MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

16 February 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 also increased our neutral position in foreign cash to moderately overweight, 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 hedged yields and marginally attractive real yields over equivalent inflation-linked bonds, especially over the longer maturities of the yield curve. Meanwhile, despite commodity-exporting emerging markets standing to benefit from the tailwind of China's recovery-led and the overall improvement in sentiment towards emerging markets, idiosyncratic issues such as the permanent electricity crisis continue to weigh on the domestic economy and may threaten social stability. Despite more downward pressure on the USD, given the outlook for the relative growth gap between the US and the rest of world, the possibility of the Bank of Japan further relaxing its yield-curve control and the divergence in money policies across major central banks this year, the ZAR may lack a catalyst for significant recovery or may worsen further. We have therefore moved from neutral to moderately overweight in offshore cash to maintain a relatively neutral position in offshore assets. We have also chosen to remain moderately underweight in foreign equity as we expect corporate earnings to come under pressure and the tailwind from the excess savings that were accumulated during the pandemic in developed markets such as the US to fade this year. This means that any material deterioration in the labour market will negatively impact consumer spending and debt default rates.

TAA Overview

Market overview	Risk assets started the year on a high note, with the MSCI World and the MSCI Emerging Markets Indices up 7.1% and 7.9% respectively in USD terms for the month of January. The rebound was driven by easing inflation figures in December 2022 in the US and the Eurozone, which triggered optimism of less-restrictive monetary policy going forward. The hopes that central banks may end the rate hiking cycle soon, together with overhanging recession worries, caused the US treasury yields to fall. The 10-year US treasury yield declined by 37bps for the month of January. This led global bonds, proxied by the World Government Bond Index, to rally by 3.2% in January. Our local nominal bonds, the ALBI Index, were up 2.9% – outperforming inflation-linked bonds, proxied by the IGOV Index, which fell by 1.1% over the same period. The MSCI World Growth Index significantly outperformed the MSCI World Value Index, as growth stocks received support from the decline in yields. Similarly, the MSCI South Africa Growth Index outperformed the MSCI South Africa Value Index, returning 9.6% vs 4.4% over the same period.

Global property indices, such as the S&P Global Property and the FTSE EPRA NAREIT Global REITs, all massively outperformed the local SAPY Index in January. However, the SAPY Index still outperformed the global property indices by c.10.0% for the year to 31 January 2023. Commodity prices were mixed, with industrial metals such as aluminium, copper and iron ore performing well on the prospect of the return of increased demand from China. Meanwhile, platinum and palladium took strain as electric and hydrogen-powered vehicles continued to disrupt the auto industry, which negatively affected the short-term demand outlook. While the dollar index weakened by 1.4% in January, the rand still depreciated by 2.2% against the USD over the same period as investors grew increasingly concerned about the detrimental impact of the persistent power crisis on domestic growth.

The asset class performances were much more muted into February as steady core inflation numbers for January dampened hopes of a near-term Fed pivot. The expectation that the Fed may keep the rate elevated for longer, together with the credit rating agency Moody issuing a warning about South Africa's growth prospects in the face of the crippling Eskom crisis, saw the rand slide by another 2.0% for the month to date.

