MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

21 January 2022

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We have decided to maintain our TAA positions across SA asset classes, remaining neutral in SA nominal bonds and equity, moderate overweight in SA ILBs and moderate underweight in SA property. We also continue to prefer foreign equity over foreign bonds and foreign property.

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 prior positions in SA nominal bonds, SA inflation-linked bonds, SA equity and SA property, with our investment cases for these asset classes remaining largely unchanged since the end of the year, while cash remains the balancing figure. We have moved back to a moderate overweight position in foreign equity, with economic fundamentals and sentiment still suggesting upside for foreign equities, this being our preferred offshore asset class as we move into an interest rate hiking cycle.

TAA Overview

Despite a resurgence in COVID-19 infections and inflation concerns, most global equities ended the year on a positive note, capping off a solid year of performance. Developed markets continued to outperform emerging markets in December as the MSCI World gained 4.3% while the MSCI Emerging Market Index made a more modest gain of 1.9%.

Local equities ended the quarter up by an impressive 15% following gains of close to 5% in December. 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. Local property also ended the year on a positive note after gaining 8% in December, bringing its gains for the year to close to 40%.

Local nominal bonds were meanwhile up by around 3% in December and for the quarter. This is despite currency weakness and a rate hike announced by 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.

The Rand 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.

SA equities

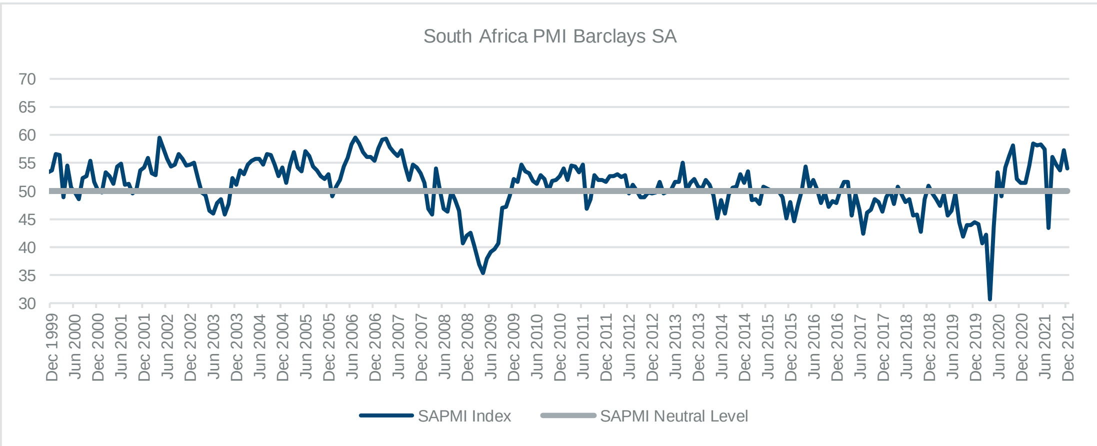
Figure 1: Major indices and asset class returns in local currency

