PRUDENTIAL UNIT TRUSTS QUARTERLY COMMENTARY
31 DECEMBER 2018

COMBINED QUARTERLY COMMENTARY

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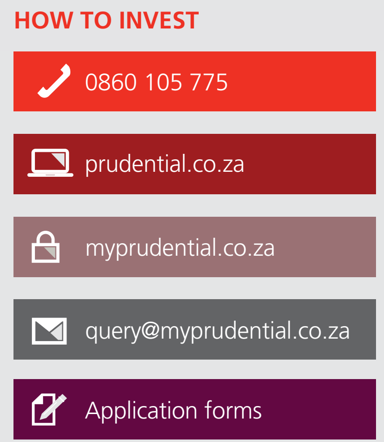
HOW TO INVEST



PRUDENTIAL MONEY MARKET FUND
31 DECEMBER 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise (SOE) debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

SA nominal bonds (BEASSA All Bond Index) managed to return 2.7% during the last quarter of 2018, with the 10-year bond starting the period around 9.0% and ending around 8.93%. However, the yield jumped to over 9.4% in mid-October, before rebounding in December. During the quarter, sentiment towards SA bonds was dented by newly appointed Finance Minister Tito Mboweni's medium-term budget in October, which forecast low growth and higher debt. It also raised the spectre of further credit rating downgrades. Another driver was the SA Reserve Bank's surprise 25bp interest rate hike in November. Despite CPI at 5.2% y/y, well within the 3%-6% target band, the SARB cited a worsening inflation outlook (largely on the weaker rand) as the main reason for its move, and its desire to maintain inflation around the 4.5% midpoint of its target band. Consensus CPI for 2019 is 5.3%, and the market is expecting one further 25bp interest rate hike in 2019.

For the year, SA bonds produced a respectable 7.7% return: along with Q4 gains, their strong Q1 rally amid the positive "Ramaphoria" sentiment managed to offset subsequent weakness in Q2 and Q3. Solid local demand also overcame high foreign sales: Offshore investors sold a net R70 billion in SA bonds in 2018 as a whole, representing a material capital outflow of around R100 billion from April onwards after having bought a net R30 billion in Q1. Meanwhile, for the quarter inflation-linked bonds delivered 0.4%, and cash as measured by the STeFI Composite Index produced 1.8%. For 2018, ILBs returned 0.3 % and cash 7.2%.

Among the quarter's other developments weighing on the SA economy was Eskom's re-introduction of load shedding around the country in the first half of December, with the possibility that it could recommence in mid-January. The land expropriation debate also continued to exacerbate uncertainty, as did political manoeuvring ahead of the 2019 general election. The market consensus for 2018 GDP growth was revised down to 0.7%, while for 2019 it was lowered to 1.5% from around 2.0% previously.

Some positive developments saw accelerating mining and manufacturing activity for October, which surprised analysts, and new appointments of capable managers at several SOEs. President Ramaphosa's Cabinet reshuffle and general messaging during the quarter reinforced positive sentiment around his commitment to fighting corruption and maladministration; while several investigations into fraud and malpractice at SOEs also progressed.

Producer Price Index (PPI) decelerated marginally from 6.9% in October to 6.8% in November in line with market consensus. Private Sector Credit Extension (PSCE) was also marginally lower in November (5.6%) compared to October (5.8%), below market consensus of 5.7%.

PERFORMANCE

For the quarter, the fund generated a return of 1.8% (net of fees) outperforming its benchmark, the STeFI Call Deposit Index, by 0.2%. For the 12 months ended 31 December 2018, the fund returned 7.4% (net of fees) while the benchmark returned 6.6% over the same period. The weighted average duration of the fund at quarter-end was 70 days relative to the 90-day maximum weighted average duration.

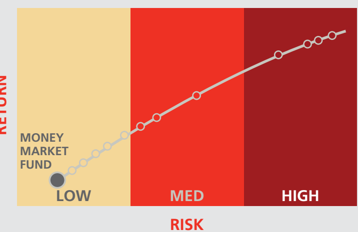
STRATEGY AND POSITIONING

Treasury Bills continued to offer attractive spreads above bank Negotiable Certificates of Deposit (NCDs) with similar tenors. We have positioned the fund to take advantage of this. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	X CLASS
1 year	7.4%	6.6%	7.5%
3 years	7.4%	6.8%	7.6%
5 years	6.8%	6.3%	6.9%
7 years	6.3%	5.9%	6.5%
10 years	6.5%	6.2%	n/a
Since inception	7.8%	7.6%	6.4%

Inception date X Class: 1 April 2011

RISK/RETURN PROFILE:



FUND MANAGERS:
Sandile Malinga and Roshen Harry

ASISA CATEGORY:
South African - Interest Bearing - Money Market

BENCHMARK:
STeFI Call Deposit Index

INCEPTION DATE:
9 April 2002

FUND SIZE:
R1 475 770 108

DISCLAIMER

Prudential Portfolio Managers Unit Trusts Ltd (Registration number: 1999/0524/06) is an approved CISCA management company (#29). Assets are managed by Prudential Investment Managers (South Africa) (Pty) Ltd, which is an approved discretionary Financial Services Provider (#45199). The Trustee's/Custodian details are: Standard Bank of South Africa Limited - Trustee Services & Investor Services. 20th Floor, Main Tower, Standard Bank Centre, Heerengracht, Cape Town. Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. Past performance is not necessarily a guide to future investment performance. Unit trusts are traded at the ruling forward price of the day, meaning that transactions are processed during the day before you or the Manager know what the price at the end of the day will be. The price and therefore the number of units involved in the transaction are only known on the following day. The unit trust fund may borrow up to 10% of the fund value, and it may also lend any scrip (proof of ownership of an investment instrument) that it holds to earn additional income. A Prudential unit trust fund may consist of different fund classes that are subject to different fees and charges. Where applicable, the Manager will pay your financial adviser an agreed standard ongoing adviser fee, which is included in the overall costs of the fund. A Collective Investment Schemes (CIS) summary with all fees and maximum initial and ongoing adviser fees is available on our website. One can also obtain additional information on Prudential products on the Prudential website. The Manager may, at its discretion, close your chosen unit trust fund to new investors and to additional investments by existing investors to make sure that it is managed in accordance with its mandate. It may also stop your existing debit order investment. The Manager makes no guarantees as to the capital invested in the fund or the returns of the fund. Excessive withdrawals from the fund may place the fund under liquidity pressure and, in such circumstances; a process of ring fencing withdrawal instructions and managed pay outs over time may be followed. A money market fund is not a bank deposit account. The Prudential Money Market Fund aims to maintain a constant price of 100 cents per unit. A forward looking yield is used. This means that the last seven days' yield (less the maximum service charges, including VAT) is taken and is annualised for the next 12 month period, assuming the income returns are reinvested. Yields for money market funds are published daily. The purpose of the money market yield is to indicate to investors a compounded annual return for all money market portfolios on a comparable basis. The yield calculation is not used for income distribution purposes. The total return to the investor is primarily made up of interest received but may also include any gain or loss made as a result of a default by an issuer of any instrument held by the fund. This can have the effect of a capital loss. Such losses will be borne by the Prudential Money Market Fund and its investors and in order to maintain a constant price of 100 cents per unit, investors' unit holdings may be reduced to the extent of such losses. Fund prices are published daily on the Prudential website. These are also available upon request. The performance is calculated for the portfolio. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Purchase and repurchase requests must be received by the Manager by 11h30 for Money Market SA time each business day. All online purchase and repurchase transactions must be received by the Manager by 10h30 (for all Funds) SA time each business day.

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL HIGH INTEREST FUND
31 DECEMBER 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise (SOE) debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

SA nominal bonds (BEASSA All Bond Index) managed to return 2.7% during the last quarter of 2018, with the 10-year bond starting the period around 9.0% and ending around 8.93%. However, the yield jumped to over 9.4% in mid-October, before rebounding in December. During the quarter, sentiment towards SA bonds was dented by newly appointed Finance Minister Tito Mboweni's medium-term budget in October, which forecast low growth and higher debt. It also raised the spectre of further credit rating downgrades. Another driver was the SA Reserve Bank's surprise 25bp interest rate hike in November. Despite CPI at 5.2% y/y, well within the 3%-6% target band, the SARB cited a worsening inflation outlook (largely on the weaker rand) as the main reason for its move, and its desire to maintain inflation around the 4.5% midpoint of its target band. Consensus CPI for 2019 is 5.3%, and the market is expecting one further 25bp interest rate hike in 2019.

For the year, SA bonds produced a respectable 7.7% return: along with Q4 gains, their strong Q1 rally amid the positive "Ramaphoria" sentiment managed to offset subsequent weakness in Q2 and Q3. Solid local demand also overcame high foreign sales: Offshore investors sold a net R70 billion in SA bonds in 2018 as a whole, representing a material capital outflow of around R100 billion from April onwards after having bought a net R30 billion in Q1. Meanwhile, for the quarter inflation-linked bonds delivered 0.4%, and cash as measured by the STeFI Composite Index produced 1.8%. For 2018, ILBs returned 0.3 % and cash 7.2%.

Among the quarter's other developments weighing on the SA economy was Eskom's re-introduction of load shedding around the country in the first half of December, with the possibility that it could recommence in mid-January. The land expropriation debate also continued to exacerbate uncertainty, as did political manoeuvring ahead of the 2019 general election. The market consensus for 2018 GDP growth was revised down to 0.7%, while for 2019 it was lowered to 1.5% from around 2.0% previously.

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The Producer Price Index (PPI) decelerated marginally from 6.9% in October to 6.8% in November in line with market consensus. Private Sector Credit Extension (PSCE) was also marginally lower in November (5.6%) compared to October (5.8%), below market consensus of 5.7%.

PERFORMANCE

For the quarter, the fund generated a return of 1.9% (net of fees) outperforming its benchmark, the STeFI Composite Index, by 0.1%. For the 12 months ended 31 December 2018, the fund returned 7.7% (net of fees) while the benchmark returned 7.2% over the same period.

The maximum term of instruments is limited to three years compared to money market funds at 13 months. The fund also has a maximum weighted average duration of 180 days, as opposed to a typical money market fund targeting a maximum 90-day weighted average maturity.

Relative to the 180-day maximum, the quarter end weighted average duration of the fund came in at 39 days.

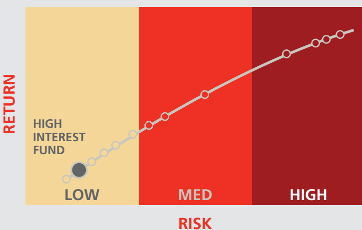
STRATEGY AND POSITIONING

We generally sought to take advantage of the banks' requirements to secure longer-dated funding which better matched the profile of their loan books. We favour investing in cash beyond the 12-month tenor and have found the big banks more amenable to offering investors attractive spreads for volume. In addition, Treasury Bills continued to offer attractive spreads above bank Negotiable Certificates of Deposit (NCDs) with similar tenors. We have positioned the fund to take advantage of this and will continue to look for opportunities to enhance the return for investors without compromising the stability of their capital.■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	X CLASS	D CLASS
1 year	7.7%	7.2%	7.8%	8.0%
3 years	8.1%	7.4%	8.3%	8.4%
5 years	7.2%	6.9%	7.4%	7.6%
7 years	6.8%	6.5%	6.9%	7.1%
Since inception	6.6%	6.4%	6.8%	7.0%

Inception dates: X Class: 1 April 2011, D Class: 9 December 2010

RISK/RETURN PROFILE:



FUND MANAGERS:
Roshen Harry and Sandile Malinga

ASISA CATEGORY:
South African - Interest Bearing - Short Term

BENCHMARK:
STeFI Composite Index measured over a rolling 12-month period

INCEPTION DATE:
8 December 2010

FUND SIZE:
R8 214 731 245

PLEASE NOTE:
This fund is capped to new investors

DISCLAIMER

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL INCOME FUND
31 DECEMBER 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise (SOE) debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

SA nominal bonds (BEASSA All Bond Index) managed to return 2.7% during the last quarter of 2018, with the 10-year bond starting the period around 9.0% and ending around 8.93%. However, the yield jumped to over 9.4% in mid-October, before rebounding in December. During the quarter, sentiment towards SA bonds was dented by newly appointed Finance Minister Tito Mboweni's medium-term budget in October, which forecast low growth and higher debt. It also raised the spectre of further credit rating downgrades. Another driver was the SA Reserve Bank's surprise 25bp interest rate hike in November. Despite CPI at 5.2% y/y, well within the 3%-6% target band, the SARB cited a worsening inflation outlook (largely on the weaker rand) as the main reason for its move, and its desire to maintain inflation around the 4.5% midpoint of its target band. Consensus CPI for 2019 is 5.3%, and the market is expecting one further 25bp interest rate hike in 2019.

For the year, SA bonds produced a respectable 7.7% return: along with Q4 gains, their strong Q1 rally amid the positive "Ramaphoria" sentiment managed to offset subsequent weakness in Q2 and Q3. Solid local demand also overcame high foreign sales: Offshore investors sold a net R70 billion in SA bonds in 2018 as a whole, representing a material capital outflow of around R100 billion from April onwards after having bought a net R30 billion in Q1. Meanwhile, for the quarter inflation-linked bonds delivered 0.4%, and cash as measured by the STeFI Composite Index produced 1.8%. For 2018, ILBs returned 0.3 % and cash 7.2%.

Among the quarter's other developments weighing on the SA economy was Eskom's re-introduction of load shedding around the country in the first half of December, with the possibility that it could recommence in mid-January. The land expropriation debate also continued to exacerbate uncertainty, as did political manoeuvring ahead of the 2019 general election. The market consensus for 2018 GDP growth was revised down to 0.7%, while for 2019 it was lowered to 1.5% from around 2.0% previously.

Some positive developments saw accelerating mining and manufacturing activity for October, which surprised analysts, and new appointments of capable managers at several SOEs. President Ramaphosa's Cabinet reshuffle and general messaging during the quarter reinforced positive sentiment around his commitment to fighting corruption and maladministration; while several investigations into fraud and malpractice at SOEs also progressed.

Producer Price Index (PPI) decelerated marginally from 6.9% in October to 6.8% in November in line with market consensus. Private Sector Credit Extension (PSCE) was also marginally lower in November (5.6%) compared to October (5.8%), below market consensus of 5.7%.

PERFORMANCE

For the quarter, the fund generated a return of 1.9% (net of fees) outperforming its benchmark, the STeFI Composite Index, by 0.1%. For the 12 months ended 31 December 2018, the fund returned 8.8% (net of fees) while the benchmark returned 7.2% over the same period.

The maximum term of instruments is not limited compared to money market funds at 13 months. The fund has a maximum weighted average duration of 2 years as opposed to a typical money market fund targeting a maximum 90-day weighted average maturity.

At quarter end the weighted average duration of the fund came in at 48 days.

