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GLOBAL PERSPECTIVES

POLITICAL HEADWINDS & GLOBAL VOLATILITY

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EMERGING NATIONS TO STAND ON THEIR OWN
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AFRICAN DEMOCRACY
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ASHBURTON INVESTMENTS
Focused Insight

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The world is seeing turmoil and volatility across societies and within country politics.

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Investing in an uncertain world

BOSHOFF GROBLER,
CEO Ashburton Investments.

Wherever you turn at the moment you are faced with change, turmoil and volatility in global markets, across societies and within country politics. While it is easy to point to the events unfolding in South Africa's National Assembly and the shenanigans leading up to local government elections on 3 August 2016, we are most certainly not alone.

In mid-May 2016, riots erupted in Nairobi, Kenya over allegedly partisan election officials; French demonstrators clashed with police in Paris over labour reforms; Brazil (already facing political turmoil following a vote to impeach incumbent President Dilma Rousseff) saw riot police clashing with protestors just weeks before the Rio Olympic Games. The European Union is faced with the effects of the British withdrawal while, across the pond in the United States, Republican presidential nominee Donald Trump is creating waves with his shoot-from-the-hip approach which has angered Muslims, Mexicans, women and new London Mayor, Sadiq Khan.

Derry Pickford offers us a thoughtful analysis of the events unfolding in Britain and the United States, and the implications of political uncertainty in two of the world's biggest and most established economies. His article offers much to ponder, especially in light of a global rise in anti-establishment popularism and the implications for the world economy.

Faced with such uncertainty, investors are, understandably, concerned about the state of the financial markets and how various asset classes perform during volatile times. Under the broad theme of 'global political headwinds and the economic impact', we've attempted to unpack the state of the world economy, turning a keen eye to the African political outlook and that of emerging markets in general. We have also revisited our previous analysis of the oil price, with Richard Robinson exploring the long-term view of the Ashburton Global Energy Fund, and the reasons for this stance.

We have Paul Clark to thank for providing some good news in his contribution: 'African democracy: Fact or fiction?' While challenges certainly exist across our continent, there are green shoots worth celebrating, not least of which are the efforts by both Nigerian President Muhammadu Buhari and Tanzanian President John Magufuli to tackle corruption head on in their respective countries.

For years commentators on Africa have decried the 'lumping together' of the 54 diverse countries which make up the continent and now, as significant differences emerge in the broader global emerging market space, we are seeing the same sort of thinking shine through. Jonathan Schlessl takes us on this journey, asking us, as investors, to move away from the grouping approach that has given us acronyms such as BRICS, CIVETS and MINTs and consider each individual country on its merits.

That said, taking this view does not necessarily bode well for the South African outlook and, with 2016 possibly being the year of the sovereign credit rating downgrade, Rob Hamer and Craig Sherman in their article, explain the implications as well as the process which ratings agencies follow.

Finally, Mark Appleton has contributed an important piece which outlines our approach to investing across various asset classes during these turbulent times, and underscoring our cautious position at this time. As he notes: "We have become somewhat more sensitive to the risks and are keeping some powder dry for opportunities as they arise."

At this time, and based on the analysis we've put together for you in this issue of Global Perspectives, I would like to assure investors that our portfolios are well positioned to navigate the short-term volatility in global markets and to take advantage of compelling medium-term valuations in equities, bonds and property. We believe in sticking to the basics during times of uncertainty and ensuring that, as always, we apply our new generation thinking to unlocking value and helping you achieve better returns at a lower cost and with lower risk.

"A sovereign credit rating is an opinion about the creditworthiness of a country. This is determined through an assessment of the sovereign's ability and willingness to honour its existing and future obligations in full and on time."

South Africa's Finance Minister Pravin Gordhan under the spotlight.

The ins and outs of ratings downgrades

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South Africa's sovereign credit rating has been steadily downgraded over the last four years and the pace of the negative ratings trajectory looks set to continue despite the recent reprieve received from Standard & Poor's on 3 June affirming South Africa's investment grade rating albeit with a negative outlook.

The rating debate has intensified since December 2015 when not one, but two, South African ministers of finance were replaced in quick succession. This promptly sent the bond market and the rand into a tailspin. Since then, the extent of damage control has been prolific with Finance Minister Pravin Gordhan stating that the government must "do whatever is necessary to avoid a cut to sub-investment grade". As a result, we have witnessed an increased dialogue between government and business, providing some form of encouragement. However, this has not yet produced any hard evidence that the structural reforms needed to promote growth in the economy, have, or will be addressed in the near future. This inaction, coupled with, a lack of bold remedies in February's Budget presentation leaves the country with the seemingly inevitable hanging over its head: a downgrade to BB+ by at least one rating agency.

But, despite the national discourse being fueled by ratings downgrade talk, many investors are unsure of the full implications of such a move or, indeed, the role of ratings agencies.

Sovereign ratings: The basics

A sovereign credit rating is an opinion about the creditworthiness of a country. This is determined through an assessment of the sovereign's ability and willingness to honour its existing and future obligations in full and on time. There are a wide variety of credit ratings that are produced by a number of international and local credit rating agencies, including both foreign currency and local currency ratings as well as the agency's future outlook for such rating.

