HOUSEVIEW TACTICAL ASSET ALLOCATION

19 January 2023

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We have maintained our moderately overweight position in SA bonds and our moderately underweight position in foreign equity. We have reduced our moderately overweight position in foreign cash 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 based on attractive valuations from a real-yield and hedged-yield perspective. Meanwhile, the current account and trade balance stand to benefit from the tailwind of China's recovery-led increase in demand for commodities and the overall improvement in sentiment towards emerging markets. We have also chosen to remain moderately underweight in foreign equity as we expect corporate earnings to come under pressure, and even if the risk-on environment does prevail, the ZAR may strengthen. Using the same line of thinking, we have moved from moderately overweight to neutral in offshore cash, as the US dollar may weaken amid central banks' potential rate path divergence. This is despite binary events that could spur the demand for greenbacks.

TAA Overview

Market overview	The last quarter of 2022 brought some relief to the market. Bond and equity markets struggled in 2022, compounded by central banks battling against inflation (fuelled by pent-up consumer demand as economies have reopened, supply chain bottlenecks and the energy crisis triggered by the war in Ukraine). Most equity markets rallied in October and November, as cooling US inflation spurred optimism about an early pivot in US monetary policy. In addition, the MSCI Emerging Markets Index kept up with other major equity indices in the bear market rally as China abandoned its zero-Covid policy. Both the ALSI and the Capped SWIX outperformed other major equity indices in Q4 2022. The MSCI World Value Index significantly outperformed the MSCI World Growth Index for the year and for the quarter due to interest rate hikes, slowing growth and re-rating. Japanese equity declined most in December after posting gains in October and November, as investors balanced strong Q3 earnings results with the decision by the Bank of Japan to widen the tolerance band of the 10-year bond yield target. Our local nominal bonds and inflation-linkers, proxied by the ALBI and the IGOV indices, have materially outperformed foreign bonds, proxied by the WGBI and Bloomberg Global Inflation-Linked Index respectively, for the year and for the quarter as global government bond prices fell sharply. This was as major central banks around the world hiked rates by more than market expectations to rein in runaway inflation and keep inflation expectations anchored so as to limit any secondary inflationary effect. Meanwhile, the SARB remained disciplined and front-loaded its

rate hiking cycle, to curb inflation and defend the ZAR. Local listed property/the SAPY Index also significantly outperformed global listed properties for the year and for the quarter. Commodity prices were largely up, with the Bloomberg Commodity Index up by 2.2% in USD terms, led by industrial metals, on the back of the China recovery narrative. The Dollar Index strengthened by 8.2% against other major currencies for the year, despite weakening by 7.7% in Q4.

