MENTENOVA

# HOUSEVIEW TACTICAL ASSET ALLOCATION

18 February 2022

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We have decided to maintain our TAA positions across SA equity and SA nominal and inflation-linked bonds while moving to neutral in SA property, with SA cash being the balancing figure. We have also moved into a neutral position in foreign assets, with a preference for foreign equity over foreign bonds.

**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, and SA equity, with our investment cases for these asset classes remaining largely unchanged since the start of the year. We have moved from moderate underweight to neutral in SA property amid an improvement in the relative value of this asset class, while SA cash remains the balancing figure. Lastly, we have chosen to move to a neutral position in foreign assets while maintaining a preference for foreign equity as we move into an interest rate hiking cycle.

## TAA Overview

January saw a notable shift in market sentiment as investors grew nervous about the threat of more aggressive monetary policy tightening and escalating tensions between Russia and Ukraine. In fact, it was the worst month for global equity markets on a whole since March 2020, with developed market equities down over 5% and emerging market equities lower by almost 2% for the month.

SA equities managed to buck the trend across global markets as the ALSI recorded modest gains for the month, supported by positive performance from both resources and financials, which rose 4% and 2.5% in January, respectively. This was partly offset by a decline of 2% for industrials in January amid a 4% appreciation in the ZAR and weakness in consumer services and healthcare.

In the fixed income space, local nominal bonds eked out gains of close to 1% for January, with the medium-to-longer dated bonds outperforming short-dated bonds after the SARB hiked interest rates for a second time. Inflation-linkers meanwhile underperformed their nominal counterparts as the IGOV dropped over 1% for the month, while listed property also slipped into negative territory as the SAPY fell almost 3%.

Oil prices continued to climb higher in January as Brent crude rose over 17% in US dollar terms for the month, with supply-side constraints and escalating geopolitical tensions in the Middle East and Eastern Europe keeping prices underpinned.

