Afrifocus
PERSONAL WEALTH

HEAD OFFICE: Afrifocus House, 31 (B) Impala Road, Chislehurston, Sandton, Tel: (+27-11) 290-7800, Fax: (+27-11)- 290-7878
CAPE TOWN: Ground Floor, Great Westerford, 240 Main Road, Rondebosch, Tel : (+27-21) 528-9900, Fax: (+27-21) 685-1112
DURBAN: Suite 119 – First Floor, Il Palazzo, 5 Zenith Drive, Umhlanga Rocks, Durban. Tel: (+27-31) 584-6491, Fax: (+27-31) 584-6847

A new dawn for South Africa

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Dear Investor,

Afrifocus wishes you and your family a very safe and prosperous 2018.

Source: Google images

The election of Cyril Ramaphosa as the 13th President of the ANC hopefully heralds a new dawn for our country. The capital markets have responded very positive to his election, with domestic shares rallying and bond yields strengthening. We now await the ruling party's next move – will they recall President Zuma or not? The current view is that a recall will allow the Government to implement plans to revive the economy, which has lagged its peers over the past 5 years; to address the overwhelming unemployment and poverty in the country and to introduce much-needed fiscal discipline at the State-Owned Enterprises (SOEs).

The global investment view can be summarised as follows

- ❖ Global economic growth remains intact; emerging markets (EM) equities should outperform developed markets (DM).

Table 1 - Global growth forecasts

Real GDP Growth Percent Change yoy	2015	2016	2017 (f) GS	2017 (f) Cons*	2018 (f) GS	2018 (f) Cons*
US	2.9	1.5	2.2	2.2	2.5	2.4
Japan	1.1	1.0	1.6	1.5	1.5	1.1
Euro Area	1.9	1.7	2.3	2.2	2.2	1.9
Germany	1.5	1.9	2.6	2.2	2.5	2.0
France	1.0	1.1	1.8	1.7	2.0	1.8
Italy	0.7	1.0	1.5	1.5	1.1	1.2
Spain	3.2	3.2	3.1	3.1	2.5	2.6
UK	2.3	1.8	1.5	1.5	1.3	1.4
China	6.9	6.7	6.8	6.8	6.5	6.4
India**	8.0	7.1	6.4	6.8	8.0	7.4
Russia	-2.8	-0.2	2.2	1.9	3.3	1.8
Brazil	-3.8	-3.6	0.9	0.7	2.7	2.4
Developed Markets	2.3	1.7	2.3	2.2	2.3	2.1
Emerging Markets	4.6	4.7	5.0	4.5	5.6	4.9
World	3.5	3.2	3.7	3.5	4.0	3.6

* Bloomberg consensus forecasts as of November.

Our preferred stocks, ETFs and income assets can be discussed with our Portfolio Managers. They will also provide you with information on Afrifocus Personal Wealth and all our investment products.

Afrifocus Personal Wealth

WealthBuilder

https://www.afrifocus.co.za/private-clients/

Online CFD Platform

https://afrifocus.tradedesk.co.za/clients

The table above by Goldman Sachs highlights their view that EM growth will exceed DM growth, and will most likely surprise to the upside.

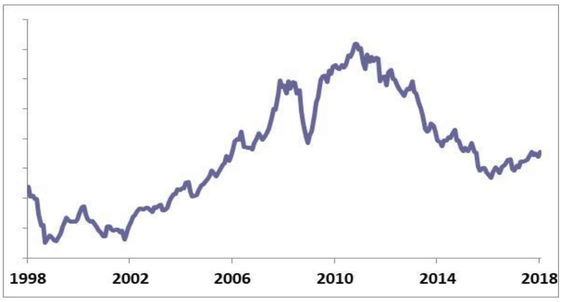

Figure 1 - Performance of Emerging market relative to Developed markets

The outperformance of EM equities started 2 years ago. We have taken exposure to this theme with the Satrix Emerging Market ETF (JSE: STXEMG).

