

FUTUREGROWTH

/ ASSET MANAGEMENT



Monthly Review

January 2016

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Market review

Economic and market review

Improved risk appetite and SARB decisiveness assist bond market	Towards the end of January, the local bond market received support from a marginal improvement in global risk appetite resulting in an appreciation of the rand. The bond market also benefited from the South African central bank's 50 basis points (bps) repo rate increase. The central bank action was a step in the right direction in managing rising inflation expectations and, more broadly, macro policy credibility, which is still recovering from the damaging December events.
Monetary policy divergence in action	Global risk appetite received a boost, albeit possibly only temporarily, from a more dovish than expected statement which accompanied the US Federal Reserve Boards' decision to leave interest rates unchanged at the recent FOMC meeting. Elsewhere, our long held view of policy divergence continued to play out as the Bank of Japan eased monetary policy while pressure continues to build on the European Central Bank to do more to address subdued economic activity, which in turn forced benchmark German bond yields to lower levels.
Local economic data also supportive of lower yields... for now	On the local economic data front, the latest inflation data printed in line with market expectations with limited evidence of significant currency pass through, while food prices started trending higher in response to the worst drought in more than a century. Better than expected external trade data for December contributed to improved sentiment, while proposals by the Minister of Finance to reduce state spending were welcomed by a weary market. Based on the December release the Ministry of Finance still remains on track to stick to its 2015-16 main budget deficit targets. Although this should be welcomed as encouraging news, market focus has already shifted to the 2016/17 and medium term budget due to be tabled this month for more evidence of fiscal consolidation.
Market recovered some of the December losses	In response to the above, both the local nominal and inflation-linked bond markets ended the month on a stronger note. The yield of the benchmark R186 closed at 9.20% or 50 bps below the December close and well below the weakest level of 9.84% for January. The JSE ASSA All Bond Index returned 4.6%, recovering some of the December loss. Inflation-linked bonds (JSE ASSA Government Inflation-linked Index) also put in a decent performance of 0.79%, beating the 0.5% cash return.

Summary

Key macroeconomic themes

Economic growth	<p>A mild cyclical and uneven global economic recovery remains our base case, with a stronger US economy leading the way. In contrast, euro zone growth remains challenged, with prospects for Japan particularly poor. We believe that the global recovery would be structurally lower than in previous cycles, mainly due to low productivity growth, high leverage levels (albeit much improved from pre-crisis levels) and demographic factors (older populations tend to save more and spend less).</p> <p>Most emerging market economies are caught between a mixed outlook for the developed world, concern about the implications of weaker Chinese growth on commodity demand and the impact of the Federal Reserve's well telegraphed intent to normalise monetary policy. Commodity producers with large external imbalances such as SA remain particularly vulnerable.</p> <p>Locally, the biggest impediment to higher local growth remains structural, while the persistent bleak outlook for metals and the severity of the drought add to the list of growth detractors.</p>
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Key macroeconomic themes *continue*

Inflation

Although recent data releases have quelled earlier excessive global deflation fears, expectations of rapid reflation are also misplaced. Global inflation trends are likely to remain subdued in our view.

Locally, the combination of sustained and broad-based rand weakness, rising local grain prices and higher Eskom tariffs have pushed our 2016 and 2017 annual average inflation forecasts to 6.2% and 5.7% respectively. We shall be keeping one eye on the core measure of inflation for a more reliable indication of underlying inflationary pressure, which is still stable below 6%. As yet, evidence of significant pass through of rand weakness remains fairly limited. However, the risk remains that this will eventually follow.

Balance of payments

The combination of rand weakness, a slow global economic recovery and an improved terms of trade position (mostly due to sharply lower crude oil prices), provide a welcome boost to the fragile balance of payment situation. As a result, we expect a narrowing in the current account deficit from an annual average of 5.4% in 2014 to 3.7% in both 2016 and 2017. Although this improvement is welcomed, we note with a fair degree of concern that South Africa is still saddled with a relatively weak external trade position which in turn will remain a drag on the currency. Similarly, it leaves the SARB with less room to manoeuvre since a deficit of this magnitude implies a higher real repo rate.

