ECONOMIC OVERVIEW

QUARTER 3, 2021

MENTENOVA

Contents

EXECUTIVE SUMMARY

Countries around the world continued to make encouraging strides in the vaccination of their populations during the third quarter, supporting the post-lockdown recovery that is under way. However, the pace of the economic recovery appears to be slowing, and the knock-on effects of the virus are becoming more pronounced as the recovery matures.

Most regions saw an improvement in their earnings outlook in Q3, and strong corporate earnings results remained a tailwind for global markets. That said, emerging market equities lagged behind their developed market peers as signs of a slowdown in China and a clampdown by the Chinese government on the country's biggest tech companies weighed heavily.

The actions by the Chinese government had ripple effects on domestic equity markets as industrial heavyweights Naspers and Prosus came under significant pressure during the quarter. This contributed to a 5% decline in the industrials sector over the quarter, while a pullback in commodity markets weighed on the resource sector. Meanwhile, financials continued to recover, returning almost 13% over the quarter.

While liquidity conditions remain accommodative, inflation was a major watchpoint for investors during Q3. Factors such as higher food and fuel costs, surging power prices, coal shortages and other supply chain bottlenecks all contributed to a further spike in inflation, raising expectations that the end of the monetary policy easing cycle is on the horizon.

Fiscal authorities continue to stimulate their economies through spending, the consequence of which has been a significant increase in global debt levels. With the US approaching its debt ceiling and China's Evergrande unable to meet its repayments, the growing pile of global debt is fast becoming another area of concern for global investors, especially as the current monetary easing cycle comes to an end.

On the domestic front, the third wave of the virus put the country back into stricter lockdowns in the third quarter, while social unrest dealt a blow to the domestic economy over the period. High-frequency economic indicators suggest that these factors set the economy back, even as the country made encouraging progress in its vaccination rollout during the quarter.

As we head into the final quarter of the year, many countries are still experiencing the early- to mid-cycle stages of the post-lockdown recovery, which remains broadly supportive of risk assets. However, concerns continue to grow over what happens next.

Rising inflation, growing piles of global debt, virus-related risks and an increasingly volatile political economy are key risks that we face as we head into 2022.

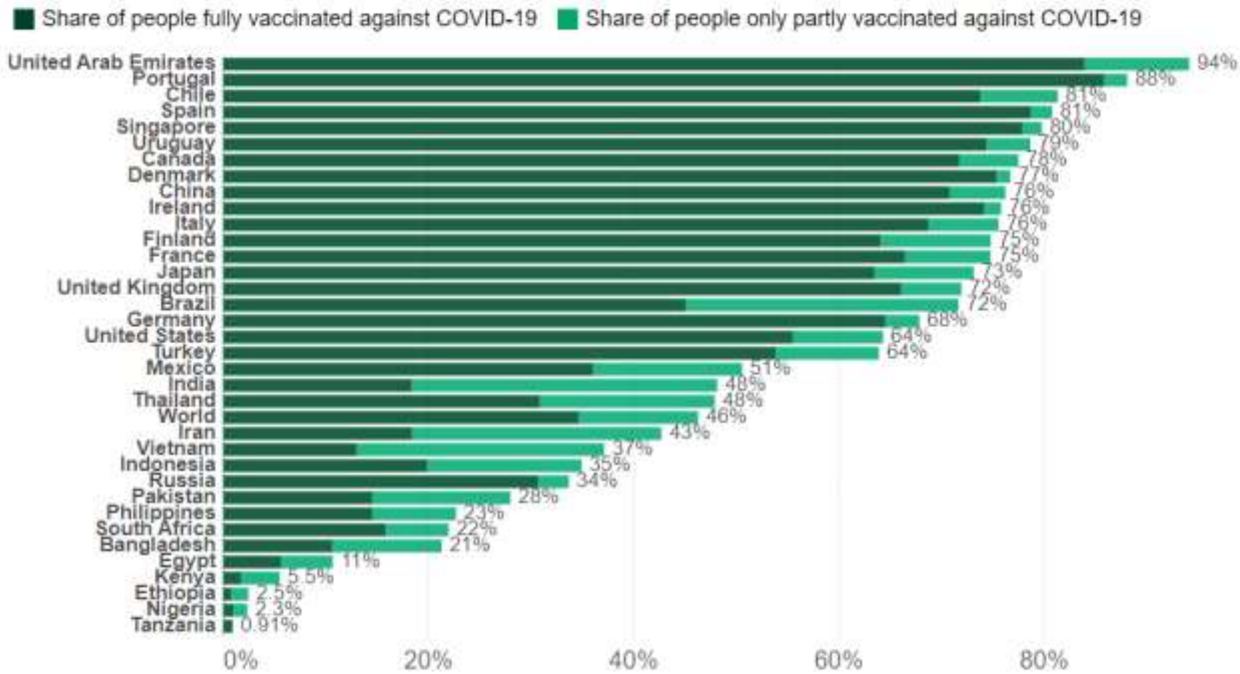
We maintain the view that the best way to achieve your investment goals is to remain invested and stick to your long-term investment strategy.

