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PROVEN FUND Managers

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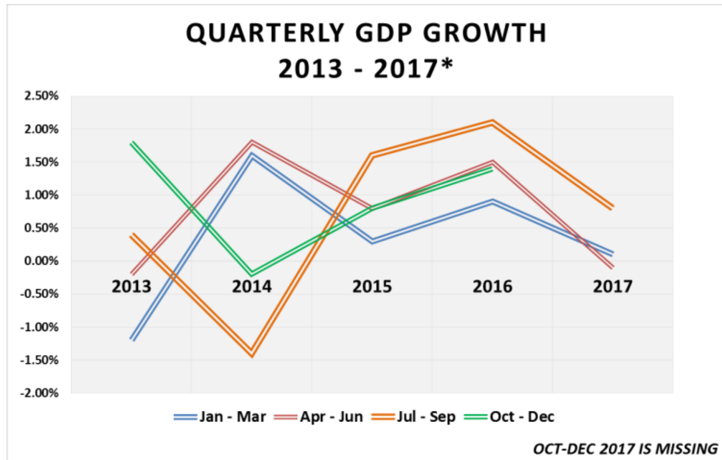
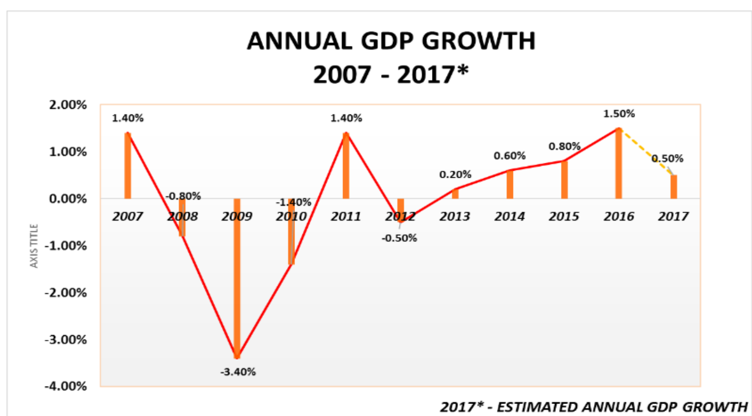
2018 Economic Analysis - Jamaica

Gross Domestic Product (GDP)



The local economy in 2017 failed to generate the momentum anticipated in 2016 when GDP growth was at 1.5%, its highest in ten (10) years. On a quarter over quarter basis the economy grew 0.8% for the three months ended September 2017. The economy increased by 0.1% in the first quarter and declined by 0.1% in the second quarter of 2017, when compared to the same quarters in 2016. The growth in the first quarter was attributable to broad-based, modest improvements in the service and goods producing sector. Although the Services Industries grew by 1.0 % over the second quarter of the calendar year, it was not enough to counteract the 3.3% decline in the Goods Producing Industries that led to a slight decline of GDP during the second quarter. However, in the third quarter of 2017, growth accelerated to 0.8% due to the Goods Producing and Services Sector growing 0.3% and 0.1%, respectively. The Manufacturing and Construction industries were the two main drivers of Jamaica's economy in the third quarter of 2017. The Manufacturing sector ramped up production due to increased outputs from both the Food, Beverages & Tobacco sub-industries and grew by 2.3%. The Construction Industry remained strong at a growth of 1.2% attributing most of its success to the ongoing renovation of the Mandela Highway and to the completion of the new Wisynco building after the destroyed by fire in May 2016. During the same period, the Agriculture sector declined by 0.8%, the sector was directly impacted by the suspension of operations at two main sugar factories, Golden Grove and Monymusk, due mainly to heavy rainfall during the second quarter of 2017.

Outlook



The fourth quarter of 2017 performance should continue the positive trend of the previous quarter, with the goods producing sector yet again leading the way as relatively low crude prices on the international market will likely result in lower input costs and help to reduce the trade deficit.

