MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

23 June 2022

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We have decided to move from a neutral position to a moderate overweight position in SA bonds, from a neutral position to a moderate underweight position in SA inflation-linked bonds, and from a moderate underweight position in offshore bonds to neutral, slightly lowering our active weight in offshore cash, 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 have reiterated our prior positions in local equities, local listed properties, offshore equities and properties over the past month. We have moved from neutral to moderately overweight in SA nominal bonds based on attractive valuations, improving fiscal conditions and better compensation for inflation than that offered by SA inflation-linked bonds. We have reduced our position in SA inflation-linked bonds from neutral to moderate underweight as the breakeven inflations implied by the inflation-linked bonds suggest this asset class is fully valued and expensive over the medium- to long-term maturities. In higher inflationary regimes, equities and bonds tend to have typically been associated with positive correlations, but equities and nominal bonds tend to be negatively correlated in growth-dominated regimes. Given the weakening growth outlook, we have therefore chosen to move from moderate underweight to neutral in offshore bonds so that the portfolio is balanced to growth and inflation.

TAA Overview

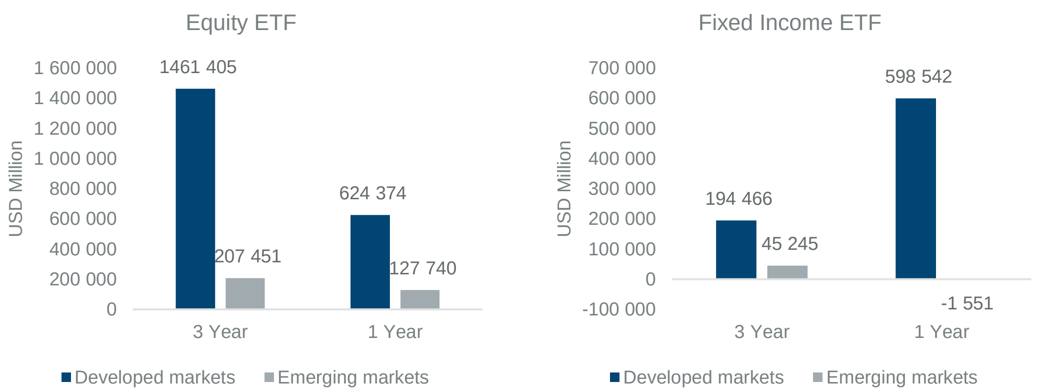
Market overview	Equity markets ended broadly flat in May but experienced significant intra-month volatility. Massive selloff took place in June as financial conditions tightened and markets grew increasingly concerned about the risk that further accelerated rate hikes could tip the major economies into recession as central banks try to tame inflation. The S&P 500, MSCI World, MSCI All Country, MSCI World Value, Growth and Small Caps indices were all down by around 11%. The MSCI Emerging Markets Index and the SA equity markets outperformed by c.3.0% in local currencies as China's lockdown eased and elevated commodity prices continued to benefit net commodity exporting countries. Energy and resource-heavy indices such as the FTSE UK Index also outperformed other developed market indices. In addition, emerging markets did not have as large net inflows as developed markets, according to the ETF flow history over the past one year and three years, thus making them less vulnerable.

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

31 May 2022 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 20 June 2022
FTSE/JSE ALSI Total Return	-0.4%	-4.0%	-0.3%	11.0%	13.0%	9.8%	11.6%	-7.9%
FTSE/JSE Capped SWIX Total Return	0.5%	-2.0%	3.1%	12.1%	10.6%	6.8%	10.2%	-7.4%
S&P 500 Total Return	0.2%	-5.2%	-12.8%	-0.3%	16.4%	13.4%	14.4%	-11.0%
STOXX 600 Total Return	-0.9%	-0.6%	-7.6%	1.8%	8.8%	5.2%	9.2%	-8.1%
Nikkei 225 Total Return	1.6%	3.7%	-4.4%	-3.6%	11.9%	8.9%	14.4%	-5.5%
MSCI World Total Return	0.2%	-5.5%	-12.8%	-4.4%	13.2%	10.3%	11.7%	-10.5%
MSCI ACWI Total Return	0.2%	-5.7%	-12.6%	-6.4%	12.2%	9.5%	10.8%	-10.1%
MSCI EM Total Return	0.5%	-7.2%	-11.7%	-19.6%	5.4%	4.2%	4.5%	-7.0%
MSCI World Value Index	2.2%	-0.5%	-3.3%	1.8%	10.9%	7.8%	10.2%	-10.6%
MSCI World Growth Index	-2.2%	-11.0%	-22.1%	-11.2%	14.5%	12.2%	12.9%	-10.6%
MSCI World Small Cap Index	-0.2%	-7.0%	-13.8%	-12.8%	10.4%	7.8%	10.9%	-10.9%
FTSE UK Series FTSE All Share TR	0.7%	2.3%	1.5%	8.3%	5.8%	4.1%	8.1%	-6.2%
MSCI AC Asia Ex. Japan Index	0.5%	-7.3%	-12.3%	-21.4%	6.2%	4.7%	6.6%	-5.7%
MSCI Europe Excluding United Kingdom Index	-0.8%	-1.0%	-9.6%	-0.1%	9.8%	6.1%	10.7%	-8.3%
STEFI	0.4%	1.1%	1.8%	4.1%	5.1%	6.0%	6.1%	0.3%
ALBI	1.0%	-0.2%	1.2%	5.6%	7.7%	8.2%	7.9%	-1.6%
IGOV	2.0%	3.2%	4.2%	10.1%	7.6%	5.6%	6.5%	-1.5%
WGBI	-0.1%	-9.2%	-12.0%	-15.0%	-2.5%	-0.6%	-0.4%	-4.4%
Bloomberg Global Inflation-Linked Total Return Index	-3.2%	-11.1%	-13.2%	-11.6%	1.3%	1.6%	1.7%	-5.8%
Bloomberg US Agg Total Return	0.6%	-5.9%	-8.9%	-8.2%	0.0%	1.2%	1.7%	-2.8%
Bloomberg EuroAgg Total Return Index	-1.5%	-6.9%	-10.0%	-10.2%	-2.3%	-0.5%	2.0%	-4.4%
Bloomberg Global Agg Corporate Total Return Index	0.6%	-7.6%	-12.3%	-13.3%	-0.2%	1.0%	2.2%	-4.1%
Bloomberg US Corporate High Yield Total Return Index	0.2%	-4.4%	-8.0%	-5.3%	3.3%	3.6%	5.4%	-5.5%
Bloomberg Pan-European High Yield Total Return Index	-1.4%	-4.1%	-8.1%	-6.9%	1.2%	1.6%	5.4%	-4.6%
J.P. Morgan EMBI Global Core Hedged EUR	0.2%	-7.3%	-15.9%	-16.6%	-3.6%	-2.1%	1.7%	-5.7%
SAPY Total Return	0.0%	3.6%	-2.6%	15.5%	-5.0%	-5.2%	4.5%	-7.5%
MSCI US REIT Total Return	-6.2%	-4.5%	-14.0%	3.8%	7.2%	7.4%	8.7%	-10.8%
S&P Global Property Total Return	-4.3%	-5.5%	-12.3%	-4.7%	3.0%	4.4%	7.1%	-10.0%
STOXX 600 Real Estate Total Return	-4.9%	-10.3%	-16.2%	-7.8%	0.6%	1.0%	7.0%	-12.4%
FTSE EPRA Nareit Global REITs TR Index	-4.8%	-4.5%	-12.7%	-0.7%	4.2%	5.4%	7.3%	-10.5%
Crude Oil	12.3%	21.6%	57.9%	77.2%	24.0%	19.5%	1.9%	-7.1%
Aluminium	-8.7%	-17.3%	-0.7%	12.2%	15.8%	7.6%	3.4%	-9.3%
Copper	-3.3%	-4.4%	-2.8%	-7.9%	17.5%	10.7%	2.4%	-5.0%
Gold	-3.1%	-3.8%	0.4%	-3.6%	12.1%	7.7%	1.6%	0.1%
Platinum	3.1%	-7.5%	0.0%	-18.6%	6.9%	0.4%	-3.7%	-3.4%
Nickel	-10.7%	15.2%	35.8%	56.8%	33.3%	26.0%	5.8%	0.0%
Palladium	-14.0%	-19.7%	5.1%	-29.3%	14.7%	19.6%	12.6%	-7.4%
Iron Ore	-0.2%	5.6%	16.9%	-33.6%	10.5%	18.9%	0.1%	-10.0%
Bloomberg Commodity Index Total Return	1.5%	14.9%	32.7%	41.9%	19.8%	10.9%	0.9%	-3.4%
USDZAR	-0.9%	1.7%	-1.9%	13.9%	2.4%	3.6%	6.3%	2.5%
GBPZAR	-0.8%	-4.4%	-8.6%	1.0%	2.3%	3.2%	4.1%	-0.4%
EURZAR	0.6%	-2.8%	-7.5%	-0.1%	1.0%	2.7%	4.8%	0.5%
JPYZAR	-0.2%	-9.1%	-12.3%	-3.1%	-3.4%	0.6%	1.1%	-2.3%
Dollar Index Spot	-1.2%	5.2%	6.4%	13.3%	1.3%	1.0%	2.1%	2.9%