There are currently three global rating agencies that rate South Africa: Moody's Investor Services (Moody's), Standard & Poor's (S&P) and Fitch Ratings. The sovereign rating methodologies of the three agencies are broadly similar and measure five assessment factors to determine the final rating:

Summary of sovereign ratings methodologies

Assessment factors	Key measurement areas
Institutional strength	Policy credibility and stability, rule of law, corruption indicators, enforceability of contracts, reliability of information, degree of social inclusion, political stability
Economic growth	GDP per capita, trend GDP growth and volatility of GDP growth
External position	External indebtedness and interest service, current account balances, level of foreign exchange reserves
Fiscal position	Net government debt to GDP, government debt including contingent liabilities, budget balance
Monetary policy	Effectiveness of monetary policy as indicated by degree of price stability, independence of central bank, level of development of financial system and capital markets

Note: The table is a summary of the key measurement areas across Moody's, Fitch and S&P methodologies.
Source: Moody's, Fitch, S&P

With regard to the fiscal assessment, South Africa's metrics are more closely aligned with the BB rating band averages as indicated below:

Fiscal position metrics compared to ratings peers (%)

	Rating	Gross debt/ GDP	Budget balance/ GDP	External debt/ GDP	Debt service/ Revenue
BBB ave		44.0	-2.4	99.0	7.9
Mexico	BBB+	44.0	-2.4	95.0	9.2
Philippines	BBB+	37.0	-1.0	82.0	8.1
India	BBB-	68.0	-6.9	99.0	23.0
SA	BBB-	50.0	-3.2	105.0	12.0
BB ave	BB	44.2	-3.5	99.0	7.9
Russia	BB+	14.0	-3.4	85.0	2.9
Turkey	BB+	34.0	-1.7	217.0	7.2
Indonesia	BB+	25.0	-2.1	133.0	7.9
Brazil	BB	73.0	-84.0	232.0	22.0

Source: S&P
*Current Account Receipts

In recent years the biggest threat to South Africa's sovereign rating has been disappointing economic growth. The latest official forecast from the 2016/2017 Budget was revised to 0.9% for this year and 1.7% for 2017, down from 1.7% and 2.6% respectively. S&P has also now revised its forecast to 0.6% down from 1.6% as of December. The inability to achieve this moderate 1.6% growth comes down to weak external demand, continued low commodity prices, domestic constraints and weak business confidence inhibiting substantial private sector investment. All factors which seemingly seal the deal for a downgrade in December 2016 by S&P. Similarly, Moody's and Fitch have forecasted 2016 GDP growth at 1.4% and 1.7%, respectively.

Why do ratings matter?

Sovereign credit ratings are an indicator of the risk level associated with the investment environment of a country and are used to determine the risk premium payable on debt instruments issued by the country. This will often also have spillover effects to the corporate, bank and state-owned company (SOC) debt markets, as these entities mostly raise debt at a premium to government, which is viewed as the least risky borrower in a country. Both bank and SOC ratings will generally be downgraded following a sovereign downgrade. This is due to the deterioration in government's ability to support its banks and SOCs as a result of weaker government fundamentals and weaker ratings uplift assumptions. These adjustments may trigger some form of general re-pricing of the cost of credit in South Africa.

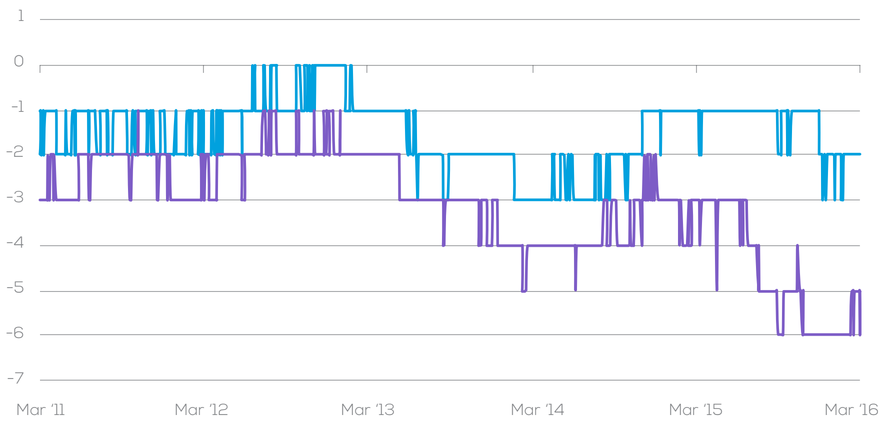
Sovereign credit ratings may also be a factor in determining the inclusion of a country's bonds in a government bond index. Index inclusion is important as this creates a natural demand for a country's bonds within passive investment strategies. Notable inclusions for South Africa are the Citibank World Government Bond Index (WGBI) as well as the JP Morgan Emerging Market Bond Index (EMBI). While the WGBI does have a minimum local currency investment grade rating requirement from Moody's or S&P, the JP Morgan EMBI has no rating requirement for inclusion and "may invest without limit in securities that are rated below investment grade". While the South African foreign currency rating will most likely be downgraded to sub-investment grade by S&P, and possibly Fitch as well this year, the local currency ratings are still three, and two notches away from sub-investment grade. This implies that a mass exodus of passive holdings of South African government bonds as a result of ratings downgrades is an unlikely occurrence in the medium-term. However, many institutional investors operating under discretionary mandates are limited to investing into investment grade bonds. This may cause some forced selling but we expect this to be orderly as the potential downgrade has been well telegraphed to the markets. In the long term the inability of these funds to buy sub-investment grade debt may limit the availability of capital to finance South Africa's borrowing needs, leading to increased costs as new pools of capital would have to be incentivised to make an investment decision.

