Current Market Environment

- time to panic?

Quick review 11 Oct 2018

ANCHOR CAPITAL

Summary of views and perspective

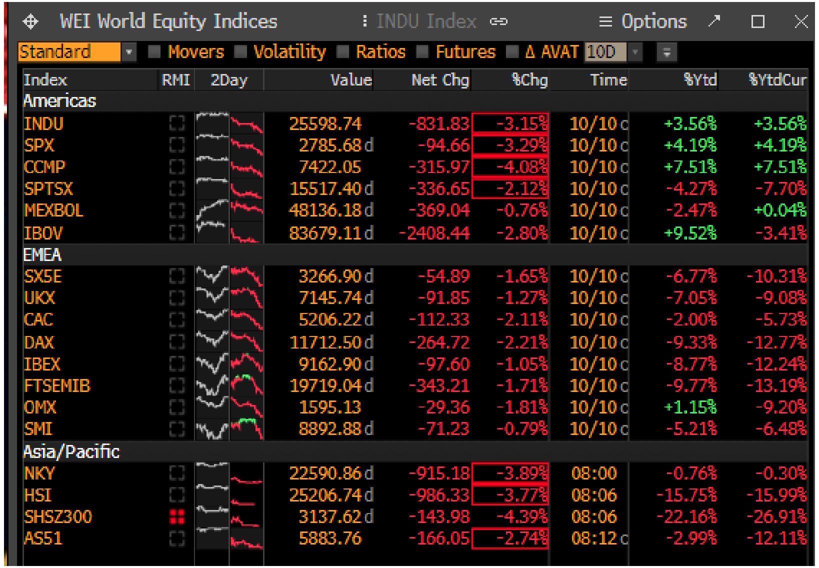
Global markets

- World Index now flat for the year, after 4% drop month to date – not unusual for equity markets
- Within this US market is up around 4%, while emerging markets (only 10% of world market) are down 13% (in US$), but 20% off peak levels
- Sharp drop in recent days has caused anxiety and outlooks and exposures are being questioned
- Increase in US bond yields and growth downgrades increasing uncertainty (World Bank has downgraded world GDP growth from 3.9% to 3.7% in 2019)
- US market valuations a little above 10 year average, but not expensive – we remain moderately positive, as earnings growth still looks very strong
- Emerging markets have been smacked and are now at 11x forward PE – trade war resolution and Chinese internet regulation clarity could see big bounce, but looks very vulnerable in the short term
- We don't think it is time to panic, but history shows market can still go lower. We would be buyers of specific shares on further weakness

