MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

20 October 2022

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We have decided to keep our tactical asset allocation unchanged for November, 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 across most asset classes. We have chosen to remain moderately overweight in SA nominal bonds and moderately underweight in inflation-linked bonds due to their distance from their respective implied yields as well as the differential they offer as inflation compensation. Owing to the leverage inherent in listed property, making this asset class more sensitive to rate hikes than the broader equities, we have remained moderately underweight in local and offshore listed properties in an environment where central banks have given their singular attention to taming inflation. Given the slowing growth, entrenched inflation and higher finance costs, which are posing risks to corporate earnings, we have maintained our moderately underweight position in offshore equities. Local equities are facing increasing downside risks, with the prolonged, severe power crisis limiting output and weighing on consumer and business sentiment. However, given more favourable valuations, we have chosen to remain neutral in local equities. The valuation of offshore bonds is looking more attractive. However, this does not yet warrant a moderate overweight position, as investors may demand a higher-term premium since the recent yield surge was driven by short-term rates. We have therefore chosen to remain neutral with an overweight position in offshore cash, as we expect the dollar to remain strong in the face of ongoing interest rate hikes and elevated macro volatility.

TAA Overview

Market overview	Most asset classes ended in the red in Q3 due to a sharp selloff in the second half of the quarter. This was as the Fed and other central banks reiterated that their focus was on reining in inflation rather than supporting growth, thus reversing the gains from the strong July rally. Markets calmed somewhat in the first half of October. The FTSE/JSE ALSI Index was up by 1.2%. The S&P 500 and the MSCI World Index were up by 2.4% and 1.4% respectively. The MSCI Emerging Markets Index continued to lag, with a drop of 2.4%, as the Chinese economy remains fragile in the face of the country's zero-COVID policy. The MSCI World Value Index was up by 2.6% for the month to date, outperforming the MSCI World Growth Index which was roughly flat over the same period. The ALBI and the IGOV both outperformed the global fixed-income sectors for the month to date in local currencies. Similarly, local property also outperformed the MSCI US REIT Index, the S&P Global Property Index and the European property sector into October. The crude oil price was up by 7.5% for the first half of October, with aluminium prices rising sharply

by 9.1% over the same period due to the deepening energy crisis which is squeezing supplies of aluminium (the production of which is very energy intensive). The US dollar was roughly flat against other major currencies for the first half of October, after posting a 3.1% gain last month, with the ZAR depreciating by another 1.0% against the US dollar into Q4, offering little reprieve after weakening by 11.1% in Q3.