STRATEGY AND POSITIONING

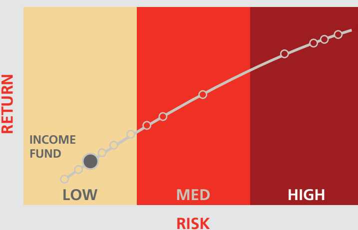
We generally sought to take advantage of the banks' requirements to secure longer-dated funding which better matched the profile of their loan books. We favour investing in cash beyond the 12-month tenor and have found the big banks more amenable to offering investors attractive spreads for volume. In addition, Treasury Bills continued to offer attractive spreads above bank Negotiable Certificates of Deposit (NCDs) with similar tenors. We have positioned the fund to take advantage of this and will continue to look for opportunities to enhance the return for investors without compromising the stability of their capital. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	D CLASS
1 year	8.8%	7.2%	8.9%
2 years	8.6%	7.4%	8.7%
Since inception	8.4%	7.4%	8.5%

[1] Inception dates: D Class: 6 December 2016

1-YEAR INCOME RETURN	A CLASS	D CLASS
Fund yield (net of fees)	8.2%	8.3%

RISK/RETURN PROFILE:



FUND MANAGERS:
Roshen Harry and Sandile Malinga

ASISA CATEGORY:
South African - Interest Bearing - Short Term

BENCHMARK:
STeFI Composite Index measured over a rolling 12-month period

INCEPTION DATE:
6 December 2016

FUND SIZE:
R1 218 604 889

DISCLAIMER

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL HIGH YIELD BOND FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise (SOE) debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

SA nominal bonds (BEASSA All Bond Index) managed to return 2.7% during the last quarter of 2018, with the 10-year bond starting the period around 9.0% and ending around 8.93%. However, the yield jumped to over 9.4% in mid-October, before rebounding in December. During the quarter, sentiment towards SA bonds was dented by newly appointed Finance Minister Tito Mboweni's medium-term budget in October, which forecast low growth and higher debt. It also raised the spectre of further credit rating downgrades. Another driver was the SA Reserve Bank's surprise 25bp interest rate hike in November. Despite CPI at 5.2% y/y, well within the 3%-6% target band, the SARB cited a worsening inflation outlook (largely on the weaker rand) as the main reason for its move, and its desire to maintain inflation around the 4.5% midpoint of its target band. Consensus CPI for 2019 is 5.3%, and the market is expecting one further 25bp interest rate hike in 2019.

The Producer Price Index (PPI) decelerated marginally from 6.9% in October to 6.8% in November in line with market consensus. Private Sector Credit Extension (PSCE) was also marginally lower in November (5.6%) compared to October (5.8%), below market consensus of 5.7%.

For the year, SA bonds produced a respectable 7.7% return: along with Q4 gains, their strong Q1 rally amid the positive "Ramaphoria" sentiment managed to offset subsequent weakness in Q2 and Q3. Solid local demand also overcame high foreign sales: Offshore investors sold a net R70 billion in SA bonds in 2018 as a whole, representing a material capital outflow of around R100 billion from April onwards after having bought a net R30 billion in Q1. Meanwhile, for the quarter inflation-linked bonds delivered 0.4%, and cash as measured by the STeFI Composite Index produced 1.8%. For 2018, ILBs returned 0.3 % and cash 7.2%.

Among the quarter's other developments weighing on the SA economy was Eskom's re-introduction of load shedding around the country in the first half of December, with the possibility that it could recommence in mid-January. The land expropriation debate also continued to exacerbate uncertainty, as did political manoeuvring ahead of the 2019 general election. The market consensus for 2018 GDP growth was revised down to 0.7%, while for 2019 it was lowered to 1.5% from around 2.0% previously.

Some positive developments saw accelerating mining and manufacturing activity for October, which surprised analysts, and new appointments of capable managers at several SOEs. President Ramaphosa's Cabinet reshuffle and general messaging during the quarter reinforced positive sentiment around his commitment to fighting corruption and maladministration; while several investigations into fraud and malpractice at SOEs also progressed.

The primary bond market issuance volume for Q4 (excluding government issues) was in line with Q3 at R31bn. Consistent with previous quarters, issuance activity remains dominated by financials followed by corporates. SOE issuances grew compared to Q3 due to the Industrial Development Corporation (IDC) issuing over R2bn during the quarter. Corporate issuances were mostly via property companies (Emira, Growthpoint, Investec Property Fund and Redefine). The remaining corporate issuers included Bidvest, Barloworld, Netcare and Woolworths, together with AECI (who placed their inaugural issuance in Q3).

PERFORMANCE

For the quarter, the fund generated a return of 2.5% (net of fees) marginally underperforming its benchmark, the BEASSA All Bond Index, by 0.3%. For the 12 months ended 31 December 2018, the fund returned 6.9% (net of fees) while the benchmark returned 7.7% over the same period.

STRATEGY AND POSITIONING

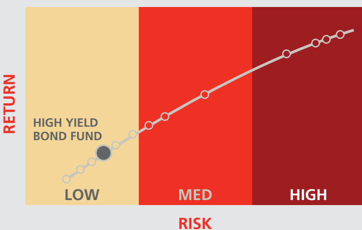
The fund maintained its long duration positon, with bond yields trading in a relatively narrow range over the quarter. We continue to view current valuations as cheap compared to our assessment of their long-term fair value. Bond yields remain attractive despite the SA government having not yet done enough to eliminate the prospects of further credit rating downgrades, especially given the deterioration in the country's growth rate.

The fund's credit exposure continues to fall in the absence of new fixed rate issuances to participate in. We continue to look for opportunities to add to the fund's credit holdings. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	6.9%	7.7%	7.2%
3 years	10.6%	11.1%	10.9%
5 years	6.9%	7.7%	7.3%
7 years	7.3%	7.8%	7.6%
10 years	7.4%	7.7%	7.7%
Since inception	10.1%	10.3%	9.1%

Inception date B Class: 1 April 2003

RISK/RETURN PROFILE:



FUND MANAGERS:
Gareth Bern and Roshen Harry

ASISA CATEGORY:
South African - Interest Bearing - Variable Term

BENCHMARK:
BEASSA Total Return All Bond Index

INCEPTION DATE:
27 October 2000

FUND SIZE:
R607 649 355

DISCLAIMER
Prudential Portfolio Managers Unit Trusts Ltd (Registration number: 1999/0524/06) is an approved CISCA management company (#29). Assets are managed by Prudential Investment Managers (South Africa) (Pty) Ltd, which is an approved discretionary Financial Services Provider (#45199). The Trustee's/Custodian details are: Standard Bank of South Africa Limited - Trustee Services & Investor Services. 20th Floor, Main Tower, Standard Bank Centre, Heerengracht, Cape Town. Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. Past performance is not necessarily a guide to future investment performance. Unit trust prices are calculated on a net asset value basis. This means the price is the total net market value of all assets of the unit trust fund divided by the total number of units of the fund. Any market movements – for example in share prices, bond prices, money market prices or currency fluctuations - relevant to the underlying assets of the fund may cause the value of the underlying assets to go up or down. As a result, the price of your units may go up or down. Unit trusts are traded at the ruling forward price of the day, meaning that transactions are processed during the day before you or the Manager know what the price at the end of the day will be. The price and therefore the number of units involved in the transaction are only known on the following day. The unit trust fund may borrow up to 10% of the fund value, and it may also lend any scrip (proof of ownership of an investment instrument) that it holds to earn additional income. A Prudential unit trust fund may consist of different fund classes that are subject to different fees and charges. Where applicable, the Manager will pay your financial adviser an agreed standard ongoing adviser fee, which is included in the overall costs of the fund. A Collective Investment Schemes (CIS) summary with all fees and maximum initial and ongoing adviser fees is available on our website. One can also obtain additional information on Prudential products on the Prudential website. The Manager may, at its discretion, close your chosen unit trust fund to new investors and to additional investments by existing investors to make sure that it is managed in accordance with its mandate. It may also stop your existing debit order investment. The Manager makes no guarantees as to the capital invested in the fund or the returns of the fund. Excessive withdrawals from the fund may place the fund under liquidity pressure and, in certain circumstances; a process of ring fencing withdrawal instructions may be followed. The Fund is an interest bearing fund. A current annualised yield is used. This means the portion of the return of the Fund that is attributed to income generated over the last 12 months, assuming the investor reinvests all distributions and incurs no transaction fees or taxes. Fund prices are published daily on the Prudential website. These are also available upon request. The performance is calculated for the portfolio. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Purchase and repurchase requests must be received by the Manager by 13h30 SA time each business day. All online purchase and repurchase transactions must be received by the Manager by 10h30 (for all Funds) SA time each business day.

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL ENHANCED INCOME FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

MULTI-ASSET

MARKET OVERVIEW

Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House. During the quarter global uncertainty also worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve (Fed)'s policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018, a figure that could rise still further should US-Chinese trade negotiations fail in 2019. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn.

US investment-grade corporate bonds saw their yields rise and spreads versus their UST counterparts widen by approximately 50bps over the year to produce a return of -2.5% in US$ for 2018, while high-yield bonds returned -2.1%. In Q4, the Bloomberg Barclays Global Aggregate Bond Index (US$) returned 1.2%, while for the year its return of -1.2% reflected weaker global corporate bonds and emerging market bonds, plus the stronger US dollar.

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

Listed property produced a disastrous -25.3% in 2018, never recovering from Q1's accusations of accounting irregularities at the Resilient group of companies, as well as growing concerns over more widespread financial engineering in the sector and downward earnings revisions at several other companies later in the year. SA nominal bonds (BEASSA All Bond Index) managed to return 2.7% during the last quarter of 2018, with the 10-year bond starting the period around 9.0% and ending around 8.93%. However, the yield jumped to over 9.4% in mid-October, before rebounding in December. During the quarter, sentiment towards SA bonds was dented by newly appointed Finance Minister Tito Mboweni's medium-term budget in October, which forecast low growth and higher debt. It also raised the spectre of further credit rating downgrades. Another driver was the SA Reserve Bank's surprise 25bp interest rate hike in November. Despite CPI at 5.2% y/y, well within the 3%-6% target band, the SARB cited a worsening inflation outlook (largely on the weaker rand) as the main reason for its move, and its desire to maintain inflation around the 4.5% midpoint of its target band. Consensus CPI for 2019 is 5.3%, and the market is expecting one further 25bp interest rate hike in 2019.

For the year, SA bonds produced a respectable 7.7% return: along with Q4 gains, their strong Q1 rally amid the positive "Ramaphoria" sentiment managed to offset subsequent weakness in Q2 and Q3. Solid local demand also overcame high foreign sales: Offshore investors sold a net R70 billion in SA bonds in 2018 as a whole, representing a material capital outflow of around R100 billion from April onwards after having bought a net R30 billion in Q1. Meanwhile, for the quarter inflation-linked bonds delivered 0.4%, and cash as measured by the STeFI Composite Index produced 1.8%. For 2018, ILBs returned 0.3 % and cash 7.2%.

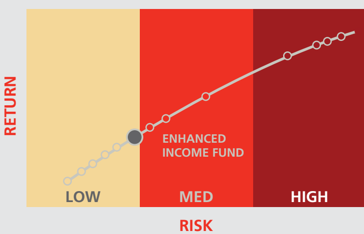
PERFORMANCE

The fund returned 0.1% (net of fees) for the fourth quarter of 2018, underperforming its benchmark by 1.7%. For the 12-month period ending 31 December 2018, the fund returned 4.7% (net of fees), underperforming its benchmark by 2.5%.

The fund's offshore exposure delivered strong returns for the year. As the local currency weakened against the US dollar we hedged most of the offshore exposure using currency futures and options. During December we removed these hedges, thereby taking advantage of rand strength against the US dollar, which added value to the fund. Investments into domestic floating rate notes issued by corporates and local banks also contributed positively to fund returns.

Detractors from performance included exposure to domestic property, which resulted in a -2.8% contribution to the return for the year. During the quarter we reduced the fund's property exposure from 10% to 4.6%. SA property has become cheaper over the quarter and priced to deliver low double- digit returns over the medium term. However, we remain concerned about the quality of earnings and possibility of further downward revisions to earnings forecasts in the short-term. We have therefore reduced exposure to SA property and deployed the proceeds into enhanced cash, which offers attractive real returns and reduces the overall volatility in the fund that would have otherwise been exhibited by holding property.

RISK/RETURN PROFILE:



FUND MANAGERS:
David Knee and Roshen Harry

ASISA CATEGORY:
South African - Multi-Asset - Income

BENCHMARK:
STeFI Composite Index measured over a rolling 36-month period

INCEPTION DATE:
1 July 2009

FUND SIZE:
R2 143 646 250

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	X CLASS	D CLASS
1 year	4.7%	7.2%	5.2%	5.0%	5.3%
3 years	7.6%	7.4%	8.1%	7.8%	8.2%
5 years	6.9%	7.0%	n/a	7.1%	7.5%
7 years	7.4%	6.8%	n/a	7.6%	8.0%
Since inception	8.1%	7.3%	6.9%	7.8%	8.1%

Inception dates: X Class: 1 April 2011, D Class: 1 July 2011, T Class: 2 January 2015

ASSET CLASS RETURNS	TOTAL RETURN Q4 2018	TOTAL RETURN 2018
SA equity – FTSE/JSE All Share Index	-4.9%	-8.5%
SA bonds – BEASSA All Bond Index	2.7%	7.7%
SA listed property – SA Listed Property Index	-4.0%	-25.3%
SA inflation-linked bonds – JSE CILI Index	0.4%	0.3%
SA cash (STeFI Composite Index)	1.8%	7.2%
Global equity – MSCI World (US$) (Developed)	-13.4%	-8.7%
Global equity – MSCI Emerging Markets (US$)	-7.5%	-14.6%
Global bonds – Bloomberg Barclays Global Aggregate Bond Index (US$)	1.2%	-1.2%
Global property – FTSE EPRA/NAREIT Global Property REIT Index (US$)	-6.0%	-6.0%

Sources: Prudential, Morningstar & Deutsche Securities

STRATEGY AND POSITIONING

We believe that despite forecasts for rising US interest rates, emerging market (EM) currencies may not fare as poorly against the US dollar as many expect. The greenback has already been strengthening against a broad basket of EM currencies for the past eight years, outperforming them by 17% or so (and by 25% against the rand) and rendering many EM currencies cheap on a purchasing power parity (PPP) basis. This would suggest that potential headwinds exist for the US currency to make further significant gains from here – investors can't rely on expectations of more US interest rate hikes to drive the greenback stronger from its current levels versus the rand and other EM currencies, especially against the backdrop of weaker US (and global) growth.

At the same time, although recent US economic data has pointed to some slowing (notably a plateauing in housing starts and building permits), several factors make us sceptical that the US is facing an imminent recession. The New York Fed's Probability of Recession indicator, although having risen from around 11 at the start of 2018 to 15 at year-end, is still well below its historical levels indicating recession, which were over 40 before the most recent downturns in both 2001 and 2007-8. US corporates have continued to report strong earnings growth, and the US consensus GDP growth forecast for 2019 is 2.6%, with inflation up to a healthy 2.2% y/y and two 25bp interest rate hikes expected. The consensus global growth forecast for 2019 is still 3.5%, only a moderate deceleration from 3.7% in 2018, and China's GDP growth is anticipated to be 6.2%. These figures suggest markets appear to have overdone their concerns over a drastic growth slowdown. In addition, while the US-China trade war is a real threat, so far much less has actually been implemented than threatened, so the notion that the full extent of each side's proposals will be actioned in 2019 is a stretch.

In global fixed income, US government bonds are slowly becoming less expensive as interest rates and yields rise there. However, in the UK, EU and Japan they are still near record-low levels, such that taken as a whole, valuations remain relatively unattractive versus equities, and are still at risk to rising interest rates globally. We do not own any global sovereign bonds and prefer to hold investment-grade US corporate bonds. These assets are now slightly cheap and have the potential for stronger returns going forward should the US interest rate hiking cycle start to slow and/or be curtailed as expected.