ECONOMIC AND MARKET OVERVIEW

EMERGING MARKETS UNDERPERFORM AS VACCINATIONS LAG, CHINA RISKS BUILD

The global economic recovery continued in the third quarter of the year, albeit at a slower pace, as fiscal and monetary policy remained broadly accommodative and vaccine rollout programmes continued to support the resumption of global business activity and trade. Vaccination numbers ramped up over the quarter as more developed countries achieved a 75% vaccination rate, although emerging markets continued to lag.

Figure 1: Share of people vaccinated against COVID-19 as at 7 October 2021

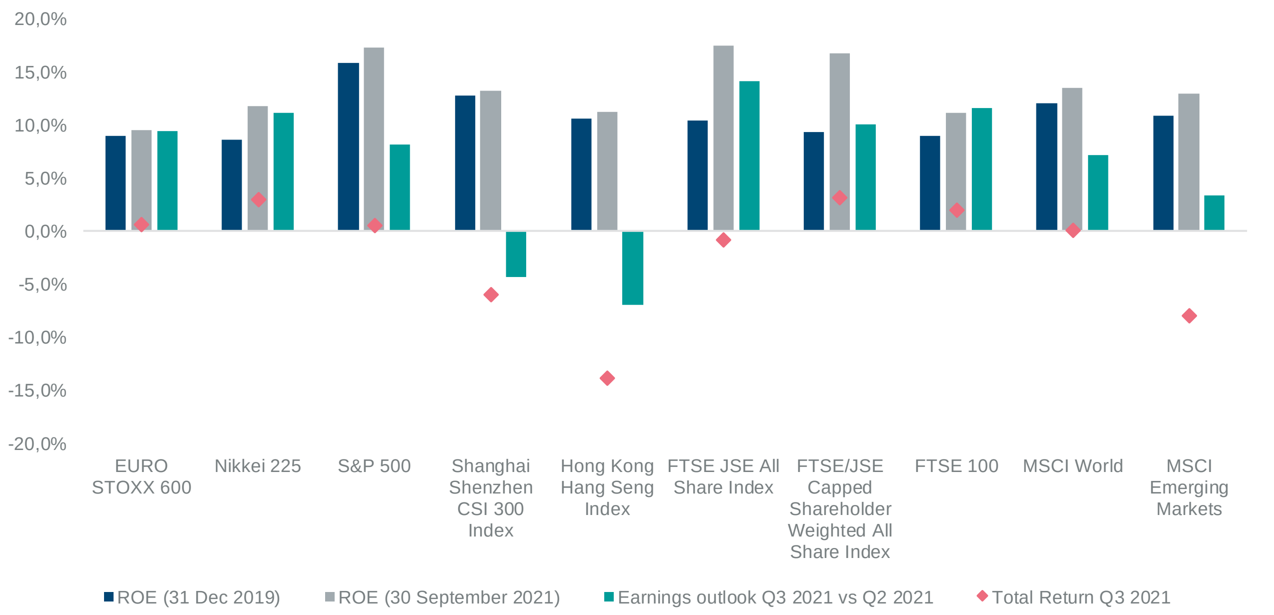


Source: Our World in Data: Coronavirus (COVID-19) Vaccinations

While the pace of global vaccinations remains encouraging, the now-prevalent Delta variant and the risk of new variants remain a threat to the global economy and the progress that has been made on the vaccination front. According to Bloomberg's global COVID vaccine tracker, it is estimated that the world is approximately six months away from 75% of the global population having been vaccinated.