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

30 September 2022 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 13 October 2022
FTSE/JSE ALSI Total Return	-4.1%	-1.9%	-10.1%	3.5%	9.2%	6.5%	9.5%	1.2%
FTSE/JSE Capped SWIX Total Return	-3.8%	-2.4%	-7.0%	1.1%	7.8%	4.2%	8.1%	1.3%
S&P 500 Total Return	-9.2%	-4.9%	-23.9%	-15.5%	8.2%	9.2%	11.7%	2.4%
STOXX 600 Total Return	-6.5%	-4.3%	-18.6%	-12.5%	1.9%	2.5%	6.5%	0.4%
Nikkei 225 Total Return	-6.9%	-0.8%	-8.1%	-10.0%	8.1%	7.1%	13.4%	1.2%
MSCI World Total Return	-9.3%	-6.1%	-25.1%	-19.2%	5.1%	5.8%	8.7%	1.4%
MSCI ACWI Total Return	-9.5%	-6.7%	-25.3%	-20.3%	4.2%	5.0%	7.8%	1.0%
MSCI EM Total Return	-11.7%	-11.4%	-26.9%	-27.8%	-1.7%	-1.4%	1.4%	-2.4%
MSCI World Value Index	-8.4%	-7.1%	-18.0%	-12.0%	2.6%	3.0%	7.0%	2.6%
MSCI World Growth Index	-10.1%	-5.0%	-32.3%	-26.7%	6.6%	8.1%	10.1%	0.1%
MSCI World Small Cap Index	-10.2%	-5.2%	-26.4%	-24.7%	3.1%	2.9%	8.0%	1.9%
FTSE UK Series FTSE All Share TR	-5.9%	-3.4%	-7.9%	-4.0%	0.8%	2.2%	6.0%	-0.7%
MSCI AC Asia Ex. Japan Index	-12.8%	-13.7%	-27.7%	-28.5%	-1.1%	-0.9%	3.3%	-3.5%
MSCI Europe Excluding United Kingdom Index	-6.2%	-3.8%	-20.1%	-13.9%	2.7%	3.3%	7.9%	0.2%
STEFI	0.5%	1.3%	3.6%	4.6%	4.9%	5.8%	6.1%	0.2%
ALBI	-2.1%	0.6%	-1.3%	1.5%	5.7%	7.1%	6.7%	0.4%
IGOV	-2.3%	-1.2%	2.0%	7.3%	6.7%	4.9%	5.3%	0.2%
WGBI	-5.1%	-7.6%	-21.3%	-22.1%	-7.0%	-3.1%	-1.8%	-1.7%
Bloomberg Global Inflation-Linked Total Return Index	-8.2%	-10.0%	-26.0%	-24.0%	-5.0%	-1.8%	-0.2%	-5.8%
Bloomberg US Agg Total Return	-4.3%	-4.8%	-14.6%	-14.6%	-3.3%	-0.3%	0.9%	-1.0%
Bloomberg EuroAgg Total Return Index	-3.7%	-4.6%	-16.2%	-16.6%	-6.1%	-1.9%	1.0%	-1.3%
Bloomberg Global Agg Corporate Total Return Index	-5.5%	-6.5%	-21.0%	-21.3%	-4.8%	-1.6%	0.5%	-1.3%
Bloomberg US Corporate High Yield Total Return Index	-4.0%	-0.6%	-14.7%	-14.1%	-0.5%	1.6%	3.9%	0.2%
Bloomberg Pan-European High Yield Total Return Index	-4.3%	-0.9%	-15.1%	-15.1%	-2.7%	-0.4%	3.6%	-0.7%
J.P. Morgan EMBI Global Core Hedged EUR	-7.1%	-5.6%	-26.2%	-26.6%	-9.0%	-4.9%	-0.7%	-1.7%
SAPY Total Return	-6.3%	-3.5%	-15.8%	-8.7%	-8.7%	-9.0%	1.2%	3.8%
MSCI US REIT Total Return	-12.1%	-10.0%	-28.3%	-16.6%	-2.0%	2.9%	6.2%	-1.6%
S&P Global Property Total Return	-12.5%	-11.6%	-28.7%	-22.7%	-5.7%	-0.8%	3.6%	-2.5%
STOXX 600 Real Estate Total Return	-17.6%	-17.2%	-42.0%	-36.9%	-12.4%	-5.5%	2.2%	-7.1%
FTSE EPRA Nareit Global REITs TR Index	-12.3%	-10.8%	-28.6%	-19.7%	-5.0%	0.7%	4.2%	-2.3%
Crude Oil	-8.8%	-23.4%	13.1%	12.0%	13.1%	8.9%	-2.4%	7.5%
Aluminium	-8.4%	-11.6%	-23.0%	-24.4%	7.9%	0.6%	0.2%	9.1%
Copper	-3.1%	-8.5%	-22.2%	-15.4%	9.7%	3.1%	-0.8%	0.2%
Gold	-2.9%	-8.1%	-9.2%	-5.5%	4.1%	5.3%	-0.6%	0.3%
Platinum	1.8%	-3.6%	-10.8%	-10.7%	-0.7%	-1.1%	-6.3%	4.5%
Nickel	-1.5%	-7.2%	0.7%	17.1%	6.9%	15.0%	1.3%	0.0%
Palladium	3.7%	11.7%	13.7%	13.2%	8.9%	18.3%	13.0%	-2.3%
Iron Ore	0.4%	-17.3%	-16.2%	-20.6%	0.9%	8.5%	-1.0%	-0.7%
Bloomberg Commodity Index Total Return	-8.1%	-4.1%	13.6%	11.8%	13.5%	7.0%	-2.1%	4.2%
USDZAR	5.6%	11.1%	13.5%	20.0%	6.1%	5.9%	8.1%	1.0%
GBPZAR	1.6%	1.9%	-6.4%	-0.5%	2.8%	2.2%	4.2%	2.4%
EURZAR	3.1%	3.9%	-2.2%	1.6%	2.4%	2.1%	5.2%	0.7%
JPYZAR	1.5%	4.2%	-9.7%	-7.7%	-3.7%	0.7%	1.6%	-0.7%
Dollar Index Spot	3.1%	7.1%	17.2%	19.0%	4.1%	3.8%	3.4%	0.2%