Source: Bloomberg

Figure 3: Developed market and emerging market ETF net flows over the past 1 year and 3 years

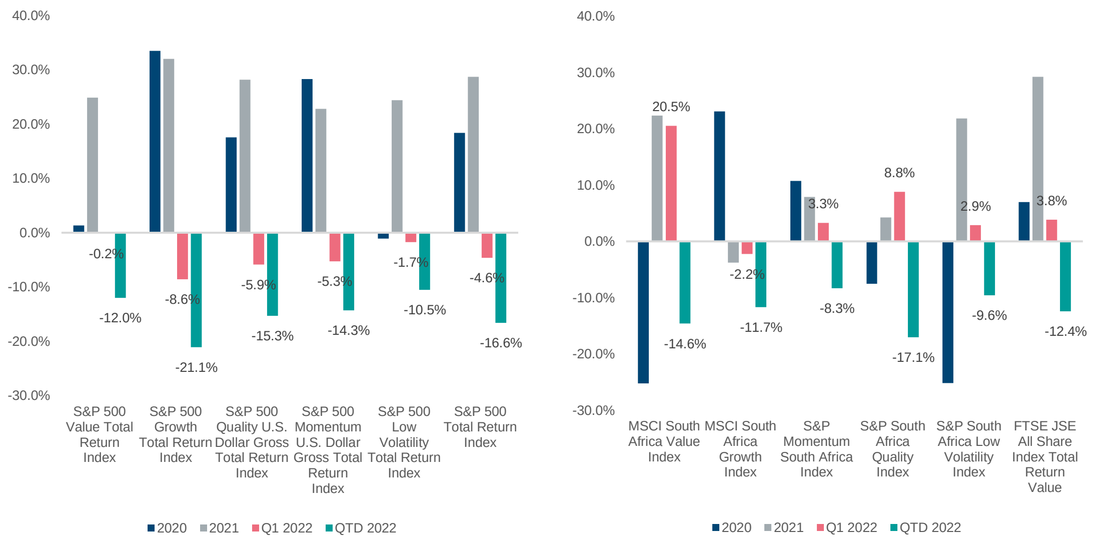


Source: Bloomberg

Local fixed income performed in line with the WGBI Index in ZAR terms but outperformed in local currencies for the month to date as at 20 June 2022. US fixed income performed better than developed market debts in May and for the month to date in June. Property markets have seen a massive exodus since the end of April as markets' focus has pivoted from inflation hedging to recession proof. Commodity prices came off the boil in May and were mixed in June. The

Bloomberg Commodity Index returned 1.5% in May but fell by 3.4% for the month to date in June as recession fears caused performance divergence within the commodity basket. The ZAR was relatively stable, appreciating by 0.9% in May and depreciating by 2.5% so far in June. The dollar strengthened to nearly 6.0% against other major currencies for the month to date.

Figure 4: US and SA style indices performance in local currency



Source: Bloomberg

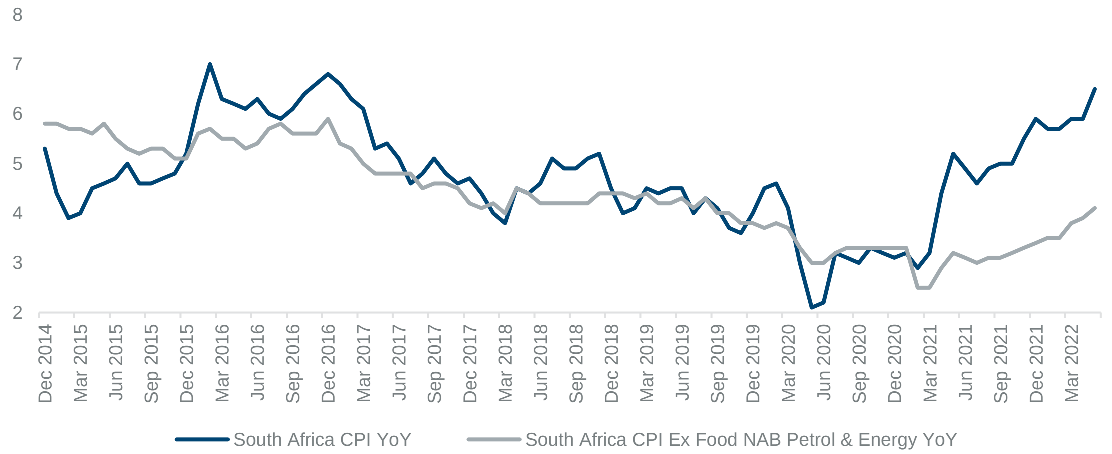
From a style perspective, the low volatility and value indices meaningfully outperformed the S&P 500 Index for the quarter to date as at 21 June 2022. For SA equities, momentum and low vol were the two best-performing indices that significantly outperformed the ALSI.

SA equities

Economic updates for South Africa were mixed, with a net positive tone over the past month. Retail sales for March were weaker than market expectations, while April numbers were better than consensus. Despite positive yearly growth, monthly growth remains slightly negative. The PMI Index increased from 50.7 to 54.8 in April; however, manufacturing production significantly disappointed the market over the same period. Imports grew by 24.0% but exports contracted by 5.8% in April year on year. Total and new car sales were up by 2.1% and 13.8% respectively in May year on year. Q1 GDP growth was 3.0%, exceeding the market expectation of 1.9%. The current account was also strong, having improved from 1.9% of GDP in Q4 last year to 2.2% of GDP in Q1 2022, and also beat the market expectation of 1.5%. Core inflation of 4.1% was in line with consensus, but headline inflation of 6.5% exceeded the market expectation of 6.1%.

A commodity price rebound over the COVID pandemic (the Bloomberg Commodity Total Return Index and the Bloomberg Precious Metals Total Return Index were up by 53.17% and 14.61% respectively in USD for the period 31 December 2019 to 28 June 2022) has been beneficial for net commodity exporting countries such as South Africa. This has offset some of the negative impacts on the domestic economy of a substantial increase in the oil price, in the form of positive terms of trade, a more stable exchange rate and ultimately an improved fiscal position. With China reopening, green inflation (i.e., demand for metals for the medium term for renewable infrastructures), ongoing sanctions against Russia as the war grinds on and the impact of climate change on agricultural production will remain supportive of commodity prices in general. However, the difficult balance between inflationary and recessionary forces will determine whether commodities can continue to outperform other asset classes once the economic momentum subsides. However, SA consumers will be under increasing pressure as the rebound from lockdowns fizzles, with the high unemployment rate and elevated fuel and food inflation eroding disposable incomes – not to mention that impediments to achieving real growth of 3% over the long term will persist.

