PRUDENTIAL UNIT TRUSTS QUARTERLY COMMENTARY
30 SEPTEMBER 2016

COMBINED QUARTERLY COMMENTARY

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PRUDENTIAL MONEY MARKET FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

INCOME FUND

PERFORMANCE

Over the past quarter, the Fund delivered a return of 1.8% (net of fees) versus its benchmark the STeFI Call Deposit Index, which returned 1.7%. The average duration of the fund at quarter end was 36 days relative to the 90-day maximum average duration.

It was another largely positive quarter for South African financial markets, buoyed by both global demand for local assets and improving data, while the likelihood of a credit rating downgrade to junk status diminished somewhat. Q2 GDP growth came in at a stronger-than-expected 3.3% (q/q annualised), avoiding a technical recession (defined as two consecutive quarters of negative growth).

The SA Reserve Bank also revised upward its growth forecasts: for 2016 to 0.4% from 0.0%; for 2017 to 1.2% and for 2018 to 1.6%. August CPI fell to a lower-than-expected 5.9% y/y from 6.0% y/y in July, and the SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting as expected. The SARB Governor signalled that the rate hiking cycle may be nearing an end, although any rate cuts would face a high bar.

CPI inflation data was in line with expectations at 5.9% y/y in August, a marginal decrease from 6.0% printed in July, led by lower petrol prices. Core inflation came in at 5.7%, flat against the July data and also in line with consensus expectations.

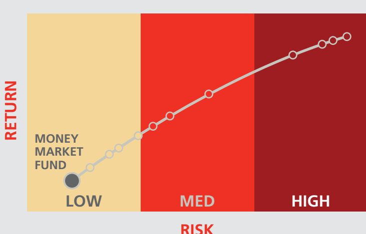
PPI inflation eased to 7.2% y/y in August from 7.4% y/y in July, surprising slightly positively against the market expectation of 7.5%. Fuel was the main contributor to the decline again, adding 2.4% y/y from 3.4% y/y in July.

Private sector credit extension moderated to 6.2% y/y for August from 6.8% y/y in July. Modest credit up take can at least partially be attributed to the SARB rate hikes in the first quarter, exerting additional pressure on arguably already-strained consumers. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	X CLASS
1 year	7.0%	6.6%	7.1%
3 years	6.1%	5.8%	6.2%
5 years	5.7%	5.5%	5.9%
7 years	5.9%	5.6%	n/a
10 years	7.2%	7.0%	n/a
Since inception	7.8%	7.7%	5.8%

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:
R3 886 625 987

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL HIGH INTEREST FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

INCOME FUND

MARKET OVERVIEW

It was another largely positive quarter for South African financial markets, buoyed by both global demand for local assets and improving data, while the likelihood of a credit rating downgrade to junk status diminished somewhat. Q2 GDP growth came in at a stronger-than-expected 3.3% (q/q annualised), avoiding a technical recession (defined as two consecutive quarters of negative growth). The SA Reserve Bank also revised upward its growth forecasts: for 2016 to 0.4% from 0.0%; for 2017 to 1.2% and for 2018 to 1.6%. August CPI fell to a lower-than-expected 5.9% y/y from 6.0% y/y in July, and the SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting as expected. The SARB Governor signalled that the rate hiking cycle may be nearing an end, although any rate cuts would face a high bar.

Moody's itself put the likelihood of a downgrade for South Africa at about 33% at year end. Meanwhile, the rand extended its winning streak against the US dollar and other major currencies, appreciating by 7.3% against the greenback, 6.1% versus the euro and 10.0% against sterling during the quarter, amid good global investor demand, as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller. Also supporting the currency was a significant narrowing of the current account deficit, to 3.1% of GDP in Q2 from 5.3% in Q1.

Meanwhile, local bonds were helped by the improving local interest rate and inflation outlooks, rising commodity prices and offshore investor demand. The SA 10-year bond rallied about 15bps to 8.66% by quarter-end, while the All Bond Index returned 3.4% in Q3. Inflation-linked bonds (ILBs) returned 0.5% in the quarter. Also reflecting the improved outlook for South Africa's credit rating and good offshore demand, the spread on South Africa's 10-year US dollar bond yield over the 10-year UST fell from 320bps to 244bps at quarter-end, and National Treasury saw excellent investor demand for its issue of US$3.0 billion in US dollar bonds: 12-year bonds at a premium of 274bps over USTs and 30-year bonds at 272bps over USTs – both low by historic standards.

In the primary bond market, several property companies and financial services companies raised debt during the quarter, with strong demand seen for short-term, high-quality issues. Auction pricing cleared below guidance levels for many issues.

FUND PERFORMANCE

The Fund generated a return of 2.1% (net of fees) for the quarter compared to its benchmark, the STeFI Composite Index, which returned 1.9%.

The Fund was launched in December 2010 with the aim of delivering returns in excess of money market yields without compromising the stability of the capital. Although capital protection is not guaranteed, we emphasise 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 3 years compared to money market funds at 13 months. The fund also has a maximum weighted average duration of 180 days, as opposed to a typical money market fund targeting a maximum 90 days weighted average maturity.

Relative to the 180-day maximum average duration, the quarter-end duration of the fund came in at 128 days.

FUND STRATEGY

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.

Exposure to floaters in the 3-year space was increased over the quarter on the back of attractive pricing. Credit issuance has been scarce this year and as such, while demand to tap into more of that market in order to lock in yield pick-up remains a focus, names we were comfortable investing in at spreads in line with our valuation metrics were limited to one addition over the quarter.

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	7.5%	7.1%	7.7%	7.9%
2 years	7.0%	6.8%	7.1%	7.2%
3 years	6.5%	6.4%	6.6%	6.9%
5 years	6.2%	6.0%	6.3%	6.5%
Since inception	6.1%	6.0%	6.2%	6.5%

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

RISK/RETURN PROFILE:

RETURN
HIGH INTEREST FUND
LOW MED HIGH
RISK

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:

R7 162 628 135

Due to a corporate action involving African Bank Investment Limited instruments, the Fund held an instrument with a tenor of longer than 36 months which was in breach of its supplemental trust deed. This was corrected within the quarter.

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL HIGH YIELD BOND FUND
30 SEPTEMBER 2016

PRUDENTIAL INVESTMENT MANAGERS

QUARTERLY COMMENTARY

PERFORMANCE

The Fund returned 3.5% (net of fees) for the third quarter of 2016, outperforming its benchmark, the BEASSA Total Return All Bond Index, which returned 3.4%. Over 12 months the Fund has returned 7.1%.

Inflation-linked bonds (JSE CILI) underperformed for the quarter with a 0.5% total return, while cash (STeFI Composite) returned 1.9%.

In our SA bond funds we have moved to neutral duration from long, taking profits as longer-dated paper rallied. Within this, we are also overweight longer-dated bonds versus shorter paper while retaining our overweight exposure to corporate bonds.

With South Africa's interest rate and inflation outlooks improving, risks to bonds and listed property have moderated somewhat, although the possibility of a credit rating downgrade is still a real threat to both sectors. While SA bond spreads have continued to narrow versus US Treasuries, yields are still pricing in an elevated risk premium.

MARKET OVERVIEW

In the US, weaker-than-expected GDP growth of 1.2% (q/q annualised) in Q2 was offset by strong employment data showing a firmer labour market and a pick-up in wages, as well as an acceleration in consumer inflation to 1.1% y/y in August. The US Federal Reserve left interest rates on hold at its September policy meeting, while signalling an increasing likelihood of a rate hike in December. The US central bank also scaled back its projections for future hikes. The interest rate market pushed up the chances of a December rate hike to 60%, while still expecting a total rate increase of 50 basis points (bps) over the next 2.5 years.

In the Eurozone, Q2 GDP growth halved to only 0.3% q/q from 0.6% q/q the previous quarter, although on an annualised basis this represented growth of 1.6% versus 1.7% previously. The French and Italian economies reported near-zero expansion (with the weakness of Italian banks gaining news headlines early in the quarter), while Germany remained the main growth engine. Consumer inflation stayed very low at 0.2% y/y in August, while the ECB left its aggressive easing programme unchanged at its September policy meeting. The German 10-year bund yield remained negative at -12bps, and for the first time two highly rated, large European companies issued corporate bonds paying negative yields (investors will have to pay a small amount to the company for the privilege of lending them money). Brexit worries eased somewhat amid better-than-expected economic data from the UK and some recovery in British markets.