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

31 December 2022 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 12 January 2023
FTSE/JSE ALSI Total Return	-2.3%	15.2%	3.6%	3.6%	12.7%	8.0%	9.9%	7.7%
FTSE/JSE Capped SWIX Total Return	-2.8%	12.2%	4.4%	4.4%	10.1%	4.9%	8.3%	6.5%
S&P 500 Total Return	-5.8%	7.6%	-18.1%	-18.1%	7.7%	9.4%	12.6%	3.8%
STOXX 600 Total Return	-3.4%	9.8%	-10.6%	-10.6%	3.0%	4.4%	7.0%	6.0%
Nikkei 225 Total Return	-6.5%	0.8%	-7.3%	-7.3%	5.3%	4.8%	11.7%	1.4%
MSCI World Total Return	-4.2%	9.9%	-17.7%	-17.7%	5.4%	6.7%	9.4%	4.6%
MSCI ACWI Total Return	-3.9%	9.9%	-18.0%	-18.0%	4.5%	5.8%	8.5%	4.8%
MSCI EM Total Return	-1.4%	9.8%	-19.7%	-19.7%	-2.3%	-1.0%	1.8%	6.5%
MSCI World Value Index	-2.4%	14.9%	-5.8%	-5.8%	4.9%	5.0%	8.1%	3.9%
MSCI World Growth Index	-6.1%	4.8%	-29.0%	-29.0%	5.0%	7.7%	10.5%	5.2%
MSCI World Small Cap Index	-3.4%	10.9%	-18.4%	-18.4%	3.4%	3.9%	8.8%	5.9%
FTSE UK Series FTSE All Share TR	-1.4%	8.9%	0.3%	0.3%	2.3%	2.9%	6.5%	4.7%
MSCI AC Asia Ex. Japan Index	-0.3%	11.2%	-19.6%	-19.6%	-1.2%	-0.4%	3.8%	6.5%
MSCI Europe Excluding United Kingdom Index	-3.4%	10.3%	-11.9%	-11.9%	4.2%	5.4%	8.3%	6.6%
STEFI	0.5%	1.6%	5.2%	5.2%	4.8%	5.8%	6.1%	0.2%
ALBI	0.6%	5.7%	4.3%	4.3%	7.1%	7.8%	7.1%	3.1%
IGOV	2.7%	2.2%	4.2%	4.2%	7.8%	5.1%	5.0%	0.6%
WGBI	-0.2%	3.8%	-18.3%	-18.3%	-5.7%	-2.5%	-1.2%	3.2%
Bloomberg Global Inflation-Linked Total Return Index	-1.7%	4.1%	-22.9%	-22.9%	-3.8%	-1.6%	-0.1%	3.1%
Bloomberg US Agg Total Return	-0.5%	1.9%	-13.0%	-13.0%	-2.7%	0.0%	1.1%	3.1%
Bloomberg EuroAgg Total Return Index	-3.6%	-1.2%	-17.2%	-17.2%	-5.8%	-2.3%	0.6%	2.8%
Bloomberg Global Agg Corporate Total Return Index	0.2%	5.4%	-16.7%	-16.7%	-3.7%	-0.8%	0.9%	3.4%
Bloomberg US Corporate High Yield Total Return Index	-0.6%	4.2%	-11.2%	-11.2%	0.0%	2.3%	4.0%	3.7%
Bloomberg Pan-European High Yield Total Return Index	-0.9%	4.7%	-11.1%	-11.1%	-2.0%	0.4%	3.4%	2.1%
J.P. Morgan EMBI Global Core Hedged EUR	-0.1%	7.4%	-20.8%	-20.8%	-7.2%	-3.7%	-0.2%	2.5%
SAPY Total Return	1.1%	19.3%	0.5%	0.5%	-3.4%	-7.2%	2.8%	1.4%
MSCI US REIT Total Return	-5.1%	5.2%	-24.5%	-24.5%	-0.1%	3.7%	6.5%	6.7%
S&P Global Property Total Return	-2.6%	7.4%	-23.4%	-23.4%	-4.5%	-0.1%	3.7%	5.8%
STOXX 600 Real Estate Total Return	-1.8%	6.4%	-38.3%	-38.3%	-12.9%	-5.5%	2.0%	11.7%
FTSE EPRA Nareit Global REITs TR Index	-3.3%	6.9%	-23.7%	-23.7%	-3.2%	1.4%	4.5%	6.1%
Crude Oil	0.6%	-2.3%	10.5%	10.5%	9.2%	5.1%	-2.5%	-2.2%
Aluminium	-4.0%	10.0%	-15.3%	-15.3%	9.5%	1.0%	1.4%	7.2%
Copper	1.6%	10.7%	-13.9%	-13.9%	10.7%	2.9%	0.5%	9.7%
Gold	3.1%	9.8%	-0.3%	-0.3%	6.3%	7.0%	0.9%	4.0%
Platinum	3.6%	24.3%	10.9%	10.9%	3.6%	3.0%	-3.5%	-0.3%
Nickel	11.2%	42.3%	43.2%	43.2%	28.9%	18.7%	5.8%	0.0%
Palladium	-4.8%	-17.3%	-5.9%	-5.9%	-2.7%	11.0%	9.8%	0.4%
Iron Ore	15.2%	16.8%	-2.1%	-2.1%	9.1%	9.6%	-2.3%	-0.3%
Bloomberg Commodity Index Total Return	-2.4%	2.2%	16.1%	16.1%	12.7%	6.4%	-1.3%	-1.5%
USDZAR	-1.0%	-5.8%	6.9%	6.9%	6.8%	6.6%	7.2%	-1.7%
GBPZAR	-0.7%	1.9%	-4.6%	-4.6%	3.5%	4.3%	4.1%	-0.7%
EURZAR	1.9%	2.8%	0.6%	0.6%	5.1%	4.2%	5.0%	-0.3%
JPYZAR	4.3%	4.0%	-6.1%	-6.1%	0.3%	3.4%	2.9%	-0.4%
Dollar Index Spot	-2.3%	-7.7%	8.2%	8.2%	2.4%	2.4%	2.6%	-1.2%

