Alliance Midmed Medical Scheme

Monthly Consulting Report

31 March 2018

Old Mutual Wealth TAS, No1 Mutual Place, 2nd Floor, 107 Rivonia Road, 2196
Sandton, Johannesburg: +27 11 217 1331 | tas@omwealth.co.za | www.omwealth.co.za

portfolio summary

valuations

month	valuation (R)
March 2018	39,354,467
February 2018	39,787,315
December 2017	39,813,103
March 2017	37,141,555
March 2016	32,193,111
March 2015	31,109,753
March 2013	25,407,359

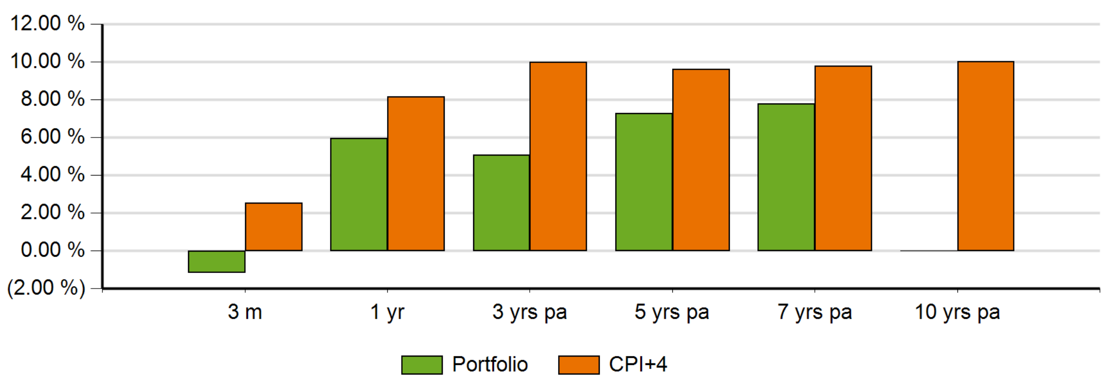
underlying investments

investment	valuation (R)
Absolute Return Fund	21,721,637
Medical Schemes Portfolio	17,632,831
total	39,354,467

transaction history

traded	fund	transaction type	value (R)
18-Oct-2016	Prudential Portfolio Managers - Absolute Return Fund	purchases	1,000,000
13-Sep-2016	Prudential Portfolio Managers - Absolute Return Fund	purchases	1,000,000
24-Aug-2016	Prudential Portfolio Managers - Absolute Return Fund	purchases	1,000,000
04-Dec-2015	Prudential Portfolio Managers - Absolute Return Fund	purchases	2,000,000
02-Dec-2015	Coronation - Medical Schemes Portfolio	sales	2,000,000
30-Nov-2012	Prudential Portfolio Managers - Absolute Return Fund	purchases	10,000,000
30-Nov-2012	Prescient Management Co. Ltd - Positive Return Fund	sales	13,843,861
25-Aug-2011	Coronation - Medical Schemes Portfolio	purchases	12,000,000
19-Aug-2011	STANLIB - Medical Investment Fund	sales	11,905,790
11-Jun-2008	Prescient Management Co. Ltd - Positive Return Fund	purchases	10,000,000

performance analysis



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	-1.15%	5.96%	5.08%	7.28%	7.81%	
CPI+4	2.53%	8.18%	9.99%	9.63%	9.79%	10.01%

Coronation - Medical Schemes Portfolio

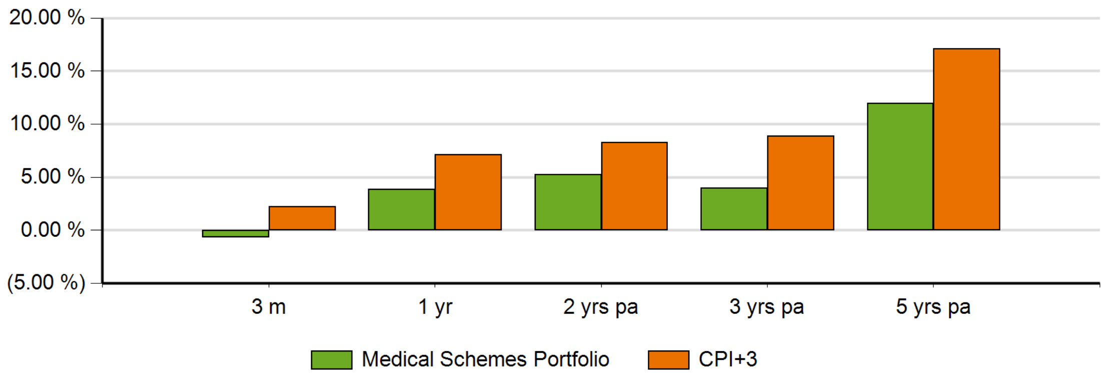
valuations

month	valuation (R)
March 2018	17,632,831
February 2018	17,691,344
December 2017	17,743,780
March 2017	16,977,037
March 2016	15,910,139
March 2015	17,700,434
March 2013	14,883,798

