MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

17 November 2022

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We have made several changes to our tactical asset allocation positions for the months of December and January 2023. We have maintained our moderate overweight position in SA bonds, reduced our substantial overweight position in foreign cash to moderate overweight and maintained our moderate underweight position in foreign equity. We have brought our moderate underweight positions in SA inflation-linked bonds, SA listed property and foreign property to neutral, 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 remained moderately overweight in SA nominal bonds, moderately underweight in foreign equity and neutral in local equities and offshore bonds, as our investment cases have remained largely unchanged. In addition, we want to approach the period of heightened macro volatility with high conviction positions. We have moved our active positions in several asset classes, such as SA inflation-linked bonds, SA listed property and global property, to neutral as we want to position our tactical asset allocation holistically. This is so that we will continue to gain alpha, regardless of whether global risk sentiment remains risk on or suddenly sways to risk off trades, as markets continue to look for direction and anticipate the next moves by central banks as well as rate outlooks, while looking for the smallest signs of any pivot changes or the troughing of this bear market.

TAA Overview

Market overview	After a bumpy start, most risk assets ended in positive territory for the month of October after the September Fed meeting minutes were released on 12 October and also after a better-than-expected Q3 US corporate earnings season. In spite of the Fed signalling that tighter policy would remain in place to address inflation pressures, the market took the cue for a potential pivot change as the central bank acknowledged the lag between monetary policy actions and the reduction in aggregate demand and inflation. It also recognised the importance of calibrating future hikes to mitigate significant adverse impacts on the economy. While Q3 earnings of the US blue-chip tech stocks disappointed, markets were encouraged by earnings reports from sectors such as health care, energy and utilities. In their respective local currencies, the ALSI and the Capped SWIX returned 4.9% and 5.3% for the month of October, lagging behind the developed market equities but outperforming the MSCI Emerging Market Index. The S&P 500 returned 8.1%, outperforming the STOXX 600 and Nikkei 225 Indices. The MSCI World Index returned 7.2%, while the MSCI Emerging Markets Index fell by 3.1%, with China the weakest-performing sub-index as the 20th Party Congress reinforced President Xi's authority and the party signalled that the zero-Covid policy would remain in place. Sentiment was also dampened as the new US export controls on semiconductors will restrict the access of Chinese companies to advanced chips. The MSCI World Value Index substantially outperformed the MSCI Growth Index, returning 9.7% vs 4.6%.

The ALBI returned 1.1%, outperforming the WGBI which returned -0.5% in October. However, the 1.5% depreciation of the ZAR against the USD has provided some cushion for USD-denominated assets. Consequently, in ZAR terms, the ALBI performed on par with the WGBI, while the IGOV returned -1.3% for the month of October. The Bloomberg Global Inflation-linked Index outperformed other bond indices, except for the high yields, as investors preferred ILBs for inflation protection. Appetite for high yields also returned in October as investors saw some high-yield bonds offering attractive income. The Bloomberg Commodity Index returned 2.0% in October, with strong energy prices offsetting weaker agriculture and precious and industrial metal prices. The Dollar Index weakened slightly by 0.5% in October and fell by a further 3.0% into November as risk sentiment improved and safe-haven purchases paused.

