MENTENOVA

# HOUSEVIEW TACTICAL ASSET ALLOCATION

18 May 2023

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We have moved from moderately overweight in SA bonds to neutral, from moderately overweight in foreign cash to significantly overweight, and from neutral to moderately overweight in foreign bonds. In addition, we have maintained our moderately underweight position in foreign equity, 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

Our investment case has seen a few amendments into June. We have maintained our moderately underweight position in offshore equities. The reason for this is that we believe that the earnings outlook is yet to fully price in a moderate recession, as negative operating leverage is expected to soften earnings per share over the upcoming results season. We have, however, moved from moderately overweight in SA nominal bonds to neutral – despite hedged yields being attractive and real yields being marginally attractive compared to equivalent inflation-linked bonds, especially over the longer maturities of the yield curve. Nevertheless, we are likely to see global investors favouring Brazilian bonds over SA equivalents. This is because they offer substantially higher real yields but without the risk of ties with Russia endangering domestic trades with the Western world, which would act as a further deterrent to investors on top of the ongoing power crisis. In addition, we have moved from neutral to moderately overweight in offshore bonds in view of their diversification benefits and the potential for investors to start pricing rate cuts into 2024 now that the end of the rate hiking cycle is approaching. We have also increased our moderately overweight position in offshore cash as the rand may remain under pressure due to domestic economic woes and rising geopolitical risk; it will also offer some protection in the event of a significant dent in global risk sentiment.

## TAA Overview

| | |
|---|---|
| **Market overview** | Positive economic data across most regions, such as improved Purchasing Managers Index (PMI) survey results, and better-than-expected Q1 GDP print in China and Japan supported the risk assets in April, despite renewed stress in the banking sector. The S&P 500 gained 1.6% over the month of April but was outperformed by the STOXX 600 Index and Nikkei 225 Index which delivered 2.4% and 2.9% respectively. European stocks were supported by resilient corporate earnings data for some sectors, such as energy and real estate. The Nikkei 225 Index benefited from a dovish monetary policy stance, yen weakness and the Tokyo Stock Exchange's efforts to boost companies' values, as well as encouraging corporate governance reforms. The MSCI Emerging Markets Index lagged the MSCI World Index, returning -1.1% against the latter's 1.8%. Investors' concerns about rising geopolitical tensions continued to exert downward pressure on Chinese equities, despite the country's solid reopening-led rebound. The MSCI |

World Value Index outperformed the MSCI World Growth Index marginally in April, with the Value Index significantly lagging the Growth Index for the first four months of this year.

The SA nominal bonds benchmark, the ALBI Index, fell by 1.1% in the month of April, while its inflation-linked bonds counterpart, the IGOV, gained 0.4% over the same period as inflationary pressures remained elevated in the country. The World Government Bond Index (WGBI), in turn, gained 0.4% in April and was outperformed by the investment grade credit, proxied by the Bloomberg Global Aggregate Corporate Total Return Index, which gained 1.2% over the same period.

The SA-listed property sector and European real estate delivered the best performance in April, mainly due to the latter's favourable corporate earnings data and the former's revenue exposure to Europe.

The Bloomberg Commodity Index returned -0.8% for the month of April, with price gains in livestock and precious metals, which were offset by falling prices in agricultural commodities, industrial metals and energy. The crude oil price managed to remain relatively flat for the month, despite the Opec+ nations announcing cuts of more than 1 million barrels per day to stabilise the price.

The Dollar Index declined by 0.8% against other major currencies in April but gained 0.4% into May, driven by changes in rate path expectations. The ZAR depreciated by 2.8% against the USD in April and by a further 5.0% into May in the wake of accusations that South Africa supplied weapons to Russia. This came on top of the growing pressure from the ongoing power crisis and the country's recent grey-listing by the Financial Action Task Force. The performance of most asset classes was subdued into May, with investors remaining on high alert in the face of the US debt ceiling debate, the risk of recession and central bank rate decisions.

