PRUDENTIAL UNIT TRUSTS QUARTERLY COMMENTARY
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

COMBINED QUARTERLY COMMENTARY

INCOME | MULTI-ASSET | PROPERTY/ EQUITY | GLOBAL

Please **DOWNLOAD** this PDF pack to make use of the new interactive functionality

Click on the **"View commentary"** button to view the fact sheet of a specific fund.
Click the **"Home"** button to come back to this page.

INCOME FUNDS	
Money Market Fund	View commentary
High Interest Fund	View commentary
High Yield Bond Fund	View commentary
MULTI-ASSET FUNDS	
Enhanced Income Fund	View commentary
Inflation Plus Fund	View commentary
Balanced Fund	View commentary
PROPERTY/EQUITY FUNDS	
Enhanced SA Property Tracker Fund	View commentary
Dividend Maximiser Fund	View commentary
Equity Fund	View commentary
GLOBAL FUND OF FUNDS	
Global High Yield Bond Fund of Funds	View commentary
Global Cautious Managed Fund of Funds	View commentary
Global Value Fund of Funds	View commentary

HOW TO INVEST

0860 105 775

prudential.co.za

myprudential.co.za

query@myprudential.co.za

Application forms

Invest now

PRUDENTIAL MONEY MARKET FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

In South Africa it was tough quarter for investors, as the rand, bonds and equities all came under selling pressure amid the risk-averse global sentiment, as well as from largely unfavourable domestic data. The land reform debate also added to uncertainty. Resources shares were a notable exception, helped by the stronger US dollar.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases (notably VAT and the fuel levy) and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

Taking note of the building inflationary pressures, but the headwinds facing the local economy as well, the SA Reserve Bank (SARB) kept interest rates on hold at its May Monetary Policy Committee meeting, as expected. Its statement sounded more hawkish than previous meetings, however. The SARB expects the rand to remain volatile amid outflows from emerging markets generally as US interest rates continue to rise, representing a significant upward risk to SA inflation in the months ahead. Taking the SARB's cue, the market no longer expects the central bank to lower interest rates this year.

Among positive developments for the quarter, the Ramaphosa government made progress on reforms - Public Enterprises Minister Pravin Gordhan took several steps forward in cleaning up state-owned enterprises, appointing new boards and new management at several of the troubled entities. The minimum wage came into effect, and secret ballots for strikes were also introduced among the unions. In a vote of confidence, all three global ratings agencies maintained their credit ratings for South Africa despite the weaker growth, although cautioned that much reform still needed to take place.

PERFORMANCE

For the 12 months ended 30 June 2018 the fund delivered 7.5%, outperforming its benchmark as measured by the STeFI Call Deposit Index by 0.8%. For the second quarter of 2018, the fund returned 1.8%, outperforming its benchmark by 0.2%.

The average duration of the fund at quarter-end was 56 days relative to the 90-day maximum average duration.

STRATEGY AND POSITIONING

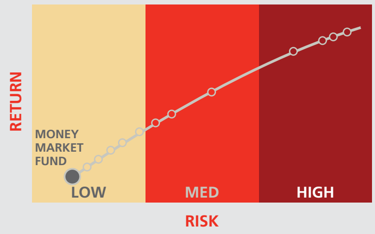
South Africa's Producer Price Inflation (PPI) accelerated to 4.6% y/y in May, above market expectations which were in line with April's figures of 4.4% y/y. The acceleration is mainly on the back of higher prices of coal and petroleum products. Month-on-month PPI rose 0.7% compared to a 1% increase recorded during the previous month.

Private Sector Credit Extension added 4.6% y/y in May from a growth of 5.1% y/y posted in April – coming in lower than market expectations of 4.9% y/y. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	X CLASS
1 year	7.5%	6.7%	7.7%
3 years	7.3%	6.7%	7.4%
5 years	6.6%	6.1%	6.7%
7 years	6.2%	5.8%	6.3%
10 years	6.8%	6.5%	n/a
Since inception	7.8%	7.6%	6.3%

[#] Inception date X Class: 1 April 2011

RISK/RETURN PROFILE:



FUND MANAGERS:
Roshen Harry and Sandile Malinga

ASISA CATEGORY:
South African - Interest Bearing - Money Market

BENCHMARK:
STeFI Call Deposit Index

INCEPTION DATE:
9 April 2002

FUND SIZE:
R1 548 077 793

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL HIGH INTEREST FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

In South Africa it was tough quarter for investors, as the rand, bonds and equities all came under selling pressure amid the risk-averse global sentiment, as well as from largely unfavourable domestic data. The land reform debate also added to uncertainty. Resources shares were a notable exception, helped by the stronger US dollar.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases (notably VAT and the fuel levy) and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

Taking note of the building inflationary pressures, but the headwinds facing the local economy as well, the SA Reserve Bank (SARB) kept interest rates on hold at its May Monetary Policy Committee meeting, as expected. Its statement sounded more hawkish than previous meetings, however. The SARB expects the rand to remain volatile amid outflows from emerging markets generally as US interest rates continue to rise, representing a significant upward risk to SA inflation in the months ahead. Taking the SARB's cue, the market no longer expects the central bank to lower interest rates this year.

Among positive developments for the quarter, the Ramaphosa government made progress on reforms - Public Enterprises Minister Pravin Gordhan took several steps forward in cleaning up state-owned enterprises, appointing new boards and new management at several of the troubled entities. The minimum wage came into effect, and secret ballots for strikes were also introduced among the unions. In a vote of confidence, all three global ratings agencies maintained their credit ratings for South Africa despite the weaker growth, although cautioned that much reform still needed to take place.

PERFORMANCE

For the 12 months ended 30 June 2018 the fund delivered 7.9%, outperforming its benchmark as measured by the STeFI Composite Index by 0.6%. For the second quarter of 2018, the fund returned 1.9%, outperforming its benchmark by 0.1%.

The fund was launched in December 2010 with the aim of delivering returns in excess of money market yields without compromising capital stability. Although capital protection is not guaranteed, we emphasize the low-risk nature of the portfolio and hence the remote prospect for capital loss over periods exceeding a few days.

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

Relative to the 180-day maximum average duration, the quarter-end duration of the fund came in at 38 days.

STRATEGY AND POSITIONING

The fund has generally sought to take advantage of banks' requirements to secure longer-dated funding which better matches the profile of their loan books. This has led to a steep credit curve, whereby they are prepared to pay significantly more for funding beyond the 12-month point. We prefer these longer-dated securities and have exposure to securities issued by banks such as ABSA, Standard Bank, FirstRand, Nedbank and Investec both in floating and fixed-rate securities.

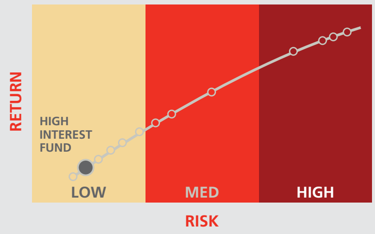
While credit issuance has been scarce since 2016, mixed with a tightening of credit spreads, 2018 so far has seen a number of banks and corporates coming to market, after some hesitance following the downgrade of the sovereign credit rating last year. Issuances were generally well supported and largely cleared around the lower-end of guidance.

We continue to look for opportunities that will enhance the return to investors without compromising the stability of their capital. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	X CLASS	D CLASS
1 year	7.9%	7.3%	8.0%	8.1%
3 years	7.9%	7.3%	8.0%	8.1%
5 years	7.0%	6.7%	7.1%	7.4%
7 years	6.6%	6.3%	6.8%	7.0%
Since inception	6.6%	6.3%	6.7%	6.9%

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:
R9 652 603 175

PLEASE NOTE:
This fund is capped to new investors

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL HIGH YIELD BOND FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

In South Africa it was tough quarter for investors, as the rand, bonds and equities all came under selling pressure amid the risk-averse global sentiment, as well as from largely unfavourable domestic data. The land reform debate also added to uncertainty. Resources shares were a notable exception, helped by the stronger US dollar.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases (notably VAT and the fuel levy) and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

Taking note of the building inflationary pressures, but the headwinds facing the local economy as well, the SA Reserve Bank (SARB) kept interest rates on hold at its May Monetary Policy Committee meeting, as expected. Its statement sounded more hawkish than previous meetings, however. The SARB expects the rand to remain volatile amid outflows from emerging markets generally as US interest rates continue to rise, representing a significant upward risk to SA inflation in the months ahead. Taking the SARB's cue, the market no longer expects the central bank to lower interest rates this year.

Among positive developments for the quarter, the Ramaphosa government made progress on reforms - Public Enterprises Minister Pravin Gordhan took several steps forward in cleaning up state-owned enterprises, appointing new boards and new management at several of the troubled entities. The minimum wage came into effect, and secret ballots for strikes were also introduced among the unions. In a vote of confidence, all three global ratings agencies maintained their credit ratings for South Africa despite the weaker growth, although cautioned that much reform still needed to take place.

Despite these positives, local bonds experienced more than R60 billion in net outflows during May and June, overwhelming the R25 billion in inflows in Q1. The BEASSA All Bond Index returned -3.8% for the quarter, while the yield on the benchmark 10-year SA government bond rose to just under 9.0% at quarter-end, from 8.0% at the start of April, a significant 100bp move on the back of the broader risk-averse sentiment. Cash as measured by the STeFI Composite Index returned 1.8%.

