ECONOMIC OVERVIEW

QUARTER 4, 2021

MENTENOVA

Contents

EXECUTIVE SUMMARY

While 2021 had its fair share of challenges, with new COVID-19 variants, inflation and supply-chain disruptions featuring prominently, global markets ended the year on a positive note and delivered some pleasing returns for investors.

Global equities benefited from strong corporate earnings and policy support in 2021, although emerging markets lagged developed market peers as they contended with a slowdown in China, slower vaccine rollouts and a firmer USD.

While emerging markets continued to underperform in Q4, the local equity market gained an impressive 15% in the final quarter of the year, bringing its total return for 2021 to just under 30%. Meanwhile local nominal bonds were up 8% by the end of the year. This is despite currency weakness and a rate hike from the SARB at its November meeting, with the central bank citing upside risks to inflation in the short term as well as the growing likelihood of policy normalisation in advanced economies.

Heading into 2022, the US Fed signalled that policy normalisation is likely to kick off in March, with three rate hikes currently pencilled in by the central bank following upward revisions to its inflation forecasts at the end of the year. While the demand and supply imbalances that are underpinning inflation are expected to moderate over the year, there is a high degree of uncertainty surrounding the inflation outlook.

Should supply constraints persist and GDP continue to recover, higher inflation could prevail and force central banks to act more forcefully. This ultimately poses some downside risks for emerging markets, with more aggressive monetary policy tightening likely to result in some capital outflows and currency depreciation for emerging markets in 2022.

That being said, central banks are likely to be more tolerant of short-term inflationary pressures, at least until there is more certainty surrounding underlying price dynamics, and this is likely to keep real rates low in 2022.

Meanwhile, with the number of coronavirus cases still on the rise at the start of 2022, the risks related to the pandemic are ever present. The emergence of new, more transmissible variants remains a key downside risk for the global economy this year. Inadequate vaccine access as well as vaccine hesitancy meanwhile remain major hurdles to dealing decisively with and eventually halting the pandemic.

The ongoing uncertainty surrounding the pandemic means that we are likely to continue seeing economies across the globe recovering at varying rates in 2022, with large disparities in vaccine access and differing policy responses contributing to a divergence in the economic outlook for both advanced and emerging economies.

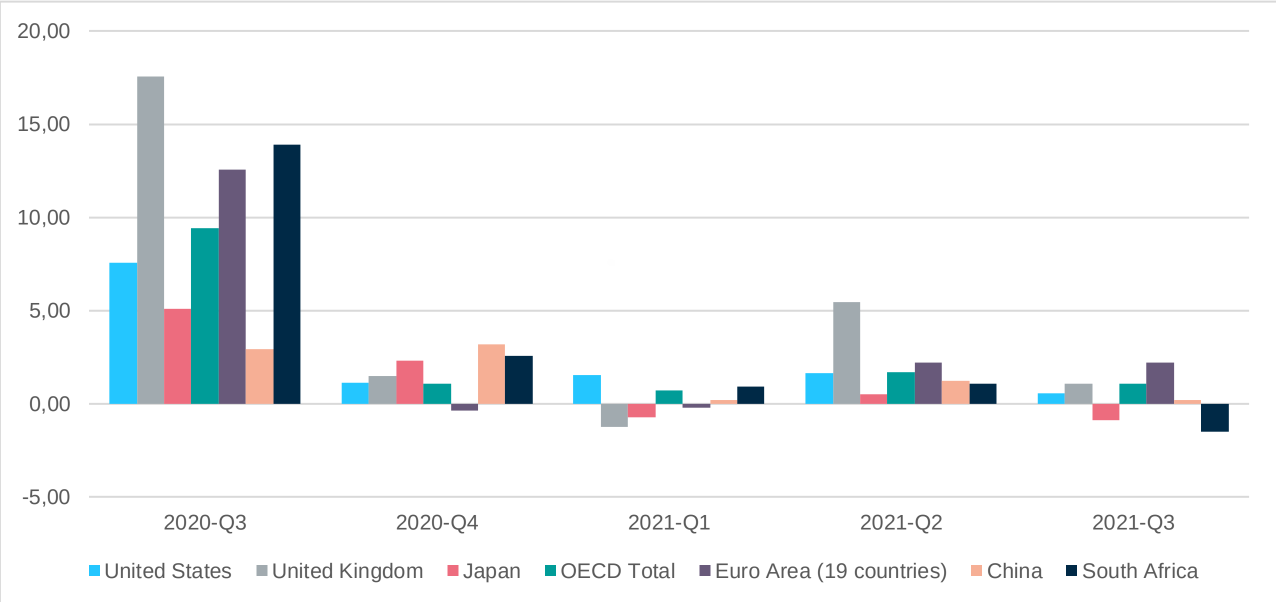
More generally, in the context of stretched asset valuations, investor sentiment is likely to remain highly sensitive to any adverse developments relating to the pandemic and associated policy responses. Cutting through the noise and remaining focused on your long-term investment goals is key to navigating a highly uncertain environment in 2022.

