MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

21 April 2022

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We have decided to maintain our TAA positions across most asset classes, except for moving from a neutral position into an underweight position in foreign property, with SA cash being the balancing figure.

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 across most asset classes over the past month. We continue to prefer SA inflation-linked bonds for inflation protection given the short-term upside inflation pressure, despite longer-term breakeven inflation suggesting this asset class is getting more expensive. We also prefer local nominal bonds over offshore developed-market government bonds from an implied yield, real yield and hedged yield perspective. In addition, we prefer foreign equity over foreign bonds as offshore equities outperformed offshore bonds over the past three hiking cycles. We remain neutral in local equities and local properties as risk skewed towards the downside. We moved from neutral to underweight in foreign property as valuation is becoming less favourable vs the 10-year US treasury bond yield and the elevated level of geopolitical risk and potential detrimental impact of faster monetary policy tightening.

TAA Overview

After another exceptional year in 2021, equities and bond markets had a difficult first quarter in 2022. Concerns over the negative economic implications of the Russia–Ukraine conflict, the potentially accelerated pace of monetary policy tightening and COVID-19 outbreaks, as well as renewed lockdowns in Shanghai and other parts of China, were the top three factors that weighed down markets.

The Russia–Ukraine conflict resulted in energy and commodity prices reaching extreme levels and becoming very volatile, exacerbating the surge in inflation and supply chain disruptions. This triggered the risk of faster rate hikes to combat higher inflation, which could halt global growth. China continued to double down on its zero-COVID strategy, with lockdowns affecting regions that contribute over 70% of the country's GDP from late March to mid-April. China's cabinet has recently called for a reduction in banks' required reserve ratio, which signals that the country's monetary policy may continue to diverge from the increasingly hawkish Fed stance to support the slowing economy. However, the lockdowns will nevertheless lead to a slower recovery from the global supply chain problem.

Global equities on average fell by 5.0% in Q1 2022, with the MSCI Emerging Markets Index down nearly 7.0%, affected by the Russia–Ukraine war and lockdowns in China. South African equities outperformed – up 3.8% for the ALSI Index and up 6.7% for the Capped SWIX Index. Rand appreciation of roughly 10.0% against major developed market currencies in Q1 further amplified the underperformance of offshore asset classes.

Figure 2: Major indices and asset class returns in local currency

31 March 2022 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 12 April 2022
FTSE/JSE ALSI Total Return	0.0%	3.8%	3.8%	18.6%	14.2%	11.4%	11.9%	-1.9%
FTSE/JSE Capped SWIX Total Return	1.5%	6.7%	6.7%	20.4%	11.9%	8.1%	10.6%	-1.8%
S&P 500 Total Return	3.7%	-4.6%	-4.6%	15.6%	18.9%	16.0%	14.6%	-2.9%
STOXX 600 Total Return	1.0%	-6.0%	-6.0%	8.5%	8.9%	6.3%	8.5%	0.4%
Nikkei 225 Total Return	5.8%	-2.5%	-2.5%	-2.8%	11.6%	10.1%	12.8%	-5.3%
MSCI World Total Return	2.8%	-5.0%	-5.0%	10.6%	15.5%	13.0%	11.5%	-3.0%
MSCI ACWI Total Return	2.2%	-5.3%	-5.3%	7.7%	14.3%	12.2%	10.6%	-3.0%
MSCI EM Total Return	-2.2%	-6.9%	-6.9%	-11.1%	5.3%	6.4%	3.7%	-2.7%
STEFI	0.4%	1.0%	1.0%	3.9%	5.2%	6.1%	6.1%	0.1%
ALBI	0.5%	1.9%	1.9%	12.4%	8.4%	8.9%	8.1%	0.0%
IGOV	-0.7%	0.2%	0.2%	10.8%	7.1%	5.0%	6.1%	2.7%
WGBI	-3.4%	-6.5%	-6.5%	-7.7%	-0.1%	1.3%	0.3%	-3.1%
SAPY Total Return	5.1%	-1.3%	-1.3%	27.1%	-3.8%	-4.9%	5.0%	-0.2%
MSCI US REIT Total Return	6.5%	-4.1%	-4.1%	26.2%	11.1%	9.6%	9.7%	-0.3%
S&P Global Property Total Return	4.1%	-3.4%	-3.4%	12.4%	5.7%	7.1%	7.6%	-1.2%
STOXX 600 Real Estate Total Return	0.2%	-6.3%	-6.3%	12.3%	3.9%	4.5%	8.1%	-1.7%
Crude Oil	6.9%	38.7%	38.7%	69.8%	16.4%	15.4%	-1.3%	-3.0%
Aluminium	3.6%	24.3%	24.3%	57.8%	22.2%	12.2%	5.1%	-6.4%
Copper	5.0%	6.7%	6.7%	18.1%	17.0%	12.2%	2.1%	-0.3%
Gold	1.5%	5.9%	5.9%	13.5%	14.4%	9.2%	1.5%	1.5%
Platinum	-5.8%	1.8%	1.8%	-16.9%	5.1%	0.7%	-5.0%	-1.7%
Nickel	0.0%	0.0%	0.0%	0.0%	-2.5%	5.2%	-0.8%	0.0%
Palladium	-9.0%	19.1%	19.1%	-13.7%	17.9%	23.2%	13.2%	2.8%
Iron Ore	12.9%	24.9%	24.9%	-7.6%	20.2%	12.2%	-0.2%	0.6%
USDZAR	-5.0%	-8.3%	-8.3%	-1.1%	0.3%	1.7%	6.7%	-0.7%
GBPZAR	-6.9%	-11.0%	-11.0%	-5.7%	0.5%	2.7%	4.6%	-1.7%
EURZAR	-6.3%	-10.8%	-10.8%	-6.7%	-0.2%	2.5%	4.7%	-2.8%
JPYZAR	-10.1%	-13.3%	-13.3%	-10.0%	-2.8%	0.0%	2.6%	-3.6%