Looking ahead to 2018, the Hotel & Tourism industry should continue to reap the benefit of continued improvement in the US economy which, thus far, has led to increased tourist arrivals to the island. However, the increasing crime levels may curtail some of the growth.

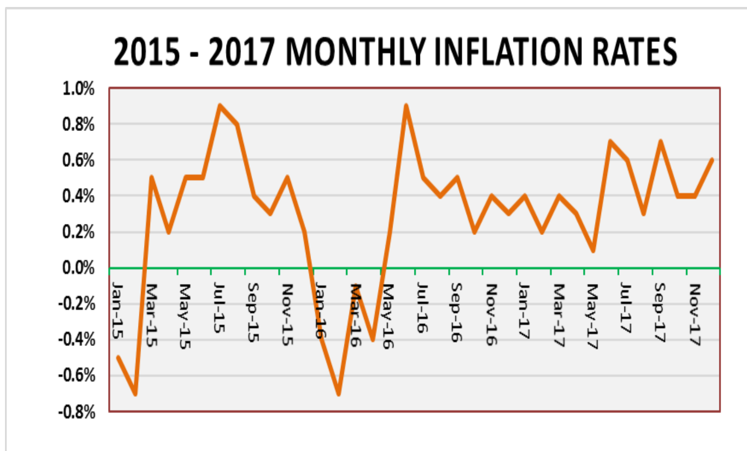
Nonetheless, the Goods producing sector is expected to play a major role in growth for 2018. Additionally, with the finance industry as a leading indicator of economic growth, we anticipate the similar trend in 2018 as the banking industry continues to ramp up loan and deposit growth to reflect improved consumer spending and discretionary income.

Despite the unpredictable weather patterns in 2017, the economy saw positive GDP growth for 10 of the last 11 quarters since 2015. With strong performances especially in tourism, construction, and manufacturing sector, unemployment reached 11.3% in July 2017, a 7-year low, along with a sustained expansion in the labour force. The IMF has reduced the GDP target for fiscal year 2017/2018 to 1.6% which is slightly lower than anticipated, as flooding adversely impacted agriculture.

With energy prices projected to increase slightly, the goods producing industry should continue to carve out positive gains in 2018. The Economic Growth Council (EGC) has made several proposals which they believe should result in above normal growth rates, but this would be most likely recorded over the medium to long term at best. The IMF projects that Jamaica should grow 2.3% in calendar year 2018, but this growth projection is unlikely to be met given the current growth trend and the inability of the government to foster growth enabling strategies. This could also be undermined by larger than anticipated fiscal deficit resulting in the curtailment of government spending, adverse weather conditions which would negatively impact the agriculture industry and a rapid appreciation in the price of crude oil. As such, ***our baseline expectation for GDP growth for 2018 lies between 0.9% - 1.4%.***

Inflation

2017 was a year when inflation tripled that of 2016 but still relatively lower than it was between 2011 and 2015. If one can recall, 2016 was an extraordinary year with inflation being mostly negative for majority of the year. For the period January to December 2017, inflation normalized and stood at 5.3% and the fiscal year-to-date movement was 4.3%. This falls comfortably between the Bank of Jamaica's range of 4-6% for 2017. The active hurricane season brought heavy rainfall and severe flooding during the latter part of the year leading to lower crop yield and increased prices.



The Consumer Price Index (CPI) for December was 248.7 when compared to the index of 247.3 for November. This reflected a 0.6 % increase in inflation. The increase was largely due to increases in index for the two heaviest weighted divisions. 'Food and Non-Alcoholic Beverages' and 'Housing, Water, Electricity, Gas and Other Fuels' rose by 0.8% and 1.2%, respectively. The upward movement in the first division was impacted by the major flood rains in December which disrupted the supplies of agricultural products resulting in a 2.2% rise in the class 'Vegetables and Starchy Foods'.