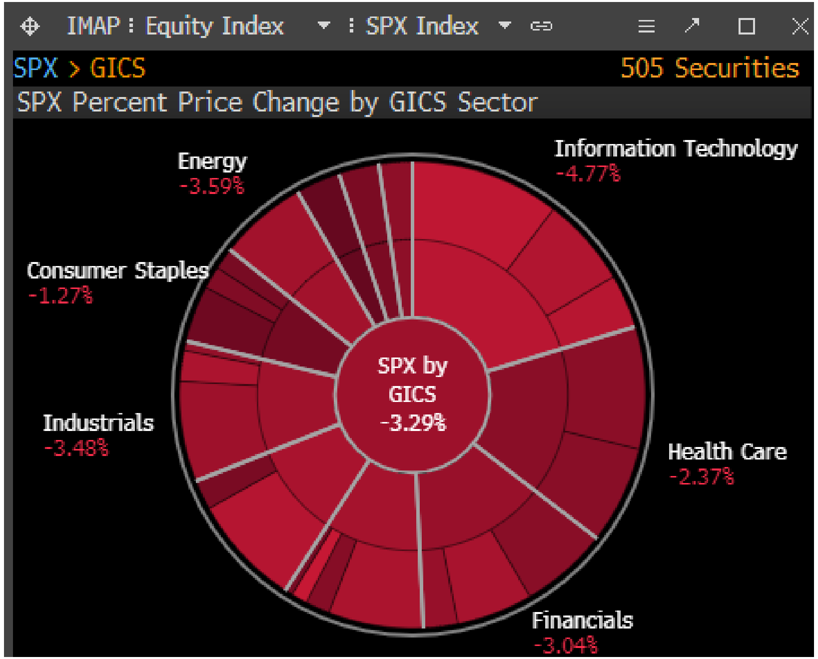
Local market

- Capped Swix Index down 11.2% year to date – 8% down since 1 September
- Global emerging market conditions, combined with poor local economics, is seeing continued pressure
- Much of poor performance is company specific (eg. MTN, Tiger Brands, Aspen, Nepi Rockcastle), and has little to do with economy
- Naspers (was +/-20% of All Share Index) down 25% year to date, which has contributed 5% to market drop. This is driven by Tencent, which is down 40% from its highs. There is a good chance of a bounce if Chinese domestic regulations are clarified. This is a great business which is expected to maintain 20-25% EPS growth for some time
- The short term way forward will largely be determined by emerging markets and trade war impacts, so risks remain high
- A lot of quality shares are now very cheap; not a time to sell … and selectively buy in the event of further declines

Yesterday’s moves

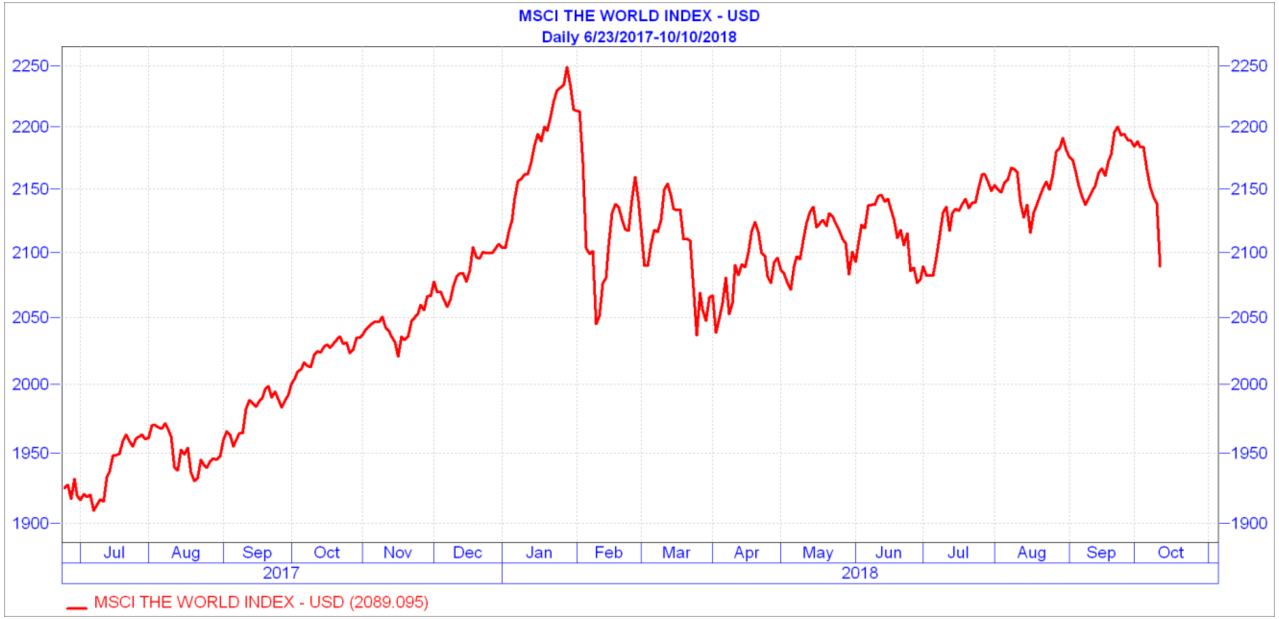

WEI World Equity Indices | INDU Index | Options
Standard | Movers | Volatility | Ratios | Futures | Δ AVAT 10D