ECONOMIC AND MARKET OVERVIEW

ECONOMIC RESTART REMAINS IMBALANCED AS THE PANDEMIC RAGES ON

Economic data released during the fourth quarter continued to exhibit the unevenness of the global economic recovery, both across advanced and emerging economies. Specifically, US GDP data released during the quarter showed that the strong US economic expansion decelerated in Q3, with the slowest growth in economic activity recorded in the post-pandemic recovery period amid a surge in COVID-19 cases and supply-chain disruptions. China's economy also experienced slower growth in Q3, made worse by a slowdown in the Chinese property market and broad regulatory crackdowns. In contrast, growth in Europe improved in Q3 as the economy continued to experience the early to mid-stages of recovery.

Chart 1: Quarterly GDP total, percentage change relative to prior period, Q3 2021

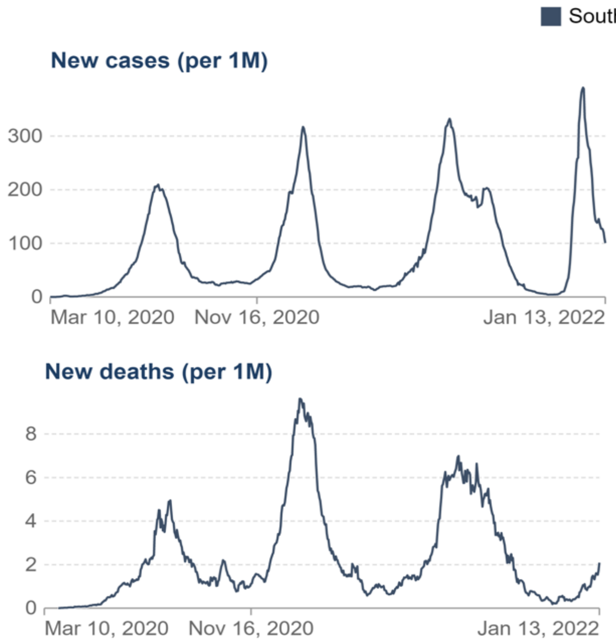


Source: OECD (2022), Quarterly GDP (indicator)

In South Africa, growth contracted in the third quarter of 2021 – the first time since Q2 2020 – with notable setbacks being the third wave and social unrest. Vaccine access and differing policy responses continue to be major contributors to gaps in economic activity across the globe, while new COVID-19 variants also continue to cause delays.

It is against this backdrop that the emergence of the Omicron variant during the fourth quarter posed further downside risks to the pace of economic recovery in the short term, with a drop-off in activity seen across several high-frequency economic indicators. That said, there is early evidence from South Africa that the variant may be less severe, as evidenced in lower numbers of hospitalisations and deaths relative to earlier waves.

Chart 2: Confirmed COVID-19 cases, deaths and hospital admissions per million people



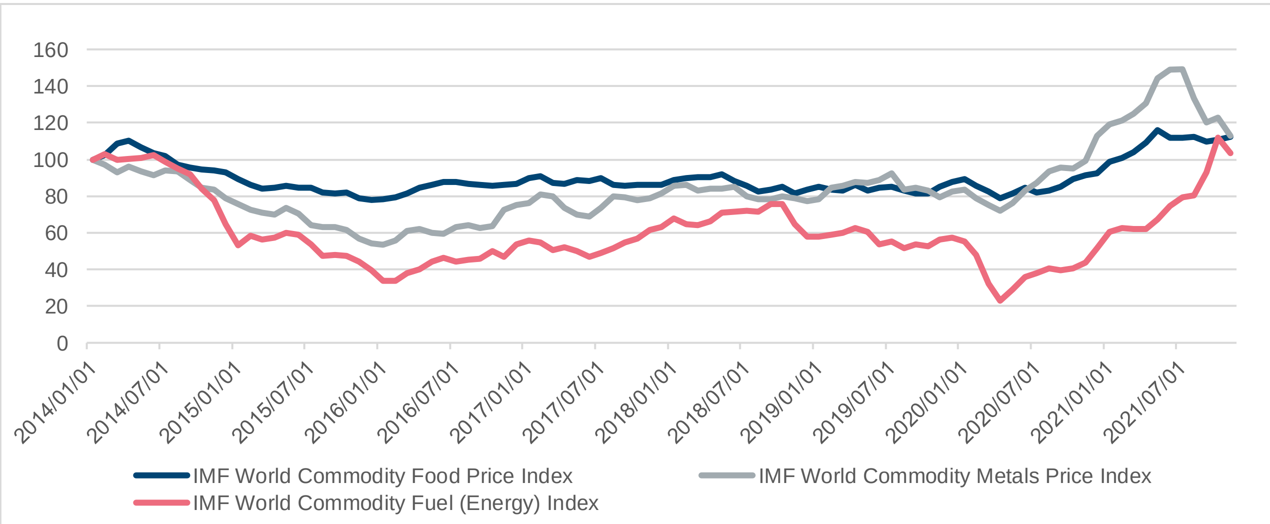
Source: Johns Hopkins University CSSE COVID-19 data, official data collated by Our World in Data