PERFORMANCE

For the 12 months ended 30 June 2018 the fund delivered 9.7%, underperforming its benchmark as measured by the BEASSA All Bond Index by 0.5%. For the second quarter of 2018, the fund returned -3.9%, marginally underperforming its benchmark by 0.1%.

We began the quarter with a neutral duration position and added duration (by purchasing longer-dated instruments) periodically over the quarter as bonds moved weaker, to end the quarter with a long duration. The primary bond market issuance over the quarter, excluding government issuances, was R22bn. This was substantially lower than the second quarter of 2017 at R34bn, however the trend was in line with market expectations due to lower refinancing needs in 2018.

Issuance volume was dominated by corporates and state-owned enterprises (SOEs). Corporate issuances were largely within the motor and telecoms sectors with Mercedes Benz, MTN and Telkom coming to the market with well-supported floating-rate note issuances. SOE issuances were dominated by private placements from Land Bank as well as Eskom through tap issues of existing notes. The Industrial Development Corporation also came to the market with a public auction of three floating-rate notes.

The lower issuance volume along with preference for floating-rate notes over the quarter resulted in us, once again, having limited opportunity to add to our fixed-rate exposure; however we continue to seek opportunities to add to our corporate bond exposure.

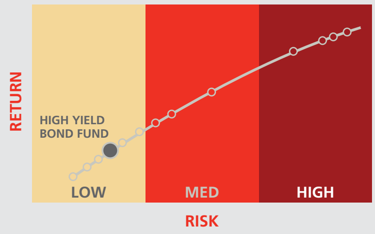
STRATEGY AND POSITIONING

In SA nominal bonds, following the quarter's sizeable rise in yields, valuations became more attractive compared to their longer-term average and we see them as cheap. Consequently, we added longer-dated bonds to our modestly overweight position with yields at levels over 9.0%. This was funded from cash holdings. We continue to prefer longer-dated government bonds due to the more attractive yields on offer, and are comfortable with the compensation bonds offer given the risk involved. We take comfort from the integrity of the SA Reserve Bank and their stated goal of anchoring inflation expectations around 4.5%, the mid-point of their targeted 3.0-6.0% band. Downside risks have eased somewhat given the government reforms underway and reinstated fiscal probity, but inflation remains a threat and the SA government and businesses have not yet done enough to eliminate the prospects of further credit rating downgrades. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	9.7%	10.2%	10.0%
3 years	7.2%	7.8%	7.5%
5 years	6.6%	7.4%	7.0%
7 years	7.7%	8.2%	8.1%
10 years	9.5%	9.8%	9.8%
Since inception	10.2%	10.4%	9.2%

Inception date B Class: 1 April 2003

RISK/RETURN PROFILE:



FUND MANAGERS:
David Knee and Gareth Bern

ASISA CATEGORY:
South African - Interest Bearing - Variable Term

BENCHMARK:
BEASSA Total Return All Bond Index

INCEPTION DATE:
27 October 2000

FUND SIZE:
R559 053 433

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL ENHANCED INCOME FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

MULTI-ASSET

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on both bond and equity markets, with emerging markets particularly hard-hit by asset sales. Developed equity markets ended the quarter returning 1.7% in US dollars, while emerging equity markets delivered -8.0%. In South Africa, the previous quarter's optimism over the election of Cyril Ramaphosa appeared to be wearing thin already on the back of a string of disappointing local economic news and a much weaker rand.

Global bonds lost 2.8% during the quarter, led lower by rising US interest rates and accelerating inflationary pressures. Confronted with a robust economy and inflation forecasts starting to overshoot its 2% inflation target, the US Federal Reserve took a hawkish stance, hiking interest rates by 25bps at its June FOMC meeting as widely expected, while also adding an extra 25bp hike to its 2018 forecast. This saw the yield on the benchmark 10-year US Treasury bond rise to 3% before retracing to end the quarter around 2.9%, barely above their end Q1 level. Shorter-dated bond yields rose even more, such that the difference between the 2-year yield (at about 2.5%) and the 10-year yield narrowed to around 40bps, its lowest since the global financial crisis. A negative differential (when shorter-dated bond yields are higher than longer-dated bonds, such that the yield curve is inverted) is a leading indicator of a global recession, a factor that captured the attention of many investors. This supported a key theme for the quarter - the spreading view that global economic growth might slow sooner than expected.

In South Africa it was a tough quarter for investors, as the rand, bonds and equities all came under selling pressure amid the risk-averse global sentiment, as well as from largely unfavourable domestic data. The land reform debate also added to uncertainty. Resources shares were a notable exception, helped by the stronger US dollar.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases (notably VAT and the fuel levy) and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

Taking note of the building inflationary pressures, but the headwinds facing the local economy as well, the SA Reserve Bank (SARB) kept interest rates on hold at its May Monetary Policy Committee meeting, as expected. Its statement sounded more hawkish than previous meetings, however. The SARB expects the rand to remain volatile amid outflows from emerging markets generally as US interest rates continue to rise, representing a significant upward risk to SA inflation in the months ahead. Taking the SARB's cue, the market no longer expects the central bank to lower interest rates this year.

Among positive developments for the quarter, the Ramaphosa government made progress on reforms - Public Enterprises Minister Pravin Gordhan took several steps forward in cleaning up state-owned enterprises, appointing new boards and new management at several of the troubled entities. The minimum wage came into effect, and secret ballots for strikes were also introduced among the unions. In a vote of confidence, all three global ratings agencies maintained their credit ratings for South Africa despite the weaker growth, although cautioned that much reform still needed to take place.

Despite these positives, local bonds experienced more than R60 billion in net outflows during May and June, overwhelming the R25 billion in inflows in Q1. The BEASSA All Bond Index returned -3.8% for the quarter, while the yield on the benchmark 10-year SA government bond rose to just under 9.0% at quarter-end, from 8.0% at the start of April, a significant 100bp move on the back of the broader risk-averse sentiment. Meanwhile, inflation-linked bonds were even weaker, delivering -4.5%. Property shares returned -2.2% amid the deteriorating inflation and growth outlook.

PERFORMANCE

For the 12 months ended 30 June 2018 the fund delivered 7.4%, outperforming its benchmark as measured by the STeFI Composite Index by 0.1%. For the second quarter of 2018, the fund returned 2.0%, outperforming its benchmark by 0.3%.

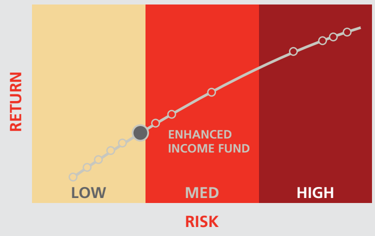
The fund's exposure to offshore securities benefited performance as the rand weakened against the US dollar. Investments in domestic floating- and fixed-rate instruments also contributed positively towards fund returns. Detractors from performance included exposure to inflation-linked bonds and local property. We maintained our duration position during the second quarter of 2018 as global volatility increased.

STRATEGY AND POSITIONING

In **global fixed income**, as in previous quarters, despite rising government bond yields, they continue to trade at very low yields (and high valuations) historically, and remain at risk to rising interest rates in the US and UK, and increasingly in Europe as well. We continue to be underweight global sovereign bonds and underweight duration to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds.

For **global equities,** gains in developed markets over the quarter lifted valuations slightly, but these are still modestly cheap on a broad

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 155 639 030

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	X CLASS	D CLASS
1 year	7.4%	7.3%	7.9%	7.7%	8.0%
3 years	7.4%	7.3%	7.9%	7.6%	8.0%
5 years	7.3%	6.9%	n/a	7.6%	7.9%
7 years	7.8%	7.1%	n/a	8.1%	n/a
Since inception	8.5%	7.3%	7.5%	8.2%	8.4%

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

ASSET CLASS RETURNS	TOTAL RETURN Q2 2018
Global equity – MSCI World (US$) (Developed)	1.7%
Global equity – MSCI Emerging Markets (US$)	-8.0%
Global bonds – Bloomberg Barclays Global Aggregate Bond Index (US$)	-2.8%
Global property – FTSE EPRA/NAREIT Global Property REIT Index (US$)	6.1%
SA equity – FTSE/JSE All Share Index	4.5%
SA bonds – BEASSA All Bond Index	-3.8%
SA listed property – SA Listed Property Index	-2.2%
SA inflation-linked bonds – JSE CILI Index	-4.5%
SA cash (STeFI Composite Index)	1.8%

Sources: Prudential, Morningstar & Deutsche Securities

basis, having started the quarter at about 10% cheap. However, valuation disparities between developed and emerging markets widened in Q2, with markets like the Nasdaq returning 7.3% and S&P 500 3.4%, while many emerging markets were punished, making many materially cheap. In line with our active management approach, during the quarter we pared our overweight equity position modestly as developed markets became more expensive. 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, Italy and Japan, and selected emerging markets such as South Korea, Thailand and China. These overweight positions are financed primarily by an underweight in global bonds, as well as US equities to a lesser extent. As in the previous quarter, we still see better value in many regions compared to South Africa, 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.