Index	RMI	2Day	Value	Net Chg	%Chg	Time	%Ytd	%YtdCur
Americas								
INDU			25598.74	-831.83	-3.15%	10/10 c	+3.56%	+3.56%
SPX			2785.68 d	-94.66	-3.29%	10/10 c	+4.19%	+4.19%
CCMP			7422.05	-315.97	-4.08%	10/10 c	+7.51%	+7.51%
SPTSX			15517.40 d	-336.65	-2.12%	10/10 c	-4.27%	-7.70%
MEXBOL			48136.18 d	-369.04	-0.76%	10/10 c	-2.47%	+0.04%
IBOV			83679.11 d	-2408.44	-2.80%	10/10 c	+9.52%	-3.41%
EMEA								
SX5E			3266.90 d	-54.89	-1.65%	10/10 c	-6.77%	-10.31%
UKX			7145.74 d	-91.85	-1.27%	10/10 c	-7.05%	-9.08%
CAC			5206.22 d	-112.33	-2.11%	10/10 c	-2.00%	-5.73%
DAX			11712.50 d	-264.72	-2.21%	10/10 c	-9.33%	-12.77%
IBEX			9162.90 d	-97.60	-1.05%	10/10 c	-8.77%	-12.24%
FTSEMIB			19719.04 d	-343.21	-1.71%	10/10 c	-9.77%	-13.19%
OMX			1595.13	-29.36	-1.81%	10/10 c	+1.15%	-9.20%
SMI			8892.88 d	-71.23	-0.79%	10/10 c	-5.21%	-6.48%
Asia/Pacific								
NKY			22590.86 d	-915.18	-3.89%	08:00	-0.76%	-0.30%
HSI			25206.74 d	-986.33	-3.77%	08:06	-15.75%	-15.99%
SHSZ300			3137.62 d	-143.98	-4.39%	08:06	-22.16%	-26.91%
AS51			5883.76	-166.05	-2.74%	08:12 c	-2.99%	-12.11%

