MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

23 September 2021

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We have decided to maintain our TAA positions in offshore equity and offshore bonds, while also moving to moderate underweight in local listed property and moderate overweight in offshore cash, from neutral.

Figure 1: Houseview Tactical Asset Allocation

Asset class	--	-	Neutral	+	++
SA cash			■		
SA bonds			■		
SA inflation-linked bonds			■		
SA listed property		■			
SA equity			■		
Foreign cash				■	
Foreign bonds		■			
Foreign equity				■	
Foreign property			■		

Synopsis

We reiterate our positions in SA nominal bonds, SA inflation-linked bonds, SA equity, offshore equity, offshore bonds and offshore property, with our investment cases for these asset classes remaining largely unchanged over the past month. We moved from neutral to moderate underweight in SA listed property as valuation is not supportive, while secular and fundamental challenges remain. There is also less policy support as central banks signal some approaching tightening and a potential contagion effect from the debt crisis in the Chinese property market. We also moved from neutral to moderate overweight in offshore cash as we expect more uncertainty in the USD outlook and EM assets being subject to greater volatility with less policy support.

TAA Overview

Offshore bonds

We remain moderately underweight in offshore bonds as we expect to see gradually higher yields as the time for the Fed's tapering approaches, while the market continues to price in the global economic restart.

Despite supply chain bottlenecks and logistics disruptions, the global manufacturing PMI for most geographies remained in the expansionary zone. China's manufacturing and services PMI numbers both plunged into a state of contraction as the uptick in COVID-19 cases in the country and the subsequent restrictions weighed on production, business activities and domestic consumption.