Source: Bloomberg

Tactical views

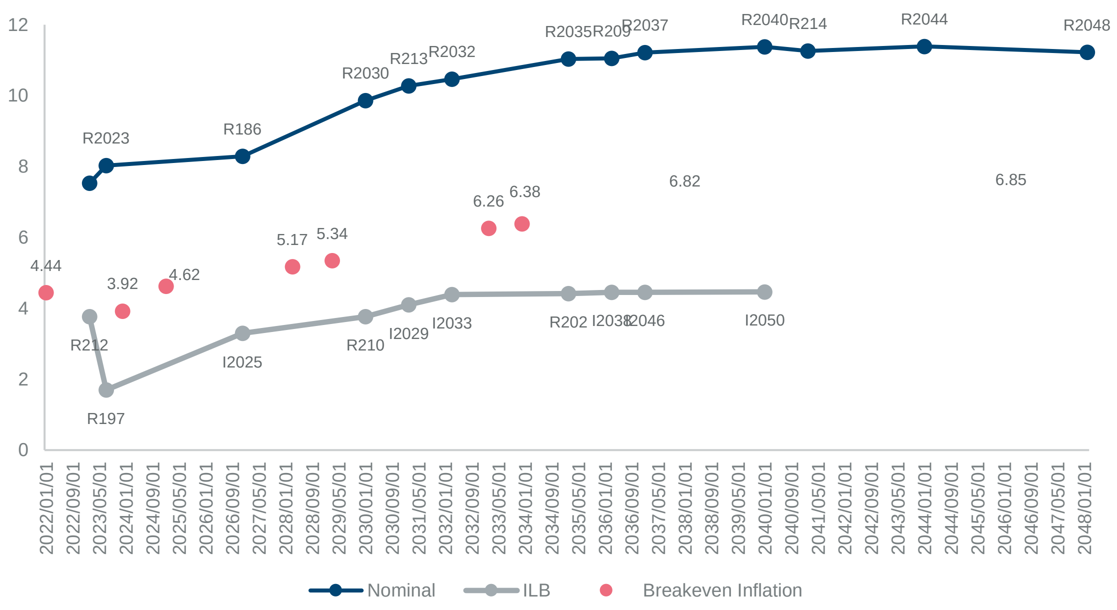
Continued tilting towards local nominal bonds with China's reopening set to benefit commodity exporters

We maintained our moderately overweight position in local nominal bonds as the 10-year nominal bonds and longer maturity bonds offered more compensation for inflation. The Q3 current account deficit improved from R87bn to R18bn and will mostly be supported, since the demand for commodities should continue to recover in the wake of the Chinese government loosening its Covid restrictions, which have largely constrained the country's economic growth over the past three years.

The monetary policies of the Fed and other major central banks will likely remain restrictive for most of 2023 but will be relatively more stable than in 2022 as there are signs of inflation peaking, although it remains uncomfortably high. The labour market in most of the developed markets remains very tight. The US unemployment rate declined from 3.7% in November to 3.5% in December, the Eurozone unemployment rate declined from 6.6% in September to 6.5% in

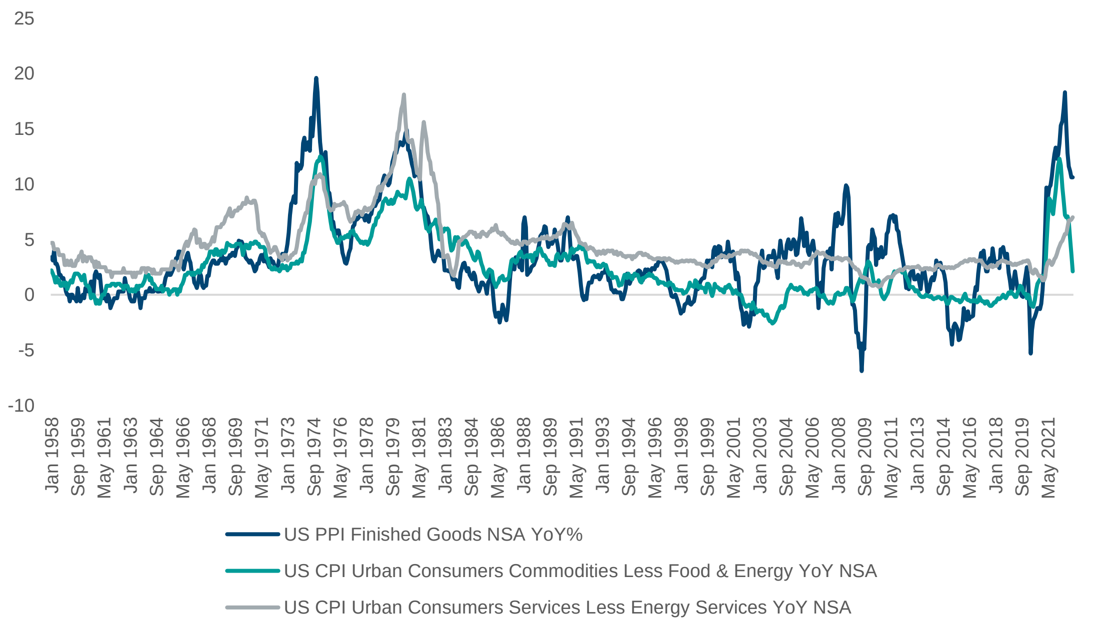
November, the unemployment rate in the UK and Japan remained unchanged at 3.7% and 2.6% respectively in November. The labour-intensive services sector has been one of the major drivers of core inflation in the US, as consumers rotate their spending from goods to services, while the easing of supply chain pressure has helped to reduce goods inflation. As a result, policymakers are more likely to pause rates at a high level than to make sharp rate cuts in the second half of 2023.