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

31 January 2023 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 09 February 2023
FTSE/JSE ALSI Total Return	8.9%	19.6%	8.9%	11.8%	16.6%	9.8%	10.5%	0.7%
FTSE/JSE Capped SWIX Total Return	7.0%	14.0%	7.0%	9.1%	13.6%	6.4%	8.9%	0.3%
S&P 500 Total Return	6.3%	5.8%	6.3%	-8.2%	9.9%	9.5%	12.7%	0.2%
STOXX 600 Total Return	6.7%	10.2%	6.7%	-0.8%	5.7%	5.4%	7.5%	2.0%
Nikkei 225 Total Return	4.7%	-0.8%	4.7%	3.5%	7.7%	5.5%	11.5%	0.9%
MSCI World Total Return	7.1%	9.8%	7.1%	-7.0%	8.1%	7.0%	9.6%	0.2%
MSCI ACWI Total Return	7.2%	11.1%	7.2%	-7.5%	7.3%	6.1%	8.8%	0.1%
MSCI EM Total Return	7.9%	22.3%	7.9%	-11.7%	1.8%	-1.1%	2.4%	-0.7%
MSCI World Value Index	4.7%	9.7%	4.7%	-0.1%	7.6%	5.0%	8.0%	-1.0%
MSCI World Growth Index	9.7%	9.9%	9.7%	-14.2%	7.6%	8.4%	11.0%	1.4%
MSCI World Small Cap Index	9.3%	12.1%	9.3%	-3.5%	7.5%	5.0%	9.1%	-0.3%
FTSE UK Series FTSE All Share TR	4.5%	10.4%	4.5%	5.2%	5.0%	4.2%	6.3%	1.9%
MSCI AC Asia Ex. Japan Index	8.2%	28.4%	8.2%	-10.0%	3.0%	-0.3%	4.5%	0.0%
MSCI Europe Excluding United Kingdom Index	7.5%	11.3%	7.5%	-0.5%	7.0%	6.5%	8.7%	2.0%
STEFI	0.6%	1.7%	0.6%	5.5%	4.8%	5.8%	6.2%	0.2%
ALBI	2.9%	7.6%	2.9%	6.4%	7.7%	8.1%	7.4%	0.1%
IGOV	-1.1%	2.4%	-1.1%	4.3%	7.5%	5.2%	4.9%	0.0%
WGBI	3.2%	7.7%	3.2%	-13.8%	-5.3%	-2.2%	-0.8%	-0.8%
Bloomberg Global Inflation-Linked Total Return Index	3.3%	6.4%	3.3%	-18.3%	-3.4%	-1.2%	0.2%	-0.5%
Bloomberg US Agg Total Return	3.1%	6.4%	3.1%	-8.4%	-2.3%	0.9%	1.4%	-1.1%
Bloomberg EuroAgg Total Return Index	2.2%	0.9%	2.2%	-14.4%	-5.7%	-1.8%	0.9%	0.2%
Bloomberg Global Agg Corporate Total Return Index	4.0%	10.0%	4.0%	-10.6%	-3.0%	-0.2%	1.3%	-0.9%
Bloomberg US Corporate High Yield Total Return Index	3.8%	5.4%	3.8%	-5.2%	1.3%	3.0%	4.3%	0.1%
Bloomberg Pan-European High Yield Total Return Index	3.2%	5.9%	3.2%	-7.0%	-1.0%	0.9%	3.8%	1.3%
J.P. Morgan EMBI Global Core Hedged EUR	3.1%	10.6%	3.1%	-15.8%	-6.7%	-3.1%	0.2%	-0.5%
SAPY Total Return	-1.0%	6.4%	-1.0%	2.4%	-2.7%	-5.5%	2.6%	0.8%
MSCI US REIT Total Return	10.6%	11.0%	10.6%	-10.3%	3.0%	6.7%	7.2%	-1.2%
S&P Global Property Total Return	8.3%	14.1%	8.3%	-12.7%	-1.8%	1.3%	4.1%	-0.8%
STOXX 600 Real Estate Total Return	10.1%	11.7%	10.1%	-29.3%	-10.5%	-3.4%	3.3%	2.5%
FTSE EPRA Nareit Global REITs TR Index	9.3%	12.5%	9.3%	-10.9%	-0.6%	3.5%	5.2%	-0.9%
Crude Oil	-1.7%	-10.9%	-1.7%	-7.4%	13.3%	4.1%	-3.1%	0.0%
Aluminium	11.2%	19.0%	11.2%	-12.5%	15.4%	3.6%	2.4%	-5.5%
Copper	10.2%	23.8%	10.2%	-3.0%	18.3%	5.3%	1.2%	-2.6%
Gold	5.7%	18.0%	5.7%	7.3%	6.7%	7.5%	1.5%	-3.5%
Platinum	-5.6%	9.0%	-5.6%	-0.7%	1.8%	0.2%	-4.9%	-5.5%
Nickel	0.9%	39.0%	0.9%	32.5%	33.2%	17.3%	5.1%	0.0%
Palladium	-7.8%	-10.4%	-7.8%	-29.8%	-10.3%	9.9%	8.3%	-1.2%
Iron Ore	5.5%	49.4%	5.5%	-11.0%	9.7%	10.5%	-2.4%	-3.4%
Bloomberg Commodity Index Total Return	-0.5%	-0.3%	-0.5%	6.2%	15.4%	5.9%	-1.6%	-3.4%
USDZAR	2.2%	-5.2%	2.2%	13.1%	5.0%	8.0%	6.9%	2.0%
GBPZAR	4.1%	1.9%	4.1%	3.6%	2.7%	5.0%	4.2%	0.4%
EURZAR	3.7%	4.3%	3.7%	9.4%	4.3%	5.2%	4.5%	0.8%
JPYZAR	2.8%	8.3%	2.8%	0.0%	-1.2%	4.3%	3.2%	1.0%
Dollar Index Spot	-1.4%	-8.5%	-1.4%	5.8%	1.6%	2.8%	2.6%	1.1%