Although SA listed property became marginally cheaper over the quarter, we have decided to reduce our exposure to SA listed property to balance the risk/return factors. At the end of 2018 the sector is priced to deliver attractive, low-double-digit returns over the next five years. Some 80% of listed property companies were trading at a discount to their NAV's at year-end. Despite this, we remain concerned about the quality of earnings and possibility of further downward revisions to earnings forecasts in the short-term.

In SA nominal bonds, valuations remained cheap at year-end compared to their longer-term fair value despite the quarter's gains. We continue to hold a modest exposure to this asset class and prefer to own shorter-dated corporate credit versus the longer-dated government bonds. We are also comfortable with the compensation bonds offer given the risk involved, while recognising that inflation remains a threat and the SA government and businesses have not yet done enough to eliminate the prospects of further credit rating downgrades, especially given the deterioration in the country's growth rate. Despite the attractive yield offered from long-dated government bonds, we are mindful of the volatility these assets exhibit and hence have hedged out most of the interest risk in the fund, thereby reducing the volatility in the fund.

In SA variable rate bonds we consider the credit spreads being offered as attractive and adequately compensating investors for the risks being taken on. These instruments by construction have very little interest rate risk and suit the risk profile of the fund. Hence, about half of the fund is invested in floating rate notes offered by the big local banks and good quality SA corporates.

For inflation-linked bonds, following the quarter's return of 0.4%, valuations were little changed. ILBs produced a nominal return of 0.3% for the year, and their performance has been disappointing for the past six years due to falling inflation and rising real yields. Real yields are attractive at around 3.0%, the highest level in a decade. The fund has a modest exposure to bank- issued inflation-linked bonds that are offering real yields of about 4%. ■

DISCLAIMER

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL INFLATION PLUS FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

MULTI-ASSET

MARKET OVERVIEW

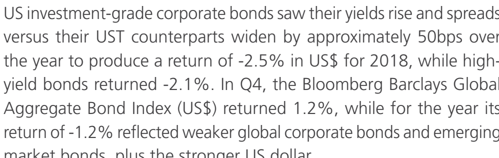
Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House. US equity markets experienced exceptional tumult in the closing weeks of the year, posting the largest-ever one-day gain, as well as the worst December losses since the Great Depression in 1931. In fact, 2018 ended as one of worst years ever for investors in terms of the breadth of poor returns: Deutsche Bank reported on 20 December that 93% of the global assets it follows recorded negative returns for the year on a US dollar-adjusted basis, the highest percentage since it started collecting data in 1901. Apart from cash, it was largely the traditional safe-haven assets like US Treasuries, German bunds and Japanese government bonds that managed to deliver positive performance over the year.

For South African investors with rand investments, SA bonds and cash proved to be a relative safe haven amid a broad rout in equities and listed property which saw 83% of the JSE's top 40 stocks deliver negative price returns for the year. Offshore diversification also worked well against the backdrop of a sharply weaker rand: in rand terms, global equity (the MSCI All Country World Index) returned 6.5%, global bonds (the Bloomberg Barclays Global Bond Index) delivered a strong 15.5% and global property (the FTSE EPRA/NAREIT Index) produced 11.1% for 2018.

During the quarter global uncertainty also worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve (Fed)'s policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018, a figure that could rise still further should US-Chinese trade negotiations fail in 2019. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn. For the quarter, US equities were punished: the S&P 500 returned -13.5% for a 2018 return of –4.4%, the Dow Jones Industrial 30 Index delivered -11.3% and -3.5% in 2018, and the Nasdaq produced -16.8% for Q4 and was flat for the year (all in US$).

Other developed equity markets also reflected the bearish sentiment, as the Dow Jones Eurostoxx 50 returned -12.9% (in US$) for the quarter and -16.2% for the year, its worst performance since the 2008 Global Financial Crisis. The UK's FTSE 100 Index returned -11.7% (in US$) for the quarter and -14.0% for the year and the Nikkei 225 Index returned -14.4% (in US$) in Q4 and -8.5% for the year.

Emerging markets were punished even more, with the MSCI Emerging Markets Index recording a -14.6% return for the year. Among the 2018 returns in large emerging markets (in US$), the MSCI Turkey was the biggest loser with a total return of -41.1%, the MSCI South Africa returned -24.3%, South Korea's KOSPI produced -22.0%, the MSCI China recorded – 18.7% and the MSCI India delivered -7.3%, while Brazil's Bovespa returned -1.8%. The MSCI Russia was one of the only markets in the black with a small 0.2% return.



US investment-grade corporate bonds saw their yields rise and spreads versus their UST counterparts widen by approximately 50bps over the year to produce a return of -2.5% in US$ for 2018, while high-yield bonds returned -2.1%. In Q4, the Bloomberg Barclays Global Aggregate Bond Index (US$) returned 1.2%, while for the year its return of -1.2% reflected weaker global corporate bonds and emerging market bonds, plus the stronger US dollar.

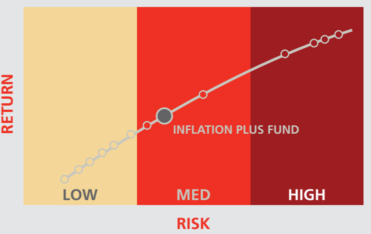
Another volatile quarter for South Africa

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise (SOE) debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

Following December's sharp global equity sell-off, the FTSE/JSE All Share Index returned -4.9% in Q4 2018, for a full year return of -8.5%. Returns were broadly negative, with only Resources in positive territory in 2018 with a 17.8% return (spurred by the weaker rand, improving operational performance and cheap valuations). Financials were in the red with -8.8%, and Industrials delivered -17.6% for the year, led by big declines in large stocks like Naspers and British American Tobacco. Listed property produced a disastrous -25.3% in 2018, never recovering from Q1's accusations of accounting irregularities at the Resilient group of companies, as well as growing concerns over more widespread financial engineering in the sector and downward earnings revisions at several other companies later in the year.

SA nominal bonds (BEASSA All Bond Index) managed to return 2.7% during the last quarter of 2018, with the 10-year bond starting the period around 9.0% and ending around 8.93%. However, the yield jumped to over 9.4% in mid-October, before rebounding in December. During the quarter, sentiment towards SA bonds was dented by newly appointed Finance Minister Tito Mboweni's medium-term budget in October, which forecast low growth and higher debt. It also raised the spectre of further credit rating downgrades. Another driver was the SA Reserve Bank's surprise 25bp interest rate hike in November. Despite CPI at 5.2% y/y, well within the 3%-6% target band, the SARB cited a worsening inflation outlook (largely on the weaker rand) as the main reason for its move, and its desire to maintain

RISK/RETURN PROFILE:



FUND MANAGERS:
David Knee, Michael Moyle and Johny Lambridis

ASISA CATEGORY:
South African - Multi-Asset - Low Equity

OBJECTIVE (BEFORE FEES):
CPI+5% p.a. over a rolling 3-year period

INCEPTION DATE:
1 June 2001

FUND SIZE:
R32 334 377 669

AWARDS:
Raging Bull: 2013
Morningstar: 2015

ANNUALISED PERFORMANCE	A CLASS	OBJECTIVE#	T CLASS	X CLASS	B CLASS
1 year	-5.0%	8.6%	-4.5%	-4.7%	-4.3%
3 years	2.8%	8.9%	3.3%	3.1%	3.5%
5 years	5.7%	8.8%	n/a	6.0%	6.5%
7 years	9.0%	8.8%	n/a	9.3%	9.8%
10 years	9.6%	8.7%	n/a	n/a	10.4%
Since inception	11.9%	9.5%	4.0%	9.5%	11.8%

Objective (After A Class Fees) over a rolling 3-year period. Fee adjustment to gross Fund Objective for different classes: A class -1.6%, T class -1%, X class -1.4%, B class -0.9%.
Inception dates: X Class: 1 July 2011, B Class: 1 July 2002, T Class: 2 January 2015

ASSET CLASS RETURNS	TOTAL RETURN Q4 2018	TOTAL RETURN 2018
SA equity – FTSE/JSE All Share Index	-4.9%	-8.5%
SA bonds – BEASSA All Bond Index	2.7%	7.7%
SA listed property – SA Listed Property Index	-4.0%	-25.3%
SA inflation-linked bonds – JSE CILI Index	0.4%	0.3%
SA cash (STeFI Composite Index)	1.8%	7.2%
Global equity – MSCI World (US$) (Developed)	-13.4%	-8.7%
Global equity – MSCI Emerging Markets (US$)	-7.5%	-14.6%
Global bonds – Bloomberg Barclays Global Aggregate Bond Index (US$)	1.2%	-1.2%
Global property – FTSE EPRA/NAREIT Global Property REIT Index (US$)	-6.0%	-6.0%

Sources: Prudential, Morningstar & Deutsche Securities

inflation around the 4.5% midpoint of its target band. Consensus CPI for 2019 is 5.3%, and the market is expecting one further 25bp interest rate hike in 2019.

For the year, SA bonds produced a respectable 7.7% return: along with Q4 gains, their strong Q1 rally amid the positive "Ramaphoria" sentiment managed to offset subsequent weakness in Q2 and Q3. Solid local demand also overcame high foreign sales: Offshore investors sold a net R70 billion in SA bonds in 2018 as a whole, representing a material capital outflow of around R100 billion from April onwards after having bought a net R30 billion in Q1. Meanwhile, for the quarter inflation-linked bonds delivered 0.4%, and cash as measured by the STeFI Composite Index produced 1.8%. For 2018, ILBs returned 0.3 % and cash 7.2%.

PERFORMANCE

The fund returned -4.1% (after fees) for the fourth quarter of 2018 and has returned -5.0% for the 12-month period ending 31 December 2018. The fund has delivered a return of 11.9% per annum since inception (after fees), compared to its after-fee objective of 9.5% per annum over the same period.

The largest positive contributor to absolute performance for the period was the fund's exposure to SA bonds, where the fund is overweight. SA cash and international cash also added value, with the latter helped by the weaker rand. The largest detractors from absolute performance were the fund's holdings in international and SA equities, given the sharp sell-off in global equity markets and SA listed property to a lesser extent.

STRATEGY AND OUTLOOK

Offshore, the fund remains underweight global bonds and global cash, and overweight global equities, with the latter offering attractive valuations in many markets (particularly when viewed relative to bonds), and much higher potential returns over the medium term. The total offshore exposure remains at around 25% (within Regulation 28 limits).

In November we took advantage of rand strength against the US$ to sell the currency hedges that we had added in September when the US$ was above R15.50, adding value to the fund. We believe that despite forecasts for rising US interest rates, EM currencies may not fare as poorly against the US dollar as many expect. The greenback has already been strengthening against a broad basket of emerging market (EM) currencies for the past eight years, outperforming them by 17% or so (and by 25% against the rand) and rendering many EM currencies cheap on a purchasing power parity (PPP) basis. This would suggest that potential headwinds exist for the US currency to make further significant gains from here – investors can't rely on expectations of more US interest rate hikes to drive the greenback stronger from its current levels versus the rand and other EM currencies, especially against the backdrop of weaker US (and global) growth.

At the same time, although recent US economic data has pointed to some slowing (notably a plateauing in housing starts and building permits), several factors make us sceptical that the US is facing an imminent recession. The New York Fed's Probability of Recession indicator, although having risen from around 11 at the start of 2018 to 15 at year-end, is still well below its historical levels indicating recession, which were over 40 before the most recent downturns in both 2001 and 2007-8. US corporates have continued to report strong earnings growth, and the US consensus GDP growth forecast for 2019 is 2.6%, with inflation up to a healthy 2.2% y/y and two 25bp interest rate hikes expected. The consensus global growth forecast for 2019 is still 3.5%, only a moderate deceleration from 3.7% in 2018, and China's GDP growth is anticipated to be 6.2%. These figures suggest markets appear to have overdone their concerns over a drastic growth slowdown. In addition, while the US-China trade war is a real threat, so far much less has actually been implemented than threatened, so the notion that the full extent of each side's proposals will be actioned in 2019 is a stretch.

In global fixed income, US government bonds are slowly becoming less expensive as interest rates and yields rise there. However, in the UK, EU and Japan they are still near record-low levels, such that taken as a whole, valuations remain relatively unattractive versus equities, and are still at risk to rising interest rates globally. We remain underweight global sovereign bonds and underweight duration to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds. These assets are now slightly cheap and have the potential for stronger returns going forward should the US interest rate hiking cycle start to slow and/or be curtailed as expected.

For global equities, widespread losses made asset valuations even more attractive and we maintained our overweight position. Emerging markets and currencies were especially well valued on many measures: for example, South Korea's KOSPI was trading at less than 1x its 12-month forward price/book value. Although the US saw bigger losses than most other markets over the quarter, it was coming off a relatively expensive base and so we maintained our underweight in that market. We believe other global markets offer better value.

We continue to prefer the global banking sector, which has underperformed the broader market, as well as certain developed markets where equities are undervalued but fundamentals for earnings growth remain positive, including Germany and Japan, and selected emerging markets such as South Korea, Indonesia and China. These overweight positions are financed primarily by an underweight in global bonds, as well as US equities to a lesser extent. Many regions offer better value than the South African equity market, which is why we continue to be overweight global equities in our house view portfolios. SA equity earnings have been depressed relative to their long-term trends, and therefore have the potential to improve if the current government has even modest success in lifting the rate of potential growth.

Although South African equities became cheaper during the quarter, we did not add to SA equity holdings in the Inflation Plus Fund given the fund's maximum limit of 40% total equity exposure. We still see better equity opportunities offshore.

The fund still holds resources stocks with exposure to global growth and foreign currency earnings like Anglo American, BHP Billiton, Exxaro, Sasol and Sappi, as well as global giants such as Naspers and British American Tobacco. We have also maintained our overweight exposure to financial shares including Old Mutual, Standard Bank and Barclays Group Africa, which have offered attractive valuations with relatively high dividend yields. Meanwhile, we are still underweight retail stocks in our house view portfolios, given the pressure under which local consumers find themselves, but do hold a select overweight in Pick 'n Pay.

Going into 2019 we are cautiously optimistic regarding SA equity market returns due to the prevailing excessive levels of pessimism reflected in share prices and valuations. The recent flurry of announcements around small cap companies being taken private is an interesting phenomenon, as it potentially provides some evidence that broader underlying trading conditions may not be as depressed as previously reported, or that the cycle may well have troughed.

Although SA listed property became marginally cheaper over the quarter, we continue to have a neutral exposure in the fund to balance the risk/return factors. At the end of 2018 the sector is priced to deliver attractive, low-double-digit returns over the next five years. Some 80% of listed property companies were trading at a discount to their NAV's at year-end. Despite this, we remain concerned about the quality of earnings and possibility of further downward revisions to earnings forecasts in the short-term.

Apart from the well-publicised issues at the Resilient group of companies, many property companies have been relying on financial engineering and other non-rental and once-off income sources to continue to grow their distributions. Risks to rental earnings growth are also relatively high given pressure on landlords to reduce their rentals, particularly in the retail space where retailers are facing sluggish consumer spending. Equally, oversupply in office space is negative for listed property earnings currently. However, we are mindful that these are largely shorter-term risks (given that property is a lagging sector in any economic recovery phase), and that improving economic growth should help the sector to produce attractive returns over the medium term, especially relative to other local asset classes.

