Local Economic Commentary

The Jamaica Stock Exchange (JSE) was reported by Bloomberg[i] as being the world's best performing Stock market for the 2015 calendar year with the Main Market Index growing in excess of 95% which compares favourably to the S&P 500 and the Dow Jones Industrial Average Index, which fell 2.15% and 3.48% over the same period. Of note, the majority of the 2015 gains were achieved between September 2015 and December 2015 subsequent to the announcement of the take-over of Red Stripe (trading as Desnoes & Geddes Limited) by Heineken International.

On the heels of this performance, and announcement on December 23rd, 2015, the nation entered into a 5-month period of electioneering, political campaigns, a change of Government on February 25, 2016 and the first submission of the budget estimates on May 12, 2016. In that time, the JSE Main Market Index remained virtually unchanged from January 04, 2016 (index value – 151,469.36) to May 13, 2016 (151,766.65). It would appear, however, that the stakeholders of the market received the budget submission favourably, as it has appreciated to 153,423.94 (a gain of 1.09%) in the 4 days since its reading.

Growth of the Jamaica Stock Exchange Main Market index value takes on greater importance when one considers that Jamaica contends with varying degrees of foreign exchange variability (2015 devaluation vs the USD – 5.01%) and inflation (2015[ii] – 3.7%; 2014 – 5.3%). Therefore for an investor to experience a 'real' rate of return, capital gains and dividend income should reasonably clear 10% per annum. Therefore, while the 2015 performance of the JSE would have provided significant returns from all vantage points, the bar of expectation for a 'real rate of return' is firmly set at 10% per annum.

For 2015, growth in the Gross Domestic Product (GDP) of Jamaica increased by 0.8% [iii] over 2014. Positive outcomes were the passing of ten consecutive IMF (International Monetary Fund) tests and improving business and consumer confidence metrics. With the new Jamaica Labour Party (JLP) Administration's stated intention of abiding within the structures of the IMF deal, and restoring the incentives of the JSE Junior Market, one can reasonably foresee growth in the Jamaica Stock Exchange in the short-medium term. It may be too optimistic an expectation for similar growth but if all holds and remains on course, growth, and by extension a satisfactory return on investment should be the end result.

For growth to be sustained however, additional displays of confidence in the Jamaican economy are required. For instance, we have not seen a major entity list on the Main Market in recent years. In fact, some of the more illustrious companies have actually delisted. Examples of such are Lascelles de Mercado, Red Stripe and Courts Jamaica Limited. Were entities of a similar ilk to find their way on the JSE, we are of the opinion that consumer and business confidence metrics would improve at a faster and more sustained rate. Foreign Direct Investments are a vote of confidence also and is likely an underlying reason for the spike in the market post the Heineken/Red Stripe deal.

Stock to Watch

With Total Assets of $555.6 billion, a price-to-earnings ratio (P/E Ratio) of 7.46 times and a dividend yield of 5.62% as at May 13, 2016, National Commercial Bank Jamaica Limited (NCBJ) is the largest financial institution in Jamaica and a recommended BUY at this time. Separate from recent news regarding its acquisition 29.9% of Guardian Holdings Limited shares from the Lok Jack and Ahamad families, IFC and one of the IFC's affiliates, NCBJ has consistently grown its earnings organically whilst being undervalued relative to the market P/E ratio of 8.62 times for the week ended May 13, 2016.

Applying the market P/E ratio to NCBJ's annualized earnings of $4.88 per share, gives a 5% upside from its current price of $39.18. Further, assuming growth of 9 – 12% per annum, and potential upswings in the JSE to a market P/E of 10 times earnings will likely cause further revisions upwards in the share price of NCBJ.

Drawing information from the Bank's recently-released earnings report for the 6 months ended March 31st, 2016 reveals strong growth in metrics which include:

- Customer deposits – $251.0 billion – an increase of $41.0 billion, or 19.5%.
- Loans and advances – $172.7 billion (net of provision for credit losses) – an increase of $14.8 billion of 9.4%
    - o Led by an 11.5% increase in the Retail Banking portfolio
- A 3.40% decrease in Non-performing loans, from $8.8 billion as at March 31, 2015 to $8.5 billion as at March 31, 2016
- 9.6% year-on-year increase in net profit of NCB Capital Markets, the Wealth, Asset Management & Investment Banking arm that contributed 20.1% to segment operating profit

NCBJ has been taking steps to integrate itself in the Eastern Caribbean via the establishing of NCB Capital Markets Barbados which followed closely on the heels of the formation of NCB Global Finance Limited (NCBGF) in Trinidad & Tobago. These moves augur well for the sustainable growth of the entity whilst managing risk and exposure to any single economy and/or means of earning. It is also worth noting the rarely spoken of (almost forgotten) fact that NCB Capital Markets is the single largest shareholder in Jamaica Money Market Brokers Group (JMMB) which is deepening its roots in the Caribbean, the Dominican Republic and Central America.

