MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

23 March 2023

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We have kept our TAA positions unchanged, 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 compared to equivalent inflation-linked bonds, especially over the longer maturities of the yield curve. South Africa should benefit from China reopening, since a rebound in economic activities would increase demand for commodities and revitalise global tourism. However, the ongoing electricity crisis and the lack of much-needed economic reforms continue to weigh on the domestic economy. We have maintained our moderately underweight position in offshore equities as we believe the earnings outlook is yet to fully price in a moderate recession. Meanwhile, near-term volatility may remain elevated as damage from rate hikes may reveal further cracks in the economy. We have also maintained our moderately overweight position in offshore cash to ensure both a relatively neutral allocation to offshore overall and some protection in the event of a significant dent in global risk sentiment. However, we expect limited further material weakness in the ZAR against the USD.

TAA Overview

Market overview	Improving inflation data fuelled hopes of an imminent end to the global monetary tightening cycle, which drove the markets higher in January. However, resilient economic data in February led to a decline in equity markets as investors reassessed the potential peak in interest rates. Instead of cheering the chances of a delayed recession, markets were disappointed by the prospect of delayed monetary policy easing after the latest round of economic data releases. Central banks certainly need to do more to bring inflation back to the target level. The MSCI World Index returned -2.4%, outperforming the MSCI Emerging Markets Index, which returned -6.5% in February. This was while a re-escalation in geopolitical tensions weighed on risk sentiment and the better-than-expected economic data from the US pushed up interest rate expectations, drove the greenback higher and sent further headwinds to the emerging markets. European equities, the STOXX 600 Index, returned 1.9% as the composite PMI index for the Eurozone region advanced from neutral in January into expansionary territory in February. This painted an encouraging economic picture for the region, with lower energy costs improving both consumer and business sentiment. The MSCI World Value Index underperformed against the MSCI World Growth Index again in February as well as into March. The ALSI Index declined by 2.2% in February and fell by another 6.3% into March, driven by the grey-listing by the Financial Action Task Force, the effects of the crippling power crisis on South African companies' earnings,

and heightened concerns over the stability of the financial systems in the US and Europe after the SVB and Credit Suisse bank failures.