transaction history

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

performance analysis



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	-0.63%	3.86%	5.27%	4.02%	6.00%
CPI+3	2.28%	7.14%	8.29%	8.93%	8.58%

Prudential Portfolio Managers - Absolute Return Fund

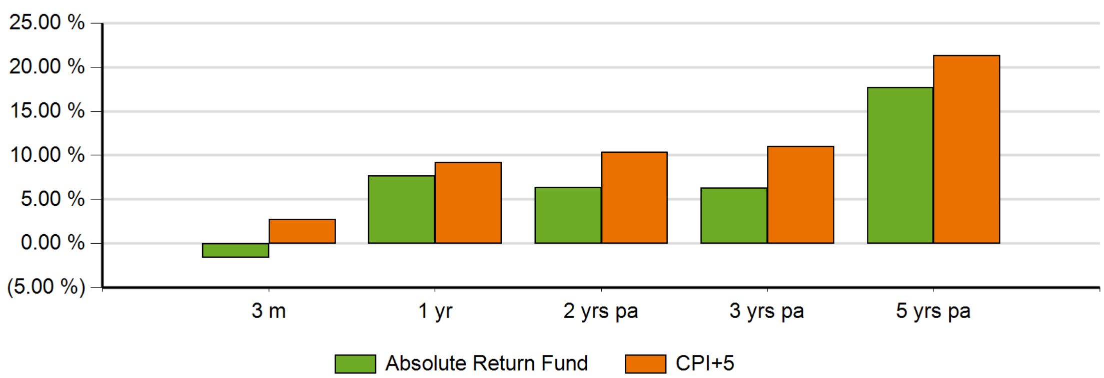
valuations

month	valuation (R)
March 2018	21,721,637
February 2018	22,095,971
December 2017	22,069,323
March 2017	20,164,519
March 2016	16,282,972
March 2015	13,409,319
March 2013	10,523,560

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

performance analysis



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	-1.58%	7.72%	6.38%	6.29%	8.88%
CPI+5	2.78%	9.22%	10.38%	11.04%	10.68%

Alliance Midmed Medical Scheme

Treasury Management Report

March 2018

Old Mutual Wealth TAS, No1 Mutual Place, 2nd Floor, 107 Rivonia Road, 2196
Sandton, Johannesburg: +27 11 217 1331 | tas@omwealth.co.za | www.omwealth.co.za

Table of Contents

Portfolio Analysis

average funds (R)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
call deposits	6,555,572	6,818,666	6,818,666	6,194,280	7,201,549	7,559,130	7,664,230	7,379,808	6,996,535
fixed deposits	2,709,677	2,119,676	2,119,676	2,160,871	2,615,068	2,588,237	3,225,396	3,797,147	5,269,645
weighted totals	9,265,249	8,938,342	8,938,342	8,355,151	9,816,617	10,147,368	10,889,626	11,176,955	12,266,179

average interest earned (R)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
call deposits	37,492	37,587	37,587	34,453	40,946	43,344	43,952	40,589	35,316
fixed deposits	15,682	11,091	11,091	11,260	14,552	14,676	18,715	20,926	25,901
weighted totals	53,174	48,678	48,678	45,713	55,498	58,020	62,667	61,515	61,217

note: weighted totals are per month

Alliance Midmed Medical Scheme

Performance Analysis

average investment returns (%)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
weighted totals	0.58	1.67	1.67	3.41	7.05	7.12	7.15	6.83	6.26

industry returns (%)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
cash benchmark: STeFI Call Index	0.52	1.62	1.62	3.28	6.79	7.22	7.12	6.69	6.05
STeFI Composite	0.56	1.76	1.76	3.57	7.41	7.51	7.50	7.20	6.60
STeFI 3 Month	0.54	1.69	1.69	3.41	7.05	7.11	7.13	6.83	6.29

please note: the 18 - 60 months returns are annualized

Cash flow Summary

contribution and withdrawals	number	total rand value
contribution	5	6,840,000
withdrawal	8	7,270,000