Source: Bloomberg

Tactical views	Stick with the high-conviction, active bets while the world economy is at a crossroads

Tactical views

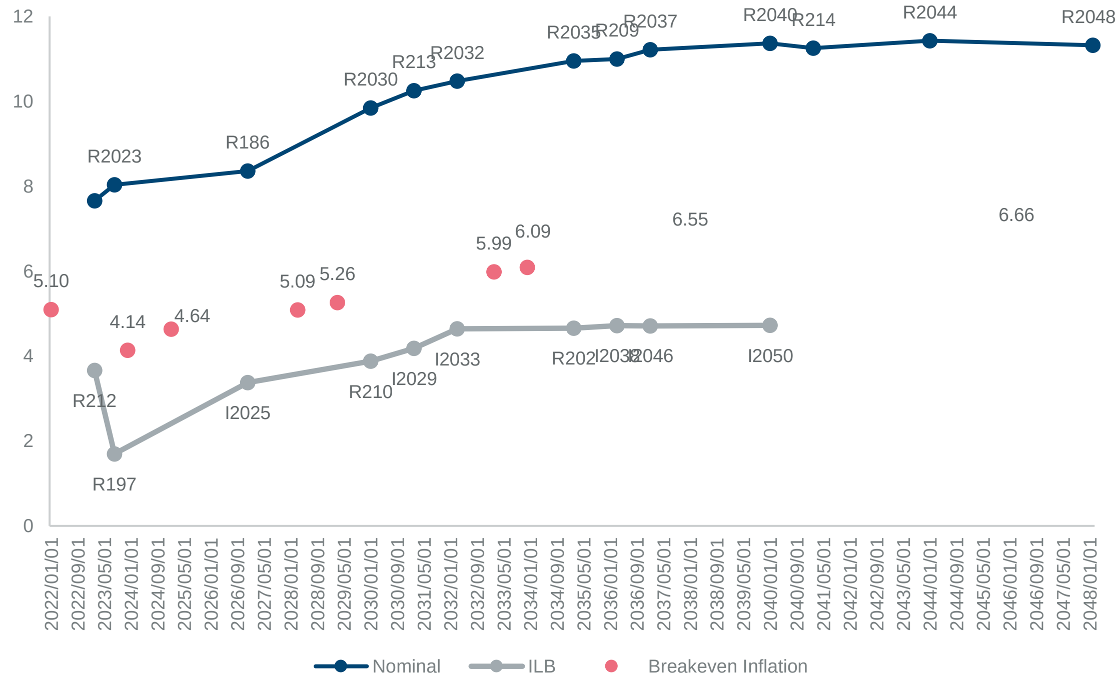
Stick with the high-conviction, active bets while the world economy is at a crossroads

We maintained our moderately overweight position in local nominal bonds as the 10-year nominal bonds and longer maturity bonds offered marginally more compensation for inflation than their equivalent maturity inflation-linked bonds. The local nominal bonds also remained attractive from a hedged-yield perspective as the hedged-yield spread remains elevated, despite having come down from its COVID peak. Our 10-year nominal bonds are also offering real yields on a par with those of the Brazilian 10-year government bonds, based on inflation expectations. However, the latter are offering high nominal and real yields, judging from the latest inflation figure.

We expect China's reopening to benefit commodity-exporting countries in the short to medium term, as the recovery in business activity and the Chinese government's infrastructure investment push and potential monetary policy easing could drive demand for commodities. This would benefit countries such as South Africa, offsetting the impact, to some extent, of slowing growth in developed markets. Yet the persistent loadshedding in South Africa continues to weigh on consumer and business sentiment, the cost of living and operating margins, and commodity export volumes.

