Zimnat ASSET MANAGEMENT
associated with Sanlam group

Zimnat Asset Management

Investment Report

2nd Quarter 2019

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1.0 GLOBAL ECONOMY

- **Global economic outlook**: Increases in tariffs by the US and China, announced in May, signal a re-escalation in trade tensions. Global industrial activity and goods trade have lost significant momentum in 2019, according to the World Bank's Global Economic Prospects June 2019 report. As global economic prospects deteriorate and inflation remains persistently low, major banks have implemented more accommodative monetary policies for the near term. Global growth is projected at 2.6% and 2.7% for 2019 and 2020 respectively.
- **The US:** Activity is being strengthened by government spending and corporate tax cuts. Unemployment recently fell to lowest recorded levels in nearly five decades. Productivity is on the rise in the US, according to the World Bank's Global Economic Prospects June 2019 report. Growth of exports, especially to Europe and Asia, have slowed in the wake of rising trade tensions. The US Federal reserve does not expect to raise interest rates for the rest of 2019 amid slow economic growth. Monetary policy makers in the US voted to keep the interest rate range between 2.25% and 2.5%, changing their initial outlook that had predicted two interest rate hikes in 2019. Real GDP growth is projected at 2.5% and 1.7% for 2019 and 2020 respectively.
- **China:** Growth in China appears to be stabilizing, following periods of broad-based deceleration. The World Bank is forecasting a growth of 6.2% in 2019 down from 6.6% in 2018. Trade flows have been weak, because of softened manufacturing output, trade tensions with the US and slow global growth. In response to the tension with the US, softening exports and softening domestic demand, authorities have provided monetary and fiscal support. Authorities have also stepped up structural reform efforts. New laws protecting foreign investors as well as laws strengthening intellectual property rights are likely to benefit businesses.
- **Sub-Saharan Africa:** The economic environment in Sub-Saharan Africa remains challenging. External and domestic headwinds that caused the slowdown in 2018 have not dissipated as quickly as previously predicted. Growth in the three largest economies in this region – Angola, Nigeria and South Africa- has remained subdued. In Nigeria, recovery of the oil sector has not been as strong as anticipated. Policy uncertainty continues to constrain investment in new capacity. In South Africa, policy uncertainty and rolling power cuts have slowed economic progress in the first half of 2019. Economic activity is expected to recover due to easier external financing conditions. The new administration is also fast tracking previously delayed reforms that will gradually improve the business environment.
- **Commodities:** Prices of most industrial commodities picked up in the first half of 2019. They however were still lower than peak prices from 2018. Price forecasts, as a whole, have been projected downwards due to weaker than expected global growth. Gold increased by 10% to end the 1st half at $1,409/oz , whilst nickel increased by 19% to $12,666/tonne.
- **Oil:** Since the beginning of 2019, crude oil has experienced a price increase of almost 30%. Prices however have not fully recovered from the 40% drop in the fourth quarter of 2018. Demand for oil in 2019 has been dented by the ongoing trade war between the two major consumers of crude oil and higher than expected US oil production. According to OPEC's monthly market report, demand for oil is expected to increase by 1.3 million bpd in 2019, but growing US shale oil activity is expected to limit price gains. Oil prices are forecasted to average at $66 per barrel