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

31 October 2022 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 10 November 2022
FTSE/JSE ALSI Total Return	4.9%	-1.3%	-5.7%	3.3%	9.8%	6.2%	9.5%	6.1%
FTSE/JSE Capped SWIX Total Return	5.3%	-0.1%	-2.0%	3.7%	8.4%	4.2%	8.3%	5.2%
S&P 500 Total Return	8.1%	-5.9%	-17.7%	-14.6%	10.2%	10.4%	12.8%	2.2%
STOXX 600 Total Return	6.3%	-5.6%	-13.5%	-11.1%	3.6%	3.4%	7.1%	4.8%
Nikkei 225 Total Return	6.4%	0.1%	-2.2%	-2.4%	8.4%	6.7%	14.1%	-0.5%
MSCI World Total Return	7.2%	-6.7%	-19.7%	-18.1%	6.6%	6.9%	9.5%	3.6%
MSCI ACWI Total Return	6.1%	-7.5%	-20.8%	-19.6%	5.3%	5.8%	8.5%	3.7%
MSCI EM Total Return	-3.1%	-14.0%	-29.2%	-30.7%	-4.1%	-2.7%	1.2%	4.9%
MSCI World Value Index	9.7%	-2.5%	-10.0%	-7.6%	5.1%	4.8%	8.0%	3.9%
MSCI World Growth Index	4.6%	-10.9%	-29.2%	-28.2%	7.2%	8.5%	10.8%	3.1%
MSCI World Small Cap Index	8.1%	-6.1%	-20.4%	-21.4%	4.8%	4.2%	8.9%	4.0%
FTSE UK Series FTSE All Share TR	3.1%	-4.6%	-5.0%	-2.8%	2.3%	2.4%	6.2%	4.7%
MSCI AC Asia Ex. Japan Index	-6.1%	-18.0%	-32.1%	-33.8%	-4.5%	-3.1%	2.7%	6.3%
MSCI Europe Excluding United Kingdom Index	6.6%	-5.1%	-14.8%	-12.5%	4.5%	4.2%	8.5%	5.3%
STEFI	0.5%	1.5%	4.1%	4.8%	4.8%	5.8%	6.1%	0.2%
ALBI	1.1%	-0.8%	-0.3%	3.1%	6.2%	7.9%	6.9%	3.9%
IGOV	-1.3%	-1.1%	0.7%	5.3%	6.4%	4.7%	5.0%	3.0%
WGBI	-0.5%	-9.7%	-21.7%	-22.2%	-7.4%	-3.1%	-1.7%	2.9%
Bloomberg Global Inflation-Linked Total Return Index	1.0%	-12.9%	-25.2%	-25.1%	-4.8%	-1.6%	-0.2%	3.6%
Bloomberg US Agg Total Return	-1.3%	-8.2%	-15.7%	-15.7%	-3.8%	-0.5%	0.7%	1.9%
Bloomberg EuroAgg Total Return Index	0.1%	-8.3%	-16.1%	-16.0%	-5.8%	-2.1%	0.9%	1.4%
Bloomberg Global Agg Corporate Total Return Index	-0.3%	-9.3%	-21.2%	-21.6%	-5.3%	-1.7%	0.4%	2.8%
Bloomberg US Corporate High Yield Total Return Index	2.6%	-3.7%	-12.5%	-11.8%	0.3%	2.0%	4.1%	0.4%
Bloomberg Pan-European High Yield Total Return Index	2.0%	-3.8%	-13.4%	-13.0%	-2.1%	-0.2%	3.6%	1.4%
J.P. Morgan EMBI Global Core Hedged EUR	0.0%	-8.5%	-26.2%	-26.6%	-9.0%	-5.0%	-0.7%	3.4%
SAPY Total Return	11.0%	-1.6%	-6.5%	3.0%	-6.1%	-7.5%	2.7%	2.9%
MSCI US REIT Total Return	4.9%	-13.4%	-24.8%	-18.8%	-0.9%	4.1%	6.8%	4.6%
S&P Global Property Total Return	1.9%	-15.6%	-27.4%	-24.7%	-5.9%	-0.3%	3.7%	5.4%
STOXX 600 Real Estate Total Return	4.9%	-23.4%	-39.1%	-37.4%	-11.9%	-4.8%	2.1%	8.6%
FTSE EPRA Nareit Global REITs TR Index	3.9%	-14.5%	-25.8%	-21.6%	-4.6%	1.7%	4.5%	5.0%
Crude Oil	7.8%	-13.8%	21.9%	12.4%	16.3%	9.1%	-1.4%	-1.2%
Aluminium	2.8%	-10.7%	-20.9%	-18.2%	8.2%	0.6%	1.5%	4.7%
Copper	-1.5%	-5.9%	-23.4%	-21.5%	8.7%	1.7%	-0.4%	11.0%
Gold	-1.6%	-7.5%	-10.7%	-8.4%	2.6%	5.1%	-0.5%	7.5%
Platinum	7.7%	3.5%	-3.9%	-9.0%	-0.1%	0.2%	-5.1%	11.3%
Nickel	3.4%	-7.9%	4.0%	11.2%	9.2%	12.1%	3.0%	0.0%
Palladium	-14.8%	-13.4%	-3.1%	-7.9%	0.9%	13.4%	11.8%	6.9%
Iron Ore	-17.5%	-24.4%	-30.8%	-28.4%	-2.3%	6.2%	-4.0%	7.5%
Bloomberg Commodity Index Total Return	2.0%	-6.2%	15.8%	11.2%	13.4%	6.9%	-1.6%	2.4%
USDZAR	1.5%	10.4%	15.2%	20.4%	6.7%	5.4%	7.8%	-5.4%
GBPZAR	4.2%	4.0%	-2.5%	0.8%	2.5%	2.3%	4.2%	-3.3%
EURZAR	2.3%	6.7%	0.1%	3.1%	2.5%	2.0%	4.9%	-2.3%
JPYZAR	-1.3%	-1.0%	-10.9%	-7.7%	-4.1%	-0.1%	1.3%	-0.2%
Dollar Index Spot	-0.5%	5.3%	16.6%	18.5%	4.6%	3.4%	3.4%	-3.0%

Source: Bloomberg

Tactical views

Navigating through a period of heightened macro volatility

The Fed hiked its benchmark rate by another 75bps on 2 November, broadly in line with market expectations. Markets then reacted sharply to the US CPI number for October, released on 10 November, which was slightly softer than what the market expected. The year-on-year change was 7.7% versus the market expectation of 7.9%, representing a slowdown from the 8.2% seen in September. Markets turned very optimistic on the CPI number, which offered hope of a Fed pivot, where the central bank would slow down or pause the aggressive pace of rate hikes aimed to rein in inflation. Core CPI goods inflation slowed to 5.1% but core CPI services inflation remained elevated at 6.7% as consumers continued to rotate spending from goods to services. Transportation commodities less motor fuel and apparel goods were the largest negative contributors to goods inflation. Medical care services disinflation was the largest negative contributor to services inflation.