What is the market telling us?

Since the global financial crisis, rating agencies have been widely criticised for being backward looking and for failing to take timeous action. The nature of the ratings process, however, involves analysing historical quantitative information and it is therefore helpful to compare traditional credit ratings with market indicators such as credit default swap (CDS) spreads, bond yields and the market implied ratings (MIR) displayed by such traded instruments. CDS spreads are often used as a proxy for the credit risk premium, which is quantified as the cost of insuring debt against a default.

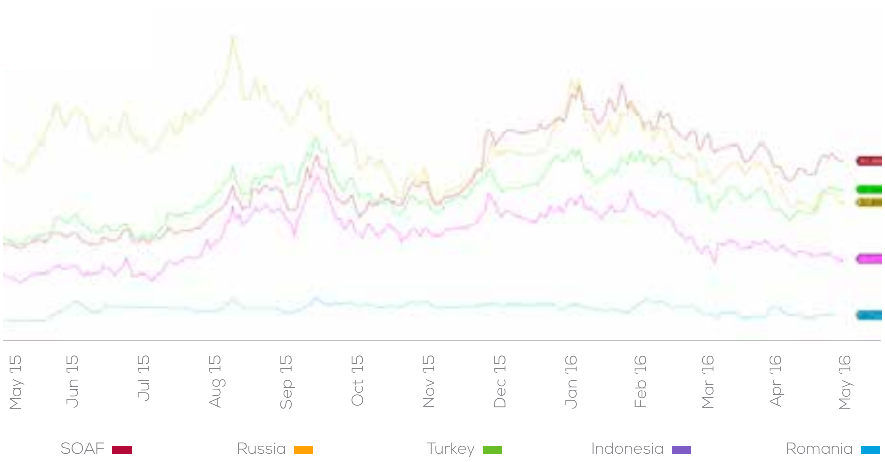
We look at these indicators to determine what the market is telling us a sovereign rating should be. The Moody's bond and CDS MIR currently indicate a two and five notch gap between the published rating and the market priced ratings. This implies that bond yields and CDS spreads are currently pricing South African ratings as low as Ba1 and B1 - in line with Morocco, Portugal, Hungary (Ba1) and Kenya, Uganda and Vietnam (B1).

South Africa's bond and CDS implied ratings gap



Source: Moody's

South Africa and ratings peers CDS spreads



Foreign currency long term rating

Country	Fitch	Moody's	S&P
South Africa	BBB-	Baa2	BBB-
Romania	BBB-	Baa3	BBB-
Turkey	BBB-	Baa3	BB+
Russia	BBB-	Ba1	BB+

Source: Bloomberg

What happens next?

Not only do South Africa's fundamental rating indicators appear in line with sub-investment grade averages, but market indicators such as CDS spreads and MIR ratings echo the fact that South Africa is de facto a sub-investment grade country. The question now is: What would the impact be of a foreign currency downgrade to sub-investment grade on the local bond and credit markets?

Simply put, probably not much. Ashburton Investments believes the local government bond market has largely priced in a downgrade and that the specific impact on bond yields at the time of a downgrade will be driven mostly by the outlook for a recovery in the global economy, especially the United States. From a local equity market perspective, valuations will be influenced by prevailing risk free rates (i.e. 10 year bond yields) and much will depend on the reaction here.

At a country level, however, research by Avior indicates that, on average, bond yields, currency and CDS spreads peak on the date on which a country is downgraded, and could improve from then. However, other possible consequences of a ratings downgrade could include further negative sentiment on foreign investment, a rise in the cost of capital, continued high levels of rand volatility, decreasing competitiveness of South African businesses in Africa and elsewhere and further diversification (externalisation) efforts by SA Inc. Clearly, already challenging market conditions will become even more difficult.

What is also of concern is that, on average, it takes a country seven-and-a-half years to regain its investment grade rating, if at all, once it has been downgraded to sub-investment grade. Changing the negative ratings trajectory would require more than is currently being done from a policy and economic perspective to stimulate GDP growth and provide much-needed business confidence to the private sector.

Our portfolios are positioned to look through this short-term volatility and take advantage of compelling medium-term valuations in equities, bonds and property. During this time of uncertainty, our approach is to stick to the basics: select counterparties carefully, ensure we are well positioned to execute as opportunities arise, and ensure that each of our assets is priced for value through the cycle.

"South Africa's fundamental rating indicators appear in line with sub-investment grade averages"

Global political uncertainty: The Donald and the rise of popularism

DERRY PICKFORD,
Co-Head of Allocation,
Ashburton Investments.

The likes of South Africa and Brazil are not alone in tackling political uncertainty; unfolding events in the United States and the United Kingdom could have a profound impact on international relations and markets.