In August the Japanese government announced Y28 trillion fiscal stimulus package, including cash handouts to 22 million low-income earners. The country's GDP growth nearly stalled in Q2 at only 0.2% (q/q annualised) on the back of declining exports and business investment, from 2.0% in Q1.

In China, Q2 GDP growth held steady at 6.7% (q/q annualised), slightly above consensus and within the government's 6.5%-7.0% target for the year. The Chinese central bank has kept interest rates at record lows and reduced bank reserve requirements to buoy the economy, although consumer spending has been somewhat softer.

Other emerging markets continued to be supported by the improvement in investor risk appetite. Five-year credit default swap spreads (a measure of sovereign default risk) trended lower across most emerging markets. EM bonds and currencies were also generally stronger.

The price of Brent crude oil was $50 per barrel at quarter end, climbing after OPEC's surprise agreement to limit production. Gold lost 0.5% as its safe-haven status lost its appeal, but among notable commodity price gains, tin and lead each rose 18% and palladium jumped nearly 23%.

In South Africa, Q2 GDP growth came in at 3.3% (q/q annualised), avoiding a technical recession (defined as two consecutive quarters of negative growth) and the SA Reserve Bank revised upward its growth forecasts. August CPI fell to a lower-than-expected 5.9% y/y from 6.0% y/y in July, and the SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting. The SARB Governor signalled that the rate hiking cycle may be nearing an end, although any rate cuts would face a high bar.

The rand strengthened against the US dollar and other major currencies amid good global investor demand as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller. Also supporting the currency was a significant narrowing of the current account deficit, to 3.1% of GDP in Q2 from 5.3% in Q1.

Local bonds were helped by the improving local interest rate and inflation outlooks, rising commodity prices and offshore investor demand. National Treasury saw excellent investor demand for its issue of US$3.0 billion in US dollar bonds which cleared at low premiums to USTs versus previous issues.

In the primary bond market, several property companies and financial services companies raised debt during the quarter, with strong demand seen for short-term, high-quality issues. Auction pricing (yields) cleared below guidance levels for many issues.

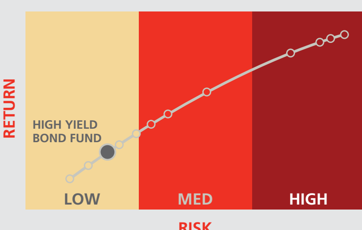
Despite improving outlooks for local inflation, interest rates and growth over the quarter, and a supportive global environment, material risks remain for a possible credit rating downgrade, including the currently elevated political risk around the Finance Minister. Moody's will be announcing its decision on 25 November, S&P on 2 December and Fitch also in early December. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	7.1%	7.6%	7.5%
3 years	5.9%	6.8%	6.3%
5 years	7.5%	8.0%	7.9%
7 years	8.5%	8.7%	8.8%
10 years	8.3%	8.5%	8.6%
Since inception	10.4%	10.6%	9.3%

Inception date B Class: 1 April 2003

INCOME FUND

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:
R508 820 744

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL ENHANCED INCOME FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

INCOME FUND

PERFORMANCE

For the 12 months to 30 September 2016, the Fund returned a very respectable 7.9% (net of fees), beating cash as measured by the STeFi composite (fund benchmark) by 0.8%. For the quarter, the Fund delivered a return of 2.0% (net of fees), outperforming cash by 0.1%.

MARKET OVERVIEW

It was the ongoing "search for yield" that shaped global financial markets in the third quarter of 2016, as US rate hike expectations were again pushed out to December, and other major economies continued to be stuck on their low-growth, low-inflation, low-interest rate paths. Although markets remained volatile, equity markets and especially emerging markets were the biggest beneficiaries of the renewed "risk-on" sentiment. Bonds and gold, on the other hand, were less well supported, while commodity prices were mixed, although the surprise OPEC agreement to limit oil production sent the oil price climbing back to around $50 per barrel at the end of the quarter.

In the US, weaker-than-expected GDP growth of 1.2% (q/q annualised) in the second quarter (half the 2.5% consensus) was somewhat offset by strong employment data showing a firmer labour market and a pick-up in wages, as well as an acceleration in consumer inflation to 1.1% y/y in August. As became expected, the US Federal Reserve again left interest rates on hold at its September policy meeting, while signalling the increasing likelihood of a rate hike in December. However, the US central bank also scaled back its projections for future hikes: the Fed's consensus for 2017 fell to only two hikes for the year, versus three previously. The interest rate market took the Fed's signals to heart pushing up the chances of a December rate hike to 60%.

The Barclays Global Aggregate Bond Index (US$), a mixture of government and corporate bonds, posted a total return of 0.8% in the quarter after its strong performance in Q2. The 10-year US Treasury (UST) bond yield strengthened about 20bps, as did investment-grade corporate bond spreads versus USTs. US high-yield corporate bonds benefited from both the stronger investor risk appetite and the improved outlook for the energy market: spreads vs USTs fell steadily over the quarter from around 613bps to 497bps, with energy sector bond spreads dropping from about 800bps to 673bps.

In the Eurozone, Q2 GDP growth halved to only 0.3% q/q from 0.6% q/q the previous quarter, although on an annualised basis this represented growth of 1.6% versus 1.7% previously – slow but steady. The German 10-year bund yield remained negative at -12bps, and for the first time ever two highly rated, large European companies issued corporate bonds paying negative yields. Brexit worries eased somewhat amid better-than-expected economic data from the UK and some recovery in British markets, with the FTSE 100 returning 4.7% in the quarter. France's CAC 40 returned 6.7% and Germany's DAX 10.1% (all in US$).

Similarly to the previous quarter, other emerging markets continued to be supported by the improvement in investor risk appetite. Five-year credit default swap spreads (a measure of sovereign default risk) trended lower across most emerging markets, with South Africa's spread down over 30bps.

It was another largely positive quarter for South African financial markets, buoyed by both global demand for local assets and improving data, while the likelihood of a credit rating downgrade to junk status diminished somewhat. Q2 GDP growth came in at a stronger-than-expected 3.3% (q/q annualised), avoiding a technical recession (defined as two consecutive quarters of negative growth). The SA Reserve Bank also revised upward its growth forecasts: for 2016 to 0.4% from 0.0%; for 2017 to 1.2% and for 2018 to 1.6%. August CPI fell to a lower-than-expected 5.9% y/y from 6.0% y/y in July, and the SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting as expected. The SARB Governor signalled that the rate hiking cycle may be nearing an end, although any rate cuts would face a high bar.

The rand extended its winning streak against the US dollar and other major currencies, appreciating by 7.3% against the greenback, 6.1% versus the euro and 10.0% against sterling during the quarter, amid good global investor demand, as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller. Also supporting the currency was a significant narrowing of the current account deficit, to 3.1% of GDP in Q2 from 5.3% in Q1.

Meanwhile, local bonds were helped by the improving local interest rate and inflation outlooks, rising commodity prices and offshore investor demand. The SA 10-year bond rallied about 15bps to 8.66% by quarter-end, while the All Bond Index returned 3.4% in Q3. Inflation-linked bonds (ILBs) returned 0.5% in the quarter. Also reflecting the improved outlook for South Africa's credit rating and good offshore demand, the spread on South Africa's 10-year US dollar bond yield over the 10-year UST fell from 320bps to 244bps at quarter-end, and National Treasury saw excellent investor demand for its issue of US$3.0 billion in US dollar bonds: 12-year bonds at a premium of 274bps over USTs and 30-year bonds at 272bps over USTs – both low by historic standards.

Looking at the difference in yields between conventional bonds and ILBs, 10-year breakeven inflation expectations fell from near 7.0% to 6.80% at quarter-end. Cash (the STeFI composite) returned 1.9%. In the Forward Rate Agreements (FRAs) market, any further interest rate hikes have now nearly been priced out of the market: three-month interest rates are now seen at 7.40% in two years' time, down from 7.80% at the end of June. No rate cuts are forecast, either.

STRATEGY AND OUTLOOK

We are constructive (overweight) on long-dated nominal government bonds, and the Fund benefitted from the bond market rally during the quarter. With South Africa's interest rate and inflation outlooks improving, risks to bonds and listed property have moderated somewhat, although the possibility of a credit rating downgrade is still a real threat to both sectors. While SA bond spreads have continued to narrow versus USTs, yields are still pricing in an elevated risk premium.