Economic data released over the past month was mixed and also prompted mixed reactions from the markets. For example, strong economic data may be interpreted as prompting central banks to continue with the current pace of rate hikes to bring down aggregate demand and inflation, while weak economic data may signal that the economy is losing momentum more quickly and is thus likely to induce a lower inflation outlook and smaller rate hikes.

In the US, the labour market remains strong, with non-farm payrolls up by 261 000 in October, beating the market expectation of 193 000.However, initial jobless claims are showing nascent signs of upward trending and the unemployment rate also ticked up from 3.5% in September to 3.7% in October. Tech companies such as Amazon, Apple, Intel, Meta and Twitter have either slashed jobs or slowed hiring to manage costs and protect profitability amid an operating environment of higher interest rates, slower consumer consumption and a strong USD. This is exactly why the Fed is trying to use restrictive monetary policies to temper inflation. The housing market continued to cool as new home sales, existing home sales and housing starts trended lower but with few systemic risks in sight. Retail sales were strong and delivered a monthly change of 1.3% in October, better than the market expectation of 1.0%. Consumer sentiment remained subdued in the face of elevated economic uncertainty. The US manufacturing PMI continued to hover around the neutral level of 50, while The services PMI remained in the expansionary zone but ticked lower from 56.7 in September to 54.4 in October. Durable goods and factory orders remained steady. However, the leading index remained negative at -0.3% to -0.4%. Q3 GDP was up 2.6% QoQ annualised, which was better than the market expectation of 2.4%, largely driven by a narrowing trade deficit and increases in consumer spending, non-residential fixed investment and government spending, while declines in residential fixed investment and private inventories were the negative contributors.

For the Eurozone, Q3 GDP was up 2.1% QoQ annualised, in line with the market expectation. CPI for September was up 9.9% year on year, against a market expectation of 10.0% and no slowdown from 9.1% in August. Core CPI for September was up 4.8%, unchanged from the previous month. Other economic data such as consumer confidence, manufacturing PMI and services PMI remained depressed, at levels that were consistent with recession. New fiscal stimulus support valued at €40bn and measures such as a price cap and a common purchases system should provide some help to households and businesses coping with the region's ongoing energy crisis. With storage facilities close to full capacity after a ramping up of imports, in-place energy saving measures and a relatively warm weather so far, the scenario for the region's potential gas shortages this winter has turned out better than the market expected.

Core machine orders in Japan slowed in late Q3 and early Q4. Q3 GDP QoQ annualised was -1.2%, hurt by a decrease in net exports and driven by a strong increase in services imports and a weak yen. The manufacturing PMI for October was roughly unchanged at 50.7, while the services PMI remained in an expansionary zone of 53.2. The strength in the services sector indicates ongoing reopening dynamics as Covid-19 restrictions were removed. National CPI and national CPI excluding fresh food for September were both up 3.0% year on year.

Economic data from China was mostly disappointing, as sporadic Covid-19-related lockdowns hurt sentiment and activities. Q3 GDP for China was up 3.9% year on year, better than the market expectation of 3.3%. However, exports and imports contracted by 0.3% and 0.7% respectively in October. The Caixin manufacturing PMI and services PMI stood at 49.2 and 48.4 respectively in October, in a contractionary zone. CPI for October weakened to 2.1% from 2.8% in September. PPI also dropped from 0.9% in September to -1.3% in October. With inflation in China and Japan being far lower than in the rest of the developed countries, the People's Bank of China and the Bank of Japan have the room to continue to pursue their accommodative policies in contrast to other major central banks around the world. However, further monetary policy easing for both countries may not be effective in stimulating growth. The USD has strengthened notably against the yen and renminbi as the central banks for the two countries have adopted a much more accommodative policy stance. For Japan, with the latest PPI yearly growth of 9.1%, further monetary easing will hurt the yen, prompting higher input costs, further reducing net exports and hurting GDP growth and corporate earnings. For China, the borrowing demand is weak, households have slowed the pace of home purchases, new loans have come largely from the corporate book and companies are cautious about investing in an environment of Covid-19 restrictions. Therefore, the People's Bank of China has decided to hold its key rate unchanged in November to defend its currency, as lowering borrowing costs provided marginal support to the economy where most strong headwinds were from the zero-Covid policy and the supply and demand imbalance in the property sector.