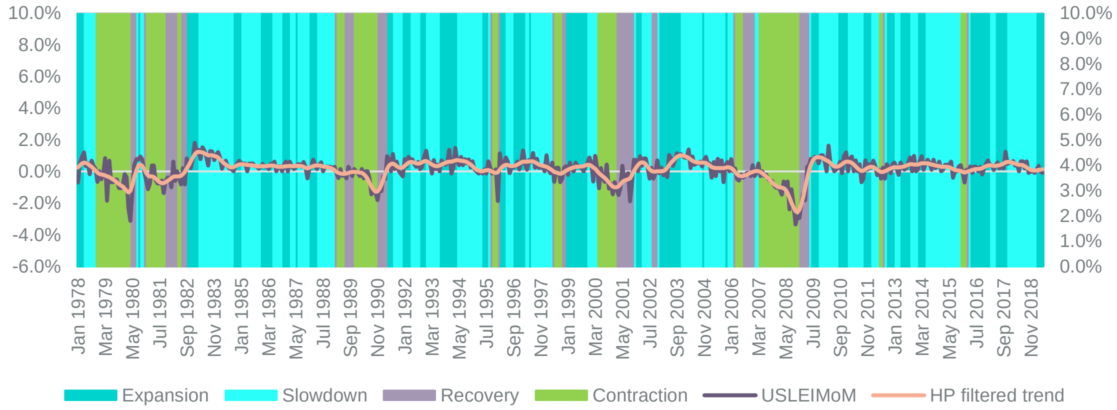
Figure 2: Global manufacturing PMI

	Jan 2020	Feb 2020	Mar 2020	Apr 2020	May 2020	Jun 2020	Jul 2020	Aug 2020	Sep 2020	Oct 2020	Nov 2020	Dec 2020	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021	Jun 2021	Jul 2021	Aug 2021
Global Manufacturing PMI	50.3	47.1	47.3	39.6	42.4	47.9	50.6	51.8	52.4	53.1	53.8	53.8	53.6	54	55	55.8	56	55.5	55.4	54.1
Developed Markets	49.8	49.6	45.9	36.8	39.5	46.4	49.8	51.2	52.1	52.8	53.8	54.8	55.2	56.5	58.5	59.3	59.8	59.5	59.8	58.3
Emerging Markets	51	44.6	49.1	42.7	45.4	49.6	51.4	52.5	52.8	53.4	53.9	52.8	52.1	51.5	51.3	52.2	52	51.2	50.6	49.6
Eurozone	47.9	49.2	44.5	33.4	39.4	47.4	51.8	51.7	53.7	54.8	53.8	55.2	54.8	57.9	62.5	62.9	63.1	63.4	62.8	61.4
France	51.1	49.8	43.2	31.5	40.6	52.3	52.4	49.8	51.2	51.3	49.6	51.1	51.6	56.1	59.3	58.9	59.4	59	58	57.5
Germany	45.3	48	45.4	34.5	36.6	45.2	51	52.2	56.4	58.2	57.8	58.3	57.1	60.7	66.6	66.2	64.4	65.1	65.9	62.6
Italy	48.9	48.7	40.3	31.1	45.4	47.5	51.9	53.1	53.2	53.8	51.5	52.8	55.1	56.9	59.8	60.7	62.3	62.2	60.3	60.9
Spain	48.5	50.4	45.7	30.8	38.3	49	53.5	49.9	50.8	52.5	49.8	51	49.3	52.9	56.9	57.7	59.4	60.4	59	59.5
Greece	54.4	56.2	42.5	29.5	41.1	49.4	48.6	49.4	50	48.7	42.3	46.9	50	49.4	51.8	54.4	58	58.6	57.4	59.3
Ireland	51.4	51.2	45.1	36	39.2	51	57.3	52.3	50	50.3	52.2	57.2	51.8	52	57.1	60.8	64.1	64	63.3	62.8
Australia	49.6	50.2	49.7	44.1	44	51.2	54	53.6	55.4	54.2	55.8	55.7	57.2	56.9	56.8	59.7	60.4	58.6	56.9	52
Sweden	51.5	52.5	43.5	36.1	40.1	48.8	52.2	54.4	56.6	58.9	59.7	64.8	62.6	61.7	64.1	68.7	66.1	65.4	64.5	60.1
Denmark	52.8	47.7	46.2	35.5	53	53	54.8	51.4	53.6	62.9	46.7	41.6	42.8	46.1	65.6	66.6	65.5	65.5	69.7	67.3
UK	50	51.7	47.8	32.6	40.7	50.1	53.3	55.2	54.1	53.7	55.6	57.5	54.1	55.1	58.9	60.9	65.6	63.9	60.4	60.3
US	51.9	50.7	48.5	36.1	39.8	49.8	50.9	53.1	53.2	53.4	56.7	57.1	59.2	58.6	59.1	60.5	62.1	62.1	63.4	61.1
Japan	48.8	47.8	44.8	41.9	38.4	40.1	45.2	47.2	47.7	48.7	49	50	49.8	51.4	52.7	53.6	53	52.4	53	52.7
China	51.1	40.3	50.1	49.4	50.7	51.2	52.8	53.1	53	53.6	54.9	53	51.5	50.9	50.6	51.9	52	51.3	50.3	49.2
Indonesia	49.3	51.9	45.3	27.5	28.6	39.1	46.9	50.8	47.2	47.8	50.6	51.3	52.2	50.9	53.2	54.6	55.3	53.5	40.1	43.7
South Korea	49.8	48.7	44.2	41.6	41.3	43.4	46.9	48.5	49.8	51.2	52.9	52.9	53.2	55.3	55.3	54.6	53.7	53.9	53	51.2
Taiwan	51.8	49.9	50.4	42.2	41.9	46.2	50.6	52.2	55.2	55.1	56.9	59.4	60.2	60.4	60.8	62.4	62	57.6	59.7	58.5
India	55.3	54.5	51.8	27.4	30.8	47.2	46	52	56.8	58.9	56.3	56.4	57.7	57.5	55.4	55.5	50.8	48.1	55.3	52.3
Brazil	51	52.3	48.4	36	38.3	51.6	58.2	64.7	64.9	66.7	64	61.5	56.5	58.4	52.8	52.3	53.7	56.4	56.7	53.6
Mexico	49	50	47.9	35	38.3	38.6	40.4	41.3	42.1	43.6	43.7	42.4	43	44.2	45.6	48.4	47.6	48.8	49.6	47.1
Russia	47.9	48.2	47.5	31.3	36.2	49.4	48.4	51.1	48.9	46.9	46.3	49.7	50.9	51.5	51.1	50.4	51.9	49.2	47.5	46.5
South Africa	43.7	39.7	41.7	30.3	43.7	53.3	49.4	55.8	58.5	60.9	52.6	50.3	50.9	53	57.4	56.2	57.8	57.4	43.5	57.9

