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PROSPERITY

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PRIVATE CLIENT SECURITIES

OLDMUTUAL WEALTH

INTRODUCTION

I am excited to announce that we have crossed another milestone in the history of Old Mutual Wealth Private Client Securities or "PCS" as it's better known. October 1 2018, marks the fifth year since the appointment of our first private client portfolio managers and the signing up of our first clients in PCS. We are proud that those very first clients are still clients today and we want to thank them and each one of our valued clients for entrusting us with the stewardship of their wealth. I also thank our business partners and our financial advisory partners for their support and being part of our growth story thus far.

When we launched our bespoke investment capability, Amazon was a US$300 share, today it's worth nearly US$2000 a share and the company is worth more than all of the local shares of companies listed on the JSE! Such is the power of international diversification and of compounding … and of the disruption we are seeing in most industries across the world. Wayne Gretzky, one of the world's greatest ice hockey players said, "A good hockey player plays where the puck is. A great hockey player plays where the puck is going to be." This is the case with great investments as well. The global arena presents significantly more and better opportunities than the local market and if we want to achieve great results we will need to invest globally.

Going from start-up to scale-up calls for celebration. It also calls for forward thinking because I believe that our greatest accomplishments still lie ahead of us. We want to become more efficient and effective in serving our clients, we want to enhance our capabilities to address more of our clients' needs and we want to add meaningful shareholder value and be a great place to work.

"Winning takes talent, to repeat takes character." – Chris Potgieter

ECONOMIC OVERVIEW

The US Federal Reserve hiked its key policy interest rate for the eighth time in the cycle that started in December 2015. This takes the federal funds rate to 2.25%. The US economy is doing very well at the moment, with strong gains in employment and high levels of consumer confidence. Although the impact of the trade battles with other countries is evident in certain data releases, overall it is not derailing the economic engine driven by consumer spending. Inflation is also pretty much where the Fed wants it to be. Core inflation (which excludes the volatile food and fuel components) is around 2% and is expected to remain there. Further gradual interest rate increases are expected over the next two years.

The turmoil in emerging markets eased in the second half of the month after steep interest rate hikes as well as promised government spending cuts in Turkey and Argentina gave investors some comfort. A number of other emerging markets also hiked rates during the month, including Russia, Philippines and Indonesia.

While the SA Reserve Bank targets domestic inflation, it cannot isolate itself from what its peers are doing. The Monetary Policy Committee decided to keep the repo rate unchanged, but three of its seven members were in favour of a hike. This despite the fact that consumer inflation fell to 4.9% in August and South Africa was in a technical recession in the first half of the year. A surprise 0.7% economic contraction in the second quarter, following the much larger 2.6% decline in the first quarter put the economy in a technical recession. While year-on-year growth was still positive at 0.4%, the economy is clearly under pressure and is not benefiting from solid global growth. One of the reasons is that the global price of oil, our main import, has shot up, but the prices of our main commodity exports have not.

In order to reignite economic growth, President Ramaphosa announced a multi-faceted stimulus package that includes emphasis on infrastructure spending, rural development, and addresses some of the key bottlenecks to doing business in the country. Also on the agenda is removing policy uncertainty in terms of land reform and mining. Although the announcement was well received, it is unlikely to immediately jump-start the economy as its impact will be felt over time. Crucial details on funding will only be announced in the Medium Term Budget.

MARKET OVERVIEW

The JSE All Share Index ended the month 4.2% lower as emerging markets remained under pressure and local political uncertainty continued to weigh heavily on the market. After beginning the month with news that the local economy contracted by 0.7% in the second quarter of 2018, the rand reached R15.69 against the US dollar but recovered towards the end the month to finish September stronger at R14.13 to the US dollar.

In the US, the S&P 500 and Dow Jones ended September 0.4% and 1.2% higher, respectively. Japan's Nikkei hit a 27-year high after GDP was revised up from an initial reading of 1.9% to 3.0%. Chinese equities, along with most emerging market equities, struggled through the month of September, which lived up to its reputation as being a tough month to produce meaningful returns.

Gold moved sideways for much of the month, but was hurt by a stronger dollar as quarter three came to a close. Brent crude prices reached a four-year high. As a result, consumers will be faced with more fuel hikes, adding further pressure to the local economy.

GLOBAL EQUITIES

NIKE

Nike posted results exceeding both management and analyst expectations, continuing to build on a strong 2018 final result. The Group posted 10% growth in revenue to US$9.94 billion and 18% growth in diluted earnings per share for the quarter to US$0.67. Higher average selling prices and a favourable full-price sales mix supported revenue growth in excess of the 9% growth in cost of sales allowing for a 50bps gross margin expansion to 44.2%. Selling and administration expenses increased 7% driven by a 13% increase in advertising as Nike ramped up their sports marketing campaign. Despite this, Nike's operating margin expanded over the period by 1.2% to 13.4%, this was a positive result owing to higher revenue and operating leverage. Management confirmed their 2019 full year guidance, expecting high single digit revenue growth and 50bps margin expansion, the same expectation was confirmed for Q2 2019.