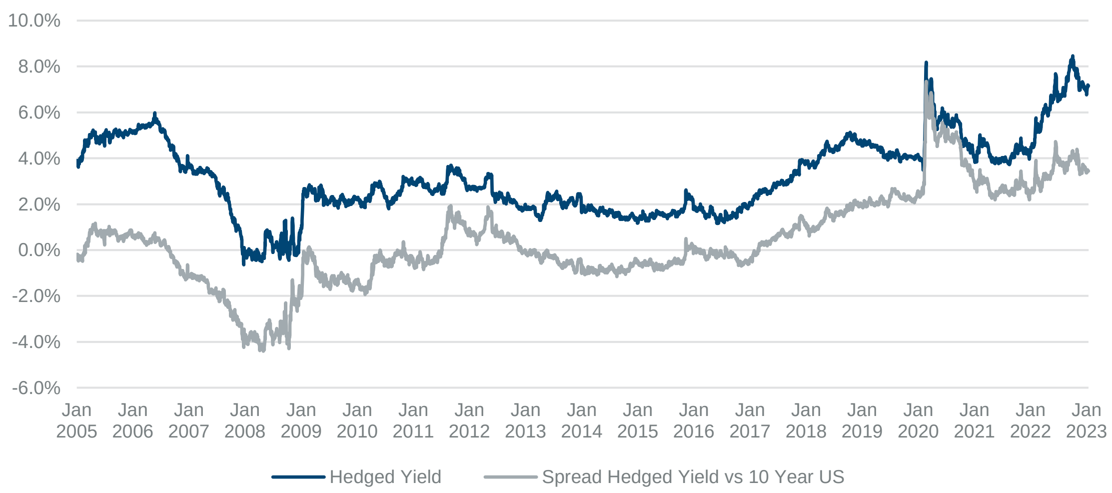
Retail sales for December were much weaker than the market expectation, i.e., -0.6% vs 0.5%. CPI year on year slowed from 7.2% in December 2022 to 6.9% in January 2023. However, core CPI year on year was much stickier at 4.9%. We expect local consumers to remain under tremendous pressure, given the double-digit increases in food and transport prices. Manufacturing production year on year contracted by 4.7% in December. The good news, though, is that the manufacturing PMI stayed relatively robust at 53 for January 2023.