31 December 2021 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 18 January 2022
FTSE/JSE ALSI Total Return	4,8%	15.1%	29.2%	29.2%	15.7%	11.4%	12.2%	1.7%
FTSE/JSE Capped SWIX Total Return	4,9%	8.7%	27.1%	27.1%	10.9%	7.2%	10.7%	2.1%
S&P 500 Total Return	4,5%	11.0%	28.7%	28.7%	26.1%	18.5%	16.6%	-3.9%
STOXX 600 Total Return	5,4%	7.6%	24.9%	24.9%	15.8%	8.9%	10.1%	-1.6%
Nikkei 225 Total Return	3,6%	-2.1%	6.7%	6.7%	15.0%	10.6%	15.2%	-1.9%
MSCI World Total Return	4,3%	7.9%	22.3%	22.3%	22.3%	15.6%	13.3%	-3.3%
MSCI ACWI Total Return	4,0%	6.8%	19.0%	19.0%	21.0%	15.0%	12.4%	-2.8%
MSCI EM Total Return	1,9%	-1.2%	-2.2%	-2.2%	11.3%	10.3%	5.9%	0.8%
STEFI	0,3%	1.0%	3.8%	3.8%	5.5%	6.3%	6.2%	0.2%
ALBI	2,7%	2.9%	8.4%	8.4%	9.1%	9.1%	8.2%	0.2%
IGOV	4,7%	5.2%	15.7%	15.7%	7.2%	4.8%	6.4%	-2.1%
WGBI	-0,6%	-1.1%	-7.0%	-7.0%	2.7%	2.9%	1.0%	-1.4%
SAPY Total Return	7,9%	8.3%	36.9%	36.9%	-2.9%	-4.4%	5.9%	-0.7%
MSCI US REIT Total Return	8,7%	16.3%	43.1%	43.1%	18.5%	10.8%	11.3%	-4.9%
S&P Global Property Total Return	5,9%	8.5%	22.6%	22.6%	11.9%	8.6%	9.4%	-3.5%
STOXX 600 Real Estate Total Return	1,5%	8.7%	17.6%	17.6%	10.8%	6.1%	9.9%	-4.9%
Crude Oil	10,2%	-0.9%	50.2%	50.2%	13.1%	6.5%	-3.2%	12.5%
Aluminium	7,0%	-1.8%	41.8%	41.8%	15.0%	10.6%	3.3%	7.7%
Copper	2,9%	8.8%	25.2%	25.2%	17.7%	11.9%	2.5%	-0.5%
Gold	3,1%	4.1%	-3.6%	-3.6%	12.6%	9.8%	1.6%	-0.8%
Platinum	3,2%	0.1%	-9.6%	-9.6%	6.8%	1.4%	-3.6%	1.7%
Nickel	0,0%	0.0%	0.0%	0.0%	3.8%	4.0%	-1.6%	0.0%
Palladium	9,4%	-0.4%	-22.2%	-22.2%	14.7%	22.8%	11.3%	0.1%
Iron Ore	20,9%	-5.3%	-25.4%	-25.4%	17.4%	7.9%	-1.9%	0.3%
USDZAR	0,3%	5.8%	8.5%	8.5%	3.6%	3.0%	7.0%	-2.6%
GBPZAR	2,2%	6.3%	7.4%	7.4%	5.6%	5.0%	5.6%	-2.3%
EURZAR	0,7%	3.8%	1.0%	1.0%	3.3%	4.6%	5.6%	-3.1%
JPYZAR	-1,4%	2.2%	-2.6%	-2.6%	1.8%	3.3%	2.8%	-2.2%

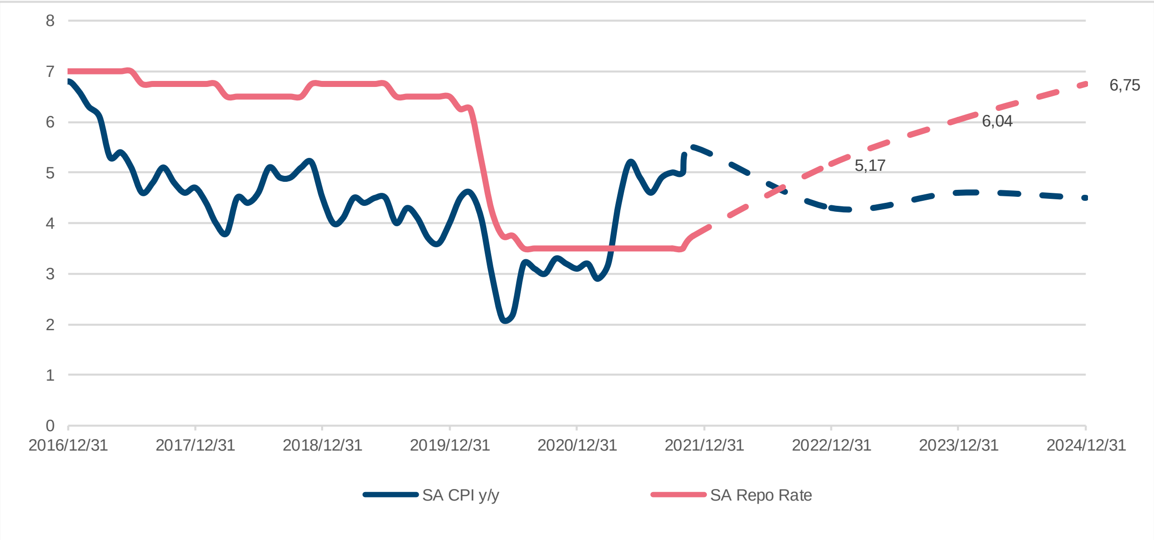
Source: Bloomberg

We saw a modest decline in local sentiment and economic indicators at the end of the year amid the fourth wave of COVID-19 infections, with the likes of the SA manufacturing PMI losing some momentum in December as all major sub-components trended lower, except for inventory.