In SA nominal bonds, valuations remained cheap at year-end compared to their longer-term fair value despite the quarter's gains. We continue to be overweight in this asset class and still prefer longer-dated government bonds due to the more attractive yields on offer. We are also comfortable with the compensation bonds offer given the risk involved, while recognising that inflation remains a threat and the SA government and businesses have not yet done enough to eliminate the prospects of further credit rating downgrades, especially given the deterioration in the country's growth rate.

For inflation-linked bonds, following the quarter's return of 0.4%, valuations were little changed. ILBs produced a nominal return of 0.3% for the year, and their performance has been disappointing for the past six years due to falling inflation and rising real yields. We remain neutrally positioned in this asset class. Real yields are attractive at around 3.0% for 10-years, the highest level in a decade, but we still believe that better value exists elsewhere – in long-dated nominal bonds and equities. ■

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL BALANCED FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

MULTI-ASSET

MARKET OVERVIEW

Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House. US equity markets experienced exceptional tumult in the closing weeks of the year, posting the largest-ever one-day gain, as well as the worst December losses since the Great Depression in 1931. In fact, 2018 ended as one of worst years ever for investors in terms of the breadth of poor returns: Deutsche Bank reported on 20 December that 93% of the global assets it follows recorded negative returns for the year on a US dollar-adjusted basis, the highest percentage since it started collecting data in 1901. Apart from cash, it was largely the traditional safe-haven assets like US Treasuries, German bunds and Japanese government bonds that managed to deliver positive performance over the year.

For South African investors with rand investments, SA bonds and cash proved to be a relative safe haven amid a broad rout in equities and listed property which saw 83% of the JSE's top 40 stocks deliver negative price returns for the year. Offshore diversification also worked well against the backdrop of a sharply weaker rand: in rand terms, global equity (the MSCI All Country World Index) returned 6.5%, global bonds (the Bloomberg Barclays Global Bond Index) delivered a strong 15.5% and global property (the FTSE EPRA/NAREIT Index) produced 11.1% for 2018.

During the quarter global uncertainty also worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve (Fed)'s policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018, a figure that could rise still further should US-Chinese trade negotiations fail in 2019. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn. For the quarter, US equities were punished: the S&P 500 returned -13.5% for a 2018 return of –4.4%, the Dow Jones Industrial 30 Index delivered -11.3% and -3.5% in 2018, and the Nasdaq produced -16.8% for Q4 and was flat for the year (all in US$).

Other developed equity markets also reflected the bearish sentiment, as the Dow Jones Eurostoxx 50 returned -12.9% (in US$) for the quarter and -16.2% for the year, its worst performance since the 2008 Global Financial Crisis. The UK's FTSE 100 Index returned -11.7% (in US$) for the quarter and -14.0% for the year and the Nikkei 225 Index returned -14.4% (in US$) in Q4 and -8.5% for the year.

Emerging markets were punished even more, with the MSCI Emerging Markets Index recording a -14.6% return for the year. Among the 2018 returns in large emerging markets (in US$), the MSCI Turkey was the biggest loser with a total return of -41.1%, the MSCI South Africa returned -24.3%, South Korea's KOSPI produced -22.0%, the MSCI China recorded – 18.7% and the MSCI India delivered -7.3%, while Brazil's Bovespa returned -1.8%. The MSCI Russia was one of the only markets in the black with a small 0.2% return.

US investment-grade corporate bonds saw their yields rise and spreads versus their UST counterparts widen by approximately 50bps over the year to produce a return of -2.5% in US$ for 2018, while high-yield bonds returned -2.1%. In Q4, the Bloomberg Barclays Global Aggregate Bond Index (US$) returned 1.2%, while for the year its return of -1.2% reflected weaker global corporate bonds and emerging market bonds, plus the stronger US dollar.

Another volatile quarter for South Africa

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise (SOE) debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

Following December's sharp global equity sell-off, the FTSE/JSE All Share Index returned -4.9% in Q4 2018, for a full year return of -8.5%. Returns were broadly negative, with only Resources in positive territory in 2018 with a 17.8% return (spurred by the weaker rand, improving operational performance and cheap valuations). Financials were in the red with -8.8%, and Industrials delivered -17.6% for the year, led by big declines in large stocks like Naspers and British American Tobacco (BAT). Listed property produced a disastrous -25.3% in 2018, never recovering from Q1's accusations of accounting irregularities at the Resilient group of companies, as well as growing concerns over more widespread financial engineering in the sector and downward earnings revisions at several other companies later in the year.

SA nominal bonds (BEASSA All Bond Index) managed to return 2.7% during the last quarter of 2018, with the 10-year bond starting the period around 9.0% and ending around 8.93%. However, the yield jumped to over 9.4% in mid-October, before rebounding in December. During the quarter, sentiment towards SA bonds was dented by newly appointed Finance Minister Tito Mboweni's medium-term budget in October, which forecast low growth and higher debt. It also raised the spectre of further credit rating downgrades. Another driver was the SA Reserve Bank's surprise 25bp interest rate hike in November. Despite CPI at 5.2% y/y, well within the 3%-6% target band, the SARB cited a worsening inflation outlook (largely on the weaker rand) as the main reason for its move, and its desire to maintain inflation around the 4.5% midpoint of its target band. Consensus CPI for 2019 is 5.3%, and the market is expecting one further 25bp interest rate hike in 2019.

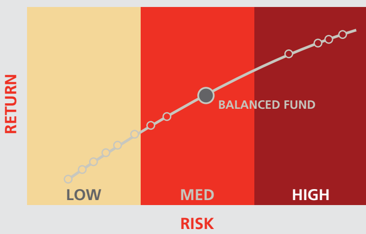
For the year, SA bonds produced a respectable 7.7% return: along with Q4 gains, their strong Q1 rally amid the positive "Ramaphoria" sentiment managed to offset subsequent weakness in Q2 and Q3. Solid local demand also overcame high foreign sales: Offshore investors sold a net R70 billion in SA bonds in 2018 as a whole, representing a material capital outflow of around R100 billion from April onwards

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	X CLASS	B CLASS
1 year	-3.3%	-3.6%	-2.8%	-3.0%	-2.6%
3 years	4.0%	2.4%	4.5%	4.2%	4.7%
5 years	6.3%	4.8%	n/a	6.6%	7.1%
7 years	10.7%	8.2%	n/a	n/a	11.5%
10 years	11.3%	8.9%	n/a	n/a	12.3%
Since inception	13.3%	11.4%	4.7%	9.2%	13.5%

Inception dates: X Class: 2 January 2013, B Class: 1 July 2002, T Class: 2 January 2015

ASSET CLASS RETURNS	TOTAL RETURN Q4 2018	TOTAL RETURN 2018
SA equity – FTSE/JSE All Share Index	-4.9%	-8.5%
SA bonds – BEASSA All Bond Index	2.7%	7.7%
SA listed property – SA Listed Property Index	-4.0%	-25.3%
SA inflation-linked bonds – JSE CILI Index	0.4%	0.3%
SA cash (STeFI Composite Index)	1.8%	7.2%
Global equity – MSCI World (US$) (Developed)	-13.4%	-8.7%
Global equity – MSCI Emerging Markets (US$)	-7.5%	-14.6%
Global bonds – Bloomberg Barclays Global Aggregate Bond Index (US$)	1.2%	-1.2%
Global property – FTSE EPRA/NAREIT Global Property REIT Index (US$)	-6.0%	-6.0%

RISK/RETURN PROFILE:



FUND MANAGERS:

David Knee, Michael Moyle and Johny Lambridis

ASISA CATEGORY:

South African - Multi-Asset - High Equity

BENCHMARK:

ASISA South African - Multi-Asset - High Equity Category Average

INCEPTION DATE:

2 August 1999

FUND SIZE:

R20 536 918 695

Sources: Prudential, Morningstar & Deutsche Securities

after having bought a net R30 billion in Q1. Meanwhile, for the quarter inflation-linked bonds delivered 0.4%, and cash as measured by the STeFI Composite Index produced 1.8%. For 2018, ILBs returned 0.3 % and cash 7.2%.

PERFORMANCE

The fund returned -6.3% (after fees) for the fourth quarter of 2018 and has returned -3.3% for the 12-month period ending 31 December 2018, outperforming its benchmark's -3.6% return. The fund has delivered a return of 13.3% per annum since inception (after fees), compared to its benchmark of 11.4% per annum over the same period. To 31 December 2018 it retains its top-quartile or better performance over all annual periods from 2-10 years, according to Morningstar.

The largest contributor to the fund's absolute performance was its holding in SA bonds, followed to a lesser extent by SA cash and international cash.

The most significant detractors to returns were its exposure to SA equity, international equity and SA listed property. The fund's overweights in financial shares like Old Mutual, Absa, FirstRand and Standard Bank added value, as did its exposure to Anglo American, while BAT was a notable detractor.

STRATEGY AND POSITIONING

Offshore, the fund remains underweight global bonds and global cash, and overweight global equities, with the latter offering attractive valuations in many markets (particularly when viewed relative to bonds), and much higher potential returns over the medium term. The total offshore exposure remains at around 25% (within Regulation 28 limits).

In November we took advantage of rand strength against the US$ to sell the currency hedges that we had added in September when the US$ was above R15.50, adding value to the fund. We believe that despite forecasts for rising US interest rates, EM currencies may not fare as poorly against the US dollar as many expect. The greenback has already been strengthening against a broad basket of emerging market (EM) currencies for the past eight years, outperforming them by 17% or so (and by 25% against the rand) and rendering many EM currencies cheap on a purchasing power parity (PPP) basis. This would suggest that potential headwinds exist for the US currency to make further significant gains from here – investors can't rely on expectations of more US interest rate hikes to drive the greenback stronger from its current levels versus the rand and other EM currencies, especially against the backdrop of weaker US (and global) growth.

At the same time, although recent US economic data has pointed to some slowing (notably a plateauing in housing starts and building permits), several factors make us sceptical that the US is facing an imminent recession. The New York Fed's Probability of Recession indicator, although having risen from around 11 at the start of 2018 to 15 at year-end, is still well below its historical levels indicating recession, which were over 40 before the most recent downturns in both 2001 and 2007-8. US corporates have continued to report strong earnings growth, and the US consensus GDP growth forecast for 2019 is 2.6%, with inflation up to a healthy 2.2% y/y and two 25bp interest rate hikes expected. The consensus global growth forecast for 2019 is still 3.5%, only a moderate deceleration from 3.7% in 2018, and China's GDP growth is anticipated to be 6.2%. These figures suggest markets appear to have overdone their concerns over a drastic growth slowdown. In addition, while the US-China trade war is a real threat, so far much less has actually been implemented than threatened, so the notion that the full extent of each side's proposals will be actioned in 2019 is a stretch.

In global fixed income, US government bonds are slowly becoming less expensive as interest rates and yields rise there. However, in the UK, EU and Japan they are still near record-low levels, such that taken as a whole, valuations remain relatively unattractive versus equities, and are still at risk to rising interest rates globally. We remain underweight global sovereign bonds and underweight duration to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds. These assets are now slightly cheap and have the potential for stronger returns going forward should the US interest rate hiking cycle start to slow and/or be curtailed as expected.

For global equities, widespread losses made asset valuations even more attractive and we maintained our overweight position. Emerging markets and currencies were especially well valued on many measures: for example, South Korea's KOSPI was trading at less than 1x its 12-month forward price/book value. Although the US saw bigger losses than most other markets over the quarter, it was coming off a relatively expensive base and so we maintained our underweight in that market. We believe other global markets offer better value.

We continue to prefer the global banking sector, which has underperformed the broader market, as well as certain developed markets where equities are undervalued but fundamentals for earnings growth remain positive, including Germany and Japan, and selected emerging markets such as South Korea, Indonesia and China. These overweight positions are financed primarily by an underweight in global bonds, as well as US equities to a lesser extent. Many regions offer better value than the South African equity market, which is why we continue to be overweight global equities in our house view portfolios. SA equity earnings have been depressed relative to their long-term trends, and therefore have the potential to improve if the current government has even modest success in lifting the rate of potential growth.

South African equities became cheaper during the quarter, as prices dropped but forward earnings moved largely sideways (with some volatility). Using one measure, the FTSE/JSE SWIX's 12-month forward P/E fell to around 11.8X at quarter-end from around 12.6X in Q3, 19% cheap compared to its long-term fair value estimate of 14.5X. Notably, companies' trailing (reported) earnings have risen substantially in the past two years, and are forecast to rise further, with the market's 12-month forward earnings growth estimated around 25%. This means that even if this anticipated earnings growth does not materialise, there is still a fair amount of room for earnings to disappoint. On the back of more attractive valuations, during the quarter we added further to our overweight position in SA equities, buying out of cash in the fund.

The fund still holds resources stocks with exposure to global growth and foreign currency earnings like Anglo American, BHP Billiton, Exxaro, Sasol and Sappi, as well as global giants such as Naspers and British American Tobacco. We have also maintained our overweight exposure to financial shares including Old Mutual, Standard Bank and Barclays Group Africa, which have offered attractive valuations with relatively high dividend yields. Meanwhile, we are still underweight retail stocks in our house view portfolios, given the pressure under which local consumers find themselves, but do hold a select overweight in Pick 'n Pay.

Going into 2019 we are cautiously optimistic regarding SA equity market returns due to the prevailing excessive levels of pessimism reflected in share prices and valuations. The recent flurry of announcements around small cap companies being taken private is an interesting phenomenon, as it potentially provides some evidence that broader underlying trading conditions may not be as depressed as previously reported, or that the cycle may well have troughed.

Although SA listed property became marginally cheaper over the quarter, we continue to have a neutral exposure in the fund to balance the risk/return factors. At the end of 2018 the sector is priced to deliver attractive, low-double-digit returns over the next five years. Some 80% of listed property companies were trading at a discount to their NAV's at year-end. Despite this, we remain concerned about the quality of earnings and possibility of further downward revisions to earnings forecasts in the short-term.

Apart from the well-publicised issues at the Resilient group of companies, many property companies have been relying on financial engineering and other non-rental and once-off income sources to continue to grow their distributions. Risks to rental earnings growth are also relatively high given pressure on landlords to reduce their rentals, particularly in the retail space where retailers are facing sluggish consumer spending. Equally, oversupply in office space is negative for listed property earnings currently. However, we are mindful that these are largely shorter-term risks (given that property is a lagging sector in any economic recovery phase), and that improving economic growth should help the sector to produce attractive returns over the medium term, especially relative to other local asset classes.

In SA nominal bonds, valuations remained cheap at year-end compared to their longer-term fair value despite the quarter's gains. We continue to be overweight in this asset class and still prefer longer-dated government bonds due to the more attractive yields on offer. We are also comfortable with the compensation bonds offer given the risk involved, while recognising that inflation remains a threat and the SA government and businesses have not yet done enough to eliminate the prospects of further credit rating downgrades, especially given the deterioration in the country's growth rate.

The fund has a very small holding in inflation-linked bonds. Following the quarter's return of 0.4%, valuations were little changed. ILBs produced a nominal return of 0.3% for the year, and their performance has been disappointing for the past six years due to falling inflation and rising real yields. We remain neutrally positioned in this asset class. Real yields are attractive at around 3.0% for 10-years, the highest level in a decade, but we still believe that better value exists elsewhere – in long-dated nominal bonds and equities. ■

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL ENHANCED SA PROPERTY TRACKER FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

PROPERTY

MARKET OVERVIEW

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. Among the quarter's other developments weighing on the SA economy was Eskom's re-introduction of load shedding around the country in the first half of December, with the possibility that it could recommence in mid-January. The land expropriation debate also continued to exacerbate uncertainty, as did political manoeuvring ahead of the 2019 general election.