In SA listed property, as the sector became cheaper over the quarter, we took advantage of this to buy more in the portfolio out of cash. Valuations are attractive versus ILBs and nominal bonds. In the absence of a material de-rating in the market's valuation, listed property is priced to deliver double-digit returns over the medium term, which is comfortably above inflation.

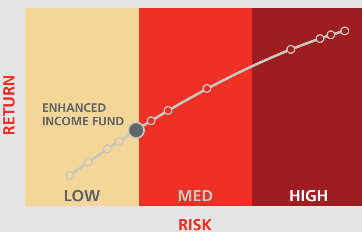
Inflation-linked bonds remained somewhat expensive compared to conventional bonds over the quarter, leading us to maintain our modest (underweight) exposure in these assets. Although the break-even inflation rate has fallen to 6.8%, it still appears elevated compared to our long-term benchmark of 6.0%.

Despite improving outlooks for local inflation, interest rates and growth (the latter to a very marginal extent) over the quarter, and a supportive global environment, material risks remain for a possible credit rating downgrade, including the currently elevated political risk around the Finance Minister. Investors can expect continued volatility as we approach year end and move closer to a US interest rate hike and credit rating decisions by the three global ratings agencies. Moody's will be announcing its decision on 25 November, S&P on 2 December and Fitch also in early December. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	X CLASS	D CLASS
1 year	7.9%	7.1%	8.4%	8.2%	8.5%
3 years	7.4%	6.7%	n/a	7.7%	8.0%
5 years	8.0%	6.7%	n/a	8.3%	8.6%
7 years	8.6%	7.3%	n/a	n/a	n/a
Since inception	8.8%	7.3%	7.3%	8.4%	8.6%

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

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 144 149 105

HOW TO INVEST

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL INFLATION PLUS FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

MULTI-ASSET

MARKET OVERVIEW

It was the ongoing "search for yield" that shaped global financial markets in the third quarter (Q3) of 2016, as US rate hike expectations were pushed out to December, and other major economies continued to be stuck on their low-growth, low-inflation, low-interest rate paths. Although markets remained volatile, equity markets, and especially emerging markets, were the biggest beneficiaries of the renewed "risk-on" sentiment. Bonds and gold, on the other hand, were less well supported, while commodity prices were mixed, although the surprise OPEC agreement to limit oil production sent the oil price climbing back to US$50 per barrel at the end of the quarter.

In the US, weaker-than-expected Q2 GDP growth of 1.2% (q/q annualised) was somewhat offset by strong employment data. As became expected, the US Federal Reserve again left interest rates on hold, while signalling the increasing likelihood of a rate hike in December. The interest rate market was pricing in a 60% chance of a December rate hike at quarter-end. Brexit worries eased somewhat amid better-than-expected UK economic data and some recovery in British markets, with the FTSE 100 returning 4.7% in the quarter. France's CAC 40 returned 6.7% and Germany's DAX 10.1% (all in US$).The S&P 500 returned 3.9%, while the Nasdaq returned 10.7%, reflecting the good growth and prospects of tech companies. The Barclays Global Aggregate Bond Index (US$), a mixture of government and corporate bonds, posted a total return of 0.8%.

Among emerging markets, the MSCI China returned 14.0% (in US$) over the three months, the strongest performer. Brazil's Bovespa kept up its run, gaining 12% in Q3 for a return of 62% year-to-date (US$). The MSCI South Africa gained 6.4%, MSCI Russia returned 8.9% and South Korea's KOSPI 10.5%, while the MSCI Turkey lost 5.3% (all in US$) following the failed coup attempt and credit rating downgrade. EM bonds and currencies were also generally stronger.

It was another largely positive quarter for South African financial markets, buoyed by both global demand for local assets and improving data. Q2 GDP growth was stronger-than-expected at 3.3% (q/q annualised), while the SA Reserve Bank also revised upward its growth forecasts: for 2016 to 0.4% from 0.0%; for 2017 to 1.2% and for 2018 to 1.6%. August CPI fell to a lower-than-expected 5.9% y/y, and the SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting as expected. The SARB Governor signalled that the rate hiking cycle may be nearing an end, although any rate cuts would face a high bar.

Moody's itself put the likelihood of a downgrade for South Africa at year-end at about 33%. Meanwhile, the rand appreciated by 7.3% against the greenback, 6.1% versus the euro and 10.0% against sterling amid good global investor demand, as well as inflows from the conclusion of AB InBev's purchase of SABMiller. Rand strength undermined offshore investment returns.

Local bonds were helped by the improving local interest rate and inflation outlooks, rising commodity prices and offshore investor demand. The All Bond Index returned 3.4% in Q3, while inflation-linked bonds (ILBs) returned 0.5%. Cash (the STeFI composite) returned 1.9%. In the Forward Rate Agreements (FRAs) market, any further interest rate hikes have now nearly been priced out of the market: three-month interest rates are now seen at 7.40% in two years' time, down from 7.80% at the end of June. No rate cuts are forecast, either.

In SA equities, the FTSE/JSE All Share Index returned 0.5% for the quarter, dragged down by a -2.1% return in Industrial shares. Resources returned 8.1%, and Financials returned 0.9%. Listed Property lost 0.7%. The total return from the ALSI year to date is 4.8%.

PERFORMANCE

The Fund returned 0.6% (net of fees) for the third quarter of 2016 and has returned 7.5% for the 12-month period ending 30 September 2016. The Fund's underweight holdings in international fixed income added the most relative value to returns, while its overweight holdings in SA nominal bonds and neutral weighting in SA equities also added value. The largest detractors from performance were international equity and cash holdings, hurt by the stronger rand over the period. The Fund has delivered a return of 13.4% per annum since inception (net of fees), while CPI inflation has averaged 5.8% per annum over the same period.

STRATEGY AND OUTLOOK

Our global asset allocation continues to favour global equities over global sovereign bonds and cash. However, given the rise in valuations in several global equity markets in Q3, to approximately the same valuations as South Africa, we have moved to a largely neutral position in our view of global equities versus SA equities. Both are slightly expensive. Within global equities, we still favour cheaper European markets versus expensive US and Japanese equities, as well as certain emerging markets like India. We also took advantage of the very cheap levels of certain UK-listed property stocks in the wake of Brexit to increase exposure to these assets.

We have a neutral position in South African equities in the Fund, which were trading at a level we find slightly expensive compared to their longer-term fair value. By sector, Financial stocks remain attractive on a risk/reward basis, despite the risks of a sovereign downgrade and other potential challenges. Key overweights remain Investec and Old Mutual. We also have overweights in Barclays Africa and First Rand, followed by Standard Bank. We retain our defensive positioning in Resources stocks, given concerns over balance sheet strength, avoiding gold and platinum miners and preferring diversified miners like BHP Billiton. We also prefer non-mining stocks like Sappi and Mondi. In consumer stocks, we prefer services companies like Tsogo Sun, City Lodge and Sun International to many of the retailers. Our top underweights include expensive industrials like Aspen and Steinhoff.

In SA listed property, we took advantage of the cheaper valuation over the quarter to buy more listed property, so that we are now slightly overweight in the Fund from our previous neutral positioning. Listed property companies (excluding developers) continue to be priced to deliver double-digit returns comfortably above inflation over the medium-term (assuming no change in the market's valuation of property).

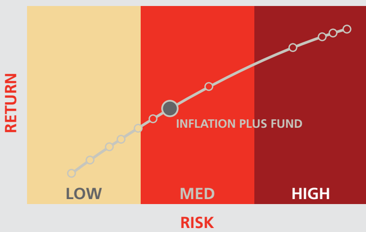
In SA bonds, the Fund is still modestly overweight, benefiting from the market rally during the quarter. Within this, we are also somewhat overweight longer-dated bonds versus shorter paper due to the more attractive yields on offer, while retaining our overweight exposure to corporate bonds.

Inflation-linked bonds remained somewhat expensive compared to conventional bonds over the quarter, although less so than previously, leading us to maintain our underweight in these assets.