Nike's fastest growing regions are outside the US (60% of revenue), a trend that we expect to continue. Its market leadership, particularly in China, will be a key growth driver as consumers spend more, particularly within the digital space. On Tmall.com, China's largest digital platform, Nike is the number one sports brand. While fully cognisant of the short-to-medium term North American challenges, we expect the continued focus on direct to consumer sales coupled with the continued product innovation to result in higher sales and margin enhancement over time. The Nike Direct business continues to grow at double digits, increasing its contribution to group profitability.

ACCENTURE

Accenture produced strong results that came in above management's guidance for the quarter and fiscal year and surpassed the market's expectations for the past three months. For Q4, net revenues grew 11% in both USD and constant currency to US$10.15bn while diluted EPS grew 7% to US$1.58. For FY 2018, Accenture grew net revenues 14% in USD and 10.5% in constant currency to US$39.6bn. Foreign-exchange movements added 3% to net revenues compared to FY 2017.

Within the technology services that Accenture provides, the majority (60%) are derived from offerings within digitisation, cloud and security solutions. We see these as the most attractive trends within IT services and expect them to support Accenture's growth ahead of the broader IT services sector. Accenture's business model generates a significant amount of free cash flow. Since listing in 2001, we estimate that the Group has generated around $40bn in free cash flow and paid out over 90% of this cash to shareholders via dividends and share buybacks. We expect this good capital allocation to continue to drive shareholder returns.

LOCAL EQUITIES

AVI LTD

AVI reported results in line with expectations but missed their 10% earnings growth target, posting 7% growth in headline earnings per share to R5.43. This growth is commendable granted that group revenue was up only 1.9% to R13.4 billion, the lowest top line growth since FY 2010. AVI's biggest division, Food and Beverages (comprised of Entyce Beverages, Snackworks and I&J) grew revenue by 2% to R10.2bn and operating profit by 7.4% to R1.9bn. The Fashion Brands division (encompassing Personal Care, and Footwear and Apparel) grew revenue by 1.5% to R3.1bn and operating profit by 6.2% to R645m. Cash generation remains strong, with cash from operations up 16.1% to R2.69bn. Strong cash generation allowed for a final dividend of R2.60, bringing the FY normal dividend to R4.35, up 7.4% on 2017. Management remain committed to returning excess cash to shareholders, declaring a special dividend of R2.50. Despite weak top line growth, savings on the restructure completed in the prior year helped management improve their return on capital employed to 28.7%. The trading environment is expected to remain difficult for FY 2019, with management indicating that low or negative growth can be expected in many product categories.

We believe that AVI's strong brand portfolio will continue to outperform peers in the segments in which they operate. Evidence of the Group's solid brands can be seen in their ability to pass on price increases to somewhat offset unfavourable exchange rates or falling volumes. We see this as a key differentiator in the current difficult trading environment. We expect the business to continue to benefit from its well diversified business model. The Group is highly cash generative, which we believe will continue to support the generous 80% pay-out ratio.

BIDVEST

The Bidvest Group grew trading profit in five of its seven divisions. A satisfactory result overall, though below analyst expectations as reflected in the share price decline post the earnings call. Overall group revenue growth of 8.4% to R77 billion was driven by international acquisitions during the year while organic growth was flat. Gross profit margin is down 0.2% as the inclusion of lower margin Noonan and USS in Services reset the overall margin lower. Despite a marginally lower gross margin, trading profit is up 8.2% to R6.5 billion driven by Services and Freight, offset by lower profits in Electrical, Automotive and Namibia divisions. Like for like expense growth was well managed, increasing only 3.4% allowing for the trading margin to be maintained at 8.5%. Adcock Ingram and Comair performed well resulting in a 21.7% increase in the Group's earnings from associates. The Group's key metric, normalised headline earnings per share (HEPS) is up by 12.5% to R12.55 and a final dividend of 301 cents per share was declared, up 14% from the prior period, bringing the total dividend to 556 cents per share.

With a very strong management team, led by Lindsay Ralphs, the company has a history of superb capital allocation, resulting in close on 30 years of consistent trading profitability, and strong cash generation. Bidvest now consists of a blended portfolio of both defensive and cyclical growth assets with growing annuity type income streams. Thus it has the defensive qualities required in an economy that is struggling yet will also feel the benefit of an improving economy. We believe Bidvest will benefit from a cyclical upswing in South African economic and business sentiment and activity. With this we expect top line growth to drive margin expansion and earnings growth which will ultimately result in increased shareholder returns. The Group also maintains optionality with the potential monetisation of Adcock Ingram, Mumbai Airport and Comair.

RMI HOLDINGS

Despite the low economic growth environment across its underlying markets, RMI reported double digit earnings growth on the back of strong performance contributions from Discovery and Outsurance, whose returns comprised c.82% of RMI normalised earnings. RMI's key metrics, headline earnings, was up 17% to R4 billion and normalised earnings per share was up 13% to R2.95. RMI maintained its dividend policy of paying out all dividends received from underlying investments after funding commitments and declared a final dividend of 65 cents per share (cps) with an option to elect scrip in lieu of cash or to reinvest all or part of the cash dividend. The total dividend for the year of 104cps is down 12% from the prior year.