Source: Bloomberg

The spill over from the Russia–Ukraine conflict had a net positive effect on South Africa. Higher export commodity prices have translated into favourable terms of trade while higher mining revenue has offset some of the economic hit to domestic growth.

Over the past month, we saw consumer confidence drop, but business confidence improved slightly. Depressed consumer confidence tied in with the significantly weakened retail spending data in February. Building activity continued to improve and car sales were strong. The PMI Index reached 60 with strong expansion in most sub-indices, except for employment which retreated to below the neutral level of 50. Imports grew by 31.5%, fuelled by oil price hikes, while exports grew by 8.1% year on year for February. Credit extensions picked up slowly.

SA equities

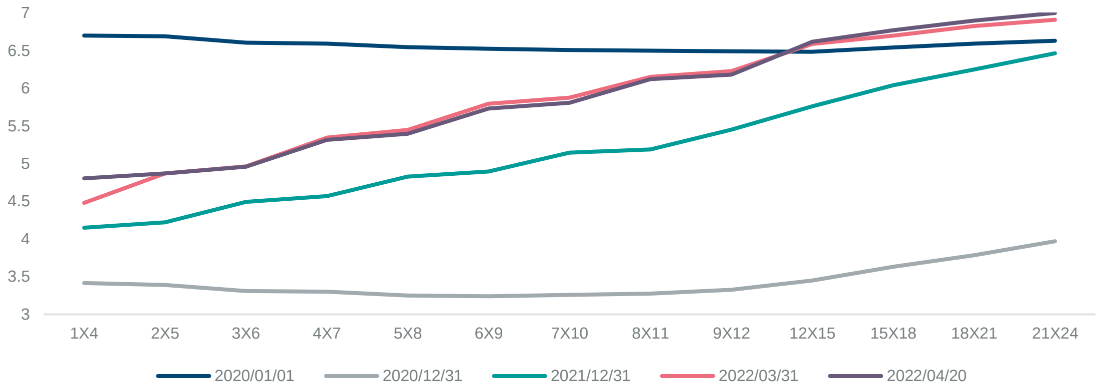
We continue to prefer to stay neutral in SA equities as we see risk skew to the downside. The South African economy started the year on a solid footing following a better-than-expected rebound in the last quarter of 2021. Activities also picked up as COVID-19-related curbs were relaxed as the fourth wave receded. Favourable commodity prices and minimal direct Russian exposure also cushioned SA asset performance. On the fiscal side, the debt-to-GDP ratio also stabilised from high tax collections and a commodity windfall. Going forward, the upside is if commodity prices continue to rise faster than the brent crude price, thereby creating a favourable commodity trade-off to support short-term growth and offset some of the negative impact of higher inflation and potentially slower global growth on domestic GDP. Over the long run, we need faster and more decisive reforms, from an enhanced power supply and the easing of bottlenecks for investment growth to more productive use of financial and human capital to achieve the desired 3.0% economic growth rate.

The downside risks are the worsening of the Russia–Ukraine conflict and Europe – our main trading partner – going into recession. Accelerated Fed policy tightening could choke global growth and result in global stagflation. The usual domestic woes remain, including ongoing electricity supply shortages, struggling SOEs and one of the world's highest unemployment rates.