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

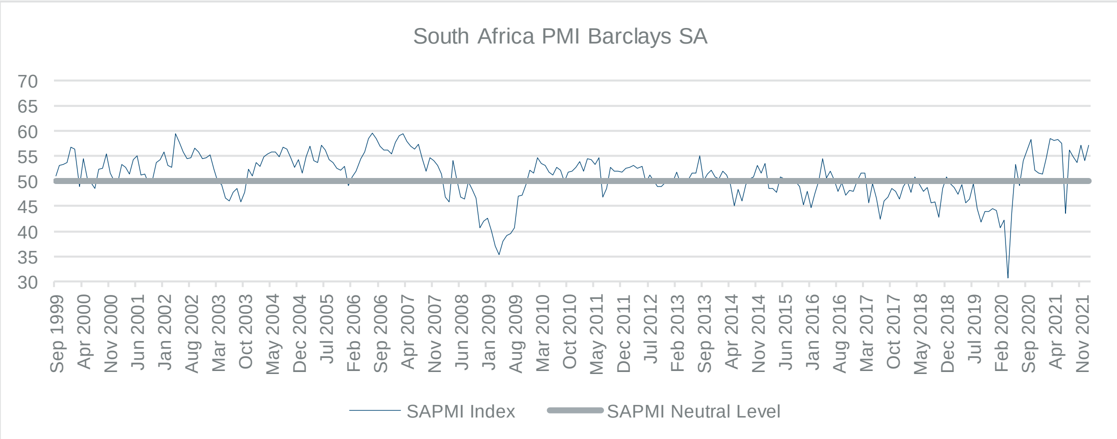
| 31 January 2022 (Local Currency) | 1M | 3M | YTD | 1 Year | 3 Year (annualised) | 5 Year (annualised) | 10 Year (annualised) | MTD 13 February 2022 |
|---|---|---|---|---|---|---|---|---|
| FTSE/JSE ALSI Total Return | 0.9% | 10.4% | 0.9% | 23.9% | 15.0% | 10.6% | 11.6% | 2.8% |
| FTSE/JSE Capped SWIX Total Return | 2.4% | 8.4% | 2.4% | 26.2% | 10.8% | 7.2% | 10.4% | 2.3% |
| S&P 500 Total Return | -5.2% | -1.6% | -5.2% | 23.3% | 20.7% | 16.8% | 15.4% | -2.1% |
| STOXX 600 Total Return | -3.8% | -1.2% | -3.8% | 21.0% | 12.0% | 8.1% | 9.2% | 0.2% |
| Nikkei 225 Total Return | -6.2% | -6.4% | -6.2% | -0.8% | 11.2% | 9.3% | 14.0% | 2.6% |
| MSCI World Total Return | -5.3% | -3.3% | -5.3% | 17.0% | 17.2% | 13.8% | 12.1% | -0.6% |
| MSCI ACWI Total Return | -4.9% | -3.4% | -4.9% | 13.7% | 16.0% | 13.2% | 11.2% | -0.2% |
| MSCI EM Total Return | -1.9% | -4.1% | -1.9% | -6.9% | 7.6% | 8.7% | 4.5% | 2.7% |
| STEFI | 0.3% | 1.0% | 0.3% | 3.9% | 5.4% | 6.2% | 6.2% | 0.1% |
| ALBI | 0.8% | 4.2% | 0.8% | 8.5% | 8.4% | 8.9% | 8.1% | 1.7% |
| IGOV | -1.2% | 3.4% | -1.2% | 12.0% | 6.2% | 4.2% | 6.2% | 1.9% |
| WGBI | -2.1% | -2.8% | -2.1% | -7.8% | 1.5% | 2.3% | 0.6% | -1.2% |
| SAPY Total Return | -2.9% | 7.1% | -2.9% | 37.4% | -6.6% | -5.2% | 5.1% | -0.5% |
| MSCI US REIT Total Return | -6.9% | 0.5% | -6.9% | 32.9% | 11.5% | 9.2% | 9.8% | -2.8% |
| S&P Global Property Total Return | -5.0% | -1.5% | -5.0% | 17.7% | 6.4% | 7.3% | 8.0% | -1.0% |
| STOXX 600 Real Estate Total Return | -3.8% | -1.1% | -3.8% | 17.1% | 5.7% | 6.2% | 8.9% | -3.6% |
| Crude Oil | 17.3% | 8.1% | 17.3% | 63.2% | 13.8% | 10.4% | -1.9% | 3.5% |
| Aluminium | 7.6% | 11.2% | 7.6% | 52.8% | 16.5% | 10.7% | 3.0% | 3.8% |
| Copper | -2.2% | 0.1% | -2.2% | 21.0% | 15.5% | 9.7% | 1.3% | 3.7% |
| Gold | -1.8% | 0.8% | -1.8% | -2.7% | 10.8% | 8.2% | 0.3% | 3.4% |
| Platinum | 5.5% | 0.0% | 5.5% | -5.2% | 7.5% | 0.5% | -4.3% | 0.9% |
| Nickel | 0.0% | 0.0% | 0.0% | 0.0% | -2.0% | 4.3% | -2.4% | 0.0% |
| Palladium | 23.7% | 17.5% | 23.7% | 5.4% | 20.6% | 25.6% | 13.2% | -2.0% |
| Iron Ore | 16.1% | 20.1% | 16.1% | -15.1% | 18.7% | 9.7% | -0.7% | 2.5% |
| USDZAR | -3.5% | 1.0% | -3.5% | 1.5% | 5.1% | 2.7% | 7.0% | -1.1% |
| GBPZAR | -4.1% | -0.9% | -4.1% | -0.4% | 6.0% | 4.1% | 5.3% | -0.3% |
| EURZAR | -4.7% | -1.8% | -4.7% | -6.2% | 4.4% | 3.5% | 5.4% | -0.1% |
| JPYZAR | -3.5% | 0.0% | -3.5% | -7.7% | 3.2% | 2.3% | 2.7% | -1.5% |

*Source: Bloomberg*

**SA equities**

Local business conditions and sentiment showed an improvement at the start of the year as the threat of the omicron variant retreated, offering some reprieve for the local economy. The SA manufacturing PMI rose to 57.1 in January, increasing above the average recorded in the fourth quarter of the year, aided by an improvement in business activity, inventories, and new sales.

