APRIL 2017

PROSPERITY

IN THIS CLIENT **NEWSLETTER**

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- Local and global equities

PRIVATE CLIENT SECURITIES

OLD MUTUAL WEALTH

A month ago we saw substantial changes being made to the cabinet and most concerning were the changes made at Treasury. These events were quickly followed by downgrades of our sovereign debt and banks. Since then, we have seen a surprisingly resilient currency. The rand quickly weakened by 10% following the Cabinet reshuffle, but recovered most of the loss during April. However, we must not be lulled into a false sense that it is all 'business as usual'. The rand has been the beneficiary of risk appetite increasing in global markets and has been lifted with the tide. Portfolio flows into emerging markets are strong and buoyed by a synchronised global recovery with the US, China, Japan and Europe all growing. There are signs that core inflation rates may, at last, be picking up. There are several things that could reverse global risk appetite. Political risk remains high on the agenda as does the high expectations of US fiscal stimulus and sustained business and consumer confidence. Without the rising tide of global risk appetite, there is unfortunately little to support the rand. As always, we encourage investors to consider an appropriate level of international diversification for their portfolios. Now may be good time to act.

Having moved sideways for two years, local equities now also offer better value. Additionally, several locally listed companies provide exposure to global growth rather than the SA economy. A local portfolio, such as our Core Equity model portfolio, will provide a good hedge against any rand weakness. For investors seeking local income from their portfolio, there are also now more attractive options on offer, given the level of interest rates and dividend yields. Our Equity Income model portfolio is an excellent option to consider if income is your requirement.

In May, we welcome our new Chief Investment Officer, Andrew Dittberner, to our team. Andrew has a solid background in investment management, having served with distinction as research analyst, portfolio manager and eventually as CIO at Cannon Asset Managers. Andrew has extensive knowledge and insight into valuing businesses across multiple industries and identifying suitable investment opportunities. He holds a Master's Degree in Economic Science from the University of the Witwatersrand. Last year, Andrew obtained a PhD in Investments and Securities from the University of Pretoria upon completing his thesis titled "Fundamental Momentum: A New Approach to Investment Analysis".

Closing thoughts: Do not attempt to time the market or the level of currencies. Stay true to your long-term strategy. Too often investors become speculators when markets are in turmoil. Do not hesitate to diversify your wealth - an appropriate level of diversification is the only 'free lunch' when investing.

"Hesitation increases in relation to risk in equal proportion to age" – Ernest Hemmingway

ECONOMIC AND MARKET OVERVIEW

The global growth outlook continues to improve. The International Monetary Fund's quarterly global growth forecast has been upgraded for the first time in six years, with a moderate acceleration in global growth expected. The world's largest economy posted a mediocre first quarter growth number, but the underlying US growth rate remains around 2% - stable but unexciting. Evidence suggests that Europe's growth rate is accelerating, despite political uncertainty. In France, the outcome of the first round of the presidential election was as expected, with centrist Emmanuel Macron in the lead. Markets, fearing that two extremist candidates might go through to the second round, rallied in relief. In the UK, Prime Minister Theresa May called a snap election with the aim of gaining a stronger majority in parliament as Brexit negotiations get underway.

China posted its best economic growth numbers in a year in the first quarter, with the economy expanding 6.9% year-on-year in real terms. However, with the stronger growth comes worries that the property sector is running too hot again and that authorities will have to tap the brakes. Regulators are also increasingly clamping down on leverage in the banking sector and in financial markets

Despite South Africa being downgraded by two ratings agencies, the main local asset classes were positive in April. While the rand was slightly stronger against the US dollar in April, global equities were also positive in rand terms during the month.

The credit ratings downgrades and the political environment in general are likely to weigh on business sentiment. However, to date there has been no currency or interest rate shock. All the indications are still that inflation is declining, supported by much larger than expected crops, a firmer rand compared to a year ago, and low global goods inflation. Therefore, there is no reason for the Reserve Bank to hike interest rates.