Although this data out of South Africa is encouraging, what the full impact of the Omicron variant will be across the globe remains to be seen, and the outlook relating to the pandemic remains highly uncertain as we head into 2022. Vaccine access remains a major constraint in developing countries, while the demand for booster shots is growing in more advanced economies.

DEMAND AND SUPPLY MISMATCHES KEEP PRICES UNDERPINNED

While the global economic restart remains imbalanced, the recovery in activity during 2021 as well as ongoing supply disruptions have led to some significant demand and supply mismatches, pushing up global prices. For instance, the sharp pickup in demand for microchips has far exceeded supply, which has been constrained by COVID-19-related and trade restrictions. Commodity price strength has also had a major role to play, with oil prices and non-oil commodity prices up sharply over the past year.

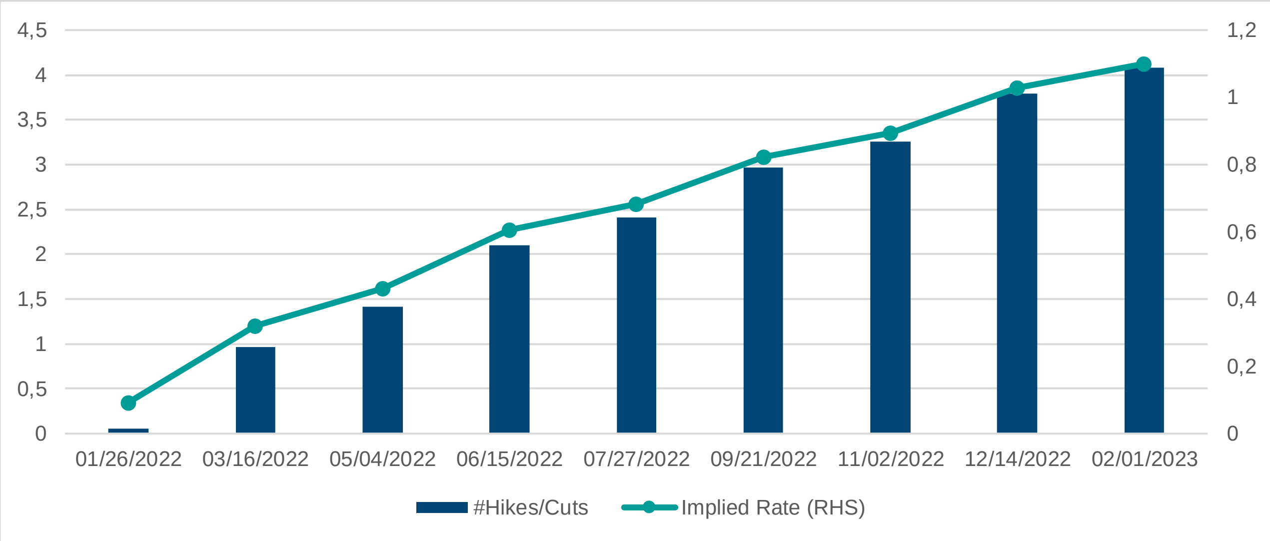
Chart 3: IMF commodity price indices, normalised as at 31 January 2014



Source: IMF, Bloomberg

It is in this context that US inflation topped 7% in 2021, the highest level in nearly four decades, prompting the Fed to raise its inflation forecasts and move its interest rate hiking cycle forward. According to its December meeting projections, the Fed is expected to raise rates three times during 2022.

Chart 4: US implied overnight rate and number of hikes/cuts as at 15 January 2022



Source: Bloomberg

While the market is now pricing in four US rate hikes by Q1 2023, central bankers have warned that there is a high degree of uncertainty relating to the persistence of inflation and, by extension, the path of policy normalisation. Ultimately the Fed, and central banks more broadly, will need to keep inflation under control without allowing growth to stagnate.