Source: Bloomberg

Tactical views

Global growth continued to slow, with global inflationary pressures moderating to some extent

Economic data released over the third quarter continued to suggest a slowdown in global growth, evident from the declining PMI numbers which have broadly entered contractionary territory. Global inflation moderated on the back of lower oil and food prices in Q3, but remained largely red hot, significantly above the target ranges of central banks in most countries.

The Global Supply Chain Pressure Index continued to ease in September, approaching its pre-COVID level. This should provide some relief in terms of goods inflation which was exacerbated by supply bottlenecks. However, commodities disinflation was countered by services inflation, as there was a lag in the transmission of commodity price shocks to service prices. In addition, services components inflation suggests that underlying inflationary pressures are likely to remain entrenched for the remainder of this year.

Figure 3: Global composite PMI indices

	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	Apr 2022	May 2022	Jun 2022	Jul 2022	Aug 2022	Sep 2022
Global Composite PMI	52.5	53.4	53.1	52.7	52.3	53.2	54.8	56.7	58.5	56.6	55.8	52.5	53	54.5	54.8	54.3	51.4	53.4	52.7	51	51.3	53.5	50.8	49.3	49.7
Global Services PMI	52	52.9	52.2	51.8	51.6	52.8	54.7	57	59.5	57.5	56.3	52.8	53.4	55.6	55.6	54.6	51.3	53.9	53.4	51.9	51.9	53.9	51.1	49.2	50
Developed Markets	51.9	52.7	52.2	52	52.4	53.9	55.9	58.2	61.2	59.3	57.5	54.1	53.8	55.2	55.8	54.8	51.3	54.7	56	55.5	53.7	52.5	49	46.9	49.3
Emerging Markets	53.7	54.6	54.9	54.1	52.1	52	52.6	53.5	52.7	50.8	52	49.3	52.3	52.8	52.5	53.3	50.8	51.3	46.8	43.4	46.9	55.2	54	53.4	50.1
Eurozone	50.4	50	45.3	49.1	47.8	48.8	53.2	53.8	57.1	59.5	60.2	59	56.2	54.2	55.4	53.3	52.3	55.5	54.9	55.8	54.8	52	49.9	48.9	48.1
France	48.5	47.5	40.6	49.5	47.7	47	50	51.6	57	57.4	56.6	55.9	55.3	54.7	56.1	55.8	52.7	55.5	56.3	57.6	57	52.5	51.7	50.4	51.2
Germany	54.7	55	51.7	52	50.8	51.1	57.3	55.8	56.2	60.1	62.4	60	55.5	52	52.2	49.9	53.8	55.6	55.1	54.3	53.7	51.3	48.1	46.9	45.7
Italy	50.4	49.2	42.7	43	47.2	51.4	51.9	51.2	55.7	58.3	58.6	59.1	56.6	54.2	57.6	54.7	50.1	53.6	52.1	54.5	52.4	51.3	47.7	49.6	47.6
Spain	44.3	44.1	41.7	48.7	43.2	45.1	50.1	55.2	59.2	62.4	61.2	60.6	57	56.2	58.3	55.4	47.9	56.5	53.1	55.7	55.7	53.6	52.7	50.5	48.4
Ireland	46.9	49	47.7	53.4	40.3	42.7	54.5	58.1	63.5	63.4	65	62.6	61.5	62.5	59.3	56.5	56.5	59.1	61	59.6	57.5	52.8	52.9	51	52.2
Australia	51.1	53.5	54.9	56.6	55.9	53.7	55.5	58.9	58	56.7	45.2	43.3	46	52.1	55.7	54.9	46.7	56.6	55.1	55.9	52.9	52.6	51.1	50.2	50.9
Sweden	55.5	56.5	59.2	59.6	61	62.4	62.8	67.1	70.1	67.2	67.8	63.7	68.2	67	67.1	65.8	66.9	65.3	63.1	64.4	64.2	60.3	57.2	56.9	53.5
UK	56.5	52.1	49	50.4	41.2	49.6	56.4	60.7	62.9	62.2	59.2	54.8	54.9	57.8	57.6	53.6	54.2	59.9	60.9	58.2	53.1	53.7	52.1	49.6	49.1
US	54.3	56.3	58.6	55.3	58.7	59.5	59.7	63.5	68.7	63.7	59.9	55.4	55	57.6	57.2	57	51.1	55.9	57.7	56	53.6	52.3	47.7	44.6	49.5
Japan	46.6	48	48.1	48.5	47.1	48.2	49.9	51	48.8	48.9	48.8	45.5	47.9	50.7	53.3	52.5	49.9	45.8	50.3	51.1	52.3	53	50.2	49.4	51
China	54.5	55.7	57.5	55.8	52.2	51.7	53.1	54.7	53.8	50.6	53.1	47.2	51.4	51.5	51.2	53	50.1	50.1	43.9	37.2	42.2	55.3	54	53	48.5
India	54.6	58	56.3	54.9	55.8	57.3	56	55.4	48.1	43.1	49.2	55.4	55.3	58.7	59.2	56.4	53	53.5	54.3	57.6	58.3	58.2	56.6	58.2	55.1
Brazil	53.6	55.9	53.8	53.5	48.9	49.6	45.1	44.5	49.2	54.6	55.2	54.6	54.7	53.4	52	52	50.9	53.5	56.6	58.5	58	59.4	55.3	53.2	51.9
Russia	53.7	47.1	47.8	48.3	52.3	52.6	54.6	54	56.2	55	51.7	48.2	50.5	49.5	48.4	50.2	50.3	50.8	37.7	44.4	48.2	50.4	52.2	50.4	51.5

Source: Bloomberg

Figure 4: Global manufacturing PMI indices

	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	Apr 2022	May 2022	Jun 2022	Jul 2022	Aug 2022	Sep 2022
Global Manufacturing PMI	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	52.3	52.2	51.1	50.3	49.8
Developed Markets	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	52.5	51.3	50.3	50.1
Emerging Markets	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	51.7	50.8	50.2	49.4
Eurozone	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	52.1	49.8	49.6	48.4
France	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	51.4	49.5	50.6	47.7
Germany	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	52	49.3	49.1	47.8
Italy	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	50.9	48.5	48	48.3
Spain	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	52.6	48.7	49.9	49
Greece	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	51.1	49.1	48.8	49.7
Ireland	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	53.1	51.8	51.1	51.5
Australia	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	56.2	55.7	53.8	53.5
Sweden	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	54.9	53.7	53.1	50.6	49.2
Denmark	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	61.2	71.3	38	48	49.8
UK	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	52.8	52.1	47.3	48.4
US	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	52.7	52.2	51.5	52
Japan	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	52.7	52.1	51.5	50.8
China	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	51.7	50.4	49.5	48.1
Indonesia	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	50.2	51.3	51.7	53.7
South Korea	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	51.3	49.8	47.6	47.3
Taiwan	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	49.8	44.6	42.7	42.2
India	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	53.9	56.4	56.2	55.1
Brazil	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	54.1	54	51.9	51.1
Mexico	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	52.2	48.5	48.5	50.3
Russia	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	50.9	50.3	51.7	52
South Africa	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	52.2	47.6	52.1	48.2