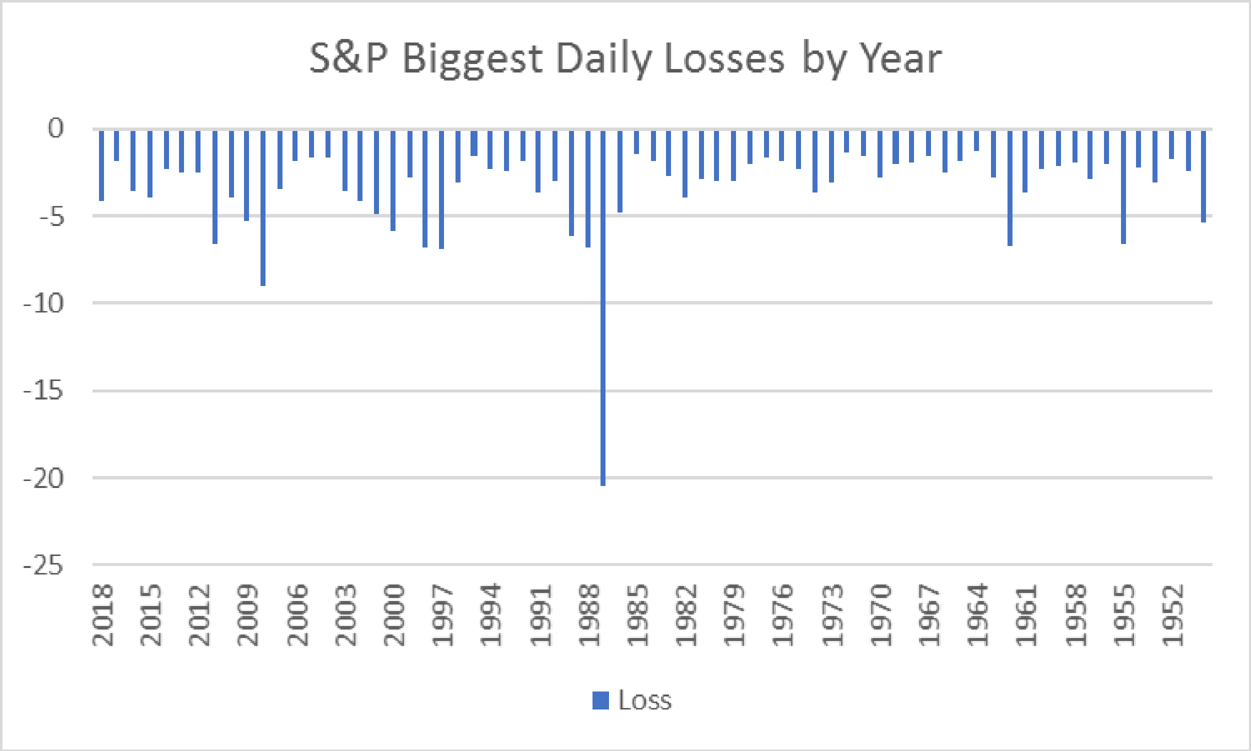


- 2-5% drops yesterday across the board, with emerging markets the worst
- IT down close to 5% - high beta segment of the market
- Chinese internet shares have been smashed, but ironically they are fairly immune to global macro conditions

MSCI World Index flat for the year



- Flat for the year, but in the midst of a short term fall
- This is while US earnings have been growing at 25% and world GDP growth at 4%
- Concerns over whether US earnings have peaked – US 3Q earnings in coming weeks will be key



- Yesterday’s drop big, but not out of the normal for when markets dip

G20 Country ETFs, % Below All-Time High (Note: Total Return Prices, in US $)		
Sector	ETF	% Below All-Time High Close
Turkey	TUR	-65.8%
Russia	RSX	-53.9%
Italy	EWI	-46.3%
Brazil	EWZ	-46.2%
Indonesia	EIDO	-35.1%
South Africa	EZA	-32.9%
Argentina	ARGT	-31.6%
Mexico	EWW	-28.4%
China	FXI	-28.1%
India	PIN	-21.4%
South Korea	EWY	-19.1%
Germany	EWG	-17.4%
United Kingdom	EWU	-10.2%
Australia	EWA	-10.1%
France	EWQ	-8.7%
Japan	EWJ	-7.9%
Canada	EWC	-6.5%
Saudi Arabia	KSA	-5.4%
US	SPY	-1.9%

Pension Partners
The ATAC Rotation Manager
@CharlieBilello

- The real pain has been in emerging markets, with big drops from all time highs (note different to year to date)
- This is measured in US$, so this is the impact of the market and currency
- Drops of this magnitude are large and shares often bounce from these types of declines

Valuations – PE multiples reasonable but not cheap

- US (orange) forward PE of 17x a little above 15 year average
- World (red) forward PE of 15.7x closer to 15 year average
- Emerging markets (purple) forward PE of 11.4x cheap, but tends to trade at lower multiples