GLOBAL EQUITIES END THE YEAR ON A POSITIVE NOTE, ALTHOUGH EMERGING MARKETS CONTINUE TO LAG

Despite a resurgence in COVID-19 infections and inflation concerns, most global equities ended the year on a positive note, capping off another year of solid performance. Strong corporate earnings, together with ongoing monetary and fiscal support, buoyed global equities during Q4 and 2021 as a whole.

Chart 5: Global equity indices performance to 31 December 2021

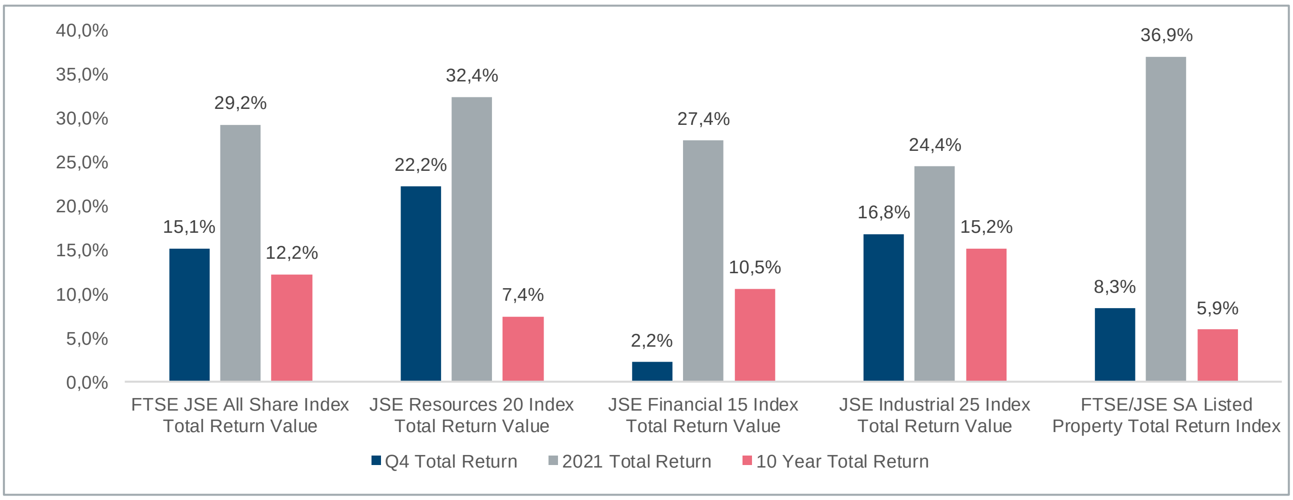
31 December 2021 (Local Currency)	3M	1 Year	3 Year (annualised)	5 Year (annualised
FTSE/JSE ALSI Total Return	15.1%	29.2%	15.7%	11.4%
FTSE/JSE Capped SWIX Total Return	8.7%	27.1%	10.9%	7.2%
S&P 500 Total Return	11.0%	28.7%	26.1%	18.5%
STOXX 600 Total Return	7.6%	24.9%	15.8%	8.9%
Nikkei 225 Total Return	-2.1%	6.7%	15.0%	10.6%
MSCI World Total Return	7.9%	22.3%	22.3%	15.6%
MSCI ACWI Total Return	6.8%	19.0%	21.0%	15.0%
MSCI EM Total Return	-1.2%	-2.2%	11.3%	10.3%

Source: Bloomberg

The domestic equity market had a particularly strong quarter, with the JSE All Share Index up an impressive 15%, bringing its total gains for 2021 to just over 29%. Resources came out on top for the quarter as the sector returned over 22%, supported by basic materials and strong performance from precious metals mining. Industrials also had a solid quarter, underpinned by luxury goods retailer Richemont which was up almost 60% for the quarter. Financials meanwhile had a softer quarter, although the sector was still up over 27% for the year.

The domestic listed property market was the top-performing local asset class in 2021, returning just under 40% for the year after underperforming significantly in 2020. While domestic fundamentals have gradually improved, thus supporting the sector, structural challenges in the domestic property market persist and the sector has yet to recover fully to pre-pandemic levels.