*Extracts from the World Bank's Global Economic Prospects June 2019 report

2.0 LOCAL ECONOMIC ACTIVITY

- **IMF Staff Monitored Program (SMP)** – The government of Zimbabwe entered a SMP that will run from 15 May 2019 to 15 March 2020. SMP empowers IMF to further assist government in with technical advice on tackling market distortions e.g. subsidies, fuel arbitrage, and forex market. The IMF is of the view that if fiscal reforms remain (including strict management of money supply growth), the economy will stabilise over next 12 months, currency market will stabilise and inflation will normalize. However, political will remains key to the success of this program and a decision on funding, post SMP will be largely determined by the US government.
- **GDP growth:** The IMF projected a negative real growth of 3.1% for 2019, following the introduction of the RTGS dollar. We expect GDP growth this year to be in the region of negative 5% following the announcement of Statutory Instrument 142/2019, whereby the RTGS dollar is now the sole currency for local trades. Inflation and foreign currency shortages will continue to weaken demand and strain production in the short term. Premature removal of the multi-currency system has further deteriorated business and consumer confidence in terms of policy reforms.
- **Statutory Instrument 142 of 2019 (SI 142):** The Ministry of Finance on the 24th of June 2019 removed the multi-currency system in Zimbabwe and pronounced the Zimbabwe dollar as the sole currency for legal tender purposes. Government believes that the increased domestic transactional demand for US dollars was driving the black-market rate to unprecedented levels, resultantly accelerating the re-dollarization of the economy. The core objective of this policy intervention was an effort to save the RTGS and Bond notes from complete collapse, given the devaluation of the RTGS on the parallel market.
- The success or failure of this policy intervention will be determined by the market, over the next few months. However, the determinants of the success or failure of the Zimbabwe dollar, from our perspective, will be fiscal discipline, decreased money supply growth, political reforms, Re-Engagement & Arrears Clearance.
- **Nostro FCA's** - According to SI 142 of 2019, the opening and operating of foreign currency designated accounts (Nostro FCAs) shall continue to be designated in the foreign currencies with which they are opened and in which they are operated. What is clear from the subsection is that Nostro FCAs will likely be only used for external payments only, going forward.
- **Taxes**- Custom duties and VAT payable on the importation of goods specified as luxury goods will remain in foreign currency. The promulgation of SI 142 of 2019, is likely imply that all domestic taxes will have to be paid in Zimbabwe dollars, doing away with the multicurrency tax regime that was in place. One of the most effective means of creating demand for Zimbabwe dollars in the formal sector, is through enforcing all tax payments be in the local currency.
- **Inflation:** Official May year on year inflation was at 97.85% just a few percentage points shy of the 100% mark that moves the country into hyperinflation. Food and non-alcoholic beverages annual inflation was at 126.43% whilst non-food inflation was at 85.94%.
- **Gold:** The country racked in US$3,2 billion from mineral exports in 2018, of which US$1,1 billion was from gold. The experience for 2019 is likely to fall below expectations given the declining deliveries to Fidelity Printers, which in the five months to May dropped by 20% to 10.8tonnes from 13.59tonnes in the same period last year. Gold miners are compelled by exchange control regulations to surrender 45% of their export proceeds to the Reserve Bank of Zimbabwe (RBZ) and this low retention level has negative impacts on the mines ability to meet its working capital requirements and encourages

deliveries to be made outside the formal channels, especially for small scale miners. In addition to foreign currency constraints, erratic supply of electricity is disrupting production.

- **Tobacco:** In 2018, the country produced record 252 million kilograms of flue-cured tobacco, generating at least US$1 billion in foreign currency earnings. However, the 2018/19 season has been below par because of the change in payment modalities and unfavorable weather conditions. In its June 2019 report, the Zimbabwe Tobacco Association said early indications were that tobacco production and US dollar earnings from tobacco in the 2018/19 season would decline compared to prior year. As at 12 June 2019, deliveries were down 11% in volume at 171.2 million kilograms. Halfway through the selling season, the price dropped by 37% compared to last year. The average price mid-June was US$1.85/kg, against US$2.87/kg a year ago.
- **Fiscal Performance**: On the 20th of May 2019, the 2nd fuel price increment was implemented, from $3.36 and $3.22 for petrol and diesel respectively to $4.97 and $4.89. This followed a directive from the RBZ for procurement of fuel by the Oil Marketing Companies (OMCs) to be done through the interbank foreign exchange market. This meant that the 1:1 exchange rate that was being used by OMCs for the procurement of fuel was discontinued with the intention of having one foreign exchange rate for the importation of all goods and services. It is not clear at this juncture how fuel prices going forward will be affected by SI 142.
- The increase in excise on fuel is expected to contribute significantly to government's revenue.
- For the year to 30 April 2019, total tax revenue was 9% above budget at $2.68 billion mainly driven by the IMTT tax and excise duty.
- The government consistently recorded a surplus before capital payments from in January to April 2019. However, the sustainability of the surplus remains questionable, as fuel consumption declined following the prices increases and there were wage adjustments for civil servants effective 1 April 2019 ranging from 13-29%. Total expenditure for the first four months of the year was 7% above budget.