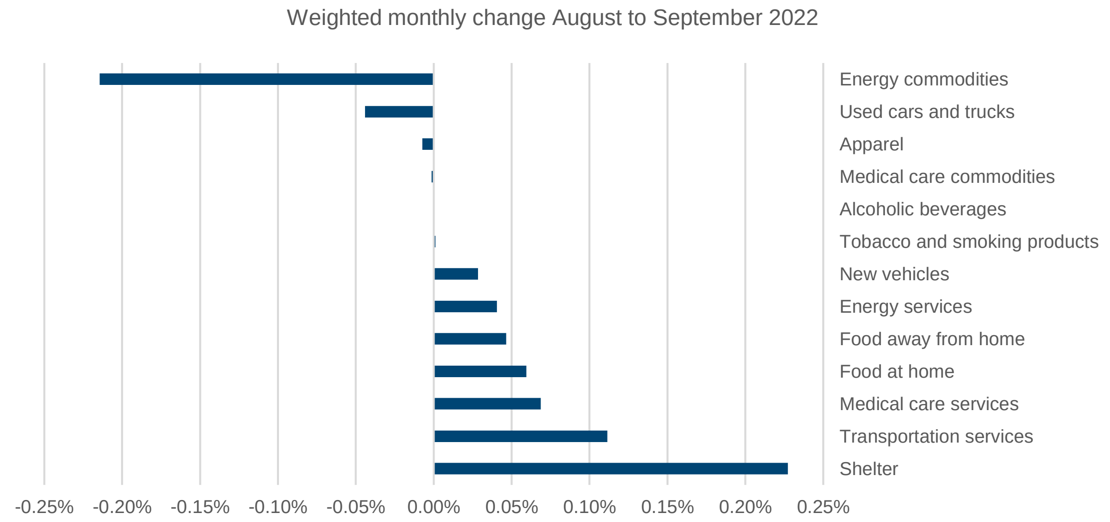
Source: Bloomberg

Figure 5: Global inflation

	Sep 2021	Oct 2021	Nov 2021	Dec 2021	Jan 2022	Feb 2022	Mar 2022	Apr 2022	May 2022	Jun 2022	Jul 2022	Aug 2022	Sep 2022
Global	4.3	4.6	5.2	5.7	6.0	6.4	7.0	8.0	8.8	9.1	9.7	9.8	10.0
Citi Inflation Surprise Index - Global	47.7	43.9	58.1	82.9	70.5	74.0	80.0	80.8	80.1	68.9	63.1	47.8	42.1
Citi Inflation Surprise Index - Major Economies	62.3	58.8	71.9	107.8	97.6	104.7	113.5	107.4	102.2	89.4	82.2	64.6	63.7
Citi Inflation Surprise Index - Emerging Markets	25.8	21.6	37.3	45.4	29.9	27.9	29.9	40.8	46.9	38.1	34.3	22.6	9.7
France	2.2	2.6	2.8	2.8	2.9	3.6	4.5	4.8	5.2	5.8	6.1	5.9	5.6
Germany	4.1	4.5	5.2	5.3	4.9	5.1	7.3	7.4	7.9	7.6	7.5	7.9	10.0
Greece	2.2	3.4	4.8	5.1	6.3	7.2	8.9	10.2	11.3	12.1	11.6	11.4	12.0
Ireland	3.7	5.1	5.3	5.5	5.0	5.6	6.7	7.0	7.8	9.1	9.1	8.7	8.2
Italy	2.5	3.0	3.7	3.9	4.8	5.7	6.5	6.0	6.8	8.0	7.9	8.4	8.9
Spain	4.0	5.4	5.5	6.5	6.1	7.6	9.8	8.3	8.7	10.2	10.8	10.5	8.9
Sweden	2.5	2.8	3.3	3.9	3.7	4.3	6.0	6.4	7.3	8.7	8.5	9.8	10.8
Switzerland	0.9	1.2	1.5	1.5	1.6	2.2	2.4	2.5	2.9	3.4	3.4	3.5	3.3
United Kingdom	3.1	4.2	5.1	5.4	5.5	6.2	7.0	9.0	9.1	9.4	10.1	9.9	9.9
United States	5.4	6.2	6.8	7.0	7.5	7.9	8.5	8.3	8.6	9.1	8.5	8.3	8.2
Australia	3.0	3.0	3.0	3.5	3.5	3.5	5.1	5.1	5.1	6.1	6.1	6.1	6.1
Japan	0.2	0.1	0.6	0.8	0.5	0.9	1.2	2.5	2.5	2.4	2.6	3.0	3.0
Brazil	10.3	10.7	10.7	10.1	10.4	10.5	11.3	12.1	11.7	11.9	10.1	8.7	7.2
China	0.7	1.5	2.3	1.5	0.9	0.9	1.5	2.1	2.1	2.5	2.7	2.5	2.8
India	4.4	4.5	4.9	5.7	6.0	6.1	7.0	7.8	7.0	7.0	6.7	7.0	7.4
Indonesia	1.6	1.7	1.8	1.9	2.2	2.1	2.6	3.5	3.6	4.4	4.9	4.7	6.0
Mexico	6.0	6.2	7.4	7.4	7.1	7.3	7.5	7.7	7.7	8.0	8.2	8.7	8.7
Russia	7.4	8.1	8.4	8.4	8.7	9.2	16.7	17.8	17.1	15.9	15.1	14.3	13.7
South Africa	5.0	5.0	5.5	5.9	5.7	5.7	5.9	5.9	6.5	7.4	7.8	7.6	7.6
South Korea	2.4	3.2	3.8	3.7	3.6	3.7	4.1	4.8	5.4	6.0	6.3	5.7	5.6
Taiwan	2.6	2.6	2.9	2.6	2.8	2.3	3.3	3.4	3.4	3.6	3.4	2.7	2.8

Source: Bloomberg

Figure 6: US monthly CPI changes

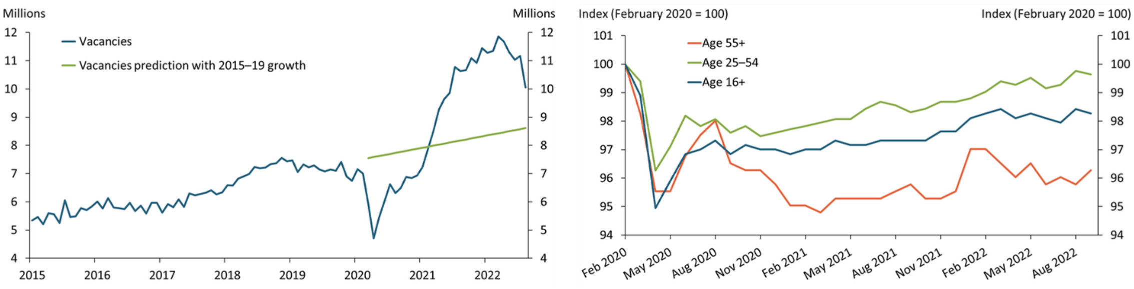


Source: Bloomberg

The labour market remains very tight in developed economies while the housing market softens

The labour market remains resilient in most developed economies. The US unemployment rate decreased from 3.7% in August to 3.5% in September. The Eurozone unemployment rate remained unchanged at 6.6% in August. The unemployment rate in Japan also decreased from 2.6% in July to 2.5% in August. In the US, there are some nascent signs of the initial jobless claims trending slightly higher, while the change in non-farm payrolls has also slowed from 315k in August to 263k in September, which is still better than the market expectation of 255k. The number of job openings in the US declined from 11.9m in March 2022 to 10.1m in August 2022 but remains elevated compared to pre-pandemic levels and trends. At the same time, labour force participation in the US remains below the pre-pandemic level, with possible contributing factors being health issues and changing lifestyles, but the situation is compounded by an aging workforce. The data suggests that with the labour supply being below pre-Covid levels, the Fed will have to continue taking interest rates to restrictive levels in order to contain the demand for labour.