Figure 3: South African nominal vs real-yield and breakeven inflation



Source: Bloomberg

Figure 4: US core goods and services inflation, YoY



Source: Bloomberg

Sentiment towards emerging markets had already begun to improve in Q4 and this positive trend may continue if China's recovery largely offsets the slowdown in growth in the developed markets. Overall, we favour local nominal bonds as their valuation is attractive from a real-yield and hedged-yield perspective, while peaking inflation and stable monetary policies should be supportive of risk-on trade. Moreover, commodity exporters such as South Africa should benefit as commodity demand from China recovers.

Slowing growth inevitable, bringing earnings into focus

While the jury is out on whether there will be a mild recession, deeper recession or soft landing in the US, what is certain is that growth will continue to slow and the earnings outlook will remain uninspiring. On the one hand, stronger corporate and household balance sheets entering the slowdown may sustain the US economy, with an unusually warm winter and falling gas prices in the Eurozone providing some relief in terms of energy costs. On the other hand, inflation seems to have peaked in the US. However, to bring core inflation within the 2.0–2.5% range, wage growth needs to come down, which means that unemployment needs to go up and a recession becomes necessary. Quantitative tightening is also still in the early stages. The probability of the US landing up in a recession over the next 12 months has risen to 47.31%, according to the New York Federal Reserve Bank.

Figure 5: Global composite PMI indices

	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
Global Composite PMI	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
Global Services PMI	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
Developed Markets	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
Emerging Markets	54.1	52.1	52	52.6	53.5	52.7	50.8	52	49.3	52.3	52.8	52.5	53.3
Eurozone	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
France	49.5	47.7	47	50	51.6	57	57.4	56.6	55.9	55.3	54.7	56.1	55.8
Germany	52	50.8	51.1	57.3	55.8	56.2	60.1	62.4	60	55.5	52	52.2	49.9
Italy	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
Spain	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
Ireland	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
Australia	56.6	55.9	53.7	55.5	58.9	58	56.7	45.2	43.3	46	52.1	55.7	54.9
Sweden	59.6	61	62.4	62.8	67.1	70.1	67.2	67.8	63.7	68.2	67	67.1	65.8
UK	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
US	55.3	58.7	59.5	59.7	63.5	68.7	63.7	59.9	55.4	55	57.6	57.2	57
Japan	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
China	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
India	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
Brazil	53.5	48.9	49.6	45.1	44.5	49.2	54.6	55.2	54.6	54.7	53.4	52	52
Russia	48.3	52.3	52.6	54.6	54	56.2	55	51.7	48.2	50.5	49.5	48.4	50.2

	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22
Global Composite PMI	51.4	53.4	52.7	51	51.3	53.5	50.8	49.3	49.7	49	48	48.2
Global Services PMI	51.3	53.9	53.4	51.9	51.9	53.9	51.1	49.2	50	49.2	48.1	48.1
Developed Markets	51.3	54.7	56	55.5	53.7	52.5	49	46.9	49.3	48.5	47.3	47.1
Emerging Markets	50.8	51.3	46.8	43.4	46.9	55.2	54	53.4	50.1	49.8	49	50.1
Eurozone	52.3	55.5	54.9	55.8	54.8	52	49.9	48.9	48.1	47.3	47.8	49.3
France	52.7	55.5	56.3	57.6	57	52.5	51.7	50.4	51.2	50.2	48.7	49.1
Germany	53.8	55.6	55.1	54.3	53.7	51.3	48.1	46.9	45.7	45.1	46.3	49
Italy	50.1	53.6	52.1	54.5	52.4	51.3	47.7	49.6	47.6	45.8	48.9	49.6
Spain	47.9	56.5	53.1	55.7	55.7	53.6	52.7	50.5	48.4	48	49.6	49.9
Ireland	56.5	59.1	61	59.6	57.5	52.8	52.9	51	52.2	52.1	48.8	50.5
Australia	46.7	56.6	55.1	55.9	52.9	52.6	51.1	50.2	50.9	49.8	48	47.5
Sweden	66.9	65.3	63.1	64.4	64.2	60.3	57.2	56.9	53.5	54	51.9	51
UK	54.2	59.9	60.9	58.2	53.1	53.7	52.1	49.6	49.1	48.2	48.2	49
US	51.1	55.9	57.7	56	53.6	52.3	47.7	44.6	49.5	48.2	46.4	45
Japan	49.9	45.8	50.3	51.1	52.3	53	50.2	49.4	51	51.8	48.9	49.7
China	50.1	50.1	43.9	37.2	42.2	55.3	54	53	48.5	48.3	47	48.3
India	53	53.5	54.3	57.6	58.3	58.2	56.6	58.2	55.1	55.5	56.7	59.4
Brazil	50.9	53.5	56.6	58.5	58	59.4	55.3	53.2	51.9	53.4	49.8	49.1
Russia	50.3	50.8	37.7	44.4	48.2	50.4	52.2	50.4	51.5	45.8	50	48

