Alliance Midmed Medical Scheme
Quarterly Investment Management Report

Prepared by **Old Mutual Wealth Treasury and Advisory Services**

Quarterly Report – 31 March 2018

Table of Contents

1. Introduction

The purpose of this document is to monitor and evaluate the performance of the underlying assets of the Alliance Midmed Medical Scheme (“the Scheme”) as at 31 March 2018.

2. Investment Strategy Statement

The Trustees are ultimately responsible for achieving the investment objectives of the Scheme. The Trustees have outsourced the functions of achieving the investment objectives to Old Mutual Wealth who invest the funds with the following purpose and philosophy, but not limited to, in mind:

2.1. Purpose

- Actual investments are outsourced to specialist asset managers
- Managers selected and mandates are consistent with the fund’s objectives
- Performance will be evaluated

2.2 Philosophy

- Prudent investment portfolio
- Objectives are considered as a whole
- Seek real returns as measured by cpi
- Ensure liquidity
- Preservation of capital is paramount
- Ensure compliance
- Risk profile includes low investment risk only

2.3 Risk Tolerance

The most important financial objective of the scheme is to provide for benefit payments and expenses as they fall due. The major components of the **liabilities** are therefore **short term** in nature and the risk tolerance for short term volatility is very low.

3. Asset Liability Matching

3.1. Scheme Facts as at 31 March 2018

Investment Status

Total investments (March 2018)	R84.5m
Investment income March 2018 YTD	R0.3m

Cash Flow Analysis

Solvency (March 2018)	36.4%
Budgeted Annual contributions (2018)	R93.4m
Budgeted Annual claims (2018)	R86.5m
Budgeted Annual non-healthcare expenditure (2018)	R6.4m
Savings liability (March 2018)	R32.2m
Provision for outstanding claims (March 2018)	R3.6m

Membership Data

Number of members	1,803

3.2. Reserve Levels

3.2.1. Statutory reserve levels

The Medical Schemes Act requires medical schemes to maintain accumulated reserves, expressed as a percentage of contributions, of no less than 25% for the accounting period under review. Based on the budgeted contributions for 2017, the statutory reserve requirement would be **R21.5m**.

3.2.2. Liquidity

In order to manage liquidity risk, the medical schemes should typically have sufficient liquid assets available at all times to meet claims and expenses for **two months**. This amounts to **R16.8m** based on average actual expenses for 1Q18.

3.2.3. Solvency assets and surplus assets

In determining the value of the legislated assets, the following principle applies. In terms of Regulation 30(1) and 30(2), a medical scheme is required to hold assets of not less than the sum of :

- The fair value of the Scheme's liabilities ; PLUS
- The minimum statutory accumulated funds required in terms of 29(2) - 25% of gross annual contributions

This amount can be referred to as the solvency assets and the balance will be referred to as excess assets. The valuations are:

	March 2018 (R)
Required solvency	23,338,323
Savings plan liability	32,247,755
Accounts payable	2,872,873
Provision for outstanding claims	3,563,010
Legislated assets	**62,021,961**
Surplus assets	22,454,931
Total Investments including savings	**84,476,892**

3.2.4. Tax

Registered Medical Schemes are exempt from tax in terms of Section (1) (d) of the Income Tax Act. Medical Schemes are also exempt from Capital Gains Tax.

.

Return Objective Analysis

4.1. Return Objective

The return objective of the long term assets is CPI+4%.

4.2. Analysis of Medical Inflation

4.2.1 Components of Medical Inflation

Medical inflation is monitored by Statistics SA and is made up of the following components:

Medical Products	
Pharmaceutical products	36.5%
Pharmaceutical products-dispensing fees	1.4%
Out Patient Services	
Medical services	45.3%
Dental services	6.1%
Hospital Services	
Hospital services	10.8%

Please note: medical inflation represents approximately 1.48% of the CPI from January 2009.