Source: Bloomberg

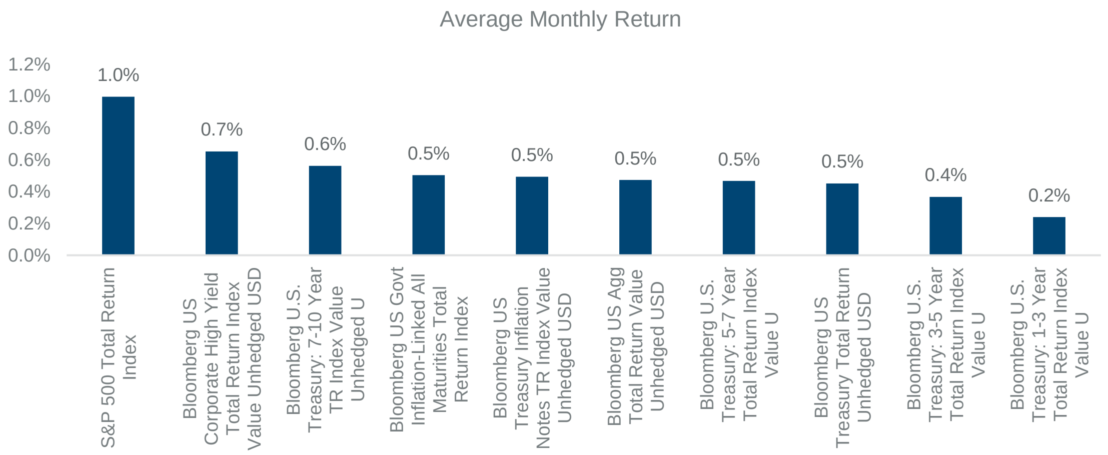
We used the Conference Board US Leading Index Ten Economic Indicators and extracted the cyclical trend using the Prescott and Hodrick filter to classify the trend into four different business cycle regimes: recovery, expansion, slowdown and contraction. We noticed that US fixed income treasuries outperformed US equities during contraction, US fixed income high yield outperformed US equities during recovery, and US equities outperformed fixed income assets during expansion. The latest data suggests that the US economy may be entering a slowdown phase. While no business cycles behaved alike, historical returns suggest that US equities outperformed US treasuries during slowdown on average.

Figure 3: Business cycle phases inferred from the Conference Board US Leading Index Ten Economic Indicators



Source: Bloomberg, R programming

Figure 4: Performance of S&P 500 and US fixed income assets during slowdown



Source: Bloomberg, period under analysis Jan 1993 to Jul 2021, returns in USD

We are neutral on European bonds as the European Central Bank is in favour of more monetary policy easing to support the economic rebound in the region.

Offshore equities

Valuation scores continue to suggest moderate underweight offshore equities, while sentiment and economics scores stayed largely unchanged.

Consumer sentiment in the US remained relatively unchanged, with mixed signals from different sentiment indices. The University of Michigan Consumer Sentiment Index steadied at 71 in September, the Conference Board Consumer Confidence Index weakened from 125.1 in July to 113.8 in August, while the Bloomberg US Weekly Consumer Comfort Index improved from 54.6 in August to 57.7 in September. US manufacturing confidence was unchanged in August, but business activity and the production outlook fell over the same period as supply shortages were further exacerbated by tough weather conditions. According to the US Business Leaders Survey, businesses still expect to increase capital spending and wages in the next six months. Consumer confidence in the Eurozone lost a bit of momentum, while economic sentiment was marginally dented. Japanese consumer confidence also largely held steady in August.

US retail sales month on month were up 1.8% in August, improving from -1.0% in July. The latest data does suggest a cooling housing market as high prices deter some consumers. Consumer demand is losing a bit of steam as spending intentions for homes, cars and appliances softened. Trade data was slightly mixed, with exports gaining 1.3% month on month in July but imports contracting by -0.2%. The biggest disappointment was the labour market as US jobless claims were higher than market expectations and payroll numbers were significantly lower, reflecting persistent hiring challenges. Most of the US payroll gains were concentrated in the leisure and hospitality sector. This is because air travel has recovered sharply in the wake of the vaccine rollout, despite still being below normal levels, with rising numbers of consumers intending to take a vacation in the next six months.

Figure 5: US jobless claims

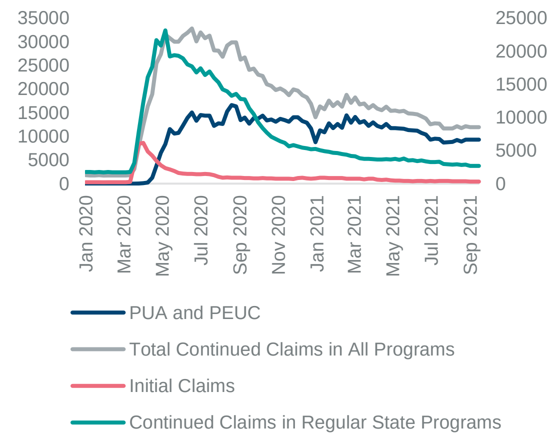
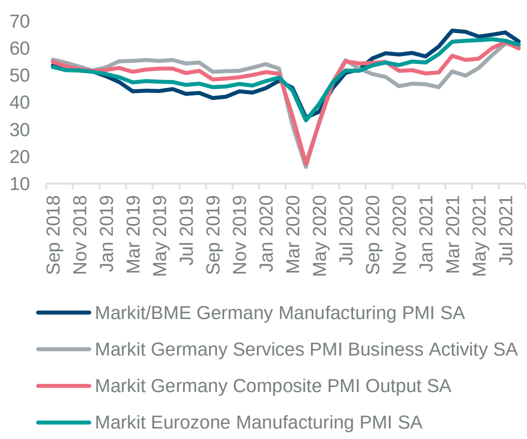