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

| 30 April 2023 (Local Currency) | 1M | 3M | YTD | 1 Year | 3 Year (annualised) | 5 Year (annualised) | 10 Year (annualised) | MTD 11 May 2023 |
|---|---|---|---|---|---|---|---|---|
| FTSE/JSE ALSI Total Return | 3.4% | -0.2% | 8.7% | 12.6% | 20.2% | 10.0% | 10.9% | -1.5% |
| FTSE/JSE Capped SWIX Total Return | 3.4% | -0.9% | 6.0% | 7.9% | 19.0% | 6.4% | 9.0% | -3.3% |
| S&P 500 Total Return | 1.6% | 2.7% | 9.2% | 2.7% | 14.5% | 11.4% | 12.2% | -0.9% |
| STOXX 600 Total Return | 2.4% | 4.0% | 11.0% | 6.4% | 13.8% | 6.5% | 7.4% | -0.3% |
| Nikkei 225 Total Return | 2.9% | 6.6% | 11.7% | 10.0% | 14.8% | 7.3% | 9.7% | 0.9% |
| MSCI World Total Return | 1.8% | 2.5% | 9.8% | 3.7% | 13.6% | 8.7% | 9.3% | -0.6% |
| MSCI ACWI Total Return | 1.5% | 1.7% | 9.0% | 2.6% | 12.6% | 7.6% | 8.5% | -0.5% |
| MSCI EM Total Return | -1.1% | -4.7% | 2.9% | -6.1% | 4.7% | -0.7% | 2.2% | 0.2% |
| MSCI World Value Index | 2.0% | -1.5% | 3.2% | 2.7% | 14.3% | 6.0% | 7.2% | -2.2% |
| MSCI World Growth Index | 1.6% | 6.7% | 17.1% | 4.3% | 12.2% | 10.8% | 11.1% | 0.7% |
| MSCI World Small Cap Index | -0.1% | -4.5% | 4.4% | -1.3% | 13.2% | 4.7% | 8.0% | -1.0% |
| FTSE UK Series FTSE All Share TR | 3.4% | 1.9% | 6.5% | 6.0% | 13.2% | 4.4% | 6.1% | -1.3% |
| MSCI AC Asia Ex. Japan Index | -2.1% | -5.5% | 2.2% | -5.6% | 3.5% | -0.2% | 4.0% | -0.1% |
| MSCI Europe Excluding United Kingdom Index | 2.3% | 4.9% | 12.8% | 9.0% | 14.8% | 7.9% | 8.8% | -0.5% |
| STEFI | 0.6% | 1.7% | 2.3% | 6.2% | 4.8% | 5.8% | 6.2% | 0.3% |
| ALBI | -1.1% | -0.7% | 2.2% | 6.4% | 9.8% | 6.8% | 6.8% | -3.8% |
| IGOV | 0.4% | 2.3% | 1.3% | 3.3% | 9.2% | 5.1% | 4.7% | -2.0% |
| WGBI | 0.4% | 0.7% | 3.9% | -3.5% | -5.5% | -1.9% | -0.7% | 0.2% |
| Bloomberg Global Inflation-Linked Total Return Index | -0.3% | 0.9% | 4.2% | -10.5% | -2.7% | -0.7% | 0.2% | -0.2% |
| Bloomberg US Agg Total Return | 0.6% | 0.5% | 3.6% | -0.4% | -3.1% | 1.2% | 1.3% | 0.2% |
| Bloomberg EuroAgg Total Return Index | 0.1% | 0.0% | 2.2% | -7.3% | -5.1% | -1.9% | 0.6% | 0.5% |
| Bloomberg Global Agg Corporate Total Return Index | 1.2% | 0.7% | 4.7% | 0.0% | -2.0% | 0.5% | 1.2% | -0.3% |
| Bloomberg US Corporate High Yield Total Return Index | 1.0% | 0.8% | 4.6% | 1.2% | 4.7% | 3.3% | 4.0% | -0.3% |
| Bloomberg Pan-European High Yield Total Return Index | 0.5% | 0.2% | 3.4% | -1.5% | 2.6% | 1.0% | 3.4% | 0.4% |
| J.P. Morgan EMBI Global Core Hedged EUR | 0.3% | -1.5% | 1.5% | -4.1% | -2.6% | -2.5% | -0.1% | 0.2% |
| SAPY Total Return | 5.4% | 1.0% | 0.0% | 3.3% | 17.6% | -4.5% | 1.2% | -4.3% |
| MSCI US REIT Total Return | 0.8% | -6.4% | 3.6% | -14.7% | 9.4% | 5.9% | 5.3% | -0.8% |
| S&P Global Property Total Return | 2.0% | -5.6% | 2.3% | -14.6% | 4.6% | 0.8% | 2.5% | -0.9% |
| STOXX 600 Real Estate Total Return | 5.7% | -8.5% | 0.8% | -29.4% | -4.9% | -5.5% | 1.5% | -4.5% |
| FTSE EPRA Nareit Global REITs TR Index | 1.5% | -5.6% | 3.2% | -14.1% | 7.6% | 2.8% | 3.5% | -0.9% |
| Crude Oil | -0.3% | -5.9% | -7.4% | -27.3% | 46.6% | 1.1% | -2.5% | -5.7% |
| Aluminium | -2.4% | -10.9% | -0.9% | -22.8% | 16.4% | 0.9% | 2.3% | -6.2% |
| Copper | -4.4% | -6.8% | 2.7% | -12.0% | 18.3% | 4.8% | 2.0% | -5.0% |
| Gold | 1.1% | 3.2% | 9.1% | 4.9% | 5.7% | 8.6% | 3.0% | 1.3% |
| Platinum | 8.3% | 6.3% | 0.4% | 14.8% | 11.5% | 3.6% | -3.3% | 1.7% |
| Nickel | 2.3% | -19.7% | -18.9% | -23.7% | 25.9% | 12.2% | 4.7% | 0.0% |
| Palladium | 2.9% | -8.9% | -15.9% | -35.2% | -8.6% | 9.3% | 8.0% | 3.5% |
| Iron Ore | -12.5% | -9.7% | -4.6% | -20.3% | 8.9% | 10.8% | -2.3% | -6.3% |
| Bloomberg Commodity Index Total Return | -0.8% | -5.6% | -6.1% | -16.6% | 21.1% | 4.7% | -1.5% | -2.9% |
| USDZAR | 2.8% | 5.1% | 7.4% | 15.8% | -0.4% | 8.0% | 7.4% | 5.0% |
| GBPZAR | 4.7% | 7.2% | 11.6% | 15.6% | -0.5% | 6.0% | 5.1% | 4.4% |
| EURZAR | 4.5% | 6.6% | 10.5% | 20.9% | -0.2% | 6.0% | 5.5% | 4.1% |
| JPYZAR | 0.3% | 0.5% | 3.4% | 10.3% | -8.1% | 3.3% | 3.9% | 6.2% |
| Dollar Index Spot | -0.8% | -0.4% | -1.8% | -1.3% | 0.9% | 2.1% | 2.2% | 0.4% |