4.2.2. Medical Inflation vs. Return Objective

% YoY	Dec 2005	Dec 2006	Dec 2007	Dec 2008	Dec 2009	Dec 2010	Dec 2011	Dec 2012	Dec 2013	Dec 2014	Dec 2015	Dec 2016	Dec 2017
CPI	3.6	5.8	9.0	9.5	6.3	3.5	6.1	5.7	5.4	5.3	5.2	6.8	4.7
Medical	7.0	6.5	5.8	6.9	10.5	7.3	5.2	5.4	4.5	5.6	6.3	5.7	5.7
CPI plus 4%	7.6	9.8	13.0	13.5	10.3	7.5	10.1	9.7	9.4	9.3	9.3	10.8	8.7

The return objective has been consistently ahead of medical inflation.

5. Risk / Return Analysis

April 2018	Annualised Return				Volatility
Asset Class/Index	Quarter	1 yr pa	3 yrs pa	5 yrs pa	3 yrs
Cash / SteFi Comp	1.7%	7.5%	7.2%	6.6%	0.2%
Bonds / ALBI	5.3%	13.7%	8.6%	6.7%	7.8%
Property/SAPY (TR)	-3.9%	-0.5%	2.0%	7.2%	14.3%
Equity /JSE ALSI (TR)	-1.0%	11.4%	5.3%	11.7%	11.5%
CPI (March 2018)	1.4%	3.8%	5.4%	5.3%	-
Medical Inflation (March 2018)	4.1%	5.1%	5.9%	5.8%	-

Source: Statistics SA, Reuters and I-net

6. Market Overview : First Quarter 2018

Synopsis:

- **Markets shrug off Fed rate hike, but sell off as fears over a trade war increase.**
- **Moody's maintains South Africa's investment grade credit rating as economic growth prospects improve.**
- **SARB cuts rates as inflation falls faster than expected.**

Global

The US Federal Reserve (the Fed) hiked interest rates as expected for only the sixth time in the current cycle that started in December 2015, but the market reaction was muted. Instead, the market reaction was focused on the prospect of a tit-for-tat trade war after US President Donald Trump announced tariffs on US imports of steel and aluminium, and on some $60 billion of Chinese goods. China retaliated, announcing it would raise tariffs on $3bn of mostly food imports from the US. By themselves, these tariffs impact a relatively small slice of US (and Chinese) trade, and shouldn't hurt economic growth much. The risk is rather that it escalates into a global trade war, where each country puts up higher barriers, disrupting the trade-based global economy.

As it is global trade has not rebounded as strongly as global economic growth, in contrast to the pre-2008 experience. In Trump's worldview, trade is a zero-sum game, where one party's gains are another's losses, but in fact trade between nations increases overall prosperity. However, it does so precisely by putting inefficient producers out of business. In other words, by creating winners and losers in each country. The winners tend to be consumers, who are spread widely and each gain a little. The losers tend to be factory workers, fewer in number but concentrated geographically, whose losses are large. If the winners fail to look after the losers, as has been the case in many places, it creates fertile ground for populist politicians.

The Fed hike takes the federal funds rate target range to 1.5% to 1.75%. What the market really wanted to know was whether the "dot plot" – the projections of each individual meeting participant - would show a faster path of rate hikes in the future. According to these dots, rates could rise somewhat faster in 2019 and 2020 than previously thought. By 2020, the federal funds rate is expected to be 3.4%, 50 basis points above what the Fed considers to be the long-run (or neutral) rate of 2.9%. In other words, while rates are rising, only by 2020 will the Fed's policy stance be contractionary. The current stance is therefore still expansionary and should continue supporting economic activity and financial markets.