Figure 5: SA inflation



Source: Bloomberg

Figure 6: SA inflation rates per category

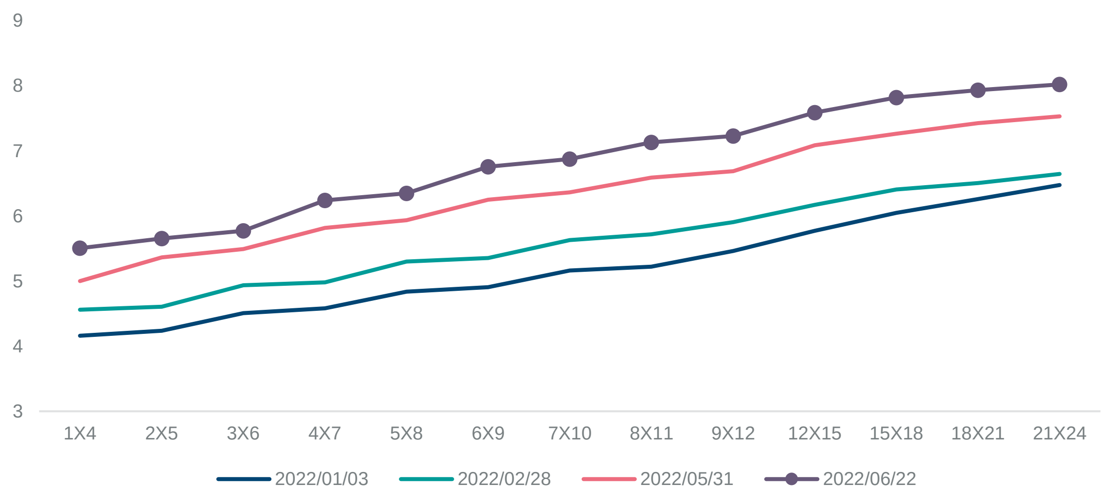
	Latest Weight	July 2021 YoY	August 2021 YoY	September 2021 YoY	October 2021 YoY	November 2021 YoY	December 2021 YoY	January YoY	February YoY	March YoY	April YoY	May YoY
Reported		4.6%	4.9%	5.0%	5.0%	5.5%	5.9%	5.7%	5.7%	5.9%	5.9%	6.5%
Calculated		4.7%	5.0%	5.0%	5.1%	5.5%	5.9%	5.7%	5.7%	6.1%	5.9%	6.6%
Housing & Utilities	22.6%	3.8%	3.8%	4.0%	4.0%	3.9%	4.3%	4.3%	4.4%	4.8%	4.8%	4.9%
Food & Non Alcoholic Beverages	19.2%	6.7%	6.9%	6.6%	6.1%	5.5%	5.5%	5.7%	6.4%	6.2%	6.0%	7.6%
Miscellaneous Goods & Services	14.8%	4.2%	4.2%	4.3%	4.3%	4.2%	4.3%	4.6%	3.2%	3.2%	3.8%	3.9%
Transport	14.7%	8.0%	9.9%	10.1%	10.9%	15.0%	16.7%	14.5%	14.3%	15.7%	14.7%	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%	6.3%	6.6%
Recreation & Culture	4.9%	1.7%	1.9%	1.6%	1.4%	1.3%	1.4%	1.9%	2.0%	1.7%	1.5%	1.9%
Household Contents & Services	4.3%	1.3%	1.3%	1.8%	1.8%	1.9%	2.1%	2.2%	2.6%	3.0%	3.3%	4.3%
Clothing & Footwear	4.0%	1.8%	2.0%	1.9%	1.9%	1.8%	1.7%	1.5%	1.6%	1.6%	1.7%	1.7%
Restaurants & Hotels	3.4%	2.3%	2.7%	3.2%	4.1%	3.7%	4.2%	5.0%	6.1%	6.7%	5.6%	6.2%
Communication	2.6%	-0.5%	-0.5%	-0.6%	-0.6%	-0.6%	-0.6%	-0.9%	-0.9%	-0.9%	-0.9%	-0.6%
Education	2.3%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.4%	4.4%	4.4%
Health	1.3%	3.6%	3.5%	3.6%	3.8%	3.8%	3.7%	3.4%	4.9%	4.9%	4.7%	4.9%

Source: Bloomberg

Current FRA rates suggest that the market is pricing in the policy rate of 6.25% by the end of this year, implying a 50bps rate hike at every monthly SARB Monetary Policy Committee meeting for the remainder of 2022. The SARB has been hiking rates in line with the Fed. Higher inflation suggests that the SARB will continue hiking rates, in tandem with the approach taken by the Fed, to bring inflation rate back within the 3–6% target range. Tighter financial conditions are not great for growth but will support the currency.

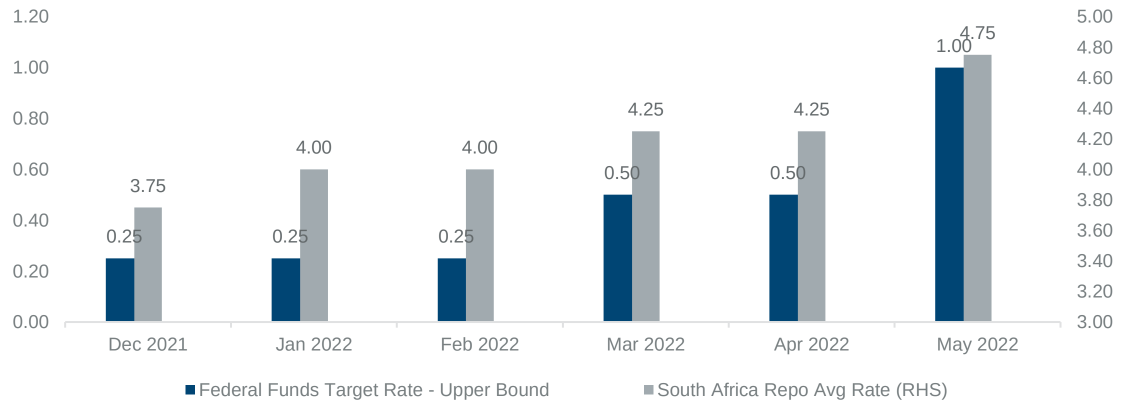
Overall, markets lacked a clear catalyst for a change in sentiment. We continue to prefer to stay neutral in SA equities given high inflationary pressures, tighter monetary policies and other idiosyncratic issues constraining domestic growth.