Figure 2: SA Manufacturing PMI to 31 December 2021

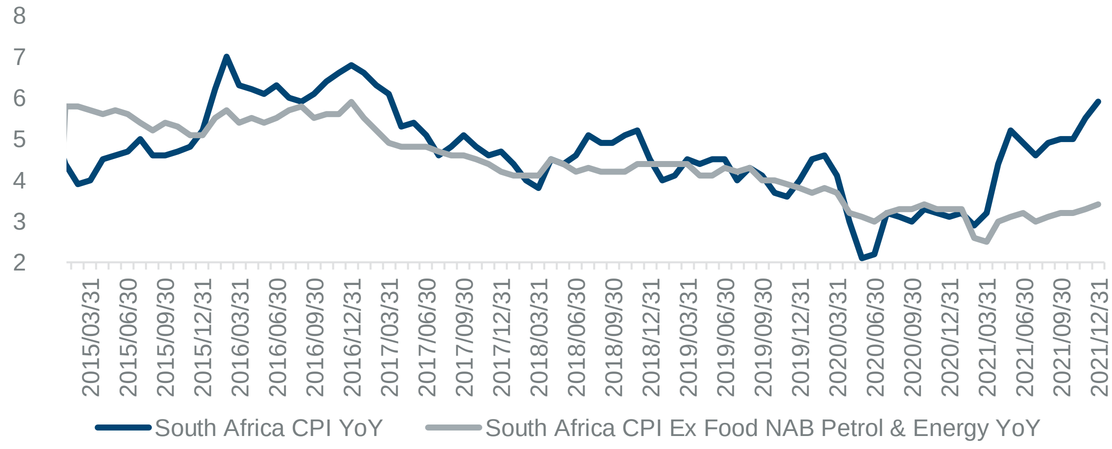


Source: Bloomberg

	While limited restrictions on activity and evidence of the lower severity of the Omicron variant are likely to have prevented another major economic setback, risks related to the pandemic continue to feature prominently. South Africa still has some way to go in its quest to vaccinate the majority of the population, and the threat of new, more transmissible variants could further delay the country's economic restart. Structural challenges, such as electricity supply constraints and record-high unemployment, meanwhile remain major constraints to economic growth. Meanwhile, global liquidity conditions are gradually turning less supportive as monetary policy normalisation in advanced economies draws closer, which will force the SARB to continue tightening monetary policy following its first rate hike in November. Lastly, SA equity valuation metrics remain near their long-term averages, all supporting a neutral position in SA equities.
SA bonds	The SARB officially kicked off its interest rate hiking cycle at its final MPC meeting of 2021, citing upside risks to inflation as well as the risk of capital flows and financial market volatility owing 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. **Figure 3: Historical and forecasted annual CPI and repo rate**  *Source: National Treasury, Bloomberg* While the value offered by SA bonds remains attractive on a real-yield basis compared to other emerging-market nominal bonds, the interest rate outlook may exert some pressure on the hedged yield and dent the rationale for carry trade. Thus, we have chosen to maintain our neutral position in local bonds.
SA inflation-	SA CPI rose to 5.9% y/y in December, remaining above the central bank's 4.5% mid-point inflation target for the seventh consecutive month and increasing to the highest level since 2017.

linked bonds

Figure 4: SA CPI and CPI ex Food, NAB, Petrol and Energy y/y to 31 December 2021



Source: Bloomberg

While core inflation remains well-contained, first- and second-round inflation effects stemming from elevated food and energy prices are keeping short-term inflation risks skewed to the upside. We therefore continue to favour the ability of inflation-linked bonds to protect against short-term inflation above breakeven inflation.

SA-listed property

We have chosen to maintain a moderate underweight position in SA property after the index rose to close to 40% in 2021, with valuation metrics still showing that the yield spread relative to SA equities and bonds remains below the historical average. The SAPY dividend yield also continues to trend below its 5-year rolling average.