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



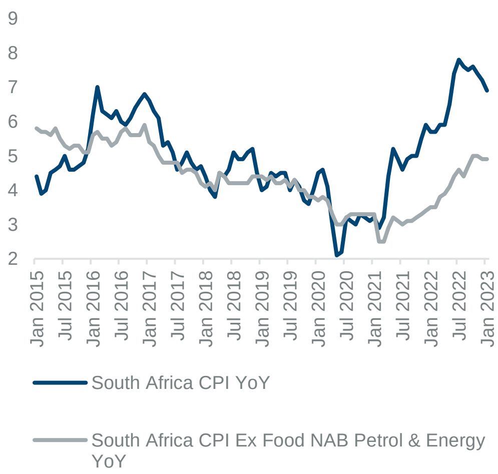
Source: Bloomberg

Figure 4: South Africa 10-year USD-hedged yield and spread



Source: Bloomberg

Figure 5: South Africa CPI and core CPI YoY



Source: Bloomberg

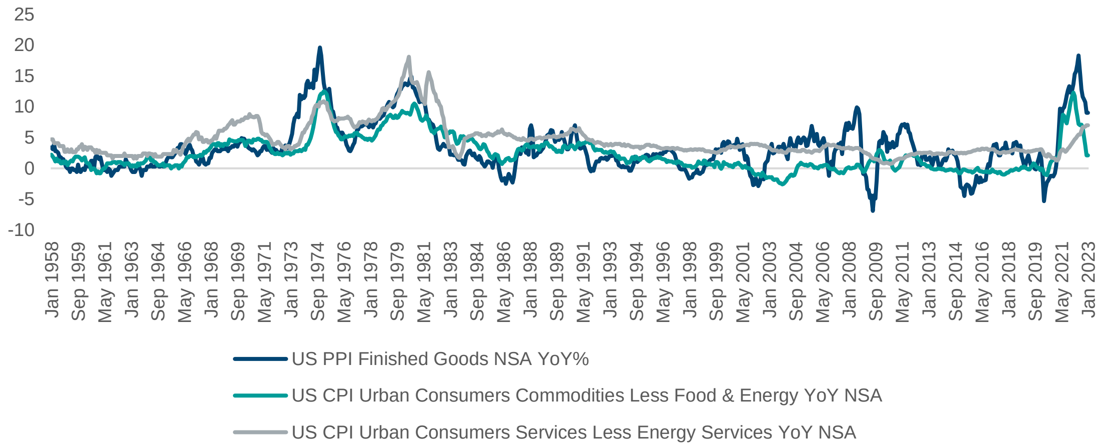
Figure 6: South Africa CPI per category

	September YoY	October YoY	November YoY	December YoY	January YoY
Housing & Utilities	4.2%	4.3%	4.3%	4.1%	4.1%
Food & Non Alcoholic Beverages	11.9%	12.0%	12.5%	12.4%	13.4%
Miscellaneous Goods & Services	4.0%	4.8%	4.8%	4.9%	4.8%
Transport	17.9%	17.1%	15.3%	13.9%	11.1%
Alcoholic Beverages & Tobacco	5.9%	6.2%	6.5%	6.2%	6.5%
Recreation & Culture	2.9%	2.9%	2.9%	3.4%	3.2%
Household Contents & Services	5.1%	5.5%	5.6%	6.1%	6.2%
Clothing & Footwear	2.8%	2.8%	2.7%	2.8%	2.7%
Restaurants & Hotels	7.9%	7.8%	7.9%	7.8%	5.5%
Communication	-0.4%	-0.4%	-0.9%	-0.9%	-0.4%
Education	4.4%	4.4%	4.4%	4.4%	4.4%
Health	4.3%	4.6%	4.8%	4.8%	4.8%

The performance of local bonds has largely been determined by global financial conditions, which means the asset class would benefit from the risk-on trade when risk sentiment is supportive. However, we believe that, by virtue of it being a fixed income, it also provides some protection against an economic downturn. Therefore, we chose to remain moderately overweight in this asset class.

Turning to global equities, our investment case remained unchanged. While inflation in the US and Eurozone has shown signs of peaking, the speed of deceleration differs markedly across the developed nations. CPI in the Eurozone slowed from 10.1% in November to 9.2% in December, due to a relatively mild winter and a lower average natural gas purchase price which mitigated the risk of a deep winter recession. However, core CPI for the region climbed from 5.0% to 5.2% over the same period. Inflation in the UK also remained very elevated, with CPI annual growth slowing from 10.5% in December to 10.1% in January 2023 and core CPI year on year slowing from 6.3% to 5.8% over the same period. US CPI year on year slowed from 6.5% in December to 6.4% to January; similarly, core CPI remained sticky as it saw only a marginal decline, from 5.7% to 5.6%, over the same period.

Figure 7: US core goods and services inflation YoY



Source: Bloomberg

While goods inflation has seen a sharp moderation since June last year, services inflation has risen and wage growth has remained robust. The labour market remains tight in most developed markets, with unemployment rates at historical lows. However, labour participation has seen a steady recovery in the US. Cooling wage growth and housing markets should help to take the heat off shelter and services inflation, contributing to a further moderation in overall consumer prices. Nevertheless, inflation rates may still be above the central bank targets for most of the year.

Figure 8: US hourly earnings

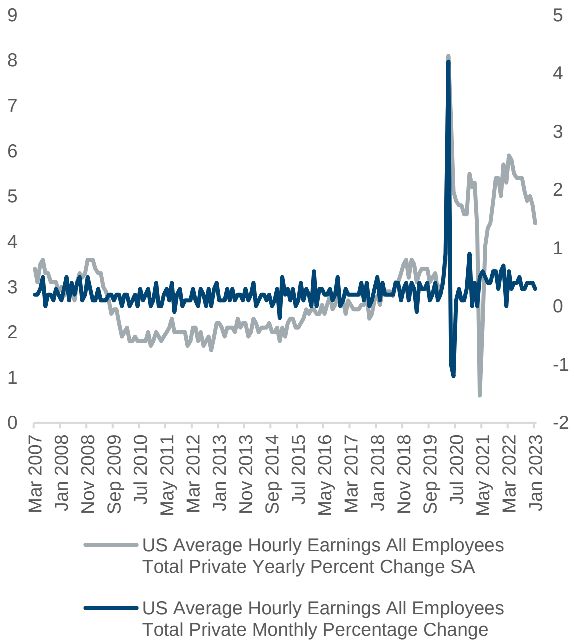
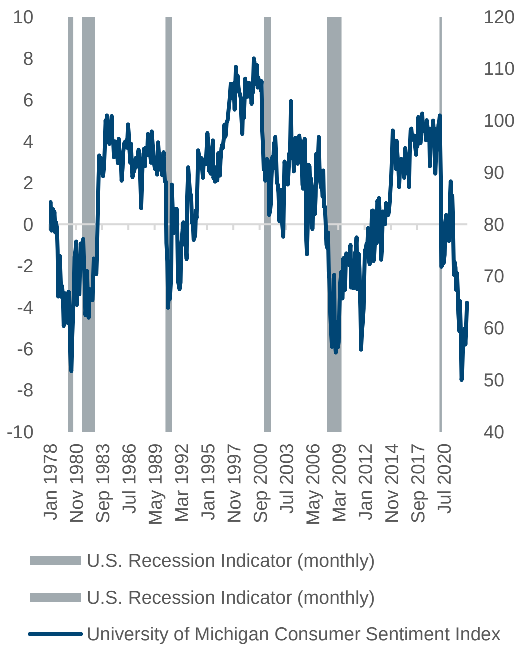


