STRONG START TO THE YEAR

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After December's market carnage, global equities bounced back strongly in January. Indeed, while December was the worst end to a year for the US benchmark S&P 500 equity index since the 1930s, January's 8% return made it the best start to a year since the mid-1980s. Talk about ups and downs.

The old aphorism 'as goes January, so goes the year' reflects a combination of superstition and wishful thinking more than it reflects actual data. In recent times, January 2016 started off with a slump in global markets, but that turned out to be the bottom of a sharp correction and markets rallied for the next two years. In contrast, January 2018 had a euphoric feel to it as the combination of US corporate tax cuts and strong global growth ignited investor spirits. We know how the rest of the year turned out. In any event, markets don't move in straight lines, and a repeat of the January surge seems unlikely, but for now, nobody is complaining.

BEING PATIENT

One of the main reasons behind the Christmas Eve slump, and the New Year's rally is the market's view of US monetary policy. In December, the fear was that the Federal Reserve (Fed) was on autopilot and that its interest rate increases and balance sheet reduction would choke off the US economy and drain liquidity from markets. Indeed, the Fed hiked rates at its December policy meeting. But at that meeting, it also signalled that it would be more cautious in raising rates, given still-low inflation and signs of strain in interest rate-sensitive areas like housing.

Last week, this caution became part of its official policy stance, with the post-meeting statement indicating that the Fed would be 'patient' in light of muted inflation pressures and a slowing global economy. The explicit reference to future hikes that had been in the statement since 2015 was removed. A separate statement noted that the Fed would make changes to its balance sheet reduction programme if conditions warranted it. Currently, $50 billion in bonds that were purchased during its various rounds of quantitative easing (QE) are allowed to mature each month without being replaced, meaning that the Fed's portfolio of assets is steadily shrinking.

The Fed has always maintained that interest rates, not the size of its balance sheet, is the main tool impacting the economy, but many investors saw balance sheet reduction (also called quantitative tightening or QT) as a massive drag on markets. However, just as the impact of QE was probably overstated, so is the impact of QT.

AROUND THE WORLD

Looking at how some other equity markets responded, the Eurostoxx 600 gained 6.35% in euro in January, but is still down 6% over the past 12 months. The Japanese benchmark Nikkei 225 delivered a more subdued but positive 3.8% in January in yen.

Emerging market equities outperformed developed markets in January, having lagged in 2018. The MSCI Emerging Markets Index returned 8.7% in US dollars, with Brazil delivering the best performance (18%) due to a combination of a stronger real and optimism over economic policy reform. The MSCI All Country World Index, covering both developed and emerging markets, returned 7.9% in US dollars in January, which reduced the one-year loss to -7%.

Of course the bond market is also hugely sensitive to shifts in expectations of future interest rates and inflation. The benchmark US 10-year government yield hit a multi-year high of 3.24% in early November, but was down to 2.63% at the end of January, a substantial shift (bond prices and yields move in opposite directions).

SOFTER DOLLAR, FIRMER RAND

With US interest rates on hold, the divergence between US rates and those in other major economies that support the dollar is less pronounced. The trade-weighted dollar index declined somewhat, which should support earnings for US multinationals. But it is still 6% higher than a year ago. The main component of the index is the euro, and it has been under pressure for different reasons, particularly the surprisingly sharp slowdown in Eurozone growth.

But against emerging market currencies, the dollar has retreated sharply over the past five weeks. Indeed, January has seen the best start to the year for the rand in three decades and the rand-dollar exchange rate is now back to where it was in August.

At the end of January, the rand was 12% weaker against the dollar than a year ago, but that is because it was much stronger at the start of 2018 following the ANC elective conference. It weakened during the course of last year. So whether the rand is stronger or weaker depends on where you start. Either way, both up and down movements have positive and negative side effects.

THE RAND GIVES AND TAKES

A firmer rand places downward pressure on imported prices and therefore on overall inflation. This tends to be good for interest rate-sensitive assets like bonds and bank shares and January was a good month for bonds. At the current exchange rate, the oil price well behaved and the Fed on hold, the chances of further SARB rate hikes are greatly diminished.

The local 10-year government bond yield declined to 8.7% from 8.88% and the All Bond Index returned 2.8%. Retail shares are also usually counted among interest rate-sensitive assets, since they depend on local consumer spending, but low inflation has become something of a headwind as it caps total revenue growth. Shoprite's dismal trading update highlighted problems in Angola and Zambia, but its local operations were plagued by deflation, with 10 719 items still experiencing falling prices in December. With selling prices falling but input prices still rising, it is no wonder that the share price took a beating.