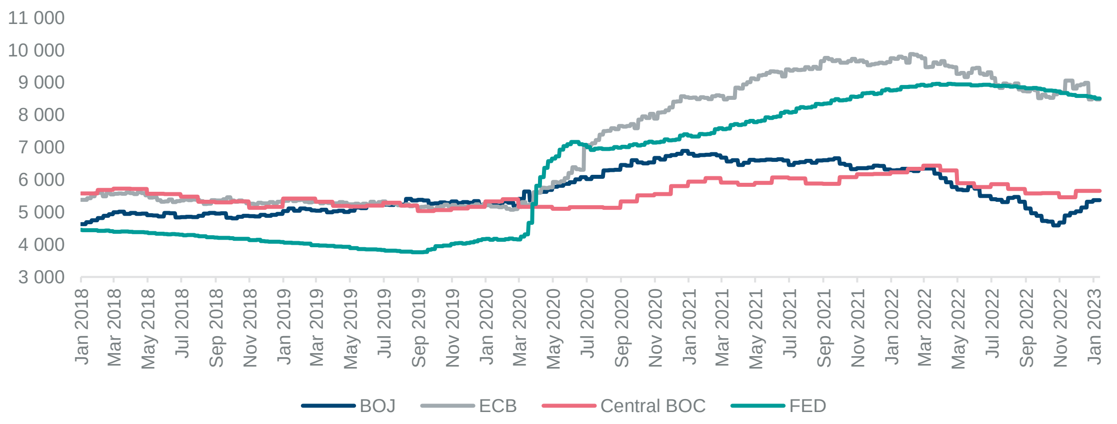
Source: Bloomberg

Figure 6: Global inflation

	Nov 2021	Dec 2021	Jan 2022	Feb 2022	Mar 2022	Apr 2022	May 2022	Jun 2022	Jul 2022	Aug 2022	Sep 2022	Oct 2022	Nov 2022	Dec 2022
Global	5.2	5.7	6.0	6.4	7.0	8.0	8.8	9.1	9.7	9.8	10.0	10.3	10.0	9.7
Citi Inflation Surprise Index - Global	58.1	82.9	70.5	74.0	80.0	80.8	80.1	68.9	63.1	47.8	42.1	44.2	31.6	18.4
Citi Inflation Surprise Index - Major Economies	71.9	107.8	97.6	104.7	113.5	107.4	102.2	89.4	82.2	64.6	63.7	69.5	51.7	33.1
Citi Inflation Surprise Index - Emerging Markets	37.3	45.4	29.9	27.9	29.9	40.8	46.9	38.1	34.3	22.6	9.7	6.3	1.6	-3.7
France	2.8	2.8	2.9	3.6	4.5	4.8	5.2	5.8	6.1	5.9	5.6	6.2	6.2	5.9
Germany	5.2	5.3	4.9	5.1	7.3	7.4	7.9	7.6	7.5	7.9	10.0	10.4	10.0	8.6
Greece	4.8	5.1	6.3	7.2	8.9	10.2	11.3	12.1	11.6	11.4	12.0	9.1	8.5	7.2
Ireland	5.3	5.5	5.0	5.6	6.7	7.0	7.8	9.1	9.1	8.7	8.2	9.2	8.9	8.9
Italy	3.7	3.9	4.8	5.7	6.5	6.0	6.8	8.0	7.9	8.4	8.9	11.8	11.8	11.6
Spain	5.5	6.5	6.1	7.6	9.8	8.3	8.7	10.2	10.8	10.5	8.9	7.3	6.8	5.7
Sweden	3.3	3.9	3.7	4.3	6.0	6.4	7.3	8.7	8.5	9.8	10.8	10.9	11.5	12.3
Switzerland	1.5	1.5	1.6	2.2	2.4	2.5	2.9	3.4	3.4	3.5	3.3	3.0	3.0	2.8
United Kingdom	5.1	5.4	5.5	6.2	7.0	9.0	9.1	9.4	10.1	9.9	10.1	11.1	10.7	10.7
United States	6.8	7.0	7.5	7.9	8.5	8.3	8.6	9.1	8.5	8.3	8.2	7.7	7.1	6.5
Australia	3.0	3.5	3.5	3.5	5.1	5.1	5.1	6.1	6.1	6.1	7.3	7.3	7.3	7.3
Japan	0.6	0.8	0.5	0.9	1.2	2.5	2.5	2.4	2.6	3.0	3.0	3.7	3.8	3.8
Brazil	10.7	10.1	10.4	10.5	11.3	12.1	11.7	11.9	10.1	8.7	7.2	6.5	5.9	5.8
China	2.3	1.5	0.9	0.9	1.5	2.1	2.1	2.5	2.7	2.5	2.8	2.1	1.6	1.8
India	4.9	5.7	6.0	6.1	7.0	7.8	7.0	7.0	6.7	7.0	7.4	6.8	5.9	5.7
Indonesia	1.8	1.9	2.2	2.1	2.6	3.5	3.6	4.4	4.9	4.7	6.0	5.7	5.4	5.5
Mexico	7.4	7.4	7.1	7.3	7.5	7.7	7.7	8.0	8.2	8.7	8.7	8.4	7.8	7.8
Russia	8.4	8.4	8.7	9.2	16.7	17.8	17.1	15.9	15.1	14.3	13.7	12.6	12.0	11.9
South Africa	5.5	5.9	5.7	5.7	5.9	5.9	6.5	7.4	7.8	7.6	7.5	7.6	7.4	7.4
South Korea	3.8	3.7	3.6	3.7	4.1	4.8	5.4	6.0	6.3	5.7	5.6	5.7	5.0	5.0
Taiwan	2.9	2.6	2.8	2.3	3.3	3.4	3.4	3.6	3.4	2.7	2.8	2.7	2.4	2.7