Monetary policy

The US finally started the long awaited and well telegraphed monetary policy normalisation process. We agree with the Federal Reserve's intent to follow a slow and gradual process.

The current trend of global monetary policy divergence is expected to continue over the next year or so. With more policy tightening in the US (and eventually in the UK) on the cards, the European Central Bank (ECB) and Bank of Japan (BOJ) will retain their quantitative easing programmes. This was confirmed by the BOJ's most recent policy action. At the same time some of the smaller advanced and commodity driven economies may be forced to ease policy, mainly due to low growth and a modest inflation backdrop. On the positive side, monetary policy divergence will act to soften the impact of higher US rates on global growth.

In the case of South Africa, we feel comfortable with the prospects of a very gradual tightening process, especially considering that the repo rate has already been increased by a cumulative 1.75% in this cycle. A cautious approach is supported by the weak economic growth backdrop, low levels of credit extension growth and limited evidence of demand-led inflation. Unfortunately, the monetary authorities cannot ignore rising cost pressures, especially those originating from food prices, energy prices and persistent currency weakness. Moreover, monetary policy, even if credible, cannot be considered in isolation. It goes hand in hand with fiscal prudence and a more balanced external account. Considering the size of the balance of payments deficit, the real repo rate has to be raised more.

Key macroeconomic themes continue

Fiscal policy

The fiscal situation remains delicately balanced. In our view, the 2015 Medium Term Budget Policy announcements under delivered with regards to the appropriate pace of deficit reduction. We are nervous about the financial state of some of the state-owned enterprises and what it implies for a stretched fiscal situation. Even so, monthly public finance data to the end of December suggest that government may meet its deficit target for the current fiscal year. However, the forthcoming fiscal year(s) are of greater concern, which in turn adds to the risk of South Africa losing its investment grade status. At the very least, Minister Gordhan is seemingly pulling out all the stops to avert a worsening of the credibility crisis.

Investment view and strategy

The global growth recovery remains fragile and patchy, which sets the scene for a more modest future inflation profile as well as significant monetary policy divergence. It also implies a steady and shallow tightening cycle for the few economies that are in a position to normalise monetary policy, especially the US. This should cap global bond yields especially as inflation pressures in developed markets remain subdued. On the negative side, the continued uncertainty about the Chinese growth outlook remains a risk, especially for emerging market commodity producers with a weak external position like South Africa.

Locally, investors face a worsening inflation outlook on the back of rising food prices, the risk posed by sustained rand weakness and the likely increase in inflation expectations. Although the Minister of Finance is clearly determined to rectify the damage to fiscal policy credibility and, by implication, a sovereign credit downgrade to non-investment status, the jury is still out on actual delivery. Besides South African idiosyncratic factors, we also expect global risk appetite to remain volatile. As a result, we will approach the market with caution and focus on increasing our holding of low duration inflation-linked bonds. Moreover, the SARB will need to raise the repo rate again, a move already anticipated by both the money and bond markets.

At face value, this backdrop favours an overweight position in cash, underweight position in nominal bonds and the further accumulation of inflation-linked bonds. However, in acknowledgement of the fact that markets move fast in pricing risk, we would retain a small overweight exposure to long-dated nominal bonds.

Our broad interest rate investment strategy for a core bond fund benchmarked against the ALBI is as follows:

- Modified duration - Underweight
- Cash - Overweight
- Nominal bonds (1-12 years) - Underweight
- Nominal bonds (15+ years) - Overweight
- Inflation-linked bonds - Overweight

Key economic indicators and forecasts (annual averages)

	2012	2013	2014	2015	2016	2017
Global GDP						
USA	2.2%	1.9%	2.4%	2.5%	2.3%	2.6%
Euro area	0.1%	-0.4%	0.9%	1.5%	1.8%	2.3%
Japan	2.1%	1.6%	-0.1%	0.5%	0.9%	1.5%
China	7.8%	7.7%	7.4%	6.8%	6.6%	6.5%
SA GDP	2.2%	2.2%	1.5%	1.4%	1.2%	2.0%
SA Headline CPI	5.6%	5.8%	6.1%	4.6%	6.2%	5.7%
SA Current Account (% of GDP)	-5.2%	-5.8%	-5.4%	-3.9%	-3.7%	-3.7%