For the calendar year 2018, we anticipate that inflation will fall within the same range as 2017, as crude oil and commodity prices are expected to increase moderately. With the local economy not expected to pick up pace in terms of economic growth over 2017, we anticipate "more of the same" in the coming year (0.9%-1.4%). Furthermore, we don't foresee any real risks of inflation being rampant even in the face of higher oil prices on the international market. Furthermore, the passthrough effect of any devaluation should be minimal; even though our base case scenario points to continued stability amidst stable US inflows and a liquid local US money market. ***We project that inflation will range between 4.5% and 5.5% for 2018. Risks to the outlook reside in higher than expected oil prices along with a faster than expected depreciation in the local currency and a very active hurricane season resulting in adverse weather conditions.***

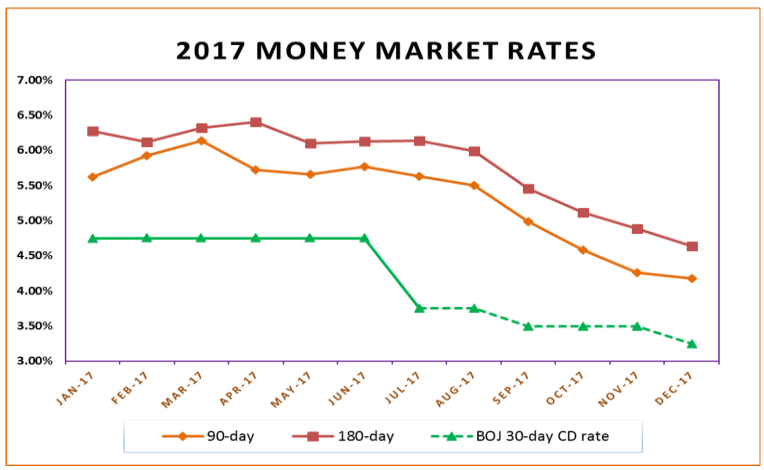
Fiscal Accounts

Total revenues and grants for the fiscal period April to November 2017 stood at J$336.6B, 4.03% or J$13.0B over the budgeted J$323.5B. Total expenditure was 1.8% below the budgeted J$359.8B at J$353.2. This translates to a fiscal deficit of J$16.7B, 54.1% or J$19.6B below the budgeted deficit of J$36.3B. A primary surplus of J$26.6B, 6.4% or J$1.8B less than the budgeted J$28.4B was recorded for the period. This 8-month performance has placed the government in good stead in achieving its estimated budget deficit of J$6.0B and primary balance of J$131.9B for the fiscal year ended March 31, 2018. With the new precautionary SBA with the IMF, the GOJ is expected to continue to practice fiscal discipline and keep debt on its downward trajectory.

This agreement seeks to continue the target of a 60% debt-to-GDP ratio by 2025/26 through sustained economic growth and the maintenance of a 7% primary surplus. It also sees the government continuing its commitment to a tax reform strategy that intends to rebalance from direct to indirect taxes. This is as the government aims to broaden the tax net, improve tax collection, and stimulate domestic consumption.

Going forward we don't anticipate any change in policy by the current administration. We anticipate continued fiscal constraint will continue with the aim of maintaining the downward trajectory in debt dynamics. We do foresee lower rates which should aid in reducing the country's interest burden. However, other critical achievements such as reducing the size of the public sector is yet to be seen and fully articulated. This could have a negative impact on economic growth over the short term.