Figure 6: Eurozone and Germany PMIs



Source: Bloomberg

Eurozone manufacturing PMI and Germany PMI numbers dropped slightly in August but remained in the strong expansionary zone.

Japan’s mobility indicators improved for a second straight week as new COVID-19 cases halved for the week ending 17 September compared to the previous week. However, sluggish electricity demand suggests lower factory operating rates, which were partly due to COVID-19 containment measure (and related weak domestic consumption) and partly due to vehicle production being constrained by chip shortages.

Investors continue to navigate in a world of heightened risks. We saw the economic surprise indices fall into negative territory as reported economic figures missed market expectations on

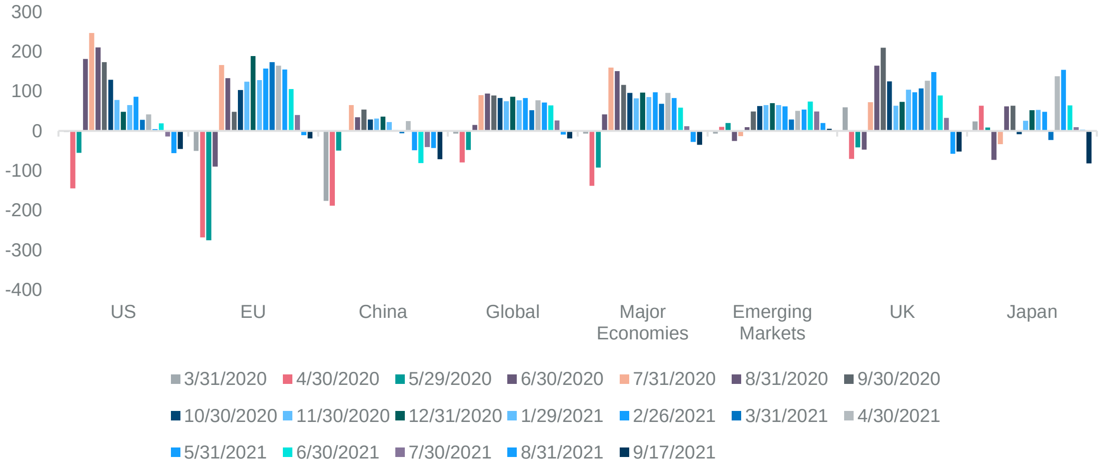
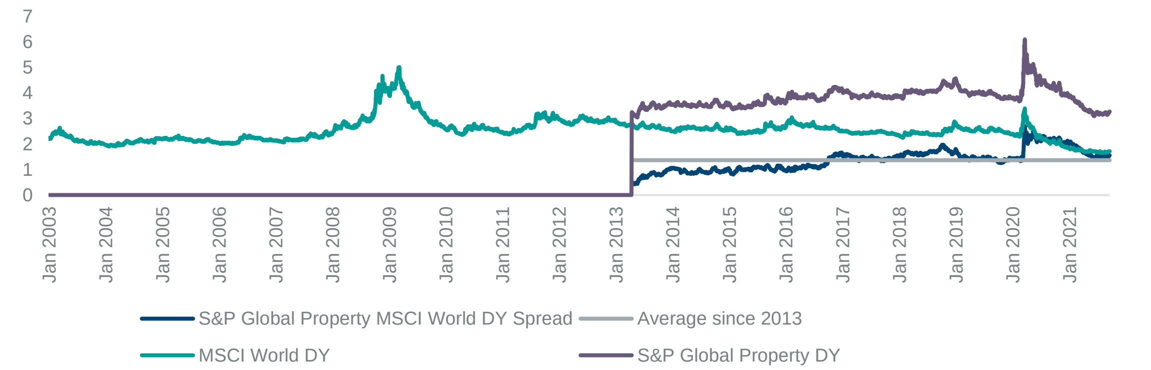
	average. Higher fuel and food costs, surging power prices from Europe to China, an accelerated transition to clean energy in Europe, coal shortages in China – on top of other production restraints and the expectation that the Fed will start tapering soon – have triggered heightened concerns about stagflation, where higher inflation is accompanied by lower growth. **Figure 7: Economic surprise indices**  *Source: Bloomberg* Derivative data suggests increasing demand for protection against broad market decline. While the CBOE US weekly equity put-to-call volume ratio increased marginally, the CBOE US weekly S&P 100 put-to-call option volume ratio jumped to 3.68 in August before calming slightly to 2.64 on 14 September. The Bloomberg CFTC CME E-Mini S&P 500 net commercial and non-commercial futures positions both ended in short positions respectively by 14 September. We reiterate our moderate overweight position in offshore equities. Despite potential bouts of volatility and less room for risk assets to push higher, there has been a broad restart in regions such as Europe, Japan and other emerging market countries as virus dynamics improve and vaccine rollouts accelerate. Many countries that are still in the early to mid-cycle may see activity pick up further. At the same time, US corporate earnings have been strong and the returns on equity for major indices have improved to pre-pandemic levels. While the Fed said that it could begin scaling back asset purchases in November, with growing speculation among FOMC officials that rate hikes could start as early as 2022, we believe that the Fed has sent the right signals so far; therefore, such news should not surprise the market or cause significant disruptions.
Offshore property	Valuation of global property was largely unchanged over the past month, with price-to-tangible book value decreasing slightly from 1.52x to 1.48x and return on equity improving further from 4.91% to 5.76%.