Figure 7: SA FRA rates



Source: Bloomberg

Figure 8: US and SARB policy rates since Jan 2022



Source: Bloomberg

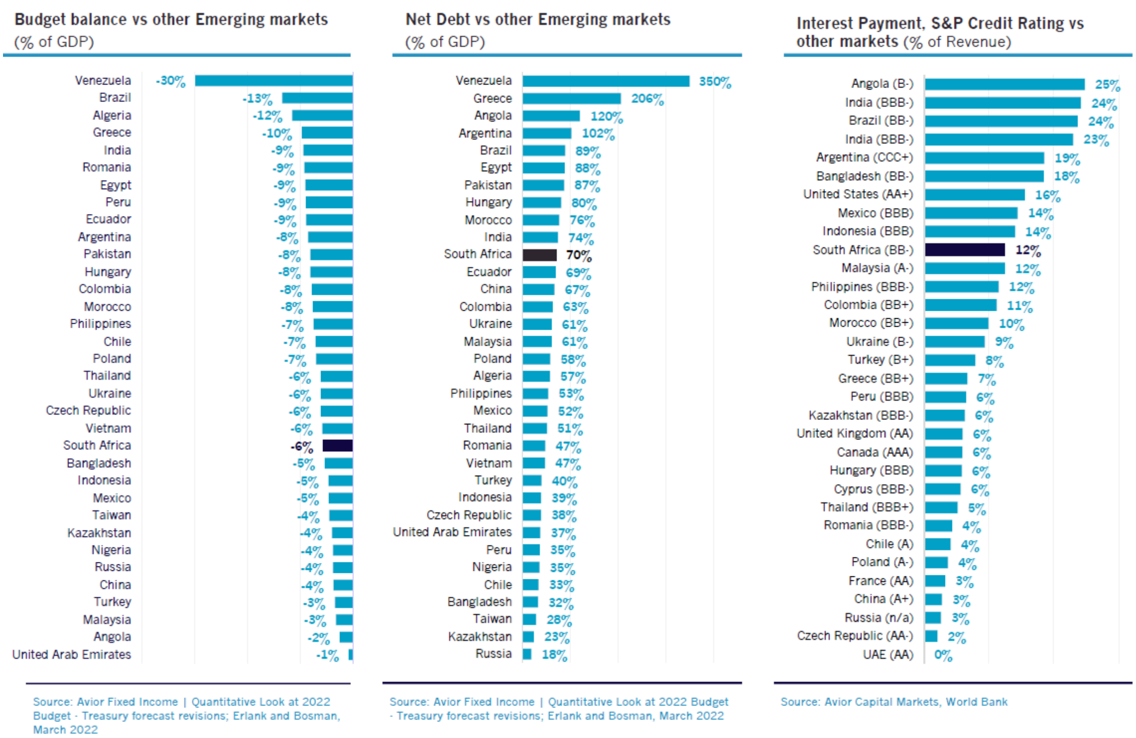
SA bonds

Despite SA bonds continuing to be attractive from an implied yield and a hedged yield perspective, while offering good value on a real-yield basis compared to other emerging-market nominal bonds as well as local inflation-linked bonds and cash, we have not seen a significant return of investors' appetite for our local nominal bonds over the past few months. Non-residents' holdings of SA government bonds steadily declined from 36.9% in February 2020 to 28.4% in May 2022. Banks, local pension funds and asset managers have been buying local government bonds. Foreign investors net sold $8.4bn of SA bonds as at 22 June, an increase from $6.9bn as at 31 May 2022. Foreign investors mainly assess emerging market debt on the basis of five factors: governance, growth, visibility of the interest rate path, the dollar story and global risk sentiment. While SA government debt scored well from a governance perspective, the visibility of the rate path and external factors seemed to dominate investors' appetite for our bonds.

On the other hand, our budget balance and debt levels have improved, and foreign debt is a small share of our total debt. In addition, rating agencies have upgraded our credit rating outlook (S&P recently upgraded SA's credit rating from stable to positive, while Moody's upgraded us from negative to stable), despite the risk of potential downgrades if the current level of intensive loadshedding is extended.

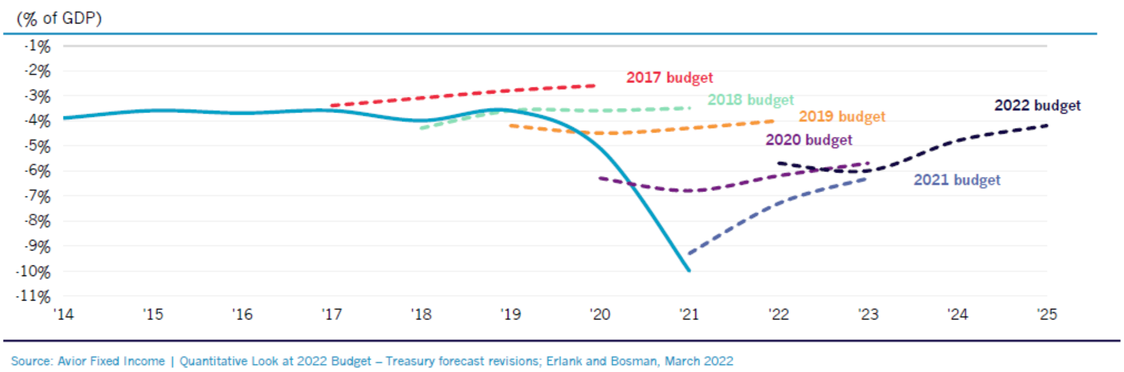
Given the stronger current account and low levels of external debt, SA should be less vulnerable to tightening of global liquidity and a stronger dollar as the Fed's rate hikes and tapering continue. With the relatively attractive valuation of our nominal bonds, together with the attractiveness of our nominal bonds over inflation-linked bonds as compensation for inflation, we therefore chose to increase our position in SA nominal bonds from neutral to moderately overweight.

Figure 9: SA fiscal conditions



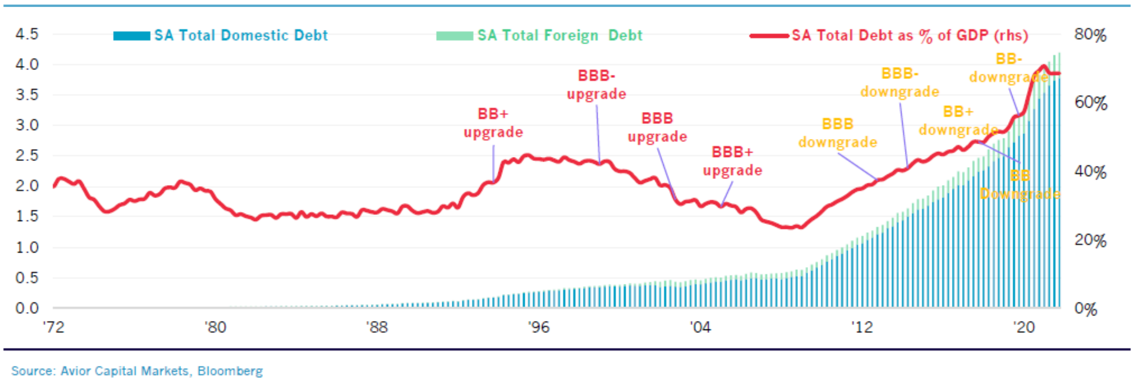
Source: Avior

Figure 10: Treasury budget balance forecasts



Source: Avior

Figure 11: SA total debt (ZAR trillion) and debt as % of GDP, S&P credit up and downgrades



Source: Avior

Figure 12: SA 10-year nominal bond real yields vs other EM peers

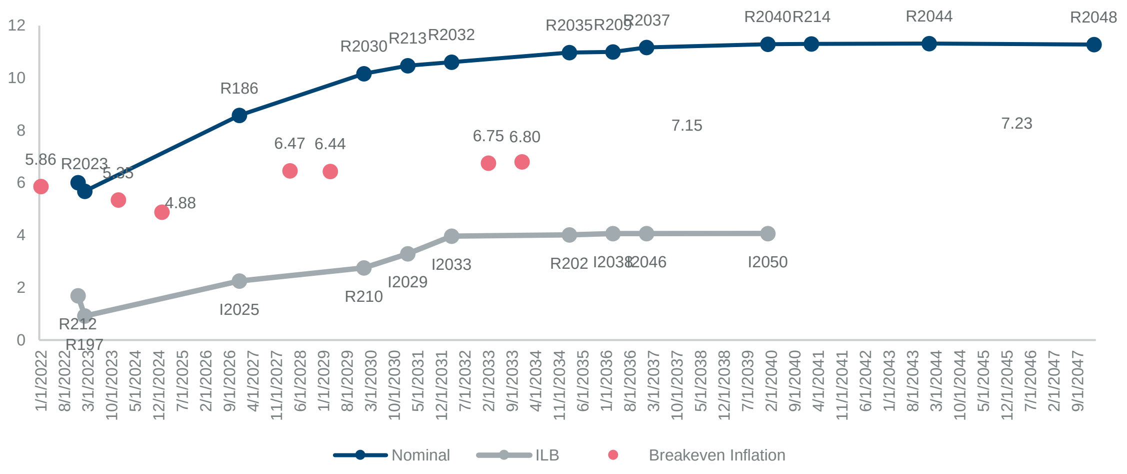
	South Africa	India	Indonesia	Russia	Mexico	Brazil	Turkey
10 Year Yield	**10.63%**	**7.48%**	**7.49%**	**15.99%**	**9.24%**	**12.82%**	**19.76%**
Inflation	6.5%	7.0%	3.55%	3.3%	7.7%	11.7%	73.5%
Inflation Expectation	6.20%	6.20%	1.60%	6.70%	5.70%	8.30%	19.60%
10 Year Real Yield	**4.13%**	**0.44%**	**3.94%**	**12.69%**	**1.59%**	**1.09%**	**-53.74%**
10 Year Real Yield based on inflation expectation	4.43%	1.28%	5.89%	9.29%	3.54%	4.52%	0.16%
Currency Risk Premium	**4.80%**	**2.84%**	**3.11%**	**12.71%**	**4.30%**	**6.71%**	**8.40%**
Sovereign Risk Premium	**3.01%**	**1.36%**	**1.11%**		**1.66%**	**2.84%**	**8.09%**
US 10 Year Yield	2.82%	3.27%	3.27%	3.27%	3.27%	3.27%	3.27%
S&P Rating - Foreign Currency	**BB-**	**BBB-u**	**BBB**	**NR**	**BBB**	**BB-**	**B+u**
Moody's Rating - Foreign Currency	Ba2	Baa3	Baa2	NR	Baa1	Ba2	B2