Interest Rates

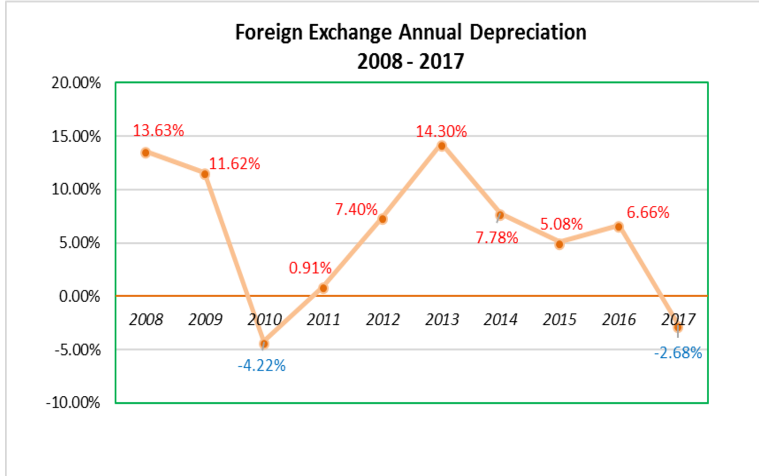


For the first half of 2017 Interest Rates were steady at 4.75%. The Bank of Jamaica announced that, with effect from July 1, 2017 its policy rate would be the interest rate that it pays on overnight deposits held by deposit-taking institutions ("DTIs") at Bank of Jamaica. The rates on the Bank's weekly 14-day repurchase operations and 30-day Certificate of Deposit (CD) will continue to be determined by an auction. As at January 17, 2018, the 4.00% FR Certificate of Deposit had an average yield of 3.69%.

The Bank of Jamaica continues to offer 30-day certificates of deposit to primary dealers and DTIs but, at fixed volumes by competitive multiple-price auctions. The Bank is making this change to the monetary policy framework in order to strengthen the relationship between the policy rate and market interest rates which, in turn, influence the spending and saving decisions made by businesses and consumers. By this means, the Bank is able to influence the rate of inflation in pursuit of the inflation target.

During the year, the Bank of Jamaica (BOJ) cut the interest rate offered on overnight placements with the Bank, the policy interest rate, thrice fell by 25 basis points (75 basis points, or 0.75% total) from 3.75% to 3.00%. The yield on the Government of Jamaica Treasury Bill (T-Bill) also fell throughout the year on all tenors. Lack of investment securities and increased J$ liquidity contributed to the downward trend in short term instruments. Going forward, we anticipate that interest will inch lower but is gradually bottoming out. ***We anticipate that the rate will be stable throughout the year at 3.00%. This would likely influence general market rates such as Treasury Bills to fall further over the next twelve months.***

Foreign Exchange



The Jamaican dollar closed the year at J$125.00: US$1.00, appreciating 2.68% throughout the year. This was the lowest daily exchange rate since it stood at J$124.80 back in May 17, 2016. Furthermore, this represented the first annual appreciation in the local currency vis a vis the US dollar since 2010.

The appreciation in the Jamaican dollar was supported by improving economic indicators which included: increased tourist visits to the island, growth in remittances and a robust Net International Reserve(NIR). In the January to June window, net remittances increased by 2.2% YoY to US$1,034.1M, a US$2.1M increase relative to the corresponding period in the year prior. The increase in inflows was largely influenced by the 2.9% growth through remittance companies and a marginal 0.6% growth in Other Remittances. Additionally, the unanticipated excess US inflows stemming from the early redemption of the GOJ 2020 USD local bonds (US$525Mn) further contributed to the oversupply of the USD funds in the market. The NIR hovered at over US$2.0B throughout the year, and the BOJ drew upon it in times of excess demand for USD to temper the rate of depreciation.

For 2018, the increase in foreign exchange inflows from the tourism sector (as well as the informal sector), and the significant levels of the net international reserves (NIR), should contribute to the continued stability in the foreign exchange market. The challenge with predicting exchange rate movements over the short term locally is that it is driven less by exchange rate models and more from market dynamics and policy shifts. The change in the FX auction market by the BOJ has been said to bring greater transparency and predictability to the process. Last year, our prediction was that the local currency would have devalued based on the pace at which the BOJ had reduced their benchmark rate, which would have potentially resulted in portfolio switching to hard currency investments. Market dynamics however have changed with a greater momentum shift towards local currency investments, mainly due to the influx of USD in the market and need for JMD securities. This will further keep speculators at bay and lead to a more normal movement in the exchange rate.

We anticipate that the local currency will move between -1% (appreciation) to 3% (devaluation) in the calendar year. We have however maintained our thesis that there is limited downside from this point forward as the interest rate differential narrowing could potential spur speculative investors.