The predictably unpredictable Donald Trump – Republican nominee.

In general, elections in most Group of Seven (G7) countries don't matter that much for either markets or economies. After elections in Canada, France, Germany, Italy, Japan, the United Kingdom or the United States we seldom see a huge shift in economic policy; despite what the pundits say. But the United States presidential election in November could prove the exception to the rule.

If you believe the bookmakers, then Democrat Hillary Clinton is a near shoe-in for the presidency come November: the Betfair online market has previously priced the chance of her winning as high as 75%. That said, as anyone who has been following the English Premier League football season knows, the bookies can get things spectacularly wrong. Furthermore, if there is one thing to count on with Republican nominee Donald Trump it is that he will be predictably unpredictable. This is a candidate who the Economist magazine has described as "terrible news for Republicans, America and the world". Markets are, therefore, paying close attention to this election; and rightly so.

The optimal strategy for any underdog is to take risks and to be as disruptive as possible. The more uncertainty there is, the greater the chance the underdog has of winning. The size of Trump's victories in the Indiana and East Coast primaries suggest that he is connecting with a large part of the electorate who feel that traditional politicians have let them down. This begs the question: Why is America so unhappy? Pew Research Center data tells us that, between 1999 and 2014, the median household income fell more in three quarters of United States metropolitan areas than it has so far over this century. Americans are angry, and many of these Americans happen to reside in areas which will prove crucial in deciding the next president.

Springfield, Ohio, a rust-belt city that lies to the west of the state capital Columbus, epitomises the economic dissatisfaction evident in many households across the United States. The median income there has fallen 27% since 2000. Trump's narrative that their plight has been driven by globalisation and immigration in general, and trade with China and Mexico in particular, has struck a chord; it is no surprise that he believes these are the areas in which he can score big wins.

The majority of states in the country use a winner-takes-all system when it comes to the polls, one which awards all the Electoral College votes to the winning candidate in the state. This means that 40 of the 50 states are firmly either Democratic or Republican and the outcome of the election is determined by a small number of 'swing states'. Ohio is one of those key states. Obama won Ohio by a margin of 3% in 2012 and this year's race is equally tight in the polls. Clinton remains ahead in Pennsylvania, another state which has been buffeted by de-industrialisation, but only marginally. A wrong-step, including potentially embarrassing revelations about her use of a personal email account for government business when Secretary of State, might be enough to tip the balance in Trump's favour. Given Trump's ability to - so far - confound initial expectations, it is far too early to write him off.

We are, therefore, faced with two potential courses for economic policy in a post-election United States; two approaches which are, arguably, more disparate than in any United States presidential election in the last 30 years. Although the Trump campaign has been somewhat inconsistent in its policy programme, there are some details which are clear. Trump's attitude to free trade can only be considered as hostile. The North American Free Trade Agreement will be under attack under a Trump administration, and there will also be big penalties for United States companies which outsource production abroad.

It is important to note that, globally, the rise of anti-establishment populism isn't just constrained to the United States. The British public recently voted to leave the European Union (EU), an outcome many didn't expect, and definitely not the financial markets.

"In the United Kingdom, the 'Leave' campaign has failed to provide a convincing model of how Britain will trade with the rest of the world post-Brexit."

Hillary Clinton, Democrat nominee, tries for the second time to be US president.

While the majority of economists agree, at least in the short term, that the United Kingdom leaving the EU will be disruptive for both the country and global economy, one cannot ignore the significance of the disruption. The UK is now in political turmoil, its sovereign credit ratings have been downgraded and devolved territories, led by Scotland, are agitating for independence.

The main economic damage to the UK in the short term will come from increased uncertainty, delaying and reducing investment. We expect both residential and commercial real estate to be negatively impacted. Exports are more sensitive to a country's key importers' demand, rather than foreign exchange depreciation.

This outcome will also mean that northern European members of the EU will lose a powerful ally in trying to make the EU a more pro-market environment for business. An EU without Britain is likely to become more anti-trade and more pro-worker rights.

Of course, there are good reasons why the bookies believe that Clinton will be the next US President. Donald Trump has alienated a huge part of the US electorate with 86% of African-Americans and 80% of Hispanics having negative views of him. Even if we avoid these potential shocks to the global economy, they are indicative of a rising tide of nationalism across the world. France and Italy are also vulnerable to either a far right or far left government taking power in the next couple of decades. Global political uncertainty is a risk that looks set to be around for many years yet.

Credit ratings and Economic growth

Baa3

A bond is considered investment grade or IG if its credit rating is BBB- or higher by Standard & Poor's or **Baa3** or higher by Moody's.

7.5 years

is what it takes a country on average to regain its investment grade rating, once it has been downgraded to sub-investment grade.

4 years

For 4 years SA's credit rating has been steadily downgraded.

0.9%

the latest official economic growth forecast from the 2016/2017 budget for this year, 1.7% for 2017.

0.6%

Standard & Poor's revised growth forecast for South Africa, down from 1.6%.

African Democracy

50%

of Africans now live in authoritarian regimes, **down from 73% in 2010.**

18th

Out of 167 countries - Mauritius - regarded as a full democracy - is Africa's most democratic country, ahead of the United States at 20th.