Source: Bloomberg

SA inflation-linked bonds

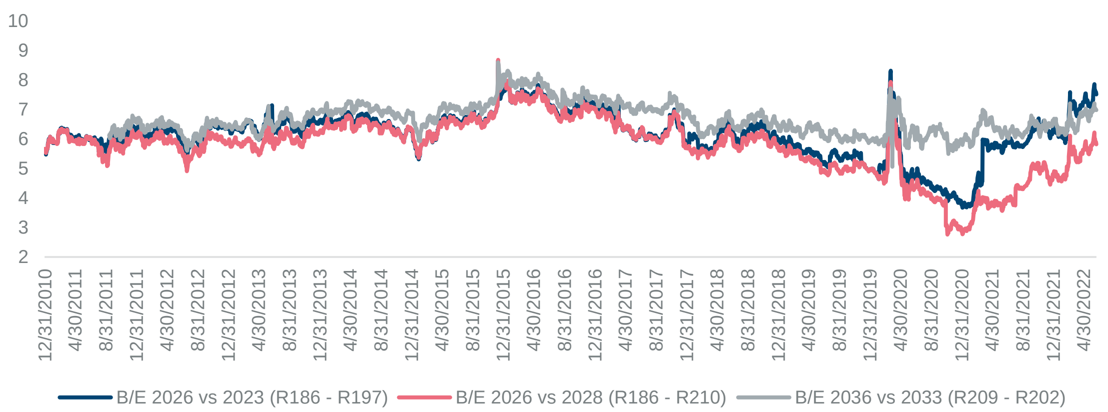
The level of core inflation indicates that underlying inflationary pressure remains. However, the level of breakeven inflation suggests that inflation-linked bonds are fully valued over the medium term and getting expensive vis-à-vis the longer maturities. The real yield of the 10-year inflation-linked bond is also trending below that of the implied yield, again suggesting the high cost of SA inflation-linked bonds. We therefore moved to reduce our position from neutral to moderate underweight in SA inflation-linked bonds as we prefer SA nominal bonds which provide better compensation for inflation.

Figure 13: SA breakeven inflation as at 22 June 2022



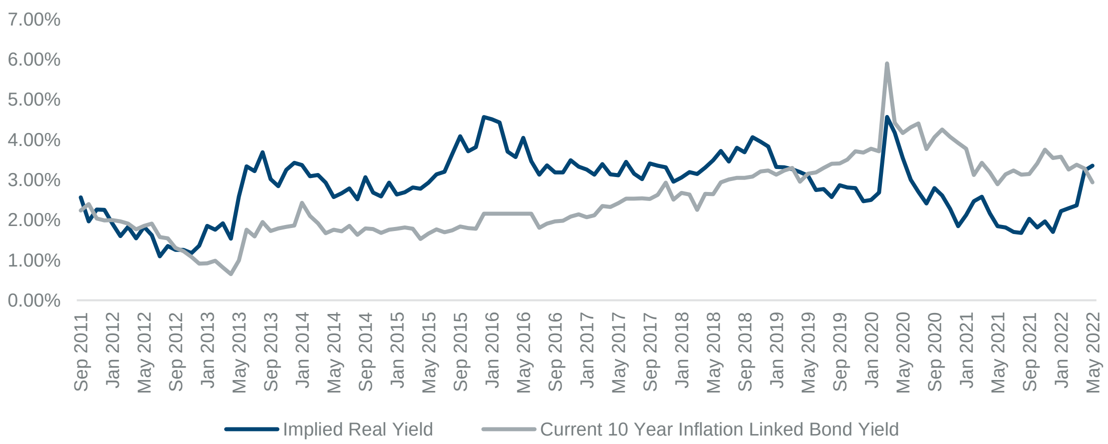
Source: Bloomberg

Figure 14: SA breakeven inflation rates over time



Source: Bloomberg

Figure 15: SA inflation-linked bonds yield and implied yield



Source: Bloomberg

SA-listed property

Our investment case for the local property market was largely unchanged. Tapering and rate hikes, which would tighten financial conditions, and rising discount rates would be negative for real estate due to the leverage inherent in this asset class – thus making it more sensitive to rate hikes than the broad equity class.

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, real estate usually performs well in an inflationary environment as rentals tend to increase with inflation. However, the inflation hedging ability is subject to supply/demand dynamics. In addition, if growth concerns are becoming a dominating factor in driving investors' sentiment, that is not good for listed properties. We therefore chose to remain moderately underweight in listed property.

Figure 16: SAPY yield spread vs ALSI

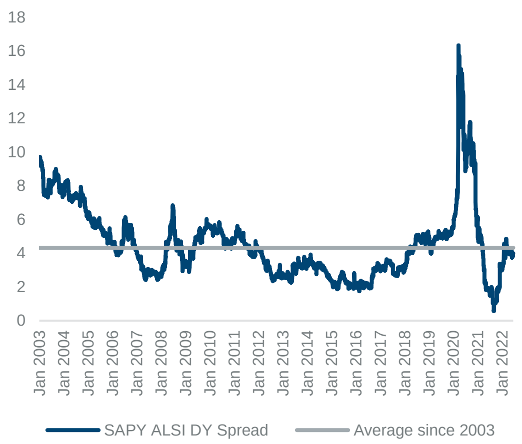
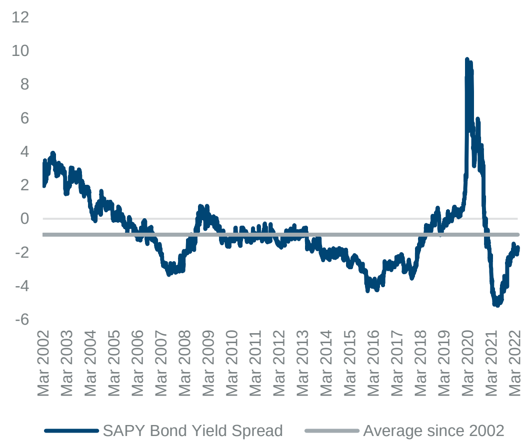


Figure 17: SAPY yield spread vs 10-year bonds



Source: Bloomberg

Offshore equities

We continue to see inflation rates breaching the upper target levels of central banks in the short term. Global manufacturing PMIs have continued to cool in most regions, but most are still above the neutral level of 50. The improved China PMI figure for May, despite still being below 50, should continue to pick up from here as the lockdown eases.