Figure 7: US job openings and participation rates



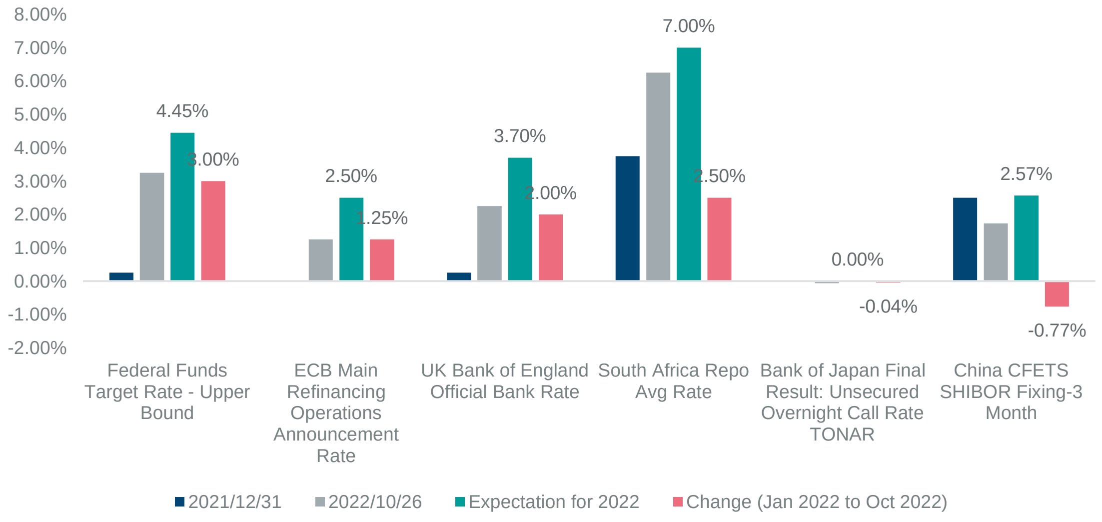
Source: US Bureau of Labor Statistics and Federal Reserve Bank of Kansas City

The US housing market continued to cool, with mortgage applications showing persistently negative growth. There was a pick-up in new home sales and housing starts in August. However, overall, the affordability of housing has been compromised by house price escalations since the onset of the pandemic, rising construction costs and accelerated rate hikes. Companies' adoption of more flexible modes of working is alleviating some of the pressure, as consumers can look at neighbourhoods and areas that are further away from the city centres. We do not yet see any risk of a significant financial crisis stemming from the US housing market, as the overall delinquency rate remains stable, there is a strong rental market, and the credit profile of the mortgage book was very different from that in the 2007–2008 period.

Recession looms with its magnitude dependent on the effectiveness of central bank measures

Central banks have been singularly focused on fighting inflation. So far this year, the Fed, the ECB, the BOE and the SARB have hiked rates by 3.0%, 1.25%, 2.0% and 2.5% respectively. Moreover, markets expect further rate hikes from their current levels to 4.45%, 2.5%, 3.7% and 7.0% by year end. Economic data released in Q3 already indicates a deceleration in the global economy. We have seen consumer confidence tank and remain depressed across most regions due to elevated inflation, accelerated rate hikes and heightened levels of economic uncertainty. Recent retail sales in South Africa and the US fell short of market expectations, but retail sales were strong in Japan as the economy continued its post-pandemic recovery. The energy crisis has also had a profound impact on consumers and businesses in the Eurozone. Germany manufacturing and services PMI declined from 48.3 and 45.4 to 47.8 and 45 in September respectively. German factory orders were down by 2.4% month on month in August, and monthly industrial production contracted by 0.8%. Economic data from China was soft due to ongoing regional lockdowns that hurt economic activities and consumer sentiment. Conditions in Japan continued to improve, although the economy is still exposed to the global economic slowdown. However, the People's Bank of China and the Bank of Japan have been able to ease or retain their expansionary monetary policy, in marked contrast to the rest of world, as the inflation environment has been relatively benign.