Bonds

GOJ Global Bonds gave bond investors another year to smile. Despite the volatility in the global bond market, and pending rate increases by the US Federal Reserve, GOJ Global bonds recorded average total return of for 2017. Investors who increased their duration towards longer dated GOJ Bonds were adequately compensated with the 2045s and 2039s recording the highest returns for the year.

GOJ Bond Yield and Price Summary									
GOJ GLOBAL BONDS	**Coupon**	**Maturity**	**Offer Yield 30-Dec-16**	**Offer Yield 29-Dec-17**	**Offer Price 30-Dec-16**	**Offer Price 29-Dec-17**	**YOY Price Change**	**Price Change %**	**Total Return**
JAMAN2019	8.000%	24-Jun-19	2.590%	2.470%	J$ 107.70	J$ 105.25	-J$ 2.45	-2.275%	5.725%
JAMAN2022	11.625%	15-Jan-22	5.570%	3.570%	J$ 126.75	J$ 130.00	J$ 3.25	2.564%	14.189%
JAMAN2025	7.625%	09-Jul-25	5.150%	4.250%	J$ 115.25	J$ 119.00	J$ 3.75	3.254%	10.879%
JAMAN2025	9.250%	17-Oct-25	5.480%	4.390%	J$ 126.00	J$ 131.75	J$ 5.75	4.563%	13.813%
JAMAN2028	6.750%	28-Apr-28	5.380%	4.920%	J$ 110.75	J$ 113.55	J$ 2.80	2.528%	9.278%
JAMAN2036	8.500%	28-Feb-36	6.840%	6.030%	J$ 117.50	J$ 126.95	J$ 9.45	8.043%	16.543%
JAMAN2039	8.000%	15-Mar-39	6.970%	6.000%	J$ 111.25	J$ 123.35	J$ 12.10	10.876%	18.876%
JAMAN2045	7.875%	28-Jul-45	7.080%	5.150%	J$ 109.63	J$ 122.75	J$ 13.13	11.973%	19.848%

The movement in bond prices throughout the year reflected the idiosyncrasies of the local market with the excess US dollar liquidity in the local market driving prices slightly higher. However, notwithstanding that, the improving fiscal position of the GOJ, along with the yearn for attractive yield in the low global environment helped to maintain elevated bond prices.

Outlook

With the expected, but gradual, 2-3 pending rate hikes by the US Federal Reserve, we don't anticipate that there will be any significant upward movement in bond prices over the next twelve months. We anticipate more downward pressure on bond prices over the next 12-18 months.

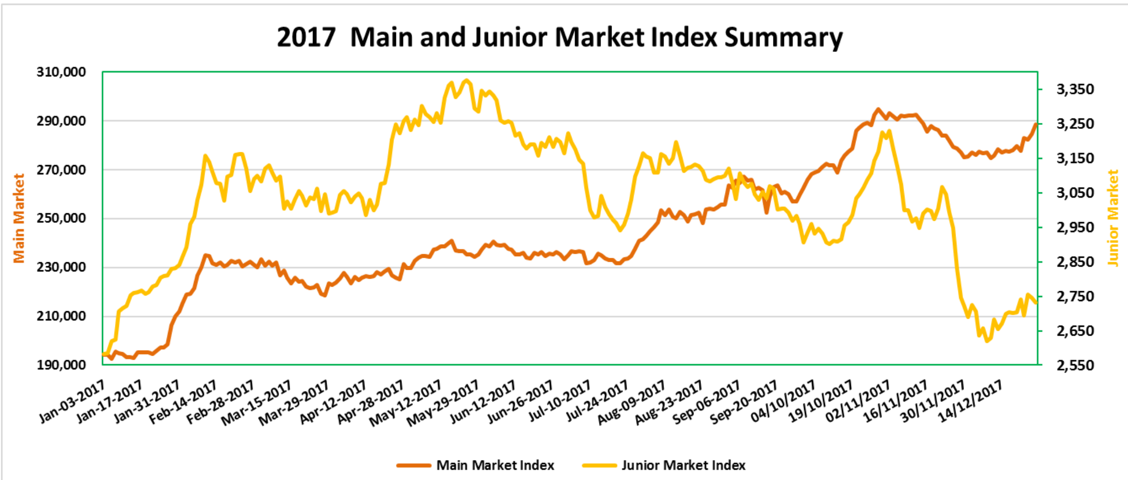
Our base case scenario is for GOJ bond prices to remain fairly stable with limited capital appreciation and greater downside price risk; but nevertheless, a positive return for investors who currently hold the bond. This premise is driven from our core principle of comparative analysis, where other economies (Dominican Republic in particular) with better credit ratings are providing investors with a similar yield. We believe that while the local economy has improved along with the debt dynamics seemingly on a downward path and the government successfully reopening existing bonds at historically low yields and repaying expensive debt, it has already priced in a potential upgrade and even then, would be slightly overvalued. At the same time, given the dynamics of the local market, bond prices could remain at these elevated levels over the near term despite all the aforementioned. We continue to believe that the greatest value is likely to be in the belly of the curve; with the 2025s and 2028s providing the best risk adjusted return for investors.