Overall, liquidity will remain tight with central banks continuing to hike rates as inflation remains very elevated across the world. However, central banks may be opening the door to smaller rate hikes as the accelerated pace of the rate hikes has been rather unprecedented. The economic outlook remains challenging as global growth continued to slow, with PMI numbers largely in the contractionary zone. However, the declines in the equity and bond markets for the year to date as at the end of October are a sign that some of the bad news has already been priced in. A lot of volatility that investors have been experiencing this year was not due to company revenue and earnings growth but rather changes in outlook. As central banks have singularly focused on curbing inflation by imposing rate hikes and reducing their balance sheets, they have become a source of volatility instead of stability. Thus, our base view is that volatility will be elevated into next year amid uncertain macroeconomic conditions.

Figure 3: Global composite PMI indices

	Oct 2020	Nov 2020	Dec 2020	Jan 2021	Feb 2021	Mar 2021	Apr 2021	May 2021	Jun 2021	Jul 2021	Aug 2021	Sep 2021
Global Composite PMI	53.4	53.1	52.7	52.3	53.2	54.8	56.7	58.5	56.6	55.8	52.5	53
Global Services PMI	52.9	52.2	51.8	51.6	52.8	54.7	57	59.5	57.5	56.3	52.8	53.4
Developed Markets	52.7	52.2	52	52.4	53.9	55.9	58.2	61.2	59.3	57.5	54.1	53.8
Emerging Markets	54.6	54.9	54.1	52.1	52	52.6	53.5	52.7	50.8	52	49.3	52.3
Eurozone	50	45.3	49.1	47.8	48.8	53.2	53.8	57.1	59.5	60.2	59	56.2
France	47.5	40.6	49.5	47.7	47	50	51.6	57	57.4	56.6	55.9	55.3
Germany	55	51.7	52	50.8	51.1	57.3	55.8	56.2	60.1	62.4	60	55.5
Italy	49.2	42.7	43	47.2	51.4	51.9	51.2	55.7	58.3	58.6	59.1	56.6
Spain	44.1	41.7	48.7	43.2	45.1	50.1	55.2	59.2	62.4	61.2	60.6	57
Ireland	49	47.7	53.4	40.3	42.7	54.5	58.1	63.5	63.4	65	62.6	61.5
Australia	53.5	54.9	56.6	55.9	53.7	55.5	58.9	58	56.7	45.2	43.3	46
Sweden	56.5	59.2	59.6	61	62.4	62.8	67.1	70.1	67.2	67.8	63.7	68.2
UK	52.1	49	50.4	41.2	49.6	56.4	60.7	62.9	62.2	59.2	54.8	54.9
US	56.3	58.6	55.3	58.7	59.5	59.7	63.5	68.7	63.7	59.9	55.4	55
Japan	48	48.1	48.5	47.1	48.2	49.9	51	48.8	48.9	48.8	45.5	47.9
China	55.7	57.5	55.8	52.2	51.7	53.1	54.7	53.8	50.6	53.1	47.2	51.4
India	58	56.3	54.9	55.8	57.3	56	55.4	48.1	43.1	49.2	55.4	55.3
Brazil	55.9	53.8	53.5	48.9	49.6	45.1	44.5	49.2	54.6	55.2	54.6	54.7
Russia	47.1	47.8	48.3	52.3	52.6	54.6	54	56.2	55	51.7	48.2	50.5

	Oct 2021	Nov 2021	Dec 2021	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22
Global Composite PMI	54.5	54.8	54.3	51.4	53.4	52.7	51	51.3	53.5	50.8	49.3	49.7	49
Global Services PMI	55.6	55.6	54.6	51.3	53.9	53.4	51.9	51.9	53.9	51.1	49.2	50	49.2
Developed Markets	55.2	55.8	54.8	51.3	54.7	56	55.5	53.7	52.5	49	46.9	49.3	48.5
Emerging Markets	52.8	52.5	53.3	50.8	51.3	46.8	43.4	46.9	55.2	54	53.4	50.1	49.8
Eurozone	54.2	55.4	53.3	52.3	55.5	54.9	55.8	54.8	52	49.9	48.9	48.1	47.3
France	54.7	56.1	55.8	52.7	55.5	56.3	57.6	57	52.5	51.7	50.4	51.2	50.2
Germany	52	52.2	49.9	53.8	55.6	55.1	54.3	53.7	51.3	48.1	46.9	45.7	45.1
Italy	54.2	57.6	54.7	50.1	53.6	52.1	54.5	52.4	51.3	47.7	49.6	47.6	45.8
Spain	56.2	58.3	55.4	47.9	56.5	53.1	55.7	55.7	53.6	52.7	50.5	48.4	48
Ireland	62.5	59.3	56.5	56.5	59.1	61	59.6	57.5	52.8	52.9	51	52.2	52.1
Australia	52.1	55.7	54.9	46.7	56.6	55.1	55.9	52.9	52.6	51.1	50.2	50.9	49.8
Sweden	67	67.1	65.8	66.9	65.3	63.1	64.4	64.2	60.3	57.2	56.9	53.5	54
UK	57.8	57.6	53.6	54.2	59.9	60.9	58.2	53.1	53.7	52.1	49.6	49.1	48.2
US	57.6	57.2	57	51.1	55.9	57.7	56	53.6	52.3	47.7	44.6	49.5	48.2
Japan	50.7	53.3	52.5	49.9	45.8	50.3	51.1	52.3	53	50.2	49.4	51	51.8
China	51.5	51.2	53	50.1	50.1	43.9	37.2	42.2	55.3	54	53	48.5	48.3
India	58.7	59.2	56.4	53	53.5	54.3	57.6	58.3	58.2	56.6	58.2	55.1	55.5
Brazil	53.4	52	52	50.9	53.5	56.6	58.5	58	59.4	55.3	53.2	51.9	53.4
Russia	49.5	48.4	50.2	50.3	50.8	37.7	44.4	48.2	50.4	52.2	50.4	51.5	45.8