**Figure 2: SA Manufacturing PMI to 31 January 2021**




*Source: Bloomberg*

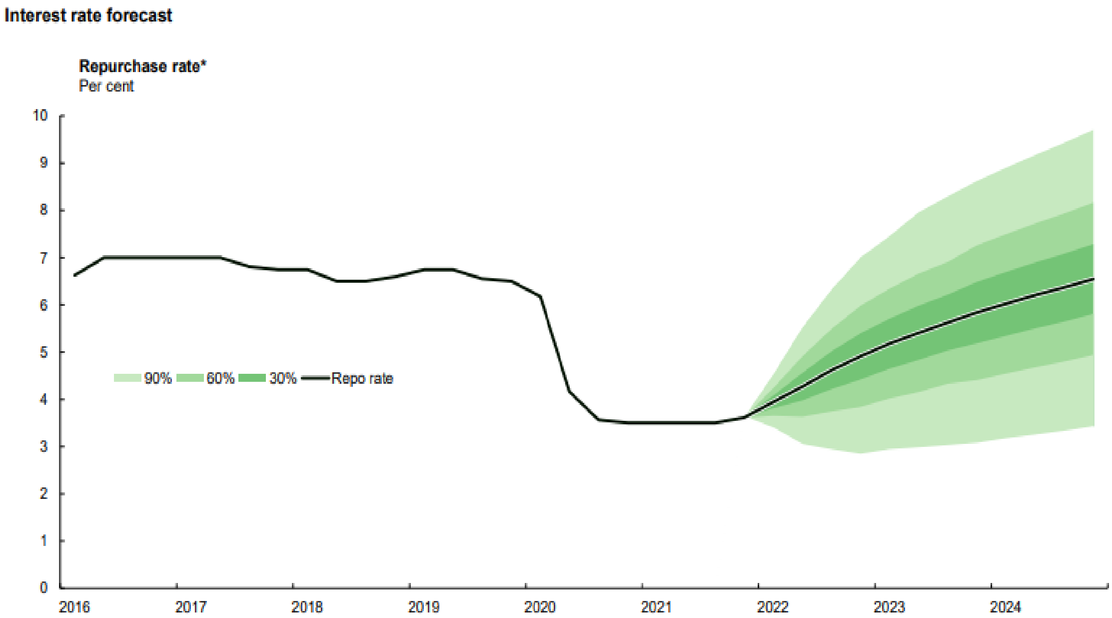
Local consumption has also shown some improvement recently, with demand for big-ticket items in the form of new and total car sales showing an uptick. While encouraging, the domestic economic outlook remains hampered by structural challenges, such as electricity supply constraints and record-high unemployment. In addition, global economic conditions have turned less supportive for emerging markets as the rebound from the pandemic fades, while slow vaccination progress remains a risk.

Elevated global inflationary pressures are meanwhile expected to accelerate the normalisation of interest rates across the globe, which is less supportive of liquidity conditions. It is against this backdrop that we prefer to remain neutral in local equities, supported by SA equity valuation metrics remaining near their long-term averages.

**SA bonds**

The SARB hiked interest rates for the second consecutive time at its monetary policy meeting in January, taking the repo rate to 4%. The central bank cited upside risks to inflation due to elevated global producer prices and food prices as well as the sharp rise in oil prices. It is against this backdrop that the SARB revised its 2022 headline CPI forecast to 4.9% from a prior 4.3%, while the central bank's latest QPM forecasts indicate gradual normalisation in the first quarter of 2022, and into 2023 and 2024.

**Figure 3: SARB MPC fans January 2022**



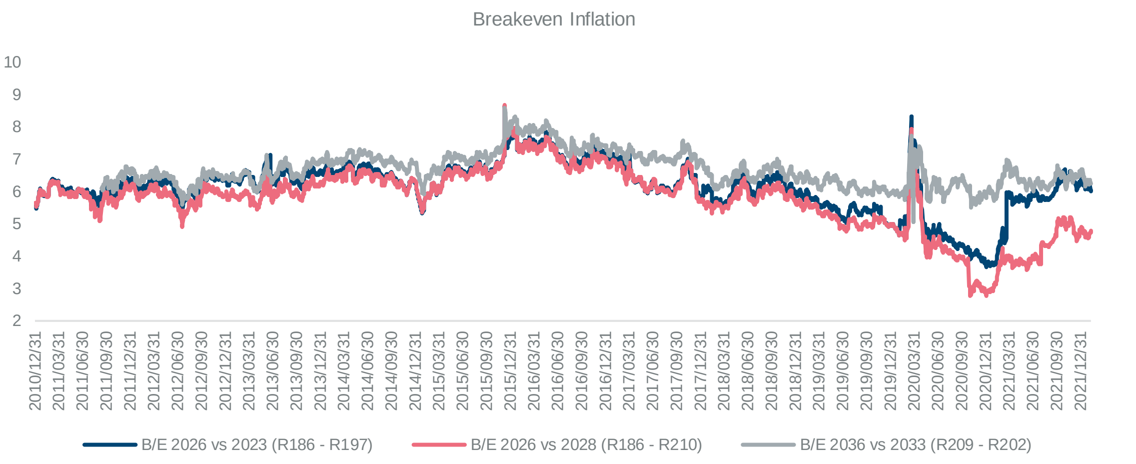

*Source: SARB, Statement of the monetary policy committee January 2022*

While SA bonds continue to offer good value on a real-yield basis compared to other emerging-market nominal bonds as well as cash, we still expect that SA bonds could come under some pressure from elevated global inflation and rising interest rates. We have thus chosen to maintain our neutral position in local bonds for now.