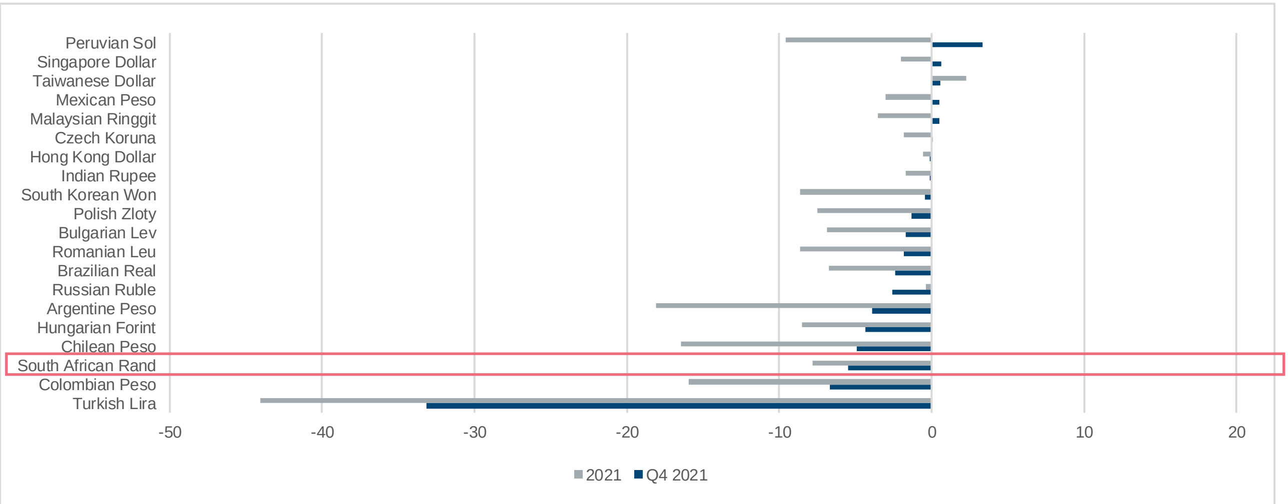
Chart 6: JSE total return indices to 31 December 2021



Source: Bloomberg

The Rand meanwhile depreciated by 6% against the USD in the fourth quarter, weakening alongside most other emerging market currencies as the currency complex had to contend with capital outflows and a firmer USD. A sharp sell-off of the Turkish Lira also had knock-on effects for EM currencies during the quarter after Turkey unexpectedly cut interest rates, despite elevated inflation, putting real rates in Turkey deep into negative territory.

Chart 7: EM currency returns to 31 December 2021`

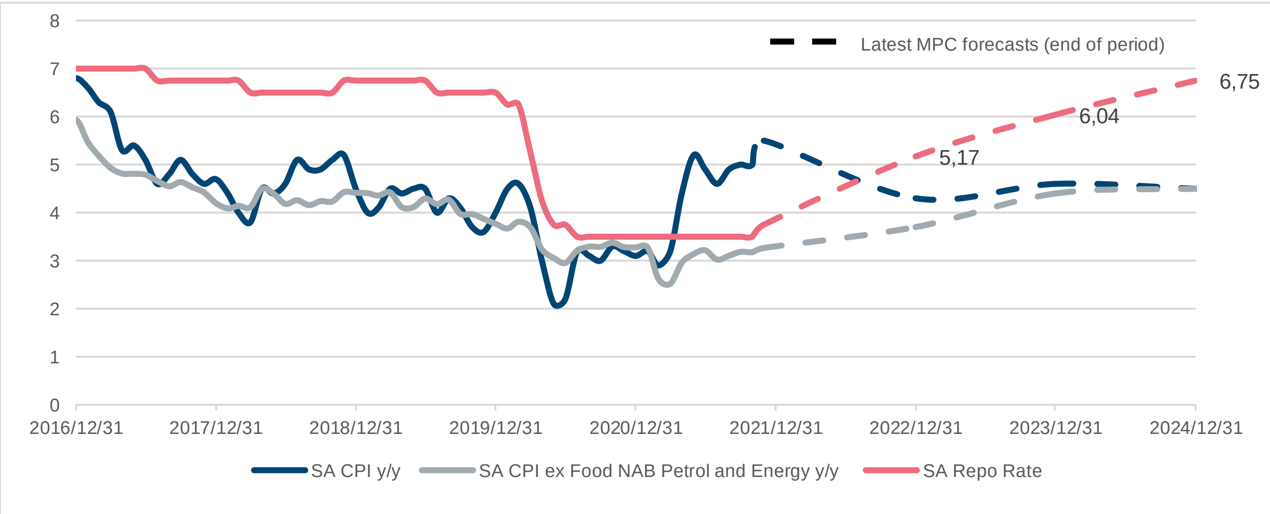


Source: Bloomberg

IN Q4 SARB HIKES RATES FOR THE FIRST TIME SINCE 2018

In contrast to Turkey's central bank, and as part of its mandate to protect the value of the domestic currency, the South African Reserve Bank hiked interest rates for the first time since 2018 in November, citing further upside risks to inflation in the near term. The SARB also highlighted the risk of capital flows and financial market volatility due to high levels of uncertainty surrounding the normalisation path for interest rates across advanced economies. It is against this backdrop that the SARB's latest quarterly projection model is showing 25bps-increment rate hikes in each quarter of 2022.

