3rd Quarter 2018 Investment Report

"Creating, maintaining and protecting wealth"

Zimnat | ASSET MANAGEMENT

associated with Sanlam group

TABLE OF CONTENT

1.0 EXECUTIVE SUMMARY

Global & Regional Outlook

- Global growth expected to at 3.7% as trade tensions between the US and other trading partners start to hit economic activity.
- US Economy growth expected to remain strong despite ongoing fears of a trade war.
- Oil and energy prices remain strong on the back of controlled supply side.
- Weak performance from precious and base metals in the third quarter.

Domestic Economy

- IMF reviews country's 2018 GDP forecast from 1% to 2.4% to 3.6%.
- GDP rebased and 2018 is forecast to grow by 6.3% to $25billion.
- Trade deficit at $1.6billion as at 31 August 2018 against $1.1million in August 2017.
- Y-o-y increase in domestic credit of 47% as at 30 June 2018 from $8.4 billion to $12.4billion.
- Y-o-y inflation of 4.8% as at August 2018.
- Separation of FCA balances from local RTGS dollars.

Investment Markets

- Deposit and lending rates remained largely unchanged in the first nine months of 2018.
- Increased interest in the RBZ Savings bond by investors in search of higher fixed income returns in light of inflation.
- ZSE All Share up 15.12% and 12.75% for the year to date and Q3-2018 respectively. Gains were driven by the aforementioned political and economic concerns, along with the strong earnings which were released during the quarter.

ZAM Strategy

- ZAM's strategy therefore remains focused on value preservation through consolidating our positions in defensive stocks
- ZAM has developed a pipeline of property development opportunities

2.0 GLOBAL ECONOMY

- **Global Economy:** Although global economic growth will remain resilient this year mainly due to an outstanding first half 2018 performance, dark clouds begun to swell in the third quarter. A strengthening U.S. dollar and higher borrowing costs are unnerving financial markets in developing economies, while rising trade protectionism is starting to weigh on business sentiment.
- **US Economy**: The manufacturing sector kept running at full capacity, with large order books poised to maintain strong activity in coming months. Job creation also remained robust, while wage growth accelerated and consumer confidence hit an 18-year high in August, boding well for private consumption despite softening August retail sales. The near-term outlook remains bright thanks to buoyant activity, tax-cut effects and large federal spending increases expected throughout the second half of 2018. Looking further ahead, however, growth is likely to dampen in 2019 and beyond as tax-cut effects fade while inflation heightens and interest rates continue rising.
- **UK Economy:** The economy performed better than expected driven by the services sector. Moreover, the labour market remained in good health as unemployment was contained at a multi-decade low. On the political front, there are still considerable differences between the EU and the UK over important aspects of Brexit negotiations. Both sides are looking to make substantial progress before another key EU summit on 18 October 2018.
- Going forward, fixed investment is likely to remain depressed by Brexit uncertainty. However, a slight pick-up in government spending should provide some support. A failure to reach a Brexit agreement with the EU before the UK departs in March 2019 is the key downside risk.
- **Chinese Economy**: Two manufacturing surveys from China, at the end of September, pointed to weakening in its vast manufacturing sector as domestic demand continued to lose momentum and U.S. tariffs bite. The combination is likely to prompt Beijing to roll out more growth-support measures in coming months. However, analysts do not expect additional stimulus to start stabilizing China's economy until at least early next year.
- **Sub-Saharan Africa**: The recently published World Bank Global Economic report projected growth to accelerate to 3.1% in 2018. This upswing reflects rising oil and metals production, encouraged by a recovery in commodity prices, and improving agricultural production following droughts. A rebound in consumer spending amid declining inflation and an increase in investment will also underpin the pickup.
- However, growth will remain below its long-term average and insufficient to substantially reduce poverty. Public debt levels are high and rising, and debt servicing costs will absorb a large share of government revenue in some countries. The main downside risks include a faster tightening of global financing conditions, heightened conflicts, and weak implementation of reforms.
- **South Africa:** An index tracking South African manufacturing activity fell to a 14-month low in September. The Purchasing Managers' Index (PMI) compiled by the Stellenbosch-based Bureau for Economic Research for Absa Group Ltd. declined to 43.2 in September from 43.4 in August.
- Mining output shrank the most since October 2012 on a monthly basis, data released by Statistics South Africa in September showed. Retail sales climbed less than estimated on an annual basis. The PMI survey inspires little hope that the South African economy will stage a strong recovery.
- **Commodities:** The Bloomberg Commodity Index (BCOM) fell 2.5 percent in the third quarter amid a stronger dollar, trade frictions and concerns over the Chinese-demand outlook (BCOM is made up of 30% metals, 30% energy, the rest is grains and livestock). Copper slid into bear markets and gold posted its longest run of monthly losses in two decades in September. Crude oil was among the few bright spots.
- **Gold:** had a sixth straight monthly decline in September (1.26%), the longest string of losses since 1997. The metal is being buffeted by rising US interest rates, the dollar holding near recent highs and stronger returns across other assets.
- **Oil:** With renewed sanctions on Iran set for November, OPEC signaled it will only produce enough crude to meet demand, and won't send additional supplies onto the market. Oil is expected to continue on an upward trend reflecting the collapse in Venezuela's production and unexpected outages in Canada and Libya.