SA bonds

While SA bonds continue to be attractive from an implied yield and a hedged yield perspective, and 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, rising interest rates and the capricious nature of risk sentiment. We have thus chosen to remain neutral in local bonds. The SARB has hiked rates by 25bps at three consecutive meetings and the speed of further hikes would depend on the outcome of the Russia–Ukraine conflict and the Fed's policy. The FRA rates show that the market expects the SARB to increase its rate to 5.7% in six months' time, which is steeper than the 5.0% expected from a survey of 15 economists.

Figure 3: SA FRA rates

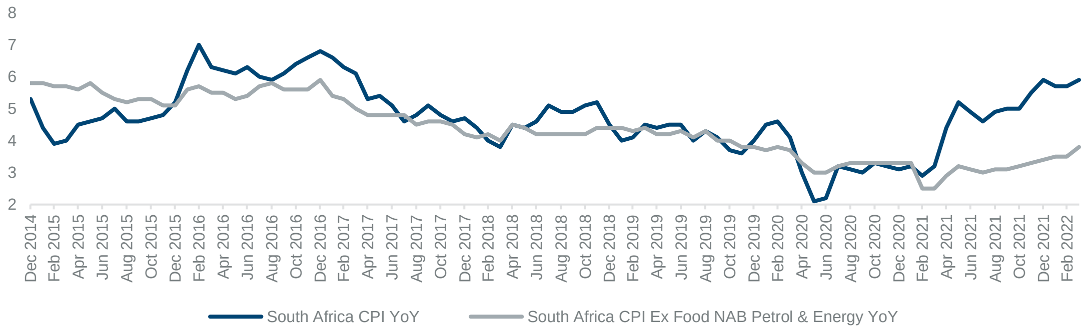


Source: Bloomberg

SA inflation-linked bonds

March CPI and core CPI were up 5.9% and 3.8% respectively, in line with market expectations. The contribution of essential expenditures, such as food, transportation and housing, to the overall inflation figure has continued to grow since the second half of 2021, suggesting that underlying inflationary pressures are more persistent.

Figure 4: SA inflation



Source: Bloomberg

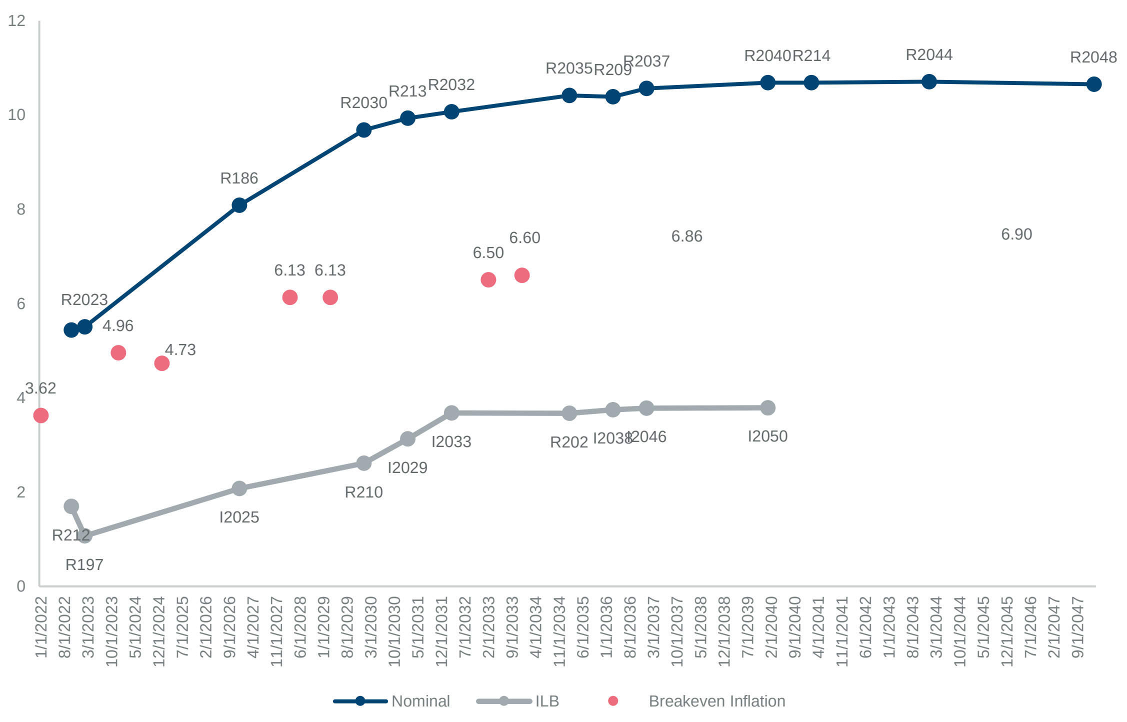
Figure 5: SA inflation rates per category