Chart 8: Historical and forecasted annual CPI and core CPI relative to repo rate

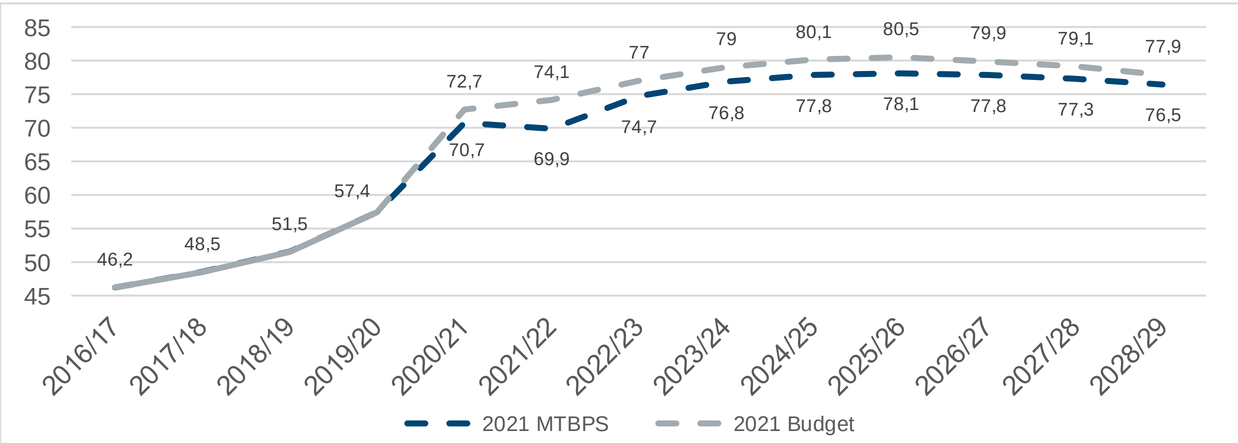


Source: Bloomberg

While the SARB's prudent monetary policy stance should help keep inflation expectations anchored and reduce volatility in the Rand, which will ultimately feed through to borrowing costs, stabilising public debt remains a key challenge for South Africa.

Short-term revenue windfalls from higher commodity prices and improving terms of trade saw the National Treasury revise its budget deficit and debt-to-GDP forecasts downwards in its 2021 Medium-Term Budget. While encouraging, there are still material risks to the medium-term fiscal outlook. Structural reforms enabling sustainable, long-term growth in South Africa, as well as fiscal consolidation, are ultimately required to ensure that the country remains an attractive investment destination over the coming years.

Chart 9: Gross loan debt outlook as a % of GDP, 2021 Budget vs 2021 MTBPS



Source: National Treasury, 2021 MTBPS

2022 OUTLOOK

After a strong year for risk assets in 2021, many investors are asking themselves whether this can be repeated in 2022, and how this will influence their investment strategy. While there is no straightforward answer to this question, cutting through the noise and remaining focused on your long-term investment goals is key to navigating a highly uncertain environment. That said, it is worth unpacking some of the key themes that are likely to shape the 2022 investment landscape.

With the number of coronavirus cases still on the rise at the start of 2022, the risks relating to the pandemic remain ever present. The emergence of new, more transmissible variants remains a key downside risk for the global economy this year. Meanwhile, inadequate vaccine access as well as vaccine hesitancy remain major hurdles in overcoming the pandemic.

Although the trajectory of the pandemic remains uncertain, there is mounting evidence that the risk of hospitalisation and death among the fully vaccinated is significantly lower than among the unvaccinated, making vaccination a key global priority over the coming year. The charts below show the results of a recent study conducted in the UK over December 2021.