Figure 8: Changes in interest rates and interest rate expectation for 2022



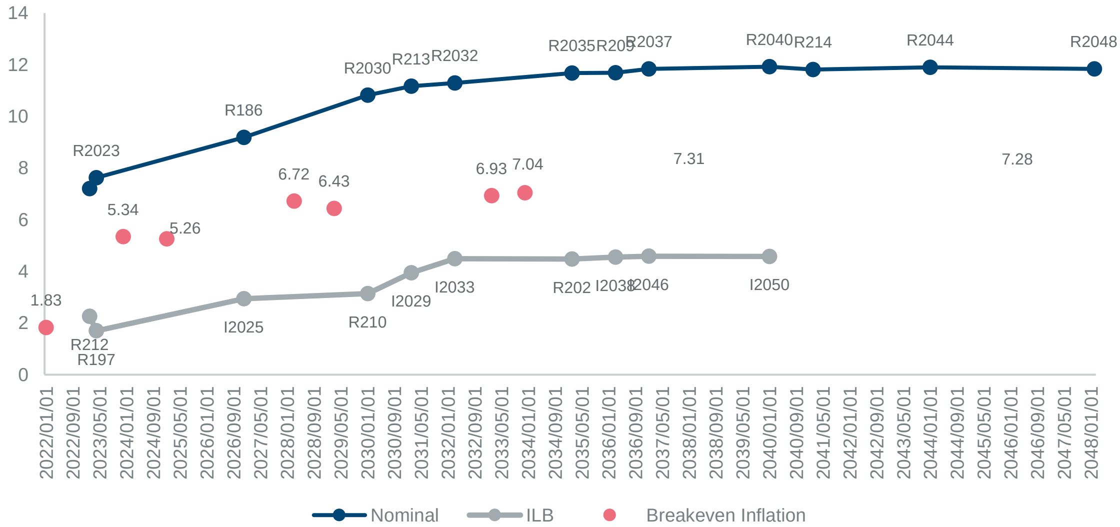
Source: Bloomberg

In the face of persistent inflation, with services inflation balancing out commodity price softness and a tight labour market, the market has every reason to believe that central banks will continue to prioritise fighting inflation over supporting growth. However, we have mentioned before that there is a lag between the implementation of monetary policy and its underlying effects throughout the economy. Therefore, with every 50bps or 75bps rate hike, there is a higher risk of overtightening, which will likely tip economies into recession next year. The magnitude of the potential recession will depend on the effectiveness of central bank policies in subduing demand and lowering inflation. Like all businesses, central banks are very data driven. Therefore, when they perceive an imminent catastrophic economic or liquidity risk, they will quickly take their foot off the pedal.

Our investment cases and positions have remained unchanged for all the asset classes.

Our nominal bonds remain attractive from a USD hedged-yield perspective and are trading at a discount to the implied 10-year yield. Meanwhile, SA inflation-linked bonds are trading at a premium to the implied real yield due to investors displaying a stronger appetite for near-term inflation protection. Our nominal bonds have continued to offer better inflation compensation over comparable inflation-linked bonds. We have chosen to retain our moderately overweight position in SA nominal bonds and moderately underweight position in SA inflation-linked bonds.

Figure 9: SA nominal and real yields



Source: Bloomberg

Relentless power outages continue to weigh heavily on the local economy, restricting output volumes, increasing input costs and also adding to the burden on SA consumers who are already under severe pressure from elevated prices and high unemployment. The strong USD will be negative for commodities (especially metals) and this, coupled with the global slowdown and weak Chinese economy, will be negative for our resource-heavy equity bourse. However, SA equities are trading at better valuations than in developed markets. The tourism and hospitality sectors may also continue to show positive growth rates, benefiting from the upcoming festive season. We have therefore also chosen to remain neutral in SA equities, despite having to tolerate a rise in downside risk.

Turning to local and offshore properties, our dashboard suggests that we should go neutral in both asset classes from a valuation perspective as they are trading at a fair valuation or at a slight discount vs broader equity indices but at a reasonable premium vs 10-year bond yields. However, the leverage inherent in the listed property sector makes the latter relatively more sensitive to rate hikes than broader equities – even if some property companies have reduced the level of risk in their balance sheets and are trying to mitigate the impact of accelerated rate increases by fixing some of their borrowings. The truth is that they operate at a higher gearing ratio than the broader equity markets and the operating margin is showing signs of softening. Therefore, despite valuations looking more attractive, we prefer to remain moderately underweight in both local and offshore properties.

Figure 10: SAPY debt to equity vs ALSI

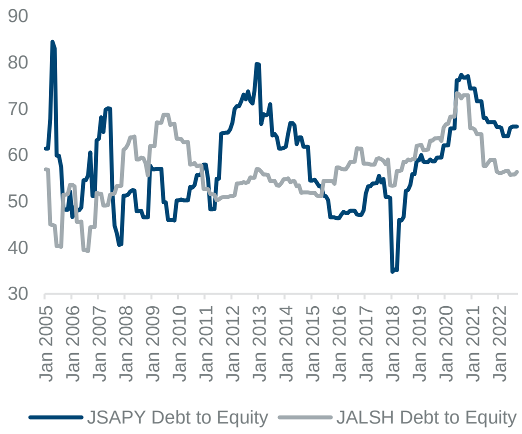
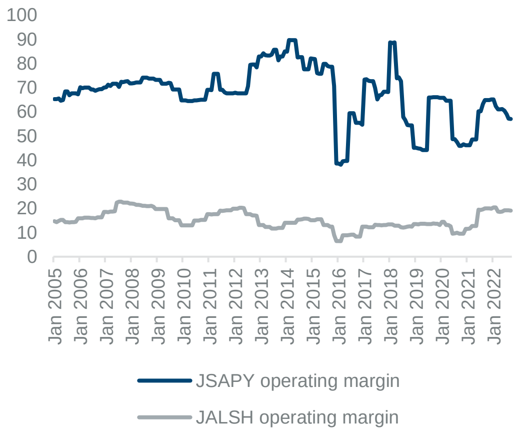


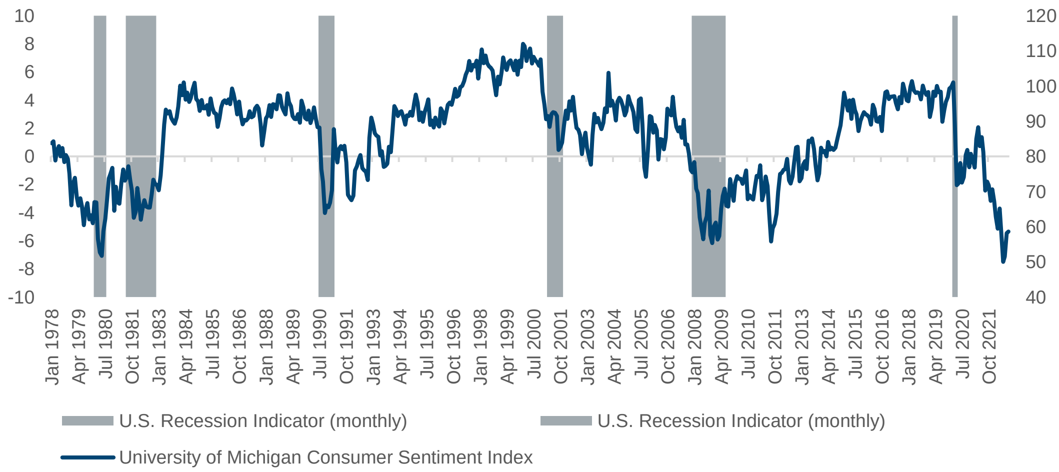
Figure 11: SAPY operating margin vs ALSI