Figure 8: S&P Global Property dividend yield spread relative to the MSCI World Index



Source: Bloomberg

The spread between the S&P Global Property yield and that of the MSCI World Index and the 10-year US treasury yield stood at long-term average levels respectively. We therefore choose to stay neutral in offshore property.

SA bonds

We saw investors buying the dip amid the market rout triggered by the crisis at the Chinese property company, the Evergrande Group. For the week ending 17 September, investors poured $1.57bn into US-based emerging market ETFs, bringing this year's total inflows to $38.9bn. Investors bet that emerging markets can overcome the string of instability, from China's regulatory clampdown and Evergrande's debt crisis to political uncertainty issues in Brazil. At the same time, some investors increased their EM holdings during the quarterly rebalance, whose performance has lagged that of developed market countries. South African equity ETFs attracted $50.5m in inflows, while bonds ETF attracted $0.4m over the week.

Figure 9: Weekly emerging market net flows

Source: Bloomberg

The implied vs actual yield spread widened from 520bps on 30 July to 559bps on 17 September. The 10-year nominal yield spread over the US 10-year treasury yield was largely unchanged, from 7.60% to 7.61% over the past month. The US dollar-hedged 10-year yield continued to offer value, but narrowed slightly to 3.7%, with the spread over the US 10-year nominal yield also dropping from 260bps to 230bps. SA nominal bonds still appeared attractive compared to Brazilian nominal bonds, based on real yield and calculated from reported inflation. Our investment case remains unchanged. While valuation is attractive, we continue to believe that the imminent US Fed tapering may exert some pressure on the hedged yield and dent the rationale for carry trade.