Figure 18: Global inflation rates

	Sep 2020	Oct 2020	Nov 2020	Dec 2020	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021
Global	2.8	2.6	2.3	2.1	2.1	2.2	2.6	3.1	3.6
Citi Inflation Surprise Index - Global	-3.2	-3.2	-5.4	0.0	5.3	17.7	15.7	21.6	34.8
Citi Inflation Surprise Index - Major Economies	-0.9	1.0	-2.8	6.4	10.6	26.6	19.7	25.3	43.4
Citi Inflation Surprise Index - Emerging Markets	-6.6	-9.4	-9.3	-9.5	-2.6	4.3	9.6	16.1	21.9
France	0.0	0.0	0.2	0.0	0.6	0.6	1.1	1.2	1.4
Germany	-0.2	-0.2	-0.3	-0.3	1.0	1.3	1.7	2.0	2.5
Greece	-2.0	-1.8	-2.1	-2.3	-2.0	-1.3	-1.6	-0.3	0.1
Ireland	-1.2	-1.5	-1.1	-1.0	-0.2	-0.4	0.0	1.1	1.7
Italy	-0.6	-0.3	-0.2	-0.2	0.4	0.6	0.8	1.1	1.3
Spain	-0.4	-0.8	-0.8	-0.5	0.5	0.0	1.3	2.2	2.7
Sweden	0.4	0.3	0.2	0.5	1.6	1.4	1.7	2.2	1.8
Switzerland	-0.8	-0.6	-0.7	-0.8	-0.5	-0.5	-0.2	0.3	0.6
United Kingdom	0.5	0.7	0.3	0.6	0.7	0.4	0.7	1.5	2.1
United States	1.4	1.2	1.2	1.4	1.4	1.7	2.6	4.2	5.0
Australia	0.7	0.7	0.7	0.9	0.9	0.9	1.1	1.1	1.1
Japan	0.0	-0.4	-0.9	-1.2	-0.7	-0.5	-0.4	-1.1	-0.8
Brazil	3.1	3.9	4.3	4.5	4.6	5.2	6.1	6.8	8.1
China	1.7	0.5	-0.5	0.2	-0.3	-0.2	0.4	0.9	1.3
India	7.3	7.6	6.9	4.6	4.1	5.0	5.5	4.2	6.3
Indonesia	1.4	1.4	1.6	1.7	1.6	1.4	1.4	1.4	1.7
Mexico	4.0	4.1	3.3	3.2	3.5	3.8	4.7	6.1	5.9
Russia	3.7	4.0	4.5	4.9	5.2	5.7	5.8	5.5	6.0
South Africa	3.0	3.3	3.2	3.1	3.2	2.9	3.2	4.4	5.2
South Korea	0.9	0.1	0.6	0.6	0.9	1.4	1.9	2.5	2.6
Taiwan	-0.6	-0.3	0.1	0.1	-0.2	1.4	1.2	2.1	2.5

	Jun 2021	Jul 2021	Aug 2021	Sep 2021	Oct 2021	Nov 2021	Dec 2021	Jan 2022	Feb 2022	Mar 2022	Apr 2022	May 2022
Global	4.1	4.2	4.2	4.3	4.6	5.2	5.7	6.0	6.4	7.0	8.0	8.8
Citi Inflation Surprise Index - Global	38.5	40.5	42.8	47.7	43.9	58.1	82.9	70.5	74.0	80.0	80.8	80.1
Citi Inflation Surprise Index - Major Economies	48.3	55.3	57.5	62.3	58.8	71.9	107.8	97.6	104.7	113.5	107.4	102.2
Citi Inflation Surprise Index - Emerging Markets	23.9	18.2	20.7	25.8	21.6	37.3	45.4	29.9	27.9	29.9	40.8	46.9
France	1.5	1.2	1.9	2.2	2.6	2.8	2.8	2.9	3.6	4.5	4.8	5.2
Germany	2.3	3.8	3.9	4.1	4.5	5.2	5.3	4.9	5.1	7.3	7.4	7.9
Greece	1.0	1.4	1.9	2.2	3.4	4.8	5.1	6.3	7.2	8.9	10.2	11.3
Ireland	1.6	2.2	2.8	3.7	5.1	5.3	5.5	5.0	5.6	6.7	7.0	7.8
Italy	1.3	1.9	2.0	2.5	3.0	3.7	3.9	4.8	5.7	6.5	6.0	6.8
Spain	2.7	2.9	3.3	4.0	5.4	5.5	6.5	6.1	7.6	9.8	8.3	8.7
Sweden	1.3	1.4	2.1	2.5	2.8	3.3	3.9	3.7	4.3	6.0	6.4	7.3
Switzerland	0.6	0.7	0.9	0.9	1.2	1.5	1.5	1.6	2.2	2.4	2.5	2.9
United Kingdom	2.5	2.0	3.2	3.1	4.2	5.1	5.4	5.5	6.2	7.0	9.0	9.0
United States	5.4	5.4	5.3	5.4	6.2	6.8	7.0	7.5	7.9	8.5	8.3	8.6
Australia	3.8	3.8	3.8	3.0	3.0	3.0	3.5	3.5	3.5	5.1	5.1	5.1
Japan	-0.5	-0.3	-0.4	0.2	0.1	0.6	0.8	0.5	0.9	1.2	2.5	2.5
Brazil	8.4	9.0	9.7	10.3	10.7	10.7	10.1	10.4	10.5	11.3	12.1	11.7
China	1.1	1.0	0.8	0.7	1.5	2.3	1.5	0.9	0.9	1.5	2.1	2.1
India	6.3	5.6	5.3	4.4	4.5	4.9	5.7	6.0	6.1	7.0	7.8	7.0
Indonesia	1.3	1.5	1.6	1.6	1.7	1.8	1.9	2.2	2.1	2.6	3.5	3.6
Mexico	5.9	5.8	5.6	6.0	6.2	7.4	7.4	7.1	7.3	7.5	7.7	7.7
Russia	6.5	6.5	6.7	7.4	8.1	8.4	8.4	8.7	9.2	16.7	17.8	17.1
South Africa	4.9	4.6	4.9	5.0	5.0	5.5	5.9	5.7	5.7	5.9	5.9	5.9
South Korea	2.4	2.6	2.6	2.4	3.2	3.8	3.7	3.6	3.7	4.1	4.8	5.4
Taiwan	1.8	1.9	2.3	2.6	2.6	2.9	2.6	2.8	2.3	3.3	3.4	3.4

Source: Bloomberg

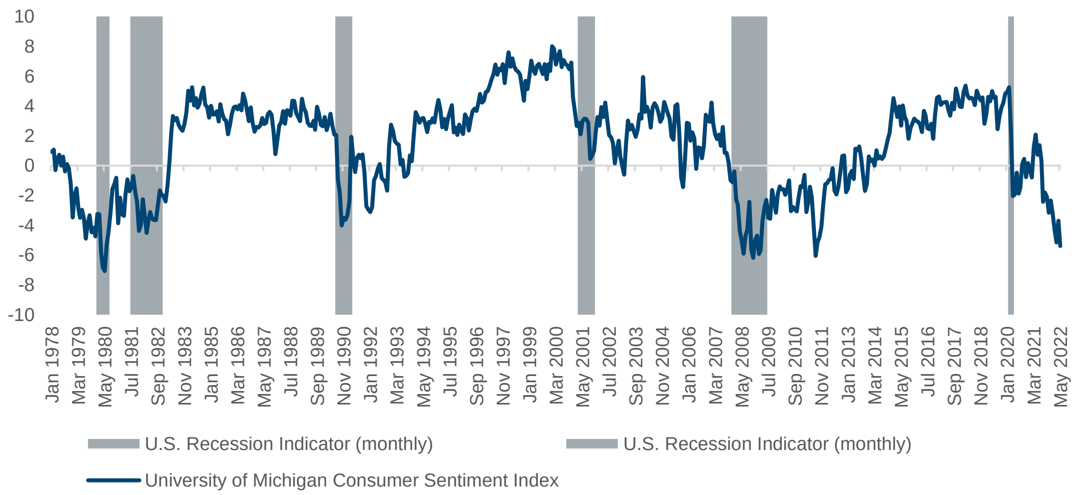
Figure 19: The Global Manufacturing PMI

	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	Apr-22	May-22
Global Manufacturing PMI	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	52.2	52.4
Developed Markets	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	56.3	55
Emerging Markets	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	48.1	49.5
Eurozone	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	55.5	54.6
France	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	55.7	54.6
Germany	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	54.6	54.8
Italy	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	54.5	51.9
Spain	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	53.3	53.8
Greece	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	54.8	53.8
Ireland	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	59.1	56.4
Australia	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	58.8	55.7
Sweden	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	55	55.2
Denmark	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	63	60.7
UK	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	55.8	54.6
US	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	59.2	57
Japan	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	53.5	53.3
China	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	46	48.1
Indonesia	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	51.9	50.8
South Korea	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	52.1	51.8
Taiwan	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	51.7	50
India	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	54.7	54.6
Brazil	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	51.8	54.2
Mexico	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	49.3	50.6
Russia	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	48.2	50.8
South Africa	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	50.7	54.8