Source: Old Mutual Investment Group

Produced by



Wikus Furstenberg
Portfolio Manager &
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Product information and performance

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
MONEY MARKET											
Call Money Market	Average Call rate of four largest SA banks	Aims to provide maximum return on overnight cash investments.	Nazley Bardien	January 2000	Product Benchmark Outperformance	5.96% 5.53% 0.43%	5.49% 5.04% 0.45%	5.41% 4.94% 0.47%	5.91% 5.41% 0.50%		7.06% 6.57% 0.49%
Core Money Market	STeFI 3-month Index	Targets high cash returns through a carefully balanced and actively managed mix of short-term interest-bearing investments. The weighted average duration for the Composite may not exceed 90 days.	Michael van Rensburg	July 2004	Product Benchmark Outperformance	6.86% 6.12% 0.74%	6.30% 5.62% 0.68%	6.14% 5.53% 0.61%	6.75% 6.04% 0.71%	7.80% 7.11% 0.69%	7.80% 7.13% 0.67%
180 day Enhanced Money Market	STeFI Composite Index	Targets high cash returns through a carefully balanced and actively managed mix of short- and medium-term interest-bearing investments with maturities ranging from 180 days to 2 years.	Michael van Rensburg	July 2004	Product Benchmark Outperformance	7.11% 6.49% 0.62%	6.45% 5.89% 0.56%	6.34% 5.73% 0.61%	6.96% 6.19% 0.77%	7.97% 7.21% 0.76%	8.01% 7.22% 0.79%
STeFI PLUS											
Yield Enhanced A STeFI+ Short Term	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of A-. Weighted average term to maturity less than 365 days.	Daphne Botha	October 2002	Product Benchmark Outperformance	7.30% 6.49% 0.81%	7.27% 5.89% 1.38%	7.39% 5.77% 1.62%	7.83% 6.34% 1.49%	8.66% 7.31% 1.35%	8.97% 7.82% 1.15%
Yield Enhanced A STeFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of A based on official ratings. Weighted average term to maturity less than five years.	Daphne Botha	January 2010	Product Benchmark Outperformance	8.33% 6.49% 1.84%	8.08% 5.89% 2.19%	7.90% 5.77% 2.13%			8.32% 5.97% 2.35%
Yield Enhanced BBB STeFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BBB.	Daphne Botha	February 2010	Product Benchmark Outperformance	10.84% 6.49% 4.35%	9.88% 5.89% 3.99%	9.68% 5.77% 3.91%			9.87% 5.94% 3.93%

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
STEFI PLUS CONT.											
Yield Enhanced BB STEFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BB.	Daphne Botha	January 2012	Product Benchmark Outperformance	13.71% 6.49% 7.22%	13.18% 5.89% 7.29%				12.44% 5.79% 6.65%
Yield Enhanced Geared BB STEFI+	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement, as well as equity risk. The Composite's weighted average rated credit quality must be a minimum of BB-.	Daphne Botha	January 2008	Product Benchmark Outperformance	12.84% 6.49% 6.35%	13.04% 5.89% 7.15%	11.29% 5.77% 5.52%	12.33% 6.34% 5.99%		12.10% 7.05% 5.05%
Power Debt	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BBB. Investments in this product are limited to listed and unlisted assets in the power sector and supporting industries.	Paul Semple	May 2014	Product Benchmark Outperformance	10.26% 6.49% 3.77%					11.36% 6.36% 5.00%
INCOME											
Core Income	50% STeFI Call Deposit Index; 50% 3-7 Years All Bond Index	Aims to deliver excess return by investing in money market and bond assets with a focus on yield enhancement while limiting interest rate risk to a maximum average duration of two years.	Wikus Furstenberg	November 2002	Product Benchmark Outperformance	2.84% 3.15% -0.31%	5.46% 5.11% 0.35%	6.41% 5.92% 0.49%	6.94% 6.28% 0.66%	7.83% 7.10% 0.73%	8.49% 7.84% 0.65%
Flexible Income	110% SteFI Call Index	Aims to deliver excess return by investing in money market, bonds, preference shares and listed property and taking advantage of yield enhancement and capital growth opportunities. The composite is not limited by duration constraints.	Wikus Furstenberg	July 2006	Product Benchmark Outperformance	2.86% 6.25% -3.39%	5.62% 5.77% -0.15%	7.24% 5.74% 1.50%	7.73% 6.31% 1.42%		8.80% 7.20% 1.60%
Yield Enhanced Income	20% All Bond Index; 80% STeFI Composite Index	Aims to deliver excess returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted assets. Interest rate risk is constrained.	Wikus Furstenberg	May 2012	Product Benchmark Outperformance	5.82% 4.03% 1.79%	7.54% 5.50% 2.04%				8.10% 5.88% 2.22%