Figure 10: SA bond yields vs EM peers as at 17 September 2021

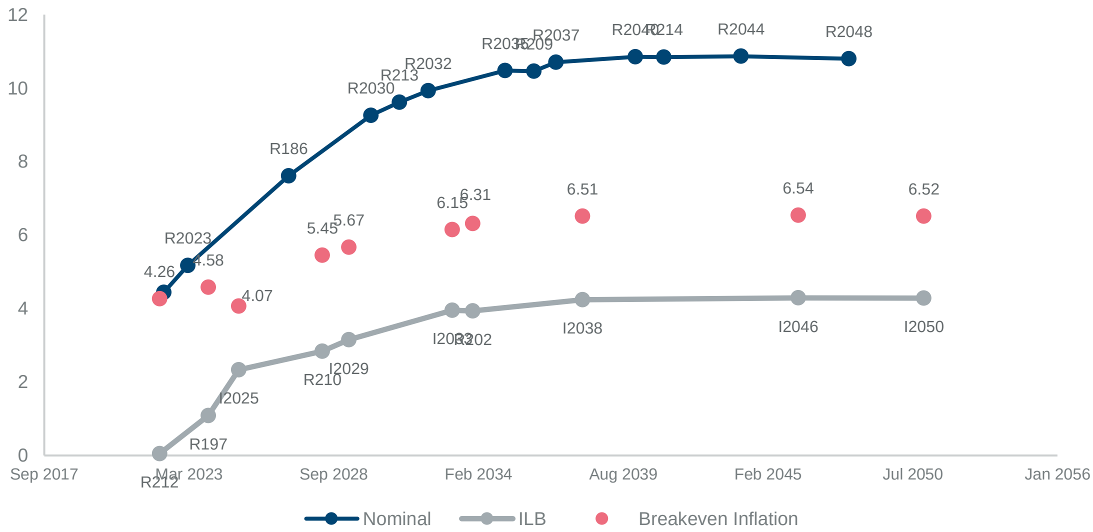
	South Africa	India	Indonesia	Russia	Mexico	Brazil	Turkey
10 Year Yield	**9.34%**	**6.17%**	**6.14%**	**7.04%**	**7.06%**	**11.14%**	**17.15%**
Inflation	4.6%	5.3%	1.59%	3.3%	5.6%	9.7%	19.3%
Inflation Expectation	4.40%	6.20%	1.80%	5.90%	5.40%	7.23%	17.10%
10 Year Real Yield	**4.74%**	**0.87%**	**4.55%**	**3.74%**	**1.47%**	**1.46%**	**-2.10%**
10 Year Real Yield based on inflation expectation	4.94%	-0.03%	4.34%	1.14%	1.66%	3.91%	0.05%
Currency Risk Premium	**5.14%**	**3.49%**	**3.27%**	**4.35%**	**4.13%**	**6.93%**	**11.41%**
Sovereign Risk Premium	**2.84%**	**1.32%**	**1.51%**	**1.33%**	**1.57%**	**2.85%**	**4.38%**
US 10 Year Yield	1.36%	1.36%	1.36%	1.36%	1.36%	1.36%	1.36%
S&P Rating - Foreign Currency	**BB-**	**BBB-**	**BBB**	**BBB-**	**BBB**	**BB-**	**B+**
Moody's Rating - Foreign Currency	**Ba2**	**Baa3**	**Baa2**	**Baa3**	**Baa1**	**Ba2**	**B2**

Source: Bloomberg

SA inflation-linked bonds

The IGOV Index underperformed against the ALBI in August, returning 1.2% vs 1.7%, but outperformed against the latter for the month to date as at 19 September, returning 0.5% vs -1.0%. Breakeven inflation increased by about 72bps on the shorter end and increased by about 28bps on the longer end of maturities, driven by near-term inflation expectations. The spread between the 10-year nominal bond real yield and the 10-year inflation-linked bond yield widened slightly from 110bps in July to 145bps in August.

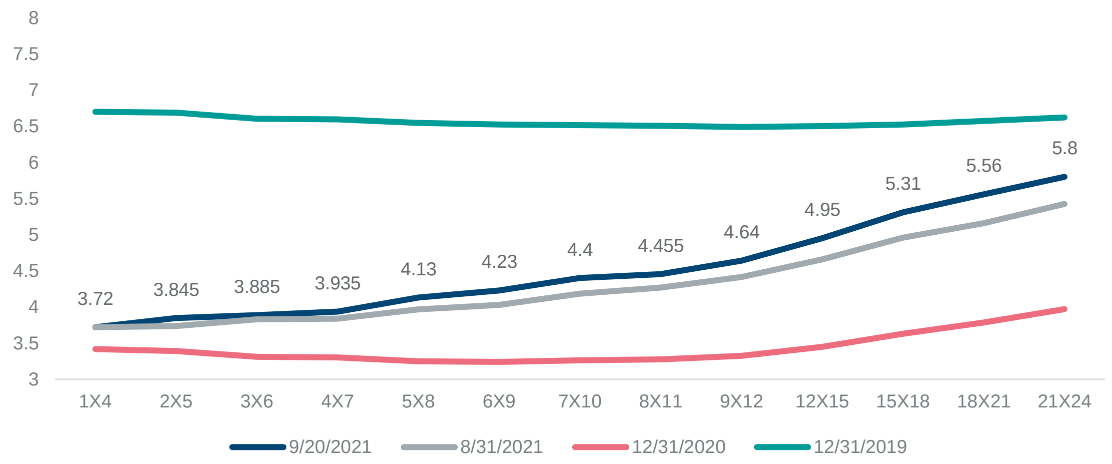
Figure 11: SA nominal and real yields as at 17 September 2021



Source: Bloomberg

The forward rate agreement (FRA) rates indicated that the market expects interest rates to rise by around 25bps by early 2022.

Figure 12: Forward rate agreement rates



Source: Bloomberg

The CPI year on year increased from 4.6% in July to 4.9% in August, with core inflation ticking up from 3.0% to 3.1% over the same period. The elevated-level, short-term inflation was mainly driven by higher fuel prices, with core inflation suggesting benign demand pressure in the underlying economy. Although we favour the ability of inflation-linked bonds to provide protection against unexpected inflation movements, from a valuation perspective we still lean slightly more towards nominal bonds. We therefore reiterate our neutral stance on inflation-linked bonds.