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

28 February 2023 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 19 March 2023
FTSE/JSE ALSI Total Return	-2.2%	4.1%	6.5%	6.2%	19.5%	9.8%	10.5%	-6.3%
FTSE/JSE Capped SWIX Total Return	-2.3%	1.6%	4.5%	3.8%	16.5%	6.1%	8.8%	-6.3%
S&P 500 Total Return	-2.4%	-2.3%	3.7%	-7.7%	12.1%	9.8%	12.3%	-1.2%
STOXX 600 Total Return	1.9%	5.1%	8.7%	4.4%	9.5%	6.6%	7.5%	-5.2%
Nikkei 225 Total Return	0.5%	-1.6%	5.2%	5.8%	11.2%	6.6%	11.1%	-0.4%
MSCI World Total Return	-2.4%	0.2%	4.6%	-6.9%	10.4%	7.4%	9.4%	-2.0%
MSCI ACWI Total Return	-2.8%	0.1%	4.2%	-7.8%	9.3%	6.3%	8.5%	-1.9%
MSCI EM Total Return	-6.5%	-0.4%	0.9%	-14.9%	1.3%	-1.5%	1.9%	-1.1%
MSCI World Value Index	-2.9%	-0.7%	1.7%	-1.4%	10.1%	5.5%	7.7%	-5.6%
MSCI World Growth Index	-1.8%	1.1%	7.7%	-12.7%	9.7%	8.7%	10.7%	1.4%
MSCI World Small Cap Index	-2.0%	3.5%	7.1%	-5.7%	10.2%	5.5%	8.8%	-7.1%
FTSE UK Series FTSE All Share TR	1.5%	4.6%	6.1%	7.3%	8.8%	5.3%	6.3%	-6.5%
MSCI AC Asia Ex. Japan Index	-6.8%	0.7%	0.8%	-14.1%	1.6%	-0.6%	3.8%	-0.3%
MSCI Europe Excluding United Kingdom Index	1.5%	5.5%	9.1%	5.3%	10.4%	7.6%	8.8%	-4.6%
STEFI	0.5%	1.7%	1.1%	5.7%	4.8%	5.8%	6.2%	0.3%
ALBI	-0.9%	2.7%	2.0%	4.9%	7.4%	7.1%	7.2%	0.1%
IGOV	0.5%	2.1%	-0.6%	2.6%	7.4%	5.1%	4.9%	0.5%
WGBI	-3.3%	-0.4%	-0.3%	-15.8%	-6.6%	-2.8%	-1.0%	3.5%
Bloomberg Global Inflation-Linked Total Return Index	-3.2%	-1.7%	0.0%	-21.1%	-4.4%	-1.5%	0.1%	2.6%
Bloomberg US Agg Total Return	-2.6%	0.0%	0.4%	-9.7%	-3.8%	0.5%	1.1%	2.5%
Bloomberg EuroAgg Total Return Index	-2.1%	-3.6%	0.1%	-14.3%	-6.5%	-2.2%	0.6%	2.8%
Bloomberg Global Agg Corporate Total Return Index	-3.2%	0.9%	0.7%	-11.7%	-4.1%	-0.4%	1.0%	1.5%
Bloomberg US Corporate High Yield Total Return Index	-1.3%	1.8%	2.5%	-5.5%	1.3%	2.9%	4.1%	-1.0%
Bloomberg Pan-European High Yield Total Return Index	0.1%	2.4%	3.3%	-4.2%	-0.3%	1.1%	3.7%	-1.2%
J.P. Morgan EMBI Global Core Hedged EUR	-2.7%	0.2%	0.3%	-12.3%	-7.2%	-3.1%	0.0%	-0.2%
SAPY Total Return	-0.7%	-0.6%	-1.7%	5.1%	2.7%	-3.6%	2.0%	-3.5%
MSCI US REIT Total Return	-4.8%	-0.1%	5.3%	-11.7%	4.1%	7.4%	6.5%	-7.0%
S&P Global Property Total Return	-4.7%	0.6%	3.3%	-14.8%	-0.8%	1.7%	3.6%	-5.6%
STOXX 600 Real Estate Total Return	-2.1%	5.9%	7.8%	-28.8%	-8.9%	-2.7%	2.9%	-10.5%
FTSE EPRA Nareit Global REITs TR Index	-4.3%	1.2%	4.6%	-12.6%	0.9%	4.0%	4.6%	-6.3%
Crude Oil	-0.7%	-1.8%	-2.4%	-16.9%	18.4%	5.0%	-2.8%	-13.0%
Aluminium	-10.2%	-4.2%	-0.2%	-29.6%	11.9%	2.2%	1.7%	-4.2%
Copper	-2.8%	8.8%	7.0%	-9.3%	16.7%	5.3%	1.4%	-4.3%
Gold	-5.3%	3.3%	0.2%	-4.3%	4.8%	6.7%	1.5%	8.9%
Platinum	-5.8%	-7.8%	-11.0%	-8.7%	3.3%	-0.6%	-4.9%	2.4%
Nickel	-18.4%	-8.4%	-17.7%	0.1%	26.4%	12.4%	4.1%	0.0%
Palladium	-14.2%	-24.7%	-20.9%	-43.1%	-18.5%	6.3%	6.9%	0.3%
Iron Ore	-0.8%	20.6%	4.6%	-7.4%	13.4%	9.1%	-2.5%	3.1%
Bloomberg Commodity Index Total Return	-4.7%	-7.5%	-5.2%	-4.7%	15.5%	5.3%	-1.6%	-3.1%
USDZAR	5.5%	6.7%	7.7%	19.4%	5.4%	9.2%	7.4%	0.6%
GBPZAR	2.9%	6.4%	7.2%	7.0%	3.2%	6.3%	4.9%	1.9%
EURZAR	2.7%	8.5%	6.4%	12.5%	4.0%	6.2%	5.1%	1.6%
JPYZAR	0.8%	8.2%	3.7%	0.9%	-2.4%	4.0%	3.3%	4.0%
Dollar Index Spot	2.7%	-1.0%	1.3%	8.4%	2.2%	3.0%	2.5%	-1.1%

Source: Bloomberg

Major global bond indices fell in February as global government bond yields moved higher in the face of markets anticipating higher rates for longer, thereby reversing many of the gains made in January. The US Corporate High Yield underperformed against the European High Yield. Our local bonds fared better with the ALBI returning -0.9% in February but underperforming against the IGOV which returned 0.5% over the same period. However, with the ZAR depreciating by 5.5% in February, the positive currency translation effect still resulted in offshore bonds outperforming local bonds in ZAR terms.