Fundamentals are nevertheless improving, which has gone a long way towards supporting corporate earnings. In Q3, the earnings outlook continued to improve for most regions (based on earnings estimates), with the exception of mainland China and Hong Kong. Encouragingly, returns on equity (ROE) are also edging closer to pre-pandemic levels across several regions.

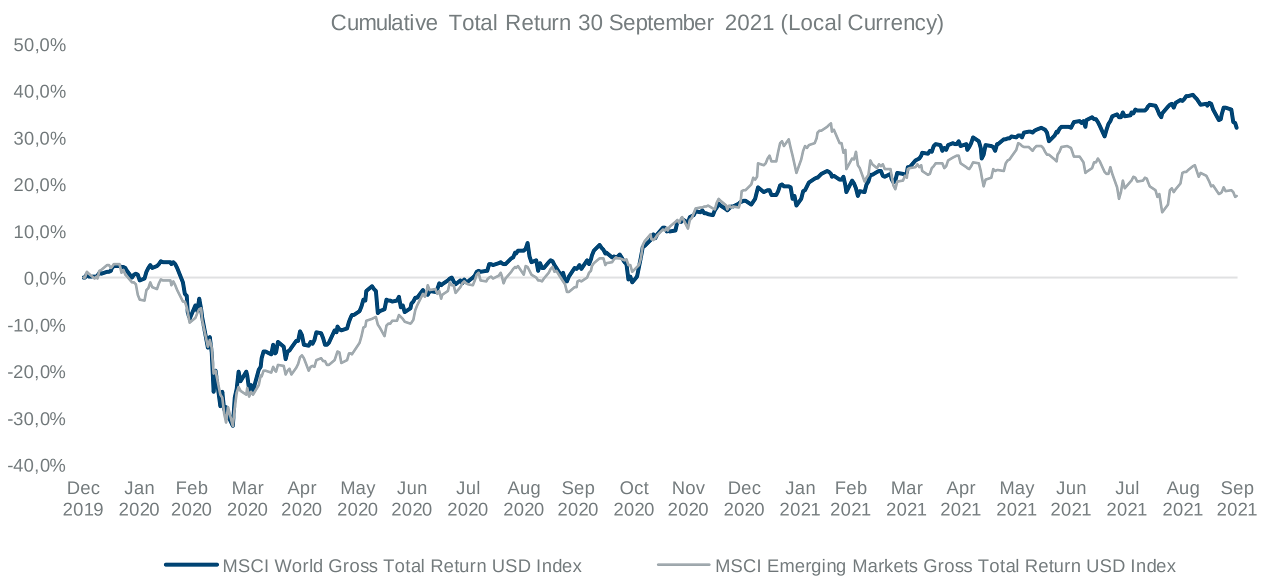
Figure 2: Major equity index performance vs return-on-equity and earnings outlook as at 30 September 2021



Source: Bloomberg

Strong corporate earnings have been a major driver of global equity markets this year, with most global equity indices having recorded double-digit growth for the year to date. That said, there has been a notable divergence between emerging and developed market equity performance more recently, with slow vaccine rollouts, a slowdown in China and the regulatory crackdown on Chinese tech companies all weighing on emerging market equities.

Figure 3: Performance of major equity indices as at 30 September 2021 (local currencies)