SA equities

Major equity indices returned positive in August in local currency terms, with the slightly stronger ZAR performance eroding some offshore-denominated returns. The rand extended its slide by 1.3% for the month to date (as at 19 September) as risk sentiment weakened in September.

Figure 13: Major indices and asset class returns in ZAR

31 August 2021 (ZAR)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 19 September 2021
FTSE/JSE ALSI Total Return	-1.7%	-0.1%	15.9%	25.2%	8.2%	8.3%	11.4%	-5.7%
FTSE/JSE Capped SWIX Total Return	2.0%	1.5%	18.6%	30.8%	5.5%	5.1%	10.4%	-4.7%
S&P 500 Total Return	2.3%	13.8%	20.2%	12.4%	17.5%	17.7%	25.2%	-0.2%
STOXX 600 Total Return	1.0%	7.8%	14.6%	11.1%	10.0%	10.2%	16.1%	-0.9%
Nikkei 225 Total Return	2.1%	2.5%	-3.8%	1.7%	9.1%	11.1%	18.5%	10.4%
MSCI World Total Return	1.8%	11.8%	16.9%	11.6%	15.0%	15.1%	21.3%	0.3%
MSCI ACWI Total Return	1.8%	10.4%	14.9%	10.7%	14.4%	14.5%	20.3%	0.2%
MSCI EM Total Return	1.9%	1.3%	1.9%	4.1%	9.8%	10.5%	13.2%	-0.4%
STEFI	0.3%	0.9%	2.5%	3.8%	5.9%	6.5%	6.2%	0.2%
ALBI	1.7%	3.7%	7.7%	14.8%	10.0%	9.6%	8.3%	-1.0%
IGOV	1.2%	0.1%	9.6%	13.6%	5.5%	3.6%	6.2%	0.5%
WGBI	-1.3%	5.5%	-4.9%	-15.5%	3.7%	1.7%	8.8%	1.1%
SAPY Total Return	7.5%	10.4%	27.4%	51.0%	-7.3%	-5.3%	5.3%	-2.0%
MSCI US REIT Total Return	1.2%	15.8%	28.7%	20.4%	10.7%	7.3%	19.0%	-0.9%
S&P Global Property Total Return	1.2%	10.9%	17.4%	11.0%	7.4%	6.3%	16.5%	-0.8%
STOXX 600 Real Estate Total Return	1.1%	12.6%	12.9%	9.9%	6.3%	5.8%	15.1%	-3.8%
Crude Oil	-5.0%	11.1%	39.3%	38.1%	-2.4%	8.9%	2.8%	5.0%
Aluminium	4.2%	15.4%	35.7%	32.1%	8.1%	10.7%	8.6%	8.0%
Copper	-2.8%	-2.2%	21.2%	24.9%	16.3%	15.2%	7.9%	-0.5%
Gold	0.0%	-4.9%	-4.5%	-7.8%	14.7%	6.7%	-0.1%	-3.3%
Platinum	-4.1%	-9.9%	-6.3%	-6.6%	8.4%	-1.0%	1.3%	-5.6%
Nickel	0.0%	0.0%	0.0%	0.0%	-2.6%	4.3%	1.4%	0.0%
Palladium	-7.8%	-7.9%	-0.3%	-5.8%	35.4%	29.3%	20.7%	-17.0%
Iron Ore	-14.9%	-19.6%	-1.0%	4.2%	34.6%	21.4%		-22.5%
USDZAR	-0.5%	5.7%	-1.2%	-14.3%	-0.4%	-0.3%	7.6%	1.3%
GBPZAR	-1.7%	2.3%	-0.6%	-11.8%	1.6%	0.6%	5.8%	1.3%
EURZAR	-1.0%	2.1%	-4.5%	-15.2%	0.2%	0.9%	5.5%	0.6%
JPYZAR	-0.8%	5.3%	-7.1%	-17.4%	0.0%	-1.5%	3.8%	1.4%

Source: Bloomberg

SA equity valuations based on price ratios and dividend yields continued to suggest a moderate overweight position. Sentiment was roughly flat, with the Bureau for Economic Research