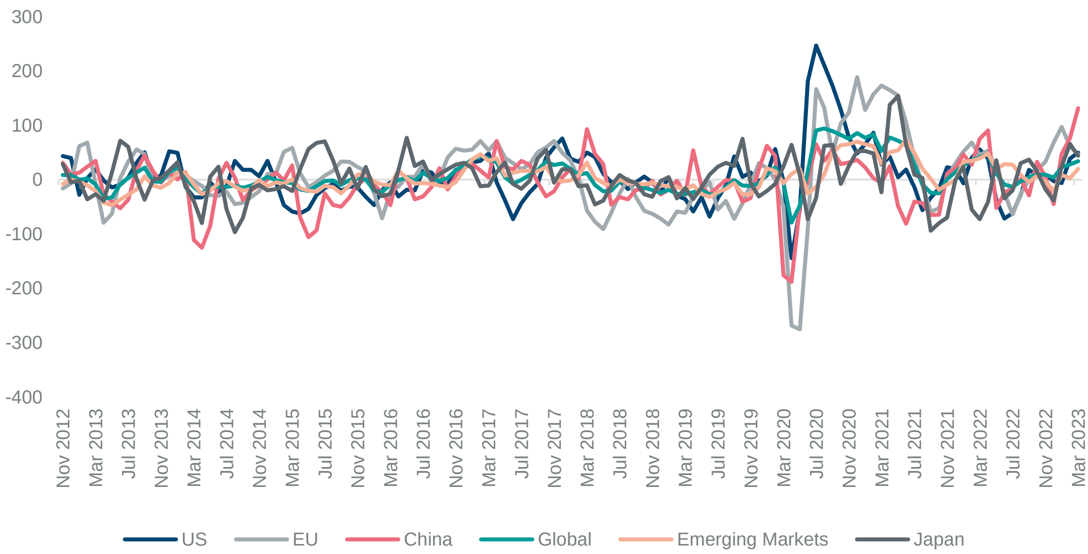
The local property SAPY Index fared much better than global property indices in local currency terms in February, while the SAPY Index significantly outperformed global properties into March. Commodities in general declined in February, with the Bloomberg Commodity Index falling by 4.7% and declining by a further 3.1% into March. The best-performing metals were gold and iron ore. The gold price was boosted by investors seeking safe havens amid the recent turmoil in the banking sector and by the anticipated end of the rate hiking cycle, allowing more room for a rise in the metal price. Iron ore mainly benefited from the positive demand forecasts in China. The Dollar Index strengthened by 2.7% against other major currencies in February but declined by 1.1% into March as concerns about the banking sector eased.

Tactical views

South Africa should benefit from a China restart despite the ongoing power crisis denting upside expectations

Most major economic regions produced macro data that exceeded market expectations. We saw the biggest jump from China as its economy returned to normal after the relaxation of the zero-Covid policy. The manufacturing PMI in China improved from 50.1 in January to 52.6 in February, while the non-manufacturing PMI improved from 54.4 to 56.3 over the same period. Meanwhile, China's CPI YoY for February slowed from 2.1% in January to 1.0% in February, leaving ample room for further monetary and fiscal stimulus. The post-lockdown re-opening of China could lead to a rapid recovery of the Chinese economy as consumption is revived, despite rising geopolitical tensions between the US and China. In addition, the rebound in economic activity and pent-up demand are expected to have positive implications for China's major trade partner. South Africa, being a commodity exporter, should also benefit from China's stronger demand for minerals. In addition, the country's underutilised tourism capacity could benefit from the post-pandemic reopening of China.

Figure 3: Economic surprise indices



Source: Bloomberg

The domestic growth outlook in South Africa remains constrained by the crippling power crisis and the government's lack of political will to implement long-awaited economic reforms. The GDP growth rate slowed from 4.1% year on year in Q3 to 0.9% in Q4 2022, well below the market expectation of 2.2%. The manufacturing PMI also contracted from 53 in January to 48.8 in February. This stood in contrast to most other emerging markets, which saw improvements in their manufacturing PMI readings. The current account balance also worsened from -0.3% of GDP in Q3 to -2.6% of GDP in Q4 2022. Our overall investment case for South Africa remained largely unchanged. China's reopening would offset some of the negative impact of the slowdown in the developed world, while persistent loadshedding in South Africa continues to weigh on consumer and business sentiment and place upward pressure on the cost of living and hurt operating margins.