	Latest Weight	July 2021 YoY	August 2021 YoY	September 2021 YoY	October 2021 YoY	November 2021 YoY	December 2021 YoY	January YoY	February YoY	March YoY
Housing & Utilities	22.6%	3.8%	3.8%	4.0%	4.0%	3.9%	4.3%	4.3%	4.4%	4.8%
Food & Non Alcoholic Beverages	19.2%	6.7%	6.9%	6.6%	6.1%	5.5%	5.5%	5.7%	6.4%	6.2%
Miscellaneous Goods & Services	14.8%	4.2%	4.2%	4.3%	4.3%	4.2%	4.3%	4.6%	3.2%	3.2%
Transport	14.7%	8.0%	9.9%	10.1%	10.9%	15.0%	16.7%	14.5%	14.3%	15.7%
Alcoholic Beverages & Tobacco	5.9%	5.2%	5.0%	4.2%	4.0%	4.8%	4.8%	4.7%	4.8%	5.9%
Recreation & Culture	4.9%	1.7%	1.9%	1.6%	1.4%	1.3%	1.4%	1.9%	2.0%	1.7%
Household Contents & Services	4.3%	1.3%	1.3%	1.8%	1.8%	1.9%	2.1%	2.2%	2.6%	3.0%
Clothing & Footwear	4.0%	1.8%	2.0%	1.9%	1.9%	1.8%	1.7%	1.5%	1.6%	1.6%
Restaurants & Hotels	3.4%	2.3%	2.7%	3.2%	4.1%	3.7%	4.2%	5.0%	6.1%	6.7%
Communication	2.6%	-0.5%	-0.5%	-0.6%	-0.6%	-0.6%	-0.6%	-0.9%	-0.9%	-0.9%
Education	2.3%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.4%
Health	1.3%	3.6%	3.5%	3.6%	3.8%	3.8%	3.7%	3.4%	4.9%	4.9%

Source: Bloomberg

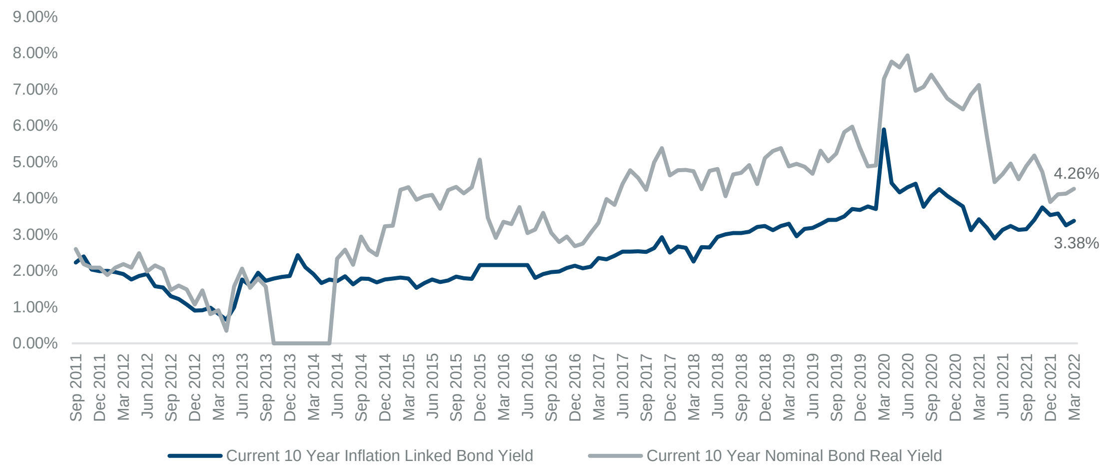
The breakeven inflation suggests that inflation-linked bonds are fairly valued over the medium term and getting expensive in the long term. In the short term, we still expect the persistent upside inflationary risks stemming from ongoing supply-chain disruptions, the elevated oil price and currency volatility to result in short-term inflation that will surpass the short-term breakeven inflation. We therefore favour inflation-linked bonds for their embedded inflation protection in the current environment. In addition, given the less than 100bps spread in the real yields between nominal and inflation-linked bonds, we have a relatively higher preference for inflation-linked bonds over nominal bonds. We have therefore chosen to maintain our moderate overweight position in inflation-linked bonds.