RMI's portfolio of listed and private holdings is largely quality investments trading at a discount to the Group's net asset value. The Group's diverse portfolio gives investors access to unlisted and higher growth businesses such as OUTsurance. The Group's portfolio strikes a balance between growth and return. Discovery is a pioneering market leader with uniquely-positioned businesses in the healthcare, long-term and short-term insurance, wellness and financial services industries. Hastings is one of the fastest-growing providers of UK general insurance and has considerable scope to continue growing their market share. OUTsurance provides short-term and long-term insurance products in South Africa and short-term insurance products in Australia, New Zealand and Namibia. We believe this diversity will continue to stand the Group in good stead.

FIRSTRAND

Amid an environment of weak GDP growth, static unemployment and mid-single digit credit growth, FirstRand delivered a satisfactory FY result, which topped most analyst expectations. The Group reported FY diluted normalised EPS of R4.70, up 8% y-o-y to R26.41bn. Gross advances and deposits grew 26% and 29% to R1.532tn and R1.267tn, respectively. Excluding Aldermore's three-month contribution (included from April 2018), normalised earnings grew 7% to R26.13bn while gross advances and deposits grew 7% and 11% to R957.81bn and R1.094tn respectively. Group return on equity declined marginally from 23.4% to 23% as the cost-to-income ratio ticked up from 51% to 51.2% on higher operating expenditure. The Group increased its dividend by 8% to R2.75 per share, maintaining a 1.71x dividend cover ratio.

Despite the recent tough operating environment, looking ahead we believe FirstRand is able to grow earnings over the medium term by high single digits, supported by good cost management and leveraging their existing customer base. We expect the Group's retail and commercial segment, FNB, to continue to gain market share, particularly in the premium segment where the Group has proven itself to be innovative and adept at on-selling. The Group is well capitalised with the total capital adequacy ratio and common equity tier 1 (CET1) recently reported at 14.7% and 11.5%, respectively, well above target levels.

DISCOVERY

Despite the poor local economic backdrop, Discovery Group produced a resilient set of FY results with all businesses contributing to bottom-line growth. Core new business grew 10% to R16.13bn, operating profit grew 17% to R8.26bn and normalised headline earnings grew 16% to R5.40bn. New business growth illustrated the attractiveness of Discovery's data-driven product offering with highlights including growth in Discovery Life new business (now accounting for 31% of the SA retail affluent market), 84% growth in new business from the Group's 25% shareholding in PingAn Health and 17% growth in Discovery Insure new business, making it the fastest growing short-term insurer in South Africa. Discovery increased their dividend by 16% to 114cps. The Group remain well capitalised with excess capital reserves remaining at R1.8bn.

Discovery Group operates at the nexus of two major global investment themes: healthcare and big data analytics. The Group has spent the past 25 years innovating, growing market presence and encouraging user adoption across a host of first-to-market products and financial services. We expect this unique value proposition to continue to drive market share growth across all of the Group's platforms. The Group's competitive advantage is predicated on the Vitality Wellness Programme and embedding this into each of their product ranges which encourages "trading-up" and client stickiness. We expect this model to grow in popularity over the long term, as individuals shift their preference to more personalised, holistic and integrated financial products and services, ultimately driving higher profits relative to peers.

CONTACT US

CAPE TOWN

Century City

TEL: 021 524 4581
ADDRESS: Old Mutual Wealth, The Estuaries, 2 Oxbow Crescent, Century City, 7441
EMAIL: PCS@omwealth.co.za

Stellenbosch

TEL: 021 861 5300
ADDRESS: The Vineyard, Building B, Corner Adam Tas and Devon Valley Road, Stellenbosch, 7600
EMAIL: PCS@omwealth.co.za

JOHANNESBURG

TEL: 011 245 3610
ADDRESS: 1 Mutual Place, 107 Rivonia Road, Sandton, Johannesburg, 2196
EMAIL: PCS@omwealth.co.za

PRETORIA

TEL: 012 369 7220
ADDRESS: 43 Ingersol Road, 3rd Floor, Podium at Menlyn, Lynnwood Glen, 0081
EMAIL: PCS@omwealth.co.za

KWAZULU NATAL

Umhlanga

TEL: 031 581 0699
ADDRESS: 61 Richefond Circle, 2nd Floor Ridgeview Building, Ridgeside Office Park, Umhlanga Ridge, KwaZulu-Natal
EMAIL: PCS@omwealth.co.za

Kloof

TEL: 031 767 7300
ADDRESS: 75 Old Main Road, Unit 7, Kloof, KwaZulu-Natal
EMAIL: PCS@omwealth.co.za

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The Estuaries, 2 Oxbow Crescent, Century City 7441. PO Box 207, Cape Town 8000, South Africa.
Tel +27 (0)21 524 4400 | Fax +27 (0)21 441 1060 | www.omwealth.co.za

Private Client Securities: Cape Town: +27 (0)21 524 4400 | Sandton: +27 (0)11 245 3805 | Pretoria: +27 (0)12 369 7236 | Durban +27 (0)31 581 0600 | PCS@omwealth.co.za