The market consensus for 2018 GDP growth was revised down to 0.7%, while for 2019 it was lowered to 1.5% from around 2.0% previously. Some positive developments saw accelerating mining and manufacturing activity for October, which surprised analysts, and new appointments of capable managers at several SOEs. President Ramaphosa's Cabinet reshuffle and general messaging during the quarter reinforced positive sentiment around his commitment to fighting corruption and maladministration; while several investigations into fraud and malpractice at SOEs also progressed.

The major listed property companies delivered per share distribution growth of 5.3% over the last six months' reporting cycle, with unusually high divergence among companies. Yields on property companies are as attractive as they have been for several years and have moved in sympathy with long-dated South African government bonds.

The FTSE/JSE South African Listed Property Index returned -25.3% for the 12 months ending 31 December 2018 with the Resilient stable of companies underperforming significantly as a result of corporate governance concerns and high starting valuations. The shock for the quarter was perhaps Rebosis forecasting a 40% decrease in dividends for 2019 following their decision not to distribute non-recurring sources of income and the suspension of dividends from their UK shopping centre investment, New Frontier Properties.

Locally, the Edcon Group's mooted restructuring has unsettled investors due to their high importance to retail landlords. Though the outcome of the proposal to its landlords in terms of potential rent reductions is not yet public, comments from Edcon's CEO appear to support an orderly restructuring of the business, which would be a positive outcome for all parties.

PERFORMANCE

The Prudential Enhanced SA Property Tracker Fund underperformed its benchmark by 0.9% (net of fees) for the quarter and by 0.1% (net of fees) for the 12 months ending 31 December 2018.

As a reminder, the fund takes limited active positions based on fundamental factors, while aiming to limit the tracking error to a maximum of 2%. For the quarter, an underweight position in Nepi Rockcastle contributed positively to performance, as did overweight positions in Investec Australia and Redefine Properties. Overweight positions in Rebosis, SA Corporate and Hammerson detracted from performance, as did an underweight in Fortress A.

STRATEGY AND POSITIONING

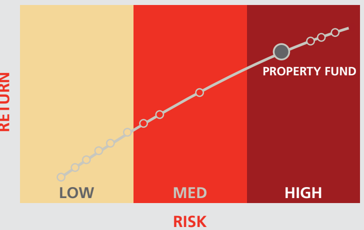
There appears to be little likelihood of strong rental growth in the majority of the office sector and the industrial sector, with the few exceptions to the rule. On the positive side, the starting yields of a number of property companies already discount the potential for slow growth or a decline in dividends.

We remain concerned by the inclusion of non-recurring income and excessive use of offshore debt to boost dividends to maintain the veneer of growth. Despite our concerns, we view current valuations as moderately attractive relative to alternative 'yield' assets. In the absence of a material change in the market's valuation (or rating) or a disorderly tenant failure, our base-case assumption is for property to deliver double-digit returns over the medium term, well above inflation. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	D CLASS
1 year	-25.4%	-25.3%	-25.3%	-25.3%
3 years	-2.0%	-1.2%	-1.9%	-1.8%
5 years	5.6%	5.7%	n/a	5.7%
7 years	9.8%	10.0%	n/a	9.9%
10 years	11.9%	12.1%	n/a	n/a
Since inception	12.7%	12.9%	-2.2%	11.1%

Inception date D Class: 1 July 2010, T Class: 1 April 2015

RISK/RETURN PROFILE:



FUND MANAGERS:
Jeanne-Marie Snalam

ASISA CATEGORY:
South African - Real Estate - General

BENCHMARK:
FTSE/JSE South African Listed Property Index (J253)

INCEPTION DATE:
2 December 2005

FUND SIZE:
R3 519 879 608

AWARDS:
Morningstar/Standard & Poor's: 2011

DISCLAIMER

Prudential Portfolio Managers Unit Trusts Ltd (Registration number: 1999/0524/06) is an approved CISCA management company (#29). Assets are managed by Prudential Investment Managers (South Africa) (Pty) Ltd, which is an approved discretionary Financial Services Provider (#45199). The Trustee's/Custodian details are: Standard Bank of South Africa Limited - Trustee Services & Investor Services. 20th Floor, Main Tower, Standard Bank Centre, Heerengracht, Cape Town. Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. Past performance is not necessarily a guide to future investment performance. Unit trust prices are calculated on a net asset value basis. This means the price is the total net market value of all assets of the unit trust fund divided by the total number of units of the fund. Any market movements – for example in share prices, bond prices, money market prices or currency fluctuations - relevant to the underlying assets of the fund may cause the value of the underlying assets to go up or down. As a result, the price of your units may go up or down. Unit trusts are traded at the ruling forward price of the day, meaning that transactions are processed during the day before you or the Manager know what the price at the end of the day will be. The price and therefore the number of units involved in the transaction are only known on the following day. The unit trust fund may borrow up to 10% of the fund value, and it may also lend any scrip (proof of ownership of an investment instrument) that it holds to earn additional income. A Prudential unit trust fund may consist of different fund classes that are subject to different fees and charges. Where applicable, the Manager will pay your financial adviser an agreed standard ongoing adviser fee, which is included in the overall costs of the fund. A Collective Investment Schemes (CIS) summary with all fees and maximum initial and ongoing adviser fees is available on our website. One can also obtain additional information on Prudential products on the Prudential website. The Manager may, at its discretion, close your chosen unit trust fund to new investors and to additional investments by existing investors to make sure that it is managed in accordance with its mandate. It may also stop your existing debit order investment. The Manager makes no guarantees as to the capital invested in the fund or the returns of the fund. Excessive withdrawals from the fund may place the fund under liquidity pressure and, in certain circumstances; a process of ring fencing withdrawal instructions may be followed. Fund prices are published daily on the Prudential website. These are also available upon request. The performance is calculated for the portfolio. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Purchase and repurchase requests must be received by the Manager by 13h30 SA time each business day. All online purchase and repurchase transactions must be received by the Manager by 10h30 (for all Funds) SA time each business day.

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL DIVIDEND MAXIMISER FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

EQUITY

MARKET OVERVIEW

The last quarter of 2018 saw a sharp escalation in the market worries around the effect that the trade war between the US and China might be having on global markets. The heightened investor risk aversion that we saw impacting negatively on emerging markets during the previous quarters, flowed through to developed markets. Poor economic data from China started to confirm market fears that the trade war issues might start to be having a real impact on the Chinese economy. Global equity market volatility and a severe pullback over the quarter ensued. Underlying global economic fundamentals though appear to be reasonably resilient and consensus earnings forecasts have remained intact for now. On this basis, valuations appear undemanding and we think equities globally now look very attractive. Emerging market valuations are even more compelling, although risks and currency volatility remain elevated. In South Africa, share price volatility was notable during 2018, as outside of the Global Financial Crisis in 2008 (when 90% of ALSI 40 shares posted a negative total return), 2018 recorded the highest number of stocks with a negative total return in the last decade.

During the quarter global uncertainty worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve's policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018. The Fed adopted a somewhat more dovish stance at its December FOMC meeting. Although it hiked the benchmark interest rate by 25bps as widely expected, it also eliminated one 25bp interest rate hike from its 2019 rate outlook and lowered its 2019 GDP growth forecast to 2.3% from 2.5% previously. Still, the market had been pricing in an even easier stance, sparking further equity weakness. Both the market and Fed are now forecasting only two 25bp rate hikes in 2019.

In the EU, Q3 GDP growth slowed to a disappointing 1.7% (q/q annualised) from 2.2% in Q2, attributed to weaker manufacturing activity and poorer business sentiment. The Italian government's dispute with the EU over its budget deficit forecast created more questions over its future within the grouping, denting financial markets and the euro. This was resolved in December with an agreement favouring the EU's lower deficit target, but worries remain over the populist-led government. Social unrest in France and sluggish German growth also added to the region's woes. The European Central Bank (ECB) in December pledged to keep interest rates at record lows at least through mid-2019. The UK government descended into further turmoil during Q4 as opposition to the Brexit deal agreed by PM Theresa May with the EU came from all fronts, increasing the probability of "no deal", the very worst outcome for the UK economy. The BOE left its interest rate unchanged at its November meeting, but cited rising risks to future growth from Brexit despite solid GDP growth of 1.5% (q/q annualised) in Q3 2018.

The Japanese economy contracted by 1.2% (q/q annualised) in Q3 2018 compared to its 3.0% expansion in Q2, due to a slowdown in exports, an increase in imports and declines in private spending and public fixed investment. The Bank of Japan said the downside risks to growth were rising due to tariff threats from the US (particularly on its auto exports) and a slowdown in the global economy, and kept interest rates on hold at its December meeting as expected, while also continuing to buy securities. Japanese growth is expected to slow later in 2019 due to the anticipated negative impact of a new consumption tax on spending and consumer prices. In China, GDP growth slowed to 6.5% (q/q annualised) in Q3 from 6.7% the previous quarter and below the 6.6% expected, due partly to the impact of financial deleveraging and subdued consumer spending, as well as anxiety over the impact of Trump's trade war on economic growth – China has the most to lose of any other country.

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. Among the quarter's other developments weighing on the SA economy was Eskom's re-introduction of load shedding around the country in the first half of December, with the possibility that it could recommence in mid-January. The land expropriation debate also continued to exacerbate uncertainty, as did political manoeuvring ahead of the 2019 general election. The market consensus for 2018 GDP growth was revised down to 0.7%, while for 2019 it was lowered to 1.5% from around 2.0% previously. Some positive developments saw accelerating mining and manufacturing activity for October, which surprised analysts, and new appointments of capable managers at several SOEs. President Ramaphosa's Cabinet reshuffle and general messaging during the quarter reinforced positive sentiment around his commitment to fighting corruption and maladministration; while several investigations into fraud and malpractice at SOEs also progressed.

The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

For South African investors with rand investments, SA bonds and cash proved to be a relative safe haven amid a broad rout in equities and listed property which saw 83% of the JSE's top 40 stocks deliver negative price returns for the year. Offshore diversification also worked well against the backdrop of a sharply weaker rand: in rand terms, global equity (the MSCI All Country World Index) returned 6.5%, global bonds (the Bloomberg Barclays Global Bond Index) delivered a strong 15.5% and global property (the FTSE EPRA/NAREIT Index) produced 11.1%.

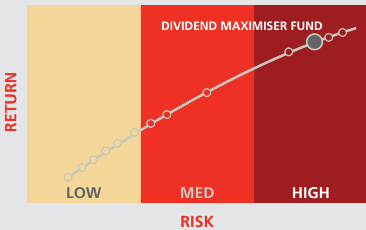
Following December's sharp global equity sell-off, the FTSE/JSE All Share Index returned -4.9% in Q4 2018, for a full year return of -8.5%. Returns were broadly negative, with only Resources in positive territory in 2018 with a 17.8% return (spurred by the weaker rand, improving operational performance and cheap valuations). Financials were in the red with -8.8%, and Industrials delivered -17.6% for the year, led by big declines in large stocks like Naspers and British American Tobacco. Listed property produced a disastrous -25.3% in 2018, never recovering from Q1's accusations of accounting irregularities at the Resilient group of companies, as well as growing concerns over more widespread financial engineering in the sector and downward earnings revisions at several other companies later in the year.

PERFORMANCE

The Prudential Dividend Maximiser Fund produced a return of -8.9% (net of fees) for the fourth quarter of 2018, underperforming its benchmark (the average of general equity funds) by 3.9%. For the year ended 31 December 2018, the fund returned -7.8% (net of fees), outperforming its benchmark by 1.2%.

The fund's dual focus of buying undervalued companies with strong cash flows and dividends remains intact, but this strategy did not prove helpful this year. Although the fund once again outperformed

RISK/RETURN PROFILE:



FUND MANAGERS:
Ross Biggs, Craig Butters and Rehana Khan

ASISA CATEGORY:
South African - Equity - General

BENCHMARK:
ASISA South African – Equity - General Category Mean

INCEPTION DATE:
2 August 1999

FUND SIZE:
R4 291 060 095

AWARDS:
Raging Bull: 2006, 2008
Morningstar/Standard & Poor's: 2007, 2009

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	B CLASS
1 year	-7.8%	-9.1%	-7.4%	-7.5%
3 years	2.4%	1.9%	2.8%	2.8%
5 years	4.9%	3.3%	n/a	5.3%
7 years	10.3%	7.9%	n/a	10.8%
10 years	12.0%	10.2%	n/a	12.5%
Since inception	16.1%	13.0%	2.7%	10.4%

[#] Inception date B Class: 2 January 2007, T Class: 2 January 2015

Sources: Prudential, Morningstar & Deutsche Securities

its benchmark over 12 months, it was still down by almost 8% over the course of 2018. The fund benefited from its 30% invested in offshore markets over the year, however this was largely as a result of the weaker rand, which depreciated by 15% as it moved from its R12.50/US$ "Ramaphoria" levels at the start of 2018 to R14.50/US$ levels by the end of the year.

We acknowledge that while it is very difficult to forecast the future and we do not make any attempt to do this, we do spend a lot of time thinking about the economic cycles that various sectors are in, and where valuations are. In this way, we aim to try make money for our clients through these cycles and continue to try and buy positions in companies that have a proven dividend and cash flow track record and which can withstand the normal upheavals that occur in markets over time. We aim to continue building risk-cognisant portfolios that seek to add value through stock selection relative to benchmark.

During the last quarter, the largest detractor from performance was our overweight position in British American Tobacco (BAT). We view BAT as a very high quality company with exceptionally strong cash flows. BAT is trading on valuations now which we would regard as exceptionally attractive. In fact the dividend yield of BAT is now one of the most attractive in the South African market. BAT is often viewed as a "defensive" stock due to the stability of its cash flows, but this year saw the emergence of multiple possible risks for the Tobacco sector, the notable one being the possible banning of menthol cigarettes in the US. With the BAT dividend yield now approaching 8%, we think we are being more than suitably compensated for the re-emergence of risks. We think it extremely unlikely that the BAT dividend will be cut.

Sasol, after having been a top performer for the fund this year, had a very poor quarter due to the fall in the oil price. This is a company we regard highly as it has been able to grow its cash flows and earnings strongly over decades. Over the last few years however, cash flow growth has been fairly flat, as a lot of cash flow has been going into the Lake Charles Chemicals Project. As this project nears completion over the next year, we expect cash flows to return to their growth projector and we envisage stronger dividend growth and therefore maintain a large position in this company despite the lower oil price.

Our substantial underweight position to Aspen was one of the strongest contributors to relative performance for the year. We have owned none or very small amounts of this company over the last decade due to the poor cash flow, dividend growth and dividend yield of this company. We continue to think that Aspen trades on the expensive side of fair value and given the poor cash flows of the business and indebted balance sheet, we see limited scope for strong dividend growth going forward. Aspen has been very acquisitive over time and has exhibited relatively poor dividend yields.

STRATEGY AND POSITIONING

On market valuations, we currently view the market in South Africa as being undervalued. While we have been cautious regarding dividend growth in the South African market over the last five years, we now have more conviction that earnings and dividends should show a return to growth. This growth in dividends is based mainly on a return to more normal profit margins among the mining companies and related industries. We still consider some offshore equity markets to be relatively undervalued and attractive, and therefore maintain the fund's offshore exposure. We have in addition allocated some capital to the rest of Africa where we think dividends could show excellent growth over the next five years, particularly in Nigeria and Egypt.