37th

out of 167 countries – that is South Africa's ranking according to Economist Intelligence Unit (EIU) which publishes a comprehensive Democracy Index, rating 167 countries on a scale of 0 to 10.

Oil and the Energy Fund

1.8 trillion

Barrels per day were supplied in 2015, which was an oversupply.

US$40

Was the price of oil in August last year, before plummeting further to US$26/barrel in January 2016.

4%

The percentage by which the Ashburton Global Energy Fund outperformed the benchmark, between January and mid - April 2016.

90%

Reduction in new wells being drilled and supply from shale oil already 600kbb lower since June in the United States.

6.68%

China has just reduced 2016 production targets by 6.86% to four million barrels 600kbb lower since June in the United States.

Election Dates 2016

3 August 2016

The 2016 South African municipal elections will take place in all 9 provinces.

11 August 2016

Zambia, President Edgar Lungu won power earlier this year to serve out the remainder of Michael Sata's term who died in office.

8 November 2016

United States presidential elections.

27 November 2016

The Democratic Republic of Congo (DRC), faced a critical test in 2016 – Joseph kabila has ruled the country for 15 years.

7 December 2016

Ghana, the economic headwinds could be too much to overcome for current President John Mahana despite the advantages of incumbency. closed down 4.6%.

Sources: Standard & Poor's, Fitch, Moody's, USA Today, The Economist Intelligence Unit, IMF Economic Outlook 2016, OPEC, Ashburton Investments, Quarts Africa, www.investopedia.com

Know your asset attributes

Varying asset classes behave and perform differently during volatile times, making the process of determining exposure of paramount importance. This requires asking some searching questions.

MARK APPLETON,
SA Head of Asset and Strategy,
Ashburton Investments.

What is an asset worth? The basic theory has it that it's the present value of all the future income streams that that asset is capable of producing over time. While this makes intuitive sense, of course it begs the question of why the prices of these assets seem to move around so much these days. Why are markets seemingly so volatile? Determining a future income stream is both an art and a science, as is determining the right discount rate to use in calculating what those income streams are worth in today's money.

"Determining a future income stream is both an art and a science, as is determining the right discount rate to use in calculating what those income streams are worth in today's money."

It's precisely because the inputs to the equation appear to be so varied and so uncertain these days that the sense of worth also appears so volatile.

So what are these volatile inputs? On the income side of the equation the primary source of uncertainty in today's market flows from an uncertain economic outlook both globally and locally. Uncertainty is evidenced by a lack of consumer confidence, which leads to a lack of spending and demand. Corporate revenues tend to be constrained in this type of environment and this, in turn, serves to stunt profit growth.

In the past few years profits have been supported by increasingly low interest rates (lower borrowing costs) and by the ability of corporates to drive down input costs. The big questions now are:

- How much lower can interest rates go?
- How stimulatory will these ultra-low interest rates prove in terms of incentivising people to spend money and thereby boost corporate revenues?

Can interest rates go deeply negative? Surely if they do then people will keep their cash under their beds and not in the bank? And if banks can't attract deposits, then how do they lend? From a saver's perspective, if the expectation is that interest rates will stay low for a very long time, then does it not mean that you will be tempted to save more for your retirement, not less, because you may have to draw down on capital? This means less spending, not more.

From a cost containment perspective most of the benefits of low interest rates are now in the base and so the benefits for profit growth are becoming increasingly limited. On top of this there is evidence of decelerating productivity growth, which leads to squeezed margins.

What about the discount rate effect?

There is little doubt that low discount rates boost the present values of future income. But the bulk of this effect has already been felt. Indeed the shock absorbing capability of lowering interest rates to offset any economic shocks is becoming increasingly limited. At the same time, if interest rates started to rise in the absence of an improved economic outlook then this would certainly prove deeply unsettling to markets. There is still some concern in the market that the United States Federal Reserve may make a policy error by hiking rates prematurely, and this has added to the uncertain outlook.

How does one invest during these volatile times?

Recognising changing risk profiles is becoming increasingly important in today's turbulent market. Different asset classes have differing relative values and their relationships with each other change from time to time. This means there will be an increased emphasis on tactical asset allocation in volatile times. Are equities cheap or expensive relative to a changing risk outlook? Is corporate debt a better value proposition than sovereign debt? Are emerging market currencies cheap? Are cyclical equities better than defensives?

Right now we are cautious. We have become somewhat more sensitive to the risks and are keeping some powder dry for opportunities as they arise. We are underweight equities and overweight cash in very broad terms. From a South African perspective we are of the view that the rand, while generally vulnerable and fragile, will have bouts of strength from deeply oversold positions. This means that even though we will tend to have a rand hedge bias within an equity portfolio over time, we may also be attracted to high yielding sovereign bonds that are likely to do well in times of rand strength.

African democracy: Fact or fiction?

In 2015 several key elections took place across the African continent which provided hope that African politics had matured and that future changes would come via the ballot box of democracy.

PAUL CLARK,
Fund Manager,
Ashburton Investments.

The most momentous of these was the peaceful transition of power from the People's Democratic Party to the All Progressives Congress in Nigeria (Africa's most populous nation), when former President Goodluck Jonathan conceded defeat to his opponent and current President Muhammadu Buhari. This transition came in only the fourth election since the end of military rule in Nigeria in 1999.