	Consumer Confidence Index improving slightly from -13 in Q2 to -10 in Q3. The SA PMI index rebounded from 43.5 in July to 57.9 in August, as sentiment in the manufacturing sector steadied after the riots and looting disrupted supply chains and industrial output. Retail sales were disappointing, down 1.93% year on year in July. Retail sales contracted by 11.2% month on month in July, which was significantly below the market expectation of -2.7%. Total and new car sales, however, were strong, growing by 25.7% and 32.0% respectively in August, month on month. Export and import growth were positive year on year, but contracted by 11.2% and 0.74% respectively, month on month, in July. Private credit extension remained soft, but turned positive to 0.61% in July, year on year. Overall, the data continued to suggest that local demand remains vulnerable. We reiterate our neutral position in SA equities. While the valuation improved in the face of the recent selloff, trends in sentiment and fundamentals were largely unchanged. Domestic consumption remains weak and vulnerable due to the record-high unemployment rate. While many emerging markets are in the early to mid-cycle in terms of economic recovery from the pandemic, some may be forced to start tightening their monetary policies because of inflationary pressure and the Fed's actions.
SA-listed property	SA-listed property returned 27.4% for the year to date as at 30 August, one of the best performing asset classes, driven by reopening optimism. The yield spread relative to SA equities and the 10-year bond remained significantly below the long-term average. The SAPY dividend yield continued to trend below its 1-year and 5-year rolling averages. The price-to-tangible book value increased from 0.75x in July to 0.82x in August.

Figure 14: SAPY yield spread relative to FTSE/JSE All Share Index

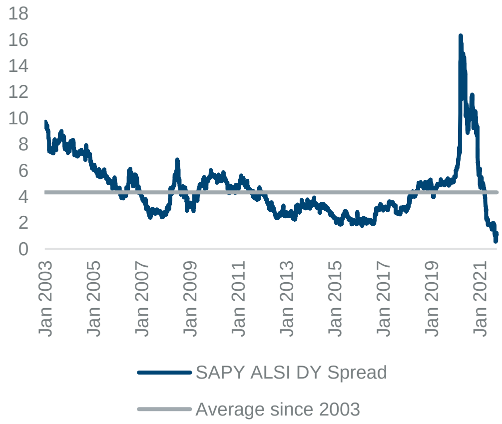
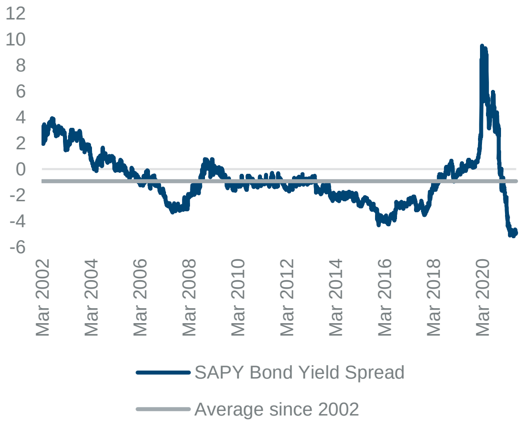
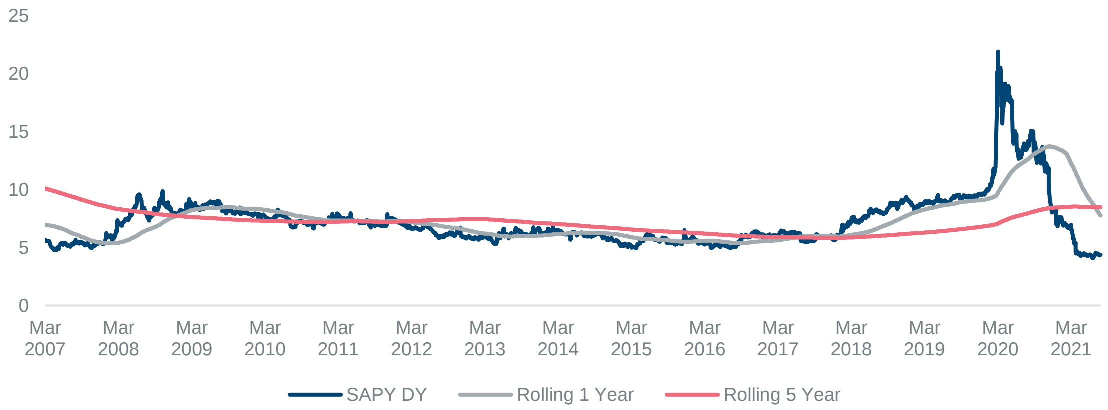


Figure 15: SAPY yield spread relative to 10-year bond



Source: Bloomberg

Figure 16: SAPY yield relative to 1-year and rolling 5-year rolling averages



Source: Bloomberg

We moved to moderate underweight in local listed property given the current valuation, persistent structural and secular challenges facing the local property sector, central banks scaling back policy support (less support for EM equities in general) and the potential contagion effect from Chinese property companies' debt crisis – all of which serve to dampen the appetite for this asset class.

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