Figure 4: Global manufacturing PMI

	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23
Global Manufacturing PMI	53.2	53.6	53	52.2	52.3	52.2	51.1	50.3	49.8	49.4	48.8	48.6	49.1	50
Developed Markets	56.3	56.6	56.5	56.3	55	52.5	51.3	50.3	50.1	48.8	47.8	47.3	48.1	48.1
Emerging Markets	50	50.9	49.2	48.1	49.5	51.7	50.8	50.2	49.4	49.8	49.7	49.8	49.9	51.6
Eurozone	58.7	58.2	56.5	55.5	54.6	52.1	49.8	49.6	48.4	46.4	47.1	47.8	48.8	48.5
France	55.5	57.2	54.7	55.7	54.6	51.4	49.5	50.6	47.7	47.2	48.3	49.2	50.5	47.4
Germany	59.8	58.4	56.9	54.6	54.8	52	49.3	49.1	47.8	45.1	46.2	47.1	47.3	46.3
Italy	58.3	58.3	55.8	54.5	51.9	50.9	48.5	48	48.3	46.5	48.4	48.5	50.4	52
Spain	56.2	56.9	54.2	53.3	53.8	52.6	48.7	49.9	49	44.7	45.7	46.4	48.4	50.7
Greece	57.9	57.8	54.6	54.8	53.8	51.1	49.1	48.8	49.7	48.1	48.4	47.2	49.2	51.7
Ireland	59.4	57.8	59.4	59.1	56.4	53.1	51.8	51.1	51.5	51.4	48.7	48.7	50.1	51.3
Australia	55.1	57	57.7	58.8	55.7	56.2	55.7	53.8	53.5	52.7	51.3	50.2	50	50.5
Sweden	62.4	58.6	57.3	55	54.9	53.7	53.1	50.6	49.2	46.8	45.9	45.9	46.8	47
Denmark	60.9	50.7	62.1	63	61.2	71.3	38	48	49.8	52.1	45.9	51.2	54.9	44.1
UK	57.3	58	55.2	55.8	54.6	52.8	52.1	47.3	48.4	46.2	46.5	45.3	47	49.3
US	55.5	57.3	58.8	59.2	57	52.7	52.2	51.5	52	50.4	47.7	46.2	46.9	47.3
Japan	55.4	52.7	54.1	53.5	53.3	52.7	52.1	51.5	50.8	50.7	49	48.9	48.9	47.7
China	49.1	50.4	48.1	46	48.1	51.7	50.4	49.5	48.1	49.2	49.4	49	49.2	51.6
Indonesia	53.7	51.2	51.3	51.9	50.8	50.2	51.3	51.7	53.7	51.8	50.3	50.9	51.3	51.2
South Korea	52.8	53.8	51.2	52.1	51.8	51.3	49.8	47.6	47.3	48.2	49	48.2	48.5	48.5
Taiwan	55.1	54.3	54.1	51.7	50	49.8	44.6	42.7	42.2	41.5	41.6	44.6	44.3	49
India	54	54.9	54	54.7	54.6	53.9	56.4	56.2	55.1	55.3	55.7	57.8	55.4	55.3
Brazil	47.8	49.6	52.3	51.8	54.2	54.1	54	51.9	51.1	50.8	44.3	44.2	47.5	49.2
Mexico	46.1	48	49.2	49.3	50.6	52.2	48.5	48.5	50.3	50.3	50.6	51.3	48.9	51
Russia	51.8	48.6	44.1	48.2	50.8	50.9	50.3	51.7	52	50.7	53.2	53	52.6	53.6
South Africa	57.1	58.6	60	50.7	54.8	52.2	47.6	52.1	48.2	50	52.6	53.1	53	48.8

Source: Bloomberg

Inflation in South Africa proved to be a lot stickier than the market expectation, with the CPI year on year up from 6.9% in January to 7.0% in February. The core CPI, which is a much better gauge of inflationary pressure in the underlying economy, increased from 4.9% to 5.2% over the same period. While the 10-year nominal SA government bond is trading at a discount to the implied 10-year yield, the equivalent linker is trading at a slight premium, as investors favour inflation-linked bonds for inflation protection. However, based on breakeven inflation, longer-maturity nominal bonds are clearly more attractive than inflation-linked bonds. The hedged SA 10-year yield spread vs the US 10-year treasury has narrowed from 4.15% to 4.04% but is still at a considerably higher level than the historical average.