- ❖ The overvalued US$ will remain under pressure as capital flows to risk assets

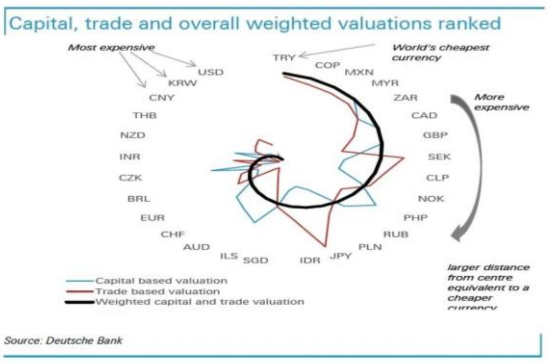

Figure 2 - Currency valuations – *Deutsche Bank*

We should see a continuation of interest rate hikes in the USA, as the QE stimulus unwinds. Given that the European recovery is taking shape, we could see a reversal in interest rates in the EU as well this year. Global inflation remains stubbornly benign, which could result in lower than anticipated hikes.

❖ Equity markets are getting overvalued

A large driver of equity market performance since the 2007 crises has been the creation of excess liquidity through the various QE programmes.

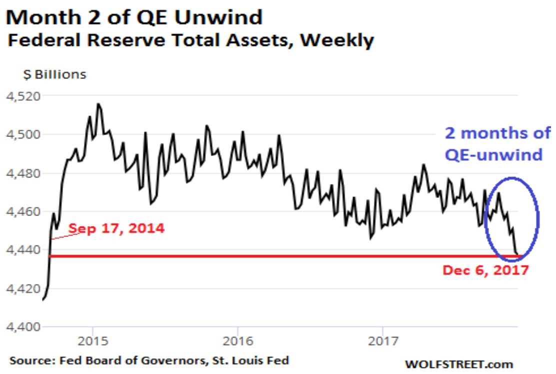

Figure 3 – Unwinding of the QE programme

Although it's still early days in the unwind process, the combination of high valuations and removal of liquidity from the system could be a toxic mixture sometime in the future.

❖ The commodity rally remains intact

A combination of strong EM growth in China and India, the prospects of the Chinese Silk Road project, supply disruptions in China due to environmental issues and curtailing of supply from mining houses has created a boom in commodity prices from the December 2015 lows.

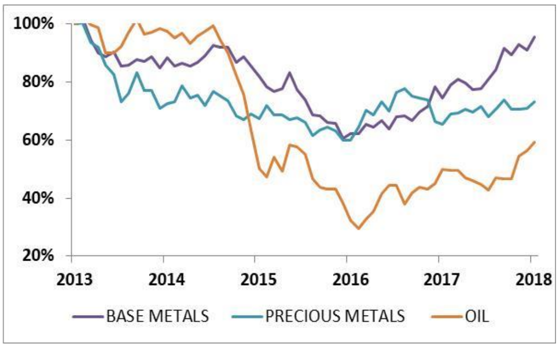

Figure 4 – Commodities (based to 100%) are rallying

The proposed introduction of electric vehicles (EVs) by some major economies to replace the internal combustion engine over time has seen strong demand for those metals used in the manufacture of EV batteries, namely lithium, cobalt and to a lesser extent copper. Currently 0.2% of the world's vehicles are electric, so the growth potential is immense.

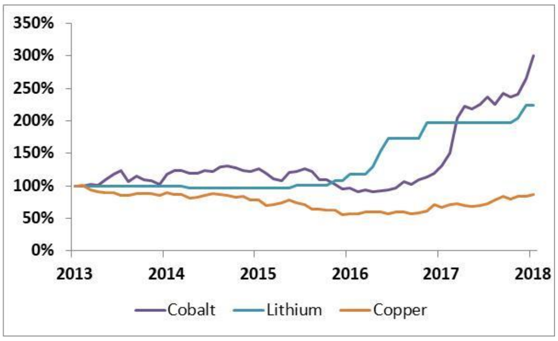

Figure 5 – EV metals (based to 100%) are rocketing

Listed on the JSE, the two shares geared towards these metals are GLENCORE (JSE: GLN) and TAWANA (JSE: TAW). The latter is especially interesting as a pure play on lithium, with their Baldhill operation in Australia coming into production this year.