Figure 6: SA breakeven inflation as at 15 April 2022



Source: Bloomberg

Figure 7: SA real yields from nominal and inflation-linked bonds



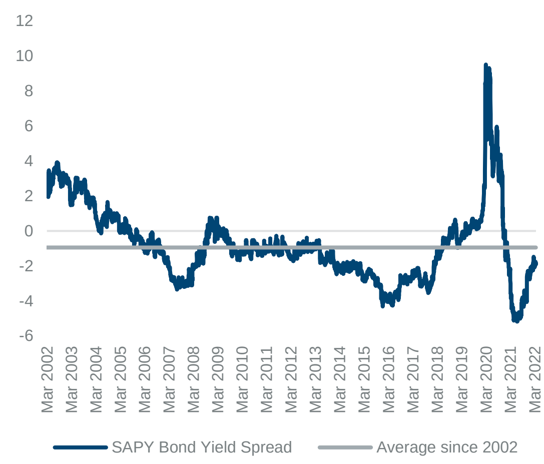
Source: Bloomberg

SA-listed property

Our investment case for the local property market remains unchanged. The yield spreads between the SAPY and the ALSI and the SAPY and the 10-year bond yield suggest a neutral position in this sector from a valuation perspective. Fundamentally, while real estate usually performs well in an inflationary environment as rentals tend to increase with inflation, the leverage inherent in the sector makes this asset class more sensitive to rate hikes than the broad equity asset class. As the domestic economy is still recovering from the COVID-19 pandemic and with our listed property sector having material exposure to Europe, we expect rental reversions to be negative or below inflation and vulnerable to the geopolitical uncertainty offshore.

Figure 8: SAPY yield spread vs ALSI

Figure 9: SAPY yield spread vs 10-year bonds



Source: Bloomberg

Offshore equities

Central banks across the globe are facing the dilemma of taming inflation or supporting growth. We continue to see inflation rates breaching the upper target levels of central banks. The supply chain issue and a recovery in demand for goods have fuelled inflation since late 2021 and the commodity supply shock from the Russia–Ukraine conflict drove inflation even higher and more persistent than policy makers initially expected. Global manufacturing PMIs are in the expansionary zone for most regions.