Figure 5: South Africa CPI and core CPI YoY

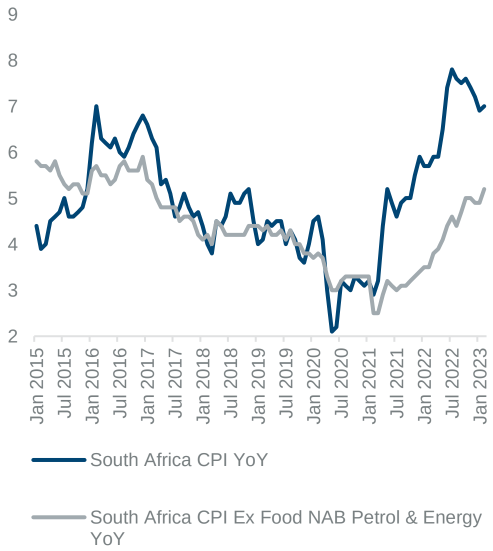
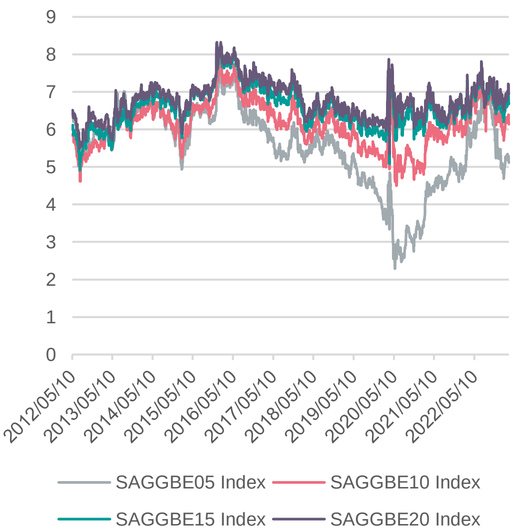


Figure 6: South Africa breakeven inflation



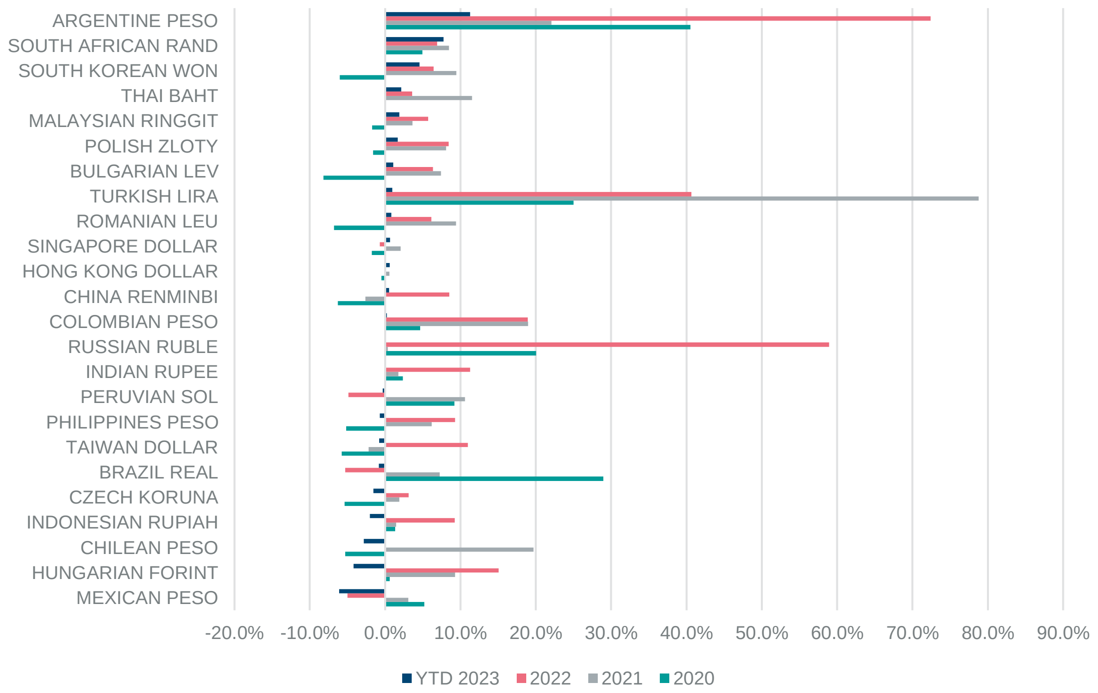
Source: Bloomberg

Figure 7: South Africa 10-year USD-hedged yield and spread

Source: Bloomberg

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. Local nominal bonds also remained attractive from a hedged-yield perspective as the hedged-yield spread remained elevated. The Rand has been one of the worst-performing emerging market currencies for the year to date; therefore, at the current FX level, we believe there is limited further downside risk to the ZAR. At this level, foreign investors may find SA assets increasingly cheap.