Source: Bloomberg

Consumer sentiment has remained largely unchanged from previous months and activities are slowing down. The University of Michigan Consumer Sentiment Index stabilised at 58.6 in September, with a preliminary reading of 59.8 for October. The Conference Board Consumer Confidence Index improved from 103.2 in August to 108 in September, with a preliminary reading of 105 for October. The ISM Manufacturing PMI decreased from 52.8 in August to 50.9 in September, below the market expectation of 52. The ISM Services PMI remained strong at 56.7 in September, above the market expectation of 55.9. Eurozone Consumer confidence in September remained unchanged at -28.8. The region's manufacturing and services PMI numbers remained in contractionary territory.

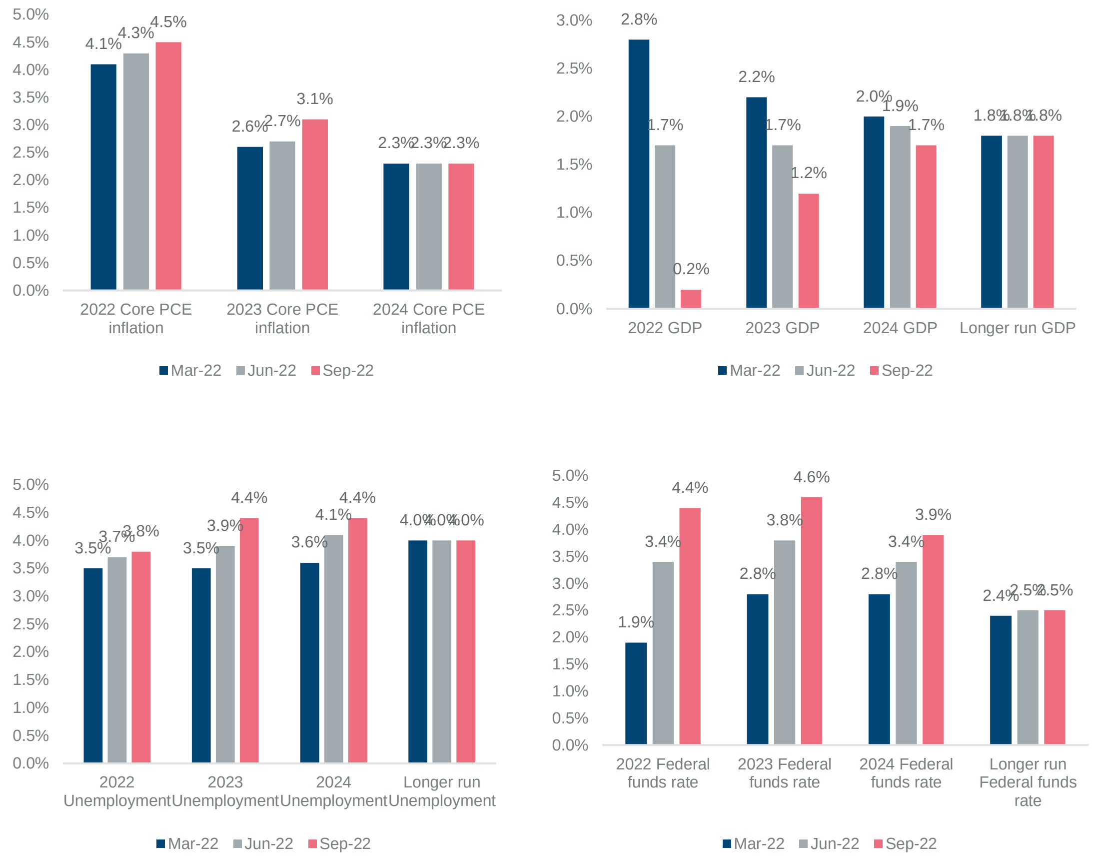
Figure 12: University of Michigan Consumer Sentiment Index



Source: Bloomberg

From the Fed's latest economic projections, we can see that the underlying inflationary pressure persists, and so it is unlikely that the Fed will materially slow down the rate hikes this year. We have chosen to remain moderately underweight in global equities. Despite valuations becoming more attractive, we still hold the view that slowing growth and rising input costs will pose risks to elevated corporate profit margins.