LOCAL EQUITIES

MEDICLINIC

Mediclinic reported a mixed set of results for 1H17. While South Africa and Switzerland reported decent numbers, the Middle East disappointed on the back of regulatory changes, doctor vacancies and integration issues. Revenue for the Middle East was up 112%, with the recent Al Noor acquisition contributing to the vast majority of the growth. Organic growth is estimated to be at low-to-mid single digits. EBITDA margin fell from 21% to 11% mainly due to the introduction of co-payments by the government's Thiqa medical insurance scheme. Volumes from Thiqa declined from 20% to 12.3%. Following the release of the results, the Abu Dhabi government announced that it would cancel the requirement for its citizens to make a co-payment for treatment at private facilities. This was well-received by private healthcare providers in the region and the Mediclinic share price surged follow the announcement. In South Africa, Mediclinic's revenue rose 8% over the year to R7.3 billion, largely driven by the 2.6% increase in paid patient days. The Swiss business reported solid revenue growth of 4.6% to CHF819 million, which can be attributed to the 3.7% growth in inpatient volume. **The recent developments in Mediclinic highlight the most significant challenge that hospital groups face: regulatory risk. Our preference for Mediclinic over its peers attempts to moderate this risk by investing in the highest quality healthcare group that operates in four distinct markets. While it is possible that further negative regulatory changes could ensue in each of the group's key regions, our current view is that over time, the group will navigate past these and the demand for quality private healthcare in a largely ageing world population will remain an attractive theme.**

NASPERS

Naspers reported solid results for the 1H17 period, largely driven by the strength in the ecommerce businesses and Tencent. Currencies once again had a significant impact on the group's earnings. At constant currencies, group revenue and core headline earnings per share rose 27% and 25% respectively. Development spend increased 38% year-on-year to US$387 million, of which US$188 million was spent on new initiatives. The ecommerce segment, including Tencent, grew revenues by 30% to US$4.9 billion. Operating profits grew 54% on the back of Tencent's performance and smaller losses in many ecommerce businesses. Within ecommerce, the payments division saw strong revenue growth of 71% on increased transactions volume. Notwithstanding total subscriber growth of 7.6% year-on-year, video entertainment reported revenue and operating profit declines of 8% and 43% respectively. Local currency weakness coupled with higher USD content costs played a significant role in the earnings decline. Naspers were not able to pass the full price increases onto consumers, and in some regions the group decreased prices. In aggregate, the group saw consumers trading down to smaller/cheaper bouquets on the back of a weak macro environment. Naspers highlighted that they have seen little impact of consumers moving to streaming video on demand platforms like Netflix. **Despite the challenges that Naspers' PayTV business is currently facing, we maintain a constructive view on the business' investment case. The group's diversification as a media company is unrivalled, certainly within the emerging market universe. The group's has a proven ability to re-invent itself by investing in favourable long-term themes. With about 80% of group profits being generated within the internet segment, we continue to expect significant earnings growth over the coming years.**

SPAR

Spar reported FY 2016 results that were ahead of expectations. The group's recent foray into Switzerland, Ireland and South West England contributed 32% to turnover and 18% to profit after tax. The Southern African business, which contributes 73% of group earnings, grew wholesale turnover by 9% over the year. Tops was the best performer, rising 12%, with Build it growing by 11.6%. Despite the heightened marketing and promotional activity, gross margins held at 8.2% and other recurring costs were in line with expectations. Benefits from the supply chain were passed onto retailers, as the weak macro environment continued to challenge the industry. The Irish business reported good growth. Constant currency sales growth was 14.4%, with 3.1% organic growth. Gross margins rose to 10.8% from 10.5% in 2015, as the group improved distribution efficiencies and had a better product mix. The newly acquired Swiss business made a marginal contribution to profits, reporting a disappointing operating margin of 0.5%. Management pointed out that there were some distortions in the form of IFRS accounting for pension costs and future minority buyout obligations. On an operational level, the result was in line with management's expectations, although it is clear that there is work to be done in making the Swiss business more profitable. **We regard Spar to be a well-managed and diversified food retailer. The group's capex profile and high cash generation leaves room for acquisitions, which we expect to augment organic growth.**