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
INTEREST RATE ASSET ALLOCATION											
Interest Rate Asset Allocation	ALBI (62.5%); JSE ILB IGOV Index (30%); STe-FI Call Deposit Index (7.5%)	Aims to deliver excess return mainly through a combination of aggressive asset allocation within the various interest-bearing asset classes.	Wikus Furstenberg	July 2010	Product Benchmark Outperformance	-5.78% -1.74% -4.04%	5.62% 4.42% 1.20%	9.34% 8.05% 1.29%			9.39% 8.29% 1.10%
INFLATION-LINKED BONDS											
Passive ILB Index	Barclays Capital/ Absa SAGILB	Aims to match the returns of the benchmark through passive interest rate and yield curve management.	Nazley Bardien	September 2005	Product Benchmark Outperformance	4.43% 4.51% -0.08%	5.47% 5.54% -0.07%	9.53% 9.67% -0.14%	9.46% 9.56% -0.10%	9.75% 9.85% -0.10%	9.95% 10.03% -0.08%
Core ILB	JSE ILB IGOV Index	Aims to deliver excess return through active interest rate risk management and limited yield enhancement.	Wikus Furstenberg	November 2005	Product Benchmark Outperformance	4.30% 4.49% -0.19%	5.47% 5.53% -0.06%	9.95% 9.66% 0.29%	9.90% 9.56% 0.34%		10.15% 9.87% 0.28%
Yield Enhanced Inflation-linked	RSA Inflation Linked Government Bond R202 Total Return Index	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted assets.	Mei-Chi Liou	June 2011	Product Benchmark Outperformance	5.88% 3.48% 2.40%	9.22% 6.70% 2.52%				12.07% 9.95% 2.12%
Power Inflation-Linked***	RSA Inflation Linked Government Bond I2038 Total Return Index	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted assets in the power sector and supporting industries.	Mei-Chi Liou	January 2014	Product Benchmark Outperformance	6.92% 4.32% 2.60%					9.18% 6.78% 2.40%
Infrastructure & Development Inflation-linked	Barclays BESA SAGILB 15+	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Mei-Chi Liou	Pending	Product Benchmark Outperformance	N/A					
NOMINAL BONDS											
Passive All Bond	All Bond Index	Aims to match the returns of the benchmark through passive interest rate and yield curve management.	Nazley Bardien	June 2000	Product Benchmark Outperformance	-5.64% -5.61% -0.03%	3.66% 3.65% 0.01%	7.50% 7.52% -0.02%	7.31% 7.32% -0.01%	7.39% 7.38% 0.01%	10.76% 10.74% 0.02%
Core Bond	All Bond Index	Aims to deliver excess return through a combination of interest-bearing asset allocation, active duration management and yield enhancement.	Daphne Botha/ Wikus Furstenberg	January 2000	Product Benchmark Outperformance	-6.00% -5.61% -0.39%	4.30% 3.65% 0.65%	8.22% 7.52% 0.70%	8.14% 7.32% 0.82%	8.11% 7.38% 0.73%	11.22% 10.61% 0.61%