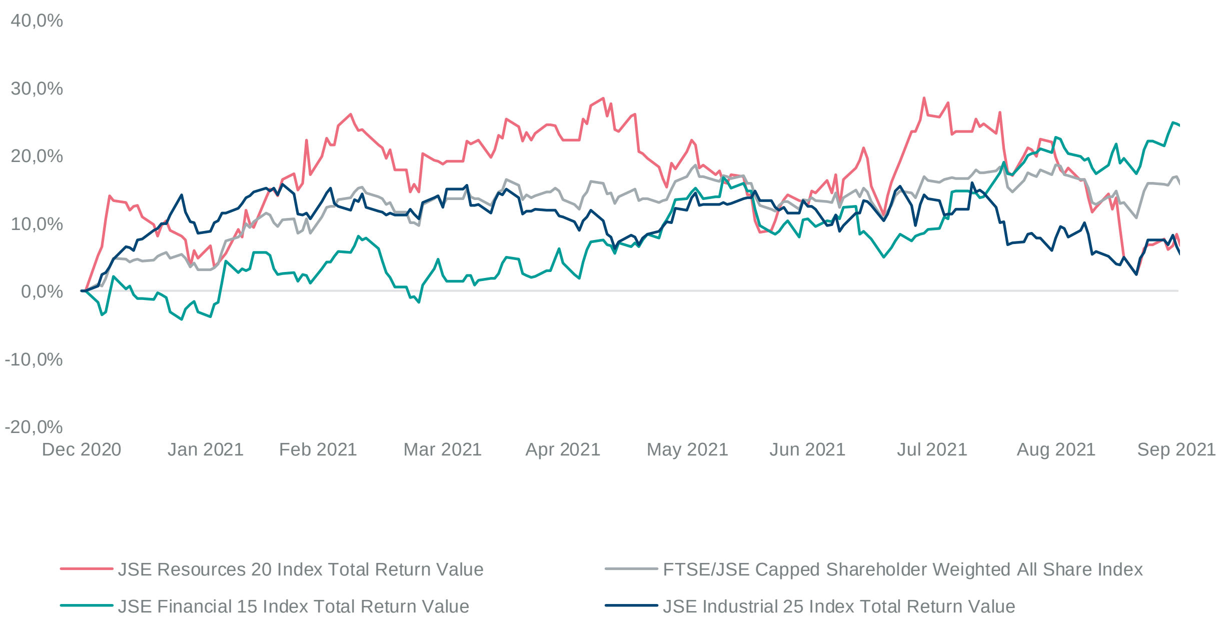


Source: Bloomberg

Specifically, the Hang Seng Index and the Shanghai Shenzhen CSI 300 Index fell by -13.9% and -6.0%, respectively, in Q3 due to a sweeping regulatory clampdown by China on the country's tech giants, sending shock waves across these markets. With anti-trust and cybersecurity fast becoming a priority for Chinese authorities, they have rapidly and aggressively tightened their regulatory grip in several sectors, including tech, e-commerce and online education. This has called into question whether China is still an attractive investment destination as well as the ability of Chinese firms to maintain listings in offshore jurisdictions.

For local investors, these regulatory issues were felt through exposure to JSE-listed counters, Naspers and Prosus (NPN/PRX), which derive around 28% of their value from the Chinese tech behemoth, Tencent. These regulatory threats saw NPN/PRX hit a 52-week low at the end of July. This contributed to the 5% decline in the JSE industrials sector in Q3, making it the worst-performing sector for the quarter. Meanwhile, weaker commodity prices weighed on the resource sector, with the sector down by just over 3% for the quarter. Financials, in contrast, experienced a stellar quarter as the sector recorded gains of 12.7%.

Figure 4: SA equity index performance YTD as at 30 September 2021



Source: Bloomberg

INFLATION, GLOBAL DEBT CLIMB AS POLICY SUPPORT CONTINUES

Monetary and fiscal policy remained broadly supportive of risk assets during the third quarter, even as inflationary pressures picked up. Factors such as higher food and fuel costs, surging power prices, coal shortages and other supply chain bottlenecks all contributed to accelerating inflation in Q3, while central banks are beginning to signal the end of recent monetary policy accommodation. Specifically, the US Federal Reserve has said it could begin scaling back recent asset purchases as soon as November.

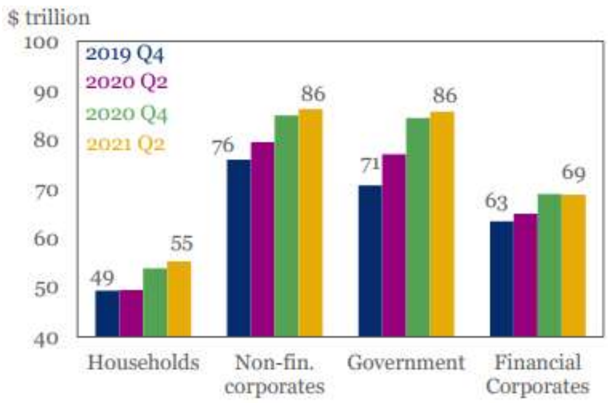
With central banks having largely exhausted their monetary policy easing tools in response to the COVID-19 pandemic, fiscal authorities continue to offer support to their economies through spending. While this has helped to spur an economic restart, it has led to government debt levels across most of the world exceeding normal levels, with significant political and social implications.