Monthly Fiscal Performance - 2019

	Jan-19 ($ mln)	Feb-19 ($ mln)	Mar-19 ($ mln)	Apr-19 ($ mln)	YTD actual ($ mln)	Budget ($ mln)	Weight %
Total tax Revenue	**468.19**	**597.08**	**812.17**	**810.25**	**2,687.69**	**2,454.53**	
Taxes on Income	107.66	141.36	255.97	135.12	640.12	630.81	23%
Customs Duties	22.85	20.69	47.43	53.43	144.40	178.33	5%
Excise Duties	96.99	227.96	240.71	295.07	860.73	560.63	31%
VAT	120.09	87.72	149.42	187.81	545.04	675.03	20%
IMT Tax	98.52	94.73	87.72	104.07	385.04	282.65	14%
Other taxes	22.08	24.62	30.92	34.75	112.36	127.08	4%
Non tax revenue	19.39	9.64	20.14	11.76	60.93	29.39	2%
Total Income	**487.58**	**606.72**	**832.30**	**822.01**	**2,748.61**	**2,483.92**	100%
Employment Costs	281.93	285.58	282.04	320.69	1,170.24	1,116.96	54%
Other recurrent expenditure	103.10	159.22	198.40	236.27	696.99	631.65	32%
Recurrent Expenditure	385.04	444.80	480.44	556.95	1,867.23	1,748.60	
Primary surplus before capital expenditure	**102.54**	**161.93**	**351.85**	**265.05**	**881.38**	**735.32**	
Capital Expenditure	0.12	76.52	96.56	138.34	311.55	432.90	14%
Total Expenditure	**385.16**	**521.32**	**577.00**	**695.30**	**2,178.78**	**2,181.50**	100%
			-				
Monthly Surplus/(Deficit)	**102.42**	**85.40**	**255.30**	**126.71**	**569.83**	**302.42**	