GLOBAL EQUITIES

VISA

Visa reported 1Q17 results that were ahead of expectations. Revenues for the quarter rose 25% to US$4.5 billion, largely due to the inclusion of Visa Europe. Earnings per share rose 7% to 86c, ahead of the expected 78c. The discrepancy between revenue and earnings growth is a result of a non-recurring and non-cash expense related to the Visa Europe acquisition. Operating expenses rose by 16%, trailing revenue growth and resulting in the operating margin increasing to 69% from 67%. Revenue growth was driven by accelerating growth in payment volume, cross border payments and processed transactions across all the regions that the group operates in. Adverse currency moves detracted from earnings and revenue by approximately 3%. **Visa has the leading market share in the global payments industry, an industry that has exciting prospects as consumers, governments and businesses migrate to electronic payments.** Estimates point to over US$16 trillion transactions being done by cash and cheques every year, giving the industry significant scope for growth. **VisaNet, Visa's proprietary transaction network, is the backbone of Visa's offering. The network is the world's largest electronic payment network and is a wide economic moat that will support strong earnings growth in the coming years.**

AMAZON

Amazon's 4Q2016 results showed continued solid growth and marked Amazon's second most profitable quarter ever. Sales for the important fourth quarter were up 22% to US$43.7 billion vs the expected US$44.7 billion. On a constant currency basis, revenue would have been up 24%. Operating income growth was up 13% to US$1.54 billion and gross margins rose to 33.8%. Amazon Web Services sales growth rose 47%, the first time it has grown less than 50%. The division contributed about 75% of the group's FY2016 operating profit. Management guided to slower revenue and profitability in 2017, largely due to increased investment in the group's major growth opportunities (original video, Prime benefits, Amazon India and the Alexa voice platform). Our long-term investment case for Amazon is predicated on the continued shift from brick and mortar stores to online commerce. Over the next four years, US retail sales are expected to grow by 4% versus ecommerce growth of 15%. Amazon, as the world's largest online retailer, is poised to benefit from this dichotomy. **Amazon's model of operating as both a direct seller and as a platform for third-party sellers to distribute their products places the group in a strong position. Further investments into media, IT infrastructure and cloud best position the group for strong growth in the internet services sector.**

NIKE

Nike reported 3Q17 results that were in line with expectations. Revenues for the quarter rose 5% to US$8.4 billion. On a constant currency basis, revenue was up 7% with most international geographies showing strong growth and North America up 3%. Diluted earnings per share for the quarter rose 23.6% year-on-year to US$0.68. Gross margin declined 1.4% during the quarter due to higher input costs, negative foreign currency impact and increased discounting in some markets. The group's North American operations reported growth of 3% for the quarter and are up 4% for the year-to-date. The US market, which contributes 47.7% of the Nike brand's total revenue, has seen increased competition over the past couple of years. Adidas and to a lesser extent Under Amour have been competing aggressively with Nike in the attractive US footwear and apparel segments. As the market leader, Nike has had to re-double their efforts to 'defend their turf' and management are doing so via increased innovation and enhancing the Nike store experience. We are optimistic that the group's pipeline over the coming quarters will go a long way in aiding the group to maintain market share. Nike continued to show exceptional growth in China. Revenue in the region grew by 15% on a constant currency basis. Both footwear and apparel grew by double digits across the online and wholesale platforms. **We see the global sporting goods industry as a structurally attractive market. Consumers and governments' increasing focus on health and fitness, coupled with the fast growing athleisure trend inform our view that the market will grow by mid-single digits over the next five years. Most of that growth will be in regions where Nike has a dominant market share. We expect the group to fend off competition in those key markets and retain its position as the global leading sports brand.**

GLOBAL EQUITIES CONTINUED

BANK OF AMERICA

In its 1Q2017 results, Bank of America reported a 7% year-on-year increase in revenue to US$22.2 billion. Net income increased 40% to $4.9 billion, and EPS increased 46% to $0.41, compared to $3.5 billion and $0.28, respectively.Net interest income increased 5% to US$11.1 billion, reflecting benefits from higher interest rates, as well as growth in loans and deposits. Non-interest income increased 9% to US$11.2 billion, driven by higher trading results and record investment banking fees (net investment banking fees grew 37% to $1.6 billion). In terms of the various segments' performance, Consumer Banking (33.3% of net income) reported a net income increase of 7% to $1.9 billion; Global Wealth and Investment Management (13.5% of net income) reported a net income increase of 4% to $770 million; and Global Banking (29.8% of net income) reported record Q1 net income of $1.7 billion, up 9.5%. **Regarding the outlook, management pointed to positive US business and consumer sentiment as an indication of an improving US economy. In addition, the recent US rate hike will result in higher net interest income in Q2. The company remains well capitalised and management are expected to increase their dividend pay-out ratio from the current 17% to about 30%.**

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