In East Africa, we saw a change of administration in Tanzania, when John Magufuli was selected as the surprise candidate for the ruling Chama Cha Mapinduzi (CCM) party, even though he was never a party insider.

"There is a general sense that democracy is improving across the continent, aided by improved communication and a younger generation who hanker for better economic management."


ELECTORAL COMMISSION OF ZAMBIA
Free and Fair

Muhammadu Buhari is determined to root out corruption in Nigeria.

Maguful won a hotly contested presidential race against the former Prime Minister, Edward Lowassa, who had crossed the floor to the opposition in order to run against him. Like Buhari in Nigeria, Magufuli's campaign was strongly focussed on a commitment to reduce corruption and, to date, Magufuli has appeared to be acting on his election promise. Within one month of his inauguration he suspended the head of the Tanzanian Revenue Authority and five other tax officials, pending an investigation into claims of corruption (if you want to see the impact he has had on the national discourse take a look at #WhatWould MagufuliDo on Twitter for some humourous thoughts on saving money).

In Nigeria, Buhari made it clear in his inauguration speech that corruption would not be tolerated and, by October 2015, Nigeria's former oil minister Diezani Alison-Madueke had been arrested in London. She is believed to have embezzled billions of dollars from the state-owned Nigerian National Petroleum Corporation. Buhari also ordered the arrest of the former national security adviser, accusing him of stealing about US$2 billion through phantom arms contracts.

Zambia held a presidential by-election in January 2015, after the death in office of President Michael Sata. The opposition performed strongly but their candidate, Hakainde Hichilema, lost to the ruling party's Edgar Lungu by a mere 1.7%. Given this tight race, we could well see a change in government when Zambians go to the polls on 11 August 2016; that is if the opposition can build on the momentum they built last year.

By contrast, 2016 has seen some setbacks in smaller and less well run countries. In Burundi, President Pierre Nkurunziza used a legal loophole to stand for a third term in office after failing to rally sufficient support for a constitutional amendment. Subsequent to his re-election in July, the country has faced significant unrest, which has led to many deaths and sparked fears that civil war may again erupt in the country.

President Yoweri Museveni has been re-elected in Uganda for a further five years to extend his current 30-year incumbency. His closest rival, Kizza Besigye, who garnered 34% of the vote and claimed that the election was rigged, has been imprisoned numerous times after calling for peaceful protests. During the Ugandan poll in February 2016 a social media 'blackout' was imposed on Facebook, Twitter and WhatsApp; a move which Museveni called a "security measure to avert lies".

The Republic of the Congo also saw internet and cellphone coverage blocked as citizens headed to the polls in March. President Denis Sassou-Nguesso was re-elected for a further five-year term after changes to the constitution removed age and term limits for the president. This was not an isolated event, even one of the most respected African presidents, Rwanda's Paul Kagame, called for a referendum to change term limits. The referendum, held in December 2015, saw more than 98% of voters approve the changes. Unsurprisingly, after this endorsement, Kagame announced he would run for office again in elections that are due to be held next year.

Despite these setbacks we have also seen some positive changes. President Macky Sall convinced Senegalese voters to approve changes to their constitution during a referendum in March. Changes included reducing his term of office from seven years to five, as well as strengthening the rights of citizens and opposition party members. We have also seen citizens reject constitutional changes in the Democratic Republic of the Congo and, as mentioned above, in Burundi.

There is a general sense that democracy is improving across the continent, aided by improved communication and a younger generation who hanker for better economic management. The Economist Intelligence Unit (EIU) publishes a comprehensive Democracy Index, rating 167 countries on a scale of 0 to 10. Their score is based on the ratings for 60 indicators grouped in five categories, namely: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. In terms of this analysis, even countries that hold elections can be classified as 'authoritarian regimes' (yielding a score below four) if the environment is not conducive to a fair vote taking place. African examples of this type of regime include Zimbabwe and Egypt

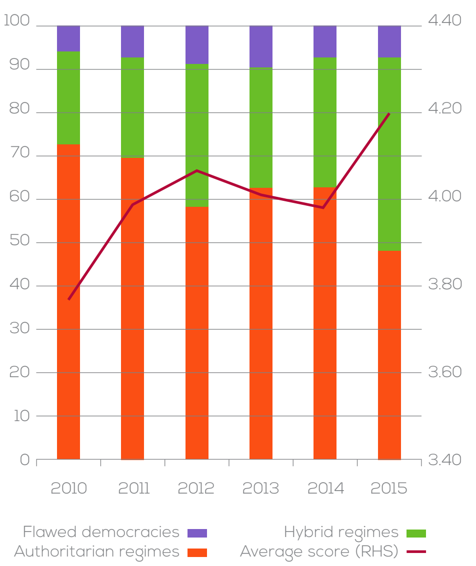
The chart below shows the data for the last five years, indicating the percentage of Africans living under each type of regime.

Based on the EIU's 2015 calculations, Mauritius – regarded as a full democracy - is Africa's most democratic country, ranking 18th out of 167 countries, ahead of the United States at 20th. Botswana (28th), Cape Verde (32nd), South Africa (37th) and Ghana (53rd) make up the rest of the top five African states. All are classified as 'flawed democracies'.