*Source: Bloomberg*

**Tactical views**

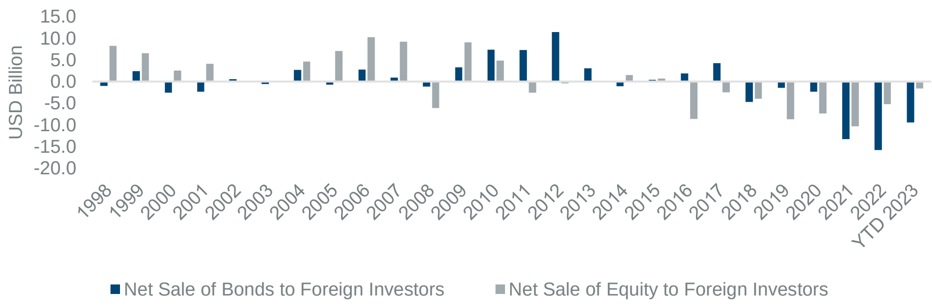
## SA caught in the crossfire of rising geopolitical tensions, making it more vulnerable to global risk sentiment

As shown in Figure 3, foreign investors continued to disinvest from SA bonds and equity into 2023, with net selling of SA bonds for the year to date increasing from $8.4bn as at 13 April 2023 to $9.4bn as at 11 May 2023. Meanwhile, net selling of SA equity for the year to date has remained relatively stable at $1.6bn.

Apart from recession worries, a potential banking crisis and the effects of monetary policy uncertainty on global risk sentiment, South Africa's economic performance and assets are being hammered by country-specific issues such as ongoing power constraints, the high unemployment rate, and an imprudent and inconsistent foreign policy in an environment of heightened geopolitical risk. News of the alleged weapons-to-Russia debacle, for example, had an immediate impact on the ZAR. The value of the currency plummeted from 18.32 to the USD on 8 May to 19.44 to the USD on 12 May amidst investor concerns about the future of SA–US trade relations which, if damaged, could deal a further blow to South Africa's economic growth prospects.

For the week ending 16 May 2023, South Africa was one of the worst-performing emerging markets in terms of ETF (exchange traded funds) outflows, as shown in Figure 4. Domestic headwinds and a foreign policy that is out of alignment with that of the US (one of South Africa's largest trading partners), set against a backdrop of global recession worries, makes SA assets increasingly vulnerable to changes in the global risk appetite and liquidity conditions.

**Figure 3: Net sale of SA bonds and equity to foreign investors**




*Source: Bloomberg*

**Figure 4: ETF flows for emerging markets for the week ending 16 May 2023**

View Highest/Lowest | Show Netflow | Market EM | Period 1W | In Millions of USD

Details | Historical

| Country/Region | Netflow | Netflow | Flow% | Assets | #Funds | Inflow | In/Out | Outflow |
|---|---|---|---|---|---|---|---|---|
| Highest | | | | | | | | |
| 10) China | | +4,774 | +1.6 | 297,221 | 1,038 | 8,633 | | -3,859 |
| 11) Taiwan | | +187 | +0.5 | 36,290 | 65 | 201 | | -14 |
| 12) India | | +77 | +0.7 | 11,512 | 188 | 100 | | -23 |
| 13) Chile | | +31 | +4.2 | 741 | 6 | 33 | | -2 |
| 14) Mexico | | +29 | +0.3 | 8,797 | 24 | 80 | | -52 |
| 15) Latam Region* | | +12 | +0.6 | 2,025 | 11 | 23 | | -12 |
| 16) Saudi Arabia | | +9 | +0.6 | 1,619 | 11 | 9 | | -- |
| 17) Indonesia | | +7 | +0.7 | 1,075 | 47 | 7 | | 0 |
| 18) Turkey | | +6 | +0.3 | 2,218 | 16 | 46 | | -40 |
| 19) Kuwait | | +5 | +5.9 | 78 | 2 | 5 | | -- |
| Lowest | | | | | | | | |
| 20) Argentina | | -- | -- | 50 | 1 | -- | | -- |
| 21) Bangladesh | | -- | -- | 10 | 1 | -- | | -- |
| 22) Malaysia | | 0 | 0.0 | 735 | 11 | 0 | | 0 |
| 23) Philippines | | 0 | 0.0 | 207 | 5 | -- | | 0 |
| 24) Colombia | | -1 | -0.1 | 1,468 | 3 | -- | | -1 |
| 25) Peru | | -6 | -3.6 | 172 | 2 | 2 | | -8 |
| 26) Vietnam | | -11 | -0.4 | 2,539 | 21 | 2 | | -13 |
| 27) Thailand | | -11 | -1.2 | 952 | 12 | 0 | | -11 |
| 28) South Africa | | -36 | -1.6 | 2,247 | 41 | 2 | | -37 |
| 29) Brazil | | -188 | -1.9 | 10,041 | 39 | 119 | | -307 |

