6.7% in Q2 2018 (q/q annualised), as expected and down slightly from 6.8% in Q1 due to slower industrial output and business fixed investment as the government continues to put the brakes on bank lending. The negative effects of new trade tariffs are only expected to be felt later in the year.

Looking at global equity market returns (all in US$), the MSCI All Country World Index returned 3.0% in July. Developed markets outperformed emerging markets, with the MSCI World Index delivering 3.1% and the MSCI Emerging Markets Index returning 2.3%. Among developed markets, the S&P 500 produced 3.7% and the Dow Jones Industrial 30 4.8%, while the technology-heavy Nasdaq posted 2.8%. In Europe, the Dow Jones EuroStoxx 50 delivered 4.2%, while the UK's FTSE 100 returned 1.0% and Japan's Nikkei 225 delivered 0.2%. Among larger emerging markets in US$, the strongest performer for the month was Brazil's Bovespa with 11.8%, while the MSCI India returned 6.5%, the

MSCI South Africa 5.1% and the MSCI Russia 4.3%. The weakest markets included the MSCI Turkey (-7.2%), the MSCI China (-2.4%) and South Korea's KOSPI (-0.6%). The Bloomberg Barclays Global Aggregate Bond Index (US$) returned -0.2%, while the EPRA/NAREIT Global Property Index (US$) produced 0.8%.

Meanwhile, Brent crude oil ended the month down at approximately US$74 per barrel from over US$77 at the beginning of July, on the back of several factors including: rising supply from OPEC and other oil producers; a much stronger-than-expected build-up in US inventories; and a revival of fears over weaker energy demand as a consequence of an expected dip in global growth from trade tensions. Gold was also weaker, down for a fourth consecutive month due partly to rising US interest rates and dollar strength. Other precious metals were also broadly weaker, as were industrial metals.

In South Africa, July data indicated that growth was on track for a mild recovery in Q2, aided by improved output across the manufacturing, transport, finance and personal services sectors and smaller contractions in the mining and agriculture sectors. Consensus GDP growth estimates are around 0.5% (q/q annualised), from the 2.2% contraction experienced in Q1. Positive sentiment was also partially revived by the government's announcement of new investment pledges from China and other countries totalling US$35.5 billion, including US$2.5 billion for struggling Eskom from the Chinese Development Bank. Other good news was a record R12 billion trade surplus in June, well ahead of consensus expectations of R5 billion. Meanwhile, June CPI was surprisingly low at 4.6% y/y in July from 4.4% from June, versus the 4.7% expected by analysts, also bolstering sentiment. The stronger rand helped ease inflation concerns highlighted by the SA Reserve Bank at its July Monetary Policy Committee meeting. The SARB kept interest rates on hold, matching market forecasts. However, it did downgrade its 2018 growth forecast to only 1.2% from 1.7% previously. It also remains fixed on trying to anchor inflation expectations around the 4.5% midpoint of its target range. Also on the downside, South Africa's unemployment rate worsened to 27.2% in Q2 from 26.7% in Q1, with unemployment among those aged 15-24 standing at 31.6%.

The BEASSA All Bond Index returned 2.4% for July, buoyed by renewed foreign and local buying as yields became more attractive after three months of strong foreign selling. Inflation-linked bonds (the Composite ILB Index) produced 0.3%, and cash as measured by the STeFI Composite Index returned 0.6%. The rand retraced some of its losses in July, gaining 4.3% against the US dollar, 4.1% against the euro, and 4.9% against the pound sterling.

As for South African equities, the FTSE/JSE All Share Index returned -0.2% in July, hurt by the stronger rand as non-rand earnings from the large Resources stocks and global companies like Naspers became less valuable in rand terms. Naspers was also dented by its stake in Chinese online group Tencent, whose shares have been under pressure for most of the year. Industrials were the worst performers with a -2.0% return in July, while Resources stocks produced -1.4%. Listed property shares were also marginally negative at -0.5%, while Financials managed to deliver a 4.7% return.

According to Morningstar data, the average ASISA SA general equity fund returned 0.6% for the month. The average multi-asset high equity (balanced) fund delivered 0.1%, while multi-asset low equity funds averaged 0.2%, and multi-asset income funds returned 0.7% on average.

To find out more about **Prudential funds** contact our Client Services Team on 0860 105 775 or at **query@prudential.co.za**.

Sources: Prudential, M&G Investments, Bloomberg, Morningstar data to 31 July 2018

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