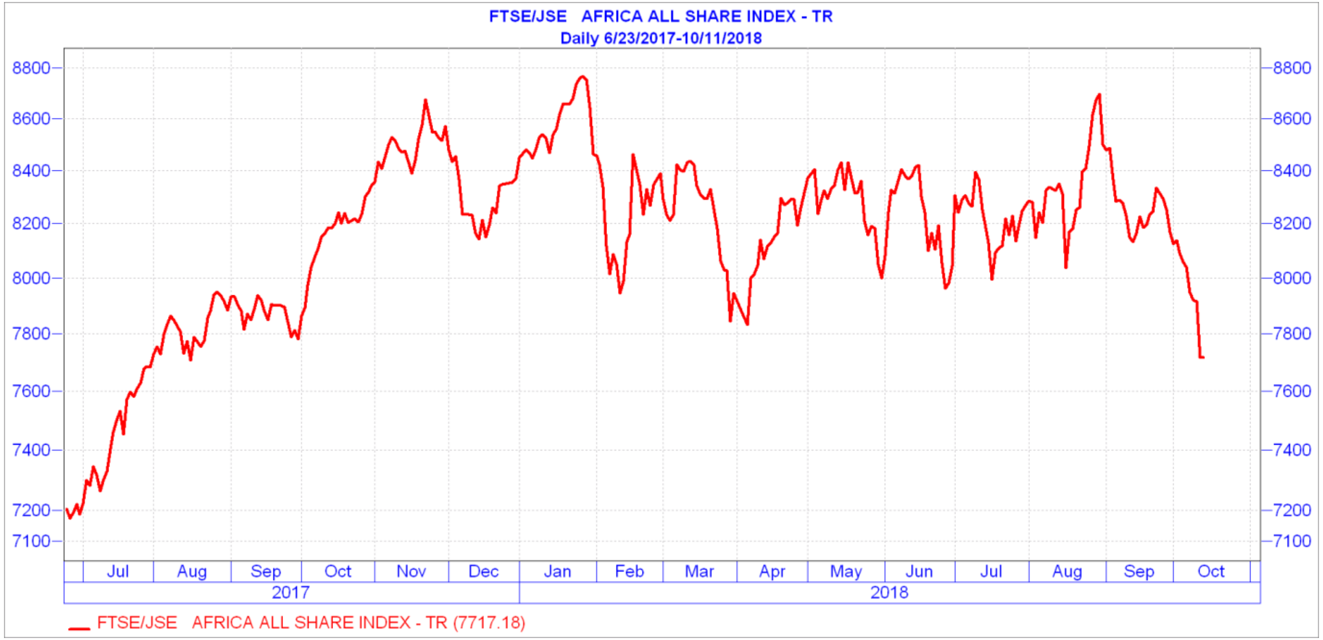
Bond Yields

- This is what is partly causing the angst
- 10 year US bond yields risen to 3.15%
- Money costs more and decreases value of assets
- Not a worrying level in itself, but market concerned that it will rise higher

Dotcom Bubble ? – NO!

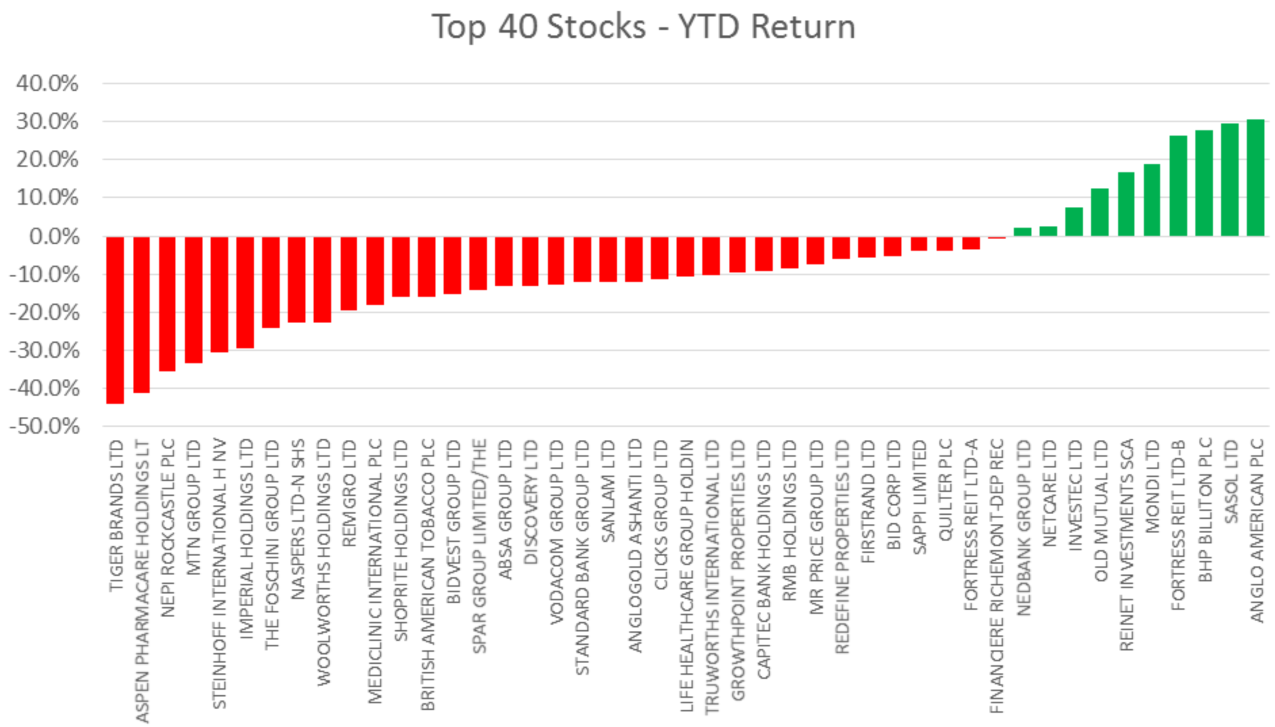
- White line shows how this has run hard for many years
- BUT (green line) shows that PE multiples are reasonable (22.6x) , which means that the rise has been due to earnings – the shares are not historically expensive and nowhere near the valuations reached in the dotcom bubble (see 2001 – 2005)
- This does not mean they cannot decline further, but this will represent entry points