*Regionally Focused Funds

*Source: Bloomberg*

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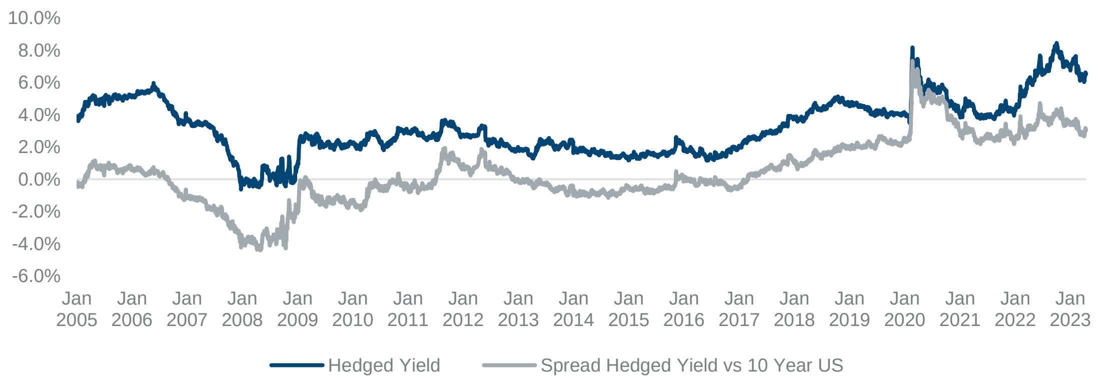
We have remained moderately overweight in local nominal bonds for some time as we have seen longer-maturity nominal bonds offering marginally more compensation for inflation than their equivalent-maturity, inflation-linked bonds. Local nominal bonds have also remained attractive from a hedged-yield perspective as the hedged-yield spread has remained elevated, as shown in Figure 5. The 10-year nominal SA government bond has been trading at a discount to the implied 10-year yield. Meanwhile, the equivalent linker has been trading at a premium as investors have favoured inflation-linked bonds as a source of inflation protection. Both are trading at similar real yields. Most of our investment case for SA nominal bonds remains unchanged. What has changed, though, is its relative attractiveness compared to other emerging market peers.

**Figure 5: South Africa 10-year USD-hedged yield and spread**




*Source: Bloomberg*

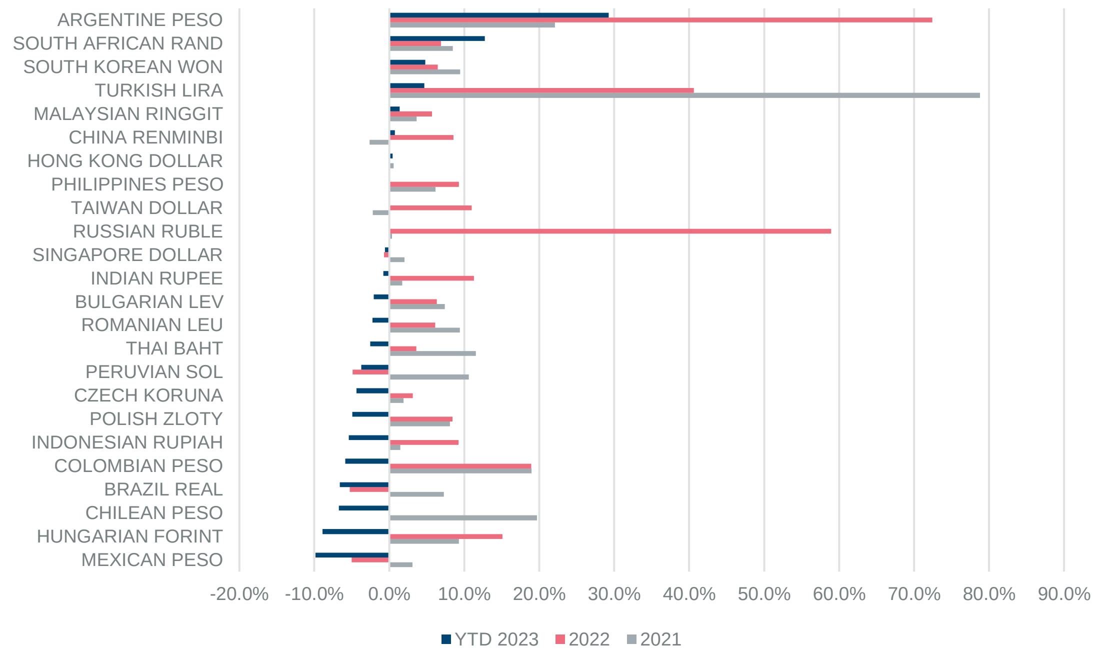
We acknowledge that the 10-year nominal yields of South Africa and Brazil are quite similar, but the 10-year real yield and the 10-year real yield based on inflation expectations are substantially higher for Brazil, as shown in Figure 6. Furthermore, the rand has been one of the worst-performing emerging market currencies for the year to date, as shown in Figure 7. Both countries are competitors in primary goods exports, and both should benefit from China's reopening rebound. While it was a relief that the S&P left South Africa's sovereign credit rating or outlook unchanged last Friday, the risk of a future downgrade is surely on the cards if the country fails to find ways to alter its growth trajectory. Given the country's self-inflicted economic woes and the lack of visible catalysts to induce a significant recovery in the currency, we believe the valuations of our nominal bonds are 'fair' in the sense that they have priced in the underlying risk factors. As the short-term outlook remains extremely volatile, we have chosen to move from moderately overweight to neutral in SA nominal bonds.

**Figure 6: Bond yields of emerging market peers**

| | South Africa | India | Indonesia | Mexico | Brazil | Turkey |
|---|---|---|---|---|---|---|
| **10 Year Yield** | **11.39%** | **7.12%** | **6.53%** | **8.79%** | **12.34%** | **12.89%** |
| Inflation | 7.1% | 4.7% | 4.33% | 6.3% | 4.2% | 43.7% |
| Inflation Expectation | 5.90% | 6.60% | 4.00% | 5.90% | 5.30% | 45.95% |
| **10 Year Real Yield** | **4.29%** | **2.42%** | **2.20%** | **2.54%** | **8.16%** | **-30.79%** |
| 10 Year Real Yield based on inflation expectation | 5.49% | 0.52% | 2.53% | 2.89% | 7.04% | -33.06% |
| **Currency Risk Premium** | **3.91%** | **2.00%** | **1.39%** | **3.20%** | **5.54%** | **3.24%** |
| **Sovereign Risk Premium** | **3.98%** | **1.61%** | **1.64%** | **2.08%** | **3.30%** | **6.15%** |
| US 10 Year Yield | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% | 3.50% |
| **S&P Rating - Foreign Currency** | **BB-** | **BBB-u** | **BBB** | **BBB** | **BB-** | **Bu** |
| **Moody's Rating - Foreign Currency** | **Ba2** | **Baa3** | **Baa2** | **Baa2** | **Ba2** | **B3** |