The Fed's preferred inflation measure - the personal consumption expenditure deflator – crept up to 1.7% in February, but is still below the 2% target. The US economy grew by 2.5% year-on-year in the final quarter of 2017

Across the Atlantic, European Central Bank (ECB) president Mario Draghi said he needed “further evidence” that inflation was heading towards the bank’s target of slightly below 2%. In the meantime, the ECB’s approach to monetary policy would “remain patient, persistent and prudent”. The ECB will continue to buy €30bn bonds per month until September, and maintain negative interest rates beyond then. Eurozone inflation was only 1.1% in February, lower than initially thought with the strong euro (up 16% against the dollar over the past 12 months) putting some downward pressure on price increases.

Eurozone sentiment indicators were lower in March, showing that growth momentum was softer. However, the absolute level of the indicators are still elevated and consistent with economic growth in excess of 2%. The Eurozone grew by 2.7% year-on-year in the final quarter of 2017. They also show solid growth across sectors and the various countries that are members of the Eurozone.

Japan’s economy grew by 2% year-on-year in the final quarter, capping one of the longest positive growth streaks (eight consecutive positive quarters) in decades.

China’s economy grew 6.9% in year-on-year in the fourth quarter, quashing fears of a downshift in growth after the implementation of measures to rein in excess credit. However, there has been a meaningful shift in the composition of economic growth, with the services sector expanding by 8%, while growth in the secondary sector (the traditional economic engines of manufacturing and construction) slowing to 6.1%). The government maintained the 2018 growth target at “around 6.5%”, but this effectively implies a reduction since it will no longer aim to overshoot its target.

Local

Real gross domestic product – the broadest measure of economic activity after inflation and seasonality are adjusted for – grew at an annual rate of 3.1% compared to the third quarter of 2017. It means that growth for the 2017 calendar year was 1.3%. This is still a pedestrian growth rate, but is double 2016’s growth rate of 0.6% (which was revised up from 0.3%) and was better than widely expected. Last year’s technical recession was also revised away as the latest estimates show only one negative quarter, not two consecutive negative quarters.

Boding well for future growth is the improvement in confidence. The BER/RMB Business Confidence Index increased to the highest level in three years in the first quarter, as businesses express optimism over the recent political changes. However, the latest reading of 45 index points still suggests that the majority of respondents are pessimistic. This should improve in coming quarters, though, resulting in businesses expanding investment and hiring in the local economy.

A number of economic forecasters are now upgrading their expectations for growth in the coming few years, including the SA Reserve Bank. The SARB expects the economy to expand by 1.7% in 2018, compared with 1.4% previously. Its Monetary Policy Committee also cut the repo rate by 25 basis points to 6.5%, but three of its seven members would have preferred rates to stay unchanged. The SARB’s inflation forecast shows a moderate improvement from the previous meeting, despite some expected upward pressure on prices from the April VAT increase, fuel levy hikes and low base. The stronger rand despite a US rate hike is a big contributing factor. Overall consumer inflation declined by more than expected in February, with the annual increase in the consumer price index dropping to 4% from 4.4% in January. Core inflation, excluding volatile food, fuel and energy prices, remained steady at 4.1%, in the bottom half of the Reserve Bank’s 3% to 6% target range.

Moody’s maintained South Africa’s local and foreign currency ratings at Baa3, the last notch above so-called junk status. It also changed the ratings outlook to stable. Moody’s noted that the decline in the country’s institutional strength had been halted, while improved growth outlook and return to fiscal consolidation were also key drivers.

Since the information that ratings agencies rely on is mostly publically available, they tend to tell investors what they already know. Instead, what made this announcement significant is that Moody’s is the last of the major agencies that rate South Africa as investment grade, allowing for our inclusion in the Citigroup World Government Bond index. A downgrade would have resulted in forced selling by investors tracking this index, a source of concern in some quarters, especially for the SARB.