SASOL remains one of the pure oil plays on the JSE. Our concern with the counter, although inherently cheap on a PE basis, revolves around a potential tax liability around its international oil procurement activities of R1.2bn for 2005 – 2014. We have therefore instead opted for BHP BILLITON (JSE: BIL) in our fully managed accounts.

As a recovery play we have introduced IMPALA PLATINUM (JSE: IMP) into our managed accounts. The next two years should see them migrate to a higher-grade ore body with the simultaneous closure of unprofitable shafts. Of more importance is their 87% stake in the high-quality Zimbabwean-based ZIMPLATS which the market is assigning zero value to in our opinion. ZIMPLATS has rallied from AU$3.5 to AU$6.5 since the collapse of the Mugabe-regime and equates to ca. R8 per IMPALA share.

We remain positive on two of the major Rand-hedge shares, namely NASPERS-N (JSE: NPN) and RICHEMONT (JSE: CFR).

NASPERS-N remains a play on TENCENT, a company that rapidly became a global technology giant. The value of NASPERS-N, adjusted for its holding in TENCENT, is trading at a negative value. Management is actively trying to unlock this value to shareholders.

RICHEMONT remains a play on the global wealth effect. The wealth created by the excess liquidity introduced into the system post the 2007 crisis, bodes well for the luxury good sector. With the anticipated GDP growth in EM over the next two years exceeding expectations, RICHEMONT should continue benefitting.

From the disaster that became STEINHOFF, and the lack of active participants over the quiet December period and lack of news flow from the Group, our initial communication to our investors was to hold their stock. A month later we are assessing our view.

- ❖ The major decline in the value can be attributed to the shock of a corporate scandal at a global level, the forced liquidation of geared positions, a lack of liquidity in the market over the December period and the reckless comments made by some respected investment managers on a limited set of facts. One of the major causalities of the collapse was the Chairman Christo Wiese himself, who saw his shareholding sold off by almost 100m shares to cover margin calls.
- ❖ The Company acted swiftly by replacing the CEO Markus Jooste, and Wiese resigned immediately to prevent a conflict of interest.
- ❖ The Company met their bankers and identified assets for sale to shore up liquidity. To date only a portion of their PSG holding has been sold, potentially indicating that liquidity is less of a concern.
- ❖ Poundland, one of their UK subsidiaries, indicated that they enjoyed a robust trading period in December and had also secured independent funding for its operation. So bankers appear to be comfortable with lending money to the operating subsidiaries.
- ❖ The report by the Viceroy Research Group, that contributed to the collapse, values the shares at EUR1.6 or R23 a share

The old saying that "the time to buy is when there's blood in the streets" comes to mind. And STEINHOFF couldn't be bloodier, having fallen 90% from its peak. We would therefore rate the stock as a SPECULATIVE BUY until more details of the alleged fraud and the findings of the European courts later this month is made known. If the Company cannot produce audited results, the possibility of the stock being suspended remains.

Our banking shares have rallied substantially from the lows of December 2015 and are reaching an overvalued situation. We would reduce the exposure to underweight at this stage.

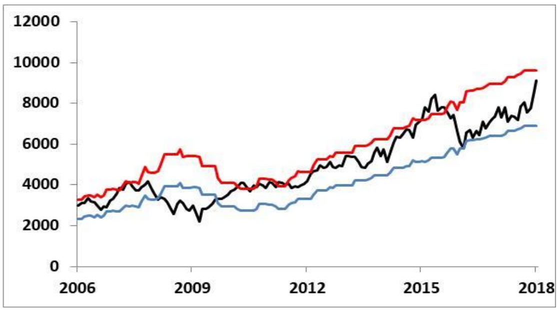

Figure 6 – JSE BANKS reaching overvalued area

The cheapest banks, given their growth prospects, are INVESTEC (JSE: INL/INP) on a FPE and FDY of 8.9x and 5.3%, and NEDBANK (JSE: NED) on a 9.8x and 5.3% respectively.