It is important to note, however, that over the last five years, the improvement in democracy across the continent means that less than 50% of Africans now live in authoritarian regimes, down from 73% in 2010. The average score is also improving for Africa. Sadly more than half of the world's 51 authoritarian regimes (27 of them) are still found on the continent, so there is still much work to be done.

"Like Muhammadu Buhari in Nigeria, Tanzania's John Magufuli's campaign was strongly focussed on a commitment to reduce corruption."

% Africans in each regime



Source: The Economist Intelligence Unit, International Monetary Fund's World Economic Outlook 2016, Ashburton Investments

Time for emerging nations to stand on their own

"We would caution against the increasingly widespread view that a financial crisis is imminent due to China's apparent high levels of debt"

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It has certainly been a tough few years for emerging markets; and so far 2016 is continuing to pile on the pressure.

As a group we have seen marked underperformance of emerging market (EM) equities versus developed market counterparts in 2016, and most EM currencies have seen substantial devaluations against the US dollar. Local bond market performances have been mixed, as the relative attraction of high yields has battled with falling currencies and, in many cases, deteriorating macro-economic conditions.

Indeed, the whole proposition of grouping an eclectic mix of countries in a basket such as EM or even the BRICS (Brazil, Russia, India, China and South Africa) has been called into question in recent years. These baskets contain a multitude of countries with differing economic cycles, differing political cycles and, indeed, differing stages of development. We would also argue that these baskets make little sense from an investment perspective, other than convenience. Therefore, we believe that investors should start considering some of the larger EM countries as stand-alone investment propositions.

Despite this view, when looking at the performance of EMs more recently, particularly EM equity and currency markets, there has been a noticeable pick-up in performance versus developed markets in the wake of the brutal sell-off at the beginning of this year. If we look at the equities and currencies that have rallied hardest, again focusing on the larger EM economies, then the standout performers have been Russia and Brazil, with South Africa not far behind. The Asian EM giants of China and India have lagged.

So what factors have been behind these recent moves and are they sustainable over the coming months? We would argue that, in most instances, the positive returns are not due to improvements in underlying ›

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political and economic fundamentals, rather that there are two 'big daddies' in the room driving these movements: the United States Federal Reserve and China. The former is directly influencing most EMs as investors have swayed from hawkish to dovish over expectations on United States interest rates and, therefore, the outlook for the US dollar.

However, China remains, in our opinion, the single biggest factor influencing EM assets and will remain so for some time to come. Ultimately, domestic politics and the growth slowdown currently underway in China will ensure that the country's dominant exports will be deflation and volatility. The global impact of China's growth slowdown was well explored in the last edition of Global Perspectives, but this is a trend which will continue to influence EMs for some time.

So far this year a weakening US dollar and better economic data out of China have had a positive impact on EM. The rally in commodity and energy markets is a direct consequence of a weakening US dollar, and is also being driven by hopes for a demand-led recovery in China. Clearly many EM economies are reliant on energy and commodity production for a significant proportion of economic output.

Therefore, rising prices (in combination with extremely bearish investor positioning in these areas) has led to commodity- and energy-related EM equities and currencies rallying hardest, while leaving the commodity consumers of Asia underperforming. Valuations of both the equity and currency markets of the commodity producing countries were in some instances getting cheap, particularly currencies. Ultimately, we believe that underlying fundamentals do not bode well for a more sustained trend shift, favouring broad-based EM outperformance. While the outlook for the US dollar is not as strong as we have experienced over the last couple of years - which should help EM assets - it is China that concerns us more.

The leadership in China is battling a major transition in its economy, trying to manage the process of a growth slowdown and refocus on services from manufacturing. While the current administration were given early plaudits for their apparent reform zeal, there are signs aplenty that the slowdown in the economy, and the related impact on employment and social stability, are pushing Beijing back to the tried and tested plans of the past. In other words: an escalation of debt to achieve the political imperative of sustaining growth ahead of next year's Party Congress. China's reliance on credit injections to maintain growth is unsustainable, except in the short-term, and shows an absence of a clear economic strategy.

We would caution against the increasingly widespread view that a financial crisis is imminent due to China's apparent high levels of debt. Most debt is issued by state-owned entities and local governments in local currency, and household and central government debt

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remains relatively low. Beijing still has immense resources at its disposal which should mean it will be some time before the debt situation becomes unsustainable. The trend slowdown in growth is, however, inevitable and ultimately the move away from a commodity intensive growth model to services means we are unlikely to see the start of a new bull market in commodities in the near future. That is great news for commodity consuming economies such as India, where we see little evidence of a risk of imported inflation.

That brings us to the final differentiator in EM: reforms. Some governments have genuinely embraced reform and change in an attempt to revive economic growth. India leads the pack in this regard and, while growth on the sub-continent is yet to reflect a broad-based recovery, we remain extremely confident that the country is on the right path. Other larger EM governments are not on the same agenda, with Brazil, in particular, in the grips of a major political crisis.

Ultimately the outlook for EM remains mixed for the remainder of the year. Reduced headwinds from the US dollar should help, but China remains the main source of uncertainty. On the other hand the outlook for a country like India looks attractive. It is our belief, therefore, that investors will start to increasingly consider the major EM countries on their own merits.