Source: Bloomberg

Figure 4: Global manufacturing PMI indices

	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	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22
Global Manufacturing PMI	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	49.4
Developed Markets	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	48.8
Emerging Markets	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	49.8
Eurozone	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	46.4
France	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	47.2
Germany	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	45.1
Italy	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	46.5
Spain	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	44.7
Greece	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	48.1
Ireland	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	51.4
Australia	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	52.7
Sweden	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	46.8
Denmark	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	52.1
UK	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	46.2
US	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	50.4
Japan	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	50.7
China	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	49.2
Indonesia	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	51.8
South Korea	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	48.2
Taiwan	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	41.5
India	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	55.3
Brazil	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	50.8
Mexico	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	50.3
Russia	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	50.7
South Africa	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	50

Source: Bloomberg

Figure 5: Global inflation

	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	Oct 2022
Global	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	8.0	8.8	9.1	9.7	9.8	10.0	10.3
Citi Inflation Surprise Index - Global	-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	80.8	80.1	68.9	63.1	47.8	42.1	44.2
Citi Inflation Surprise Index - Major Economies	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	107.4	102.2	89.4	82.2	64.6	63.7	69.5
Citi Inflation Surprise Index - Emerging Markets	-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	40.8	46.9	38.1	34.3	22.6	9.7	6.3
France	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	4.8	5.2	5.8	6.1	5.9	5.6	6.2
Germany	-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	7.4	7.9	7.6	7.5	7.9	10.0	10.4
Greece	-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	10.2	11.3	12.1	11.6	11.4	12.0	9.1
Ireland	-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	7.0	7.8	9.1	9.1	8.7	8.2	9.2
Italy	-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	6.0	6.8	8.0	7.9	8.4	8.9	11.9
Spain	-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	8.3	8.7	10.2	10.8	10.5	8.9	7.3
Sweden	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	6.4	7.3	8.7	8.5	9.8	10.8	10.8
Switzerland	-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	2.5	2.9	3.4	3.4	3.5	3.3	3.0
United Kingdom	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	9.0	9.1	9.4	10.1	9.9	10.1	10.1
United States	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	8.3	8.6	9.1	8.5	8.3	8.2	7.7
Australia	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	5.1	5.1	5.1	6.1	6.1	6.1	7.3	7.3
Japan	-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	1.2	2.5	2.5	2.4	2.6	3.0	3.0	3.0
Brazil	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	12.1	11.7	11.9	10.1	8.7	7.2	6.5
China	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	2.1	2.1	2.5	2.7	2.5	2.8	2.1
India	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	7.8	7.0	7.0	6.7	7.0	7.4	7.4
Indonesia	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	3.5	3.6	4.4	4.9	4.7	6.0	5.7
Mexico	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	7.7	7.7	8.0	8.2	8.7	8.7	8.4
Russia	4.0	4.4	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	17.8	17.1	15.9	15.1	14.3	13.7	12.6
South Africa	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	5.9	5.9	6.5	7.4	7.8	7.6	7.5	7.5
South Korea	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	4.8	5.4	6.0	6.3	5.7	5.6	5.7
Taiwan	-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	3.4	3.4	3.6	3.4	2.7	2.8	2.7