In **SA listed property**, we continue to have a neutral exposure in the Prudential Enhanced Income Fund. Even though the sector has fallen sharply in value, this is still largely due to the effect of the Resilient group's share prices. Excluding the four Resilient companies, the asset class is trading modestly above its fair value range. It is priced to deliver attractive low double-digit returns over the medium term, but we also remain concerned about the risks in the sector, including slow growth and rising inflationary pressures.

In **SA nominal bonds**, following the quarter's sizeable rise in yields, valuations became more attractive compared to their longer-term average and we see them as cheap. Consequently, we added longer-dated bonds to our modestly overweight position with yields at levels over 9.0%. This was funded from cash holdings. We continue to prefer longer-dated government bonds due to the more attractive yields on offer, and are comfortable with the compensation bonds offer given the risk involved. We take comfort from the integrity of the SA Reserve Bank and their stated goal of anchoring inflation expectations around 4.5%, the mid-point of their targeted 3.0-6.0% band. Downside risks have eased somewhat given the government reforms underway and reinstated fiscal probity, but inflation remains a threat and the SA government and businesses have not yet done enough to eliminate the prospects of further credit rating downgrades.

For **SA inflation-linked bonds**, we continue to be neutrally positioned in this asset class. Real yields are attractive, especially after this quarter's weakness, but we still believe that better value exists elsewhere – in long-dated nominal bonds and equities. ■

Sources: Prudential, Morningstar & Deutsche Securities

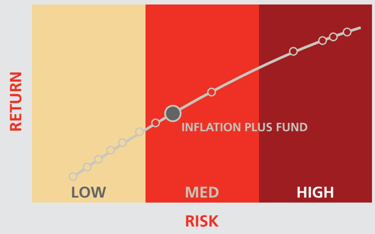
PRUDENTIAL INFLATION PLUS FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

MULTI-ASSET

RISK/RETURN PROFILE:



FUND MANAGERS:
Michael Moyle, David Knee, Duncan Schwulst 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:
R35 625 590 589

AWARDS:
Raging Bull: 2013
Morningstar: 2015

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on both bond and equity markets, with emerging markets particularly hard-hit by asset sales. Developed equity markets ended the quarter returning 1.7%, while emerging markets delivered -8.0%. In South Africa, the previous quarter's optimism over the election of Cyril Ramaphosa appeared to be wearing thin already on the back of a string of disappointing local economic news and a much weaker rand.

Global bonds lost 2.8% during the quarter, led lower by rising US interest rates and accelerating inflationary pressures. Confronted with a robust economy and inflation forecasts starting to overshoot its 2% inflation target, the US Federal Reserve took a hawkish stance, hiking interest rates at its June FOMC meeting as widely expected, while also forecasting an extra 25bp hike in 2018.

A key theme for the quarter was the spreading view that global economic growth would slow sooner than expected. US Q1 GDP growth was revised downward to 2.2% (q/q annualised) versus the 2.3% expected. At the same time, in the Eurozone, Q1 GDP growth slowed to 2.5% (q/q annualised) from 2.8%, attributed to extreme winter weather, strikes in France and other temporary factors. Meanwhile, UK growth was reported at only 1.2% (q/q annualised) for Q1, and after two years of growth, the Japanese economy contracted by 0.6% (q/q annualised) in Q1 2018, due to slower consumer spending on the back of harsh winter weather and higher food prices. In China, Q1 GDP growth came in at 6.8% (q/q annualised), steady from the previous quarter and in line with expectations. There were growing signs of a slowdown in Q2, though, in the form of disappointing May data for industrial output, retail sales and investment.

Emerging markets experienced large capital outflows during the quarter from both bond and equity markets. Brazil and Turkey were among the largest losers due to particularly adverse local conditions: Brazil's Bovespa lost 26.5% for the three months, while the MSCI Turkey lost 25.7% (both in US$). South Korea's KOSPI returned -9.2% and the MSCI South Africa delivered -11.7% (also in US$).

In South Africa it was a tough quarter for investors, as the rand, bonds and equities all came under selling pressure amid the risk-averse global sentiment, as well as from largely unfavourable domestic data. The land reform debate also added to uncertainty. Resources and large industrial shares were notable exceptions, with their offshore earnings boosted by the stronger US dollar.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

Taking note of the building inflationary pressures, but the headwinds facing the local economy as well, the SA Reserve Bank (SARB) kept interest rates on hold at its May Monetary Policy Committee meeting, as expected. Its statement sounded more hawkish than previous meetings, however. The SARB expects the rand to remain volatile amid outflows from emerging markets generally as US interest rates continue to rise, representing a significant upward risk to SA inflation in the months ahead. Taking the SARB's cue, the market no longer expects the central bank to lower interest rates this year.

In this environment, local bonds experienced over R60 billion in net outflows during May and June – overwhelming the R25 billion in inflows in Q1. The BEASSA All Bond Index returned -3.8% for the quarter, while the yield on the benchmark 10-year SA government bond rose to just under 9.0% at quarter-end, from 8.0% at the start of April. Meanwhile, inflation-linked bonds were even weaker, delivering -4.5%. The FTSE/JSE All Share index managed to return 4.5% over the three months, propped up almost entirely by Resources stocks, which delivered 21.7% on the back of the stronger US dollar and still-expanding global growth. For 2018 so far, the ALSI is still in negative territory with a -1.7% return. Industrials managed to deliver 4.0%, but Financials produced -6.0%, giving up their gains following Ramaphosa's election, due largely to their more localised earnings. Finally, Property shares returned -2.2% on the back of rising global interest rates and challenging local conditions.

PERFORMANCE

The fund returned 1.8% (after fees) for the second quarter of 2018 and has returned 6.3% for the 12-month period ending 30 June 2018. The fund has delivered a return of 12.5% per annum since inception (after fees), compared to its after-fee objective of 9.5% per annum over the same period. To 30 June it retains its top-quartile or better performance over annual periods from 5-10 years, according to Morningstar.

The largest contributor to absolute performance by far was the fund's exposure to SA equities, with holdings in resources shares like Anglo American, BHP Billiton, Sappi and Exxaro adding to returns. Underweights in retailers Mr Price and Truworths also contributed to returns. Helped by the weaker rand, the fund's global cash and equity exposure also added value. The primary detractor from absolute performance was its exposure to global fixed income. Weakness in financial shares like Standard Bank and Barclays Group Africa also detracted from value, as did exposure to SA inflation-linked bonds.

ANNUALISED PERFORMANCE	A CLASS	OBJECTIVE#	T CLASS	X CLASS	B CLASS
1 year	6.3%	7.8%	6.9%	6.6%	7.1%
3 years	5.4%	8.7%	6.0%	5.7%	6.2%
5 years	8.4%	8.8%	n/a	8.7%	9.2%
7 years	10.5%	8.9%	n/a	n/a	11.3%
10 years	10.1%	9.0%	n/a	n/a	10.9%
Since inception	12.5%	9.5%	5.7%	10.7%	12.5%

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 Q2 2018
Global equity – MSCI World (US$) (Developed)	1.7%
Global equity – MSCI Emerging Markets (US$)	-8.0%
Global bonds – Bloomberg Barclays Global Aggregate Bond Index (US$)	-2.8%
Global property – FTSE EPRA/NAREIT Global Property REIT Index (US$)	6.1%
SA equity – FTSE/JSE All Share Index	4.5%
SA bonds – BEASSA All Bond Index	-3.8%
SA listed property – SA Listed Property Index	-2.2%
SA inflation-linked bonds – JSE CILI Index	-4.5%
SA cash (STeFI Composite Index)	1.8%

Sources: Prudential, Morningstar & Deutsche Securities

STRATEGY AND OUTLOOK

In **global fixed income**, as in previous quarters, despite rising government bond yields, they continue to trade at very low yields (and high valuations) historically, and remain at risk to rising interest rates in the US and UK, and increasingly in Europe as well. We continue to be underweight global sovereign bonds and underweight duration to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds.

For **global equities**, gains in developed markets over the quarter lifted valuations slightly, but these are still modestly cheap on a broad basis, having started the quarter at about 10% cheap. However, valuation disparities between developed and emerging markets widened in Q2, with markets like the Nasdaq returning 7.3% and S&P 500 3.4%, while many emerging markets were punished, making many materially cheap. We see better value in many regions compared to South Africa, which is why we continue to prefer global equities to SA equities, given the fund's total 40% equity limit. SA equity earnings have been depressed relative to their long-term trends, particularly in financials.

In line with our active management approach, during the quarter we pared our overweight global equity position modestly as developed markets became more expensive. 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, Italy and Japan, and selected emerging markets such as South Korea, Thailand and China. These overweight positions are financed primarily by an underweight in global bonds, as well as US equities to a lesser extent.

South African equities moved to more attractive valuations during the quarter: the FTSE/JSE ALSI 12-month forward P/E fell to around 13.7X at quarter-end from around 14.1X in Q1. This is slightly cheaper than our long-term fair value estimate of 14.5X. At current levels the market is priced to deliver attractive medium-term returns. However, we see better opportunities offshore due to stronger earnings growth potential in certain markets. Consequently we continue to be slightly underweight SA equities in the Prudential Inflation Plus Fund and overweight global equities, with total equity exposure close to the maximum allowed.