Oil and the Energy Fund

For the past two years oil prices have been on a veritable rollercoaster ride, what's the outlook as we head into the mid-point of 2016?

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Oil markets started 2015 still in the grips of OPEC's about-face in November 2014, when the oil producers' cartel decided to no longer act as the 'swing producer' (market balancer). Until end-2014, OPEC's policy had been to protect an oil price which they regarded as 'fair' (over US$100 per barrel) but to also avoid prices that may jeopardise economic growth and, therefore, oil demand. Essentially OPEC was striving for high prices but with low price volatility, something they had been successful in achieving; in fact 2013 oil price volatility was the lowest in a decade. However, the unintended consequence was to create fertile conditions for the United States to grow and develop its short-cycle unconventional oil shale.

Worried about the growth in United States shale and OPEC's declining market share (Saudi Arabia, the OPEC policy setter, saw market share drop from 11.7% in 1995 to 9.9% by late 2014), OPEC's pricing policy changed. OPEC turned on the taps, putting most of its 'spare capacity' to work, with an objective of driving the price, and therefore non-OPEC production, lower. As a result, 2015 saw an oversupply of approximately 1.8 million barrels a day, as non-OPEC production took time to respond. Oil prices plummeted, falling to a US$40 barrel low in August 2015, before sinking further to US$26/barrel in January 2016.

The managers of the Ashburton Global Energy Fund, while maintaining a long-term view, are extremely cognisant of the cyclical nature of the sector. Consequently, the managers have adopted an investment process that looks to reduce the Fund's sensitivity to the oil price at the negative end of the oil price cycle, while increasing it during the positive part of the cycle. Having spent most of last year with a negative outlook on the oil price the managers employed an oil price sensitivity that was 5%-10% lower than the benchmark. The Fund performed well, outperforming its benchmark by 12% (ranking it, according to Morningstar, as the top energy fund, globally, over the last 12 months). Most of the outperformance during 2015 emanated from an overweight stance in the shipping sector (a sector with a low oil price sensitivity) which performed relatively well, thanks to increasing volumes of demand (an approximate rule of thumb is that every US$10 fall in the oil price should be reflected by a 0.1% increase in demand). However, in November 2015, the managers became more bullish on the oil price outlook. A combination of data and face-to-face conversations with companies during road trips to Texas, United States, consolidated a view that we would see significant capital spend contractions in 2016, and therefore lower supply.

Armed with a more bullish oil price outlook, we have continued to switch into higher oil price sensitive stocks. Since the end of January our overweight stance in the higher oil price sensitive areas has been rewarded, with exploration and production companies and services leading the alpha generation. This approach is already bearing fruit with the Fund rising almost 36% and outperforming the benchmark, between January and mid-April, by almost 4%.

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In the past, supply driven markets have been notoriously slow to respond and have taken years or even decades to rebalance. This particular supply-driven correction is different because although a significant amount of oil can quickly enter the market, it will also rapidly deplete (well production falls 55%-75% in the first year. This oil is known as 'short cycle' oil and is being sourced from 'unconventional' United States resources (specifically fracked shale). Investments in short cycle oil production (it costs approximately US$6-US$7 million per well) are predicated on a well-by-well basis, unlike the behemoth long cycle oil projects (e.g. Prudhoe Bay in Alaska or Cantarell in Mexico), which are approved based on the full oil price cycle view. Consequently, once approved and the billions of dollars of cost are sunk, long cycle oil's production is divorced from oil price swings. We are already seeing the advantage of being supplied by this more pragmatic source of supply and are seeing strong evidence that supply is being reduced. The United States is seeing a 90% reduction in new wells being drilled and supply from shale oil already 600kbbld lower since June. We have also begun to see a fall in more mature sources of oil, such as China. China has just reduced 2016 production targets by 6.86% to four million barrels.

Demand is, however, recovering from its recent (seasonal) softness and looks like outpacing the last decades average compound annual growth rate of 1.1% and settling between 1.3% and 1.5% higher for 2016 (the International Energy Agency believe that the world's energy demand growth over the next decade will, in fact, outpace the demand growth of the last decade). Consequently we are retaining high oil price sensitivity as a tightening market should lead to firmer oil prices.

Indeed, International Energy Agency chief Fatih Birol has begun to warn that the combination of a sharp drop in non-OPEC supply and the largest back-to-back drops in upstream activity since the 1980s will lead to tightening markets and the creation of a supply shortfall that they expect will be increasingly met by United States onshore short cycle production.

We would agree, but believe that although short cycle oil will be the first to recover, the scale of the recovery will ultimately be insufficient to compensate for the shortage in long cycle oil, since long cycle (offshore) oil produces approximately 30% of global supply and short cycle oil just 5%. Consequently, in order to incentivise the 'base load' of production from the more expensive but critical, long cycle oil, markets will need a price above US$65/ barrel in order to be adequately supplied over the longer term. The longer we remain below this level, the wider the supply shortage could become and the more likely we are to see an oil price overshoot on the upside. This could be the seed that starts to move the global oil price back towards triple digit oil levels as we approach 2020.

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