Figure 10: Global inflation rates

	Sep 2020	Oct 2020	Nov 2020	Dec 2020	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021	Jun 2021	Jul 2021	Aug 2021	Sep 2021	Oct 2021	Nov 2021	Dec 2021	Jan 2022	Feb 2022	Mar 2022
Global	2.8	2.6	2.3	2.1	2.1	2.2	2.6	3.1	3.6	4.1	4.2	4.2	4.3	4.6	5.2	5.7	6.0	6.4	7.0
Citi Inflation Surprise Index - Global	-3.2	-3.2	-5.4	0.0	5.3	17.7	15.7	21.6	34.8	38.5	40.5	42.8	47.7	43.9	58.1	82.9	70.5	74.0	80.0
Citi Inflation Surprise Index - Major Economies	-0.9	1.0	-2.8	6.4	10.6	26.6	19.7	25.3	43.4	48.3	55.3	57.5	62.3	58.8	71.9	107.8	97.6	104.7	113.5
Citi Inflation Surprise Index - Emerging Markets	-6.6	-9.4	-9.3	-9.5	-2.6	4.3	9.6	16.1	21.9	23.9	18.2	20.7	25.8	21.6	37.3	45.4	29.9	27.9	29.9
France	0.0	0.0	0.2	0.0	0.6	0.6	1.1	1.2	1.4	1.5	1.2	1.9	2.2	2.6	2.8	2.8	2.9	3.6	4.5
Germany	-0.2	-0.2	-0.3	-0.3	1.0	1.3	1.7	2.0	2.5	2.3	3.8	3.9	4.1	4.5	5.2	5.3	4.9	5.1	7.3
Greece	-2.0	-1.8	-2.1	-2.3	-2.0	-1.3	-1.6	-0.3	0.1	1.0	1.4	1.9	2.2	3.4	4.8	5.1	6.3	7.2	8.9
Ireland	-1.2	-1.5	-1.1	-1.0	-0.2	-0.4	0.0	1.1	1.7	1.6	2.2	2.8	3.7	5.1	5.3	5.5	5.0	5.6	6.7
Italy	-0.6	-0.3	-0.2	-0.2	0.4	0.6	0.8	1.1	1.3	1.3	1.9	2.0	2.5	3.0	3.7	3.9	4.8	5.7	6.5
Spain	-0.4	-0.8	-0.8	-0.5	0.5	0.0	1.3	2.2	2.7	2.7	2.9	3.3	4.0	5.4	5.5	6.5	6.1	7.6	9.8
Sweden	0.4	0.3	0.2	0.5	1.6	1.4	1.7	2.2	1.8	1.3	1.4	2.1	2.5	2.8	3.3	3.9	3.7	4.3	6.0
Switzerland	-0.8	-0.6	-0.7	-0.8	-0.5	-0.5	-0.2	0.3	0.6	0.6	0.7	0.9	0.9	1.2	1.5	1.5	1.6	2.2	2.4
United Kingdom	0.5	0.7	0.3	0.6	0.7	0.4	0.7	1.5	2.1	2.5	2.0	3.2	3.1	4.2	5.1	5.4	5.5	6.2	7.0
United States	1.4	1.2	1.2	1.4	1.4	1.7	2.6	4.2	5.0	5.4	5.4	5.3	5.4	6.2	6.8	7.0	7.5	7.9	8.5
Australia	0.7	0.7	0.7	0.9	0.9	0.9	1.1	1.1	1.1	3.8	3.8	3.8	3.0	3.0	3.0	3.5	3.5	3.5	3.5
Japan	0.0	-0.4	-0.9	-1.2	-0.7	-0.5	-0.4	-1.1	-0.8	-0.5	-0.3	-0.4	0.2	0.1	0.6	0.8	0.5	0.9	0.9
Brazil	3.1	3.9	4.3	4.5	4.6	5.2	6.1	6.8	8.1	8.4	9.0	9.7	10.3	10.7	10.7	10.1	10.4	10.5	11.3
China	1.7	0.5	-0.5	0.2	-0.3	-0.2	0.4	0.9	1.3	1.1	1.0	0.8	0.7	1.5	2.3	1.5	0.9	0.9	1.5
India	7.3	7.6	6.9	4.6	4.1	5.0	5.5	4.2	6.3	6.3	5.6	5.3	4.4	4.5	4.9	5.7	6.0	6.1	7.0
Indonesia	1.4	1.4	1.6	1.7	1.6	1.4	1.4	1.4	1.7	1.3	1.5	1.6	1.6	1.7	1.8	1.9	2.2	2.1	2.6
Mexico	4.0	4.1	3.3	3.2	3.5	3.8	4.7	6.1	5.9	5.9	5.8	5.6	6.0	6.2	7.4	7.4	7.1	7.3	7.5
Russia	3.7	4.0	4.5	4.9	5.2	5.7	5.8	5.5	6.0	6.5	6.5	6.7	7.4	8.1	8.4	8.4	8.7	9.2	16.7
South Africa	3.0	3.3	3.2	3.1	3.2	2.9	3.2	4.4	5.2	4.9	4.6	4.9	5.0	5.0	5.5	5.9	5.7	5.7	5.7
South Korea	0.9	0.1	0.6	0.6	0.9	1.4	1.9	2.5	2.6	2.4	2.6	2.6	2.4	3.2	3.8	3.7	3.6	3.7	4.1
Taiwan	-0.6	-0.3	0.1	0.1	-0.2	1.4	1.2	2.1	2.5	1.8	1.9	2.3	2.6	2.6	2.9	2.6	2.8	2.3	3.3

Source: Bloomberg

Figure 11: The Global Manufacturing PMI

	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	Sep 2021	Oct 2021	Nov 2021	Dec 2021	Jan-22	Feb-22	Mar-22
Global Manufacturing PMI	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	54.1	54.3	54.2	54.2	53.2	53.6	53
Developed Markets	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	57.1	56.6	56.9	56.6	56.3	56.6	56.5
Emerging Markets	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	50.8	51.6	51.2	51.7	50	50.9	49.2
Eurozone	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	58.6	58.3	58.4	58	58.7	58.2	56.5
France	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	55	53.6	55.9	55.6	55.5	57.2	54.7
Germany	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	58.4	57.8	57.4	57.4	59.8	58.4	56.9
Italy	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	59.7	61.1	62.8	62	58.3	58.3	55.8
Spain	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	58.1	57.4	57.1	56.2	56.2	56.9	54.2
Greece	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	58.4	58.9	58.8	59	57.9	57.8	54.6
Ireland	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	60.3	62.1	59.9	58.3	59.4	57.8	59.4
Australia	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	56.8	58.2	59.2	57.7	55.1	57	57.7
Sweden	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	64.6	64.4	63.1	62.1	62.4	58.6	57.3
Denmark	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	65.2	71.9	68.1	64.4	60.9	50.7	62.1
UK	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	57.1	57.8	58.1	57.9	57.3	58	55.2
US	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	60.7	58.4	58.3	57.7	55.5	57.3	58.8
Japan	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	51.5	53.2	54.5	54.3	55.4	52.7	54.1
China	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	50	50.6	49.9	50.9	49.1	50.4	48.1
Indonesia	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	52.2	57.2	53.9	53.5	53.7	51.2	51.3
South Korea	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	52.4	50.2	50.9	51.9	52.8	53.8	51.2
Taiwan	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	54.7	55.2	54.9	55.5	55.1	54.3	54.1
India	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	53.7	55.9	57.6	55.5	54	54.9	54
Brazil	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	54.4	51.7	49.8	49.8	47.8	49.6	52.3
Mexico	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	48.6	49.3	49.4	49.4	46.1	48	49.2
Russia	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	49.8	51.6	51.7	51.6	51.8	48.6	44.1
South Africa	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	56.8	53.6	57.2	54.1	57.1	58.6	60