During the quarter we sold down our overweight holdings in Resources shares after the sector's strong run (returning 21.7% over the three months). However, the fund still holds resources companies including Anglo American, BHP Billiton, Sasol, Sappi and Exxaro, as well as large global companies with significant exposure to global growth like Naspers, Aspen and British American Tobacco. We have also maintained our overweight exposure to financial shares including Old Mutual, Investec, Standard Bank and Barclays Group Africa, which have offered attractive valuations with relatively high dividend yields. Additionally, the fund is broadly underweight retail stocks, given the financial stresses faced by SA consumers, but holds select overweights in Pick 'n Pay and Foschini.

In **SA listed property**, we continue to have a neutral exposure in the Inflation Plus Fund. Even though the sector has fallen sharply in value, this is still largely due to the effect of the Resilient group's share prices. Excluding the four Resilient companies, the asset class is trading modestly above its fair value range. It is priced to deliver attractive low double-digit returns over the medium term, but we also remain concerned about the risks in the sector, including slow growth and rising inflationary pressures.

In **SA nominal bonds**, following the quarter's sizeable rise in yields, valuations became more attractive compared to their longer-term average and we see them as cheap. Consequently, we added longer-dated bonds to our modestly overweight position with yields at levels over 9.0%. This was funded from cash holdings. We continue to prefer longer-dated government bonds due to the more attractive yields on offer, and are comfortable with the compensation bonds offer given the risk involved. We also take comfort from the integrity of the SA Reserve Bank and their stated goal of anchoring inflation expectations around 4.5%, the mid-point of their targeted 3.0-6.0% band. Downside risks have eased somewhat given the government reforms underway and reinstated fiscal probity, but inflation remains a threat and the SA government and businesses have not yet done enough to eliminate the prospects of further credit rating downgrades.

For **SA inflation-linked bonds**, we continue to be neutrally positioned in this asset class. Real yields are attractive, especially after this quarter's weakness, but we still believe that better value exists elsewhere – in long-dated nominal bonds and equities. ■

Sources: Prudential, Morningstar & Deutsche Securities

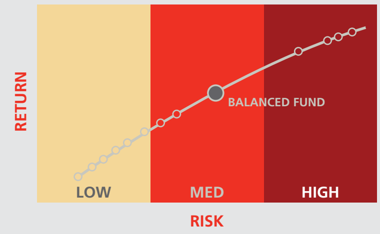
PRUDENTIAL BALANCED FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

MULTI-ASSET

RISK/RETURN PROFILE:



FUND MANAGERS:
David Knee, Duncan Schwulst, 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 429 233 243

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on both bond and equity markets, with emerging markets particularly hard-hit by asset sales. Developed equity markets ended the quarter returning 1.7% in US$, while emerging markets delivered -8.0%. In South Africa, the previous quarter's optimism over the election of Cyril Ramaphosa appeared to be wearing thin already on the back of a string of disappointing local economic news and a much weaker rand.

Global bonds lost 2.8% (in US$) during the quarter, led lower by rising US interest rates and accelerating inflationary pressures. Confronted with a robust economy and inflation forecasts starting to overshoot its 2% inflation target, the US Federal Reserve took a hawkish stance, hiking interest rates at its June FOMC meeting as widely expected, while also adding an extra 25bp hike in 2018 to its interest rate forecasts.

A key theme for the quarter was the spreading view that global economic growth would slow sooner than expected. US Q1 GDP growth was revised downward to 2.2% (q/q annualised) versus the 2.3% expected. At the same time, in the Eurozone, Q1 GDP growth slowed to 2.5% (q/q annualised) from 2.8%, attributed to extreme winter weather, strikes in France and other temporary factors. Meanwhile, UK growth was reported at only 1.2% (q/q annualised) for Q1, and after two years of growth, the Japanese economy contracted by 0.6% (q/q annualised) in Q1 2018, due to slower consumer spending on the back of harsh winter weather and higher food prices. In China, Q1 GDP growth came in at 6.8% (q/q annualised), steady from the previous quarter and in line with expectations. There were growing signs of a slowdown in Q2, though, in the form of disappointing May data for industrial output, retail sales and investment.

Emerging markets experienced large capital outflows during the quarter from both bond and equity markets. Brazil and Turkey were among the largest losers due to particularly adverse local conditions: Brazil's Bovespa lost 26.5% for the three months, while the MSCI Turkey lost 25.7% (both in US$). South Korea's KOSPI returned -9.2% and the MSCI South Africa delivered -11.7% (also in US$).

In South Africa it was a tough quarter for investors, as the rand, bonds and equities all came under selling pressure amid the risk-averse global sentiment, as well as from largely unfavourable domestic data. The land reform debate also added to uncertainty. Resources and large industrial shares were a notable exception, with their offshore earnings boosted by the stronger US dollar.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases (notably VAT and the fuel levy) and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

Taking note of the building inflationary pressures, but the headwinds facing the local economy as well, the SA Reserve Bank (SARB) kept interest rates on hold at its May Monetary Policy Committee meeting, as expected. Its statement sounded more hawkish than previous meetings, however. The SARB expects the rand to remain volatile amid outflows from emerging markets generally as US interest rates continue to rise, representing a significant upward risk to SA inflation in the months ahead. Taking the SARB's cue, the market no longer expects the central bank to lower interest rates this year.

In this environment, local bonds experienced over R60 billion in net outflows during May and June – overwhelming the R25 billion in inflows in Q1. The BEASSA All Bond Index returned -3.8% for the quarter, while the yield on the benchmark 10-year SA government bond rose to just under 9.0% at quarter-end, from 8.0% at the start of April. Meanwhile, inflation-linked bonds were even weaker, delivering -4.5%. The FTSE/JSE All Share index managed to return 4.5% over the three months, propped up almost entirely by Resources stocks, which delivered 21.7% on the back of the stronger US dollar and still-expanding global growth. For 2018 so far, the ALSI is still in negative territory with a -1.7% return. Industrials managed to deliver 4.0%, but Financials produced -6.0%, giving up their gains following Ramaphosa's election, due largely to their more localised earnings. Finally, Property shares returned -2.2% on the back of rising global interest rates and challenging local conditions.

PERFORMANCE

The fund returned 4.5% (after fees) for the second quarter of 2018 and has returned 10.5% for the 12-month period ending 30 June 2018. The fund has delivered a return of 13.9% per annum since inception (after fees), compared to its after-fee benchmark of 11.9% per annum over the same period. To 30 June 2018 it retains its top-quartile or better performance over all annual periods from 1-10 years, according to Morningstar.

The largest contributor to the fund's relative performance versus the benchmark by far was its exposure to SA equities, with overweight holdings in Resources shares like Anglo American, BHP Billiton, Sappi and Exxaro adding positively to returns. Underweight holdings in retailers Mr Price and Truworths also added value. Among the primary detractors from relative performance were exposure to global fixed income, given global bond weakness, and the fund's overweight exposure to South African nominal bonds. Weakness in financial shares like First Rand, Standard Bank and Barclays Group Africa also detracted from value.

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	X CLASS	B CLASS
1 year	10.5%	7.2%	11.0%	10.8%	11.3%
3 years	6.7%	4.6%	7.2%	6.9%	7.5%
5 years	10.2%	8.0%	n/a	10.5%	11.1%
7 years	11.9%	9.4%	n/a	n/a	12.9%
10 years	10.9%	8.4%	n/a	n/a	11.9%
Since inception	13.9%	11.9%	6.9%	11.1%	14.3%

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

ASSET CLASS RETURNS	TOTAL RETURN Q2 2018
Global equity – MSCI World (US$) (Developed)	1.7%
Global equity – MSCI Emerging Markets (US$)	-8.0%
Global bonds – Bloomberg Barclays Global Aggregate Bond Index (US$)	-2.8%
Global property – FTSE EPRA/NAREIT Global Property REIT Index (US$)	6.1%
SA equity – FTSE/JSE All Share Index	4.5%
SA bonds – BEASSA All Bond Index	-3.8%
SA listed property – SA Listed Property Index	-2.2%
SA inflation-linked bonds – JSE CILI Index	-4.5%
SA cash (STeFI Composite Index)	1.8%

Sources: Prudential, Morningstar & Deutsche Securities

STRATEGY AND POSITIONING

In **global fixed income**, government bond yields continue to trade at low levels (and high valuations) historically, and remain at risk to rising interest rates in the US and UK, and increasingly in Europe as well. We remain underweight global sovereign bonds and underweight duration in the fund to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds.

For **global equities**, in line with our active management approach, we trimmed our overweight global equity exposure during the quarter as prices ran ahead of fundamentals, although we are still overweight these assets in the fund. Despite the possible deceleration in global growth, the outlook for corporate earnings growth remains positive. As in the previous quarter, we still see better value in many regions compared to South Africa, which is why we continue to be overweight global equities in the Prudential Balanced Fund. 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.

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, Italy and Japan, and selected emerging markets such as South Korea, Thailand and China. These positions are financed by an underweight in global bonds and US equities (to a lesser extent).