ANNUALISED PERFORMANCE	A CLASS	OBJECTIVE	T CLASS	X CLASS	B CLASS
1 year	7.5%	10.9%	8.1%	7.8%	8.3%
3 years	9.8%	10.7%	n/a	10.1%	10.6%
5 years	12.9%	10.7%	n/a	13.2%	13.7%
7 years	12.3%	10.3%	n/a	n/a	13.1%
10 years	11.4%	11.5%	n/a	n/a	12.1%
Since inception	13.4%	11.3%	6.7%	12.8%	13.4%

Inception dates: X Class: 1 July 2011, B Class: 1 July 2002, T Class: 2 January 2015

RISK/RETURN PROFILE:



FUND MANAGERS:
Michael Moyle, Duncan Schwulst and Johny Lambridis

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

OBJECTIVE:
CPI+5% p.a. over a rolling 3-year period

INCEPTION DATE:
1 June 2001

FUND SIZE:
R38 738 166 112

AWARDS:
Raging Bull: 2013
Morningstar: 2015

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL INFLATION PLUS FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

MULTI-ASSET

LOOKING AHEAD

Despite improving outlooks for local inflation, interest rates and growth (the latter to a very marginal extent) over the quarter, and a supportive global environment, material risks remain for a possible credit rating downgrade, including the currently elevated political risk around the Finance Minister. Investors can expect more volatility as we approach year-end and move closer to a US interest rate hike and credit rating decisions by the three global ratings agencies. Moody's will be announcing its decision on 25 November, S&P on 2 December and Fitch also in early December. ■

ASSET CLASS RETURNS IN RANDS	Q3 2016	YTD
SA Equity (FTSE/JSE All Share Index)	0.5%	4.8%
SA Property (FTSE/JSE SA Listed Property Index)	-0.7%	8.8%
SA Bonds (BESA All Bond Index)	3.4%	15.0%
SA Inflation-linked Bonds (RSA Composite Inflation-linked Bond Index)	0.5%	7.0%
SA Cash (STeFI Composite)	1.9%	5.4%
Global Equity (MSCI World Free Index - US$)	5.0%	6.1%
Global Equity (MSCI Emerging Markets Index – US$)	9.0%	16.0%
Global Bonds (Barclays Global Aggregate Bond Index – US$)	0.8%	9.9%
Rand (Rand/USD move)	7.3%	12.8%

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL BALANCED FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

MULTI-ASSET

PERFORMANCE REVIEW

The Fund returned 1.3% over the quarter (net of fees), outperforming the 0.6% returned by the benchmark. The main contributors to its absolute return were the relatively large exposure to domestic assets, specifically equities and nominal bonds, as these asset classes also delivered the strongest returns for the fund. International assets detracted from the overall fund return as the rand strengthened over the quarter. However, international equities did offset most of this loss due to the strong rally in international equities, as well as the positive contribution from stock selection within international equity. The main contributor to the Fund's performance relative to the market, was its strong returns from equity (both domestic and international) that outperformed their respective market indices. For the 12 months ending September 2016, the Fund returned 7.5% (net of fees), 0.7% higher than the 6.8% returned by the benchmark.

In the US, weaker-than-expected GDP growth in the second quarter (Q2) was somewhat offset by strong employment data, as well as an acceleration in consumer inflation to 1.1% y/y in August. As became expected, the US Federal Reserve again left interest rates on hold at its September policy meeting, while signalling the increasing likelihood of a rate hike in December. However, the US central bank also scaled back its projections for future hikes.

The Barclays Global Aggregate Bond Index (US$) posted a total return of 0.8% in the quarter. The 10-year US Treasury (UST) bond yield strengthened, as did investment-grade corporate bond spreads versus USTs. US high-yield corporate bonds benefited from both the stronger investor risk appetite and the improved outlook for the energy market. The S&P 500 returned 3.9% amid a continued decline in corporate quarterly earnings growth spurred by weakness in energy companies, political uncertainty and lower industrial production.

In the Eurozone, Q2 GDP growth halved to only 0.3% q/q. Consumer inflation stayed very low, while the ECB left its aggressive easing programme unchanged. The German 10-year bund yield remained negative. Brexit worries eased somewhat amid better-than-expected economic data from the UK and some recovery in British markets, with the FTSE 100 returning 4.7% in the quarter. France's CAC 40 returned 6.7% and Germany's DAX 10.1% (all in US$). In recognition of the increasing ineffectiveness of monetary policy to further boost growth, the Japanese government in August announced a large fiscal stimulus package. The country's GDP growth nearly stalled in Q2 at only 0.2% (q/q annualised) on the back of declining exports and business investment. The Nikkei 225 Index returned 8.3% over the quarter. In China, Q2 GDP growth held steady at 6.7% (q/q annualised). Other emerging markets continued to be supported by the improvement in investor risk appetite, with EM equities, bonds and currencies generally stronger.

After having eased for much of the quarter, the price of Brent crude oil surged back to the $50 per barrel level at quarter end after OPEC agreed to limit production. Gold lost 0.5% as its safe-haven status lost its appeal.

It was another largely positive quarter for South African financial markets, buoyed by both global demand for local assets and improving data, while the likelihood of a credit rating downgrade to junk status diminished somewhat. Q2 GDP growth came in at a stronger-than-expected 3.3% (q/q annualised), and the SA Reserve Bank also revised upward its growth forecasts. August CPI fell slightly and the SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting as expected. The SARB Governor signalled that the rate hiking cycle may be nearing an end. Moody's itself put the likelihood of a downgrade for South Africa at about 33% at year end. Meanwhile, the rand appreciated by 7.3% against the greenback, 6.1% versus the euro and 10.0% against sterling during the quarter, amid good global investor demand, as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller. Also supporting the currency was a significant narrowing of the current account deficit, to 3.1% of GDP in Q2.

Meanwhile, local bonds were helped by the improving local interest rate and inflation outlooks, rising commodity prices and offshore investor demand. The All Bond Index returned 3.4% in Q3, while Inflation-linked bonds (ILBs) returned 0.5%. Looking at the difference in yields between conventional bonds and ILBs, 10-year breakeven inflation expectations fell from near 7.0% to 6.80% at quarter-end. Cash (the STeFI composite) returned 1.9%.

In SA equities, the FTSE/JSE All Share Index returned 0.5% for the quarter, dragged down by a -2.1% return in Industrial shares. Resources returned 8.1%, and Financials returned 0.9%. Listed Property lost 0.7%, although recovered to return 1.1% in September. Total return from the ALSI year to date is 4.8%.

STRATEGY AND OUTLOOK

For global equities, the rally in many global equity markets over the past three months has brought valuations more in line with those of South Africa. Consequently we have moved from our previously overweight to a neutral allocation in global equities versus SA equities. However, we continue to favour equities over global bonds and cash in our global asset allocation portfolios. In our higher return-targeting multi-asset funds we continue to be very near our maximum permitted 25% offshore weighting. Our overweight exposures continue to be concentrated in European markets where long-standing growth concerns have kept valuations on the cheap side of fair value, as well as selected Emerging Markets including India. With the US equity market looking expensive relative to the cost of protection, we decided to buy some downside protection in the form of put options. We also took advantage of the very cheap levels of certain UK-listed property stocks in the wake of Brexit to increase exposure to these assets out of global cash.

In global fixed income, we remain underweight duration and continue to hold cash and shorter-term bonds in order to reduce interest rate risk. We are still positive on both investment-grade and high-yield corporate bonds in the US and Europe relative to government bonds, where we see yields as unsustainable in the medium term. Gains during the quarter in these holdings benefited our portfolios, although we now see spreads versus USTs at fair value, rather than cheap as they were the previous quarter. During the quarter we took profits on the US dollar-denominated South African government and dollar Eskom debt we purchased in Q2, which outperformed the domestic equivalents.

South African equities remained slightly expensive over the quarter compared to their long-term fair value. However, with global equity valuations moving higher, there is no longer a significant valuation difference between the two. In general in our multi-asset funds we continue to be neutrally weighted in local equities on an asset allocation basis. The medium-term prospects for SA earnings to recover to their trend level continue to depend extensively on a recovery in commodity prices. In our domestic portfolios, we remain underweight expensive global heavyweights like Aspen and Steinhoff. By contrast, we are holding British American Tobacco as one of our top overweights as a solid defensive stock. We also retain our defensive positioning in Resources, being underweight gold and platinum miners, while preferring non-mining shares like Sappi and Mondi. Financial stocks remain undervalued, attractive on a risk/reward basis, despite the risks of a sovereign downgrade at year-end. Among our top overweights are Old Mutual, Investec and Barclays Group Africa. We remain underweight in Retailers, preferring to gain our consumer exposure via well-priced consumer services providers like Tsogo Sun and Sun International. On a medium-term valuation basis we prefer Netcare to Mediclinic, and MTN to Vodacom.