3.0 DOMESTIC ECONOMY

3.1 GROWTH FORECASTS

- GDP - Zimbabwe country rebased its GDP figures this year to take into account the changes in the structure of industrial activities between 2009 and 2012, changes in relative prices of various products and the increase in the number if establishments during the same period. The rebased 2017 GDP figures was $22.2billion compared to S18billion before rebasing.
- **GDP growth** – In their October 2018 edition of the World Economic Outlook, the International Monetary Fund revised upwards Zimbabwe's economic growth rate for 2018 from 2.4% to 3.6%. This is above the Sub-Saharan of 3.1% but is still lower than the minimal 7% growth rate required to grow the economy to enable it to meet its 2030 growth target.
- Mining and agriculture continue to be the key sectors with 2018 growth projections of 26% and 12.4% respectively. Tobacco production hit 237.1million kgs by the end of the selling season reaching an all-time high despite the difficult operating environment within the economy. Gold, chrome and coal have shown significant increases in output in comparison to last year and production is expected to remain strong for the rest of the year.
- We note that both IMF and World Bank forecasts are far more conservative than government's view that output will grow by 6.3% to $25.8billion in 2018 although a widening budget deficit risks destabilizing the financial sector and the economy as a whole.

3.2 ECONOMIC ACTIVITY

- **Money supply**: Broad money supply as at 30 June 2018 was at $9.1billion, representing a year to year growth of 40%. Significant increases were recorded in the months of May and June 2018 as the country prepared for elections.
- **Claims on central government** increased by $1.4billion in the first half of the year to $7.7billion as the government continues to fund its budget deficit through domestic debt in the form of treasury bills and RBZ overdrafts. With money supply growing much faster than production output price rises are anticipated with inflation set to accelerate as is being experienced currently.
- The use of electronic platforms continues to increase in light of physical cash shortages, with $64.7billion worth of transactions being done in the first half of 2018. The government announced its intention to levy a 2% tax on electronic transactions with a few exemptions so as to widen the tax base and tax the informal sector.
- **Inflation**: Continued foreign currency shortages have resulted in increased parallel market activities and the costs are being passed onto the consumer leading to the erosion of disposable incomes and subdued consumer spending
- Official figures are widely considered as understating the real situation, with players in the financial sector preferring to use the Old Mutual implied rate (OMIR) or the OK Internal Inflation Index among other proxies. Official Y-o-y inflation as at August 2018 was at 4.83%.
- **Trade deficit:** The cumulative trade deficit for the year to August 2018 was at $1.6billion up from $1.1billion same period last year. The year is forecast to end with a trade deficit of $2.23million arising from exports of $5.1billion and imports of $7.3billion.
- **Transitional Stabilization Program (TSP)-** The reform program lays out plans and policies to be set in place between October 2018 to December 2020 through five strategic clusters; governance, macroeconomic stability and reengagement, inclusive growth, infrastructure and utilities and social development.
- Policy reforms are needed to stimulate domestic production, exporting, rebuilding and transforming of the economy to an Upper Middle-Income Status by 2030.
- The program has thus far been met with skepticism as similar projects, namely ZIMASSET and numerous reform programs with the exception of Tendai Biti's STERP in 2009, of it have operated and failed on a macroeconomic level.