South African equities moved to more attractive valuations during the quarter: the FTSE/JSE ALSI 12-month forward P/E fell to around 13.7X at quarter-end from around 14.1X in Q1. This is slightly cheaper than our long-term fair value estimate of 14.5X. At current levels the market is priced to deliver attractive medium-term returns. As such, we remain overweight SA equities in the Prudential Balanced Fund.

During the quarter we took profits and sold down our overweight Resources position across our funds following the 21.7% return from the local Resources sector. However, the fund still holds resources companies such as Anglo American, BHP Billiton, Sasol, Sappi and Exxaro, as well as those with significant exposure to global growth like Naspers and British American Tobacco. We have also maintained our overweight exposure to financial shares including Old Mutual, First Rand, Standard Bank and Barclays Group Africa, which have offered attractive valuations with relatively high dividend yields. Additionally, the fund is broadly underweight retail stocks, given the financial stresses faced by SA consumers, but holds select overweights in Pick 'n Pay and Foschini.

In **SA listed property**, we continue to have a neutral exposure in the Balanced Fund. Even though the sector has fallen sharply in value, this is due almost entirely to the decline in the share prices of the Resilient group of four property companies. Excluding the four Resilient companies, the asset class is trading modestly above its fair value range and is priced to deliver attractive returns in the low double-digits over the medium term. However, the sector also faces risks arising from higher inflation, rising interest rates and low growth.

In **SA nominal bonds**, following the quarter's sizeable rise in yields, valuations became more attractive compared to their longer-term average and we see them as cheap. Consequently, we added longer-dated bonds to our modestly overweight position with yields at levels over 9.0%. This was funded from cash holdings. We continue to prefer longer-dated government bonds due to the more attractive yields on offer, and are comfortable with the compensation bonds offer given the risk involved. Downside risks have eased somewhat given the government reforms underway and reinstated fiscal probity, but inflation remains a threat and the SA government and businesses have not yet done enough to eliminate the prospects of further credit rating downgrades.

For **SA inflation-linked bonds**, we continue to be neutrally positioned in this asset class. Real yields are attractive, but we still believe that better value exists elsewhere – in long-dated SA nominal bonds and equities. ■

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL ENHANCED SA PROPERTY TRACKER FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

PROPERTY

MARKET OVERVIEW

In South Africa it was tough quarter for investors, as the rand, bonds and equities all came under selling pressure amid the risk-averse global sentiment, as well as from largely unfavourable domestic data. The land reform debate also added to uncertainty. Resources shares were a notable exception, helped by the stronger US dollar.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases (notably VAT and the fuel levy) and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

Taking note of the building inflationary pressures, but the headwinds facing the local economy as well, the SA Reserve Bank (SARB) kept interest rates on hold at its May Monetary Policy Committee meeting, as expected. Its statement sounded more hawkish than previous meetings, however. The SARB expects the rand to remain volatile amid outflows from emerging markets generally as US interest rates continue to rise, representing a significant upward risk to SA inflation in the months ahead. Taking the SARB's cue, the market no longer expects the central bank to lower interest rates this year.

Among positive developments for the quarter, the Ramaphosa government made progress on reforms - Public Enterprises Minister Pravin Gordhan took several steps forward in cleaning up state-owned enterprises, appointing new boards and new management at several of the troubled entities. The minimum wage came into effect, and secret ballots for strikes were also introduced among the unions. In a vote of confidence, all three global ratings agencies maintained their credit ratings for South Africa despite the weaker growth, although cautioned that much reform still needed to take place.

For local equities, the FTSE/JSE All Share index (ALSI) managed to return 4.5% over the three months, propped up almost entirely by Resources stocks, which delivered 21.7% on the back of the stronger US dollar and still-expanding global growth. For 2018 so far, the ALSI remains in negative territory with a -1.7% return. Industrials managed to deliver 4.0%, helped by large global shares, but Financials produced -6.0%, giving up their gains following Rampahosa's election, due largely to their more localised earnings. Property shares returned -2.2% amid the deteriorating inflation and growth outlook.

PERFORMANCE

For the 12 months ended 30 June 2018 the fund delivered -11.2%, underperforming its benchmark as measured by the South African Listed Property Index by 1.3%. For the second quarter of 2018, the fund returned -2.5%, marginally underperforming its benchmark by 0.3%.

Detractors from relative performance were largely as a result of underweight positions in Fortress REIT B shares and NEPI Rockcastle of 0.15% and 1.75% respectively. These positions are examples of the risk-conscious approach to active stock selection and of our fundamental strategy; being underweight large-cap and lower-yielding stocks and holding excess weight in higher-yielding stocks.

STRATEGY AND POSITIONING

In SA listed property, we maintained a neutral exposure in our multi-asset funds through the quarter. Yields are currently considered to be at elevated levels following the sell-off at the beginning of 2018. At quarter-end, listed property companies (excluding developers) were priced to return approximately 17% p.a. over the medium term (assuming no change in the market's valuation of property), comfortably above inflation and, we believe, appropriate compensation for the risk involved.

Actual delivered growth in distributions per share for the major listed property companies averaged 9.8% for the last six months' reporting cycle.

We estimate that one-year forward earnings forecasts for the SAPY, excluding developers, grew by 1.7% on an annualised basis over the quarter. This implies slight downgrades to forecasts for the sector (relative to expectations) given that consensus forecasts have been for growth rates of the order of 8%.

The decline in the SAPY index is largely explained by the de-rating of Resilient, Fortress, Greenbay and NEPI Rockcastle. At 1 January 2018, the four companies represented approximately 42% of the SAPY index, but after the sell-off of these four companies over the first half of the year, their weight within the SAPY declined to around 25%.

Although the domestically-focussed property companies were the outperformers over this period, local property fundamentals remain weak, with the office sector remaining the weakest. The restructuring of the Edcon group and their brands could put further downward pressure on the retail sector of listed property.

The weak local property fundamentals have contributed to a decline in the quality of earnings over the past year, and have resulted in companies lowering their guidance or rebasing their distributions per share. Counters excluding the Resilient stable that have rebased their earning include: Accelerate, Arrowhead and Emira, and counters that have lowered guidance include Redefine and SA Corporate. Although lower, core earnings growth remains reasonable.

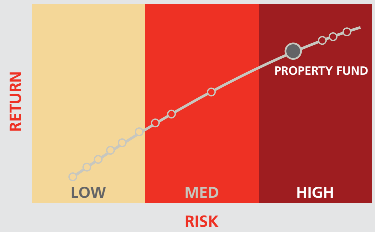
We view the current valuations as attractive relative to inflation-linked bonds (ILBs). In the absence of a material change in the market's valuation (or rating), listed property is priced to comfortably deliver double-digit returns over the medium term, well above inflation.

An important aspect of the investment case for listed property is illustrated by comparing property yields to those from ILBs. Currently the SAPY, excluding developers, is priced to deliver a one-year forward distribution yield of 9%. This yield exceeded 10-year ILB yields by close to 6%. Assuming yields remain constant, property should outperform ILBs by at least 6%. In our view, this return premium is commensurate with the elevated risks of investing in listed property at present. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	D CLASS
1 year	-11.2%	-9.9%	-11.2%	-11.1%
3 years	1.2%	0.9%	1.2%	1.3%
5 years	7.0%	6.7%	n/a	7.1%
7 years	11.6%	11.7%	n/a	11.7%
10 years	15.8%	16.0%	n/a	n/a
Since inception	13.8%	13.9%	-0.6%	12.7%

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

RISK/RETURN PROFILE:



FUND MANAGERS:
Duncan Schwulst and 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:
R4 045 311 774

AWARDS:
Morningstar/Standard & Poor's: 2011

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL DIVIDEND MAXIMISER FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

EQUITY

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on both bond and equity markets, with emerging markets particularly hard-hit by asset sales. Developed equity markets ended the quarter returning 1.7% in US dollars, while emerging equity markets delivered -8.0%.

In South Africa, the previous quarter's optimism over the election of Cyril Ramaphosa was replaced by concern around emerging markets. Rising US interest rates are essentially increasing the hurdle rate above which all other asset classes must produce a return. The required return for emerging market assets is therefore increasing and it could be argued that the dividend yield required from South African equities is therefore rising. We do though now think that emerging market assets including South Africa are some of the most well-priced assets globally.

The latest version of the Mining Charter released by the Minister of Mineral Resources, Gwede Mantashe, appeared more investor friendly than former minister Zwane's; however, it's unlikely to reverse the hiatus in South African mining investment. While the new charter seems to at least respect the "once empowered, always empowered" principle (in line with a recent High Court judgement), it introduces new hurdles such as the demand for a 10% "free carry" for communities and employees on new mining right applications. While companies may challenge the "free carry" principle, we question why one community should benefit over others. The Freedom Charter states that the mineral wealth beneath the soil should be transferred to the ownership of the people as a whole. It would make sense, in our opinion, that if the "free carry" were to be instituted, it should rather be contributed into a Sovereign Wealth Fund for the benefit of South Africans as a whole. Despite the release of the Mining Charter, Resource stocks performed well in the second quarter, partly aided by a weakening rand.

It is important to recognize that many of the very large mining companies like Anglo American and BHP Billiton are global commodity companies, and therefore the commodity cycle and valuations of these companies can be the most important drivers of returns to shareholders. The Prudential Dividend Maximiser Fund has been overweight these large mining companies as we think the cash flow yields these companies are generating are currently high and the market is under-pricing the cash flows. In our view, while commodity prices are currently high, the market is pricing the shares of the commodity companies as if commodity prices were toward the bottom end of the cycle. We are therefore happy to earn the high dividend yields from these companies.