Local Bonds

Lower interest rates and improved fiscal numbers were the main catalysts behind the improved trading activity in local bonds. With the GOJ not very active in the market there has been a shortage of J$ securities to mop up excess J$ liquidity. With interest rates expected to remain around current levels, and the possibility of further declines over the immediate term, we anticipate that trading will continue to be moderate in these securities. The GOJ is expected to tap the market in the current year, at least to maintain some presence to gauge market sentiment and possibly contribute to pushing rates lower.

Equity Market

The local equity market recorded yet another year of positive returns for investors; surpassing the previous year's performance. Accelerating global growth; low but stable local growth with low inflation; enlivened profit expectations and, encouraged risk-taking aided by excess liquidity and limited investment opportunities, all drove the local market to its third consecutive year of gains to bring the market to record highs throughout the year. The main JSE index closed the year at 288,381.97 which represented a 49.98% increase over 2016. This is almost double the performance in 2016. The Junior JSE index closed the year at 2,732.06 which represented a 5.84% increase over 2016 indicating a much slower pace of appreciation when compared to the prior year.

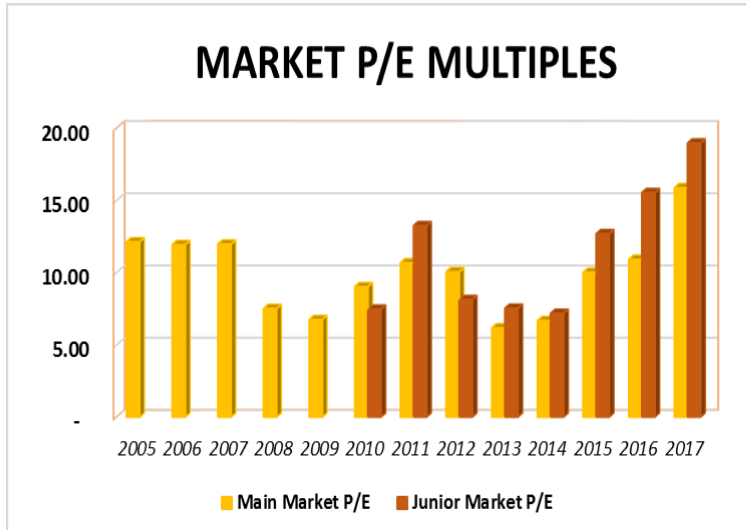


The large cap companies helped to boost the performance of the main index throughout 2017 but overall, there was a broad-based increase as only 4 stocks on the main market closed the year lower. On the Junior market, it was more evenly distributed between winners and losers.