Investment Summary

call balances	call cost (R)	call accrued int (R)	call total balance (R)	rate (%)
ABSA Bank Ltd	81,666	449	82,115	6.250
FirstRand Bank Ltd	3,430	19	3,449	6.250
Investec Bank Ltd	2,952,729	8,672	2,961,402	6.400
Nedbank Ltd	1,456,469	4,595	1,461,064	6.250
Nedbank Ltd	1,953,912	12,252	1,966,163	7.050
The Standard Bank of South Africa Ltd	2,951,307	11,505	2,962,812	6.300
total	9,399,513	37,492	9,437,005	

fixed deposit maturities	instrument	purchase date	maturity date	cost (R)	maturity value (R)	interest received (R)	rate (%)
Investec Bank Ltd	14 DAY FTD	21/02/2018	07/03/2018	1,000,000	1,002,647	2,647	6.900
Investec Bank Ltd	14 DAY FTD	28/02/2018	14/03/2018	1,000,000	1,002,647	2,647	6.900
Investec Bank Ltd	14 DAY FTD	07/03/2018	22/03/2018	1,000,000	1,002,836	2,836	6.900
Investec Bank Ltd	14 DAY FTD	14/03/2018	28/03/2018	1,000,000	1,002,647	2,647	6.900
The Standard Bank of South Africa Ltd	14 DAY FTD	28/02/2018	14/03/2018	1,000,000	1,002,560	2,560	6.675
The Standard Bank of South Africa Ltd	14 DAY FTD	07/03/2018	22/03/2018	1,000,000	1,002,743	2,743	6.675

fixed deposit purchases	instrument	purchase date	maturity date	cost (R)	current value (R)	accrued interest (R)	rate (%)
Investec Bank Ltd	14 DAY FTD	07/03/2018	22/03/2018	1,000,000	1,002,836	2,836	6.90
Investec Bank Ltd	14 DAY FTD	14/03/2018	28/03/2018	1,000,000	1,002,647	2,647	6.90
Investec Bank Ltd	14 DAY FTD	28/03/2018	11/04/2018	1,000,000	1,000,756	756	6.90
The Standard Bank of South Africa Ltd	14 DAY FTD	07/03/2018	22/03/2018	1,000,000	1,002,743	2,743	6.68
The Standard Bank of South Africa Ltd	14 DAY FTD	28/03/2018	11/04/2018	1,000,000	1,000,732	732	6.68

fixed deposit balances	instrument	purchase date	maturity date	cost (R)	current value (R)	accrued interest (R)	rate (%)
Investec Bank Ltd	14 DAY FTD	28/03/2018	11/04/2018	1,000,000	1,000,756	756	6.900
The Standard Bank of South Africa Ltd	14 DAY FTD	28/03/2018	11/04/2018	1,000,000	1,000,732	732	6.675
total				2,000,000	2,001,488	1,488	

Compliance Analysis

	moodys rating	exposure (%)	mandate requirement (%)	market value (R)
Absa Bank Ltd	Aa1.za	0.72	35.00	82,114.92
FirstRand Bank Ltd	Aaa.za	0.03	35.00	3,448.87
Investec Bank Ltd	Aa1.za	34.64	35.00	3,961,968.78
Nedbank Ltd	Aa1.za	29.96	35.00	3,427,227.09
The Standard Bank of South Africa Ltd	Aa1.za	34.65	35.00	3,963,360.93
Total funds as at month end				11,438,120.59

Economic Commentary

The economy ended 2017 in better shape than most expected. Stats SA revised the GDP figures for past three years upwards. It now shows that real GDP grew by a seasonally adjusted annualised 3.1% q-o-q in 4Q17, compared with growth of 2.3% and 2.9% in 3Q17 and 2Q17 respectively and a contraction of 0.5% in 1Q17. This acceleration helped push GDP growth for 2017 as a whole to 1.3% from an upwardly revised 0.6% in 2016. The recent revisions to the GDP figures have bumped up our forecast for 2018 and 2019 to 1.8% (previously 1.6%) and 1.9% (previously 1.8%) respectively. Our forecast for 2020 remains unchanged at 2.4%.
March was an eventful month, with Moody's leaving SA's sovereign credit rating unchanged at Baa3 and raising the outlook to stable from negative. Furthermore, the SARB reduced the repo rate by 25bps as the risks of a weaker rand has receded following the Moody's credit rating review (as the threat of a WGBI exclusion has diminished). The local bond market rallied sharply over the past month, with the nominal bond curve flattening by almost 30bps.
Similarly, the rand remained strong in March, supported by expectations of a 'stay of execution' by Moody's and a stable socio-political backdrop. The SARB decision to reduce the interest rate in March may slow down the pace of the appreciation in the rand in the near-term (due to lower real yields). Marginal rand weakness is envisaged through the course of the year. However, should the rand surprise to the upside, this will likely pose some downside risks to the inflation profile, particularly that of the SARB's.We still believe that the current real interest rate is still supportive of persistent foreign capital inflows, which could see the rand being supported further in coming months, although this is not our base case.
The SARB's key focus at the moment seems to be bringing down inflation expectations to 4.5%. Nedbank CIB Markets Research forecasts a further 25bps reduction in the repo rate this year, however, we see this cut coming through in July or September 2018 rather than in May, as the SARB reflects on various data releases (inflation expectations being key) and the trajectory of the rand exchange rate in the interim.