For local equities, the FTSE/JSE All Share Index (ALSI) managed to return 4.5% over the three months, propped up almost entirely by Resources stocks, which delivered 21.7% on the back of the stronger US dollar and still-expanding global growth. For 2018 so far, the ALSI remains in negative territory with a -1.7% return. Industrials managed to deliver 4.0%, helped by large global shares, but Financials produced -6.0%, giving up their gains following Ramaphosa's election, due largely to their more localised earnings. Property shares returned -2.2% amid the deteriorating inflation and growth outlook.

PERFORMANCE

The fund returned 5.5% for the second quarter of 2018, outperforming its benchmark (the ASISA South African - Equity – General Category Mean) by 4.4% over the same period. The fund also outperformed its benchmark by 5.3% for 12 months, with a total return of 13.2%.

Contributing towards performance over the quarter was the fund's 30% offshore allocation and exposure to stocks with significant offshore earnings (such as British American Tobacco, Sasol and Sappi), which benefited from a weakening rand. Detracting from performance, meanwhile, was the fund's underweight position to Mondi Paper. While the fund owned Mondi for a number of years and benefited substantially from the excellent dividend yields and growing dividends, we are now of the opinion that the company's dividends are unlikely to grow as quickly as they have done in the past, and there is a risk that the company is slightly overvalued. In summary, we think Mondi is priced for perfection. On the other hand, we prefer Sappi, which we think could still grow its dividends well above the rest of the market, and which we believe is very undervalued.

STRATEGY AND POSITIONING

South African equities moved to more attractive valuations during the quarter: the ALSI 12-month forward P/E fell to around 13.7X at quarter-end from around 14.1X in the first quarter. This is slightly cheaper than our long-term fair value estimate of 14.5X. At current levels the market is priced to deliver attractive medium-term returns.

The fund retained its overweight Resources position and remains broadly overweight to Resources stocks like Anglo American, BHP Billiton, Sasol and Sappi. We think that all these stocks have improving cash flows and are very well priced. We think that the dividends from these companies will be much higher in five years' time than they are today. We also purchased additional shares in Sun International as part of the group's rights issue.

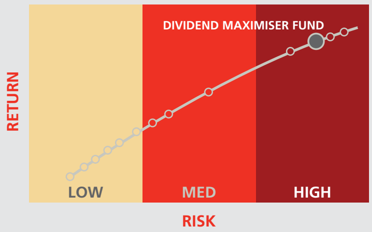
The fund maintains its holdings in Naspers and BAT. Both these companies have excellent cash flows and we think are undervalued. We have also maintained our overweight holdings in financial shares including Old Mutual, Standard Bank and Barclays Group Africa, which have offered attractive valuations with relatively high dividend yields. The fund's overweight holdings in Standard Bank and Barclays Group Africa were significant detractors from performance over the quarter, mainly as a result of the increased risk perception arising from rising US interest rates. Banks globally underperformed for the quarter for the same reason. We think that banks locally and globally are presenting exceptional valuations. Dividend yields are very high, even given rising interest rates, and the balance sheets of banks is the best we have seen in the last decade. We therefore remain overweight banks both locally and in the offshore allocation of the fund.

For global equities, gains in developed markets over the quarter lifted valuations slightly, but these are still modestly cheap on a broad basis, having started the quarter at about 10% cheap. However, valuation disparities between developed and emerging markets widened in the second quarter, with developed markets delivering a positive return against emerging markets which delivered broadly negative returns. 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, Italy and Japan, and selected emerging markets such as South Korea, Thailand and China. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	B CLASS
1 year	13.2%	7.9%	13.6%	13.6%
3 years	6.0%	2.7%	6.5%	6.5%
5 years	10.3%	7.9%	n/a	10.7%
7 years	12.0%	9.3%	n/a	12.4%
10 years	11.7%	8.6%	n/a	12.1%
Since inception	17.2%	13.8%	5.8%	11.7%

Inception date B Class: 2 January 2007, T Class: 2 January 2015

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 906 772 555

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

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL EQUITY FUND
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

EQUITY

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on both bond and equity markets, with emerging markets particularly hard-hit by asset sales. Developed equity markets ended the quarter returning 1.7% in US dollars, while emerging equity markets delivered -8.0%.

In South Africa, the previous quarter's optimism over the election of Cyril Ramaphosa appeared to be wearing thin already on the back of a string of disappointing local economic news and a much weaker rand. This is in line with our view that, while the country's political future is on a more sound footing, there is no quick fix for the domestic economy (with long-term structural reform to improve productivity and advances in the quality of education and health having not even made it to the political platform).

The latest version of the Mining Charter released by the Minister of Mineral Resources, Gwede Mantashe, appeared more investor friendly than former minister Zwane's; however, it's unlikely to reverse the hiatus in South African mining investment. While the new charter seems to at least respect the "once empowered, always empowered" principle (in line with a recent High Court judgement), it introduces new hurdles such as the demand for a 10% "free carry" for communities and employees on new mining right applications. While companies may challenge the "free carry" principle, we question why one community should benefit over others. The Freedom Charter states that the mineral wealth beneath the soil should be transferred to the ownership of the people as a whole. It would make sense, in our opinion, that if the "free carry" were to be instituted, it should rather be contributed into a Sovereign Wealth Fund for the benefit of South Africans as a whole. Despite the release of the Mining Charter, resource stocks performed well in the second quarter, partly aided by a weakening rand.

South Africa's Q1 GDP growth shocked the market with a sharp contraction of -2.2% (q/q annualised), well below the +1.5% expected, as agricultural, mining and manufacturing production all shrank. This, in turn, raised concerns over the government's longer-term ability to adhere to its budget. The much weaker rand (losing 15.2% versus the US dollar, 9.8% against the euro and 8.9% versus the pound sterling), tax increases (notably VAT and the fuel levy) and rising petrol price also brought up the spectre of higher inflation to come, denting business confidence.

For local equities, the FTSE/JSE All Share index (ALSI) managed to return 4.5% over the three months, propped up almost entirely by Resources stocks, which delivered 21.7% on the back of the stronger US dollar and still-expanding global growth. For 2018 so far, the ALSI remains in negative territory with a -1.7% return. Industrials managed to deliver 4.0%, helped by large global shares, but Financials produced -6.0%, giving up their gains following Ramaphosa's election, due largely to their more localised earnings. Property shares returned -2.2% amid the deteriorating inflation and growth outlook.

PERFORMANCE

The fund returned 5.5% for the second quarter of 2018, outperforming its benchmark (the general equity fund average) by 4.5% over the same period. The fund also outperformed its benchmark by 6.2% for 12 months, with a total return of 14.1%.

Contributing towards performance over the quarter was the fund's 20% offshore allocation and exposure to stocks with significant offshore earnings (such as British American Tobacco and Capital & Counties), which benefited from a weakening rand. Detracting from performance, meanwhile, was the fund's long-standing overweight position in Old Mutual plc, despite its separation towards the end of the quarter into Quilter plc (UK wealth manager) and Old Mutual Limited (South African-focused insurer). We believe both entities are favourably valued relative to their listed peer groups, particularly Old Mutual Limited, which we estimate trades on a P/E ratio of approximately 8X after adjusting for its stake in Nedbank. At the same time, a number of resource stocks rose between 10% and 30%, and the fund's performance over the quarter benefited from overweight positions in Anglo American, Sasol and Sappi.

STRATEGY AND POSITIONING

South African equities moved to more attractive valuations during the quarter: the FTSE/JSE ALSI 12-month forward P/E fell to around 13.7X at quarter-end from around 14.1X in Q1. This is slightly cheaper than our long-term fair value estimate of 14.5X. At current levels the market is priced to deliver attractive medium-term returns.

During the quarter we took profits on part of our overweight resources position following the sector's 20%+ gains in recent months, but the fund remains broadly overweight to resources stocks like Anglo American, BHP Billiton, Exxaro, Sasol and Sappi. In terms of individual holdings, we sold out of Glencore, but raised our exposure to BHP Billiton and Sasol. In other changes we sold out of Peregrine and increased our holdings in BAT and Reinet. We also purchased additional shares in Sun International as part of the group's rights issue.

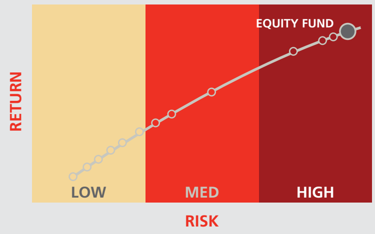
The fund maintains its holdings in global giants such as Naspers and BAT, which have significant exposure to global growth. We have also maintained our overweight holdings in financial shares including Old Mutual, Standard Bank and Barclays Group Africa, which have offered attractive valuations with relatively high dividend yields. Meanwhile, we are still underweight retail stocks in the fund, but do hold select overweights versus the benchmark like in Pick 'n Pay.