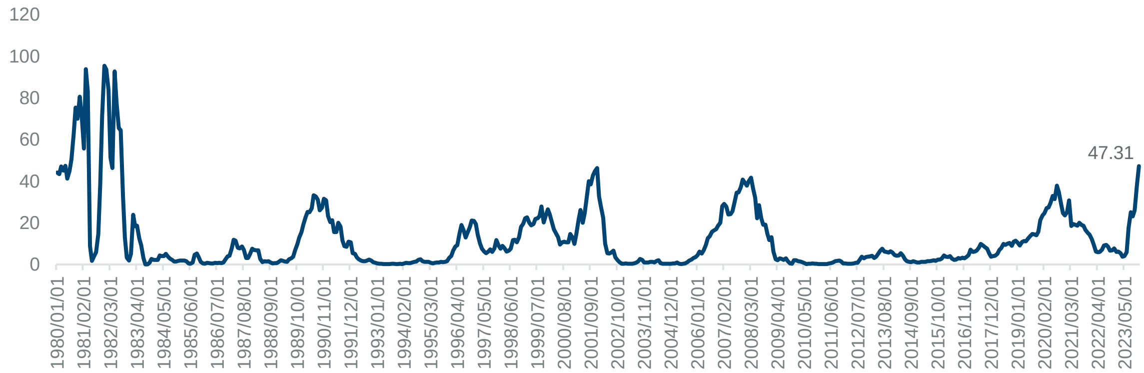
Source: Bloomberg

Figure 7: Major central banks' balance sheets in USD billions



Source: Bloomberg

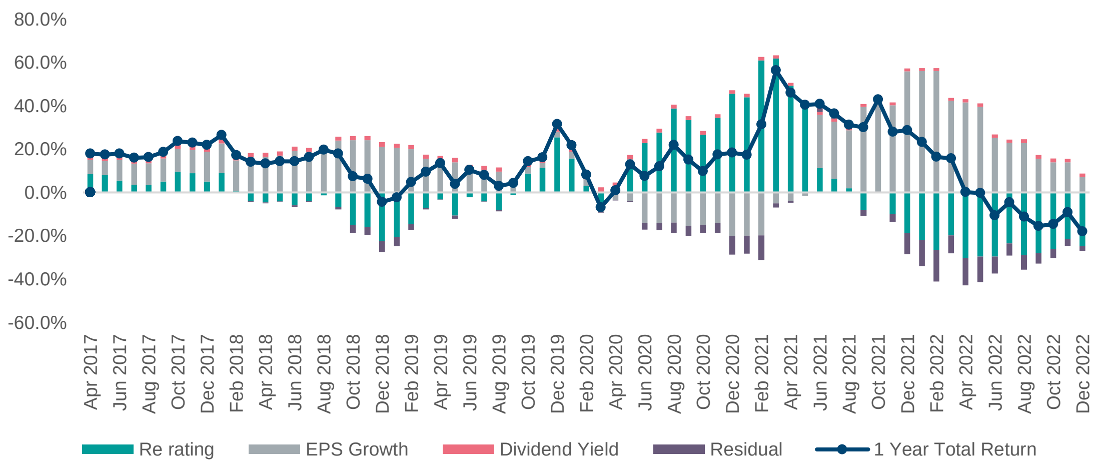
Figure 8: New York Federal Reserve Bank – probably of US recession in the next 12 months