3.0 INVESTMENT MARKETS

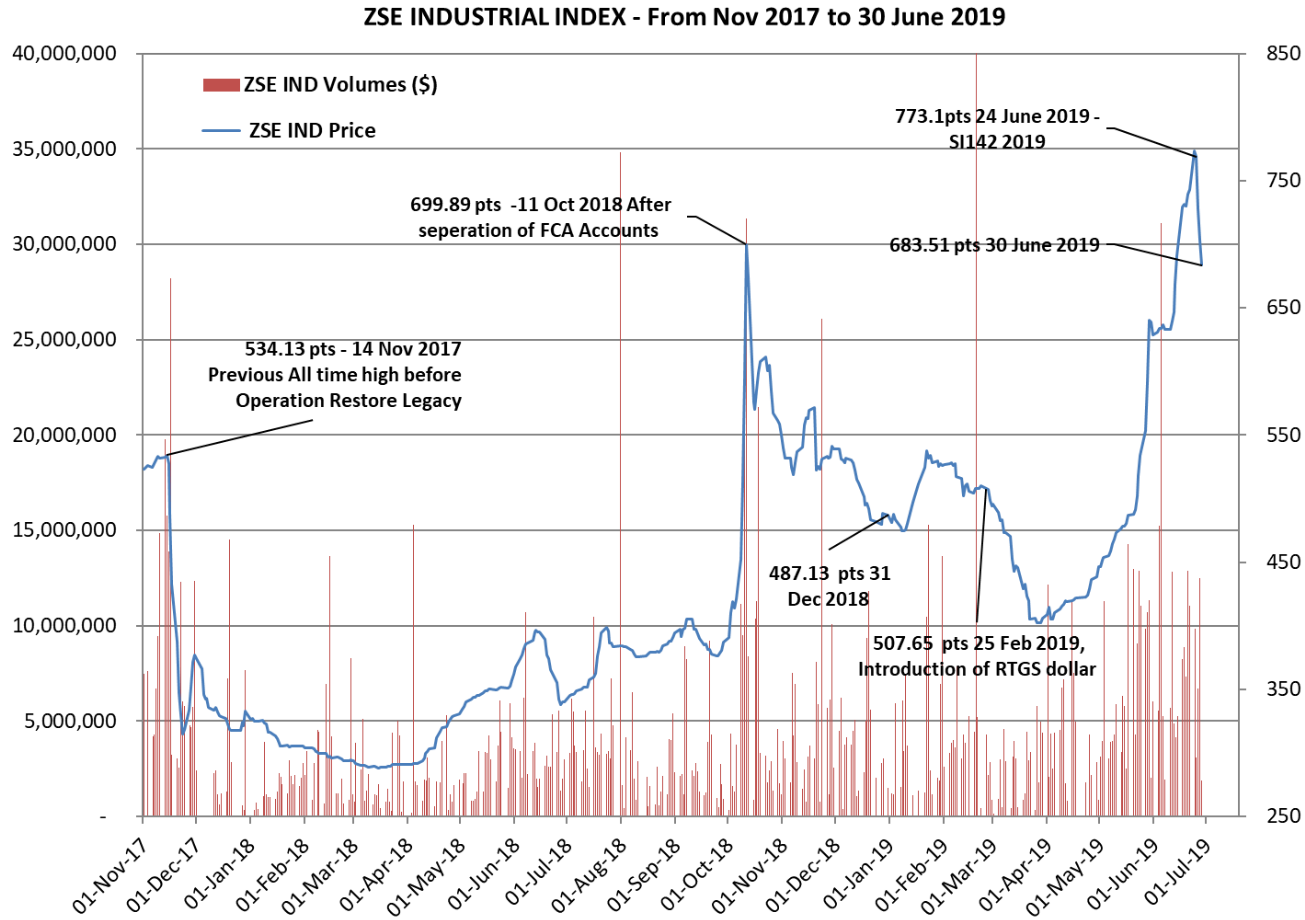
3.1 Fixed Income Investments

- Following SI142/2019, Banks were directed to transfer to the RBZ the RTGS$/ZWL$s that banks are holding as funds for the foreign currency historical or legacy debt. The Government, through the Reserve Bank, is assuming the debt at a rate of 1:1 between the RTGS$ and the US$. This RBZ policy intervention is aimed at further tightening RTGS liquidity, as this measure is expected to mop around RTGS$1.2 billion from the market. Prior to this intervention, the banking sector was already starting to feel the liquidity squeeze, as funds on the RTGS platform at the RBZ declined gradually, as the central bank sold currency through the auction system. As more liquidity is sucked out of the system, whilst on the other hand, government through SI 142 increases the demand for RTGS dollars, the resultant impact, may shock the market, from a liquidity perspective.
- **Interest rates** - The Central Bank adjusted the interest rate on the Reserve Bank overnight window upwards from the current 15% per annum to 50% per annum in line with inflation trends. A rise in interest rates generally reduces the demand for credit at household and business level within the economy, and thereby slows down overall economic activity. In Zimbabwe's case, the intervention is aimed at controlling inflation which is now out of control at 97.85% in May 2019.
- There has been a very slow increase in deposit money market rates and the expectation is with a tighter liquidity squeeze the rates may start to increase in the third quarter. On average, money market rates were at 4% per annum.
- **Prescribed asset threshold** for pension funds was increased to 20% with a compliance date of 31 December 2019. **Outlook and strategy –** With a tighter liquidity stance, it is important that we keep a closer watch on our money market counterparties liquidity positions and how they are responding to increased changes in the banking sector operating environment.

3.2 Equity Investments

- **Trading of dual listed counters on the ZSE** – A vesting period of 90 days on disposal of dual listed securities or shares purchased by investors on the Zimbabwe Stock Exchange was put in place effective 25 June 2019. The Old Mutual Implied Rate (OMIR) has always been a target for policy makers, as it has been the reference rate for the parallel market. This policy intervention significantly affects foreign investors who used Old Mutual as a means of exiting the Zimbabwe market. At inception of the policy, the Old Mutual share price reduced significantly and the next few months will tell how foreign investors will adjust to the new announcement.

- **Stock Market Performance** – The stock market had a positive second quarter with the ZSE All Share Index and ZSE Top 10 Index gaining 68.3% and 72% respectively. The market hit a fresh post dollarization high of 773.10points on 24 June 2019 and then slid into negative territory in response to the vesting period on dual listed counters. The ZSE All Share Index closed the first half at 683.51pts and up 40% on a year to date basis. On rolling year to 28 June 2019, the ZSE All Share Index was up 101% and in line with official CPI.



- **Equities outlook and strategy:** The performance on the stock market continues to be very volatile as witnessed by the last week of the second quarter. Cost push inflation is still very high due to increased energy costs following significant electricity load shedding in the second quarter of the year as well as foreign currency shortages. With increased efficiency on the interbank market, we expect that foreign currency situation to improve eventually, however, in the short-term businesses costs will be dependent on the cost at which they access the forex for their imported inputs. The extent to which a business can continue to pass on these increased costs of production considering significantly reduced disposable income following devaluation, will determine the profit margins, going forward.
- Our overall long-term strategy remains focused on value preservation through consolidating our positions in defensive stocks. In selecting our equity holding we will continue prioritizing companies with a strong cash flow generating capacity, robust and resilient business models in light of the foreign currency shortages, and a solid governance track record and structures. Valuations remain a key focus for our research team in the new RTGS environment to determine the price with which we buy and exit the stocks.