Source: Bloomberg

US consumer confidence tanked and the University of Michigan sentiment tanked from 59.1 in April to 58.4 in May, with the forecasted number for June being 50.0. This would be the lowest level since the great financial crisis as consumers grapple with red-hot inflation and accelerated rate hikes, which could tip the US economy into recession.

Figure 20: The University of Michigan Consumer Sentiment Index



Source: Bloomberg

The US housing market continued to cool as expected, with rate hikes exacerbating affordability. However, the labour market remained tight. The US unemployment rate remained low at 3.6%, changes in payrolls slowed and jobless claims picked up marginally. Despite improving labour participation from 61.9% in December 2021 to 62.3% in May 2022, as consumer spending rotated from goods into services which tend to be more labour intensive, we expect it to remain relatively tight for the remainder of this year. The US, though, is not alone in facing this issue. We have also seen a tight labour market in the UK, with the unemployment rate increasing from 3.6% to 3.8% in April. The Eurozone unemployment rate was 6.83% in Q1 this year.

Figure 21: Unemployment rate and participation rate in the US

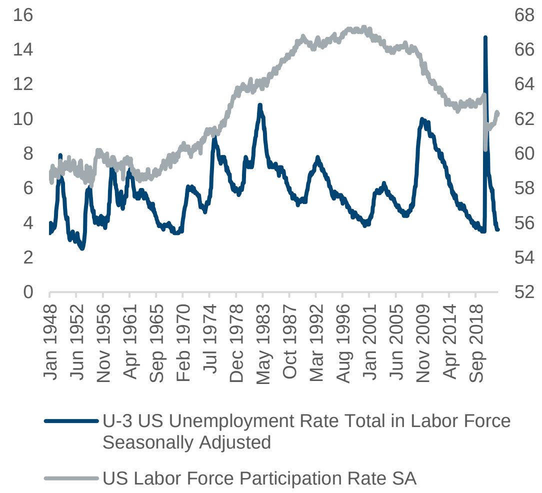
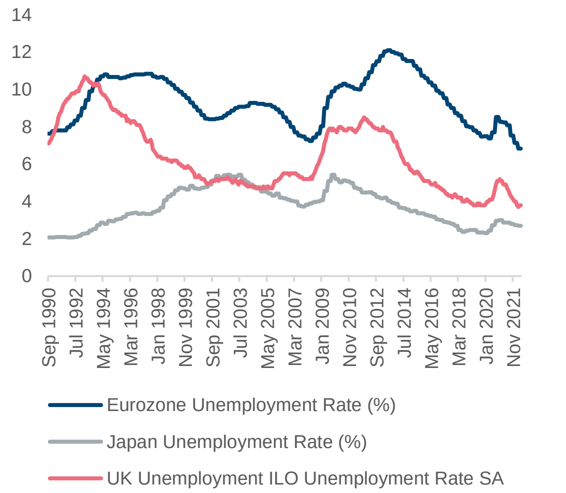


Figure 22: Unemployment rates in the Eurozone, Japan and the UK



Source: Bloomberg

While yearly nominal wage growth is roughly trending with inflation, at c.5% and c.7% in the US and UK respectively, real earnings are negative, eroding consumers' purchasing power. This has been evident in the weaker-than-expected (by the market) retail sales figures and unfavourable buying conditions. However, household wealth in the developed countries has grown during the pandemic period due to sizable unemployment benefits and house and asset price appreciations, which should provide a cushion against inflation's erosive effects. Yet higher input prices and a larger salary bill will exert downward pressure on corporate margins, especially those that lack the pricing power to pass on some of the costs to customers. Low consumer sentiment and weak retail sales will also hurt consumers' discretionary bottom lines as essential goods and services constitute a greater share of the overall consumption basket amid elevated inflation.

Figure 23: US real wage growth

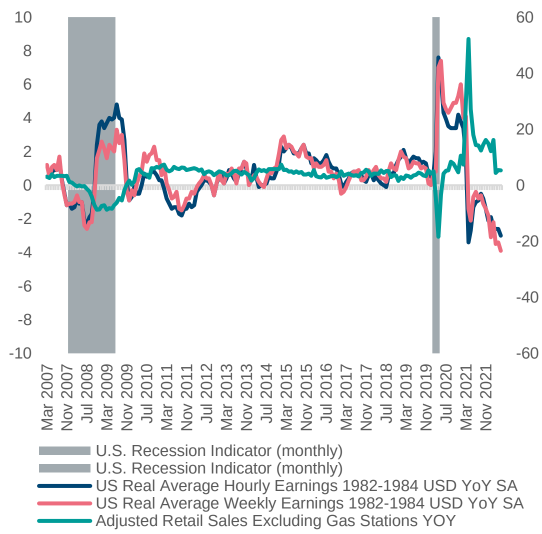
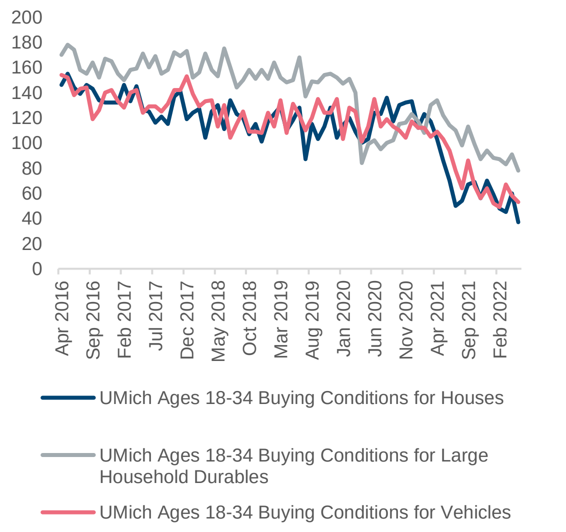


Figure 24: University of Michigan Buying Conditions indices



Source: Bloomberg

We continue to foresee an upsurge in China as we expect more fiscal and monetary stimulus to support economic recovery amid moderate levels of inflation and some signs of potential easing of regulations in the technology sector. The US will also be in a less vulnerable position, being the largest food exporter and having less of an energy burden, while the Eurozone faces no peripheral debt issues.

The bottom line is: recession or no recession, global growth is compromised. Central banks were expected to tighten up at some point as economies are on a strong enough footing as they emerge from COVID. Supply issues will be resolved as broken supply chains are rebuilt and underinvestment is reversed. But geopolitical issues, which induced the commodity price shock, has complicated the entire process. Central banks need to hike rates more aggressively, further reducing aggregate demand to offset the supply-induced cost–push inflation and to prevent the entrenchment of current levels of inflation, while limiting the secondary effect of a self-reinforcing wage price spiral. The US Business Leaders Surveys show that prices will remain elevated for the second half of this year. However, with each additional rate hike, there is a higher probability of central banks overtightening (as monetary policies take time to take effect in the underlying economies) and a higher probability of economies being tipped into recession.