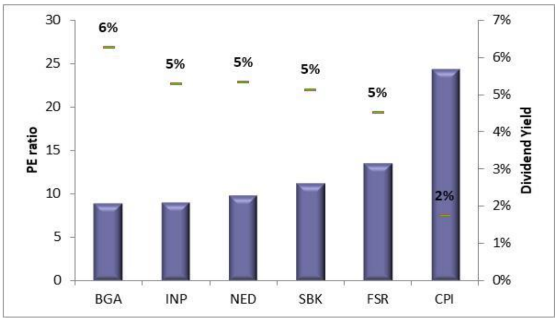

Figure 7 – JSE BANKS valuation metrics

CAPITEC (JSE: CPI) remains the high-growth counter in the sector.

We have identified MTN as a recovery stock on a 24 month view. The recent unrest in Iran is most likely putting pressure on the counter, but like all conflicts, this will eventually also be resolved.

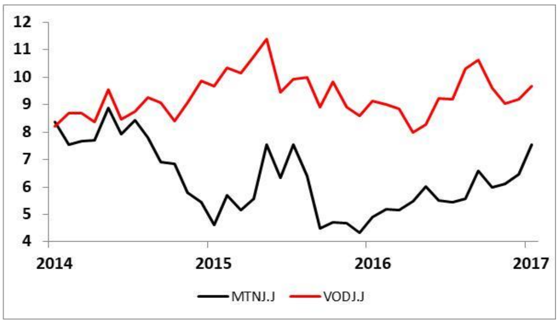

Figure 8 – MTN trading a P/Cash Flow discount to VODACOM

MTN remains a highly cash generative basis. Post the large fine paid to the Nigerian Government, and the appointment of a new CEO, we believe that the recovery of the share price will happen over the medium term. Valuation and momentum favours MTN over VODACOM.

We took an initial position in EOH for our fully managed accounts when the share price dropped to R100. With the subsequent negative news flow around raids on a Directors house, margin calls from financial institutions on geared positions taken by Directors and the reversal of certain purchases made and the restatement of earnings for the reversal, the price dropped another 30%. We have doubled up on our position, believing that the price drop is overdone.

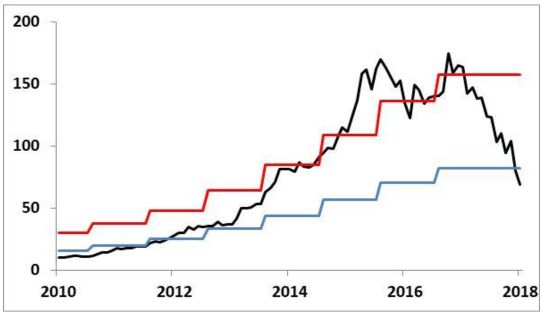

Figure 9 – EOH in value territory

At a trailing PE of 8x the share is offering value. We look to the next set of financials to see the negative impact of the purchase reversals on the share price and the return of the former CEO to the business to start its recovery.

Tax-free Savings Accounts

As we approach the end of the tax-year, we once again remind our investors about the Afrifocus Tax-free Savings Account (TFSA). You can invest R33 000 per annum into a TFSA and as per Government Regulation, all capital gains, interest and dividends earned** are exempt from income tax. Our administration fee is very competitive at 0.5% per annum and the use of low-cost ETFs over actively managed Unit Trusts will be to investors' benefit over the longer term.

Please speak to your Portfolio Manager about the ETFs that have been approved for investment – they cover all asset classes and multiple investment destinations.

*** The global ETFs pays dividend tax in the foreign jurisdictions and therefore cannot recover that tax.*

Regards

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