Source: Bloomberg

US consumer confidence improved in March and April while retail sales slowed, but growth remained positive for March. Housing market activity also slowed. The labour market remains tight, with the unemployment rate edging lower, new job creation slowing and wage growth sitting at 5.6% in March. March inflation in the US reached 8.5%, beating the market expectation of 8.4%.

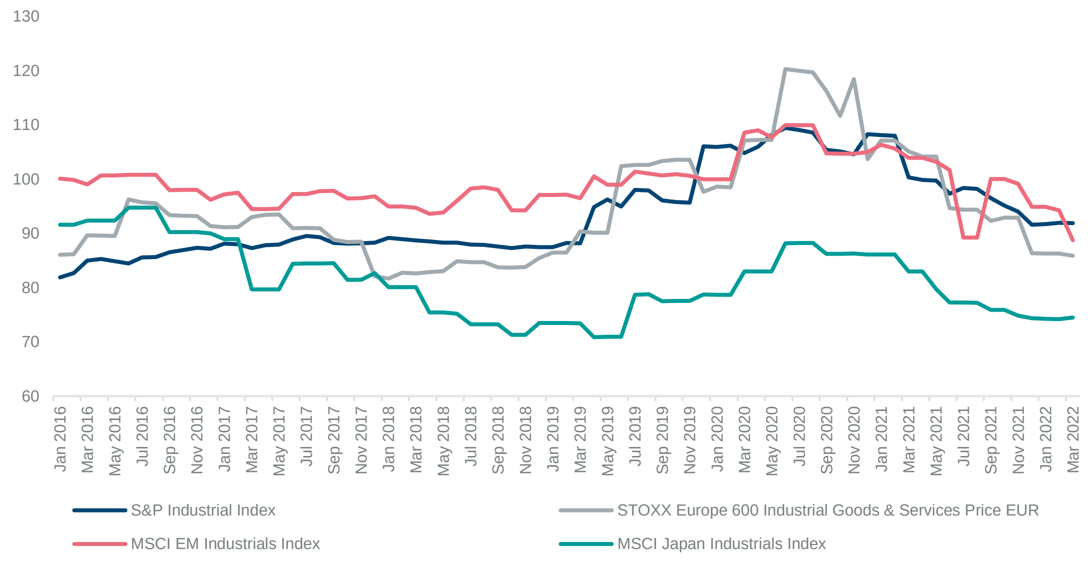
Both consumer and business confidence in the Eurozone fell in March. Retail spending growth slowed but was positive at 5.0% YoY. Industrial production remained stable for many European countries except for Italy which posted a decline of 3.4% in January due to energy price shocks and component shortages.

Retail sales were also disappointing in Japan, while consumer and business confidence improved in March. The labour market is strong and the housing market is growing, but there is mixed manufacturing data due to supply constraints from factory shutdowns and semiconductor shortages affecting production. Furthermore, capital investments were up.

We continue to prefer offshore equities to offshore bonds as yields rise but choose to remain neutral in offshore equities as we continue to believe that the risk sentiment will remain highly sensitive to any adverse developments impacting the policy environment, the corporate earnings outlook and geopolitics.

Monetary and fiscal policies in Japan will remain positive to support growth as the country's inflation remains at around 1.0%. The downside risk is that the Fed may speed up its monetary policy tightening, which could suffocate global growth, but for now, we expect US consumers to weather the rate hikes due to stimulus payments during the pandemic, a robust labour market and strong household balance sheets as a result of booming housing and equity markets. Lower-income households will suffer due to more expensive credit and higher inflation. There are also signs that inflation in the US could start to moderate soon as consumers are pivoting from spending on goods to services which are subject to more rigid price inflation. Inflation could normalise further if global supply chain bottlenecks improve. European economic growth remains highly vulnerable to the Russia–Ukraine conflict. The geopolitical risk will dampen the region's growth and the worst-case scenario is prolonged high energy prices that push the region into a recession. Fundamentally, the return-on-equity ratios for most major equity indices have fully recovered from the pandemic and many industrial companies have deleveraged, making them less exposed to rate hikes.