*Source: Bloomberg*

**Figure 7: Emerging market currencies' performance**




*Source: Bloomberg*

## The opportunity for portfolio diversification and the approaching end of the rate hiking cycle favour the holding of foreign bonds

We have seen that the economic data released over the past month has generally exceeded market expectations across most major economies, as depicted by the economic surprise indices. Composite PMI survey data has largely improved, as shown in Figure 8, but it has been driven by expansion in the services sectors. Meanwhile, manufacturing sectors in major economies have continued to contract, falling below the neutral level of 50, as indicated in Figure 9. The most pronounced divergence between the manufacturing and services sectors has been in the Eurozone, the UK and China.

**Figure 8: Global composite 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 | Mar-23 | Apr-23 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Global Composite PMI | 51.4 | 53.4 | 52.7 | 51 | 51.3 | 53.5 | 50.8 | 49.3 | 49.7 | 49 | 48 | 48.2 | 49.8 | 52.1 | 53.4 | 54.2 |
| 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 | 50.1 | 52.6 | 54.4 | 55.4 |
| Developed Markets | 51.3 | 54.7 | 56 | 55.5 | 53.7 | 52.5 | 49 | 46.9 | 49.3 | 48.5 | 47.3 | 47.1 | 48.4 | 51.1 | 52.6 | 53.7 |
| Emerging Markets | 50.8 | 51.3 | 46.8 | 43.4 | 46.9 | 55.2 | 54 | 53.4 | 50.1 | 49.8 | 49 | 50.1 | 51.9 | 53.9 | 54.6 | 54.9 |
| Eurozone | 52.3 | 55.5 | 54.9 | 55.8 | 54.8 | 52 | 49.9 | 48.9 | 48.1 | 47.3 | 47.8 | 49.3 | 50.3 | 52 | 53.7 | 54.1 |
| France | 52.7 | 55.5 | 56.3 | 57.6 | 57 | 52.5 | 51.7 | 50.4 | 51.2 | 50.2 | 48.7 | 49.1 | 49.1 | 51.7 | 52.7 | 52.4 |
| Germany | 53.8 | 55.6 | 55.1 | 54.3 | 53.7 | 51.3 | 48.1 | 46.9 | 45.7 | 45.1 | 46.3 | 49 | 49.9 | 50.7 | 52.6 | 54.2 |
| 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 | 51.2 | 52.2 | 55.2 | 55.3 |
| Spain | 47.9 | 56.5 | 53.1 | 55.7 | 55.7 | 53.6 | 52.7 | 50.5 | 48.4 | 48 | 49.6 | 49.9 | 51.6 | 55.7 | 58.2 | 56.3 |
| Ireland | 56.5 | 59.1 | 61 | 59.6 | 57.5 | 52.8 | 52.9 | 51 | 52.2 | 52.1 | 48.8 | 50.5 | 52 | 54.5 | 52.8 | 53.5 |
| Australia | 46.7 | 56.6 | 55.1 | 55.9 | 52.9 | 52.6 | 51.1 | 50.2 | 50.9 | 49.8 | 48 | 47.5 | 48.5 | 50.6 | 48.5 | 53 |
| Sweden | 66.9 | 65.3 | 63.1 | 64.4 | 64.2 | 60.3 | 57.2 | 56.9 | 53.5 | 54 | 51.9 | 51 | 49.9 | 46.1 | 47.8 | 49.1 |
| UK | 54.2 | 59.9 | 60.9 | 58.2 | 53.1 | 53.7 | 52.1 | 49.6 | 49.1 | 48.2 | 48.2 | 49 | 48.5 | 53.1 | 52.2 | 54.9 |
| US | 51.1 | 55.9 | 57.7 | 56 | 53.6 | 52.3 | 47.7 | 44.6 | 49.5 | 48.2 | 46.4 | 45 | 46.8 | 50.1 | 52.3 | 53.4 |
| Japan | 49.9 | 45.8 | 50.3 | 51.1 | 52.3 | 53 | 50.2 | 49.4 | 51 | 51.8 | 48.9 | 49.7 | 50.7 | 51.1 | 52.9 | 52.9 |
| China | 50.1 | 50.1 | 43.9 | 37.2 | 42.2 | 55.3 | 54 | 53 | 48.5 | 48.3 | 47 | 48.3 | 51.1 | 54.2 | 54.5 | 53.6 |
| India | 53 | 53.5 | 54.3 | 57.6 | 58.3 | 58.2 | 56.6 | 58.2 | 55.1 | 55.5 | 56.7 | 59.4 | 57.5 | 59 | 58.4 | 61.6 |
| Brazil | 50.9 | 53.5 | 56.6 | 58.5 | 58 | 59.4 | 55.3 | 53.2 | 51.9 | 53.4 | 49.8 | 49.1 | 49.9 | 49.7 | 50.7 | 51.8 |
| Russia | 50.3 | 50.8 | 37.7 | 44.4 | 48.2 | 50.4 | 52.2 | 50.4 | 51.5 | 45.8 | 50 | 48 | 49.7 | 53.1 | 56.8 | 55.1 |