Although the recovery in GDP has helped to contain global debt-to-GDP ratios, the absolute levels of global debt in US dollar terms has accelerated sharply in recent quarters. According to the IIF, global debt rose to an all-time high of $296 trillion at the end of Q2, with households, corporates and governments all contributing to the rise.

Figure 5: Global debt levels at end Q2 2021

Source: Institute of International Finance - Global debt monitor

Figure 6: Global sectoral indebtedness



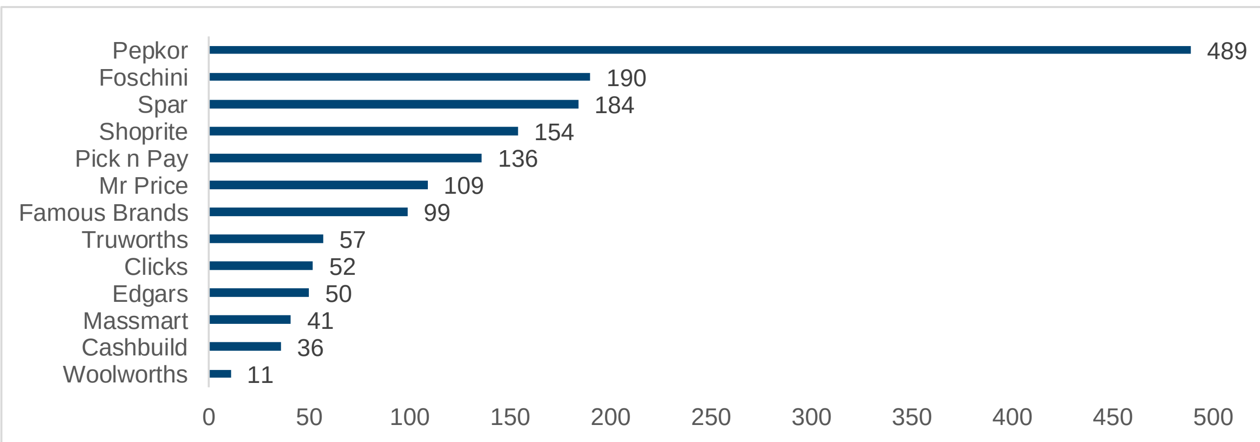
Source: Institute of International Finance - Global debt monitor

It is against this backdrop that debt concerns surfaced during the latter half of the quarter, as the near collapse of China's Evergrande Group and talk of the US breaching its debt ceiling made the headlines, and triggered some volatility at the end of the third quarter. While it is widely expected that the US will raise its debt ceiling to avert a default scenario, this scenario highlights the domino effect of the policy responses to the COVID-19 pandemic.

LOCAL ECONOMY SET BACK BY THIRD WAVE, SOCIAL UNREST

As the global economy has recovered, so too has the domestic economy, supported by stronger commodity prices and a pick-up in business activity. However, high-frequency economic indicators suggest that the domestic economy experienced another setback in Q3 as the country experienced its third wave of the pandemic, forcing the country back into stricter lockdowns. Meanwhile, the country was dealt another blow in the form of social unrest and looting in KwaZulu-Natal and Gauteng, which caused extensive damage to infrastructure, retail outlets and distribution centres.

