Winston Floquet **END Q1 2016**

Investors had to work their way through a tumultuous first quarter as widespread forecasts of an imminent global recession gathered momentum – despite no meaningful evidence that the slower world growth was anything more than a temporary slowdown. The impact on equities was severe with several of the major markets declining sharply. [CHART 1] Forced sales by sovereign wealth funds (particularly those in oil-producing countries) exacerbated the declines but significant institutional and individual investor sales added to the pressure.

Certainly, global growth had slumped badly in the final quarter of 2015 – to just 1.2% in developed economies (from 1.8%) and 3.0% (from 4.4%) in developing economies. There was little prospect that this would improve in the first quarter of 2016. A further major downswing in oil prices also impacted heavily on sentiment as the massive cuts in capital expenditure reverberated through economies, tipping manufacturing into near recessionary conditions. [CHART 2] Concerns that China might implement a large one-off devaluation of its currency triggered fears of a currency war. Another alarming factor was the slide in world trade: global export volumes turned negative for the first time ever (outside of a global recession).

However, by quarter end, markets had regained much of their composure, closing just 1% below 2015's closing levels. Several factors contributed to the improvement in sentiment. Among the key reasons were the oil price recovery, the weaker US dollar, Draghi's 'bazooka' of stimulus measures and Janet Yellen's far more dovish approach to US rate rises. None of these developments had been anticipated in the first two months of the year.

What of the outlook for the remainder of this year? Given that global growth concerns triggered the market collapse in the first two months of the year, the key to the 2016 outlook will be the evolution of the world economy over the next few quarters.

We expect global growth to gather momentum and accelerate above the past two quarters of sub-trend growth. In the US most indicators remain robust: the latest ISM jumped to 49.5 (the best in six months), house prices remain firm (up 5.8% yoy), consumer confidence rose above expectations, and manufacturing is finally recovering. Moreover, the labour market is proving remarkably resilient. The participation rate increased for the sixth consecutive month in March, its fastest rise in over two decades. With a decidedly more dovish Fed these positive trends are likely to persist.

In Europe, too, the stronger recent data should endure, aided by Draghi's stimulus measures (although Brexit is a risk). China, meanwhile, is on the cusp of reversing its declining growth rate: its strong March PMI reflected a broad-based improvement and the Asian region in general will benefit from the upturn. The dovish Fed is likely to ease concerns of a large one-off currency devaluation.

On the other hand, Japan experienced a 6.2% collapse in its industrial production in February and business sentiment deteriorated again in March. Despite Abe's recent dramatic introduction of negative rates, the outlook appears decidedly weak. Growth in the 4th quarter of 2015 was zero and is likely to be no better in the 1st quarter of this year. A gradual recovery from this low base seems probable, but uninspiring.

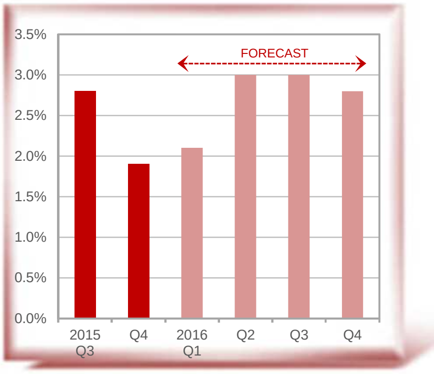
Nevertheless, for the global economy as a whole, the remaining nine months of 2016 is likely to see higher growth. [CHART 3] At the corporate level, analysts are certainly bullish: for the current 2016 year, the bottom-up global earnings growth forecast is just 2.8% but for 2017 earnings growth of no less than 13.5% is forecast! [CHART 4] Much is due to an anticipated recovery in the oil sector.

Despite the generally improved outlook we should not lose sight of the fact that the recent recovery in equities has taken the US market to just 2.7% shy of its all-time high, causing valuations to rebound above their long term averages. While markets are not quite priced for perfection, they remain vulnerable to unexpected negative surprises.

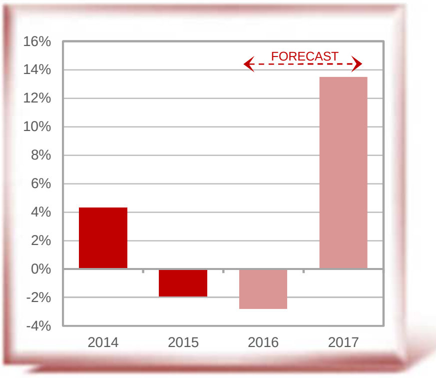
Europe, Hong Kong, Japan, UK

Brent Oil

Global GDP
(JP Morgan Forecast)



Global Earnings Growth



Flagship Asset Management (Pty) Limited
ICR House • Alphen Park • Main Road • Constantia • 7806 | Private Bag X21 • Constantia • 7848 • South Africa
Telephone +27 (21) 794 3140 • Facsimile +27 (21) 794 3135
Directors: WT Floquet CA(SA) MBA (chairman) | S de V Hudson BA LLB (ceo) | PD Floquet BCom CA(SA) CFA | NRO Brown BCom CA(SA)
www.flagshipsa.com | info@flagshipsa.com