*Source: Bloomberg*

**Figure 9: 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 | Mar-23 | Apr-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 | 49.6 | 49.6 |
| 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 | 48.4 | 48.5 |
| 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 | 50.7 | 50.5 |
| 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 | 47.3 | 45.8 |
| 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 | 47.3 | 45.6 |
| 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 | 44.7 | 44.5 |
| 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 | 51.1 | 46.8 |
| 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 | 51.3 | 49 |
| 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 | 52.8 | 52.4 |
| 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 | 49.7 | 48.6 |
| 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 | 49.1 | 48 |
| 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 | 45.7 | 45.5 |
| 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 | 44.3 | 44.2 |
| 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 | 47.9 | 47.8 |
| 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 | 49.2 | 50.2 |
| 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 | 49.2 | 49.5 |
| 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 | 50 | 49.5 |
| 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 | 51.9 | 52.7 |
| 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 | 47.6 | 48.1 |
| 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 | 48.6 | 47.1 |
| 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 | 56.4 | 57.2 |
| 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 | 47 | 44.3 |
| 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 | 51 | 51.1 |
| 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 | 53.2 | 52.6 |
| 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 | 48.1 | 49.8 |

*Source: Bloomberg*

The labour market in the developed world remains tight. For example, the US ADP employment change increased from 145k in March to 296k in April, while the change in US non-farm payrolls edged up from 236k to 253k over the same period. As a result, the unemployment rate in the US declined slightly in April, from 3.5% to 3.4%. However, there are some early signs of the US labour market cooling, with initial jobless claims reaching 264k in the second week of May, from an average of 240k per week for the past month. Jobless claims in the UK increased from 28.2k in March to 46.7k in April. In addition, the jobless rate in Japan increased from 2.6% in February to 2.8% in March, with the job-to-applicant ratio dropping from 1.34 to 1.32 over the same period. Wage pressures have eased to some degree but show signs of stickiness. In the US, the yearly growth rate in average hourly earnings moderated from 5.9% in March 2022 to 4.4% in April 2023. However, in monthly terms, the growth rate in average hourly earnings ticked up from 0.3% in March to 0.5% in April 2023. In the UK, the three-month growth rate in average weekly earnings year on year declined from 5.9% in February to 5.8% in March.

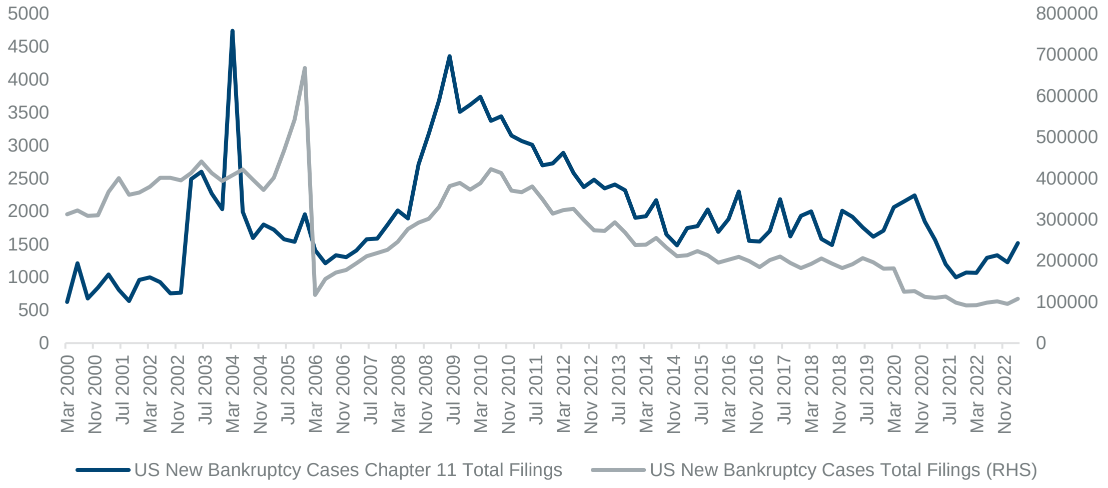
Inflation has continued to cool across most regions although there have generally been surprising increases in major economies, indicating that inflation – though cooling – is mainly driven by falling energy prices and goods disinflation. Moreover, the pace of easing has been slower than expected. The impact of rate hikes, however, is definitely working its way through economies, evidenced by the recent banking turmoil and increasingly prudent consumer spending, to a rise in the number of bankruptcies, as shown in Figure 11, with small and medium-sized enterprises being more vulnerable to higher finance and operating costs than large corporations.