**SA inflation-linked bonds**

While CPI moderated slightly in January from 5.9% y/y in December to 5.7% y/y, headline inflation remains near the upper end of the SARB's inflation target band and above short-term breakeven inflation.

**Figure 4: SA breakeven inflation as at 11 February 2022**




*Source: Bloomberg*

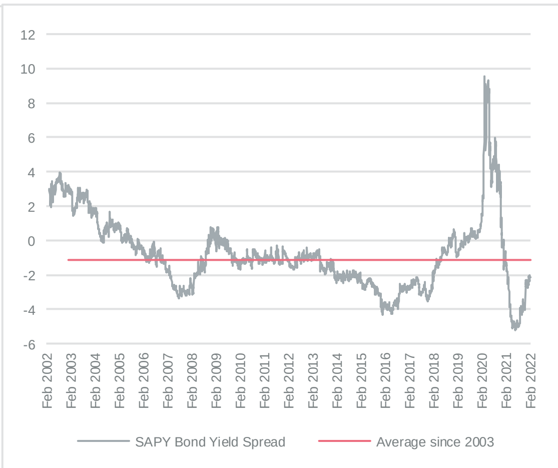
With upside risks to inflation stemming from ongoing supply chain disruptions, elevated oil price and currency volatility, we have a preference for ILBs and the embedded inflation protection in the current environment. We have therefore chosen to maintain our moderate overweight position in ILBS.

**SA-listed property**

The combination of a drop in the ALSI dividend yield and a pick-up in the SAPY dividend yield since Q4 has caused the SAPY ALSI yield spread to rise and return to its long-term average, increasing the relative value offered by SA listed property. In addition, the spread between SAPY and the 10-year bond yield has improved, albeit remaining in negative territory and below its long-term average.

**Figure 5: SAPY yield spread vs ALSI**


**Figure 6: SAPY yield spread vs 10-year bonds**




*Source: Bloomberg*

The improvement in the relative value of local property has prompted us to move from moderate underweight to neutral in local property. However, we maintain the view that the local property market continues to face structural challenges as we emerge from the pandemic, while the interest rate hiking cycle could also exert some pressure on this asset class.

**Offshore equities**

While economic fundamentals remain supportive of global equities, the global recovery is maturing and the normalisation of interest rates is imminent. The market is now pricing in at least a full 25bps interest rate hike by the US Federal Reserve at its March meeting after US inflation topped estimates in January, coming in at a multi-decade high of 7.5%. A tighter US labour market is also underpinning expectations that the Fed will officially kick off its interest rate hiking cycle in March.