Another big concern for the Reserve Bank over the years has been the current account deficit, as it is largely financed by portfolio inflows (foreigners buying shares and bonds). If these flows dry up, the rand typically comes under tremendous pressure. The fourth quarter current account deficit of 2.9% of GDP was somewhat larger than expected, and up from 2.1% in the third quarter. However, the deficit has more than halved from the almost 7% peak in 2013. That was the same year that the market was surprised by then Fed chair Ben Bernanke's musings that a scaling back or tapering of quantitative easing loomed, a sell-off that was later dubbed the "taper tantrum." The rand depreciated 23% against the dollar in 2013, and the experience clearly embedded itself in the SARB's thinking. The current environment is therefore different in two key respects: the Fed is very careful to signal its intentions and not, as far as possible, to surprise the market, and secondly our external vulnerability to a nasty Fed surprise has diminished.

Credit growth continues to be extremely weak, supporting the case for a rate cut. Total banks loans and advances expanded by only 4.3% in February from a year ago. Household credit extension grew by only 3.8%, and lending to corporates by 4.8%.

Sources: I-Net, Datastream, SARB, StatsSA, JP Morgan, Deutsche Bank

7. Allocation of Assets

7.1. Mandate / Asset Allocation – March 2018

Assets are allocated to the following mandates and managers.

Investment Portfolio	Cash		Bonds		Property		Equity		Other		Total
	"Rm"	%	"Rm"	%	"Rm"	%	"Rm"	%	"Rm"	%	"Rm"
Acsis Cash Portfolio plus current account	45.1	100.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	45.1
Coronation Medical Schemes Portfolio	4.6	25.9%	5.1	29.1%	1.7	9.7%	6.2	35.3%	-	0.0%	17.6
Prudential Inflation Plus 5% Medical Aid Fund	1.3	5.8%	10.2	46.9%	2.0	9.4%	8.1	37.1%	0.2	0.9%	21.7
Total	**50.9**	**60.3%**	**15.3**	**18.1%**	**3.7**	**4.4%**	**14.3**	**16.9%**	**0.2**	**0.2%**	**84.5**

8. Cashflow Analysis and Valuations

8.1. Cashflow

Cashflow (R)	1Q17	2Q17	3Q17	4Q17	1Q18
Acsis Treasury: Risk	-	-	-	-	-
Coronation Medical Schemes Portfolio	-	-	-	-	-
Prudential Medical Schemes Portfolio	-	-	-	-	-

8.2. Valuation : 2017 (Excluding Savings)

Portfolio Name (R)	31/03/2017	30/06/2017	30/09/2017	31/12/2017
Acsis Cash Portfolio pluscurrent account	14,301,729	14,542,778	12,812,704	12,789,606
Coronation Medical Schemes Portfolio	16,977,037	16,953,903	17,507,606	17,743,780
Prudential Inflation Plus 5%	20,175,033	20,114,803	21,124,643	22,080,191
Total	**51,453,799**	**51,611,484**	**51,444,953**	**52,613,577**
Growth/Burn Rate (Per Quarter)	**-182,143**	**157,685**	**190,989**	**977,635**

During the calendar year of 2017, the asset base of the scheme increased by R977,635.