Figure 8: Emerging market currencies performance

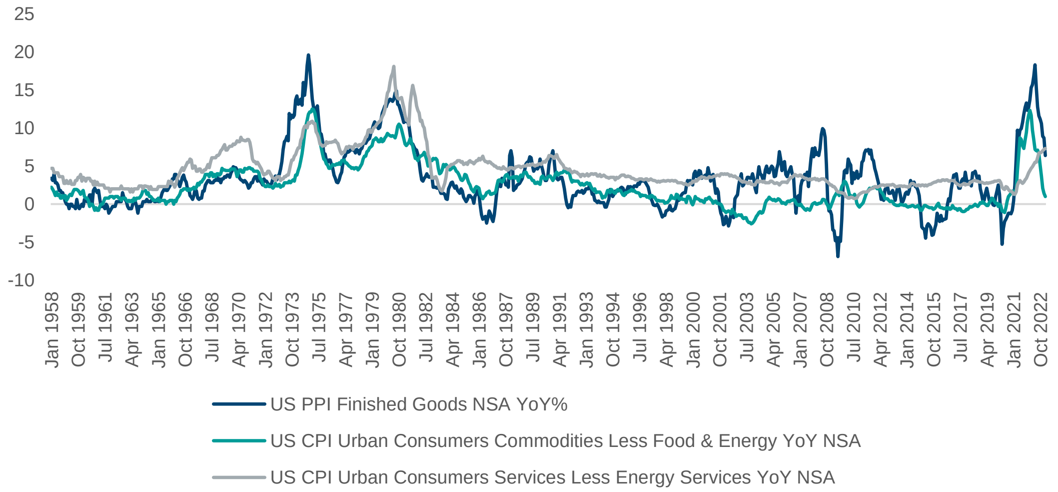


Source: Bloomberg

Corporate earnings in the US yet to fully reflect the damage from rate hikes

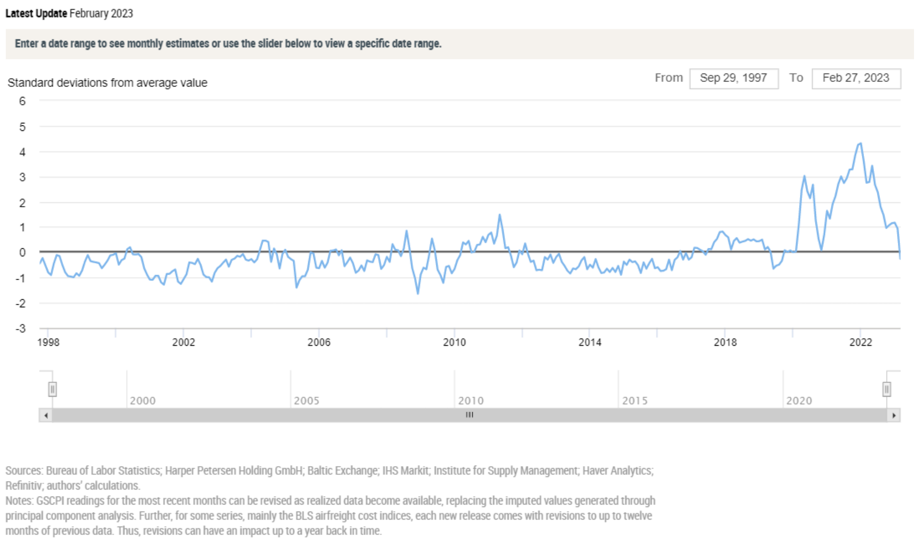
Labour markets in the US, UK, Eurozone and Japan remained very tight, with unemployment rates hovering around historical lows. However, the labour participation rate in the US continued to see gradual improvement. The US housing market continued to cool in January, but sales picked up in February as consumers took advantage of lower house prices and mortgage rates, which tracked falling bond yields amid the banking turmoil. While the US CPI year on year continued to slow from 6.4% in January to 6.0% in February, inflation in the Eurozone and the UK refused to dip. The CPI year on year in the Eurozone only slowed from 8.6% to 8.5% over the same period, with core CPI year on year for the region increasing from 5.3% to 5.6%. The UK CPI year on year increased from 10.1% in January to 10.4% in February, with core inflation also increasing from 5.8% to 6.2% over the same period. We therefore expect a divergence in the rate trajectories in the developed countries going forward, as each experiences a different pace of inflation normalisation.