Chart 10: Vaccination status: hospital admissions per 100,000

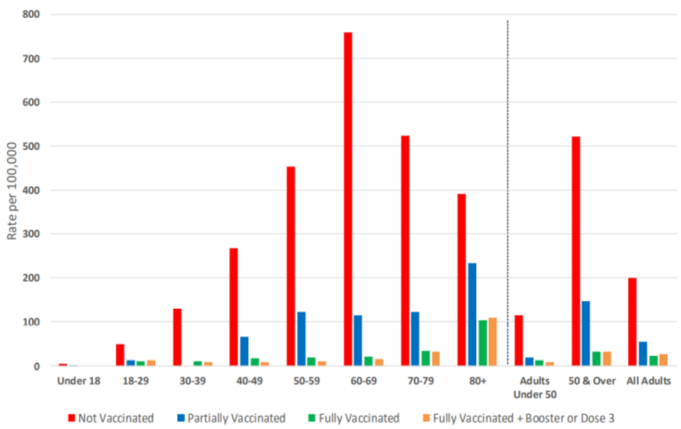
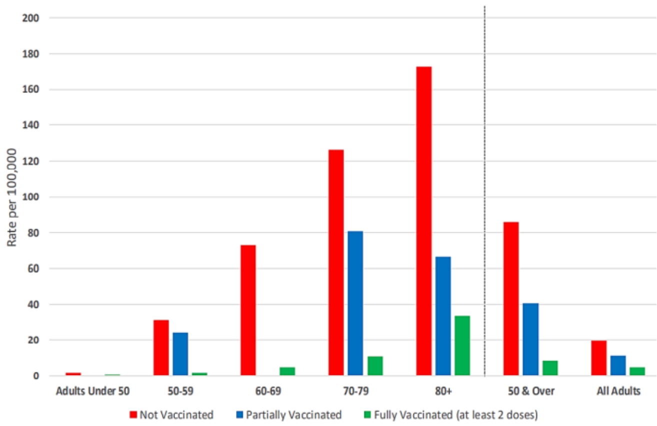


Chart 11: Vaccination status: deaths per 100,000



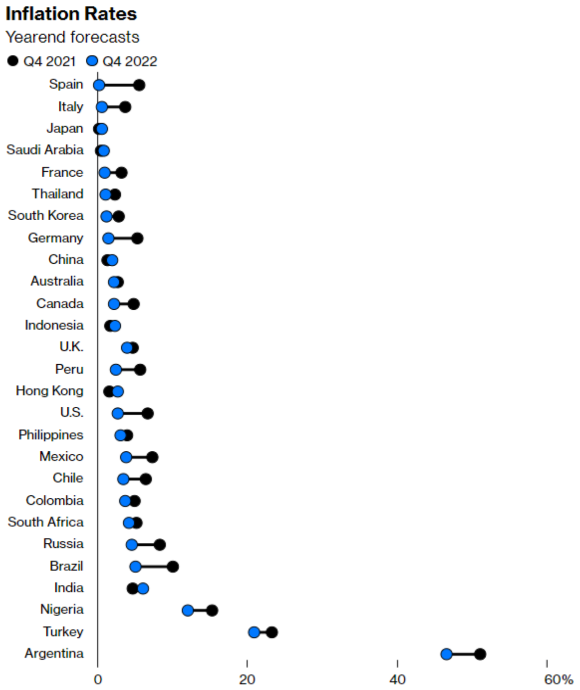
Source: gov.uk, Department of Health

The high level of uncertainty surrounding the pandemic means that we are likely to continue seeing economies across the globe recovering at varying rates in 2022, with large disparities in vaccine access and differing policy responses contributing to a divergence in the economic outlook for both advanced and emerging economies.

Inflation is another concern that is top of mind as we head into 2022, as inflationary pressures continue to broaden out in the face of persistent demand and supply imbalances. Global central banks are consequently expected to start withdrawing some monetary policy support during 2022, with the US Fed expected to set the tone for monetary policy tightening this year.

Inflation is, however, expected to moderate over the year as manufacturing and production capacity come back online and the imbalances between supply and demand begin to dissolve.

Chart 11: Year-end forecasts for global inflation, Q42021 vs Q42022



Source: Bloomberg

In the light of the above, central banks are likely to be more tolerant of short-term inflationary pressures, at least until there is more clarity about underlying price dynamics. However, should supply constraints persist and GDP continue to recover, higher inflation could persist and force central banks to act more forcefully. This ultimately poses some downside risks for emerging markets, with more aggressive monetary policy tightening likely to result in some capital outflows and currency depreciation for these markets.

More generally, in the context of stretched asset valuations, investor sentiment is likely to remain highly sensitive to any adverse developments surrounding the pandemic and associated policy responses. Other risks to the global economy and markets in 2022 stem from greater social unrest and geopolitical tensions as countries follow different paths in tackling the consequences of the pandemic, both at the policy level and in practical terms.