The SARB reduced the repo rate by 25bps to 6.5%, taking prime to 10%. This was in line with the consensus view as well as with our own expectations. Four MPC members voted in favour of the cut and three members voted for unchanged interest rates. The inflation profile was raised out to 1Q19 (taking into account the effect of a VAT hike); inflation forecasts were then reduced sharply thereafter (Chart 1). The SARB now sees headline inflation averaging 4.9% in 2018 (unchanged), while it is expected to average 5.2% in 2019 (previous 5.4%). **The SARB indicated that the risks to the inflation outlook are now balanced, compared to the upside risks highlighted in January 2018. The SARB's QPM model now generates an endogenous interest rate path, showing one interest rate hike of 25bps (vs two hikes previously) over the next two years.**
Compared with the January statement, we read today's MPC statement as more dovish than before, but we expect that it may have disappointed the market somewhat. The MPC chose to look through the VAT hike in their interest rate decision. Further supportive of the decision to reduce interest rates now was a downward revision to the growth forecast in 2019, a negative output gap, sharply lower inflation expectations (5.2% and 5.3% in 2018 and 2018 vs 5.7% and 5.9% previously), and the removal of previous upside risks to the outlook. Nonetheless, the GDP growth profile has improved, the output gap has narrowed and seen meeting potential growth by 2020. Risks to the growth outlook are assessed to be to the upside, as a result of improved business and consumer confidence, as well as better fixed investment.
It is clear that the MPC would prefer that surveyed inflation expectations be anchored closer to the 4.5% level over the medium-term. As such, given that the next BER surveyed inflation expectations report is only due for release in July 2018, the SARB may be reluctant to make any decision on the repo rate in May without knowing which way inflation expectations have moved.
It is worth noting that the SARB sees the risks to the inflation forecasts as balanced. Secondly, we note that the SARB has adjusted its neutral real rate for 2019 marginally lower, from 2.2% to 2.1%. This may be indicative of a SARB that is less concerned about the external environment. On a standalone basis, we read the recent move as slightly negative for the rand in the near-term (given lower real yields).
Overall, the stronger rand and the receding upside risks from a weaker rand warranted a cut, in our opinion. As pointed out, the SARB's QPM model still signals one hike by the end of 2019. We believe that the QPM repo rate forecast may well adjust lower again in coming months. However, key from this meeting is that the MPC has signalled that it can cut rates irrespective of what the QPM model signals.