For global equities, gains in developed markets over the quarter lifted valuations slightly, but these are still modestly cheap on a broad basis, having started the quarter at about 10% cheap. However, valuation disparities between developed and emerging markets widened in Q2, with markets like the Nasdaq returning 7.3% and S&P 500 3.4%, while many emerging markets were punished, making many materially cheap. We continue to prefer the global banking sector, which has underperformed the broader market, as well as certain developed markets were equities are undervalued but fundamentals for earnings growth remain positive, including Germany, Italy and Japan, and selected emerging markets such as South Korea, Thailand and China. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	14.1%	7.9%	14.6%
3 years	6.3%	2.7%	6.7%
5 years	10.7%	7.9%	11.1%
7 years	12.6%	9.3%	13.1%
10 years	12.2%	8.6%	12.7%
Since inception	17.2%	13.8%	12.3%

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:
R3 150 363 790

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

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL CAUTIOUS MANAGED FUND OF FUNDS
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

GLOBAL MULTI-ASSET

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on both bond and equity markets, with emerging markets particularly hard-hit by asset sales. Developed equity markets ended the quarter returning 1.7% in US dollars, while emerging equity markets delivered -8.0%.

Global bonds lost 2.8% during the quarter, led lower by rising US interest rates and accelerating inflationary pressures. Confronted with a robust economy and inflation forecasts starting to overshoot its 2% inflation target, the US Federal Reserve took a hawkish stance, hiking interest rates by 25bps at its June FOMC meeting as widely expected, while also adding an extra 25bp hike to its 2018 forecast. This saw the yield on the benchmark 10-year US Treasury bond rise to 3% before retracing to end the quarter around 2.9%, barely above their end Q1 level. Shorter-dated bond yields rose even more, such that the difference between the 2-year yield (at about 2.5%) and the 10-year yield narrowed to around 40bps, its lowest since the global financial crisis. A negative differential (when shorter-dated bond yields are higher than longer-dated bonds, such that the yield curve is inverted) is a leading indicator of a global recession, a factor that captured the attention of many investors.

This supported a key theme for the quarter - the spreading view that global economic growth might slow sooner than expected. US Q1 GDP growth was revised downward to 2.2% (q/q annualised) versus the 2.3% expected. At the same time, in the Eurozone, Q1 GDP growth slowed to 2.5% (q/q annualised) from 2.8%, with the slowdown most visible in key economies Germany and France, and attributed to extreme winter weather, strikes in France and other temporary factors. German business confidence also continued to slump in Q2.

However, the US economy remained very robust, with unemployment at 3.8% in May - its lowest level since 2000 – and the latest manufacturing and non-manufacturing data still very elevated on an historic basis. The latest container volume survey (a proxy for measuring world trade) also picked up after taking a dip earlier in the year, showing that fears could possibly be overdone. And even amid concerns about US trade policy, the Fed raised its 2018 GDP forecast to 2.8% from 2.7% previously.

The European Central Bank (ECB) kept its benchmark interest rate unchanged at its June meeting, as had been expected, and also ruled out prospects of a rate hike until mid-2019 at the earliest. However, it did vote to end its bond-buying programme at the end of the year, discounting the Eurozone's slower growth as a temporary phenomenon. Its forecasts call for around 2.0% growth for 2018. Meanwhile, UK growth was reported at only 1.2% (q/q annualised) for Q1, and the Bank of England kept its rates on hold at its May meeting as inflation steadied and the pound strengthened somewhat – the central bank is reluctant to hike rates while Brexit uncertainty remains high.

After two years of growth, the Japanese economy contracted by 0.6% (q/q annualised) in Q1 2018, attributed to slower consumer spending on the back of harsh winter weather and higher food prices. However, the Bank of Japan's expansionary monetary policy remains in place, and real consumer incomes are rising, underpinning expectations of renewed growth for Q2. In China, Q1 GDP growth came it at 6.8% (q/q annualised), steady from the previous quarter and in line with expectations. There were growing signs of a slowdown in Q2, though, in the form of disappointing May data for industrial output, retail sales and investment. Compounded by growing concerns that US tariffs could considerably dent growth prospects (some forecasts point to a decline of up to 0.5% of GDP), sentiment became more negative, helping send Chinese stocks weaker.

Emerging markets in general experienced large capital outflows during the quarter from both bond and equity markets. Brazil and Turkey were among the largest losers due to particularly adverse local conditions: Brazil's Bovespa lost 26.5% for the three months, while the MSCI Turkey lost 25.7% (both in US$). South Korea's KOSPI returned -9.2% and the MSCI South Africa delivered -11.7% (also in US$).

The rand ended the quarter significantly weaker to major currencies, losing 15.2% against the US dollar, 9.8% against the euro and 8.9% against the pound sterling.

PERFORMANCE

The fund returned 12.2% in rand terms for the quarter, versus 14.4% from its benchmark (the ASISA Global - Multi-Asset - Low Equity Category Mean). Given the weak performance of the rand relative to the US dollar over the period, the fund returned -3.0% in US dollar terms. For the 12 months ending June 2018, in rand terms the fund returned 6.1%, marginally underperforming its benchmark by 0.3%.

Detracting from performance for the quarter was the fund's overweight exposure to global equities, together with US dollar strength. For equities in particular, the tactical overweight to Turkey, South Korea and Indonesia cost performance after these markets declined significantly. Although the fund benefited from being underweight global government bonds, the overweight to corporate bonds – particularly in Europe – detracted from performance.

STRATEGY AND POSITIONING

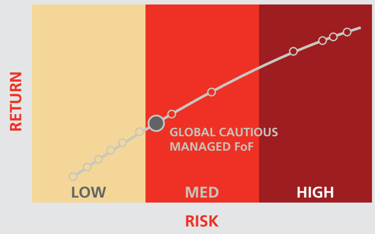
In our global portfolios we remain underweight global bonds and global cash, and overweight global equities, with the latter offering attractive valuations in many markets, particularly when viewed relative to bonds, and much higher potential returns over the medium term.

In global fixed income, as in previous quarters, despite rising government bond yields, they continue to trade at very low yields (and high valuations) historically, and remain at risk to rising interest rates in the US and UK, and increasingly in Europe as well. We continue to be underweight global sovereign bonds and underweight duration to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds.

For global equities, gains in developed markets over the quarter lifted valuations slightly, but these are still modestly cheap on a broad basis, having started the quarter at about 10% cheap. However, valuation disparities between developed and emerging markets widened in Q2, with markets like the Nasdaq returning 7.3% and S&P 500 3.4%, while many emerging markets were punished, making many materially cheap. In line with our active management approach, during the quarter we pared our overweight equity position modestly as developed markets became more expensive. 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 Indonesia, South Korea, Turkey and China. These overweight positions are financed primarily by an underweight in global bonds, as well as US equities to a lesser extent. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	6.1%	6.4%	6.4%
3 years	6.5%	6.3%	6.8%
5 years	8.7%	8.8%	n/a
7 years	11.6%	11.5%	n/a
10 years	5.6%	5.3%	n/a
Since inception	7.5%	7.0%	8.9%

RISK/RETURN PROFILE:



FUND MANAGERS:
Michael Moyle and David Knee

ASISA CATEGORY:
Global - Multi-Asset - Low Equity

BENCHMARK:
ASISA Global - Multi-Asset - Low Equity Category Mean

INCEPTION DATE:
1 March 2004

FUND SIZE:
R106 896 680

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL HIGH YIELD BOND FUND OF FUNDS
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

GLOBAL INCOME

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on bond markets, with emerging markets particularly hard-hit.

Global bonds lost 2.8% during the quarter, led lower by rising US interest rates and accelerating inflationary pressures. Confronted with a robust economy and inflation forecasts starting to overshoot its 2% inflation target, the US Federal Reserve took a hawkish stance, hiking interest rates by 25bps at its June FOMC meeting as widely expected, while also adding an extra 25bp hike to its 2018 forecast. This saw the yield on the benchmark 10-year US Treasury bond rise to 3% before retracing to end the quarter around 2.9%, barely above their end Q1 level. Shorter-dated bond yields rose even more, such that the difference between the 2-year yield (at about 2.5%) and the 10-year yield narrowed to around 40bps, its lowest since the global financial crisis. A negative differential (when shorter-dated bond yields are higher than longer-dated bonds, such that the yield curve is inverted) is a leading indicator of a global recession, a factor that captured the attention of many investors.

This supported a key theme for the quarter - the spreading view that global economic growth might slow sooner than expected. US Q1 GDP growth was revised downward to 2.2% (q/q annualised) versus the 2.3% expected. At the same time, in the Eurozone, Q1 GDP growth slowed to 2.5% (q/q annualised) from 2.8%, with the slowdown most visible in key economies Germany and France, and attributed to extreme winter weather, strikes in France and other temporary factors. German business confidence also continued to slump in Q2.

However, the US economy remained very robust, with unemployment at 3.8% in May - its lowest level since 2000 – and the latest manufacturing and non-manufacturing data still very elevated on an historic basis. The latest container volume survey (a proxy for measuring world trade) also picked up after taking a dip earlier in the year, showing that fears could possibly be overdone. And even amid concerns about US trade policy, the Fed raised its 2018 GDP forecast to 2.8% from 2.7% previously.