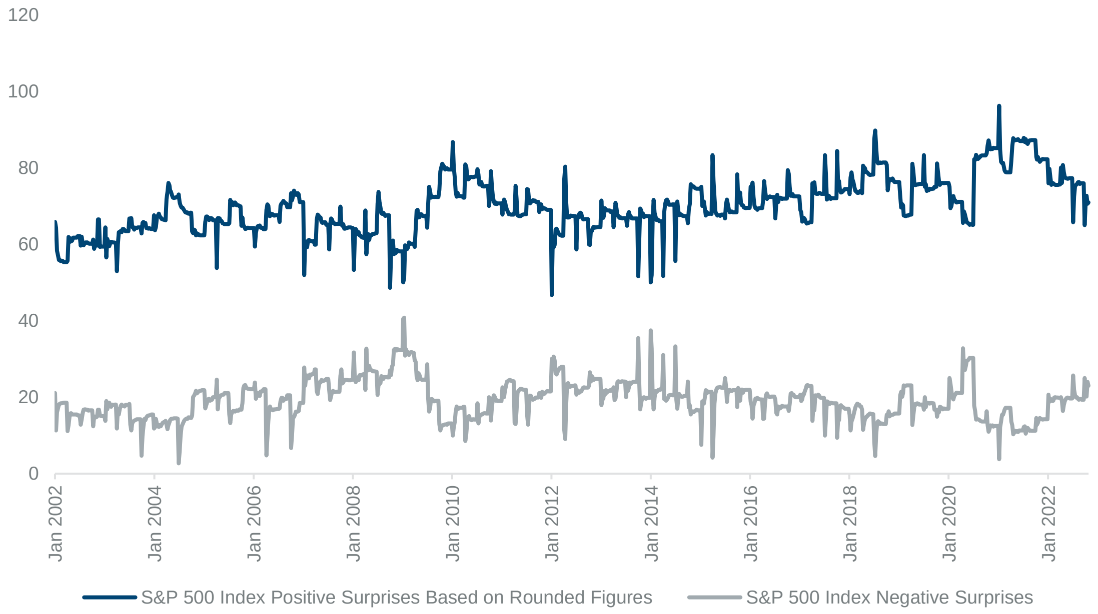
Source: Bloomberg

High conviction positions amid two potentially quite extreme scenarios

We have made several changes to our TAA positions this month for December and January 2023, as our next TAA meeting will take place on 19 January 2023. We have decided to proceed with the positions with the highest convictions as we view two potentially quite extreme scenarios playing out over the next few months amid elevated macro volatility. In the first scenario, the negative news has largely priced in the equity markets earnings growth slowdown in Q3 and Q4 but it reaccelerates from that point on, with supply chain pressures continuing to dissipate, goods disinflation persisting as consumption continues to rotate into services, US labour markets continuing to cool as companies cut jobs in the face of increasing pressure to cut costs (especially in sectors that have been key contributors to strong job growth), and aggregate demand falling. However, harsh recessions are avoided as excess household savings cushion some of the blow and the Eurozone manages to deal with the energy crisis and is left relatively less scathed, while central banks moderate future rate hikes. In the second scenario, services inflation trumps goods disinflation, the inflation expectation becomes unanchored, major central banks overtighten and equity markets valuations to reflect the weaker earnings prospects, corporate margins are crushed by higher costs and high inventory levels, and geopolitical risks remain elevated.

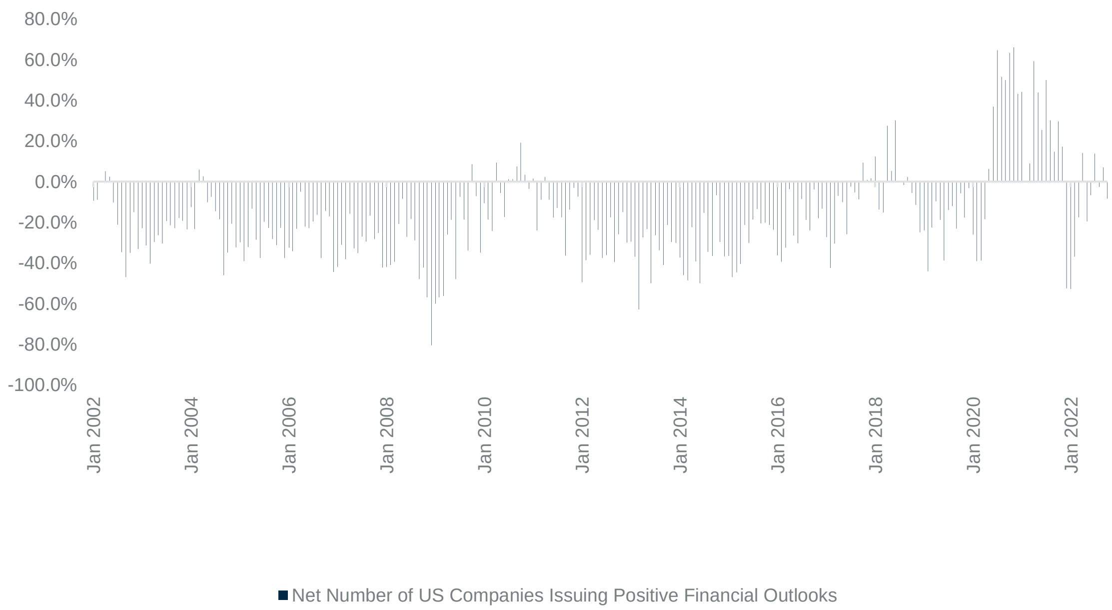
The number of S&P 500 companies issuing negative surprises has been trending upwards slightly this year, with the net number of US companies issuing positive financial outlooks moving sideways after the Covid-19 rebound. Operating margins have plunged for Japanese equities and Chinese equities, only trending slower for the S&P 500, ALSI and STOXX 600, with levels remaining around historical highs. If we look at the S&P 500 return decomposition for the 1 year, earnings growth has slowed significantly since late 2021, with much of the negative return attributable to re-rating. We do see that the market has to some extent priced in the challenging economic backdrop but inventory levels are at all-time highs as producers, wholesalers and retailers hold onto inventories to reduce the impact of any supply disruptions. This could place further pressure on margins as they need to reduce excess inventories on discounts amid falling aggregate demand.

