Cytonn INVESTMENTS

Cytonn Annual Market Outlook - 2018

Global Market Outlook

2017 was characterised by an upswing in global growth, as the US and China maintained their growth momentum, and economic recovery in the Eurozone gathering pace. A resurgence in global demand, with notable pickups in investment, trade, and industrial production, coupled with stronger business and consumer confidence were the key factors supporting global growth. Global Central Banks reversed trend, gradually removing the accommodative policies that were used to support the economic recovery since the 2008 global financial crisis. Global equity markets registered gains driven by improved investor sentiment due to better than expected corporate earnings, improved global economic growth outlook and improvement in commodity prices.

Following the improved economic growth in 2017, below we look at the 3 key themes that we believe will shape the global markets in 2018:

i. ***Monetary Policy tightening…***

The US Fed is expected to continue on the path towards tightening of monetary policy, with expectation of three further rate hikes in 2018, coupled with an unwinding of its quantitative easing program. Meanwhile, the European Central Bank reduced its quantitative easing program pace, by reducing its monthly bond-buying program to EUR 30.0 bn from EUR 60.0 bn from January 2018, with the option to either end or extend the stimulus package beyond September 2018. These accommodative policies have been used to support the economic recovery since the 2008 global financial crisis, and the reversed stance to gradually remove them by Central Banks highlights the stronger growth in their specific regions and the global economy.

ii. ***Global trade remains robust…***

The World Trade Organization (WTO) upgraded their outlook for world trade growth in 2017 to 3.6% from their 2.4% expectation in April 2017, citing resurgence in Asian trade flows as intra-regional shipments picked up, and as import demand in North America recovered after stalling in 2016. Trade growth is expected to remain robust in 2018, albeit less so than in 2017 as per WTO, with trade growth expected to slow to 3.2% in 2018, from 3.6% in 2017, due to (i) a higher base effect from a thriving 2017, compared to a weak year in 2016, (ii) tightened monetary policy in the US and Eurozone, as the Fed gradually raises rates and the European Commercial Bank (ECB) slowly phases out its quantitative easing program, and (iii) controlled fiscal expansion in China, to prevent the economy from overheating, whereby the productive capacity of an economy is unable to keep pace with growing aggregate demand.

iii. ***Stable Commodity Prices…***

Global commodity prices have registered gains in 2017, with crude oil, metals & minerals, and energy registering gains of 15.7%, 13.5%, and 11.5%, respectively, despite agriculture experiencing a decline of 2.1%, as per the World Bank Commodity Prices Index. According to the World Bank, oil prices are forecasted to rise to an average of USD 56.0 a barrel in 2018 from USD 53.0 a barrel in 2017 as a result of steadily growing demand and a sustained cap on oil production by OPEC

countries and Russia, despite increased US shale oil output.

Having considered the 3 key themes that will drive 2018, we now look at specific economic regions and expectations for their GDP performance in 2018:

World GDP Growth Rates

	Region	**2014a**	**2015a**	**2016a**	**2017e**	**2018f**
1.	India	7.2%	7.6%	7.1%	**6.7%**	7.4%
2.	China	7.3%	6.9%	6.7%	**6.8%**	6.5%
3.	United States	2.4%	2.6%	1.5%	**2.2%**	2.3%
4.	Middle East, North Africa	2.7%	2.3%	5.0%	**2.6%**	3.5%
5.	United Kingdom	3.1%	2.2%	1.8%	**1.7%**	1.5%
6.	Euro Area	1.1%	2.0%	1.8%	**2.1%**	1.9%
7.	Sub-Saharan Africa	5.1%	3.4%	1.4%	**2.6%**	3.4%
8.	Japan	0.0%	0.5%	1.0%	**1.5%**	0.7%
9.	South Africa (SA)	1.6%	1.3%	0.3%	**0.7%**	1.1%
10.	Brazil	0.1%	(3.8%)	(3.6%)	**0.7%**	1.5%
	Global Growth Rate	**3.4%**	**3.2%**	**3.2%**	**3.6%**	**3.7%**

Source-IMF

United States:

The US economy is expected to grow by 2.3% in 2018, slightly higher than 2.2% in 2017, owing to pro-growth policies being implemented by the current Trump administration. The US Fed has been on a tightening cycle, having started in December 2016 with a 25 bps interest rate increase, and followed this with a 25 bps hike each in March, June and December of 2017. The Federal Funds rate ended 2017 at 1.25% - 1.50%, from a range of 0.5% - 0.75% at the beginning of the year. The Fed is expected to raise interest rates three times in 2018, supported by a relatively stronger US economy. The Trump administration has implemented some pro-growth policies including the recently passed tax code, which is expected to hugely benefit US firms and spur economic growth, as it lowers the corporate rate to 21.0% from 35.0%, previously.

The stock market is expected to do well supported by strong earnings growth, as consumer sentiment improves. However, the current high valuations, as measured by the Cyclically Adjusted Price/Earnings (CAPE) ratio is currently near historical highs at 32.5x, far above the historical average of 16.8x, indicating an overvaluation of the market.

Eurozone:

Growth in the Eurozone is expected to come in at 1.9% in 2018, supported by rising employment, improved investor sentiment and a loose monetary stance, which is expected to underpin domestic demand, from growth of 2.1% in 2017. The ECB plans to reduce its quantitative easing program by reducing the monthly bond buying program to EUR 30.0 bn from EUR 60.0 bn as from January 2018, with the option to either end or extend the stimulus package beyond September 2018. With inflation falling to 1.3% in January, below the 2.0% target, the slow growth in prices may prompt the ECB to extend its stimulus package beyond September to support growth.

Eurozone stock markets were on a positive trend in 2017, with the Stoxx 600 index gaining 21.9% during the year 2017, driven mainly by solid corporate earnings growth and margin expansion due to higher Eurozone and international growth. In terms of valuations, the Stoxx 600 Index is currently trading at a P/E of 20.8x, slightly higher than its historical average of 20.3x.

The manufacturing sector recorded strong growth, with the Eurozone's Flash PMI rising to a 79-month high of 60.0 in November 2017, with multi-year highs seen for all the main indicators of output, demand, employment and inflation, further supporting the Eurozone's economic recovery, and this trend is expected to follow through into 2018.

China:

The Chinese economy is expected to grow by 6.5% in 2018, slightly slower than the 6.8% recorded in 2017, with the country having embraced monetary and fiscal stimulus measures in a bid to support the country's growth. The manufacturing purchasers index (PMI) came in at 51.3 in January, from 51.6 in December 2017, indicating a stable growing economy, that is gradually shifting to a consumption-led growth model so as to reduce its reliance on exports and investment.

However, despite this strong growth, China's increasing debt levels and dependency on credit to fuel growth continues to pose a major financial stability threat to the global economy, with the country's total debt to GDP expected to rise to approximately 327.0% of GDP by 2022, from 230% currently. To curb this financial stability risk, Chinese authorities have undertaken a number of policy and regulatory measures aimed at reducing macroeconomic imbalances without an adverse impact on growth. Such measures include (i) refinancing government debt with cheaper debt, which will ease the cost of servicing the debt, (ii) introduction of debt-to-equity swaps in a bid to trim China's corporate debt loads, and (iii) a slow down on accumulation of new debt. The country remains a significant contributor to global GDP as it contributed a third of global GDP growth in 2017, and hence any sway in the economy will be felt worldwide.