- Confidence and expectations in the program are therefore low. There is a particular emphasis by the project on WHAT needs to be done to turn to the economy around and yet almost no methodology as to HOW government plans to proceed
- **Monetary Policy** highlight was the Removal of commingling of US dollars and RTGS dollars through the reintroduction of FCA's with effect from 15 October 2018. This move was also important from a foreign portfolio investment (capital account) perspective, as this means that the country's stock market and debt market become more attractive.
- The removal of the "use it or lose it within 14 days policy" means local exporters can also obtain external lines of credit and be able to repay their obligations through their FCAs.
- Reintroduction of statutory reserves will enable the central bank to significantly tighten liquidity within the market. Issuance of treasury bills through an auction system is set to enable transparency.

3.3 ECONOMIC OUTLOOK

- The current monetary policy thrust has increased negative expectations within the economy. Market expectations after the removal of commingling of US dollars and RTGS dollars have generally been negative, resulting in a short term slow-down in economic activity on the back of confusion around the pricing of RTGS dollars against US dollars. Given the devaluation, expectations are that inflation under RTGS dollars may generally be higher in the future, unless excess liquidity is tightened at an aggressive pace. US dollar salaries and wages are expected to remain unchanged, whilst RTGS salaries and wages are expected to decline in real terms because of the effects of inflation and devaluation.
- We therefore anticipate a general decline in domestic demand under the tighter monetary policy regime, but may see increased foreign demand for Zimbabwean exports given the devaluation of local RTGS dollars. In addition, the protection of nostro dollars under the reintroduced FCA accounts may improve portfolio capital flows into Zimbabwe's debt and equity markets, overall improving the currency's capital account
- **Inflation**– We expect the tighter monetary policy regime to reduce domestic inflationary pressures. The most effective tool in achieving this objective will be the statutory reserve requirements, which if gradually increased, may force inflation downwards and strengthen the exchange rate between US dollars and RTGS dollars. We however expect the inflation for imported goods to remain high given the devaluation of local RTGS dollars

4.0 INVESTMENT MARKETS

4.1 Fixed income Investments

- Money market deposit rates remained flat during the 3rd quarter at an average of 3.5%p.a for 1month deposits. Weighted lending rates for individuals and corporates averaged 9% and 7% respectively.
- **Banking sector half year** results were impressive, driven by increased investments in financial securities particularly Treasury Bills and the RBZ savings bond, as well as increased fees and commissions driven by transactional income from the use of electronic money. Profits for the half year were at $176.09million compared to $100.59million in the corresponding period in 2017.

- Credit impairment charges were higher than last year owing to changes in the impairment models from IAS39 incurred loss model to IFRS9 expected loss model
- The industry is experiencing pressure on deposit rates because of competition from the RBZ's savings bonds at 7% and annual inflation at 4%. Given that lending rates are controlled, there is considerable pressure on margins
- **The Bond Market -** Private bond activity remains subdued as liquidity continues to be mopped up by the government through Treasury Bill (TB) issuances and the issue of RBZ savings bonds.
- As at 31 August 2018, the RBZ had raised $ 1.5 billion from the issue of these savings bonds. The 7% yield remains very attractive to investors as it is above the official CPI and is highly liquid.
- In light of the resurgence of expected inflation, the attractiveness of bonds which are not inflation indexed diminishes and we expect this to dampen the activity in the bond market.

4.2 Equities

- **Stock Market Performance**: The ZSE All Share index gained 12.75% in the third quarter and closed at 115.12 points.
- The market capitalization was at $12.3billion as at 28 September, which is a 25% increase for the quarter. The ZSE amended the market capitalization method to include all issued shares of listed firms whether quoted or unquoted with effect from 1 August 2018.
- **Econet Wireless Zimbabwe** became the most valued counter on the ZSE in early August 2018 after class A shares held by the majority shareholder Econet Wireless Global were integrated to the free-float ordinary shares previously recognized as the entire ordinary share capital on the ZSE.
- On 28 September Econet board advised it is considering "the demerger from the mobile network operations business, and the separate listing on the ZSE, of the company's financial technology business" which includes EcoCash and other related businesses. Econet is also pursuing the exchange of the company's 51 percent stake in Liquid Telecom Zimbabwe "for a stake of equivalent value in the holding company, Liquid Telecom Holdings". This is still subject to regulatory and shareholder approvals.
- **Seed Co International** was partially-unbundled through a dividend-in- specie of its shares to Seed Co Limited shareholders. Seed Co Limited retained a 26% shareholding in Seed Co International. The company has a primary and secondary listing on the Botswana Stock Exchange and ZSE respectively and trading started on 5 October 2018.
- **Innscor** – The group had a good second half performance driven by increased volumes across most categories, improved product mix and price adjustments in some categories, aggressive cost containment and improved efficiencies. Irvines has managed to recover from the Avian Influenza breakout and expect to return to self-reliance on hatchlings by March 2019. Profitability in the bread unit declined despite an increase in loaf volumes by 12% due to flat selling prices in an inflationary environment. Overall, earnings increased by 28% from $25.7million to $32.9million last year. The group continues to leverage on operational efficiencies.
- **Axia** remains a strong business remains strong for the following reasons: they have solid, well incentivized management with strong margins and continuous room for growth.