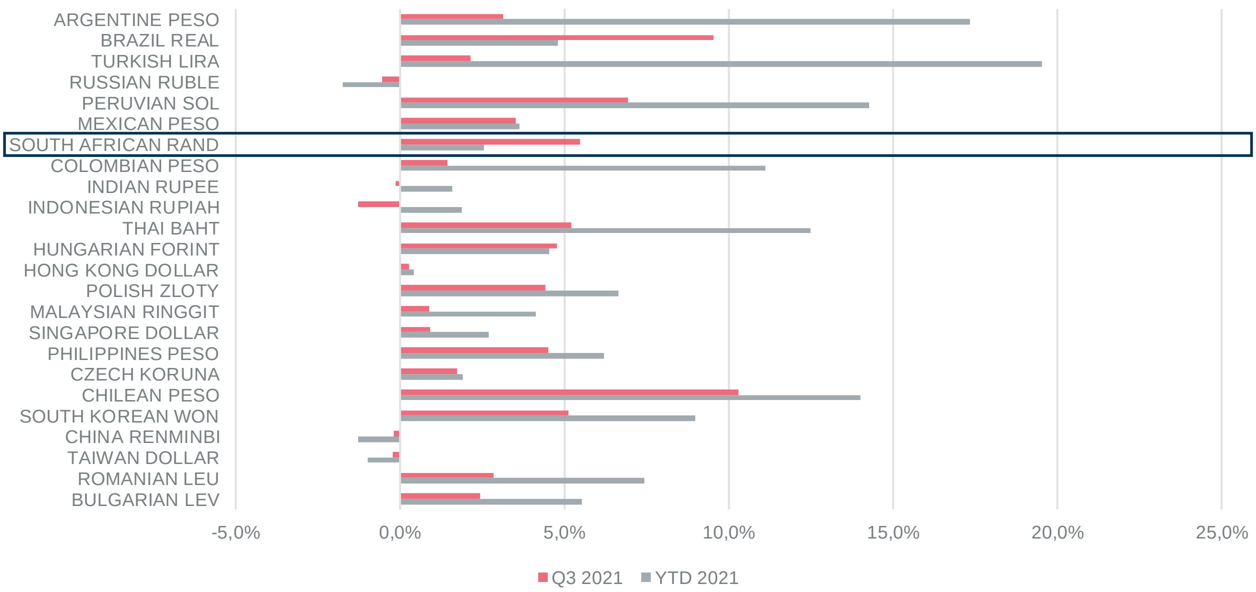
Figure 7: Number of local retail stores looted or damaged



Source: Bloomberg, company statements

These dynamics contributed to rand weakness over the quarter. The local unit weakened from R14.29/$ in June 2021 to R15.07/$ in September 2021, declining alongside most EM currencies as the dollar-strengthened and risk appetite waned. That said, the local unit remains among the best performing EM currencies for the year to date.

Figure 8: Emerging market currency spot return as at 30 September 2021



Source: Bloomberg

The rate of vaccinations in South Africa picked up dramatically in the third quarter, increasing from just over 3 million fully vaccinated people at the start of Q3 to almost 18 million by the end of the quarter. While encouraging, there is still some way to go and the risks of future waves of the virus continue to threaten the economy. Other obstacles to South Africa's economic recovery continue to stem from slow policy implementation, governance problems, electricity constraints and a weak fiscus.

LOOKING AHEAD

Although there appears to be less room for risk assets to push much higher as we head into Q4, many countries are still in the early- to mid-cycle recovery stage and policy remains broadly accommodative, which is supportive of risk assets. However, risks continue to build. From electricity shortages in China to imminent tapering by the Fed, it does not look like it will be smooth sailing into year end.

Virus-related risks

Countries around the world continue to make encouraging strides in the inoculation of their populations. However, a key risk is that the Delta variant and potential future strains of the virus prove to be resilient against vaccinations. Any major setbacks in achieving herd immunity across the world and keeping economies open could hurt sentiment.

Inflation and tapering of monetary policy easing

Stagflation (an environment in which high inflation is accompanied by low growth) is of growing concern as we head into the last quarter of the year. Attempting to avoid a stagflation situation while not tightening monetary policy too quickly is indeed a challenge that central banks will face over the coming quarters. Inflation will thus remain a major watchpoint for the markets as year-end approaches, with any indications that policy tightening could come sooner than expected likely to generate some volatility.

Stretched valuations

Several major global equity markets still score as expensive on various standard valuation measures and metrics. The P/E ratio of the S&P 500 index, for instance, remains more than one standard deviation above its long-term average. While pockets of opportunity remain, with some markets looking cheaper than others, it does imply that returns from the broader equity market may be more muted going forward.

Volatile political landscape

The knock-on effects of the COVID-19 pandemic and the shift in monetary and fiscal policy have led to an increasingly volatile political economy, and we continue to see evidence of this across the world as political and social pressures mount. A case in point is recent policymaking in China, a reminder that the political landscape has become increasingly unstable. More events like these will pose risks to the performance of the financial markets into year-end.