Figure 6: S&P 500 companies issuing positive or negative earnings surprises



Source: Bloomberg

Figure 7: Net number of US companies issuing positive financial outlooks



Source: Bloomberg

Figure 8: Operating margin

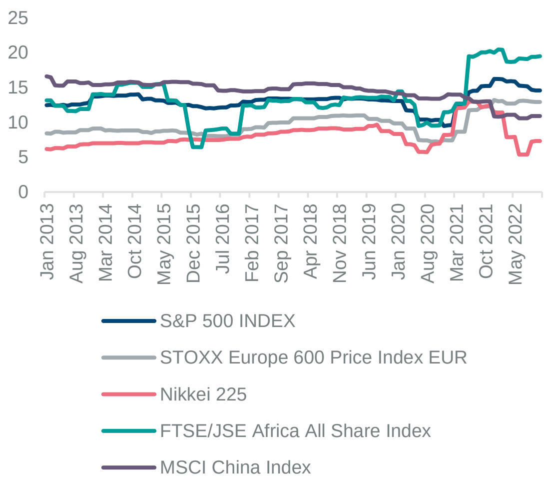
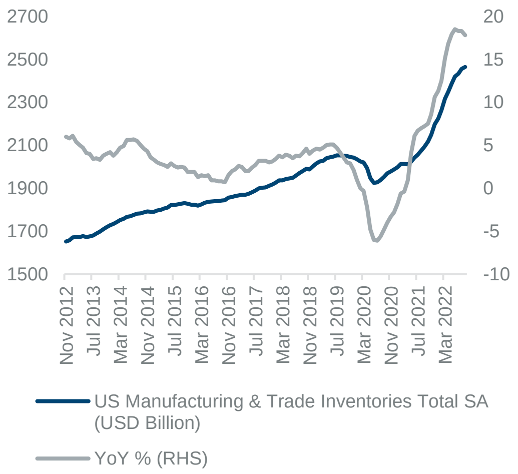
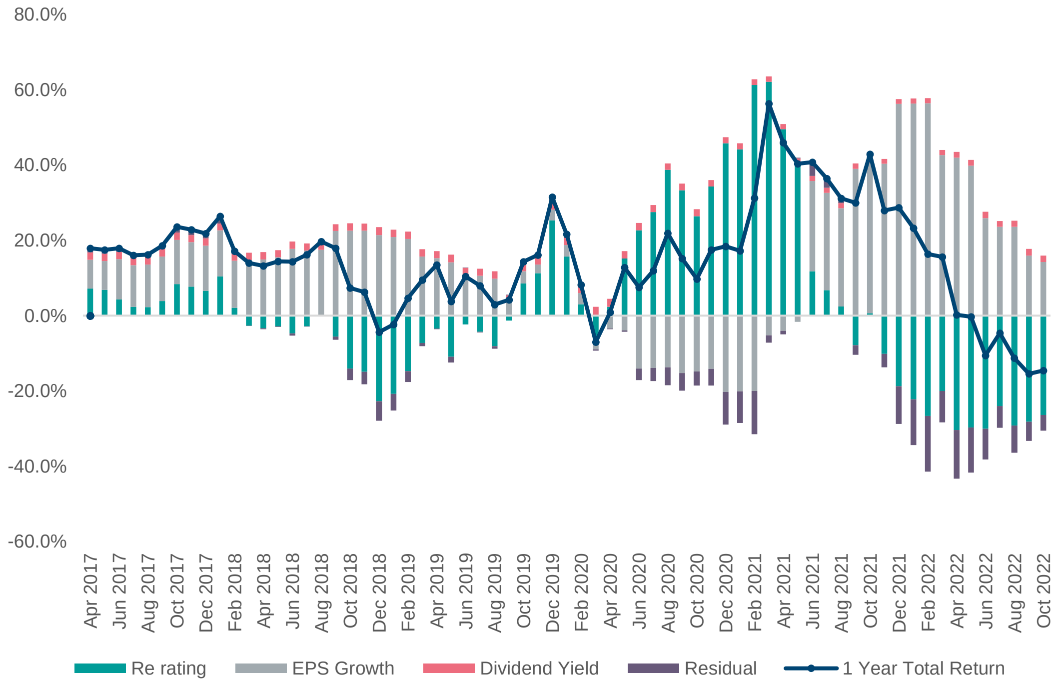


Figure 9: US business inventories



Source: Bloomberg

Figure 10: S&P 500 return decomposition



Source: Bloomberg

While there are some early signs of falling inflation, according to the University of Michigan survey, US consumers' 1-year inflation expectations remain largely elevated. The Fed hikes rates to lower inflation but also to ensure inflation expectations remain anchored to reduce any unwanted secondary impact of persistent surging inflation, which is entrenched in consumers' psyche. While US retail sales were, according to the latest figures, resilient, consumers are becoming increasingly reliant on credit cards for these purchases, which does not bode well for the demand outlook.