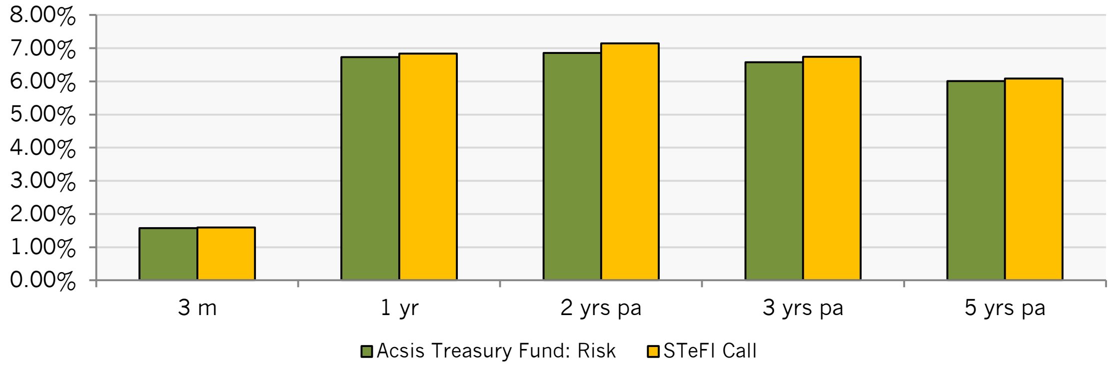
8.3. Valuation : 2018

Portfolio Name (R)	31/03/2018	30/04/2018	30/06/2018	30/09/2018
Acsis Cash Portfolio pluscurrent account	45,111,518	46,307,623		
Coronation Medical Schemes Portfolio	17,632,831	17,951,106		
Prudential Inflation Plus 5%	21,732,543	22,176,909		
Total	**84,476,892**	**86,435,638**		
Growth/Burn Rate (Per Quarter)	**31,863,315**	**-**		

During the first quarter of 2018, asset base grew by R31.7 million to R84.5 million (bearing in mind that the savings assets are now included above). In addition, the assets grew by R 2.0 millio in the month of April.

9. Return Analysis to Benchmark (after fees)

9.1. Acsis Treasury: Risk

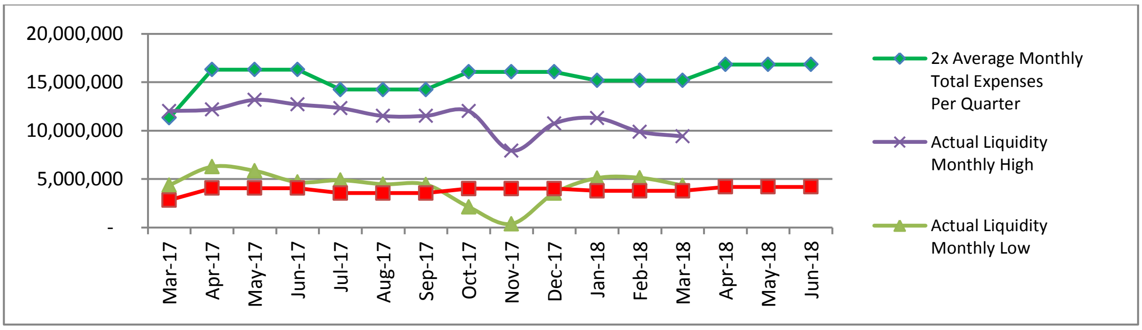


Performance as at 30 April 2018

	3 m	1 yr	2 yrs pa	3 yrs pa	5 yrs pa
Acsis Treasury Fund: Risk	1.57%	6.73%	6.85%	6.58%	6.01%
STeFI Call	1.60%	6.84%	7.14%	6.74%	6.08%

The primary purpose of this fund is to sweep the current account daily, fund claims and expenses as they fall due and maximise the return. The investment strategy is to keep 2 times monthly outflows on call and to increase the average duration by shifting assets along the curve to take advantage of the positive slope.

The liquidity strategy is to ensure a "high" level at 2 times averages monthly outflows "after contributions/before outflows" and similarly a "low" level, which is not less than 0.5 times average monthly outflows, "after outflows/before contributions".



The graph above shows the suggested liquidity levels for the next quarter based on actual outflows experienced by the scheme in the previous quarter. The graph also shows the actual "high" and "low" for each month in relation to funds under management in the liquidity portfolio.