Figure 9: US core goods and services inflation YoY



Source: Bloomberg

Figure 10: Global supply chain pressure index

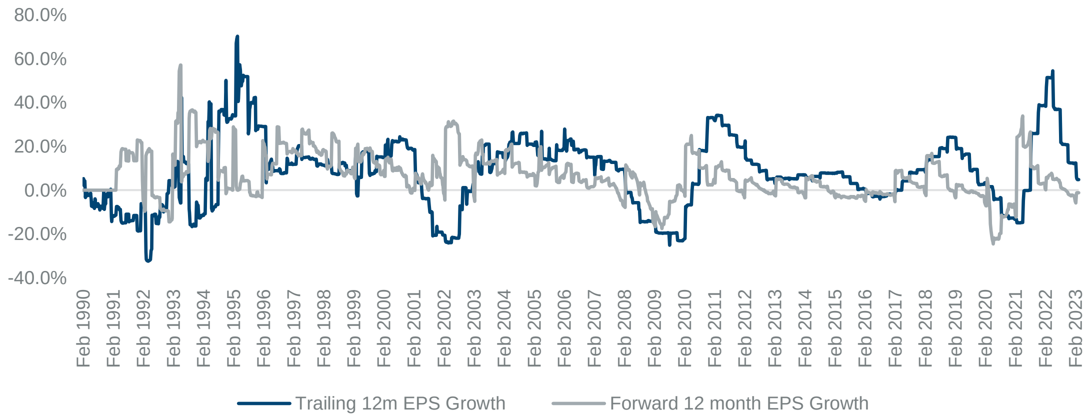


Source: New York Federal Reserve Bank

Global supply chain pressures eased significantly in February, which suggests that supply chain conditions and delivery times have improved considerably. This, together with the rotation between goods and services consumption, saw US goods inflation continuing to fall, with services inflation (such as shelter, insurance, etc.) being the main driver of overall inflation. This points to further easing of inflation. However, as strong labour markets and China's reopening could have a positive impact on the oil price, we expect rates to stay elevated for longer to tighten credit, dampen confidence, reduce consumption and moderate wages. This will bring inflation down to countries' target ranges. Central banks will be guided by the data in their rate decisions and may need to step in where necessary to preserve financial stability. However, we do not foresee major central banks jumping in at the first sign of a confirmed recession since current rate decisions were intended to hurt growth in the first place.

We are also seeing consumers (both in developed and developing countries) becoming increasingly cautious in their spending decisions. Businesses are also delaying business investment for future utilisation, with inflation keeping capital consumption at elevated levels. While forward earnings per share growth has declined from the recent peak in mid-2021, there is room for further declines if recession cannot be averted during this rate hiking cycle.