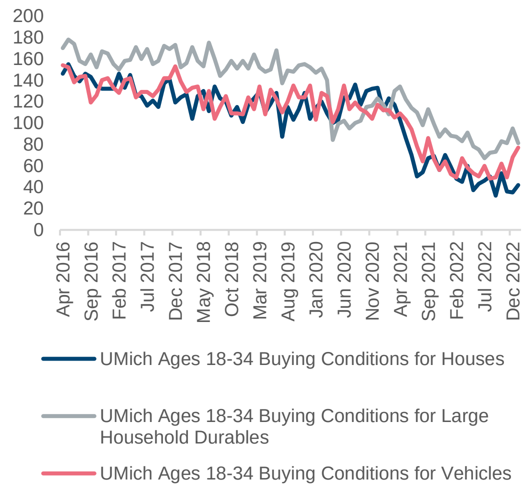
Figure 9: US consumer sentiment



Source: Bloomberg

US consumer sentiment remained subdued, with buying conditions continuing to suggest cautious spending ahead. The stimulus programmes rolled out during the pandemic, which boosted household excess savings and the resilience of the US labour market, have fuelled consumer consumption. According to the latest data release from the Bureau of Economic Analysis, the personal savings ratio dropped from a record high of 33.6% in March 2020 to 3.40% in December 2022. The level of consumer excess savings accumulated during the COVID-19 pandemic declined from a peak of USD 2.1tn to below USD1.0tn by the end of 2022. According to the New York Fed, total outstanding credit card balances reached USD 986bn by Q4 2022 (the highest level since the New York Fed began tracking these in 1999), amounting to a USD 61bn jump from Q3 2022. What is more concerning is that the delinquency rate for credit card borrowers has surpassed pre-COVID norms, with younger borrowers struggling the most. As the tailwind from the pandemic stimulus fades, a softening in the labour market could trigger a material decline in consumer spending and debt defaults.

Figure 10: US buying conditions



Source: Bloomberg, JPMorgan Asset Management

Figure 11: US household excess savings

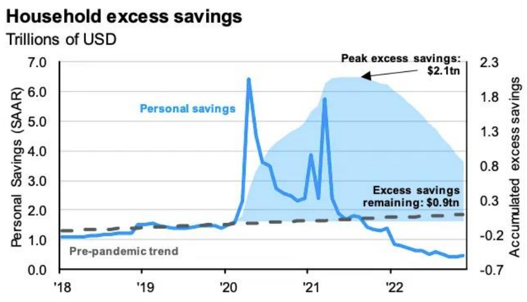
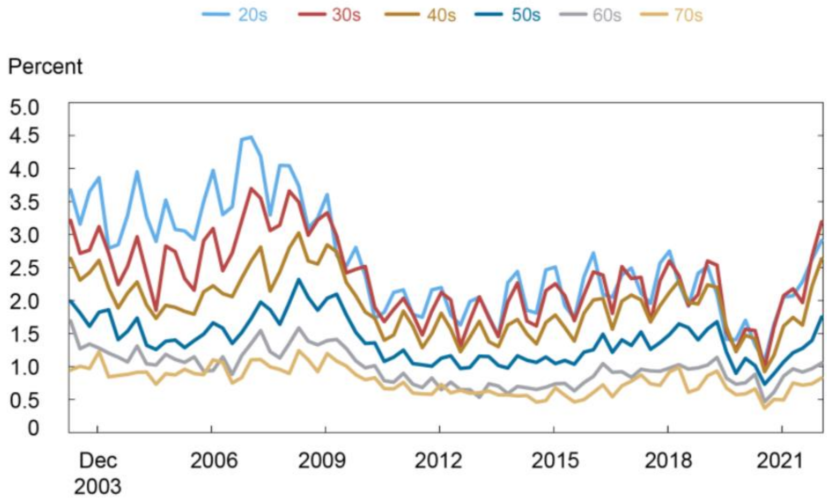