Source: Bloomberg

Based on the return decomposition below, we can see that the market has to some extent priced in the slowdown in growth in the earnings per share, with re-rating being the major reason behind the dismal performance of equities last year.

Figure 9: S&P 500 return decomposition



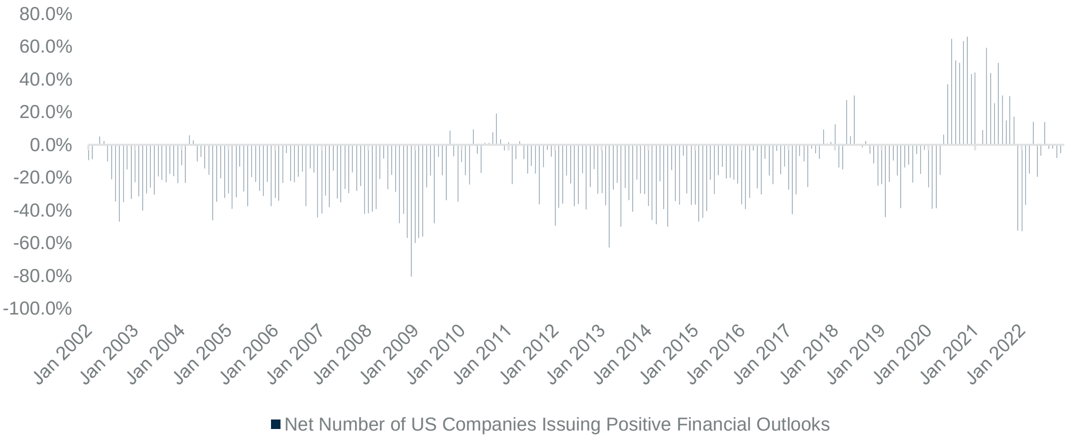
Source: Bloomberg

However, given the declining net number of US companies issuing positive financial outlooks, a shrinking percentage of companies with reported earnings above Bloomberg estimates and a rising percentage of companies with negative earnings surprises, and also given the fact that the market is currently still pricing in a 7.0% earnings growth rate for the next 12 months (although in a recession earnings can easily slide into the red), we expect company earnings to come under pressure over the next few months against the backdrop of slowing global growth.

Should the following scenario pay out – i.e., US inflation continues to cool quicker than what the Fed and the market expected, resulting in an earlier pause in interest rate hikes, and the reopening of the Chinese economy boosts consumption (not good for inflation) – this will create a risk-on sentiment, which will support EM assets and the ZAR.

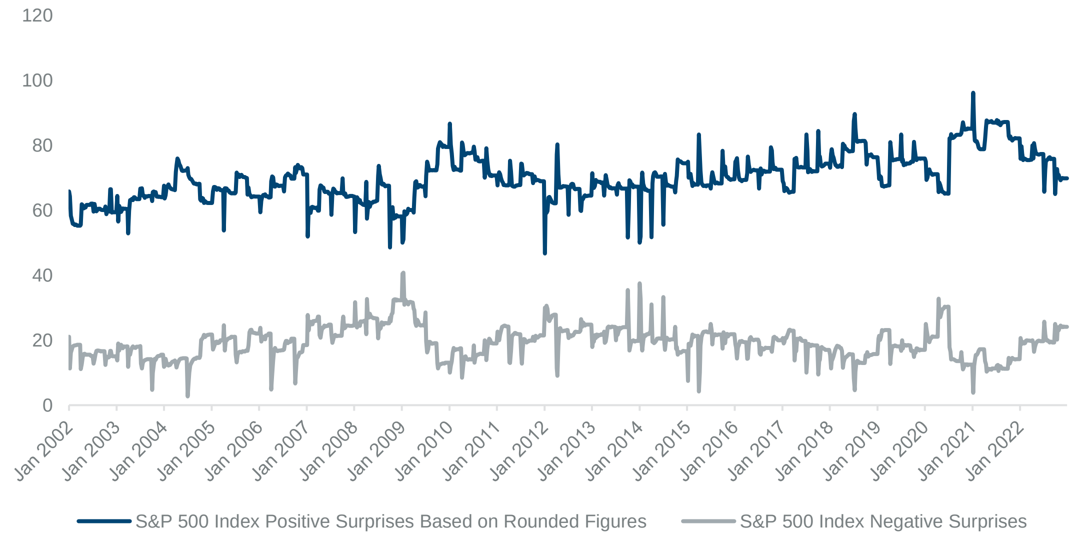
On balance, we therefore choose to maintain our moderately underweight position in offshore equity.