The European Central Bank (ECB) kept its benchmark interest rate unchanged at its June meeting, as had been expected, and also ruled out prospects of a rate hike until mid-2019 at the earliest. However, it did vote to end its bond-buying programme at the end of the year, discounting the Eurozone's slower growth as a temporary phenomenon. Its forecasts call for around 2.0% growth for 2018. Meanwhile, UK growth was reported at only 1.2% (q/q annualised) for Q1, and the Bank of England kept its rates on hold at its May meeting as inflation steadied and the pound strengthened somewhat – the central bank is reluctant to hike rates while Brexit uncertainty remains high.

After two years of growth, the Japanese economy contracted by 0.6% (q/q annualised) in Q1 2018, attributed to slower consumer spending on the back of harsh winter weather and higher food prices. However, the Bank of Japan's expansionary monetary policy remains in place, and real consumer incomes are rising, underpinning expectations of renewed growth for Q2. In China, Q1 GDP growth came it at 6.8% (q/q annualised), steady from the previous quarter and in line with expectations. There were growing signs of a slowdown in Q2, though, in the form of disappointing May data for industrial output, retail sales and investment. Compounded by growing concerns that US tariffs could considerably dent growth prospects (some forecasts point to a decline of up to 0.5% of GDP), sentiment became more negative, helping send Chinese stocks weaker.

The rand ended the quarter significantly weaker to major currencies, losing 15.2% against the US dollar, 9.8% against the euro and 8.9% against the pound sterling.

PERFORMANCE

The fund returned 10.3% in rand terms over the quarter, while its benchmark (the Bloomberg Barclays Global Aggregate Bond Index) delivered 12.5% in rand terms, helped significantly by the weak performance of the rand relative to the US dollar. The fund produced -4.7% in US dollar terms for the same period, reflecting the weakness in underlying bond markets. For the 12 months ending June 2018, the fund delivered 2.7%, underperforming its benchmark by 3.4% in rand terms.

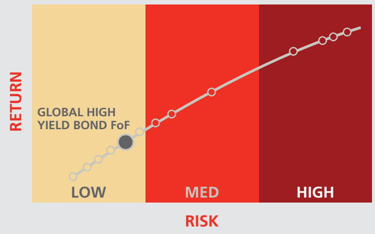
The fund benefited from being underweight global government bonds relative to its benchmark during the quarter, as they underperformed corporate bonds. Given the strength of the US dollar to the euro, the fund's overweight exposure to European corporate bonds detracted significantly from both its relative and absolute performance.

STRATEGY AND POSITIONING

In global fixed income, as in previous quarters, despite rising government bond yields, they continue to trade at very low yields (and high valuations) historically, and remain at risk to rising interest rates in the US and UK, and increasingly in Europe as well. We continue to be underweight global sovereign bonds and underweight duration to reduce interest rate risk, preferring to hold investment-grade US and European corporate bonds, which offer more attractive yields for the risk involved. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK
1 year	2.7%	6.1%
3 years	5.4%	6.8%
5 years	7.4%	8.2%
7 years	12.0%	11.9%
10 years	8.6%	8.5%
Since inception	8.4%	8.6%

RISK/RETURN PROFILE:



FUND MANAGERS:
David Knee and Michael Moyle

ASISA CATEGORY:
Global - Interest Bearing - Variable Term

BENCHMARK:
Bloomberg Barclays Global Aggregate Bond Index

INCEPTION DATE:
1 November 2000

FUND SIZE:
R440 684 743

AWARDS:
Raging Bull: 2006, 2008, 2013
Morningstar/Standard & Poor's: 2007, 2009, 2013

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL VALUE FUND OF FUNDS
30 JUNE 2018

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

GLOBAL EQUITY

MARKET OVERVIEW

It was another volatile quarter for global financial markets, hit by growing fears of a global trade war as the US, EU and China (plus others) ratcheted up tariff threats. This combined with some weaker-than-expected economic data, rising US interest rates and continuing risk-averse sentiment among global investors to weigh on both bond and equity markets, with emerging markets particularly hard-hit by asset sales. Developed equity markets ended the quarter returning 1.7% in US dollars, while emerging equity markets delivered -8.0%.

Global bonds lost 2.8% during the quarter, led lower by rising US interest rates and accelerating inflationary pressures. Confronted with a robust economy and inflation forecasts starting to overshoot its 2% inflation target, the US Federal Reserve took a hawkish stance, hiking interest rates by 25bps at its June FOMC meeting as widely expected, while also adding an extra 25bp hike to its 2018 forecast. This saw the yield on the benchmark 10-year US Treasury bond rise to 3% before retracing to end the quarter around 2.9%, barely above their end Q1 level. Shorter-dated bond yields rose even more, such that the difference between the 2-year yield (at about 2.5%) and the 10-year yield narrowed to around 40bps, its lowest since the global financial crisis. A negative differential (when shorter-dated bond yields are higher than longer-dated bonds, such that the yield curve is inverted) is a leading indicator of a global recession, a factor that captured the attention of many investors.

This supported a key theme for the quarter - the spreading view that global economic growth might slow sooner than expected. US Q1 GDP growth was revised downward to 2.2% (q/q annualised) versus the 2.3% expected. At the same time, in the Eurozone, Q1 GDP growth slowed to 2.5% (q/q annualised) from 2.8%, with the slowdown most visible in key economies Germany and France, and attributed to extreme winter weather, strikes in France and other temporary factors. German business confidence also continued to slump in Q2. However, the US economy remained very robust, with unemployment at 3.8% in May - its lowest level since 2000 – and the latest manufacturing and non-manufacturing data still very elevated on an historic basis. The latest container volume survey (a proxy for measuring world trade) also picked up after taking a dip earlier in the year, showing that fears could possibly be overdone. And even amid concerns about US trade policy, the Fed raised its 2018 GDP forecast to 2.8% from 2.7% previously.

The European Central Bank (ECB) kept its benchmark interest rate unchanged at its June meeting, as had been expected, and also ruled out prospects of a rate hike until mid-2019 at the earliest. However, it did vote to end its bond-buying programme at the end of the year, discounting the Eurozone's slower growth as a temporary phenomenon. Its forecasts call for around 2.0% growth for 2018. Meanwhile, UK growth was reported at only 1.2% (q/q annualised) for Q1, and the Bank of England kept its rates on hold at its May meeting as inflation steadied and the pound strengthened somewhat – the central bank is reluctant to hike rates while Brexit uncertainty remains high.

After two years of growth, the Japanese economy contracted by 0.6% (q/q annualised) in Q1 2018, attributed to slower consumer spending on the back of harsh winter weather and higher food prices. However, the Bank of Japan's expansionary monetary policy remains in place, and real consumer incomes are rising, underpinning expectations of renewed growth for Q2. In China, Q1 GDP growth came it at 6.8% (q/q annualised), steady from the previous quarter and in line with expectations. There were growing signs of a slowdown in Q2, though, in the form of disappointing May data for industrial output, retail sales and investment. Compounded by growing concerns that US tariffs could considerably dent growth prospects (some forecasts point to a decline of up to 0.5% of GDP), sentiment became more negative, helping send Chinese stocks weaker.

The rand ended the quarter significantly weaker to major currencies, losing 15.2% against the US dollar, 9.8% against the euro and 8.9% against the pound sterling.

PERFORMANCE

The fund returned 14.1% in rand terms for the three months ended 30 June 2018, compared to 16.3% from its benchmark (the MSCI All Countries World Index). In US dollar terms the fund delivered -1.3%, over the same period, reflecting the underlying weakness in global equity markets. For the 12 months ending June 2018, the fund returned 11.7% in rand terms, underperforming its benchmark by 4.2%.

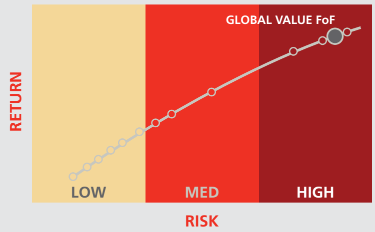
US dollar strength was a major detractor from fund performance for the quarter as the fund was underweight US dollar assets and overweight other currencies. The fund's tactical overweight position to Turkish and Indonesian stock markets, which had significant declines during the quarter, also detracted from performance. Stock selection in Japan as well as an underweight exposure to the Information Technology sector in the US also detracted from performance.

STRATEGY AND POSITIONING

Global equities offer attractive valuations in many markets. Although gains in developed markets over the quarter lifted valuations slightly, these are still modestly cheap on a broad basis, having started the quarter at about 10% cheap. Valuation disparities between developed and emerging markets widened in Q2, with markets like the Nasdaq returning 7.3% and S&P 500 3.4%, while many emerging markets were punished, making many materially cheap. 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 Indonesia, South Korea, Turkey and China. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK
1 year	11.7%	15.9%
3 years	10.8%	12.7%
5 years	14.9%	16.7%
7 years	17.0%	19.4%
10 years	9.6%	11.9%
Since inception	7.1%	8.4%

RISK/RETURN PROFILE:



FUND MANAGERS:
David Knee and Michael Moyle

ASISA CATEGORY:
Global - Equity - General

BENCHMARK:
MSCI All Country World Index (Net)

INCEPTION DATE:
18 February 2000

FUND SIZE:
R295 578 080

Sources: Prudential, Morningstar & Deutsche Securities