Local All Share – battling to deliver returns



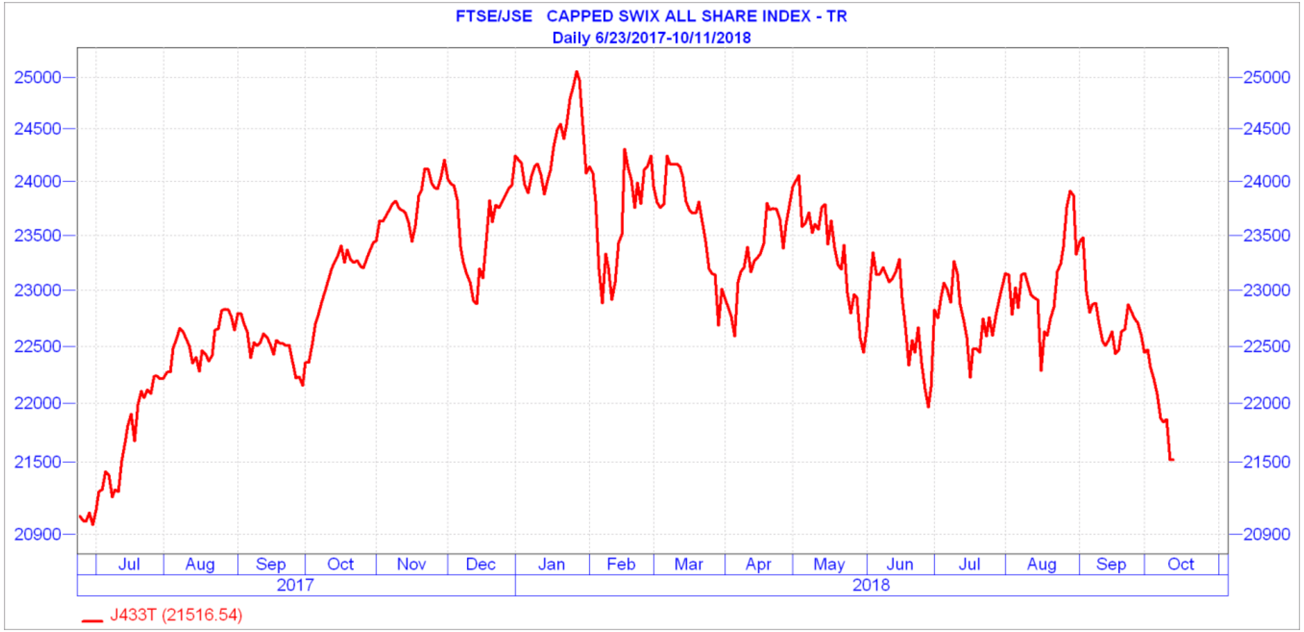
- Down 8.7% year to date

JSE top 40 winners and losers YTD



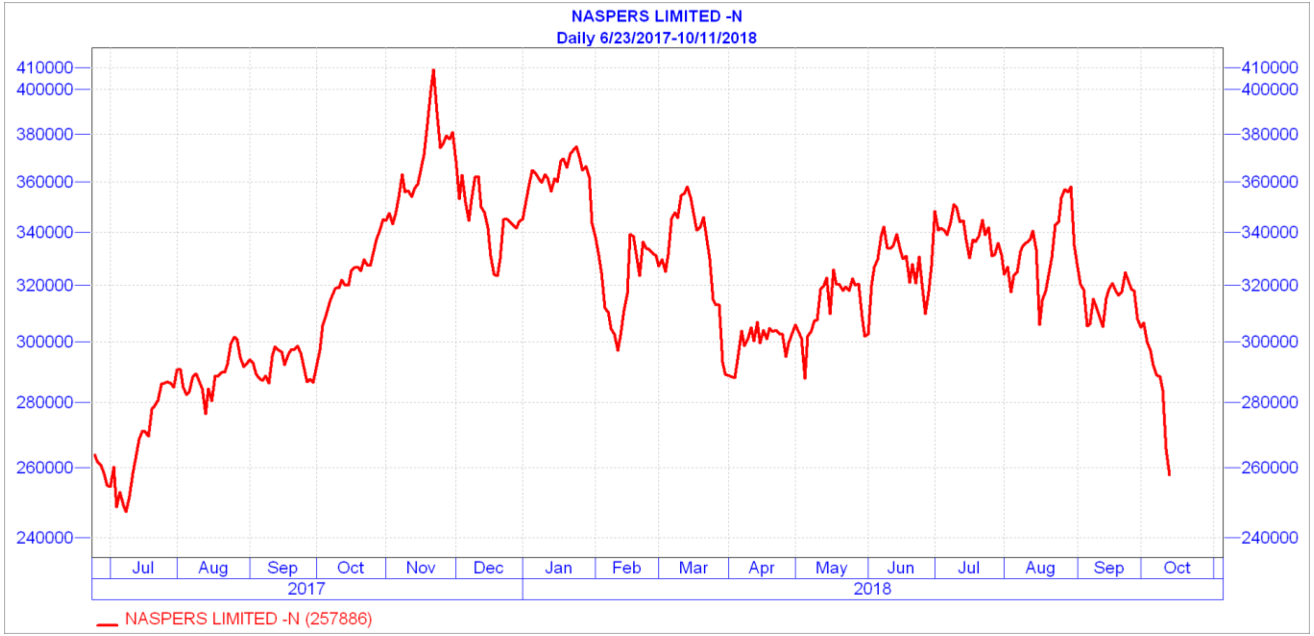
- Big losers tend to be company specific and not due to local conditions:
- Tiger (Listeriosis)
- Aspen (going ex-growth)
- NEPI (controversy)
- MTN (Nigeria)
- Naspers (Chinese internet)

JSE Capped Swix Index



- This is benchmark for local funds – down 11.2% year to date

Naspers – down 25% year to date



- All about Tencent … which is now trading at forward 25x PE with sustained good growth prospects. This company generates over US$15bn per year in cash and is a great quality business. Decline has been due to review of online gaming rules in China (about 40% of profit). An announcement/certainty in this area should be in next few months and could see re-rating of share.

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