**Figure 7: US CPI and core CPI y/y to 31 January 2021**

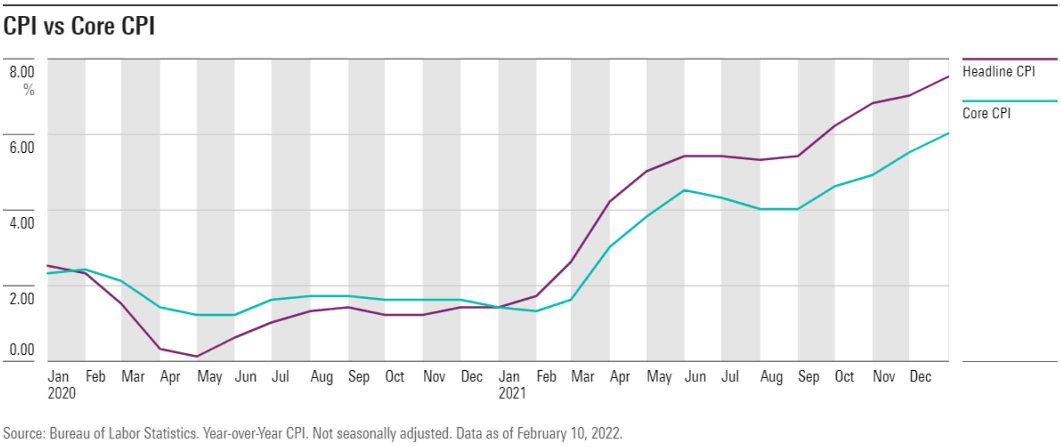
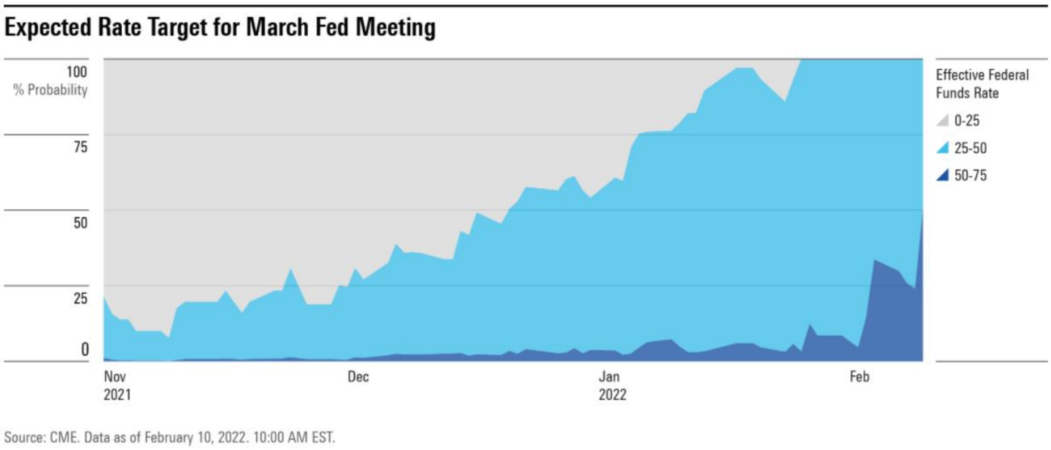
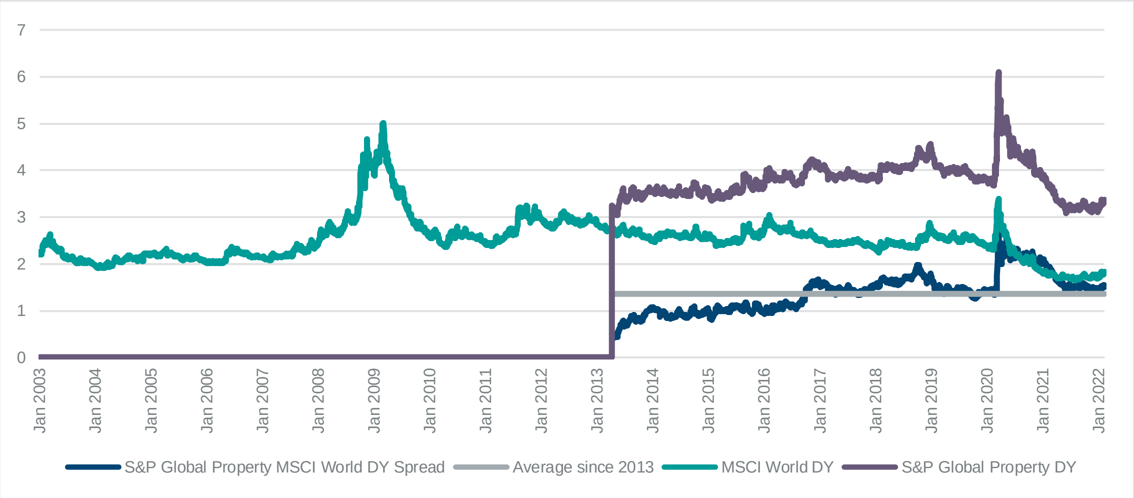



**Figure 8: US Expected rate target for March meeting as at 10 Feb 2022**




In the context of stretched valuations across most global equities, investor sentiment is expected to remain highly sensitive to any adverse developments surrounding policy setting and geopolitics. While this could generate some significant volatility in the near-term, we still prefer offshore equities to offshore bonds as we move into an interest rate hiking cycle.

Note, however, that we have moved from a moderate overweight position to a neutral position in foreign assets.

| | |
|---|---|
| **Offshore bonds** | Although renewed demand for safe-haven assets in light of geopolitical risks could generate some short-term demand for the likes of US Treasuries, we maintain the view that 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 favors offshore equities over offshore bonds. We thus choose to remain moderately underweight in offshore bonds. |
| **Offshore property** | Valuation of global property weakened at the start of the year, with price-to-tangible book value decreasing slightly from 1.53x to 1.45x, while return on equity was up at 7.7% at the end of January.<br><br>**Figure 8: S&P Global Property dividend yield spread relative to the MSCI World Index**<br><br>*Source: Bloomberg*<br><br>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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# CONTACT

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