YTD STOCK MARKET MOVEMENT			
MAIN MARKET			
MAJOR WINNERS		**MAJOR LOSERS**	
Pulse Investments Limnited	203.37%	Radio Jamaica Limited	-19.23%
Berger Paints	195.54%	Sterling Invetments Limited	-17.20%
Palace Amusement (1921) Company Limited	187.18%	Portland JSX Limited	-8.42%
Ciboney Group Limited	127.78%	Caribbean Cement Company Limited	-6.72%
Supreme Ventures Limited	119.62%		
Jamaica Producers Group Limited	80.93%		
Carreras Limited	70.79%		
Cable and Wireless Jamaica Limited	66.67%		
Kingston Wharves Limited	62.42%		
PanJam Investment Limited	58.90%		
JUNIOR MARKET			
MAJOR WINNERS		**MAJOR LOSERS**	
Knutsford Express Services Limited	275.19%	Cargo Handlers Limited	-46%
Eppley Limited	144.90%	Lasco Distributors Limited	-46%
Jetcon Corporation Limited	140.50%	AMG Packaging & Paper Company Limited	-39%
Jamaican Teas Limited	73.25%	Caribbean Cream Limited	-34%
Lasco Finanacial Services	65.83%	Honey Bun (1982) Limited	-31%
Access Financial Services Limited	65.59%	IronRock Insurance Company Limited	-29%
C2W Music Limited	45.71%	Lasco Manufacturing Limited	-23%
Blue Power Group Limited	45.45%	Consolidated Bakeries (Jamaica) Limited	-20%
Derrimon Trading Company Limited	43.30%	Caribbean Flavors & Fragrance Limited	-8%
ISP Finance Service Limited	41.88%	General Accident Insurance Company Limited	-6%

Outlook

We are emboldened by trends in the data that support the bull case for equities moving into 2018. Still, we are mindful that valuations are considerably higher than historical levels and risks still exist. At the same time, while valuations may appear stretched when compared to historical norms, it is important to note that there have been several structural changes which have resulted in a new paradigm regime- Jamaica Debt Exchange (JDX), National Debt Exchange (NDX) and Private Debt Exchange (PDX).



The new regime of lower interest rates has been supported by a much lower inflationary environment, a more stable economic environment, fiscal responsibility and a much more stable exchange rate movement. It would have been difficult for investor sentiment to have been much different then as the opportunity cost was significantly higher. This new regime has created an environment that is much more conducive to equity investing, driven by an increase in stock market listings, marketing of equity listings, and a dearth of other eligible investment opportunities. We believe that with the environment expected to the remain stable, all things being equal, that these valuation levels are now the new norm and have formed a new baseline from which we will base our projections from going forward.

We believe the strategy should be to tactically overweight in large cap blue chip value companies. As equities markets go through the slower part of the economic cycle, value companies are known to perform better than growth stocks. Furthermore, companies with a consistent dividend policy and attractive dividend yields are likely to remain resilient to any potential correction over the short and medium term.

We project lower returns from here relative to the last two years and believe that investors should underweight highly priced growth stocks with low surprise to the upside to reduce price risk. Furthermore, valuations appear to be more than stretched on junior market companies which is primarily driven by low free float which creates an artificially high demand; even when it may not be justified. Even with the expectation that several IPOs will hit the market in 2018, we believe that on a sustainable basis (after the initial IPO craze), we anticipate that the main market may end up outperforming these companies. ***For 2018, we expect the market to appreciate between 10 to 25%.***

Risks

Although we have to look hard to find signs of weakness in the incoming economic data, we recognize that risks could surface in 2018. In no particular order, we see a few potential hazards to our outlook. First is the adverse movements in the local currency. History has shown that when the currency depreciates at an above normal pace, investors tend to shun local currency investments. However, while we don't foresee any swift movements over the next 12 months, with interest rates continuing to trend lower, we do believe there will be a point where investors will prefer to hold USD assets given the lower differential spread. Furthermore, with interest rates likely to rise further by the FED, this will naturally impact USD bonds and result in higher yields. Another potential hazard is the change in investor sentiment could see a tapering off of equity gains in the new year. This coupled with the ever-present risks of the Government displaying fiscal irresponsibility may result in lower business confidence.