Figure 13: Fed's economic projections



Source: The Federal Reserve

Figure 14: S&P 500 PE ratio vs ROE

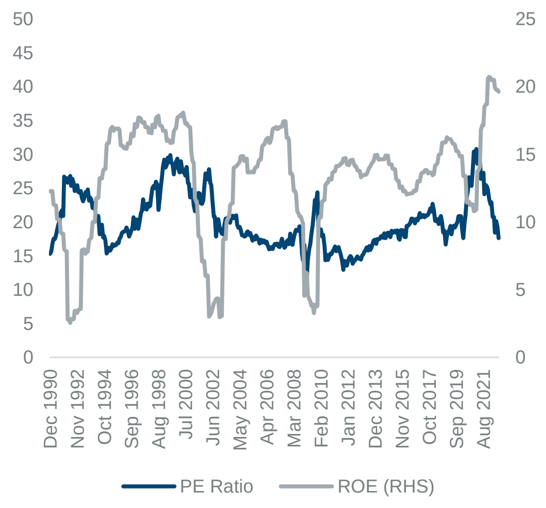


Figure 15: STOXX 600 PE ratio vs ROE

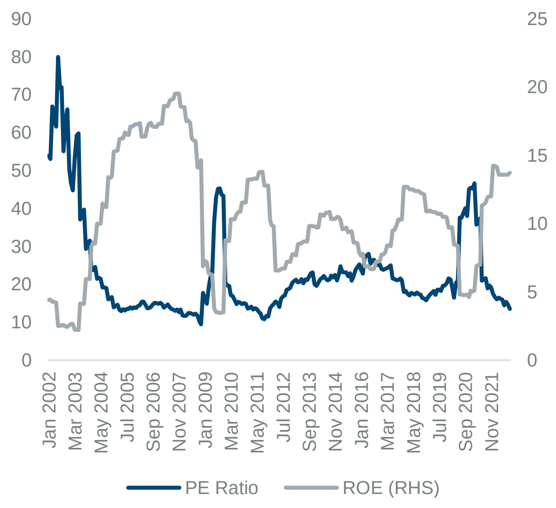
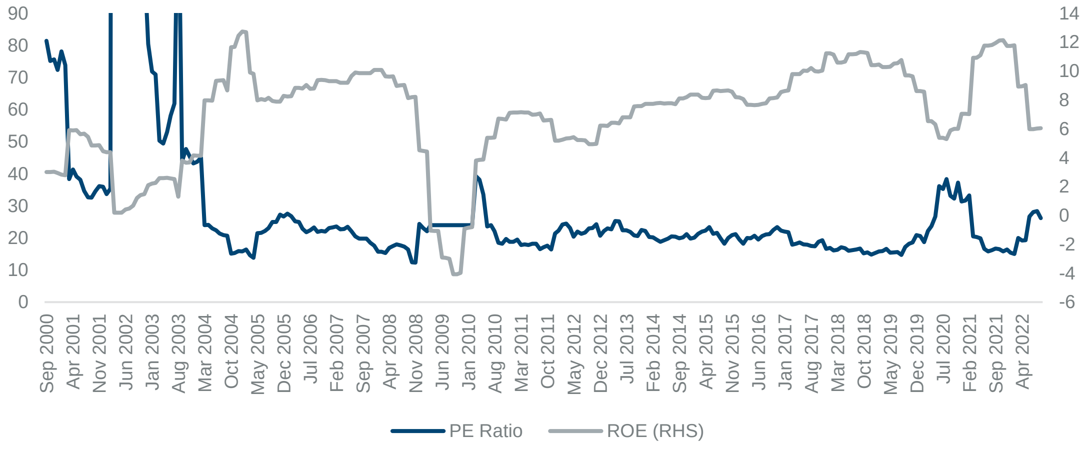


Figure 16: Nikkei 225 PE ratio vs ROE

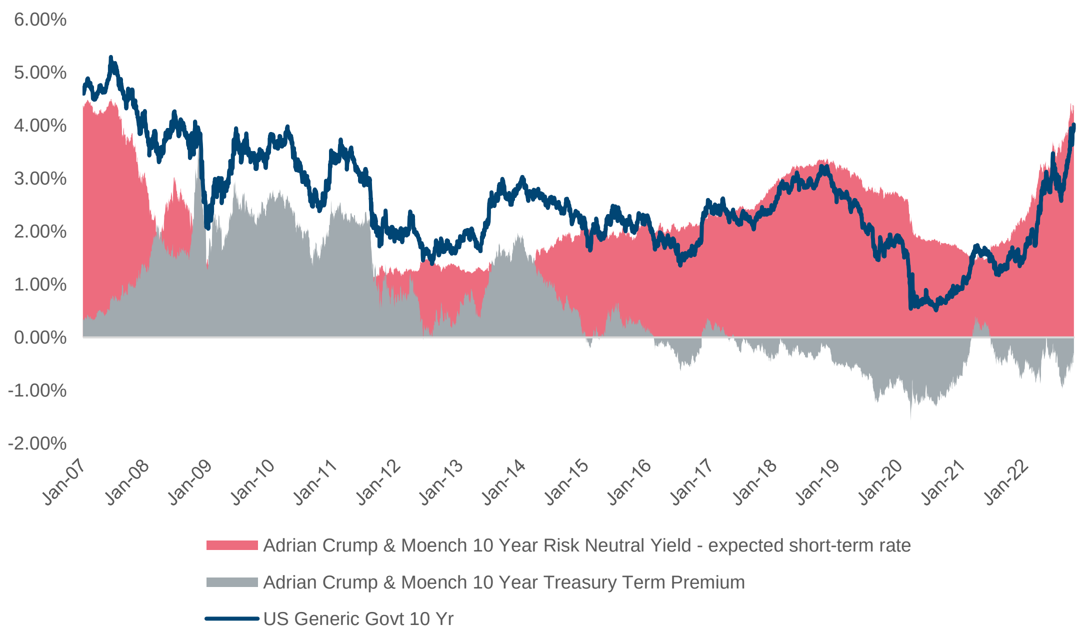


Source: Bloomberg

US treasury yield spreads continued to flash warning signs of a recession ahead. The dynamics of slowing growth, elevated inflation and tightening liquidity have driven the yield curve inversion between the 10-year and 2-year US treasuries. The US 10-year bond yield disaggregation indicates that most of the surge in yields was driven by higher-than-expected, short-term rates. Bond valuations are becoming increasingly attractive but are not yet high enough for us to move to moderately overweight, as there is still a risk that investors may demand a higher-term premium for holding longer maturity bonds. We have therefore chosen to remain neutral in offshore bonds.

We have also chosen to remain overweight in offshore cash to ensure relatively neutral offshore exposure, as our base case expectation is that there is still some room for the USD to strengthen further in a volatile macro and increasingly liquidity-tight environment.

Figure 17: US 10-year bond yield disaggregation



Source: Bloomberg

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