JSE ALSO POSITIVE

A firmer rand also erodes the returns from offshore investments and usually puts pressure on JSE-listed rand hedges, companies that predominantly generate revenues in hard currency. However, a weaker rand last year did not prevent several major rand-hedges from steep declines that contributed to the 8% negative return from the All Share.

Despite the stronger rand, the FTSE/JSE All Share Index returned 2.8% in January. In dollar terms, this amounted to a double-digit gain, one of the strongest among major markets. Industrials were flat, with rand hedges and SA retailers under pressure.

Financials had a strong bounce, as can be expected with a stronger rand environment, and returned 5.9% in January. The sector was flat over 12 months.

Listed property had a much better month after 2018's horrendous performance. The JSE All Property Index returned 8.4% in the month, but is still 10% in the red over 12 months.

Resources were helped by stronger commodity prices, especially gold, which gained support from the shift in the Fed's policy stance, and iron ore. The Chinese demand for iron remains robust, while the tragic collapse of a dam wall at a Brazil mine will see production halted there and at mines with similar tailings dams.

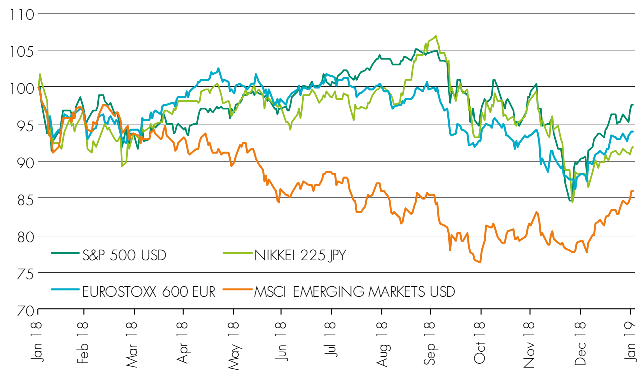
PUTTING IT ALL TOGETHER

Putting this all in a portfolio context, the bounce in local equities is key as it remains the major asset class in balanced funds under current regulations. The JSE is still some way off its record high, which remarkably was set only 12 months ago, although it was almost reached late August. (Most of last year's declines occurred in a two-month blitz between September and October.)

The gains in December and January are encouraging, but also backed up by more attractive valuations, gradual improvement in the local economy and emerging market sentiment. Despite the brief rally in bonds, they still offer high yields for investors. Listed property is also more attractively priced, which largely compensates for the challenging operational outlook. Returns from a local portfolio should therefore be better looking ahead than looking back.

The global portion of most balanced funds is meaningful at around 25% to 30% and clearly exposed to exchange rate volatility. This poses a challenge since investors want rand-denominated returns from such funds. However, the best way to think about it is that the dollar assets should be quietly growing in the background, even if the translation into rands is impacted by currency volatility. It is best to ignore such volatility. While the rand might strengthen further from here, over time it depreciates (due to higher local inflation) and investors should benefit from offshore exposure over the longer term. As discovered by the Fed belatedly, it is good to be patient.