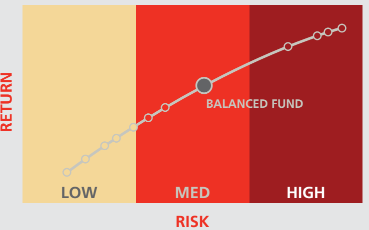
In SA listed property, as the sector became cheaper over the quarter, we took advantage of this to buy more and move to a slightly overweight position, from neutral, in our multi-asset class portfolios, buying out of cash. Valuations are attractive versus ILBs and nominal bonds. In the absence of a material de-rating in the market's valuation, listed property is priced to deliver double-digit returns over the medium term, comfortably above inflation.

In SA nominal bonds, our multi-asset portfolios are still modestly overweight conventional bonds, benefiting from the market rally during the quarter. Within this, we are also overweight longer-dated bonds versus shorter paper due to the more attractive yields on offer, while retaining our overweight exposure to corporate bonds. With South Africa's interest rate and inflation outlooks improving, risks to bonds and listed property have moderated somewhat, although the possibility of a credit rating downgrade is still a real threat to both sectors. While SA bond spreads have continued to narrow versus USTs, yields are still pricing in an elevated risk premium. In our SA bond funds we have moved to neutral duration from long, taking profits as longer-dated paper rallied. Inflation-linked bonds remained somewhat expensive compared to conventional bonds over the quarter, leading us to maintain our underweight in these assets in our multi-asset portfolios. Although the break-even inflation rate has fallen to 6.8%, it still appears elevated compared to our long-term inflation benchmark of 6.0%. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	X CLASS	B CLASS
1 year	7.5%	6.8%	8.1%	7.8%	8.3%
3 years	10.0%	8.2%	n/a	10.3%	10.8%
5 years	14.8%	11.8%	n/a	n/a	15.7%
7 years	13.5%	10.7%	n/a	n/a	14.5%
10 years	11.6%	9.7%	n/a	n/a	12.6%
Since inception	14.6%	12.7%	5.6%	12.6%	15.1%

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

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:
R14 547 476 203

Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL BALANCED FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

MULTI-ASSET

ASSET CLASS RETURNS IN RANDS	Q3 2016	YTD
SA Equity (FTSE/JSE All Share Index)	0.5%	4.8%
SA Property (FTSE/JSE SA Listed Property Index)	-0.7%	8.8%
SA Bonds (BESA All Bond Index)	3.4%	15.0%
SA Inflation-linked Bonds (RSA Composite Inflation-linked Bond Index)	0.5%	7.0%
SA Cash (STeFI Composite)	1.9%	5.4%
Global Equity (MSCI World Free Index - US$)	5.0%	6.1%
Global Equity (MSCI Emerging Markets Index – US$)	9.0%	16.0%
Global Bonds (Barclays Global Aggregate Bond Index – US$)	0.8%	9.9%
Rand (Rand/USD move)	7.3%	12.8%

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL ENHANCED SA PROPERTY TRACKER FUND
30 SEPTEMBER 2016

PRUDENTIAL INVESTMENT MANAGERS

QUARTERLY COMMENTARY

PROPERTY

PERFORMANCE

The Fund recorded a total return of -0.2% for the quarter (after fees), outperforming the SA Listed Property (SAPY) index's return of -0.7%. The Fund's outperformance versus the benchmark over this period can be largely attributed to the impact of our fundamental strategy of holding excess weight in higher-yielding stocks.

Over the past year the Fund returned 6.1%, outperforming the benchmark by 2.3%. The 10-year track record of the Fund ranks it 2nd out of its ASISA category peers, with the Fund having marginally outperformed the benchmark (after fees) over this period.

MARKET COMMENTARY

Despite strong distribution growth rates reported by the major listed property companies reporting results in the third quarter (averaging 18.8% year-on-year), SA listed property returns lagged all of the major domestic asset classes. The strong distribution growth was buoyed by once-off distribution-enhancing mergers as well as rand weakness and volatility over the preceding year.

In the US, weaker-than-expected Q2 GDP growth was somewhat offset by strong employment data, a pick-up in wages, as well as an acceleration in consumer inflation. The US Federal Reserve again left interest rates on hold at its September policy meeting, pushing out the likelihood of a rate hike to December while lowering its projections for future hikes beyond that. 10-year US Treasury bond yields fell about 20bps. Elsewhere other major economies continued to be stuck on their low-growth, low-inflation, low-interest rate paths. Equity markets, and especially emerging markets, were beneficiaries of the softening of global interest rate expectations.

South African financial markets were buoyed by both global demand for local assets and improving data, while the likelihood of a credit rating downgrade to junk status diminished somewhat. Moody's itself put the likelihood of a downgrade for South Africa at about 33% at year end. Q2 GDP growth came in at a stronger-than-expected 3.3% (q/q annualised), avoiding a technical recession (defined as two consecutive quarters of negative growth). The SA Reserve Bank also revised upward its growth forecasts: for 2016 to 0.4% (from 0.0%); for 2017 to 1.2% and for 2018 to 1.6%. August CPI fell to a lower-than-expected 5.9% y/y from 6.0% y/y in July, and the SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting as expected. The SARB Governor signaled that the rate hiking cycle may be nearing an end, although any rate cuts would face a high bar.

The rand extended its winning streak against the US dollar and other major currencies, appreciating by 7.3% against the greenback amid good global investor demand, as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller. Also supportive was a significant narrowing of the current account deficit, to 3.1% of GDP in Q2 from 5.3% in Q1.

In the Forward Rate Agreements (FRAs) market, any further interest rate hikes have now nearly been priced out of the market: three-month interest rates are now seen at 7.40% in two years' time, down from 7.80% at the end of June. No rate cuts are forecast, either.

Meanwhile, local bonds were helped by the improving local interest rate and inflation outlooks, rising commodity prices and offshore investor demand. The SA 10-year bond rallied about 15bps to 8.66% by quarter-end, while the All Bond Index returned 3.4% in Q3. Inflation-linked bonds (ILBs) returned 0.5% in the quarter. In the corporate debt market, several property companies and financial services companies raised debt during the quarter, with strong demand seen for short-term, high-quality issues. Auction pricing (yields) cleared below guidance levels for many issues.

We estimate that one-year forward earnings forecasts for the SAPY, excluding developers, increased by 1.1% during the quarter. Unfortunately earnings growth was suppressed due to currency translation losses following the rand's appreciation over the period; therefore the earnings growth over the past year and quarter (q/q annualised) no longer exceeds CPI inflation. However, post the quarter end, the rand has suffered a sharp depreciation, supporting stronger earnings growth. The office sector fundamentals remain fragile as a result of the weak SA economic environment and the sector's macro drivers. Although sector trading densities increased by above-inflation levels for the first half of the year, Hyprop's results suggest that retailers' cost of occupancy has crept up over the last few years, which is measured by the increase in the rent to sales ratio. This is largely due to cannibalization of sales from new and competing centres.

STRATEGY AND OUTLOOK

As the sector became cheaper early in the quarter, Prudential took advantage of this to buy more listed property and move to a slightly overweight position, from neutral, in our multi-asset class portfolios, buying out of cash. Valuations are attractive versus ILBs and nominal bonds. In the absence of a material de-rating in the market's valuation, listed property is priced to deliver double-digit returns over the medium term, comfortably above inflation.

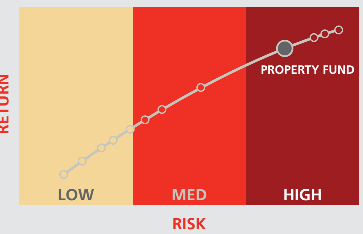
An important aspect of the investment case for listed property is illustrated by comparing property yields to those from ILBs. At quarter-end the SAPY, excluding developers, was priced to deliver a one-year forward distribution yield of 7.1%. This yield exceeded 10-year ILB yields by more than 5.1%. Assuming yields remain constant, property should outperform ILBs by at least 5%. In our view, this return premium is commensurate with the elevated risks of investing in listed property at present.