Liquidity Measurement:

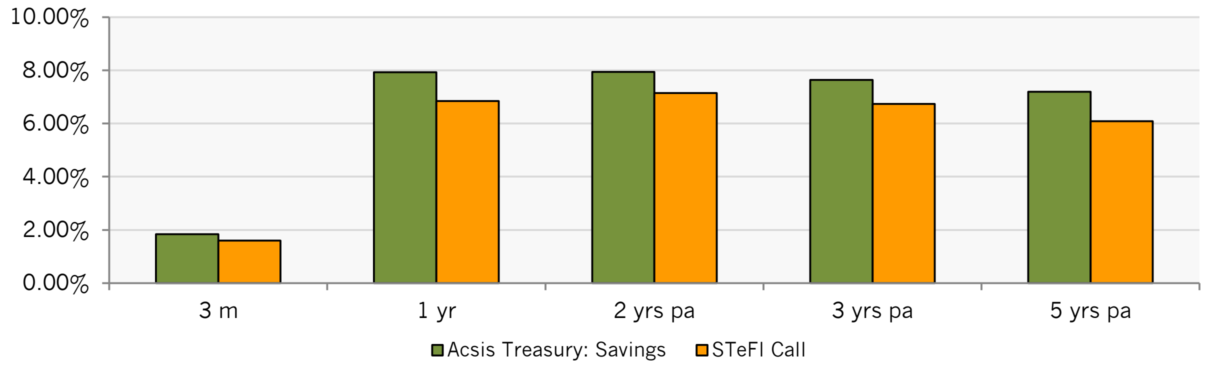
The Schemes required liquidity levels for the quarter is **R16.8m/R4.2m** and the actual high/low of March 2018 was **R9.4m/R4.3m** with a closing balance of **R9.4m** as at 31 March 2018. The liquidity levels of the scheme is sufficient to cover claims and expenses, however it is running a very short duration.

Fixed Deposits

Investments in fixed deposits amounted to **R2.0m** as at 31 March 2017. This includes **R2.0m** used on 14-day fixed deposits to take advantage of the attractive rates.

Fund Manager	: Leon Nel
Fund Size	: R12.9 million
Average Duration	: 1 day

9.2. Acsis Treasury: Savings:



Performance as at 30 April 2018

	3 m	1 yr	2 yrs pa	3 yrs pa	5 yrs pa
Acsis Treasury: Savings	1.84%	7.93%	7.94%	7.64%	7.19%
STeFI Call	1.60%	6.84%	7.14%	6.74%	6.08%

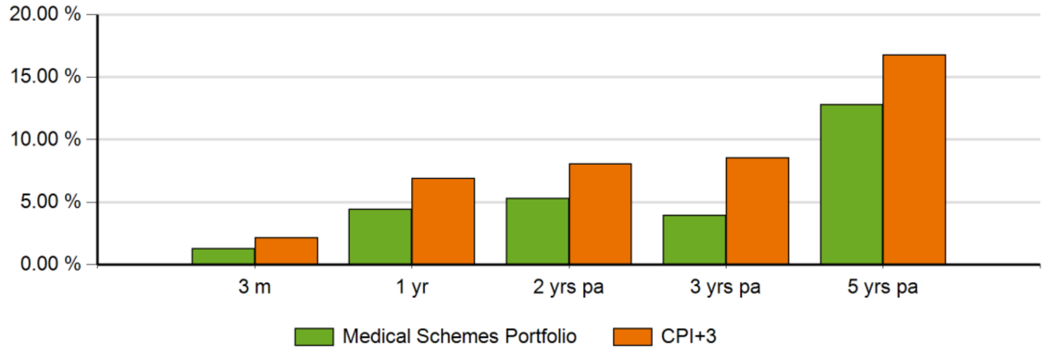
	31/03/2017	30/04/2017	31/05/2017	30/06/2017	30/09/2017	31/12/2017	31/03/2018
Gross yield (p.a.)	8.068%	8.052%	8.057%	8.063%	7.970%	7.890%	7.817%
Fee (p.a.)	0.285%	0.285%	0.285%	0.285%	0.285%	0.285%	0.285%
Net Yield (p.a.)	7.779%	7.767%	7.772%	7.778%	7.685%	7.605%	7.532%

Investments in call accounts were **R4.2m** as at 31 March 2018.

Investments in fixed deposits amounted to **R29.1m** as at 31 March 2018. This includes **R0m** of liquidity funds that were used on 14 day fixed deposits and repo's to take advantage of the attractive rates.