Figure 12: US personal savings rate

Source: Tradingeconomics.com, US Bureau of Economic Analysis

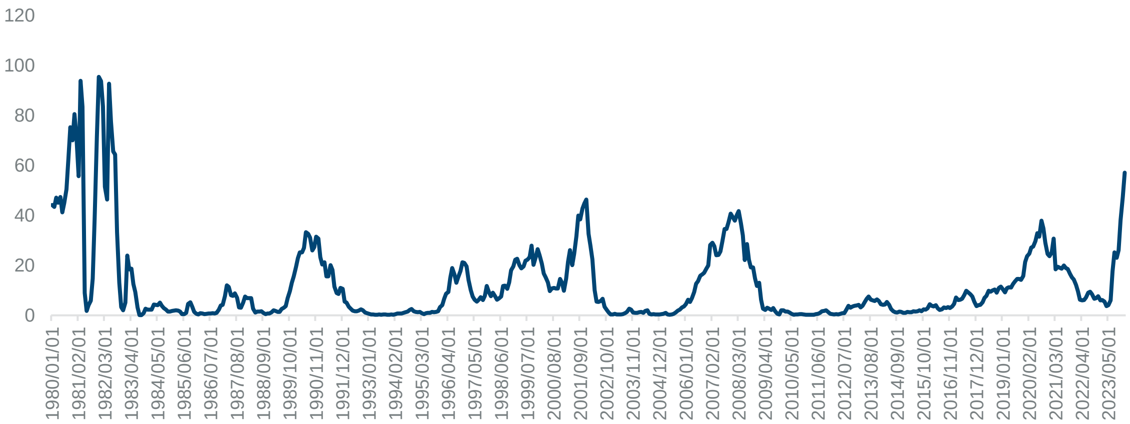
Figure 13: Share of credit card borrowers transitioning to 90 days past due by age group



Source: New York Fed Consumer Credit Panel, Equifax

The probability of the US landing in a recession over the next 12 months has risen from 47.31% to 57.13%, according to the New York Federal Reserve Bank. The trade-off between the deceleration in consumption-based inflation measures and growth will be the main determinant of risk asset performance in 2023. While our base case is for inflation rates to moderate, we expect it will take some time for labour market conditions to ease and the Fed will keep rates in restrictive territory – unless it is willing for the inflation rate to settle above the 2.0% target. We continue to expect company earnings to come under pressure over the next few months against the backdrop of slowing global growth. However, the fact that Chinese growth most likely bottomed out in December 2022 will have some positive implications for global growth. We therefore favour emerging market assets over developed market assets, which has translated into our moderately underweight position in offshore equities.

Figure 14: New York Federal Reserve Bank – probability of US recession in the next 12 months



Source: Bloomberg

We have also adopted a neutral position in offshore cash for the month of February as we expect a divergence in monetary policies, an acceleration in China's reopening, a moderated recession risk in the Eurozone from the defused energy crisis, and the possibility of the Bank of Japan

	abandoning its yield-curve control policy, which are disadvantageous towards the USD. Our relative preference for emerging market assets over developed market assets has translated into a neutral position in SA equities, a moderately overweight position in SA nominal bonds, a moderately underweight position in offshore equities, and a neutral position in offshore bonds. Yet, the domestic economy is very vulnerable as the punitive effects of various stages of loadshedding continue to weigh on consumer and business sentiment, despite a relatively positive outlook for the gap between US and non-US growth. We have therefore moved from a neutral to a moderately overweight position in offshore cash to maintain a relatively neutral allocation to offshore overall. This is to ensure some protection in the event that any significant dent in global risk sentiment and greater destabilisation of the domestic economic, political and social landscapes further weakens the ZAR against the USD.

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