The local bond market rallied sharply over the past month, with the nominal bond curve flattening by almost 30bps. There were a few reasons for this rally: foreign investors continue to buy SA bonds (despite the recent risk-off sentiment); Moody's kept SA's credit rating unchanged at Baa3, and raised the outlook to 'stable' from 'negative' which was a key surprise to themarket; National Treasury announced a large R900m/week reduction in the weekly bond auction amount, to reduce total weekly bond issuance to R3.3 billion/week from R4.2 billion previously –the reduced supply was due to lower bond yields and large non-competitive auctions (averaging R30 billion a year) which necessitated the cut. This also provides an indication that National Treasury remains confident that fiscal targets are likely to be met in 2018/19 and growth is expected to recover sharply along with revenue collection.
We replicated the SARB's Taylor Rule (which drives the nominal repo rate) that the SARB uses in their QPM. According to the SARB's latest forecast, from its March 2018 MPC meeting, the QPM signalled one hike of 25bps by the end of 2019. This was down from the two hikes projected at the January meeting**. Going forward, we do believe that inflation will likely rise marginally in 2Q18 –like we reported last month, the VAT hike combined with the fuel levy hike in April 2018 will be the key inflationary drivers, in our view . However, we still believe that the bias to the SARB's inflation forecast is to the downside.**Nonetheless, working with the SARB's assumptions, we show the QPM output (for the repo rate) alongside, relative to our estimates using Nedbank CIB Markets Research inflation estimates. Like last month, our estimated QPM profile has not changed, with a flat profile of the repo rate until the end of 2019.
We still believe that the current real interest rate is still supportive of persistent foreign capital inflows, which would likely see the rand being supported further in coming months, after some temporary weakness after the recent rate cut. While we have used a USDZAR forecast which sees the currency weaken to R13.00 by year-end, the currency could surprise to the upside, which means that the bias even for our inflation profile may be lower. Furthermore, inflation expectations have dropped sharply recently, and if we continue to see inflation materialise below 5%, inflation expectations may well come in lower in thenext report (due by July 2018).
The SARB's key focus at the moment seems to be bringing down inflation expectations to 4.5% -should we see continued strides on the expectations front, we could see further easing from the SARB. Nedbank CIB Markets Research forecasts a further 25bps reduction in the repo rate this year, however, some patience is needed. **We see a bigger probability of the cut coming through in July or September 2018 rather than in May, because the SARB has stressed that further policy decisions will be highly data-dependent** (we take this to imply both actual inflation and inflation expectations data, combined with the trajectory of the rand). Hence we think the SARB will wait to scrutinise the surveyed inflation expectations data, before deciding on a cut in July. We note that our expectations for one more cut from the SARB this year differs from the Nedbank Group house view forecast, which expects no more cuts from the SARB this year (these forecasts are presented at the end of this report). There is little consensus in the broader market regarding the trajectory of the repo rate, which will likely take a while to merge as the market starts to understand the fairly new approach to monetary policy decisions with the introduction of the QPM.

Source: Nedbank Capital

Old Mutual Wealth TAS, No1 Mutual Place, 2nd Floor, 107 Rivonia Road, 2196, Sandton, Johannesburg: +27 11 217 1331 | tas@omwealth.co.za | www.omwealth.co.za

Alliance Midmed Medical Scheme - Savings

Treasury Management Report

March 2018

Old Mutual Wealth TAS, No1 Mutual Place, 2nd Floor, 107 Rivonia Road, 2196
Sandton, Johannesburg: +27 11 217 1331 | tas@omwealth.co.za | www.omwealth.co.za

Alliance Midmed Medical Scheme - Savings

Table of Contents

Alliance Midmed Medical Scheme - Savings

Portfolio Analysis

average funds (R)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
call deposits	4,070,131	4,549,778	4,549,778	4,430,101	4,625,929	5,158,149	5,364,671	5,095,503	4,510,155
fixed deposits	28,000,000	27,401,306	27,401,306	27,166,961	25,967,110	24,588,254	23,597,060	22,448,120	21,315,537
weighted totals	32,070,131	31,951,084	31,951,084	31,597,062	30,593,039	29,746,403	28,961,731	27,543,623	25,825,692

average interest earned (R)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
call deposits	22,601	24,554	24,554	24,130	25,632	28,862	30,195	27,703	22,884
fixed deposits	190,390	181,345	181,345	182,660	176,899	168,478	160,989	147,998	128,604
weighted totals	212,991	205,899	205,899	206,789	202,531	197,340	191,184	175,700	151,488

note: weighted totals are per month

Alliance Midmed Medical Scheme - Savings

Performance Analysis

average investment returns (%)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
weighted totals	0.66	1.95	1.95	3.99	8.25	8.26	8.21	7.89	7.17

industry returns (%)	current month	ytd	3 months	6 months	12 months	18 months	24 months	36 months	60 months
cash benchmark: STeFI Call Index	0.52	1.62	1.62	3.28	6.79	7.22	7.12	6.69	6.05
STeFI Composite	0.56	1.76	1.76	3.57	7.41	7.51	7.50	7.20	6.60
STeFI 3 Month	0.54	1.69	1.69	3.41	7.05	7.11	7.13	6.83	6.29

please note: the 18 - 60 months returns are annualized

Alliance Midmed Medical Scheme - Savings

Investment Summary

call balances	call cost (R)	call accrued int (R)	call total balance (R)	rate (%)
ABSA Bank Ltd	878,130	4,830	882,960	6.250
FirstRand Bank Ltd	243,282	1,338	244,620	6.250
Investec Bank Ltd	1,504,995	8,299	1,513,294	6.400
Nedbank Ltd	825,037	4,303	829,339	6.250
The Standard Bank of South Africa Ltd	691,460	3,832	695,292	6.300
total	4,142,904	22,601	4,165,505	