Figure 5: SAPY yield spread vs ALSI

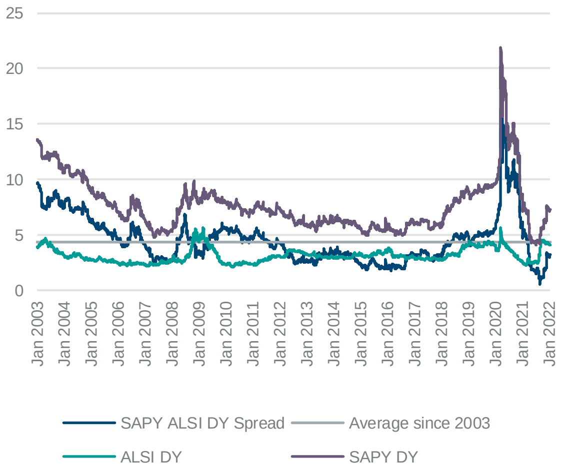
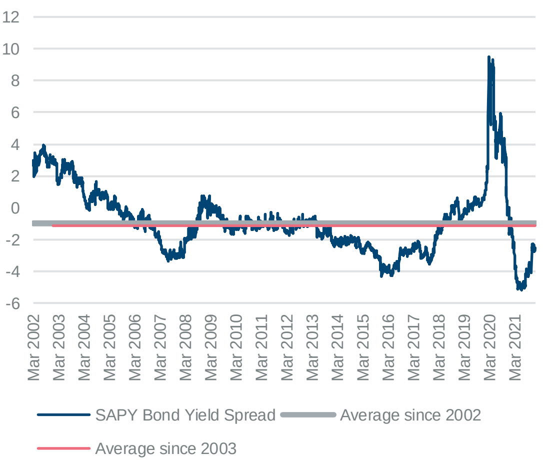


Figure 6: SAPY yield spread vs 10-year bonds



Source: Bloomberg

Ongoing secular challenges facing the local property market, as well as the end of the monetary policy easing cycle, also support the moderate underweight position in this asset class.

Offshore equities

Although the global economy continues to exhibit an uneven recovery, economic fundamentals and confidence across major advanced economies remain broadly positive, supported by ongoing stimulus and high vaccination rates. These dynamics remain supportive of the earnings outlook for global equities at the start of 2022.

At the same time, the economic recovery continues to be associated with demand and supply imbalances, pushing up general prices. In the US, inflation topped 7% in 2021, the highest level in nearly four decades. The IMF has projected inflation to average 3.9% across advanced economies this year.

Figure 7: Global inflation rates to 31 December 2021

	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021	Jun 2021	Jul 2021	Aug 2021	Sep 2021	Oct 2021	Nov 2021	Dec 2021
Global	2.1	2.2	2.6	3.1	3.6	4.1	4.2	4.2	4.3	4.6	5.2	5.7
France	0.6	0.6	1.1	1.2	1.4	1.5	1.2	1.9	2.2	2.6	2.8	2.8
Germany	1.0	1.3	1.7	2.0	2.5	2.3	3.8	3.9	4.1	4.5	5.2	5.3
Greece	-2.0	-1.3	-1.6	-0.3	0.1	1.0	1.4	1.9	2.2	3.4	4.8	5.1
Ireland	-0.2	-0.4	0.0	1.1	1.7	1.6	2.2	2.8	3.7	5.1	5.3	5.3
Italy	0.4	0.6	0.8	1.1	1.3	1.3	1.9	2.0	2.5	2.9	3.7	3.9
Spain	0.5	0.0	1.3	2.2	2.7	2.7	2.9	3.3	4.0	5.4	5.5	6.5
Sweden	1.6	1.4	1.7	2.2	1.8	1.3	1.4	2.1	2.5	2.8	3.3	3.9
Switzerland	-0.5	-0.5	-0.2	0.3	0.6	0.6	0.7	0.9	0.9	1.2	1.5	1.5
United Kingdom	0.7	0.4	0.7	1.5	2.1	2.5	2.0	3.2	3.1	3.1	5.1	5.1
United States	1.4	1.7	2.6	4.2	5.0	5.4	5.4	5.3	5.4	6.2	6.8	7.0
Australia	0.9	0.9	1.1	1.1	1.1	3.8	3.8	3.8	3.0	3.0	3.0	3.0
Japan	-0.7	-0.5	-0.4	-1.1	-0.8	-0.5	-0.3	-0.4	0.2	0.2	0.6	0.6
Brazil	4.6	5.2	6.1	6.8	8.1	8.4	9.0	9.7	10.3	10.7	10.7	10.1
China	-0.3	-0.2	0.4	0.9	1.3	1.1	1.0	0.8	0.7	1.5	2.3	1.5
India	4.1	5.0	5.5	4.2	6.3	6.3	5.6	5.3	4.4	4.5	4.9	5.6
Indonesia	1.6	1.4	1.4	1.4	1.7	1.3	1.5	1.6	1.6	1.7	1.8	1.9
Mexico	3.5	3.8	4.7	6.1	5.9	5.9	5.8	5.6	6.0	6.2	7.4	7.4
Russia	5.2	5.7	5.8	5.5	6.0	6.5	6.5	6.7	7.4	8.1	8.4	8.4
South Africa	3.2	2.9	3.2	4.4	5.2	4.9	4.6	4.9	5.0	5.0	5.5	5.5
South Korea	0.6	1.1	1.5	2.3	2.6	2.4	2.6	2.6	2.5	3.2	3.8	3.7
Taiwan	-0.2	1.4	1.2	2.1	2.5	1.8	1.9	2.4	2.6	2.6	2.9	2.6