- Although there are key risks which stem mostly from foreign payments exposure which are considerate especially with Transerv and DGA, they remain able to fund foreign payments and stay well positioned to continue growth in volumes and sales. These risks therefore will not significantly impact overall performance of the company.
- Volumes continue to grow in Distribution Group Axia and TV Sales and Home despite increasing prices within the country.
- **RioZim** issued a profit warning statement citing operational challenges that the company if now facing owing to the company's inability to access its foreign currency earnings that are required to fund its operations and sustain growth.
- **Old Mutual Managed Separation** remains on course with the UK asset management business (Quilter) having been separated from Old Mutual Plc. The unbundling of Nedbank from Old Mutual Limited is scheduled for the 15th of October 2018 and shareholders will receive 3.211176 Nedbank shares for every 100 Old Mutual Ltd shares held. We expect the local Old Mutual share to remain volatile as it continues to be used as a defensive stock.
- **Simbisa** reported strong revenue growth driven by the local operations and an improvement in EBIDTA margins. The Profits increased by 113% on a year on year basis from $9.4million to $20.4million. The company increased its shareholding in the Ghanaian and Mauritian operations to 100% from 50.1% and 87.5% from 51.0%, respectively. Due to macro-economic challenges and rising financial and operational risk the group has disposed of its interest entirely in The DRC operation with the former partner now running under a franchise agreement. The board has postponed the listing of the company on the LSE Alternative Investments Market (AIM) to a later date.

- **Equities outlook and strategy** - The prices of local equity and real estate assets in US dollars may not change, but we do expect an adjustment of the RTGS prices of these assets in-line with the prevailing foreign currency parallel exchange rate or eventual formal exchange rate. This trend has been occurring since the introduction of bond notes and is expected to continue 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 prioritising companies with a strong cash flow generating capacity, robust and resilient business models, and a solid governance trackrecord and structures

4.3 Alternative Investments

- We have developed a pipeline of property development opportunites valued at around $30 million, all of which are at various stages of implementation. We therefore will continue to approach clients on an individual basis when such projects are ready for investment.

4.4 Asset Allocation

- Given the uncertainties on the monetary front, our overall asset allocations will remain slightly in favour of equities in the short term. Where the equities market gets too over heated, we will not hesitate to take profits and invest those profits in short term high yielding bonds, whilst waiting for new opportunities. As and when our property development opportunities become available for investment, we therefore will switch clients interested on each project out of equities or fixed income assets, into the development properties.