Alliance Midmed Medical Scheme - Savings

fixed deposit maturities	instrument	purchase date	maturity date	cost (R)	maturity value (R)	interest received (R)	rate (%)
Investec Bank Ltd	10 MONTH FTD	30/05/2017	29/03/2018	500,000	533,413	33,413	8.050
Nedbank Ltd	12 MONTH FTD	10/03/2017	09/03/2018	2,000,000	2,165,047	165,047	8.275

fixed deposit purchases	instrument	purchase date	maturity date	cost (R)	current value (R)	accrued interest (R)	rate (%)
Investec Bank Ltd	12 MONTH FTD	29/03/2018	29/03/2019	500,000	500,319	319	7.77
Nedbank Ltd	12 MONTH FTD	09/03/2018	08/03/2019	2,000,000	2,009,830	9,830	7.80

fixed deposit balances	instrument	purchase date	maturity date	cost (R)	current value (R)	accrued interest (R)	rate (%)
Absa Bank Ltd	12 MONTH FTD	30/05/2017	30/05/2018	1,000,000	1,068,745	68,745	8.200
Absa Bank Ltd	12 MONTH FTD	11/08/2017	10/08/2018	1,000,000	1,049,153	49,153	7.700
Absa Bank Ltd	11 MONTH FTD	25/10/2017	25/09/2018	500,000	516,774	16,774	7.750
Absa Bank Ltd	8 MONTH FTD	29/01/2018	28/09/2018	500,000	506,412	6,412	7.550
Absa Bank Ltd	12 MONTH FTD	02/02/2018	01/02/2019	1,500,000	1,518,771	18,771	7.875
Absa Bank Ltd	12 MONTH FTD	23/02/2018	22/02/2019	500,000	503,953	3,953	7.800
FirstRand Bank Ltd	12 MONTH FTD	07/04/2017	06/04/2018	1,000,000	1,083,111	83,111	8.450
FirstRand Bank Ltd	12 MONTH FTD	21/06/2017	21/06/2018	1,000,000	1,063,025	63,025	8.100
FirstRand Bank Ltd	12 MONTH FTD	21/07/2017	20/07/2018	1,000,000	1,054,627	54,627	7.850
FirstRand Bank Ltd	12 MONTH FTD	31/07/2017	31/07/2018	1,000,000	1,051,307	51,307	7.675
FirstRand Bank Ltd	12 MONTH FTD	06/10/2017	05/10/2018	1,000,000	1,037,582	37,582	7.750
FirstRand Bank Ltd	12 MONTH FTD	01/11/2017	01/11/2018	1,000,000	1,033,406	33,406	8.075
Investec Bank Ltd	12 MONTH FTD	26/04/2017	26/04/2018	500,000	538,890	38,890	8.350
Investec Bank Ltd	12 MONTH FTD	18/05/2017	18/05/2018	2,000,000	2,144,625	144,625	8.300
Investec Bank Ltd	12 MONTH FTD	09/06/2017	08/06/2018	1,000,000	1,066,093	66,093	8.150

Alliance Midmed Medical Scheme - Savings

fixed deposit balances	instrument	purchase date	maturity date	cost (R)	current value (R)	accrued interest (R)	rate (%)
Investec Bank Ltd	12 MONTH FTD	28/08/2017	28/08/2018	1,000,000	1,045,567	45,567	7.700
Investec Bank Ltd	9 MONTH FTD	29/01/2018	29/10/2018	500,000	506,497	6,497	7.650
Investec Bank Ltd	12 MONTH FTD	29/11/2017	29/11/2018	1,000,000	1,028,138	28,138	8.350
Investec Bank Ltd	12 MONTH FTD	11/01/2018	11/01/2019	1,000,000	1,017,644	17,644	8.050
Investec Bank Ltd	12 MONTH FTD	12/01/2018	11/01/2019	1,000,000	1,017,423	17,423	8.050
Investec Bank Ltd	12 MONTH FTD	09/02/2018	08/02/2019	1,000,000	1,011,178	11,178	8.000
Investec Bank Ltd	12 MONTH FTD	29/03/2018	29/03/2019	500,000	500,319	319	7.770
Nedbank Ltd	12 MONTH FTD	19/07/2017	19/07/2018	500,000	528,318	28,318	8.075
Nedbank Ltd	12 MONTH FTD	25/10/2017	25/10/2018	500,000	516,936	16,936	7.825
Nedbank Ltd	12 MONTH FTD	13/12/2017	13/12/2018	1,000,000	1,024,637	24,637	8.250
Nedbank Ltd	12 MONTH FTD	09/03/2018	08/03/2019	2,000,000	2,009,830	9,830	7.800
The Standard Bank of South Africa Ltd	12 MONTH FTD	13/04/2017	13/04/2018	1,000,000	1,081,480	81,480	8.425
The Standard Bank of South Africa Ltd	12 MONTH FTD	22/09/2017	21/09/2018	1,000,000	1,040,293	40,293	7.700
The Standard Bank of South Africa Ltd	12 MONTH FTD	21/12/2017	21/12/2018	1,000,000	1,022,137	22,137	8.000
The Standard Bank of South Africa Ltd	12 MONTH FTD	16/02/2018	15/02/2019	500,000	504,732	4,732	7.850
total				28,000,000	29,091,606	1,091,606	