Figure 11: US consumer inflation expectations

Source: Bloomberg

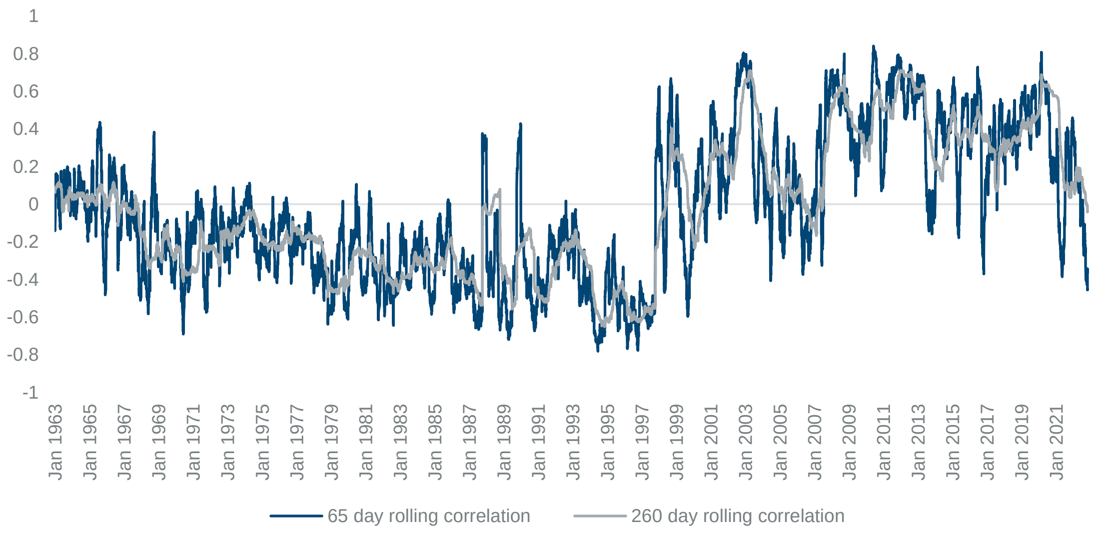
Amid the elevated macro uncertainty, where volatility is likely to trump trends over the short term, we therefore decided to place our active bets on asset classes with the highest conviction. We maintained our moderate overweight position in SA nominal bonds, as the real yield offered by our nominal bonds remains very attractive at the moment – and is also attractive from a hedged-yield and implied-yield perspective. In addition, this asset class would benefit from the risk on trade and provide diversification against an economic downturn. We have moved our moderate underweight position in SA inflation-linked bonds to neutral as they are fairly priced and core inflation remains elevated, which points to short-term consumer inflation likely remaining elevated in the short term.

For local and foreign property, we have moved from moderate underweight to neutral. We have been underweighting these two asset classes for some time as we believed that, owing to the leverage inherent in listed property, this asset class is more sensitive to rate hikes than the broader equities. They are fairly valued according to our valuation dashboard, as they have largely underperformed against their respective regional broader market indices for the year to date as at the end of October. Furthermore, we prefer to stay neutral, as risk sentiment could sway in any direction over the next few months as markets look for direction and indications of a potential soft landing in the US.

For local and offshore equities, we have maintained our neutral and moderate underweight positions respectively. Despite offering better valuations than offshore equities, SA consumers are under increasing pressure amid elevated core inflation, high interest rates, high unemployment and the prolonged, severe power crisis, thus limiting output and weighing on consumer and business sentiment. For offshore equities, our base case has remained unchanged that global growth is slowing down. While the Fed may adopt smaller rate hikes going forward, the underlying inflationary pressure persists, and so it is unlikely that the Fed will materially slow down rate hikes this year into early next year. 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.

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 and between the 10-year and 3-month 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. However, correlations between equities and bonds have been falling and the diversification benefits of holding bonds in the portfolio returned. We have therefore chosen to remain neutral in offshore bonds.

Figure 12: S&P 500 and US 10-year bond correlation



Source: Bloomberg

We have also chosen to remain overweight in offshore cash to ensure relatively neutral offshore exposure in a volatile macro and increasingly liquidity-tight environment, but that the extent of overweight has dropped slightly as we have increased our allocation to global property.

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