**Figure 10: Global inflation**

| | Dec 2020 | 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 | Jan 2023 | Feb 2023 | Mar 2023 | Apr 2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Global | 2.1 | 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 | 9.0 | 9.0 | 8.3 | 7.7 |
| Citi Inflation Surprise Index - Global | 0.0 | 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 | 6.8 | 21.3 | 3.2 | -1.5 |
| Citi Inflation Surprise Index - Major Economies | 6.4 | 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 | 17.4 | 37.9 | 15.6 | 9.9 |
| Citi Inflation Surprise Index - Emerging Markets | -9.5 | 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 | -9.0 | -3.4 | -15.2 | -18.5 |
| France | 0.0 | 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 | 6.0 | 6.3 | 5.7 | 5.9 |
| Germany | -0.2 | 4.9 | 4.2 | 4.3 | 5.9 | 6.3 | 7.0 | 6.7 | 6.7 | 7.0 | 8.6 | 8.8 | 8.8 | 8.1 | 8.7 | 8.7 | 7.4 | 7.2 |
| Greece | -2.3 | 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 | 7.0 | 6.1 | 4.6 | 3.0 |
| Ireland | -1.0 | 5.5 | 5.0 | 5.6 | 6.7 | 7.0 | 7.8 | 9.1 | 9.1 | 8.7 | 8.2 | 9.2 | 8.9 | 8.2 | 7.8 | 8.5 | 7.7 | 7.2 |
| Italy | -0.2 | 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 | 10.0 | 9.1 | 7.6 | 8.3 |
| Spain | -0.5 | 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 | 5.9 | 6.0 | 3.3 | 4.1 |
| Sweden | 0.5 | 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 | 11.7 | 12.0 | 10.6 | 10.6 |
| Switzerland | -0.8 | 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 | 3.3 | 3.4 | 2.9 | 2.6 |
| United Kingdom | 0.6 | 5.4 | 5.5 | 6.2 | 7.0 | 9.0 | 9.1 | 9.4 | 10.1 | 9.9 | 10.1 | 11.1 | 10.7 | 10.5 | 10.1 | 10.4 | 10.1 | 10.1 |
| United States | 1.4 | 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 | 6.4 | 6.0 | 5.0 | 4.9 |
| Australia | 0.9 | 3.5 | 3.5 | 3.5 | 5.1 | 5.1 | 5.1 | 6.1 | 6.1 | 6.1 | 7.3 | 7.3 | 7.3 | 7.8 | 7.8 | 7.8 | 7.0 | 7.0 |
| Japan | -1.2 | 0.8 | 0.5 | 0.9 | 1.2 | 2.5 | 2.5 | 2.4 | 2.6 | 3.0 | 3.0 | 3.7 | 3.8 | 4.0 | 4.3 | 3.3 | 3.2 | 3.2 |
| Brazil | 4.5 | 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 | 5.8 | 5.6 | 4.7 | 4.2 |
| China | 0.2 | 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 | 2.1 | 1.0 | 0.7 | 0.1 |
| India | 4.6 | 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 | 6.5 | 6.4 | 5.7 | 4.7 |
| Indonesia | 1.7 | 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 | 5.3 | 5.5 | 5.0 | 4.3 |
| Mexico | 3.2 | 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 | 7.9 | 7.6 | 6.9 | 6.3 |
| Russia | 4.9 | 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 | 11.8 | 11.0 | 3.5 | 3.5 |
| South Africa | 3.1 | 5.9 | 5.7 | 5.7 | 5.9 | 5.9 | 6.5 | 7.4 | 7.8 | 7.6 | 7.5 | 7.6 | 7.4 | 7.2 | 6.9 | 7.0 | 7.1 | 7.1 |
| South Korea | 0.6 | 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 | 5.2 | 4.8 | 4.2 | 3.7 |
| Taiwan | 0.0 | 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 | 3.1 | 2.4 | 2.4 | 2.4 |

*Source: Bloomberg*

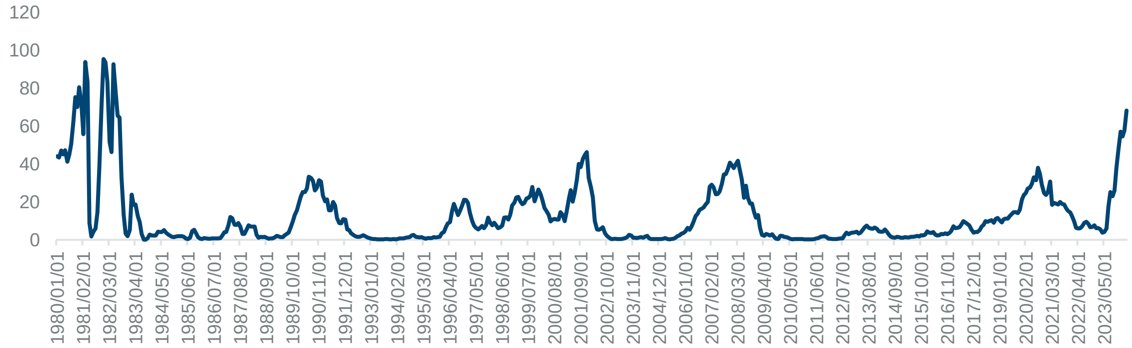
**Figure 11: US bankruptcies**




*Source: Bloomberg*

According to the New York Federal Reserve Bank, the inverted yield curve is reflected not only in the probability of the US entering a recession (within the next 12 months) increasing from 57.8% to 68.2% over the past month, as shown in Figure 12. The inverted yield curve also negatively impacts access to credit as banks, which largely generate profits from their loan books by borrowing in the short term and lending over the longer term, will cut off lending in an inverted yield curve environment, thereby reducing growth and investment opportunities for companies.

**Figure 12: New York Fed US probability of recession within the next 12 months**




*Source: Bloomberg*

The US labour productivity growth rate, quarter on quarter, slowed from 1.6% in Q4 2022 to -2.7% in Q1 2023, but the US unit labour cost growth rate, quarter on quarter, rose from 3.3% to 6.3% over the same period. Rising labour costs and falling productivity negatively impact growth in corporate earnings. What has also been noticeable over the past few months is the significantly weaker yearly import growth in the US and China, as shown in Figures 13 and 14. A closer look reveals that while the yearly growth rate in US exports to China was 6.0% in Q1, the yearly growth rate in US imports from China contracted by 35.0% over the same period. South Korea's imports from China year on year fell by 4.4% in April but South Korea's exports to China year on year fell by 33.4% over the same period. Falling prices may contribute to the decline in trade. However, the data suggests that the reopening-led rebound in China may lose some of its momentum, while geopolitical tensions between the US and China may hasten a shift in US purchases of goods away from China.