We are cautiously optimistic regarding equity market and fund returns due to the prevailing excessive levels of pessimism reflected in share prices. The recent flurry in announcements of small cap companies being taken private is also an interesting phenomenon and may provide some evidence that broader underlying trading conditions may not be as depressed as previously reported and that valuations are attractive.

We would like to remind our investors that when investing in the JSE, that they are not only buying South African exposure, but also shares in globally competitive and exposed businesses such as BHP Billiton, Naspers and BAT. In the case of the Prudential Dividend Maximiser Fund, we have also viewed foreign stocks as being relatively attractive and currently approximately 30% of the fund is directly invested offshore across various markets.

The focus of the fund continues to be on finding companies that are undervalued and which are paying good dividend yields with the potential to pay growing dividends over the long run. We are confident that we have built a portfolio of attractively priced stocks that in aggregate is cheaper than owning the index, yet still capable of delivering attractive underlying growth independent of the economic cycle in which we find ourselves. ■

DISCLAIMER

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL EQUITY FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

EQUITY

MARKET OVERVIEW

Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House.

During the quarter global uncertainty worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve's policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn. The Fed adopted a somewhat more dovish stance at its December FOMC meeting. Although it hiked the benchmark interest rate by 25bps as widely expected, it also eliminated one 25bp interest rate hike from its 2019 rate outlook and lowered its 2019 GDP growth forecast to 2.3% from 2.5% previously. Still, the market had been pricing in an even easier stance, sparking further equity weakness. Both the market and Fed are now forecasting only two 25bp rate hikes in 2019.

In the EU, Q3 GDP growth slowed to a disappointing 1.7% (q/q annualised) from 2.2% in Q2, attributed to weaker manufacturing activity and poorer business sentiment. The Italian government's dispute with the EU over its budget deficit forecast created more questions over its future within the grouping, denting financial markets and the euro. This was resolved in December with an agreement favouring the EU's lower deficit target, but worries remain over the populist-led government. Social unrest in France and sluggish German growth also added to the region's woes. The European Central Bank (ECB) in December pledged to keep interest rates at record lows at least through mid-2019. The UK government descended into further turmoil during Q4 as opposition to the Brexit deal agreed by PM Theresa May with the EU came from all fronts, increasing the probability of "no deal", the very worst outcome for the UK economy. The BOE left its interest rate unchanged at its November meeting, but cited rising risks to future growth from Brexit despite solid GDP growth of 1.5% (q/q annualised) in Q3 2018.

The Japanese economy contracted by 1.2% (q/q annualised) in Q3 2018 compared to its 3.0% expansion in Q2, due to a slowdown in exports, an increase in imports and declines in private spending and public fixed investment. The Bank of Japan said the downside risks to growth were rising due to tariff threats from the US (particularly on its auto exports) and a slowdown in the global economy, and kept interest rates on hold at its December meeting as expected, while also continuing to buy securities. Japanese growth is expected to slow later in 2019 due to the anticipated negative impact of a new consumption tax on spending and consumer prices. In China, GDP growth slowed to 6.5% (q/q annualised) in Q3 from 6.7% the previous quarter and below the 6.6% expected, due partly to the impact of financial deleveraging and subdued consumer spending, as well as anxiety over the impact of Trump's trade war on economic growth – China has the most to lose of any other country.

Despite good news regarding South Africa's emergence from recession with Q3 2018 GDP growth of 2.2% (q/q, annualised), concerns over rising government and state-owned enterprise debt, slow economic growth and worsening creditworthiness combined with the risk-averse global sentiment to weigh on local markets in Q4 2018. Among the quarter's other developments weighing on the SA economy was Eskom's re-introduction of load shedding around the country in the first half of December, with the possibility that it could recommence in mid-January. The land expropriation debate also continued to exacerbate uncertainty, as did political manoeuvring ahead of the 2019 general election. The market consensus for 2018 GDP growth was revised down to 0.7%, while for 2019 it was lowered to 1.5% from around 2.0% previously. Some positive developments saw accelerating mining and manufacturing activity for October, which surprised analysts, and new appointments of capable managers at several SOEs. President Ramaphosa's Cabinet reshuffle and general messaging during the quarter reinforced positive sentiment around his commitment to fighting corruption and maladministration; while several investigations into fraud and malpractice at SOEs also progressed.

The rand depreciated further against the strengthening US dollar, losing 1.8% as it started October around R14.14 per US$ and ended December around R14.50. This masked considerable volatility, however, as it strengthened to as low as R13.70 in the period. The local currency was virtually unchanged against the euro and pound sterling in Q4 amid turmoil arising from the Italian budget deficit and Brexit uncertainty. For the year as a whole, however, the rand was substantially weaker versus all three major currencies, down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling.

For South African investors with rand investments, SA bonds and cash proved to be a relative safe haven amid a broad rout in equities and listed property which saw 83% of the JSE's top 40 stocks deliver negative price returns for the year. Offshore diversification also worked well against the backdrop of a sharply weaker rand: in rand terms, global equity (the MSCI All Country World Index) returned 6.5%, global bonds (the Bloomberg Barclays Global Bond Index) delivered a strong 15.5% and global property (the FTSE EPRA/NAREIT Index) produced 11.1%.

Following December's sharp global equity sell-off, the FTSE/JSE All Share Index returned -4.9% in Q4 2018, for a full year return of -8.5%. Returns were broadly negative, with only Resources in positive territory in 2018 with a 17.8% return (spurred by the weaker rand, improving operational performance and cheap valuations). Financials were in the red with -8.8%, and Industrials delivered -17.6% for the year, led by big declines in large stocks like Naspers and British American Tobacco. Listed property produced a disastrous -25.3% in 2018, never recovering from Q1's accusations of accounting irregularities at the Resilient group of companies, as well as growing concerns over more widespread financial engineering in the sector and downward earnings revisions at several other companies later in the year.

PERFORMANCE

The fund delivered a return of -7.3% (net of fees) for the fourth quarter of 2018, while the benchmark, the ASISA South African Equity General Category Mean, returned -5.0% over the same period. For the year ended December 2018, the Prudential Equity Fund delivered a total return of -8.0% (net of fees), outperforming the benchmark by 1.1%.

Outside of the Global Financial Crisis in 2008 (when 90% of FTSE/JSE All Share Index (ALSI) Top 40 shares posted a negative total return), 2018 recorded the highest number of stocks with a negative total return in the last decade. Unsurprisingly, total returns for all major equity SA indices were negative in 2018 (ALSI: -8.5% and the FTSE/JSE Capped SWIX: -10.9%).

Although the Prudential Equity Fund once again outperformed its benchmark by over 100 basis points, it was also down by 7.3% over the course of 2018. The fund benefited from its 15-20% invested in offshore markets over the year, but this was largely a currency boost, as the rand depreciated from its R12.50/US$ "Ramaphoria" levels at the start of 2018 to R14.50/US$ "Rama-reality" levels by the end of the year.

Our overweight exposure to Altron and Old Mutual contributed significantly to the fund's relative outperformance (to its benchmark) both for 2018 as a whole and in the final quarter. We have patiently held Old Mutual through its managed separation (announced in early 2016), and while there has been some unlock of value we would still expect further outperformance.

The biggest detractors to relative performance in the final quarter included our overweight position in British American Tobacco (BAT) and underweight positions in Nedbank and Anglogold. BAT is often viewed as a "defensive" stock but experienced a substantial drawdown in the fourth quarter in the face of a possible ban of its menthol cigarettes by a more aggressive FDA (where BAT now earns nearly half of its profits following its recent acquisition of Reynolds). We do not expect a re-rating of BAT in the near term, but with a dividend yield approaching 8% we are being suitably compensated for the re-emergence of risks in the Tobacco sector.

STRATEGY AND POSITIONING

At the time of writing, we still have no more clarity on Brexit (originally voted on by a "misled" UK electorate back in June 2016), following UK Prime Minister Theresa May's postponement of a December parliamentary vote on her proposed deal. On the other side of the Atlantic, the US government has entered a partial shutdown, following disagreement on US$5bn of funding for Trump's controversial Mexican border wall.

We suspect South African politicians will look to add to the political "noise" in 2019, as South Africans head to elections. This could present some challenges for equity returns, however South African equity valuations are becoming increasingly attractive. Although we are yet to see forward PEs in single digits, the market's forward PE has steadily increased over the last number of years – from 15x at the start of 2014, 16x at the start of each of 2015, 2016 and 2017 and 17x at the start of 2018 post the ANC elective conference to now down around a more palatable 13x.

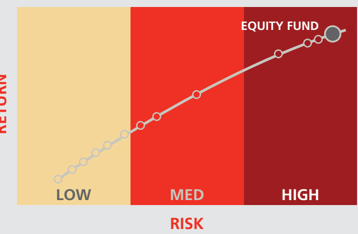
Going into 2019 we are cautiously optimistic regarding SA equity market returns due to the prevailing excessive levels of pessimism reflected in share prices and valuations. The recent flurry of announcements around small cap companies being taken private is an interesting phenomenon, as it potentially provides some evidence that broader underlying trading conditions may not be as depressed as previously reported, or that the cycle may well have troughed.

SA listed property became marginally cheaper over the quarter. At the end of 2018 the sector is priced to deliver attractive, low-double-digit returns over the next five years. Some 80% of listed property companies were trading at a discount to their NAV's at year-end. Despite this, we remain concerned about the quality of earnings and possibility of further downward revisions to earnings forecasts in the short-term. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	-8.0%	-9.1%	-7.6%
3 years	3.8%	1.9%	4.2%
5 years	5.2%	3.3%	5.7%
7 years	10.9%	7.9%	11.4%
10 years	12.5%	10.2%	13.0%
Since inception	16.2%	13.0%	11.0%

[#] Inception date B Class: 2 January 2007

RISK/RETURN PROFILE:



FUND MANAGERS:

Chris Wood, Johny Lambridis and Simon Kendall

ASISA CATEGORY:

South African - Equity - General

BENCHMARK:

ASISA South African - Equity - General Category Mean

INCEPTION DATE:

2 August 1999

FUND SIZE:

R2 904 308 561

AWARDS:

Raging Bull: 2006, 2007, 2008

Morningstar/Standard & Poor's: 2007, 2008

DISCLAIMER

Prudential Portfolio Managers Unit Trusts Ltd (Registration number: 1999/0524/06) is an approved CISCA management company (#29). Assets are managed by Prudential Investment Managers (South Africa) (Pty) Ltd, which is an approved discretionary Financial Services Provider (#45199). The Trustee's/Custodian details are: Standard Bank of South Africa Limited - Trustee Services & Investor Services. 20th Floor, Main Tower, Standard Bank Centre, Heerengracht, Cape Town. Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. Past performance is not necessarily a guide to future investment performance. Unit trust prices are calculated on a net asset value basis. This means the price is the total net market value of all assets of the unit trust fund divided by the total number of units of the fund. Any market movements – for example in share prices, bond prices, money market prices or currency fluctuations - relevant to the underlying assets of the fund may cause the value of the underlying assets to go up or down. As a result, the price of your units may go up or down. Unit trusts are traded at the ruling forward price of the day, meaning that transactions are processed during the day before you or the Manager know what the price at the end of the day will be. The price and therefore the number of units involved in the transaction are only known on the following day. The unit trust fund may borrow up to 10% of the fund value, and it may also lend any scrip (proof of ownership of an investment instrument) that it holds to earn additional income. A Prudential unit trust fund may consist of different fund classes that are subject to different fees and charges. Where applicable, the Manager will pay your financial adviser an agreed standard ongoing adviser fee, which is included in the overall costs of the fund. A Collective Investment Schemes (CIS) summary with all fees and maximum initial and ongoing adviser fees is available on our website. One can also obtain additional information on Prudential products on the Prudential website. The Fund charges a performance fee which is based on 20% of the Fund's outperformance of its benchmark, measured over a rolling 36-month basis. The performance fee will be capped at 1.25% for any rolling 12-month period. The Manager may, at its discretion, close your chosen unit trust fund to new investors and to additional investments by existing investors to make sure that it is managed in accordance with its mandate. It may also stop your existing debit order investment. The Manager makes no guarantees as to the capital invested in the fund or the returns of the fund. Excessive withdrawals from the fund may place the fund under liquidity pressure and, in certain circumstances; a process of ring fencing withdrawal instructions may be followed. The Fund may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks. The volatility of the fund may be higher and the liquidity of the underlying securities may be restricted due to relative market sizes and market conditions. The fund's ability to settle securities and to repatriate investment income, capital or the proceeds of sales of securities may be adversely affected for multiple reasons including market conditions, macro-economic and political circumstances. Further, the return on the security may be affected (positively or negatively) by the difference in tax regimes between the domestic and foreign tax jurisdictions. The availability of market information and information on any underlying sub-funds may be delayed. Fund prices are published daily on the Prudential website. These are also available upon request. The performance is calculated for the portfolio. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Purchase and repurchase requests must be received by the Manager by 13h30 SA time each business day. All online purchase and repurchase transactions must be received by the Manager by 10h30 (for all Funds) SA time each business day.

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL BOND FEEDER FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

GLOBAL INCOME

MARKET OVERVIEW

Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House. US equity markets experienced exceptional tumult in the closing weeks of the year, posting the largest-ever one-day gain, as well as the worst December losses since the Great Depression in 1931. In fact, 2018 ended as one of worst years ever for investors in terms of the breadth of poor returns: Deutsche Bank reported on 20 December that 93% of the global assets it follows recorded negative returns for the year on a US dollar-adjusted basis, the highest percentage since it started collecting data in 1901. Apart from cash, it was largely the traditional safe-haven assets like US Treasuries, German bunds and Japanese government bonds that managed to deliver positive performance over the year.

For South African investors, offshore diversification worked well against the backdrop of a sharply weaker rand: in rand terms for the year, global equity (the MSCI All Country World Index) returned 6.5%, global bonds (the Bloomberg Barclays Global Aggregate Bond Index) delivered a strong 15.5% and global property (the FTSE EPRA/NAREIT Index) produced 11.1% for 2018. The rand, meanwhile, was down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling in 2018.

During the quarter global uncertainty also worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve (Fed)'s policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018, a figure that could rise still further should US-Chinese trade negotiations fail in 2019. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn.

The Fed adopted a somewhat more dovish stance at its December FOMC meeting. Although it hiked the benchmark interest rate by 25bps as widely expected, it also eliminated one 25bp interest rate hike from its 2019 rate outlook and lowered its 2019 GDP growth forecast to 2.3% from 2.5% previously. Still, the market had been pricing in an even easier stance, sparking further equity weakness. Both the market and Fed are now forecasting only two 25bp rate hikes in 2019. Meanwhile, US Treasuries (USTs) rallied later in the quarter, for a 2018 return of 0.9% in US$. They were helped by a number of factors, including their safe-haven status, slowing growth and rate hike expectations, and the Democrats' win of the House in the November mid-term elections, which effectively ruled out further tax cuts through 2020 and also led investors to lower their rate hike expectations. The benchmark 10-year UST yield ended 2018 at around 2.7%, well off the year's 3.2% high seen in mid-November. In contrast, US investment-grade corporate bonds saw their yields rise and spreads versus their UST counterparts widen by approximately 50bps over the year to produce a return of -2.5% in US$ for 2018, while high-yield bonds returned -2.1%. This was largely as a result of the Fed's rate hikes, higher risk aversion and credit quality concerns. In Q4, the Bloomberg Barclays Global Aggregate Bond Index (US$) returned 1.2%, while for the year its return of -1.2% reflected weaker global corporate bonds and emerging market bonds, plus the stronger US dollar.