5.0 INTERNATIONAL CURRENCY AND STOCK MARKET PERFORMANCES

International Stock Market Performance

	Index	LOCAL EXCHANGE RATE TO USD					INDEX IN LOCAL CURRENCY					US DOLLAR CONVERTED				
		31-Dec-17	31-Mar-18	30-Jun-18	30-Sep-18	YTD Change	31-Dec-17	31-Mar-18	30-Jun-18	30-Sep-18	YTD Change	31-Dec-17	31-Mar-18	30-Jun-18	30-Sep-18	YTD Change
Advanced Economies																
United States	Dow Jones Industrial	1.00	1.00	1.00	1.00	↑ 0.0%	24,719	24,103	24,271	26,458	↑ 7.0%	24,719	24,103	24,271	26,458	↑ 7.0%
Britain	FTSE 100	0.74	0.71	0.86	0.77	↑ 3.5%	7,688	7,057	7,637	7,510	↓ -2.3%	10,372	9,904	8,897	9,789	↓ -5.6%
Japan	NIKKEI 225	112.66	106.24	110.68	113.52	↑ 0.8%	22,765	21,159	22,305	24,246	↑ 6.5%	202	199	202	214	↑ 5.7%
Emerging Economies																
Brazil	Bovespa Index	3.31	3.03	3.86	4.05	↑ 22.3%	76,402	84,360	72,763	79,342	↑ 3.8%	23,065	27,812	18,838	19,587	↓ -15.1%
Russia	MICEX Index	57.64	57.26	62.75	65.56	↑ 13.8%	2,110	2,286	2,296	2,475	↑ 17.3%	37	40	37	38	↑ 3.1%
India	S&P BSE SENSEX Index	63.78	64.98	68.44	72.33	↑ 13.4%	34,057	32,969	35,423	36,227	↑ 6.4%	534	507	518	501	↓ -6.2%
China	Shanghai SE Composite	6.51	6.28	6.62	6.88	↑ 5.6%	3,307	3,161	2,847	2,921	↓ -11.7%	508	503	430	425	↓ -16.4%
South Africa	JSE ALSI	12.37	11.83	13.74	14.15	↑ 14.4%	59,505	55,475	57,611	55,708	↓ -6.4%	4,811	4,691	4,192	3,938	↓ -18.2%
Sub-Sahara Countries																
Zimbabwe	All Share Index	1.00	1.00	1.00	1.00	↑ 0.0%	100	87	102	115	↑ 15.1%	100	87	102	115	↑ 15.1%
Zambia	LUSE All Share	10.01	9.51	10.00	12.27	↑ 22.5%	5,328	5,548	5,456	5,468	↑ 2.6%	532	584	546	446	↓ -16.2%
Botswana	DCI Index	9.85	9.55	10.44	10.62	↑ 7.8%	8,860	8,590	8,403	7,837	↓ -11.5%	899	899	805	738	↓ -17.9%
Tanzania	All Share	2,239	2,257	2,270	2,279	↑ 1.8%	2,396	2,409	2,281	2,105	↓ -12.1%	1.07	1.07	1.00	0.92	↓ -13.7%
Nigeria	Nigeria All Share	359.78	359.95	358.84	360.50	↑ 0.2%	38,243	41,505	38,279	32,766	↓ -14.3%	106	115	107	91	↓ -14.5%
Ghana	GSE Composite	4.53	4.42	4.75	4.77	↑ 5.3%	2,580	3,367	2,879	2,883	↑ 11.8%	569	761	606	604	↑ 6.1%
Kenya	NSE 20	103.22	100.84	100.24	100.11	↓ -3.0%	3,712	3,845	3,286	2,876	↓ -22.5%	36	38	33	29	↓ -20.1%
Mauritius	SEMDEX	33.70	33.53	33.67	33.26	↓ -1.3%	2,202	2,288	2,245	2,251	↑ 2.2%	65	68	67	68	↑ 3.6%

ZSE INDUSTRIAL INDEX - TOP 5 COUNTERS BY MARKET CAPITALIZATION

Name	Sector	Price US cents 30 Sept 2018	Weight- 30 Sept 2018	Market Cap US$ 31 December 2017	Market Cap US$ 31 March 2018	Market Cap US$ 30 June 2018	Market Cap US$ 30 Sept 2018	Q3 Change In Market Cap	YTD Change in Market Cap
Delta Corporation Limited	Beverage	2.20	25.78%	2,011,858,725	1,996,141,079	2,270,698,209	2,775,993,671	22.25%	37.98%
Econet Wireless Zim	Technology	1.28	19.02%	1,516,988,724	1,069,876,258	1,644,735,143	2,047,934,778	24.51%	35.00%
Innscor	Industrial Holding	1.35	6.79%	541,593,440	469,441,518	639,080,259	731,151,144	14.41%	35.00%
British American Tobacco	Agriculture	27.00	5.17%	742,806,612	525,345,637	515,837,925	557,104,959	8.00%	-25.00%
Seedco	Agricultural	1.90	4.28%	481,478,480	412,670,340	489,472,139	460,561,786	-5.91%	-4.34%
Sub-Total			61.04%	5,294,725,981	4,473,474,831	5,559,823,675	6,572,746,338	18.22%	24.14%
ZSE Industrial Market Capitalization				**9,296,489,814**	**8,202,946,379**	**9,657,785,408**	**11,024,278,055**	14.15%	18.59%

* Calculations done excluding Econet class A shares