**Figure 13: US imports and exports yearly growth**

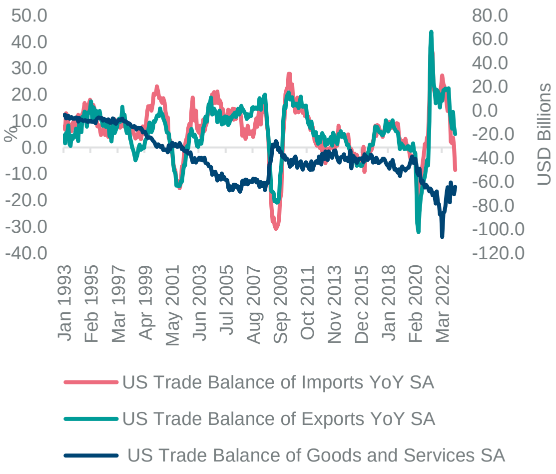



**Figure 14: China imports and exports yearly growth in CNY**


*Source: Bloomberg*

**Figure 15: South Korea imports from and exports to China YoY**

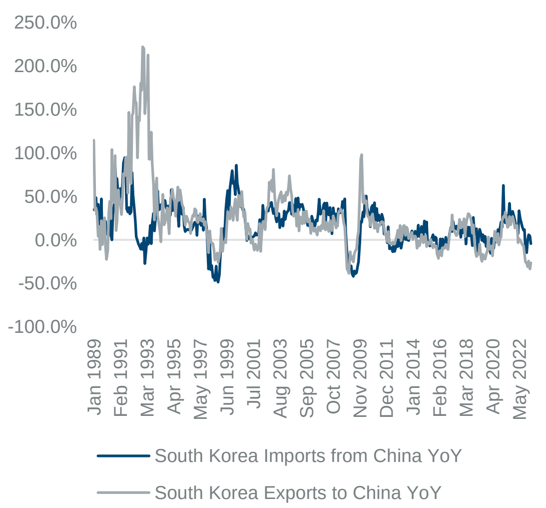
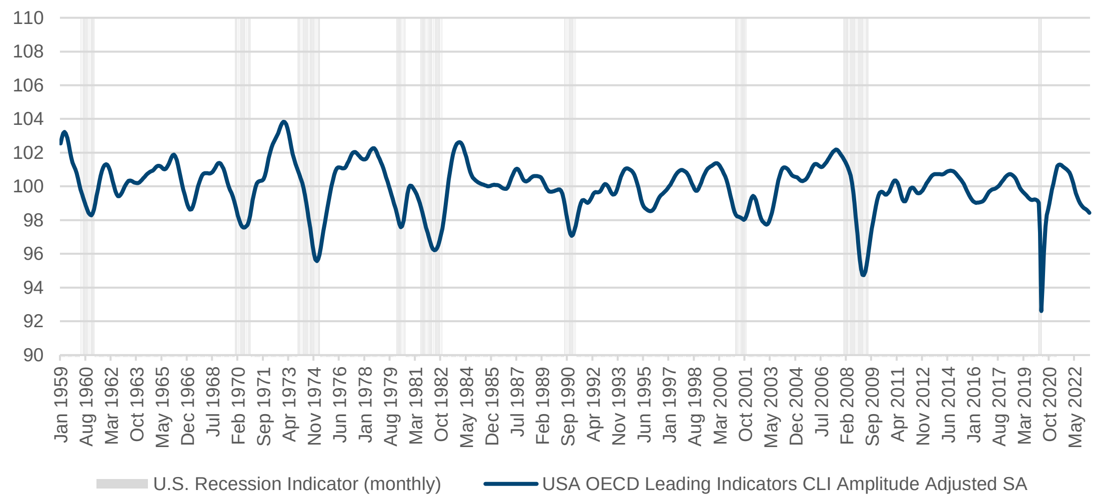



**Figure 16: US exports to and imports from China YoY**


*Source: Bloomberg*

The US's leading indicator, which has been quite useful in predicting US recessions since 1959, is approaching a level of 98, which usually points to a recession. Although this is an indication that a recession in under way in the US, the good news is that the slope is flattening, which suggests that the recession may be a shallow one.

**Figure 17: OECD US leading indicators**




*Source: Bloomberg*

While the recent set of earnings data has been mixed but in general positive, we remain of the view that the earnings outlook has not fully priced in a moderate recession, bearing in mind that small to medium enterprises become particularly vulnerable in the face of higher interest rates and elevated inflation. Furthermore, geopolitical tensions are rising and there is the systemic risk of further financial cracks due to central bank rate hikes. We have therefore decided to maintain our moderately underweight position in offshore equities.

We have also moved from neutral to moderately overweight in offshore bonds as we see short-term bonds offering income potential. This is because global yields have increased substantially due to the accelerated interest rate hikes that have taken place over the past year. While there is a risk that term premiums may increase for the longer-maturity bonds, we favour this asset class for its diversification benefits in a volatile market environment. We also expect to see a divergence in the interest rate trajectories of developed countries going forward, as each country will experience inflation normalisation at a different pace. In the US, we expect it will be closer to the end of its rate hiking cycle than in the Eurozone and the UK, given their relatively lower inflation rates. The Fed was recently quoted as saying: “In determining the extent to which additional policy firming may be appropriate … the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments”, which suggests that rate pausing is likely to mitigate the risk of overtightening. This points to the fact that global bonds may start pricing in rate cuts into next year, which will translate into the capital appreciation of these bonds.

We have maintained a moderately overweight position in offshore cash to ensure a relatively neutral allocation to offshore overall and to provide some protection in case of a significant fallout in terms of global risk sentiment. The South African government’s ties with Russia have the potential to jeopardise South Africa’s exports, valued at R60bn, to the US under the AGOA deal and trade agreements with other Western nations. In this regard, increased political uncertainty could exacerbate the already-negative pressure on the value of the rand (especially in view of the ongoing, debilitating power crisis) and further deter investment in the country or the holding

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| | of ZAR-denominated local assets. As result, we have decided to increase our overweight position in offshore cash. |

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