The entity has demonstrated a willingness for investing as in addition to JMMB, and its significant stake in Guardian Holdings, valued at USD $413,101,350 (TT $2,754,009,000) as per its 2015 Annual Report, its recent acquisition of 20% of Knutsford Express Limited has appreciated near-80%.

GK Capital Management Limited is a member of the Jamaica Stock Exchange and is well-equipped to facilitate clients investing in the shares of National Commercial Bank Jamaica Limited.

Post-Budget Analysis

The buzzword amongst most stakeholders at the time of the 2016 elections was the JLP's 'ten point plan' and the proposed waiving of PAYE (Pay As You Earn) taxes for those earning $1.5 million or below. For many, the point of interest was exactly when they could expect the relief of up to $18,000 in their monthly pay cheques. While for others, the questions of anomalies arose in terms of those earnings $1.6 - $1.8 million actually taking home less than counterparts earning $1.5 million. In the case of the movers and shakers in society, the question pertained to the impact such a threshold increase would have on the nation's already fragile financial standing.

In the interim period between February 25, 2016 and the reading of the Budget, the JSE slipped slowly downwards as many investors opted to take profits and sit on the side-lines while waiting for clarity on the way forward from the new Government. One day before the commencement of the budget debates, on May 11th, 2016, rumours started to swirl that the tax threshold for all PAYE (Pay as you Earn) contributors would be increased to just above JMD $1 million in July 2016, and another increase to $1.5 million would follow on April 1st, 2017. The reality of the 'phased' implementation of the tax threshold increase was confirmed by Minister of Finance Audley Shaw at the opening of the Budget Debate on May 12, 2016.

The response in most quarters was positive as the consensus was that the country would not be able to sustain a marked increase in the tax threshold in the absence of a robust tax package that would have impacted the vulnerable in society. This step resolved the possibility of anomalies as it appears equitable with a uniformed raise of the threshold and it also addressed (for many) the questions of how it will be funded.

Having been presented with this set of budgetary estimates, the questions remain regarding the likelihood of inflation as a result of increased fuel prices and more liquidity in the hands of the local workforce. There is also talk of the providers of public transportation increasing their rates as the Jamaica Taxi Association is said to be seeking a 30% rate hike, as they have not been privy to same since 2013. The question is also asked as to whether or not the additional funds generated via the relief will be put toward productive endeavours and buying Jamaican-made products, or whether it will continue to chase imported-fare.

Considerations to bear in mind when contemplating the success of this set of budgetary submissions will be, the profitability of the manufacturing sector relative to a potential increase in transportation costs caused by the $7 in the Special Consumption Tax (SCT) on fuel and any resultant inflationary pressures. Another external factor that could have some measure of impact (degree to be seen) is that of world oil prices which have increased since their February 2016 14-year lows. To Jamaica's credit, it would seem that our diversification of energy needs from crude oil to LNG (Liquefied Natural Gas) come August 2016 will mitigate this risk somewhat. The restoration of the JSE Junior Market incentives has been warmly-received by all.

Overseas News and Views

The word on the street, Wall Street specifically, is that US brokerage houses are now lukewarm on stocks for the year 2016, and are encouraging clients to hold cash. This strategy does bear some measure of promise when one considers that Emerging Markets (Russia, Brazil, China, India excluded) are under pressure, retail in the USA is under pressure with the exception of Wal-Mart Stores Inc. (NYSE: WMT) and commodity prices from gold to milk and oil face downside pressure and are some way off their all-time highs.

This sentiment bears a bit of irony when one considers that many of the same finance companies are under severe pressure themselves with trading revenue more or less disappearing in light of the low-interest environment that is not conducive to trading, and a muted investment banking environment. Mergers & Acquisitions have been the magic bullet of the past 2 calendar years of 2014 and 2015, a line of business felt to be inadequate to support otherwise robust operations.

The end result has been massive layoffs of traders – fixed income and foreign exchange – and general pessimism on Wall Street, which was at one time the epicentre of excess and opulence. Relatively speaking it still is, but has lost some lustre in recent times, especially as the real estate bubble that exists in Manhattan is starting to lose some air. Admittedly, there is still some way to go before either of the aforementioned return to the realm of 'normalcy'. It is clear however, that many are moving further away from the city of New York into the suburbs and commuting to the work in the City.