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
NOMINAL BONDS cont.											
Long Duration Bond	All Bond Index 12+ Years	Aims to deliver excess return through active allocation between long-dated fixed rate and inflation-linked bonds, limited yield curve selection, duration management and yield enhancement.	Wikus Furstenberg	December 2006	Product Benchmark Outperformance	-11.08% -10.22% -0.86%	3.21% 3.41% -0.20%	7.26% 7.41% -0.15%	6.90% 6.74% 0.16%		7.22% 6.86% 0.36%
Yield Enhanced Bond	All Bond Index	Targets high cash returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted assets.	Jason Lightfoot	December 2001	Product Benchmark Outperformance	-3.35% -5.61% 2.26%	6.47% 3.65% 2.82%	10.20% 7.52% 2.68%	10.08% 7.32% 2.76%	9.80% 7.38% 2.42%	11.04% 9.06% 1.98%
Infrastructure & Development Bond	All Bond Index	Targets high cash returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Jason Lightfoot	January 1995	Product Benchmark Outperformance	-3.53% -5.61% 2.08%	6.55% 3.65% 2.90%	10.24% 7.52% 2.72%	10.33% 7.32% 3.01%	10.12% 7.38% 2.74%	12.63% 10.61% 2.02%
SOCIALLY RESPONSIBLE INVESTMENTS											
Infrastructure & Development Bond	All Bond Index	Targets high cash returns through a combination of active interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Jason Lightfoot	January 1995	Product Benchmark Outperformance	-3.53% -5.61% 2.08%	6.55% 3.65% 2.90%	10.24% 7.52% 2.72%	10.33% 7.32% 3.01%	10.12% 7.38% 2.74%	12.63% 10.61% 2.02%
Development Equity	Consumer Price Index (CPI) + 10%	Targeting high returns by investing in equity and related assets that are socially responsible or developmental.	James Howard	September 2006	Product Benchmark	18.87% 15.24% 3.63%	16.76% 15.33% 1.43%	14.22% 15.55% -1.33%	14.34% 15.36% -1.02%		18.92% 16.18% 2.74%
Community Property	Consumer Price Index (CPI) + 4%	A portfolio specialising in the finance and development of retail shopping centres catering to the needs of under-served communities throughout South Africa.	Smital Rambhai (Product Manager)	June 1996	Product Benchmark	17.91% 9.23% 8.68%	11.91% 9.32% 2.59%	10.60% 9.54% 1.06%	10.33% 9.35% 0.98%	12.83% 10.22% 2.61%	13.25% 9.82% 3.43%
Agri	Consumer Price Index (CPI) + 10%	A portfolio specialising in equity investments in agricultural land, agribusinesses and farming infrastructure.	Smital Rambhai (Product Manager)	March 2010	Product Benchmark	N/A					

Product	Benchmark	Description	Portfolio manager	Inception date	Investment returns	1 Year	3 Years*	5 Years*	7 Years*	10 Years*	Since inception*
SOCIALLY RESPONSIBLE INVESTMENTS cont.											
Development Balanced**	A composite weighting of the underlying funds' benchmarks.	A balanced portfolio providing investors with social impact from a targeted and development perspective and exposure to listed equities that track the JSE's SRI Index.	James Howard	November 2004	Product Benchmark Outperformance	-4.06% -4.75% 0.69%	6.41% 5.09% 1.32%	9.53% 8.21% 1.32%	11.71% 10.81% 0.90%	10.37% 9.63% 0.74%	12.94% 12.13% 0.81%
Power Debt	STeFI Composite Index	Targets high cash returns through active interest rate risk management and yield enhancement. The Composite's weighted average rated credit quality must be a minimum of BBB. Investments in this product are limited to listed and unlisted assets in the power sector and supporting industries.	Paul Semple	May 2014	Product Benchmark Outperformance	10.26% 6.49% 3.77%					11.36% 6.36% 5.00%
Power Inflation-Linked***	RSA Inflation Linked Government Bond I2038 Total Return Index	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted assets in the power sector and supporting industries.	Mei-Chi Liou	January 2014	Product Benchmark Outperformance	6.92% 4.32% 2.60%					9.18% 6.78% 2.40%
Infrastructure & Development Inflation-Linked bond	Barclays BESA SAGILB 15+	Targets high cash returns through a combination of active, real and nominal interest rate risk management and yield enhancement by investing in listed and unlisted socially responsible and developmental assets.	Mei-Chi Liou	Pending	Product Benchmark Outperformance	N/A					

Currency: ZAR/Gross of fees

* Annualised

** Currently investors are Futuregrowth staff who may elect to invest through their retirement funds.

*** Portfolio returns. Supplemental information.

FUTUREGROWTH

/ ASSET MANAGEMENT

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