With South Africa's interest rate and inflation outlooks improving, risks to bonds and listed property have moderated somewhat, although the possibility of a credit rating downgrade as well as the currently elevated political risk around the Finance Minister are still a material threats to both sectors and investors can expect continued volatility as we approach year end. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	D CLASS
1 year	6.1%	3.8%	6.2%	6.2%
3 years	15.4%	14.5%	n/a	15.6%
5 years	18.1%	17.9%	n/a	18.2%
7 years	18.3%	18.2%	n/a	n/a
10 years	17.7%	17.6%	n/a	n/a
Since inception	17.1%	17.1%	4.2%	18.1%

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

RISK/RETURN PROFILE:



FUND MANAGERS:
Duncan Schwulst

ASISA CATEGORY:
South African - Real Estate - General

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

INCEPTION DATE:
2 December 2005

FUND SIZE:
R5 939 870 513

AWARDS:
Morningstar/Standard & Poor's: 2011

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL
INVESTMENT MANAGERS

PRUDENTIAL DIVIDEND MAXIMISER FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

EQUITY

PERFORMANCE AND POSITIONING

The Fund produced a return of 0.8% for the three months ended September 2016, outperforming the average of the ASISA General Equity funds category by 0.2% for the same period.

It was another largely positive quarter for South African financial markets, buoyed by both global demand for local assets and improving data, while the likelihood of a credit rating downgrade to junk status diminished somewhat. Q2 GDP growth came in at a stronger-than-expected 3.3% (q/q annualised). The SA Reserve Bank also revised upward its growth forecasts: for 2016 to 0.4% from 0.0%; for 2017 to 1.2% and for 2018 to 1.6%. The SARB revised downward its inflation forecasts for 2016 and 2017, while leaving interest rates unchanged at its September meeting as expected and signalled that the rate hiking cycle may be nearing an end, although any rate cuts would face a high bar.

The rand and emerging market currencies in general have continued to strengthen on the back of increased risk appetite and strongly rising commodity prices as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller.

The Fund decreased its offshore exposure to global equities during the quarter from approximately 30% to 25%. While we continue to find global equities more attractively valued than South African equities, this valuation gap has been closing as global equities and particularly US equities have re-rated.

Resource stocks have been benefiting from an improvement in commodity prices and currency tailwinds. This is leading to a prospect of increased earnings. We continue to prefer the diversified miners to the single commodity companies such as the platinum and gold counters. During the quarter we reduced our exposure to the gold sector on expectations that rand strength could lead to earnings headwinds in the sector.

The strongest contributors to relative outperformance in the quarter came from underweight positions in Aspen and MediClinic. Aspen continues to increase its global footprint through acquisitions in the Chinese and US markets. While Aspen is a high-quality company, we view its valuation as too demanding and do not think there is any margin of safety in the share price. While the MediClinic share price has fallen, we think it still trades on a fairly demanding valuation. Our preference in the hospital sector is Netcare, with its well-positioned UK operations and signs of progress with respect to a rental reduction transaction in the UK which could result in significant cost savings.

The Fund's overweight exposure to global financial companies was also a large contributor to performance in the quarter. Bank valuations globally appear low, balance sheets strong and the likelihood of increasing dividends high. Locally, we have increased our exposure to banks, also on the basis that valuations are low and strong dividend growth likely. We think the share prices of South African banks are already discounting the concerns around a possible downgrade for South African debt.

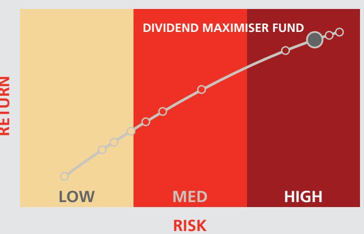
An underweight position in Shoprite detracted from performance over the quarter, as the stock rallied on speculation of a tie-up with Steinhoff following a Bloomberg interview with its chairman. In our view, the stock remains expensive and we prefer Pick 'n Pay in the food retailing space, where margins are well below competitors and are likely to improve. We remain underweight clothing retailers, preferring to gain our consumer exposure via well-priced consumer-focused hospitality and gaming shares City Lodge, Tsogo Sun and Sun International.

On market valuations, we currently view the market in South Africa as being fair value and caution that one should certainly expect a more moderate growth in dividends relative to the last 5 years, when dividends were recovering post the financial crisis. Earnings growth has been slowing and this may cause dividend growth to slow in the medium term. However, we still consider many offshore equity markets to be undervalued and therefore maintain the Fund's offshore exposure near the maximum allowable. The focus of the Fund continues to be on finding companies that are undervalued and which are paying good dividend yields with the potential to pay growing dividends over the long run. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	T CLASS	B CLASS
1 year	6.0%	6.4%	6.5%	6.4%
3 years	8.4%	7.4%	n/a	8.8%
5 years	15.0%	12.9%	n/a	15.5%
7 years	13.9%	12.1%	n/a	14.3%
10 years	13.2%	10.6%	n/a	n/a
Since inception	18.1%	14.9%	2.2%	12.1%

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

RISK/RETURN PROFILE:



FUND MANAGERS:
Ross Biggs 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 739 443 492

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

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL EQUITY FUND
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

EQUITY

PERFORMANCE AND PORTFOLIO MANAGER COMMENTS

The Fund delivered a very strong outperformance of its benchmark in the third quarter.

Resource stocks were overall some of the strongest contributors to overall performance, having benefited from an improvement in commodity prices, and currency tailwinds. This is leading to a prospect of earnings revisions. We continue to prefer the diversified miners to the single commodity companies such as the platinum and gold counters. We reduced our exposure to the gold sector on expectations that rand strength could lead to earnings headwinds in the sector, but have continued to increase our overweight exposure to Anglo American and BHP Billiton.

The strongest contributors to relative outperformance in the quarter came from underweight positions in Aspen and MediClinic. Aspen has been increasing its global footprint considerably, and is moving into the Chinese and US markets. It has nonetheless been on a demanding valuation, although this has improved following a 14% decline in the quarter. MediClinic faces regulatory hurdles in many of its operating regions – South Africa (Competition Commission, proposed NHI), Switzerland (DRG system potentially impacting margins) and in the UAE (potential implementation of DRG system, 20% co-payment on Thiqa members). MediClinic remains on a fairly demanding valuation, and our preference in this subsector is Netcare with its well positioned UK operations, and signs of progress with respect to a rental reduction transaction in the UK which could result in significant cost savings (GBP 25 million per year).

One of the largest detractors for the period was an overweight position in MTN, as the share price declined 16.2% over the quarter. The market is attributing almost zero value to the Nigerian operations due to concerns around the dramatic devaluation of the naira, and to what many perceive to be opportunism from the regulators. There are no doubt challenges in that country, but MTN's Nigerian operations remain a good contributor to profits, and we believe the market continues to misprice the stock.

An underweight position in Shoprite also detracted from performance over the quarter, as the stock rallied on speculation of a tie-up with Steinhoff following a Bloomberg interview with its chairman. In our view, the stock remains expensive, and we prefer Pick 'n Pay in the food retailing space.

Notable developments during the quarter included supporting the PPC rights issue. A debt covenant provision allowing bondholders to call their bonds in the event of a ratings downgrade caused a liquidity event, thus triggering the need for an expensive bridging loan and subsequent rights issue. We followed our rights, and took additional excess allotments. Despite controversy over the bank's behaviour, we are now more comfortable with PPC's balance sheet, allowing it space to complete its projects in Africa. The domestic cement market also remains challenging. PPC ranks as one of the cheapest stocks in the emerging market universe measured by EV/ton of cement capacity. The price of PPC rallied 16% on the quarter, bringing some relief for what has otherwise has been a difficult period for investors.

Within the portfolio, there has been some minor shuffling of bank exposures towards Barclays and Firstrand at the expense of Standard Bank. We believe these stocks remain undervalued, and attractive on a risk/reward basis, despite the risks of a sovereign downgrade. We remain overweight Old Mutual relative to Sanlam, purely on valuation grounds. We remain underweight retailers, preferring to gain our consumer exposure via well-priced consumer service providers like City Lodge, Tsogo Sun and Sun International.

We have also reduced our underweight positions within listed property. The spread of property to ILBs has moved closer to an equilibrium point, hence property looks attractive relative to bonds, offering around 15% prospective returns at current levels.

A particularly interesting recent stock position in property is to Capital and Counties (CCO). CCO has prime property in central London, which has traditionally been an expensive hard currency play. Post Brexit it has moved from trading at a premium to its NAV to a 20% discount to NAV. This is an interesting opportunity to buy into a portfolio with this exposure at this price.

