IJG SECURITIES

INVESTMENT IMPLICATIONS:

ECONOMIC OUTLOOK

JANUARY 2015

1. Widening net interest margin to be positive for banks

"In South Africa, a situation of stagflation was narrowly and luckily averted through the oil price decline, rapidly increasing the policy space available to the South African Reserve Bank (SARB), as inflation receded from the top end of the target band towards the end of 2014. This decline in inflation is to continue through the first half of 2015, and South African inflation is expected to fall to below four percent over this period. While contrary to popular opinion, it is the view of IJG that the SARB will cut interest rates by 50 basis points through the year, as inflation pressure abates, due to the anemic nature of growth in the South African economy, not to mention household deleveraging in real terms, pervasive unemployment and expected Rand strength.

While the Bank of Namibia tends to follow the SARB fairly closely due to the Namibia Dollar-Rand peg, the uncoupling of the two economies over recent years presents a challenge for Namibian policy makers. Various factors suggest that Namibia needs significantly higher interest rates than her southern neighbour. These include the fact that Namibia continues to grow at above-trend levels, while South Africa languishes well below full output; Namibia see's private sector credit extension (PSCE) growth of upward of 18 percent – leading to the possibility of a credit bubble being created, while South Africa sees PSCE growth of under four percent (deleveraging in real terms); and Namibia's reserve position has grown ever more thin over recent years (particularly in hard currency terms) due to large volumes of consumer-imports, primarily, funded through credit extension. Nevertheless, it remains unlikely that Namibia will take a drastically divergent monetary policy position from that of South Africa, but it is similarly unlikely that BoN will follow South Africa should the SARB cut rates as expected."

An interest rate cut in South Africa will lower deposit rates and thus the cost of funding for Namibian banks. At the same time, if BoN keeps rates on hold-or on the off chance, hikes rates- the interest rates on advances will remain elevated and consequently we expect to see the net interest margins of banks widening, creating positive through flow to the bottom line.

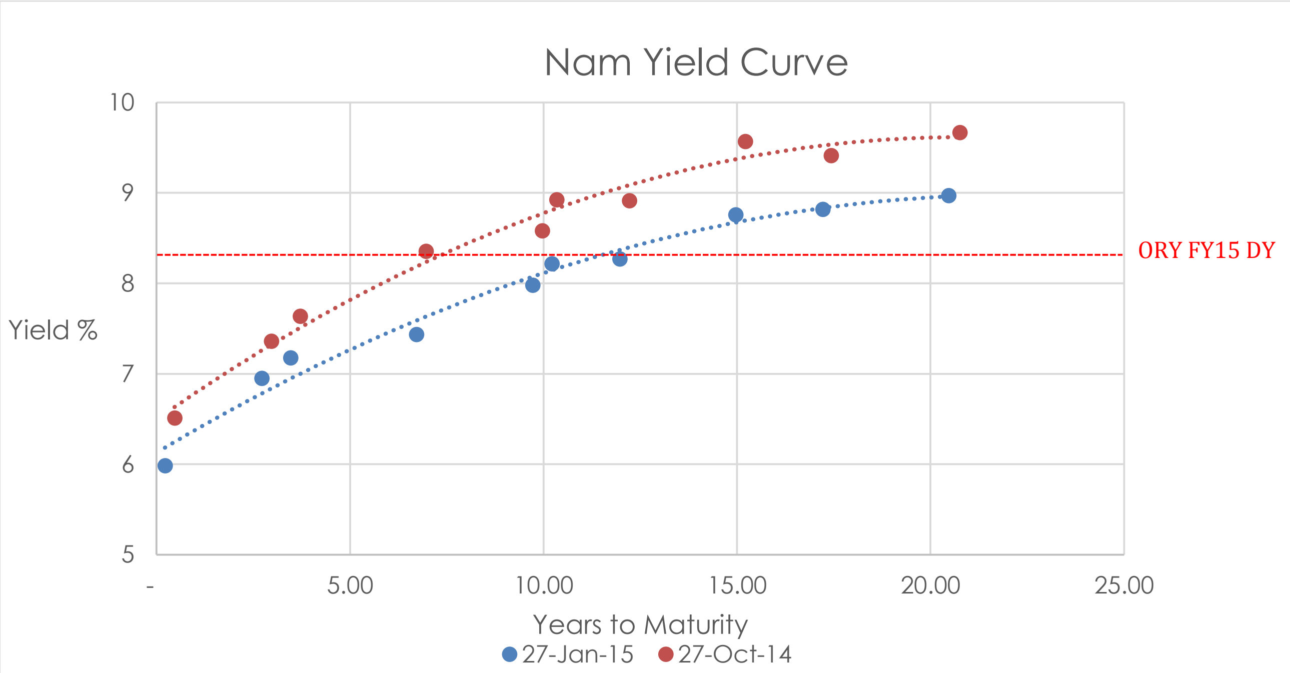
OVERWEIGHT Bank Windhoek and FNB Namibia

2. Oryx relative yield play on the back flattening yield curve

A number of factors lead to a flattening in the yield curve over the past quarter, namely the drop in the oil price, global growth concerns, ECB QE and lower inflation expectations (as discussed throughout the economic outlook report).