Figure 12: Debt-to-equity ratios



Source: Bloomberg

Offshore bonds

The recent bond selloff should prompt portfolio rebalancing for many multi-asset portfolios. Over the medium term, we continue to prefer inflation-linked bonds over nominal bonds as a risk diversifier and choose to be moderately underweight in offshore nominal bonds as a result. Yields have surged but may move higher as investors demand a higher premium for holding longer maturity bonds. While further higher yields may cap the upside potential of equity, equity tends to outperform bonds during rate hiking cycles, as suggested by the table below which shows the outperformance of the S&P 500 Index over the FTSE World Government Bond Index for the past three rate hiking cycles.

Figure 13: Performance over the past three rate hiking cycles in ZAR

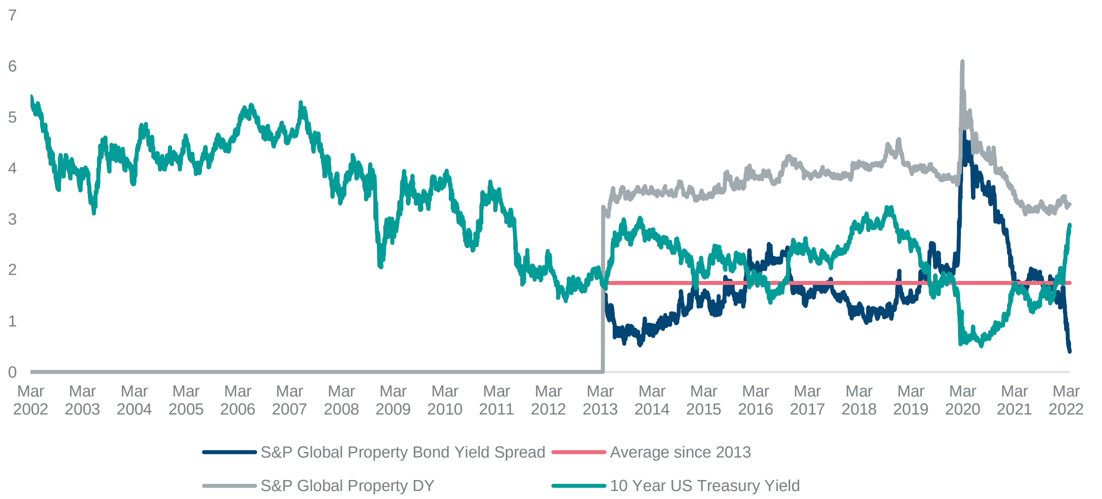
Returns in ZAR	S&P 500 Total Return Index	FTSE JSE All Share Index Total Return Value	MSCI World Gross Total Return USD Index	MSCI Emerging Markets Gross Total Return USD Index	FTSE World Government Bond Index (WGBI) USD	Bloomberg Commodity Index Total Return	FTSE/JSE ALBI Total Return Index	Federal Funds Target Rate - Upper Bound
30-Jun-93 31-Dec-00	669.8%	166.3%	459.1%	146.4%	236.2%	319.9%	222.0%	3.5%
31-Dec-03 30-Jun-07	51.9%	200.3%	76.6%	179.0%	14.5%	48.9%	34.6%	4.3%
31-Mar-15 30-Jun-19	80.4%	26.5%	62.1%	41.7%	31.1%	-1.4%	37.6%	2.3%
Q1 2022	-12.4%	3.8%	-12.8%	-14.5%	-14.1%	15.3%	1.9%	0.3%

Source: Bloomberg

Offshore property

The valuation of global property remains neutral from a dividend yield spread perspective, but as the 10-year US treasury yield has spiked up, the spread vs the 10-year US treasury yield suggests the valuation for the sector is getting expensive. Fundamentally, debt to equity has been stable and the operating margin and return on equity have largely improved but remain some distance away from the pre-pandemic level. Therefore, despite the sector's tendency to perform well during inflationary periods, we choose to be moderately underweight, given a combination of less favourable valuations, monetary policy uncertainty and geopolitical risk.

Figure 14: S&P Global Property dividend yield spread relative to the US 10-year treasury yield



Source: Bloomberg

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