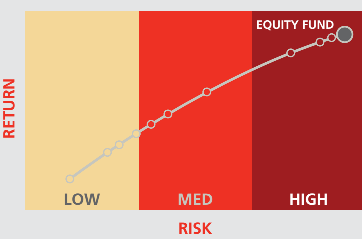
For the allocation to global equities, the rally in many global equity markets over the past three months has brought valuations more in line with those of South Africa. Our overweight exposures continue to be concentrated in European markets where long-standing growth concerns have kept valuations on the cheap side of fair value, as well as selected emerging markets including India, funded by underweights in the US, Japan and a variety of other smaller markets including Australia. With the US equity market looking expensive relative to the cost of protection, we decided to buy some downside protection in the form of put options.

Elevated risk premiums were reflected in pricing measure like yields vs ILBs, discounts to NAV and yields vs the FTSE 100. As in Q2, equity risk premiums (the yield on equities vs bonds) remain elevated and are in some cases close to the peaks seen in the Global Financial Crisis, providing a significant valuation buffer that should help to protect equities in the event of growth disappointment. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	5.7%	6.4%	6.0%
3 years	8.1%	7.4%	8.5%
5 years	15.5%	12.9%	16.0%
7 years	14.3%	12.1%	14.9%
10 years	13.7%	10.6%	n/a
Since inception	17.9%	14.9%	12.6%

Inception date B Class: 2 January 2007

RISK/RETURN PROFILE:



FUND MANAGERS:
Chris Wood and Johny Lambridis

ASISA CATEGORY:
South African - Equity - General

BENCHMARK:
ASISA South African - Equity - General Category Mean

INCEPTION DATE:
2 August 1999

FUND SIZE:
R2 563 378 896

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

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL HIGH YIELD BOND FUND OF FUNDS
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

GLOBAL INCOME

MARKET OVERVIEW

It was the ongoing "search for yield" that shaped global financial markets in the third quarter (Q3) of 2016, as US rate hike expectations were pushed out to December, and other major economies continued to be stuck on their low-growth, low-inflation, low-interest rate paths. Although markets remained volatile, equity markets, and especially emerging markets, were the biggest beneficiaries of the renewed "risk-on" sentiment. Bonds and gold, on the other hand, were less well supported, while commodity prices were mixed, although the surprise OPEC agreement to limit oil production sent the oil price climbing back to US$50 per barrel at the end of the quarter.

In the US, weaker-than-expected Q2 GDP growth of 1.2% (q/q annualised) was somewhat offset by strong employment data. As became expected, the US Federal Reserve again left interest rates on hold, while signalling the increasing likelihood of a rate hike in December. The interest rate market was pricing in a 60% chance of a December rate hike at quarter-end, while still expecting a total rate increase of 50 basis points (bps) over the next 2.5 years.

The Barclays Global Aggregate Bond Index (US$), a mixture of government and corporate bonds, posted a total return of 0.8%. The 10-year US Treasury (UST) bond yield strengthened about 20bps, as did investment-grade corporate bond spreads versus USTs. US high-yield corporate bonds benefited from both the stronger investor risk appetite and the improved outlook for the energy market: spreads vs USTs fell steadily over the quarter from around 613bps to 497bps, with energy sector bond spreads dropping from about 800bps to 673bps. Emerging market bonds and currencies were also generally stronger.

In the Eurozone, Q2 GDP growth halved to only 0.3% q/q from 0.6% q/q the previous quarter, although on an annualised basis this represented growth of 1.6% versus 1.7% previously – slow but steady. The French and Italian economies reported near-zero expansion (with the weakness of Italian banks gaining news headlines early in the quarter), while Germany remained the main growth engine. Consumer inflation stayed very low at 0.2% y/y in August, while the ECB left its aggressive easing programme unchanged at its September policy meeting. The German 10-year bund yield remained negative at -12bps, and for the first time ever two highly rated, large European companies issued corporate bonds paying negative yields (investors will have to pay a small amount to the company for the privilege of lending them money). Brexit worries eased somewhat amid better-than-expected economic data from the UK and some recovery in British markets,

In recognition of the increasing ineffectiveness of monetary policy to further boost growth, the Japanese government in August announced a Y28 trillion fiscal stimulus package, including cash handouts to 22 million low-income earners. The country's GDP growth nearly stalled in Q2 at only 0.2% (q/q annualised) on the back of declining exports and business investment, from 2.0% in Q1.

In China, however, Q2 GDP growth held steady at 6.7% (q/q annualised), slightly above consensus and within the government's 6.5%-7.0% target for the year. The Chinese central bank has kept interest rates at record lows and reduced bank reserve requirements to buoy the economy, although consumer spending has been somewhat softer. Other emerging market bonds and currencies were also generally stronger, benefiting from the "risk-on" sentiment. The rand appreciated by 7.3% against the greenback, 6.1% versus the euro and 10.0% against sterling during the quarter, amid good global investor demand, as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller. Also supporting the currency was a significant narrowing of the current account deficit, to 3.1% of GDP in Q2 from 5.3% in Q1. For investors, however, rand strength undermined offshore investment returns.

After having eased for much of the quarter, the price of Brent crude oil surged back to the $50 per barrel level at quarter end after OPEC agreed to limit production. Gold lost 0.5% as its safe-haven status lost its appeal, but among notable commodity price gains, tin and lead each rose 18% and palladium jumped nearly 23%.

PERFORMANCE

For the quarter ending 30 September 2016, the Fund returned -3.2% (net of fees, in rand), better than the average -4.7% recorded by the Global Interest Bearing Variable Term sector, as well as the -5.3% returned by its benchmark, the Barclays Capital Global Aggregate Bond Index (in rand). In absolute return terms, the rand's appreciation against major currencies during the period detracted significantly from value. In relative rand terms, among the largest positive contributions came from the tactical holding of South African bonds we added in the previous quarter, which was done on the basis of the cheapness of SA bonds vs their global counterparts. US High Yield and European Corporate bonds also added to relative performance. For the past 12 months, the Fund has returned 7.7% p.a. (net of fees), while since inception in 2000 the Fund has returned a net 9.6% p.a.

STRATEGY AND OUTLOOK

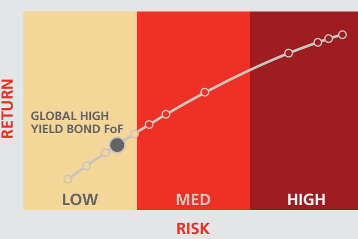
As in the previous quarter, we maintained the Fund's defensive positioning during Q3, remaining underweight duration to mitigate the rising risks from expensive global government bond markets. We also increased our already-substantial allocation to cash (at 22.7% of the fund at quarter-end from 19.2% previously). Floating-rate notes (FRNs) are key holdings to reduce capital risk, although we do also hold fixed-rate high-yield corporate bonds due to the attractive yields they offer on a risk/reward basis.

Given the continued low (and negative) yields prevailing in many developed country bond markets like the US, Germany, Japan and Switzerland, we still see limited value in developed market government bonds in the medium term. Although the downward revisions to global growth and trade forecasts experienced over the quarter reinforce the view of interest rates in developed economies remaining lower for longer, Prudential's view is that this is more than factored in already.. Investors buying bonds at these current expensive valuations are likely to be disappointed with returns going forward. Consequently, we prefer higher-yielding spread products like investment-grade and high-yield corporate bonds that offer more attractive relative yields and valuations. Investors in these products (in US dollars) would have already benefited from this quarter's bond rally arising from the improved outlook for energy prices following the OPEC agreement – rand-based investors did not due to the appreciation of the rand over the period.

Given the strong rally in South African bonds during the quarter, we took profits on the Fund's tactical holding of local bonds added the previous quarter, so that the Fund has moved from a 5% exposure to no exposure at quarter end, with the proceeds deposited into US Dollar cash. This proved to be a sound tactical trade given the relative cheapness of the bonds versus their offshore counterparts. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK
1 year	7.7%	8.4%
3 years	12.3%	13.4%
5 years	14.5%	13.1%
7 years	12.7%	11.9%
10 years	10.8%	10.4%
Since inception	9.6%	9.7%

RISK/RETURN PROFILE:



FUND MANAGERS:
David Knee and Michael Moyle

ASISA CATEGORY:
Global - Interest Bearing - Variable Term

BENCHMARK:
Barclays Capital Global Aggregate Bond Index

INCEPTION DATE:
1 November 2000

FUND SIZE:
R249 622 300

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

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL CAUTIOUS MANAGED FUND OF FUNDS
30 SEPTEMBER 2016

PRUDENTIAL
INVESTMENT MANAGERS

QUARTERLY COMMENTARY

GLOBAL MULTI-ASSET

MARKET OVERVIEW

It was the ongoing "search for yield" that shaped global financial markets in the third quarter (Q3) of 2016, as US rate hike expectations were pushed out to December, and other major economies continued to be stuck on their low-growth, low-inflation, low-interest rate paths. Although markets remained volatile, equity markets, and especially emerging markets, were the biggest beneficiaries of the renewed "risk-on" sentiment. Bonds and gold, on the other hand, were less well supported, while commodity prices were mixed, although the surprise OPEC agreement to limit oil production sent the oil price climbing back to US$50 per barrel at the end of the quarter.