This inflation picture across the globe is expected to force major central banks to start removing monetary accommodation, with the US Fed expected to set the tone for interest rate hikes this year. In addition to tapering its asset purchasing programme, the Fed is expected to hike rates at least three times this year, with its hiking cycle expected to kick off in March.

While this suggests that global liquidity conditions are gradually turning less supportive, we prefer offshore equities relative to other offshore asset classes in a rising interest rate environment, with offshore stocks expected to perform better than offshore property and bonds.

Offshore bonds

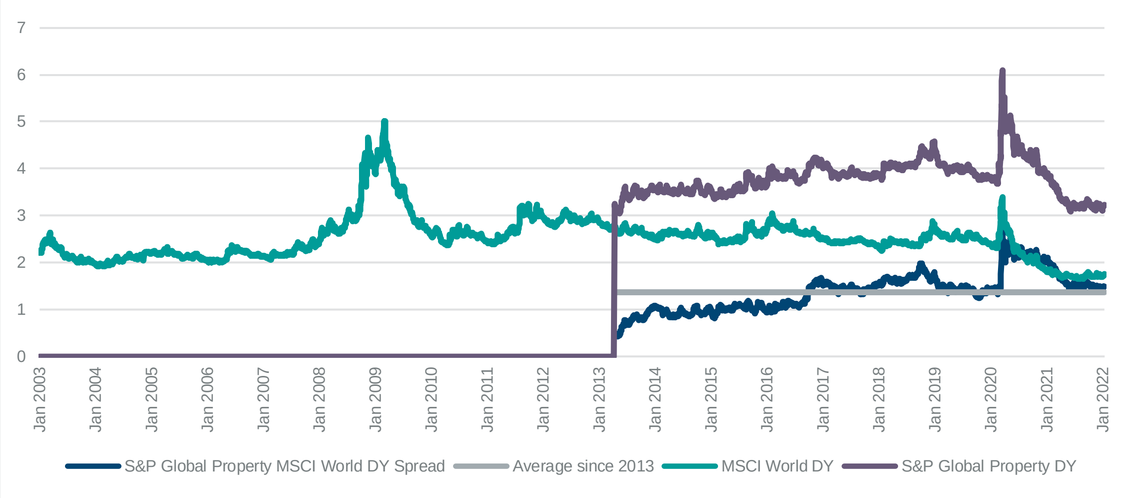
We remain moderately underweight in offshore bonds as we move into an interest rate hiking cycle. Even if central banks start to raise interest rates earlier than expected in response to persistent inflation, real interest rates will likely remain low.

The balance of risk for gradually higher yields, expectations of ongoing earnings growth in the coming years and easy monetary policy (relative to its own history) still favours offshore equities over offshore bonds.

Offshore property

Valuation of global property moderately improved since the end of the year, with price-to-tangible book value increasing slightly from 1.45x to 1.52x, while return on equity was up at 7.2%.

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 remains near long-term average levels, respectively. We therefore choose to stay neutral in offshore property.

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