In the EU, Q3 GDP growth slowed to a disappointing 1.7% (q/q annualised) from 2.2% in Q2, attributed to weaker manufacturing activity and poorer business sentiment. The Italian government's dispute with the EU over its budget deficit forecast created more questions over its future within the grouping, denting financial markets and the euro. This was resolved in December with an agreement favouring the EU's lower deficit target, but worries remain over the populist-led government. Social unrest in France and sluggish German growth also added to the region's woes. The European Central Bank (ECB) in December ended its €2.6 trillion bond buying programme as previously announced, although it also pledged to keep interest rates at record lows at least through mid-2019.

The UK government descended into further turmoil during Q4 as opposition to the Brexit deal agreed by PM Theresa May with the EU came from all fronts, increasing the probability of "no deal", the very worst outcome for the UK economy. The BOE left its interest rate unchanged at its November meeting, but cited rising risks to future growth from Brexit despite solid GDP growth of 1.5% (q/q annualised) in Q3 2018.

The Japanese economy contracted by 1.2% (q/q annualised) in Q3 2018 compared to its 3.0% expansion in Q2, due to a slowdown in exports, an increase in imports and declines in private spending and public fixed investment. The Bank of Japan said the downside risks to growth were rising due to tariff threats from the US (particularly on its auto exports) and a slowdown in the global economy, and kept interest rates on hold at its December meeting as expected, while also continuing to buy securities. Japanese growth is expected to slow later in 2019 due to the anticipated negative impact of a new consumption tax on spending and consumer prices.

In China, GDP growth slowed to 6.5% (q/q annualised) in Q3 from 6.7% the previous quarter and below the 6.6% expected, due partly to the impact of financial deleveraging and subdued consumer spending, as well as anxiety over the impact of Trump's trade war on economic growth – China has the most to lose of any other country. December manufacturing PMI dropped to 49.4 from 50 in November, the first contraction since 2016.

PERFORMANCE

The fund returned 1.6% (in rand terms, net of fees) in Q4 2018, compared to 3.0% from its benchmark. The fund returned 11.1% for the 12 months to 31 December 2018 versus its benchmark, the Bloomberg Barclays Global Aggregate Bond Index, of 15.5%. It was previously called the Prudential Global High Yield Bond Fund of Funds

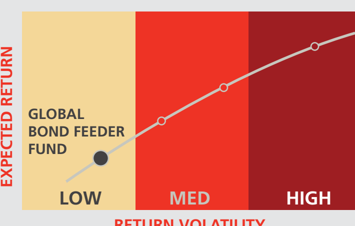
Global government bonds (treasuries) outperformed credit and corporate bonds during the quarter, due in part to higher risk aversion and concerns over corporate creditworthiness. Therefore the fund's preference for corporate credit detracted from its performance for the quarter, as did its long US dollar positioning and its underweight to Japanese yen assets. This was in part offset by exposure to emerging market government bonds in Turkey, Brazil and South Africa, further boosted by Turkish lira and Brazilian real strength.

STRATEGY AND POSITIONING

The fund remains highly active within the global bond asset class, seeking positive bets on emerging market government bonds because of the diversification qualities they can bring to a portfolio, and because of the better real yields they can offer compared to mainstream bonds. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK
1 year	11.1%	15.5%
3 years	-0.6%	0.2%
5 years	6.0%	7.6%
7 years	10.0%	9.7%
10 years	7.9%	6.8%
Since inception	8.4%	8.6%

RISK/RETURN PROFILE:



INVESTMENT MANAGER:
M&G Investment Management Limited (UK)

FUND MANAGERS OF THE UNDERLYING FUND:
Marc Beckenstrater and Craig Simpson

ASISA CATEGORY:
Global - Interest Beating - Variable Term

BENCHMARK:
Bloomberg Barclays Global Aggregate Bond Index

INCEPTION DATE:
27 October 2000

FUND SIZE:
R425 567 746

DISCLAIMER

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL INFLATION PLUS FEEDER FUND
31 DECEMBER 2018

MARKET OVERVIEW

Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House. US equity markets experienced exceptional tumult in the closing weeks of the year, posting the largest-ever one-day gain, as well as the worst December losses since the Great Depression in 1931. In fact, 2018 ended as one of worst years ever for investors in terms of the breadth of poor returns: Deutsche Bank reported on 20 December that 93% of the global assets it follows recorded negative returns for the year on a US dollar-adjusted basis, the highest percentage since it started collecting data in 1901. Apart from cash, it was largely the traditional safe-haven assets like US Treasuries, German bunds and Japanese government bonds that managed to deliver positive performance over the year.

For South African investors, offshore diversification worked well against the backdrop of a sharply weaker rand: in rand terms for the year, global equity (the MSCI All Country World Index) returned 6.5%, global bonds (the Bloomberg Barclays Global Aggregate Bond Index) delivered a strong 15.5% and global property (the FTSE EPRA/NAREIT Index) produced 11.1% for 2018. The rand, meanwhile, was down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling in 2018.

During the quarter global uncertainty also worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve (Fed)'s policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018, a figure that could rise still further should US-Chinese trade negotiations fail in 2019. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn. For the quarter, US equities were punished: the S&P 500 returned -13.5% for a 2018 return of –4.4%, the Dow Jones Industrial 30 Index delivered -11.3% and -3.5% in 2018, and the Nasdaq produced -16.8% for Q4 and was flat for the year (all in US$).

The Fed adopted a somewhat more dovish stance at its December FOMC meeting. Although it hiked the benchmark interest rate by 25bps as widely expected, it also eliminated one 25bp interest rate hike from its 2019 rate outlook and lowered its 2019 GDP growth forecast to 2.3% from 2.5% previously. Still, the market had been pricing in an even easier stance, sparking further equity weakness. Both the market and Fed are now forecasting only two 25bp rate hikes in 2019. Meanwhile, US Treasuries (USTs) rallied later in the quarter, for a 2018 return of 0.9% in US$. They were helped by a number of factors, including their safe-haven status, slowing growth and rate hike expectations, and the Democrats' win of the House in the November mid-term elections, which effectively ruled out further tax cuts through 2020 and also led investors to lower their rate hike expectations. The benchmark 10-year UST yield ended 2018 at around 2.7%, well off the year's 3.2% high seen in mid-November. In contrast, US investment-grade corporate bonds saw their yields rise and spreads versus their UST counterparts widen by approximately 50bps over the year to produce a return of -2.5% in US$ for 2018, while high-yield bonds returned -2.1%. This was largely as a result of the Fed's rate hikes, higher risk aversion and credit quality concerns. In Q4, the Bloomberg Barclays Global Aggregate Bond Index (US$) returned 1.2%, while for the year its return of -1.2% reflected weaker global corporate bonds and emerging market bonds, plus the stronger US dollar.

In the EU, Q3 GDP growth slowed to a disappointing 1.7% (q/q annualised) from 2.2% in Q2, attributed to weaker manufacturing activity and poorer business sentiment. The Italian government's dispute with the EU over its budget deficit forecast created more questions over its future within the grouping, denting financial markets and the euro. This was resolved in December with an agreement favouring the EU's lower deficit target, but worries remain over the populist-led government. Social unrest in France and sluggish German growth also added to the region's woes. The European Central Bank (ECB) in December ended its €2.6 trillion bond buying programme as previously announced, although it also pledged to keep interest rates at record lows at least through mid-2019. The Dow Jones Eurostoxx 50 returned -12.9% (in US$) for the quarter and -16.2% for the year, its worst performance since the 2008 Global Financial Crisis.

The UK government descended into further turmoil during Q4 as opposition to the Brexit deal agreed by PM Theresa May with the EU came from all fronts, increasing the probability of "no deal", the very worst outcome for the UK economy. The BOE left its interest rate unchanged at its November meeting, but cited rising risks to future growth from Brexit despite solid GDP growth of 1.5% (q/q annualised) in Q3 2018. The UK's FTSE 100 Index returned -11.7% (in US$) for the quarter and -14.0% for the year.

The Japanese economy contracted by 1.2% (q/q annualised) in Q3 2018 compared to its 3.0% expansion in Q2, due to a slowdown in exports, an increase in imports and declines in private spending and public fixed investment. The Bank of Japan said the downside risks to growth were rising due to tariff threats from the US (particularly on its auto exports) and a slowdown in the global economy, and kept interest rates on hold at its December meeting as expected, while also continuing to buy securities. Japanese growth is expected to slow later in 2019 due to the anticipated negative impact of a new consumption tax on spending and consumer prices. The Nikkei 225 Index returned -14.4% (in US$) in Q4 and -8.5% for the year.

In China, GDP growth slowed to 6.5% (q/q annualised) in Q3 from 6.7% the previous quarter and below the 6.6% expected, due partly to the impact of financial deleveraging and subdued consumer spending, as well as anxiety over the impact of Trump's trade war on economic growth – China has the most to lose of any other country. December manufacturing PMI dropped to 49.4 from 50 in November, the first contraction since 2016. The Shanghai Composite Index reflected these worries, ending the year with a loss of 25%. The decline hit all 10 sectors of the market and trading volumes fell to levels last seen in 2014.

For 2018 as a whole, developed equities in US$ posted a -8.7% total return, the worst year for developed equity markets since the 2008 Global Financial Crisis. Still this was better than the -14.6% in US$ return recorded by emerging markets. Among the 2018 returns in large emerging markets (in US$), the MSCI Turkey was the biggest loser with a total return of -41.1%, the MSCI South Africa returned -24.3%, South Korea's KOSPI produced -22.0%, the MSCI China recorded – 18.7% and the MSCI India delivered -7.3%, while Brazil's Bovespa returned -1.8%. The MSCI Russia was one of the only markets in the black with a small 0.2% return.

PERFORMANCE

The fund returned -4.3% (in rand terms, net of fees) in Q4 2018, compared to -1.2% from its benchmark. For the 12 months to 31 December 2018, the fund returned 6.7% versus its benchmark of 11.5%. The fund was previously called the Prudential Global Cautious Managed Fund of Funds.

The fund's tactical asset class exposure - overweight equities and underweight fixed income - detracted from performance for the quarter as equity markets struggled. The fund's overweight to Japanese equities, which recorded particularly poor results, and short Japanese yen exposure in fixed income detracted from performance.

STRATEGY AND POSITIONING

The fund remains overweight global equities and underweight fixed income, as in the previous quarter, due to the much more attractive valuations on offer. Within equities, the fund is underweight the relatively more expensive US market in favour of select markets which offer better value such as Germany, as well as certain emerging markets.

In terms of trades in the period, within fixed income we added Turkish lira exposure and sold some Brazil government bond exposure, while adding South Africa government bonds on attractive spreads. Finally, we switched from long-dated South African government bonds into long-dated Mexican government bonds, and increased exposure to Mexican peso duration risk in the process. We remain highly active within the global bond asset class, seeking positive bets on emerging market government bonds because of the diversification qualities they can bring to a portfolio, and because of the better real yields they can offer compared to mainstream bonds.

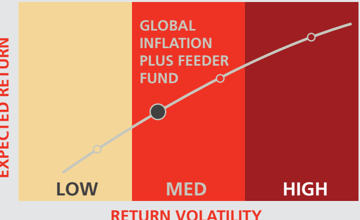
While the global economy has slowed, and company profits and Purchasing Managers' Indexes are generally down, the decline in equities in 2018 is far greater than justified by the fundamentals. Like 2016, this sentiment has pushed equity risk premia in Europe and Japan to elevated levels on heightened risk and volatility aversion, leading to some attractive valuations in many equity markets outside of the US. In this regard, we continue to back this valuation signal. Looking ahead, there is still only a small chance of a global recession in 2019, despite the doomsayers that continue to ignore pockets of positive news and data coming from the likes of the US, China and even in Europe. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	6.7%	11.5%	7.0%
3 years	-0.5%	-0.4%	-0.2%
5 years	6.3%	6.9%	6.6%
7 years	9.8%	9.8%	n/a
10 years	6.1%	5.3%	n/a
Since inception	7.2%	7.0%	8.1%

Inception date B Class: 1 July 2013

*The Fund's benchmark changed from the ASISA Global - Multi Asset - Low Equity Category Mean to Global Inflation on 1 November 2018.

RISK/RETURN PROFILE:



INVESTMENT MANAGER:

M&G Investment Management Limited (UK)

FUND MANAGERS OF THE UNDERLYING FUND:

Marc Beckenstrater and Craig Simpson

ASISA CATEGORY:

Global - Multi-Asset - Low Equity

BENCHMARK:

Global inflation

INCEPTION DATE:

1 March 2004

FUND SIZE:

R104 747 225

DISCLAIMER

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL BALANCED FEEDER FUND
31 DECEMBER 2018

QUARTERLY COMMENTARY

GLOBAL MULTI-ASSET

MARKET OVERVIEW

Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House. US equity markets experienced exceptional tumult in the closing weeks of the year, posting the largest-ever one-day gain, as well as the worst December losses since the Great Depression in 1931. In fact, 2018 ended as one of worst years ever for investors in terms of the breadth of poor returns: Deutsche Bank reported on 20 December that 93% of the global assets it follows recorded negative returns for the year on a US dollar-adjusted basis, the highest percentage since it started collecting data in 1901. Apart from cash, it was largely the traditional safe-haven assets like US Treasuries, German bunds and Japanese government bonds that managed to deliver positive performance over the year.

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During the quarter global uncertainty also worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve (Fed)'s policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018, a figure that could rise still further should US-Chinese trade negotiations fail in 2019. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn. For the quarter, US equities were punished: the S&P 500 returned -13.5% for a 2018 return of –4.4%, the Dow Jones Industrial 30 Index delivered -11.3% and -3.5% in 2018, and the Nasdaq produced -16.8% for Q4 and was flat for the year (all in US$).

The Fed adopted a somewhat more dovish stance at its December FOMC meeting. Although it hiked the benchmark interest rate by 25bps as widely expected, it also eliminated one 25bp interest rate hike from its 2019 rate outlook and lowered its 2019 GDP growth forecast to 2.3% from 2.5% previously. Still, the market had been pricing in an even easier stance, sparking further equity weakness. Both the market and Fed are now forecasting only two 25bp rate hikes in 2019. Meanwhile, US Treasuries (USTs) rallied later in the quarter, for a 2018 return of 0.9% in US$. They were helped by a number of factors, including their safe-haven status, slowing growth and rate hike expectations, and the Democrats' win of the House in the November mid-term elections, which effectively ruled out further tax cuts through 2020 and also led investors to lower their rate hike expectations. The benchmark 10-year UST yield ended 2018 at around 2.7%, well off the year's 3.2% high seen in mid-November. In contrast, US investment-grade corporate bonds saw their yields rise and spreads versus their UST counterparts widen by approximately 50bps over the year to produce a return of -2.5% in US$ for 2018, while high-yield bonds returned -2.1%. This was largely as a result of the Fed's rate hikes, higher risk aversion and credit quality concerns. In Q4, the Bloomberg Barclays Global Aggregate Bond Index (US$) returned 1.2%, while for the year its return of -1.2% reflected weaker global corporate bonds and emerging market bonds, plus the stronger US dollar.