4.0 MARKET PERFORMANCES

INTERNATIONAL STOCK MARKET PERFORMANCE

		LOCAL EXCHANGE RATE TO USD				INDEX IN LOCAL CURRENCY				US DOLLAR CONVERTED			
	Index	31-Dec-18	31-Mar-19	30-Jun-19	YTD Change	31-Dec-18	31-Mar-19	30-Jun-19	YTD Change	31-Dec-18	31-Mar-19	30-Jun-19	YTD Change
Advanced Economies													
United States	Dow Jones Industrial	1.00	1.00	1.00	0.0%	23,327	25,929	26,600	14.0%	23,327	25,929	26,600	14.0%
Britain	FTSE 100	1.27	1.30	1.27	-0.4%	6,728	7,279	7,426	10.4%	5,284	5,589	5,853	10.8%
Japan	NIKKEI 225	110.00	110.84	107.74	-2.1%	20,015	21,206	21,276	6.3%	182	191	197	8.5%
Emerging Economies													
Brazil	Bovespa Index	3.88	3.90	3.85	-0.8%	87,887	96,054	100,967	14.9%	22,669	24,621	26,247	15.8%
Russia	MICEX Index	68.94	65.12	63.21	-8.3%	2,359	2,497	2,766	17.3%	34	38	44	27.9%
India	S&P BSE SENSEX Index	69.44	69.26	68.83	-0.9%	36,068	38,673	39,395	9.2%	519	558	572	10.2%
China	Shanghai SE Composite	6.87	6.71	6.87	0.0%	2,494	3,091	2,979	19.4%	363	461	434	19.5%
South Africa	JSE ALSI	14.38	14.45	14.13	-1.8%	52,737	56,463	58,204	10.4%	3,667	3,907	4,120	12.3%
Sub-Sahara Countries													
Zimbabwe	All Share Index	1.00	3.01	6.62	562.2%	146	122	205	40.0%	146	40	31	-78.9%
Zambia	LUSE All Share	11.90	12.13	12.85	8.0%	5,248	5,600	5,678	8.2%	441	462	442	0.2%
Botswana	DCI Index	10.52	10.56	10.49	-0.2%	7,854	7,886	7,623	-2.9%	747	747	726	-2.7%
Tanzania	All Share	2,294	2,309	2,295	0.0%	2,046	2,060	1,892	-7.5%	1	0.89	0.82	-7.5%
Nigeria	Nigeria All Share	363.04	358.29	359.81	-0.9%	31,431	31,041	29,967	-4.7%	87	87	83	-3.8%
Ghana	GSE Composite	4.85	5.32	5.42	11.7%	2,499	2,417	2,395	-4.2%	515	455	442	-14.2%
Kenya	NSE 20	101.17	100.12	101.49	0.3%	2,834	2,846	2,633	-7.1%	28	28	26	-7.4%
Mauritius	SEMDEX	33.44	33.91	36.60	9.4%	2,219	2,165	2,128	-4.1%	66	64	58	-12.3%

ZSE INDUSTRIAL INDEX - TOP 5 COUNTERS BY MARKET CAPITALIZATION

Name	Sector	Price ZWL cents 30 Jun 2019	Weight- 30 Jun 2019	Market Cap ZWL$ 31 December 2018	Market Cap ZWL$ 31 March 2019	Market Cap ZWL$ 30 June 2019	Q2 Change in Market Cap	YTD Change in Market Cap
Cassava SmarTech Zimbabwe Limited	Technology	1.98	19.68%	3,691,571,986	2,590,577,000	5,120,016,383	97.64%	38.69%
Econet Wireless Zimbabwe Limited	Technology	1.84	18.27%	3,698,050,000	2,849,634,700	4,753,708,795	66.82%	28.55%
Delta Corporation Limited	Beverage	3.40	16.50%	3,802,799,433	2,839,111,436	4,291,727,030	51.16%	12.86%
Innscor Africa Limited	Industrial Holding	2.60	5.60%	1,001,947,864	730,443,017	1,457,023,922	99.47%	45.42%
Padenga Holdings Limited	Agricultural	2.19	4.56%	460,354,424	514,513,768	1,186,089,634	130.53%	157.65%
Sub-Total			64.61%	12,654,723,707	9,524,279,922	16,808,565,763	76.48%	32.82%
ZSE Market Capitalization				**19,424,406,159**	**16,084,866,459**	**27,017,166,999**	**67.97%**	**39.09%**