The move in the yield curve has priced bonds relatively more expensive when compared to Oryx Properties, thus we recommend a medium term switch out of government bonds into Oryx Properties in order to take advantage of the yield play. At current yields an investor can purchase Oryx Properties 12bps higher than the GC24, as opposed to 48bps lower than the GC24 three months ago.

Tactical INCREASE in Oryx Properties exposure



3. Drop in oil prices

"The major collapse in oil prices has been driven by both demand and supply side factors, with the latter being the more significant of the two. Major supply increases from the US has taken the country from being a major importer to close-to-self-sufficient. This major change in global supply dynamics has irrevocably altered the elasticity of supply for OPEC, who it appears is no longer able to increase prices sufficiently through a decrease in supply, to make such a move worthwhile. While conspiracy theorists suggest that OPEC is trying to sink marginal producers and regain control of global supply, or that the US is attempting to undermine the Russian economy through oil revenue collapse, neither is likely, as many OPEC producers have higher operating costs and breakeven points than the so called marginal suppliers, and investment in oil productive capacity far predates current US-Russia tensions. However, whatever the cause, the bottom line is that for net oil importers, 2015 should see improved gross value addition (cet. par.) on the back of lower input costs and increased disposable income, while oil exporters can be expected to struggle as revenues plummet."

Fuel costs represent a substantial portion of Bidvest Namibia operating costs with the company expected to benefit from the lower oil prices. Although the company is facing challenges in terms of quotas, we expect cheaper fuel and a soft rand to partially offset the negative impact from quotas.

NO CHANGE in Bidvest position, but increased probability for positive earnings surprise.

4. Euro weakness

"Following a number of hugely challenging years for the economies of Europe and the Eurozone, in early 2015 the European Central Bank (ECB) announced a long overdue bond buying, quantitative easing (QE) programme, illustrating a not-before seen commitment to driving recovery in the monetary union. While QE is unlikely to be sufficient to drive major recovery alone, it is viewed by many as a critical step in the right direction, driving down interest rates, weakening the exchange rate and improving investor and consumer confidence (particularly confidence in the commitment of policy makers)."

"Euro-Dollar parity to be seen in 2015 or Q1 2016"

A significant portion of Namibia Breweries operating costs are Euro denominated, thus the weakening Euro will decrease the company's cost base and improve operating margins with earnings likely to surprise on the upside.

NO CHANGE in Namibia Breweries position, but increased probability for positive earnings surprise.

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5. Lower inflation and probable rate cut in South Africa – Pro SA consumers

"In South Africa, a situation of stagflation was narrowly and luckily averted through the oil price decline, rapidly increasing the policy space available to the South African Reserve Bank (SARB), as inflation receded from the top end of the target band towards the end of 2014. This decline in inflation is to continue through the first half of 2015, and South African inflation is expected to fall to below four percent over this period. While contrary to popular opinion, it is the view of IJG that the SARB will cut interest rates by 50 basis points through the year, as inflation pressure abates, due to the anemic nature of growth in the South African economy, not to mention household deleveraging in real terms, pervasive unemployment and expected Rand strength."

We view the changes in inflation and interest rate expectations as positive for the SA consumer, thus we recommend buying into consumer staples and consumer discretionary in order to take advantage of this move. The consumer sectors are also ranking ever more highly in our monitored factors, namely forecast earnings revisions and price momentum.

OVERWEIGHT SA consumer staples and consumer discretionary on increased disposable income.

6. Divergence: SA versus Namibian economies

We highlighted throughout the report that the South African and Namibian economies are the most divergent they have ever been in the independent history of Namibia, from a number of perspectives. At the same time South Africa is currently on negative watch by Fitch (although still on a "stable" outlook by S&P and Moody's).

Should a ratings downgrade come through it should have a material impact on the Namibian government bonds spreads relative to the SA benchmarks.

LONG Namibian yield curve, SHORT SA yield curve to capture divergence theme

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