In the EU, Q3 GDP growth slowed to a disappointing 1.7% (q/q annualised) from 2.2% in Q2, attributed to weaker manufacturing activity and poorer business sentiment. The Italian government's dispute with the EU over its budget deficit forecast created more questions over its future within the grouping, denting financial markets and the euro. This was resolved in December with an agreement favouring the EU's lower deficit target, but worries remain over the populist-led government. Social unrest in France and sluggish German growth also added to the region's woes. The European Central Bank (ECB) in December ended its €2.6 trillion bond buying programme as previously announced, although it also pledged to keep interest rates at record lows at least through mid-2019. The Dow Jones Eurostoxx 50 returned -12.9% (in US$) for the quarter and -16.2% for the year, its worst performance since the 2008 Global Financial Crisis.

The UK government descended into further turmoil during Q4 as opposition to the Brexit deal agreed by PM Theresa May with the EU came from all fronts, increasing the probability of "no deal", the very worst outcome for the UK economy. The BOE left its interest rate unchanged at its November meeting, but cited rising risks to future growth from Brexit despite solid GDP growth of 1.5% (q/q annualised) in Q3 2018. The UK's FTSE 100 Index returned -11.7% (in US$) for the quarter and -14.0% for the year.

The Japanese economy contracted by 1.2% (q/q annualised) in Q3 2018 compared to its 3.0% expansion in Q2, due to a slowdown in exports, an increase in imports and declines in private spending and public fixed investment. The Bank of Japan said the downside risks to growth were rising due to tariff threats from the US (particularly on its auto exports) and a slowdown in the global economy, and kept interest rates on hold at its December meeting as expected, while also continuing to buy securities. Japanese growth is expected to slow later in 2019 due to the anticipated negative impact of a new consumption tax on spending and consumer prices. The Nikkei 225 Index returned -14.4% (in US$) in Q4 and -8.5% for the year.

In China, GDP growth slowed to 6.5% (q/q annualised) in Q3 from 6.7% the previous quarter and below the 6.6% expected, due partly to the impact of financial deleveraging and subdued consumer spending, as well as anxiety over the impact of Trump's trade war on economic growth – China has the most to lose of any other country. December manufacturing PMI dropped to 49.4 from 50 in November, the first contraction since 2016. The Shanghai Composite Index reflected these worries, ending the year with a loss of 25%. The decline hit all 10 sectors of the market and trading volumes fell to levels last seen in 2014.

For 2018 as a whole, developed equities in US$ posted a -8.7% total return, the worst year for developed equity markets since the 2008 Global Financial Crisis. Still this was better than the -14.6% in US$ return recorded by emerging markets. Among the 2018 returns in large emerging markets (in US$), the MSCI Turkey was the biggest loser with a total return of -41.1%, the MSCI South Africa returned -24.3%, South Korea's KOSPI produced -22.0%, the MSCI China recorded – 18.7% and the MSCI India delivered -7.3%, while Brazil's Bovespa returned -1.8%. The MSCI Russia was one of the only markets in the black with a small 0.2% return.

The price of Brent crude oil plunged by 36% during the fourth quarter, from a four-year high of over US$82 per barrel in October to around $52 at year end, representing an annual decline of nearly 20%. This was attributable to somewhat weaker demand from slowing global growth, but more so to oversupply as production continued at record levels, as well as a general lack of confidence in oil producers' December agreement to further curtail production in the new year. Looking at other commodities, gold gained ground on rising investor risk aversion, up 7.7% for the quarter but down 1.6% for the year. Industrial metals prices were broadly lower on decelerating demand in Q4, for a decline of between 16-25% in 2019.

PERFORMANCE

The fund returned -9.9% (in rand, net of fees) in Q4 2018, compared to -6.7% from its benchmark. This new unit trust does not yet have a one-year track record.

Risk assets struggled during the fourth quarter. The fund's overweight position in equities weighed on performance, as equity markets delivered poor results. Having lower bond exposure in the fund compared to the benchmark also cost performance. The fund's positions in US dollar corporate bonds and an underweight towards Japanese yen further detracted from performance.

STRATEGY AND POSITIONING

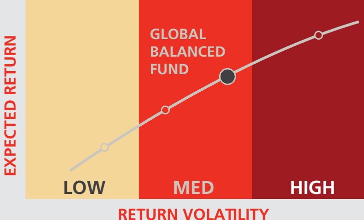
The fund remains positioned overweight global equities and underweight global bonds, as we believe the size of the equity risk premium available remains the most obvious opportunity on offer across the global investment landscape today. Within bonds, the fund is also underweight developed government bonds compared to the benchmark, preferring to hold investment-grade US and European corporate bonds.

In terms of trades in the period, we added Turkish lira exposure. We also sold some Brazil government bond exposure and added South Africa government bonds on attractive spreads. Finally, we switched from long-dated South African government bonds into long-dated Mexican government bonds, and increased exposure to Mexican peso duration risk in the process.

While the global economy has slowed, and company profits and Purchasing Managers' Indexes are generally down, the decline in equities in 2018 is far greater than justified by the fundamentals. Like 2016, this sentiment has pushed equity risk premia in Europe and Japan to elevated levels on heightened risk and volatility aversion, leading to some attractive valuations in many equity markets outside of the US. In this regard, we continue to back this valuation signal. Looking ahead, there is still only a small chance of a global recession in 2019, despite the doomsayers that continue to ignore pockets of positive news and data coming from the likes of the US, China and even Europe. ■

PERFORMANCE	A CLASS	BENCHMARK	B CLASS
Since inception of class	-4.8%	-1.3%	-4.8%

RISK/RETURN PROFILE:



INVESTMENT MANAGER:

M&G Investment Management Limited (UK)

FUND MANAGERS OF THE UNDERLYING FUND:

Marc Beckenstrater and Craig Simpson

ASISA CATEGORY:

Global - Multi Asset - High Equity

BENCHMARK:

65% MSCI All Country World Index TR (Net), 5% FTSE EPRA/NAREIT Global REIT Index, 25% Bloomberg Barclays Global Aggregate Bond Index, 5% USD 1m LIBOR

INCEPTION DATE:

19 June 2017

DISCLAIMER

Prudential Portfolio Managers Unit Trusts Ltd (Registration number: 1999/0524/06) is an approved CISCA management company (#29). Assets are managed by Prudential Investment Managers (South Africa) (Pty) Ltd, which is an approved discretionary Financial Services Provider (#45199).

The Trustee's/Custodian details are: Standard Bank of South Africa Limited - Trustee Services & Investor Services. 20th Floor, Main Tower, Standard Bank Centre, Heerengracht, Cape Town. Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. Past performance is not necessarily a guide to future investment performance. Unit trust prices are calculated on a net asset value basis. This means the price is the total net market value of all assets of the unit trust fund divided by the total number of units of the fund. Any market movements – for example in share prices, bond prices, money market prices or currency fluctuations - relevant to the underlying assets of the fund may cause the value of the underlying assets to go up or down. As a result, the price of your units may go up or down. Unit trusts are traded at the ruling forward price of the day, meaning that transactions are processed during the day, before you or the Manager know what the price at the end of the day will be. The price and therefore the number of units involved in the transaction are only known on the following day. The unit trust fund may borrow up to 10% of the fund value, and it may also lend any scrip (proof of ownership of an investment instrument) that it holds to earn additional income. A Prudential unit trust fund may consist of different fund classes that are subject to different fees and charges. Where applicable, the Manager will pay your financial adviser an agreed standard ongoing adviser fee, which is included in the overall costs of the fund. A Collective Investment Schemes (CIS) summary with all fees and maximum initial and ongoing adviser fees is available on our website. One can also obtain additional information on Prudential products on the Prudential website. The Manager may, at its discretion, close your chosen unit trust fund to new investors and to additional investments by existing investors to make sure that it is managed in accordance with its mandate. It may also stop your existing debit order investment. The Manager makes no guarantees as to the capital invested in the fund or the returns of the fund. Excessive withdrawals from the fund may place the fund under liquidity pressure and, in certain circumstances; a process of ring fencing withdrawal instructions may be followed. The Fund may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks. The volatility of the fund may be higher and the liquidity of the underlying securities may be restricted due to relative market sizes and market conditions. The fund's ability to settle securities and to repatriate investment income, capital or the proceeds of sales of securities may be adversely affected for multiple reasons including market conditions, macro-economic and political circumstances. Further, the return on the security may be affected (positively or negatively) by the difference in tax regimes between the domestic and foreign tax jurisdictions. The availability of market information and information on any underlying sub-funds may be delayed. Fund prices are published daily on the Prudential website. These are also available upon request. The performance is calculated for the portfolio. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Purchase and repurchase requests must be received by the Manager by 13h30 (11h30 for the Money Market Fund) SA time each business day. All online purchase and repurchase transactions must be received by the Manager by 10h30 (for all Funds) SA time each business day.

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL EQUITY FEEDER FUND
31 DECEMBER 2018

MARKET OVERVIEW

Global equities suffered a rout in the fourth quarter of 2018, as investors took fright over mounting evidence of slowing global growth (as the US joined other countries in reporting disappointing economic data), and some even predicted an imminent recession. Other factors included anticipation of more detrimental impacts from rising US interest rates, a possible escalation in the US-China trade war, Brexit-inspired turmoil, and increasing instability in the White House. US equity markets experienced exceptional tumult in the closing weeks of the year, posting the largest-ever one-day gain, as well as the worst December losses since the Great Depression in 1931. In fact, 2018 ended as one of worst years ever for investors in terms of the breadth of poor returns: Deutsche Bank reported on 20 December that 93% of the global assets it follows recorded negative returns for the year on a US dollar-adjusted basis, the highest percentage since it started collecting data in 1901. Apart from cash, it was largely the traditional safe-haven assets like US Treasuries, German bunds and Japanese government bonds that managed to deliver positive performance over the year.

For South African investors, offshore diversification worked well against the backdrop of a sharply weaker rand: in rand terms for the year, global equity (the MSCI All Country World Index) returned 6.5%, global bonds (the Bloomberg Barclays Global Aggregate Bond Index) delivered a strong 15.5% and global property (the FTSE EPRA/NAREIT Index) produced 11.1% for 2018. The rand, meanwhile, was down 16.9% against the US dollar, 11.4% against the euro and 10.6% versus the pound sterling in 2018.

During the quarter global uncertainty also worsened in the face of President Trump's more aggressive criticism of the US Federal Reserve (Fed)'s policy and its Chairman, and the growing impact of the US administration's imposition of steep tariffs on some 12% of US imports in 2018, a figure that could rise still further should US-Chinese trade negotiations fail in 2019. Added to this was confirmation of a further deceleration in China's growth rate, making it less able to help pull the global economy out of a downturn. For the quarter, US equities were punished: the S&P 500 returned -13.5% for a 2018 return of –4.4%, the Dow Jones Industrial 30 Index delivered -11.3% and -3.5% in 2018, and the Nasdaq produced -16.8% for Q4 and was flat for the year (all in US$).

The Fed adopted a somewhat more dovish stance at its December FOMC meeting. Although it hiked the benchmark interest rate by 25bps as widely expected, it also eliminated one 25bp interest rate hike from its 2019 rate outlook and lowered its 2019 GDP growth forecast to 2.3% from 2.5% previously. Still, the market had been pricing in an even easier stance, sparking further equity weakness. Both the market and Fed are now forecasting only two 25bp rate hikes in 2019.

In the EU, Q3 GDP growth slowed to a disappointing 1.7% (q/q annualised) from 2.2% in Q2, attributed to weaker manufacturing activity and poorer business sentiment. The Italian government's dispute with the EU over its budget deficit forecast created more questions over its future within the grouping, denting financial markets and the euro. This was resolved in December with an agreement favouring the EU's lower deficit target, but worries remain over the populist-led government. Social unrest in France and sluggish German growth also added to the region's woes. The Dow Jones Eurostoxx 50 returned -12.9% (in US$) for the quarter and -16.2% for the year, its worst performance since the 2008 Global Financial Crisis.

The UK government descended into further turmoil during Q4 as opposition to the Brexit deal agreed by PM Theresa May with the EU came from all fronts, increasing the probability of "no deal", the very worst outcome for the UK economy. The BOE left its interest rate unchanged at its November meeting, but cited rising risks to future growth from Brexit despite solid GDP growth of 1.5% (q/q annualised) in Q3 2018. The UK's FTSE 100 Index returned -11.7% (in US$) for the quarter and -14.0% for the year.

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For 2018 as a whole, developed equities in US$ posted a -8.7% total return, the worst year for developed equity markets since the 2008 Global Financial Crisis. Still this was better than the -14.6% in US$ return recorded by emerging markets. Among the 2018 returns in large emerging markets (in US$), the MSCI Turkey was the biggest loser with a total return of -41.1%, the MSCI South Africa returned -24.3%, South Korea's KOSPI produced -22.0%, the MSCI China recorded – 18.7% and the MSCI India delivered -7.3%, while Brazil's Bovespa returned -1.8%. The MSCI Russia was one of the only markets in the black with a small 0.2% return.

PERFORMANCE

The fund returned -12.0% (in rand, net of fees) in Q4 2018, compared to -11.2% from its benchmark. For the 12 months ended 31 December 2018, the fund returned 1.0% (in rand, net of fees) compared to the benchmark's 5.9% return. The fund was previously called the Prudential Global Value Fund of Funds.

The fund lagged its benchmark for the quarter in part due to its overweight to Japan, which had a particularly poor quarter, as well as a negative contribution from stock selection within the country. The fund's overweight exposure to financial stocks in Europe further detracted from performance. An underweight to the expensive IT sector in the US, as well as the fund's overweight to Indonesia, Turkey and Brazil, further boosted by currency strength in these countries, all added to performance.

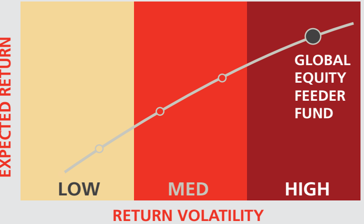
STRATEGY AND POSITIONING

The portfolio's positioning reflects a preference for South Korean assets, emerging markets assets overall, and financials relative to the benchmark. We remain more cautious on information technology (especially US tech), healthcare, consumer staples and US dollar assets more generally compared to the benchmark.

While the global economy has slowed, and company profits and Purchasing Managers' Indexes are generally down, the decline in equities in 2018 is far greater than justified by the fundamentals. Like 2016, this sentiment has pushed equity risk premia in Europe and Japan to elevated levels on heightened risk and volatility aversion, leading to some attractive valuations in many equity markets outside of the US. In this regard, we continue to back this valuation signal. Looking ahead, there is still only a small chance of a global recession in 2019, despite the doomsayers that continue to ignore pockets of positive news and data coming from the likes of the US, China and even Europe. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK
1 year	1.0%	5.9%
3 years	2.3%	4.1%
5 years	8.9%	11.0%
7 years	15.8%	17.7%
10 years	12.3%	14.1%
Since inception	6.5%	7.9%

RISK/RETURN PROFILE:



INVESTMENT MANAGER:
M&G Investment Management Limited (UK)

FUND MANAGERS OF THE UNDERLYING FUND:
Marc Beckenstrater and Craig Simpson

ASISA CATEGORY:
Global - Equity - General

BENCHMARK:
MSCI All Country World Index TR Net

INCEPTION DATE:
9 June 2017

FUND SIZE:
R269 031 567

DISCLAIMER

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