Fund Manager : Leon Nel
Fund Size : R28.6 million
Average Duration : 184 days

9.3. Coronation Medical Schemes Portfolio (R 17,951,106)



Performance as at 30 April 2018

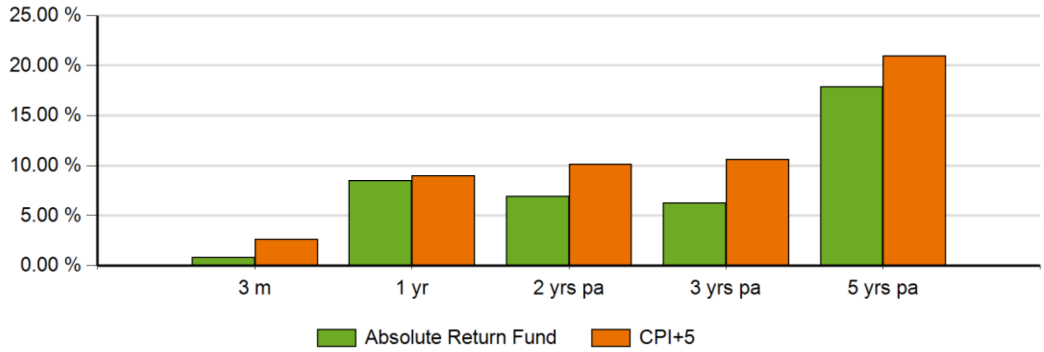
The CPI figures are lagged by one month as they were calculated before the current inflation rate was released.

	3 m	1 yr	2 yrs pa	3 yrs pa	5 yrs pa
Fund	1.28%	4.47%	5.31%	3.97%	6.41%
CPI+3	2.18%	6.92%	8.10%	8.55%	8.40%

transaction history

traded	transaction type	value (R)
02-Dec-2015	sales	2,000,000
25-Aug-2011	purchases	12,000,000

9.4. Prudential Medical Schemes Portfolio (R22,176,909)



Performance as at 30 April 2018

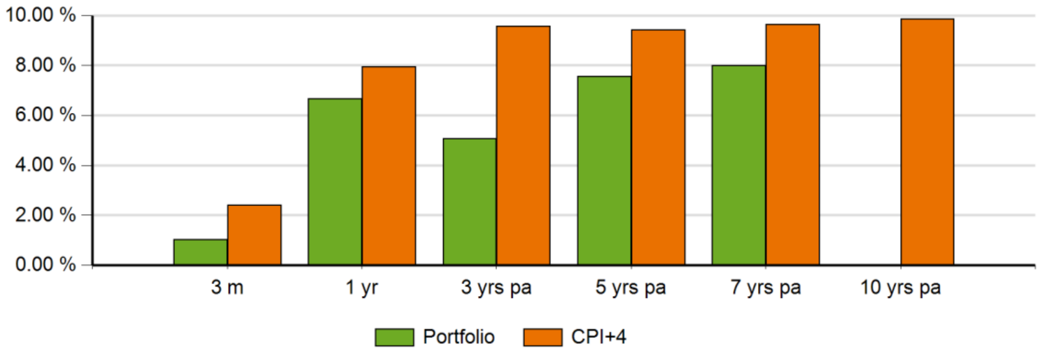
The CPI figures are lagged by one month as they were calculated before the current inflation rate was released.

	3 m	1 yr	2 yrs pa	3 yrs pa	5 yrs pa
Fund	0.84%	8.54%	6.95%	6.32%	8.97%
CPI+5	2.67%	8.99%	10.19%	10.65%	10.50%

transaction history

traded	transaction type	value (R)
18-Oct-2016	purchases	1,000,000
13-Sep-2016	purchases	1,000,000
24-Aug-2016	purchases	1,000,000
04-Dec-2015	purchases	2,000,000
30-Nov-2012	purchases	10,000,000

9.5. Growth Assets: Actual Return vs Objective (R40,128,015)



Performance as at 30 April 2018

The CPI figures are lagged by one month as they were calculated before the current inflation rate was released.