On June 23rd 2016, Britain will have a referendum in which it will put the option of remaining in the Euro zone to its citizens. There is also another question of what policy will be adopted by the Bank of Japan from the standpoint of reviving its economy; which is apparently on comatose. Several bouts of monetary policy (interest rates – negative, in this case) are yet to have much of an effect as the economy remains in a decades-long deflationary state characterized by severe challenges experienced by massive companies like SONY, SHARP, HONDA and TOYOTA which suffered its first fall in profits for 2 years. The solution seems to be some time away and the potential increase in sales tax is unlikely to have the desired effect because the last time same was executed in 2014 (from 5% to 8%), a temporary boost in economic activity preceded the increase and fell flat shortly afterwards.

The USA's Federal Reserve (The Fed) justified reluctance in increasing the Federal Funds rate has caused the Japanese Yen to appreciate relative to the US Dollar and this has exacerbated the state of affairs in Japan. Needless to say, while many will be waiting to see what The Fed will do next, with a June rate increase on the cards, it is worth keeping an eye on Japan since the two appear to be inextricably linked at this present moment.

Oil prices have recovered from their February 2016 low, and are steadily increasing as depressed prices keep the USA's shale extractors on the side-lines as they fall below their break-even level. Challenges in Nigeria and Canada in recent times have contributed to the increases however, the usual question is one of sustainability, and that remains to be seen. The presence of the shale supply in the USA, while depressed at this time as many go bankrupt, is likely to increase as the prices go higher. This is likely to cause another glut should they appreciate much further past $65 per barrel, as the rumoured break-even point for many lies between $40 and $50 per barrel. For perspective, the cost of extraction in Saudi Arabia and Qatar is said to be in the range of $10 per barrel. In June, the members of OPEC (Organization of the Petroleum Exporting Countries) are expected to have their semi-annual meeting at which it is expected that supply constraints will be agreed to, and thus cause there to be less supply pressure on oil prices subsequent to said meeting. A similar meeting in Doha, Qatar of April 2016 between OPEC and non-OPEC members did not bring about the desired effect, so it remains to be seen if OPEC is any more successful. One thing that seems certain is that oil prices will have some degree of tension between $48 and $65 per barrel over the next 12 – 18 months.

Market Expectations

For the three months to September 2016, we will be having our eyes on a number of stocks on the JSE, and the end result of some key developments. We expect for example, that the stock splits of Pan-Jamaican Investment Trust Limited (PJAM) and Honey Bun (1982) Limited (HONBUN) would have been completed, and if history is anything to go by, the market is likely to respond positively to the increased liquidity of the shares in question. It will be also interesting to see what PJAM does from the standpoint of branding the Oceana Hotel they purchased, as the possibility exists that

it could be bear the name Marriott or Starwood. Time will ultimately tell regarding this outcome and also the impact it has on the long spoken-of revitalization of Downtown Kingston.

Another development of note is the Supreme Ventures Limited (SVL) acquisition of Caymanas Track Limited (CTL) and the official closing of that deal. It will be interesting to see the impact this transaction will have on the profitability of SVL's revenues and if the promised cash infusion – should the deal close – will have the desired effect on the operations of CTL.

Changing lanes from racing to food, one can reasonably expect GraceKennedy's former subsidiary Hardware & Lumber Limited to be delisted from the JSE. Given GK's performance in the first Quarter 2016, they are also worthy of due consideration and a watchful eye. We should also see their USD $25 million HQ under development pick up more steam in this period.

Lastly, in addition to keeping an eye on oil prices, Jamaica Broilers Group Limited has been in acquisition mode recently with the purchase of Welp Inc Hatchery in Iowa[iv]. Given their challenges with Ethanol[v] and potential developments in this space, they are likely to experience great gains if they're able to offload the facility to a local or overseas interest in the energy space.

i http://www.bloomberg.com/news/articles/2015-12-24/it-s-jammin-jamaica-s-tiny-stock-market-conquers-world-in-2015
ii http://boj.org.jm/uploads/pdf/inflation_report/inflation_report_jan2016.pdf
iii http://statinja.gov.jm/PressReleases/newperssrelease quarterlyGDP.aspx
iv http://nationwideradiojm.com/jamaica-broilers-acquires-welp-inc-hatchery/
v http://www.jamaicabroilersgroup.com/news/investments/jamaica-broilers-exits-ethanol-market