Figure 25: US Business Leaders Survey future conditions

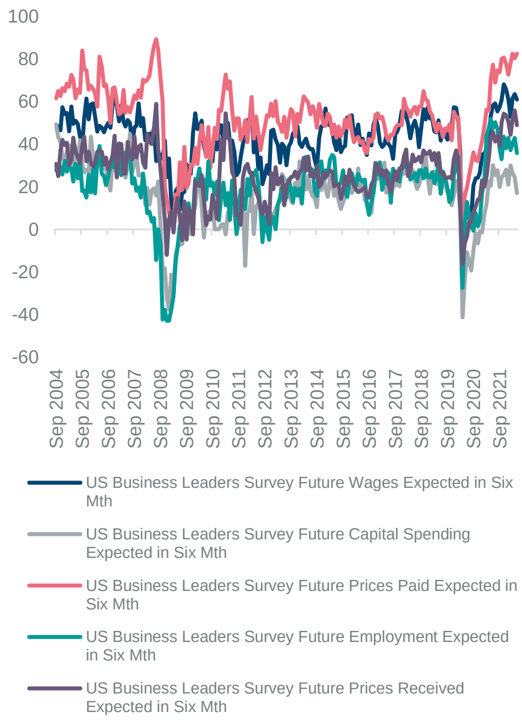
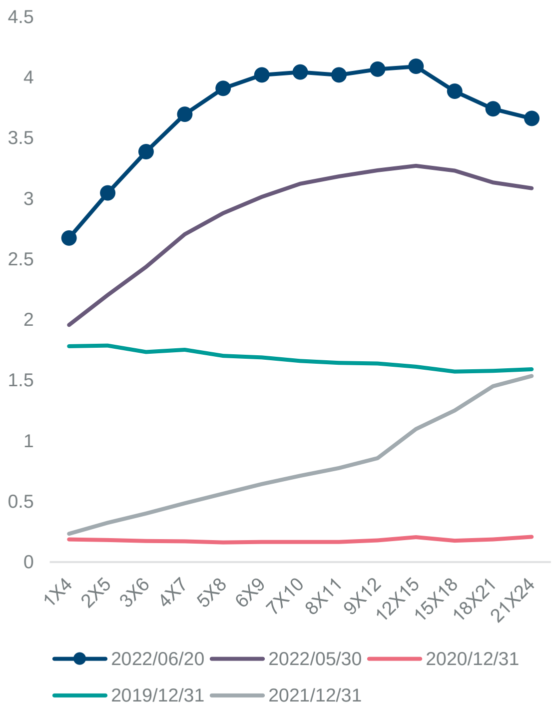


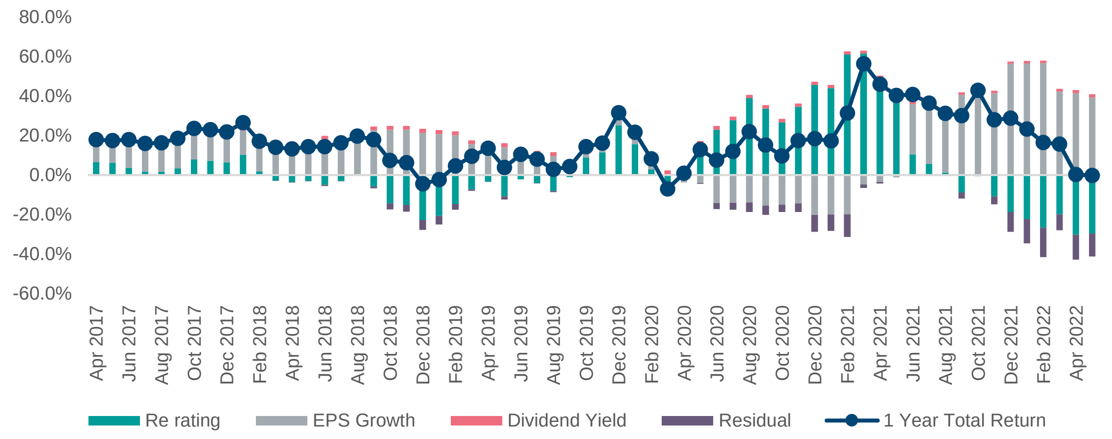
Figure 26: US FRA rates



Source: Bloomberg

We have also seen that the hit to US equities over the past several months was mostly due to yields rising, leading to re-rating rather than earnings falling. Therefore, should the earnings outlook materially weaken, that would be discounted too.

Figure 27: S&P 500 return decomposition



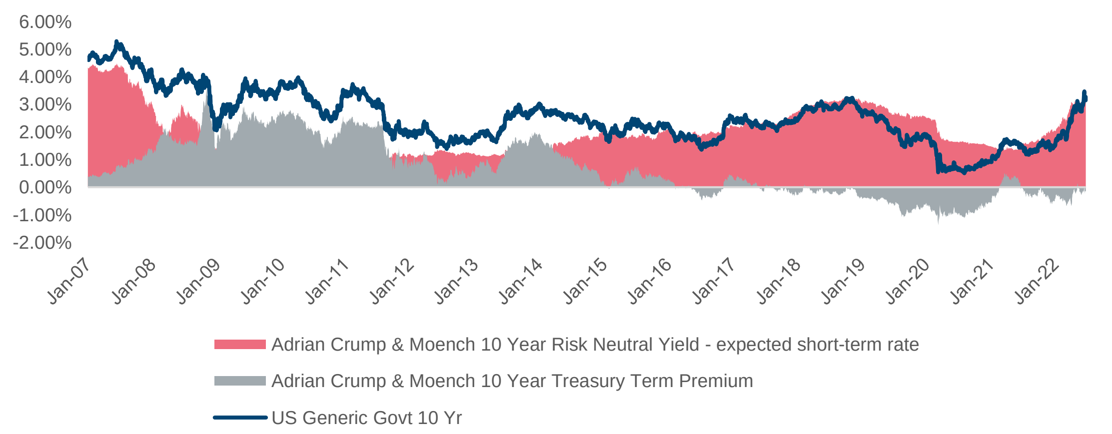
Source: Bloomberg

We choose to remain neutral in offshore equities on the balance of improving valuations, the deteriorating global growth outlook and the elevated risk of central banks overtightening their monetary policies to tame inflation, resulting in the catalyst for a rebound following the 1H equity market selloff not being meaningfully visible. At the same time, the level of policy uncertainty remains high as central banks' decisions are data driven. Should there be inflation surprises on the downside, the pace of rate hikes will normalise.

Offshore bonds

We have moved from moderate underweight to neutral in offshore bonds. The US 10-year bond yield disaggregation indicates that most of the surge in yields was driven by higher-than-expected short-term rates. Meanwhile, yields have surged and may move higher as investors demand a higher-term premium for holding longer maturity bonds. We do expect some diversifying benefits from bonds as, according to Bridgewater and Schroders' research, higher inflationary regimes have typically been associated with positive equity-bond correlations. However, equities and nominal bonds have opposite biases to growth (i.e., when growth is the dominant driver, they tend to be negatively correlated). Given the weakening growth outlook, we therefore choose to be neutral in offshore bonds, so that the portfolio is balanced to growth and inflation.

Figure 28: US 10-year bond yield disaggregation



Source: Bloomberg

Offshore property

The valuation of global property remains neutral from a dividend yield spread perspective and expensive vs the 10-year treasury bonds. This sector remains more sensitive to rate hikes than equities in general, despite the sector's inflation-hedging properties. We therefore choose to remain moderately underweight.

Figure 29: S&P Global Property dividend yield spread relative to the MSCI World dividend yield

Source: Bloomberg

Figure 30: S&P Global Property dividend yield spread relative to the US 10-year treasury yield

Source: Bloomberg

MENTENOVA

CONTACT

YANNI YANG, CFA®, FRM, CAIA
C +27 84 802 3784 **T** +27 11 447 7716
F 086 272 1177 **E** yyang@mentenova.co.za

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