CHART 1: MAJOR GLOBAL EQUITY INDICES IN LOCAL CURRENCIES, REBASED TO 100

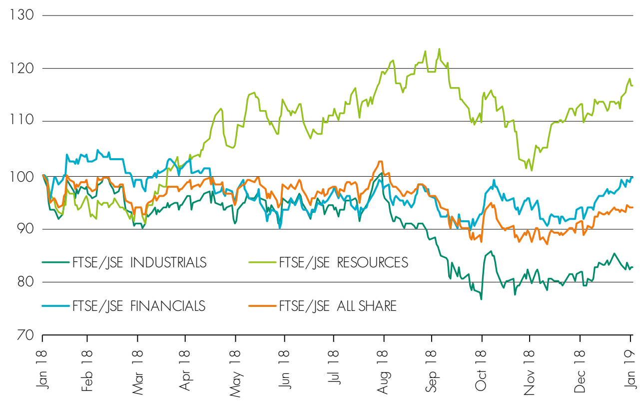


Source: Thomson Reuters Datastream

CHART 2: RAND-US DOLLAR EXCHANGE RATE

Source: Thomson Reuters Datastream

CHART 3: MAIN SECTORS ON THE JSE



Source: Thomson Reuters Datastream

INDICATORS

EQUITIES - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Global	MSCI World	US$	2 028.0	2.27%	7.64%	7.64%	-8.36%
United States	S&P 500	US$	2 704.0	2.35%	7.86%	7.86%	-4.25%
Europe	MSCI Europe	US$	1 583.0	2.06%	6.53%	6.53%	-16.38%
Britain	FTSE 100	US$	9 136.0	2.56%	6.42%	6.42%	-14.72%
Germany	DAX	US$	1 210.0	1.42%	6.51%	6.55%	-21.43%
Japan	Nikkei 225	US$	190.8	1.69%	4.50%	4.50%	-9.82%
Emerging Markets	MSCI Emerging Markets	US$	1 050.0	3.04%	8.70%	8.70%	-16.33%
Brazil	MSCI Brazil	US$	2 288.0	2.83%	17.70%	17.70%	-3.13%
China	MSCI China	US$	78.2	4.38%	11.07%	11.07%	-21.44%
India	MSCI India	US$	546.6	-0.31%	-2.05%	-2.05%	-13.52%
South Africa	MSCI South Africa	US$	499.0	4.39%	12.13%	12.13%	-19.65%

EQUITIES - SOUTH AFRICA (TR UNLESS INDICATED OTHERWISE)

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
All Share (Capital Only)	All Share (Capital Index)	Rand	54 157.0	0.97%	2.69%	2.69%	-8.99%
All Share	All Share (Total Return)	Rand	7 946.0	0.97%	2.79%	2.79%	-6.06%
TOP 40/Large Caps	Top 40	Rand	7 015.0	1.02%	2.72%	2.72%	-6.00%
Mid Caps	Mid Cap	Rand	15 682.0	0.54%	2.34%	2.34%	-7.53%
Small Companies	Small Cap	Rand	18 322.0	-0.32%	2.04%	2.04%	-12.60%
Resources	Resource 20	Rand	2 767.6	3.60%	2.79%	2.79%	16.80%
Industrials	Industrial 25	Rand	12 538.0	-0.89%	0.99%	0.99%	-17.24%
Financials	Financial 15	Rand	9 938.0	2.07%	6.76%	6.76%	4.81%
Listed Property	SA Listed Property	Rand	2 010.5	4.27%	9.21%	9.21%	-9.44%

FIXED INTEREST - GLOBAL

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
US Aggregate Bond Index	Bloomberg Barclays	US$	486.2	0.98%	1.52%	1.52%	-0.88%

FIXED INTEREST - SOUTH AFRICA

DESCRIPTION	INDEX	CURRENCY					
All Bond	BESA ALBI	Rand	651.5	1.64%	2.90%	2.90%	8.79%
Government Bonds	BESA GOVI	Rand	645.2	1.68%	2.97%	2.97%	7.97%
Corporate Bonds	SB JSE Credit Indices	Rand	103.0	0.46%	1.12%	1.12%	-19.24%
Inflation Linked Bonds	BESA CILI	Rand	257.7	-0.02%	1.66%	1.66%	3.38%
Cash	STEFI Composite	Rand	413.4	0.14%	0.60%	0.60%	7.25%

COMMODITIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
Brent Crude Oil	Brent Crude ICE	US$	61.1	0.00%	13.15%	13.15%	-11.45%
Gold	Gold Spot	US$	1 320.0	3.21%	3.04%	3.04%	-1.71%
Platinum	Platinum Spot	US$	818.0	3.15%	3.15%	3.15%	-18.44%

CURRENCIES

DESCRIPTION	INDEX	CURRENCY	INDEX VALUE	WEEK	MONTH-TO-DATE	YEAR-TO-DATE	1 YEAR
ZAR/Dollar	ZAR/USD	Rand	13.25	3.58%	8.35%	8.33%	-10.39%
ZAR/Pound	ZAR/GBP	Rand	17.36	3.23%	5.53%	5.53%	-2.76%
ZAR/Euro	ZAR/EUR	Rand	15.17	2.26%	8.59%	8.59%	-2.48%
Dollar/Euro	USD/EUR	US$	1.14	-0.88%	0.61%	0.61%	9.65%
Dollar/Pound	USD/GBP	US$	1.31	-0.36%	-2.36%	-2.36%	8.31%
Dollar/Yen	USD/JPY	US$	0.01	-0.71%	-0.67%	-0.67%	-0.27%

Source: I-Net, figures as at 1 February 2019

ASSET MANAGER MOVEMENTS

There were no manager movements over the past week.

THE WEEK AHEAD

SOUTH AFRICA

- State of the Nation Address
- Markit Purchasing Managers' index

US

- ISM Services Index
- Job openings and labour turnover

EUROPE

- Eurozone retail sales
- Bank of England interest rate decision

JAPAN

- Household spending

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