APPENDIX

Financial market performance as at 31 December 2021 (in ZAR)

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)	4,8%	15,1%	29,2%	15,7%	11,4%	9,2%	12,2%
FTSE/JSE Resources 20 Index	5,5%	22,2%	32,4%	26,2%	22,5%	12,4%	7,4%
FTSE/JSE Industrials Index	2,9%	16,1%	26,5%	15,5%	9,3%	7,7%	14,0%
FTSE/JSE Financials Index	8,6%	3,4%	29,8%	1,6%	2,9%	3,4%	10,2%
FTSE/JSE Shareholder Weighted Index (SWIX)	4,6%	8,3%	21,1%	10,7%	7,8%	6,6%	10,9%
FTSE/JSE Capped Swix Index (Capped SWIX)	4,9%	8,7%	27,1%	10,9%	7,2%	6,3%	10,7%
FTSE/JSE All-Share Top 40 Index	4,8%	16,3%	28,4%	16,7%	12,4%	9,6%	12,3%
FTSE/JSE SWIX Top 40 Index	4,5%	7,9%	17,3%	10,5%	8,0%	6,5%	10,8%
FTSE/JSE Mid Cap Index	4,3%	3,8%	28,9%	8,5%	4,3%	5,5%	9,8%
FTSE/JSE Small Cap Index	7,3%	8,8%	59,1%	15,0%	6,0%	6,5%	11,8%
FTSE/JSE Listed Property Index (SAPY)	7,9%	8,3%	36,9%	-2,9%	-4,4%	-0,7%	5,9%
FTSE/JSE Capped Listed Property Index	7,4%	8,3%	37,1%	-5,7%	-6,8%	-3,5%	4,3%
Local Interest-Bearing Indices							
FTSE/JSE All-Bond Index (ALBI)	2,7%	2,9%	8,4%	9,1%	9,1%	8,0%	8,2%
FTSE/JSE All-Bond Index 1 - 3 years	0,3%	1,4%	4,2%	7,7%	8,4%	8,0%	7,5%
FTSE/JSE All-Bond Index 3 - 7 years	1,4%	1,1%	2,5%	10,0%	9,7%	8,9%	8,5%
FTSE/JSE All-Bond Index 7 - 12 years	3,4%	2,3%	6,9%	9,8%	9,6%	8,4%	8,5%
FTSE/JSE All-Bond Index +12 years	3,1%	4,1%	12,6%	8,8%	8,7%	7,5%	8,3%
Inflation Linked Government Bonds (IGOV)	4,7%	5,2%	15,7%	7,2%	4,8%	4,8%	6,4%
Short-Term Fixed Interest Composite Index (SteFi)	0,3%	1,0%	3,8%	5,5%	6,3%	6,4%	6,2%
Inflation Index							
Consumer Price Index (1 month lagged)	0,5%	1,0%	5,5%	4,1%	4,4%	4,8%	5,0%
International Indices							
MSCI World Index	4,1%	13,7%	32,9%	26,6%	19,1%	17,4%	21,3%
MSCI Emerging Market Index	1,7%	4,1%	6,2%	15,2%	13,6%	11,5%	13,3%
FTSE World Government Bond Index (WGBI)	-0,9%	4,3%	1,0%	6,3%	6,0%	6,6%	8,1%
S&P Global Property	5,7%	14,4%	33,2%	15,7%	11,9%	11,8%	17,1%
USA S&P 500	4,2%	17,1%	39,8%	30,4%	22,0%	20,3%	24,7%
UK FTSE 100	6,6%	11,0%	27,5%	13,1%	9,8%	8,5%	12,8%
Euro STOXX 50	6,3%	10,4%	24,8%	19,0%	13,0%	11,2%	15,4%
Japan Nikkei 225	1,7%	0,0%	4,4%	17,5%	14,3%	15,2%	18,4%
Currency Movement							
Rand/Dollar (R15.89= 1 Dollar)	0,3%	5,8%	8,5%	3,6%	3,0%	4,7%	7,0%
Rand/Euro (R18.01= 1 Euro)	0,7%	3,8%	1,0%	3,3%	4,6%	3,8%	5,6%
JPY/Rand (7.13Japanese Yen= 1 SA Rand)	1,2%	-2,3%	2,6%	-1,9%	-3,3%	-5,0%	-2,7%
Rand/Pound (R21.13= 1 Pound)	2,2%	6,3%	7,4%	5,6%	5,0%	2,6%	5,6%

MENTENOVA

CONTACT

CAROLYN WEIL, CFA®
C +27 83 325 8981 T +27 11 447 7716
F 086 272 1177 E crath@mentenova.co.za

3rd Floor, Oxford & Glenhove Building 2,
114 Oxford Road, Rosebank. www.mentenova.co.za