Alliance Midmed Medical Scheme - Savings

Compliance Analysis

	moodys rating	exposure (%)	mandate requirement (%)	market value (R)
Absa Bank Ltd	Aa1.za	18.18	35.00	6,045,693.25
FirstRand Bank Ltd	Aaa.za	19.75	35.00	6,566,365.93
Investec Bank Ltd	Aa1.za	34.25	35.00	11,387,565.33
Nedbank Ltd	Aa1.za	14.76	35.00	4,908,189.36
The Standard Bank of South Africa Ltd	Aa1.za	13.06	35.00	4,343,165.29
Total funds as at month end				33,250,979.16

Economic Commentary

The economy ended 2017 in better shape than most expected. Stats SA revised the GDP figures for past three years upwards. It now shows that real GDP grew by a seasonally adjusted annualised 3.1% q-o-q in 4Q17, compared with growth of 2.3% and 2.9% in 3Q17 and 2Q17 respectively and a contraction of 0.5% in 1Q17. This acceleration helped push GDP growth for 2017 as a whole to 1.3% from an upwardly revised 0.6% in 2016. The recent revisions to the GDP figures have bumped up our forecast for 2018 and 2019 to 1.8% (previously 1.6%) and 1.9% (previously 1.8%) respectively. Our forecast for 2020 remains unchanged at 2.4%.
March was an eventful month, with Moody's leaving SA's sovereign credit rating unchanged at Baa3 and raising the outlook to stable from negative. Furthermore, the SARB reduced the repo rate by 25bps as the risks of a weaker rand has receded following the Moody's credit rating review (as the threat of a WGBI exclusion has diminished). The local bond market rallied sharply over the past month, with the nominal bond curve flattening by almost 30bps.
Similarly, the rand remained strong in March, supported by expectations of a 'stay of execution' by Moody's and a stable socio-political backdrop. The SARB decision to reduce the interest rate in March may slow down the pace of the appreciation in the rand in the near-term (due to lower real yields). Marginal rand weakness is envisaged through the course of the year. However, should the rand surprise to the upside, this will likely pose some downside risks to the inflation profile, particularly that of the SARB's.We still believe that the current real interest rate is still supportive of persistent foreign capital inflows, which could see the rand being supported further in coming months, although this is not our base case.
The SARB's key focus at the moment seems to be bringing down inflation expectations to 4.5%. Nedbank CIB Markets Research forecasts a further 25bps reduction in the repo rate this year, however, we see this cut coming through in July or September 2018 rather than in May, as the SARB reflects on various data releases (inflation expectations being key) and the trajectory of the rand exchange rate in the interim.