Figure 10: US companies issuing a financial outlook



Source: Bloomberg

Figure 11: S&P 500 positive earnings surprises and negative surprises



Source: Bloomberg

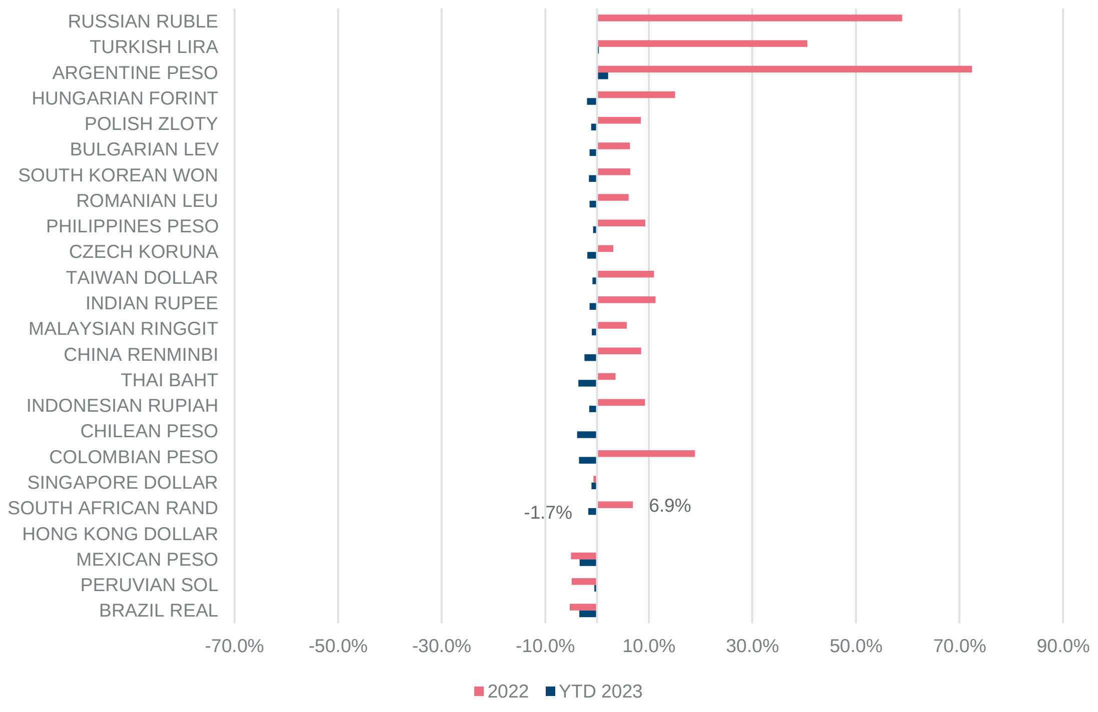
A higher probability of the US dollar weakening, despite the risk of binary events

We maintained a moderately overweight position in offshore cash for most of the second half of last year to ensure relatively neutral offshore exposure in a volatile macro and increasingly liquidity-tight environment – which resulted from our moderately underweight position in other offshore asset classes from time to time. The average overweight in offshore cash, however, has been the largest TAA alpha detractor since October 2022.

Usually, when the US hikes interest rates, the greenback appreciates against other major currencies, and vice versa, but there have been times when this correlation has not been evident. During periods of stress, investors typically favour US treasury or other USD assets denominated as safe havens, while central banks come to the rescue with rate cuts.

With inflation showing signs of peaking, the Fed and other major central banks are getting closer to slowing down or pausing their rate hikes. With inflation declining in the Eurozone and UK, but still at 9.2% and 10.5% respectively in December, there could be monetary policy divergence which would also be disadvantageous to the USD. The recovery that is under way in China may pose some near-term, upside risk to inflation, but the recovery will also offset, to some extent, the slowdown in global growth. In all, we favour emerging market assets – especially our local bourses, given their commodity exposure. We have therefore chosen to shift our moderately overweight position in offshore cash to neutral.

Figure 12: Performance of emerging market currencies



Source: Bloomberg

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