In the US, weaker-than-expected Q2 GDP growth of 1.2% (q/q annualised) was somewhat offset by strong employment data. As became expected, the US Federal Reserve again left interest rates on hold, while signalling the increasing likelihood of a rate hike in December. The interest rate market was pricing in a 60% chance of a December rate hike at quarter-end. Brexit worries eased somewhat amid better-than-expected UK economic data and some recovery in British markets, with the FTSE 100 returning 4.7% in the quarter. France's CAC 40 returned 6.7% and Germany's DAX 10.1% (all in US$).The S&P 500 returned 3.9%, while the Nasdaq returned 10.7%, reflecting the good growth and prospects of tech companies. The Barclays Global Aggregate Bond Index (US$), a mixture of government and corporate bonds, posted a total return of 0.8%.

In recognition of the increasing ineffectiveness of monetary policy to further boost growth, the Japanese government in August announced a Y28 trillion fiscal stimulus package, including cash handouts to 22 million low-income earners. The country's GDP growth nearly stalled in Q2 at only 0.2% (q/q annualised) on the back of declining exports and business investment, from 2.0% in Q1.

In China, however, Q2 GDP growth held steady at 6.7% (q/q annualised), slightly above consensus and within the government's 6.5%-7.0% target for the year. The Chinese central bank has kept interest rates at record lows and reduced bank reserve requirements to buoy the economy, although consumer spending has been somewhat softer. Other emerging market bonds and currencies were also generally stronger, benefiting from the "risk-on" sentiment. The rand appreciated by 7.3% against the greenback, 6.1% versus the euro and 10.0% against sterling during the quarter, amid good global investor demand, as well as significant inflows from the conclusion of AB InBev's purchase of SABMiller. Also supporting the currency was a significant narrowing of the current account deficit, to 3.1% of GDP in Q2 from 5.3% in Q1. For investors, however, rand strength undermined offshore investment returns.

Among emerging markets, the MSCI China returned 14.0% (in US$) over the three months, the strongest performer. Brazil's Bovespa kept up its run, gaining 12% in Q3 for a return of 62% year-to-date (US$). The MSCI South Africa gained 6.4%, MSCI Russia returned 8.9% and South Korea's KOSPI 10.5%, while the MSCI Turkey lost 5.3% (all in US$) following the failed coup attempt and credit rating downgrade. EM bonds and currencies were also generally stronger.

PERFORMANCE

For the quarter ending 30 September 2016, the fund returned -3.1% (net of fees in rand), compared to -3.3% from its benchmark (the average return of the ASISA Global Multi-Asset Low Equity sector). In US Dollars, the fund returned 3.2%, reflecting the fact that both bonds and equities delivered positive hard currency terms and highlighting the impact of the appreciating rand on absolute returns. In rand terms, holdings of global cash, that comprises about 20% of the fund, were the major performance detractors. Global bonds also saw negative rand-based returns, offset in part by the positive returns from the fund's international equity exposures, especially Asian markets and also a holding in global financials. Equity returns were assisted by decent stock selection, where the fund's underlying managers' tilts towards value-orientated equities did well.

STRATEGY AND OUTLOOK

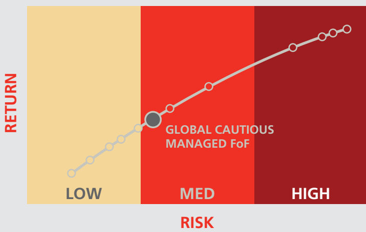
We continue to prefer global equities over bonds and cash in our global portfolios, given their superior return potential. Although developed market equities rallied over the quarter and valuations generally became more expensive, in Europe in particular we still believe markets are pricing in excessive risks to earnings growth, making them attractive on a relative basis. We therefore have maintained our equity exposure in these markets. Emerging market equities gained even more ground amid the positive investor sentiment, but still carry high risks, particularly in regard to the future path of commodity prices. We have, however, continued a tactical exposure to India. Therefore our equity allocations continue to be weighted broadly towards developed markets, since from a long-term valuation perspective developed market equities (such as Germany) are somewhat cheap - both in absolute terms and relative to cash and bonds.

In global fixed income, we are underweight duration and continue to hold floating-rate notes (FRNs) in order to reduce interest rate risk. We remain positive on both investment-grade and high-yield corporate bond markets relative to government bonds, where we see the exceptionally low yields as unsustainable in the medium term; credit spreads (the additional yield over government bonds) are trading above their long-term averages and represent decent medium-term value. These bonds have rallied in the past quarter given improving investor sentiment and a more positive growth outlook for energy companies in particular.

The portfolio has an 8.9% weighting to global property, where yields are mid-single digit and consequently significantly higher than what is achievable from global government bonds (where, as noted, the fund is underweight). ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK
1 year	5.2%	6.7%
3 years	10.8%	11.9%
5 years	12.6%	12.3%
7 years	9.7%	9.4%
10 years	6.6%	6.7%
Since inception	8.0%	7.8%

RISK/RETURN PROFILE:



FUND MANAGERS:
Michael Moyle, David Knee and Marc Beckenstrater

ASISA CATEGORY:
Global - Multi-Asset - Low Equity

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

INCEPTION DATE:
1 March 2004

FUND SIZE:
R106 885 490

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Sources: Prudential, Morningstar & Deutsche Securities

PRUDENTIAL GLOBAL VALUE FUND OF FUNDS
30 SEPTEMBER 2016

QUARTERLY COMMENTARY

GLOBAL EQUITY

MARKET OVERVIEW

It was the ongoing "search for yield" that shaped global financial markets in the third quarter (Q3) of 2016, as US rate hike expectations were again pushed out to December, and other major economies continued to be stuck on their low-growth, low-inflation, low-interest rate paths. Although markets remained volatile, equity markets, and especially emerging markets, were the biggest beneficiaries of the renewed "risk-on" sentiment. Bonds and gold, on the other hand, were less well supported, while commodity prices were mixed, although the surprise OPEC agreement to limit oil production sent the oil price climbing back to around $50 per barrel at the end of the quarter.

PERFORMANCE

The Fund outperformed its benchmark, the MSCI All Countries World Index, by 1.8% in rand terms over the quarter.

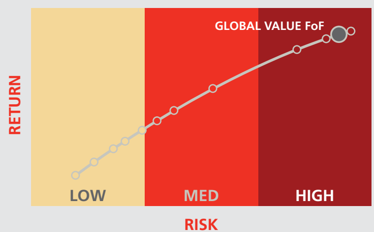
Stock selection across most of our managers, and across all major countries, added to performance, in part due to value outperforming growth globally. Our exposure to the global financial sector, which has a large exposure to Emerging Markets and hence struggled during 2015, did particularly well, outperforming its benchmark by 10% in rand terms.

STRATEGY AND OUTLOOK

Our overweight exposures continue to be concentrated in European markets such as Germany, where long-standing growth concerns have kept valuations on the cheap side of fair value, as well as selected Emerging Markets including India, funded by underweights in the US, Japan and a variety of other smaller markets including Australia. As in Q2, equity risk premiums (the yields on equities vs bonds) remain elevated and are in some cases close to the peaks seen in the Global Financial Crisis, providing a significant valuation buffer that should help to protect equities in the event of growth disappointment. ■

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK
1 year	10.1%	11.5%
3 years	14.8%	16.8%
5 years	20.9%	23.0%
7 years	14.6%	17.5%
10 years	7.8%	10.5%
Since inception	6.6%	7.9%

RISK/RETURN PROFILE:



FUND MANAGERS:
Michael Moyle and Marc Beckenstrater

ASISA CATEGORY:
Global - Equity - General

BENCHMARK:
MSCI All Country World Index (Net)

INCEPTION DATE:
18 February 2000

FUND SIZE:
R224 640 339

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