The SARB reduced the repo rate by 25bps to 6.5%, taking prime to 10%. This was in line with the consensus view as well as with our own expectations. Four MPC members voted in favour of the cut and three members voted for unchanged interest rates. The inflation profile was raised out to 1Q19 (taking into account the effect of a VAT hike); inflation forecasts were then reduced sharply thereafter (Chart 1). The SARB now sees headline inflation averaging 4.9% in 2018 (unchanged), while it is expected to average 5.2% in 2019 (previous 5.4%). **The SARB indicated that the risks to the inflation outlook are now balanced, compared to the upside risks highlighted in January 2018. The SARB's QPM model now generates an endogenous interest rate path, showing one interest rate hike of 25bps (vs two hikes previously) over the next two years.**
Compared with the January statement, we read today's MPC statement as more dovish than before, but we expect that it may have disappointed the market somewhat. The MPC chose to look through the VAT hike in their interest rate decision. Further supportive of the decision to reduce interest rates now was a downward revision to the growth forecast in 2019, a negative output gap, sharply lower inflation expectations (5.2% and 5.3% in 2018 and 2018 vs 5.7% and 5.9% previously), and the removal of previous upside risks to the outlook. Nonetheless, the GDP growth profile has improved, the output gap has narrowed and seen meeting potential growth by 2020. Risks to the growth outlook are assessed to be to the upside, as a result of improved business and consumer confidence, as well as better fixed investment.
It is clear that the MPC would prefer that surveyed inflation expectations be anchored closer to the 4.5% level over the medium-term. As such, given that the next BER surveyed inflation expectations report is only due for release in July 2018, the SARB may be reluctant to make any decision on the repo rate in May without knowing which way inflation expectations have moved.
It is worth noting that the SARB sees the risks to the inflation forecasts as balanced. Secondly, we note that the SARB has adjusted its neutral real rate for 2019 marginally lower, from 2.2% to 2.1%. This may be indicative of a SARB that is less concerned about the external environment. On a standalone basis, we read the recent move as slightly negative for the rand in the near-term (given lower real yields).
Overall, the stronger rand and the receding upside risks from a weaker rand warranted a cut, in our opinion. As pointed out, the SARB's QPM model still signals one hike by the end of 2019. We believe that the QPM repo rate forecast may well adjust lower again in coming months. However, key from this meeting is that the MPC has signalled that it can cut rates irrespective of what the QPM model signals.

The local bond market rallied sharply over the past month, with the nominal bond curve flattening by almost 30bps. There were a few reasons for this rally: foreign investors continue to buy SA bonds (despite the recent risk-off sentiment); Moody's kept SA's credit rating unchanged at Baa3, and raised the outlook to 'stable' from 'negative' which was a key surprise to themarket; National Treasury announced a large R900m/week reduction in the weekly bond auction amount, to reduce total weekly bond issuance to R3.3 billion/week from R4.2 billion previously –the reduced supply was due to lower bond yields and large non-competitive auctions (averaging R30 billion a year) which necessitated the cut. This also provides an indication that National Treasury remains confident that fiscal targets are likely to be met in 2018/19 and growth is expected to recover sharply along with revenue collection.
We replicated the SARB's Taylor Rule (which drives the nominal repo rate) that the SARB uses in their QPM. According to the SARB's latest forecast, from its March 2018 MPC meeting, the QPM signalled one hike of 25bps by the end of 2019. This was down from the two hikes projected at the January meeting**. Going forward, we do believe that inflation will likely rise marginally in 2Q18 –like we reported last month, the VAT hike combined with the fuel levy hike in April 2018 will be the key inflationary drivers, in our view . However, we still believe that the bias to the SARB's inflation forecast is to the downside.**Nonetheless, working with the SARB's assumptions, we show the QPM output (for the repo rate) alongside, relative to our estimates using Nedbank CIB Markets Research inflation estimates. Like last month, our estimated QPM profile has not changed, with a flat profile of the repo rate until the end of 2019.
We still believe that the current real interest rate is still supportive of persistent foreign capital inflows, which would likely see the rand being supported further in coming months, after some temporary weakness after the recent rate cut. While we have used a USDZAR forecast which sees the currency weaken to R13.00 by year-end, the currency could surprise to the upside, which means that the bias even for our inflation profile may be lower. Furthermore, inflation expectations have dropped sharply recently, and if we continue to see inflation materialise below 5%, inflation expectations may well come in lower in thenext report (due by July 2018).
The SARB's key focus at the moment seems to be bringing down inflation expectations to 4.5% -should we see continued strides on the expectations front, we could see further easing from the SARB. Nedbank CIB Markets Research forecasts a further 25bps reduction in the repo rate this year, however, some patience is needed. **We see a bigger probability of the cut coming through in July or September 2018 rather than in May, because the SARB has stressed that further policy decisions will be highly data-dependent** (we take this to imply both actual inflation and inflation expectations data, combined with the trajectory of the rand). Hence we think the SARB will wait to scrutinise the surveyed inflation expectations data, before deciding on a cut in July. We note that our expectations for one more cut from the SARB this year differs from the Nedbank Group house view forecast, which expects no more cuts from the SARB this year (these forecasts are presented at the end of this report). There is little consensus in the broader market regarding the trajectory of the repo rate, which will likely take a while to merge as the market starts to understand the fairly new approach to monetary policy decisions with the introduction of the QPM.

Source: Nedbank Capital

Disclaimer:
Although every care is taken in compiling this document and the information herein, OMWTC and the various asset managers do not guarantee the accuracy thereof. The value of the investments may go down as well as up and past performance is not necessarily a guide to the future. No guarantees are offered in respect of investment returns and/or capital invested.