APPENDIX

Figure 9: Financial market performance as at 30 September 2021

Index	1 Month	3 Months	1 Year	3 Years (p.a.)	5 Years (p.a.)	7 Years (p.a.)	10 Years (p.a.)
Local Equity Indices							
FTSE/JSE All-Share Index (ALSI)	-3,1%	-0,8%	23,2%	8,6%	7,8%	7,2%	11,5%
FTSE/JSE Resources 20 Index	-9,5%	-3,8%	16,8%	16,0%	17,5%	5,8%	6,1%
FTSE/JSE Industrials Index	-0,8%	-4,3%	17,0%	7,5%	5,0%	6,4%	13,3%
FTSE/JSE Financials Index	1,7%	12,0%	50,1%	-0,2%	2,8%	4,4%	10,8%
FTSE/JSE Shareholder Weighted Index (SWIX)	-1,4%	0,5%	22,9%	6,4%	5,4%	6,0%	10,9%
FTSE/JSE Capped Swix Index (Capped SWIX)	-1,4%	3,2%	30,3%	6,5%	5,0%	5,6%	
FTSE/JSE All-Share Top 40 Index	-3,6%	-1,6%	20,3%	9,0%	8,4%	7,2%	11,6%
FTSE/JSE SWIX Top 40 Index	-1,8%	-0,5%	18,3%	6,0%	5,4%	5,7%	
FTSE/JSE Mid Cap Index	0,5%	7,2%	41,1%	8,1%	3,8%	6,2%	10,2%
FTSE/JSE Small Cap Index	5,6%	11,7%	78,3%	9,0%	4,3%	6,2%	11,6%
FTSE/JSE Listed Property Index (SAPY)	-0,8%	5,9%	54,4%	-6,8%	-5,6%	-0,3%	5,5%
FTSE/JSE Capped Listed Property Index	-0,5%	6,6%	56,1%	-10,3%	-8,5%	-3,3%	
Local Interest-Bearing Indices							
FTSE/JSE All-Bond Index (ALBI)	-2,1%	0,4%	12,5%	9,1%	8,5%	8,2%	8,3%
FTSE/JSE All-Bond Index 1 - 3 years	0,1%	1,5%	4,0%	8,7%	8,4%	8,1%	7,6%
FTSE/JSE All-Bond Index 3 - 7 years	-0,6%	1,2%	5,8%	10,7%	9,7%	9,2%	8,7%
FTSE/JSE All-Bond Index 7 - 12 years	-2,2%	0,2%	12,0%	10,0%	9,2%	8,7%	8,7%
FTSE/JSE All-Bond Index +12 years	-3,0%	0,0%	17,6%	8,2%	7,9%	7,7%	8,2%
Inflation Linked Government Bonds (IGOV)	0,3%	2,0%	15,9%	5,5%	3,5%	4,4%	
Short-Term Fixed Interest Composite Index (SteFi)	0,3%	1,0%	3,8%	5,8%	6,4%	6,5%	6,2%
Inflation Index							
Consumer Price Index (1 month lagged)	0,4%	1,7%	4,9%	4,1%	4,4%	4,6%	5,0%
International Indices							
MSCI World Index	-0,1%	5,7%	17,2%	16,2%	16,6%	15,8%	20,7%
MSCI Emerging Market Index	0,1%	-2,9%	7,4%	11,3%	11,7%	10,5%	13,4%
FTSE World Government Bond Index (WGBI)	1,9%	4,3%	-12,4%	6,0%	3,3%	6,1%	7,6%
S&P Global Property	-0,8%	4,7%	15,1%	9,3%	7,7%	11,1%	16,3%
USA S&P 500	-0,6%	6,2%	17,7%	18,5%	19,2%	18,9%	24,2%
UK FTSE 100	1,8%	5,0%	18,4%	5,3%	7,4%	6,6%	12,6%
Euro STOXX 50	-1,4%	2,9%	15,4%	10,6%	11,5%	9,0%	14,7%
Japan Nikkei 225	8,5%	8,4%	10,7%	12,0%	14,6%	15,5%	18,2%
Currency Movement							
Rand/Dollar (R14.52= 1 Dollar)	3,7%	5,5%	-10,0%	2,1%	1,9%	4,2%	6,4%
Rand/Euro (R17.15= 1 Euro)	1,8%	3,0%	-11,0%	2,1%	2,5%	2,9%	4,9%
JPY/Rand (7.57Japanese Yen= 1 SA Rand)	-2,6%	-5,1%	17,1%	-2,8%	0,0%	-3,9%	-2,5%
Rand/Pound (R19.98= 1 Pound)	1,7%	2,8%	-6,2%	3,3%	2,7%	1,5%	4,9%

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