Figure 11: S&P 500 earnings per share growth

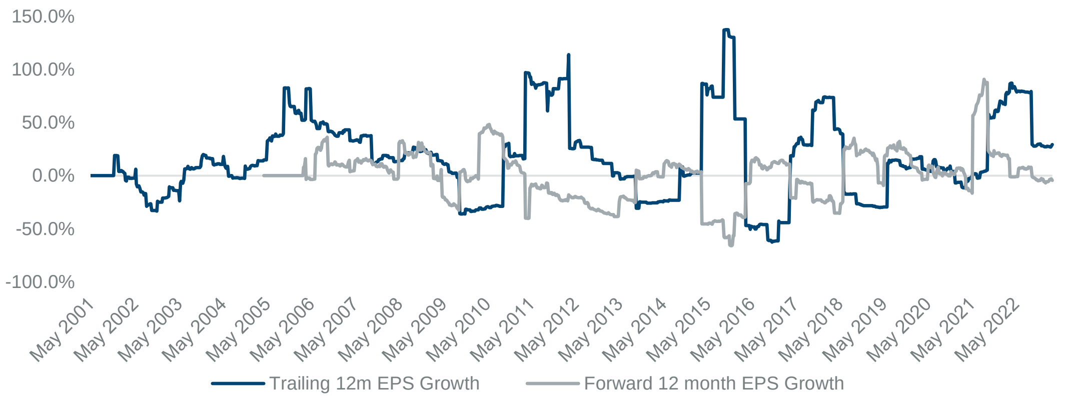


Source: Bloomberg

Figure 12: STOXX 600 earnings per share growth

Source: Bloomberg

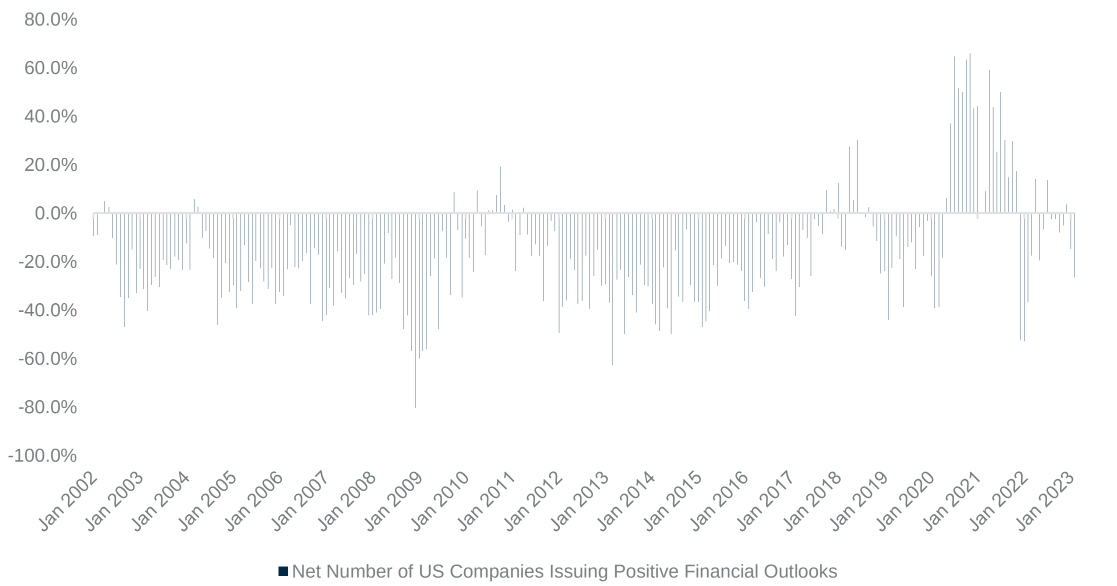
Figure 13: ALSI earnings per share growth



Source: Bloomberg

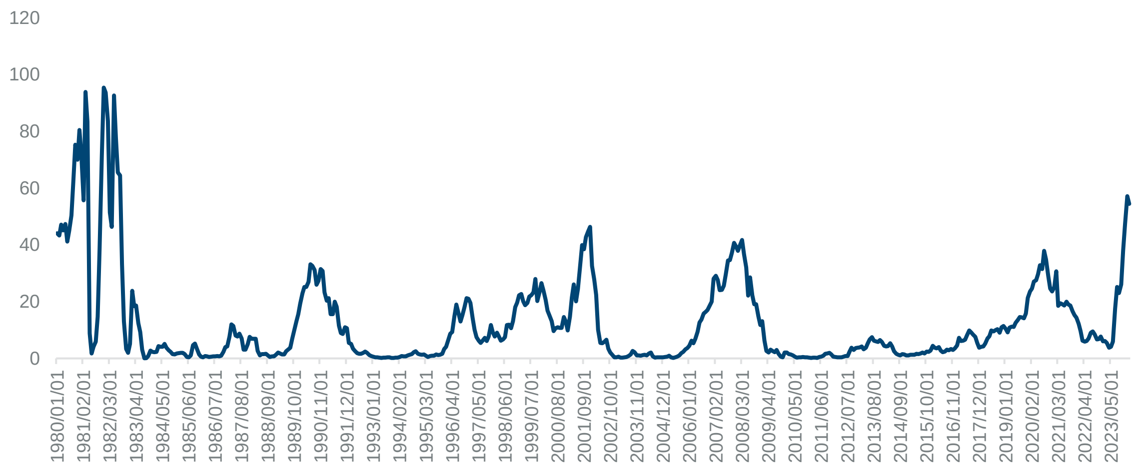
The probability of the US landing in a recession over the next 12 months has declined slightly from 57.13% to 54.59%, according to the New York Federal Reserve Bank. However, the net number of US companies issuing positive financial outlooks has fallen significantly since late 2021. We have therefore maintained our moderately underweight position in offshore equities as we believe the earnings outlook is yet to fully price in a moderate recession. Meanwhile, near-term volatility may remain elevated as damage from rate hikes may reveal further cracks in the economy. We have also maintained a moderately overweight position in offshore cash to ensure both a relatively neutral allocation to offshore overall and some protection in the event of any significant dent in global risk sentiment. However, we expect limited further material weakness in the ZAR against the USD.

Figure 14: US companies issuing positive financial outlooks



Source: Bloomberg

Figure 15: New York Fed US probability of recession in the next 12 months



Source: Bloomberg

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