	3 m	1 yr	3 yrs pa	5 yrs pa	7 yrs pa	10 yrs pa
Portfolio	1.04%	6.68%	5.08%	7.56%	8.00%	
CPI+4	2.43%	7.95%	9.60%	9.45%	9.66%	9.87%

10. Top 10 Equity Holdings as at 31 March 2018

Share Name	% of Total Investment	3 months returns % to March 2018	12 months returns % to March 2018
Naspers Ltd	1.7%	-16.2%	24.9%
British American Tobacco	1.1%	-16.0%	-21.0%
Standard Bank Group Ltd	1.0%	11.8%	52.1%
Anglo American Plc	0.9%	8.1%	35.4%
Old Mutual Plc	0.9%	6.4%	20.0%
MTN Group Ltd	0.8%	-12.9%	-2.4%
Sasol Ltd	0.7%	-5.8%	3.2%
Firstrand Ltd	0.6%	-0.5%	44.3%
Aspen Pharmacare Holdings Ltd	0.5%	-6.5%	-5.6%
Barclays Africa Grp Ltd	0.5%	4.2%	36.0%

Total investment (including the savings component)

11. Actual vs Strategic Asset Allocation

	Actual Asset Allocation		Strategic Asset Allocation	Variance to Midpoint
	R (million)	%	%	%
Cash	50.9	60.3	30-50	+20.3
Bonds	15.3	18.1	20-40	-11.9
Equity (including property)	18.2	21.6	25-35	-8.4
Total	**84.5**	**100.0**	**100.0**	**0.0**

Comment : At the last meeting, a decision was taken to include the savings assets into the overall investment strategy as well as make changes to the strategy (details in Section 13). The strategy is being implemented as the fixed deposits mature from the original savigs portfolio. As this is the early stage of the implementation process, the the actual allocations will be out of line with the strategic allocations.

12. Compliance Analysis and Measurement

Old Mutual has analysed the Scheme's investments as at 31 March 2018 in relation to Annexure B of the Medical Schemes Act of 1998 and Circular 23. The Scheme's investments were compliant in all items..

Requirement:

Compliance to Annexure B of the Medical Schemes includes:

Cash	No more than 35% to any major bank in SA. No more than 15% offshore
Bonds	Up to 100% in government bonds No more than 20% to Eskom, Transnet, Landbank etc
Property	No more than10%.
Equity	No more than 40% and no more that 7.5% per each equity No offshore exposure

Circular 23

Circular 23 was issued by the Council on 19 June 2012. It requires that medical schemes hold cash deposits directly with banks of at least 20%. As at end March 2018, this measured 53.4% for Alliance Midmed Medical Scheme (including savings). The Scheme is therefore compliant.

13. Observations

At the last meeting, a number of investment decisions were taken :

1- The savings assets are to be included in the investment strategy.

2- The savings assets (R 33 million and all in cash) are to be re-invested as follows :

R 3 million : to be retained in the Cash Portfolio
R 20 million : to the (new) StanLib Income Fund
R 5 million : to the (new) SIM Absolute Return Medical Fund
R 5 million : to the (existing) Prudential Inflation Plus 5 % Fund

3- The extracts from the minutes were duely signed on 18 April 2018 and the implementation process is under way. As the fixed deposits of the Savings portfolio mature, the proceeds will be transferred to the Cash Portfolio until complete, the StanLib Income Fund until complete, the SIM Portfolio until complete and the balance to the Prudential Fund.

The Cash Portfolio transferes are complete. During May, a tranche of R 5 million will be transferred to commence the StanLib Income Fund.

4- Strategy Allocation

In terms of actual asset allocation, the strategy will be out of line with the strategic allocation during the implementation process.

Dieter Briechle

Investment Consultant

May 2018