MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

20 July 2023

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We have kept most of our TAA positions unchanged, apart from moving from a neutral position in SA bonds to moderately overweight and moving from a neutral position in SA inflation-linked bonds to moderately underweight, 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 remained relatively unchanged into August, except for local bonds. We have favoured local nominal bonds over inflation-linked bonds due to the former offering better compensation for inflation. We have maintained our moderately underweight position in offshore equities. While recent US economic and earnings data has largely exceeded market expectations, near-term inflation and earnings data will come at high stakes. This is because the market has priced in the perfect scenario of economic resilience against the backdrop of cooling inflation, which will eventually pivot central banks towards a renewed focus on sustaining growth. Headwinds such as negative operating leverage and the end of certain fiscal support measures will continue to weigh on the earnings growth outlook and consumer sentiment. We have also remained moderately overweight in offshore bonds because they are a preferred cyclical diversifier and have the attractiveness of short-term income generation and potential capital appreciation as the end of the rate hiking cycle approaches. We also see this offshore cash position offering some protection in the event of a significant dent in global risk sentiment.

TAA Overview

Market overview	Equity markets rebounded in the first half of 2023, fuelled by cooling inflation, economic resilience and the optimism that the end of the rate hiking cycle may be in sight. After the broadly negative returns seen in May, equity markets continued their rally for the month of June and into the month of July. In local currency terms, the Nikkei 225 Index was the top performer, gaining 7.6% in June, fuelled by yen weakness, expansionary monetary policy and efforts to increase returns to shareholders. The S&P 500 Index delivered 6.6%, driven mainly by mega-cap growth stocks, outperforming the STOXX 600 Index which was up 2.4% for the same month. The MSCI World Index significantly outperformed the MSCI Emerging Markets Index for the month of June and for the year to date due to the reopening-driven rebound losing momentum in China. Countries such as South Korea and Taiwan have performed above expectations, benefiting from the AI rally. SA equities performed in line with the MSCI Emerging Markets Index for the year to date in local currency terms, but with the rand depreciating by 10.6% for the first half of 2023, offshore returns were boosted by the positive translation effect. The persistent power crisis and lack of productivity continued to weigh on investor sentiment. The MSCI World Value Index and

MSCI World Growth Index performed in line with each other in June but the MSCI World Growth Index, which was the worst performer in 2022, trumped the MSCI World Value Index for the first half of 2023.

The SA nominal bonds benchmark, the ALBI, returned 4.6% in June, after a negative 4.79% performance in May, outperforming local inflation-linked bonds, the IGOV Index. Globally, inflation-linked bonds outperformed the World Government Bond Index in June and for the first six months of 2023. Property sectors continued to see month-to-month volatility during the first half of 2023, with the best performer being the MSCI US REIT and the worst performer being the STOXX 600 Real Estate. However, the latter gained 6.2% into the month of July. Our local property index, the SAPY, lost 4.4% in the first two quarters of this year. Commodities delivered a largely negative performance in the first half of this year, although there has been some recovery into the month of July. The dollar weakened by 0.6% against major currencies in the first half of this year and slipped by another 2.9% into the month of July, with the ECB and Bank of England adopting a more hawkish stance than the Fed, given the CPI numbers. The ZAR managed to recover 4.4% against the USD in June and made further advances into the month of July.

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

30 June 2023 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 16 July 2023
FTSE/JSE ALSI Total Return	1.4%	0.7%	5.9%	19.6%	16.1%	9.6%	10.3%	2.4%
FTSE/JSE Capped SWIX Total Return	3.8%	1.2%	3.6%	13.5%	15.7%	6.9%	8.5%	2.3%
S&P 500 Total Return	6.6%	8.7%	16.9%	19.6%	14.6%	12.3%	12.9%	1.3%
STOXX 600 Total Return	2.4%	2.3%	10.9%	16.5%	11.3%	6.6%	7.7%	-0.2%
Nikkei 225 Total Return	7.6%	18.5%	28.6%	28.6%	16.4%	10.5%	11.4%	-2.4%
MSCI World Total Return	6.1%	7.0%	15.4%	19.1%	12.7%	9.6%	10.1%	1.8%
MSCI ACWI Total Return	5.9%	6.3%	14.3%	17.1%	11.5%	8.6%	9.3%	2.1%
MSCI EM Total Return	3.9%	1.0%	5.1%	2.2%	2.7%	1.3%	3.3%	4.3%
MSCI World Value Index	6.0%	3.3%	4.5%	11.6%	13.4%	6.5%	7.6%	1.2%
MSCI World Growth Index	6.1%	10.5%	27.3%	26.7%	11.3%	12.1%	12.3%	2.2%
MSCI World Small Cap Index	6.3%	3.4%	8.0%	13.5%	10.9%	4.9%	8.5%	3.0%
FTSE UK Series FTSE All Share TR	1.0%	-0.5%	2.6%	7.9%	10.0%	3.1%	5.9%	-0.9%
MSCI AC Asia Ex. Japan Index	2.7%	-1.2%	3.1%	-0.8%	1.4%	1.2%	4.8%	4.0%
MSCI Europe Excluding United Kingdom Index	2.7%	2.9%	13.4%	20.4%	12.0%	8.3%	9.1%	0.0%
STEFI	0.6%	1.9%	3.7%	6.8%	5.0%	5.8%	6.3%	0.3%
ALBI	4.6%	-1.5%	1.8%	8.2%	7.6%	7.4%	7.4%	0.3%
IGOV	1.2%	-0.8%	0.0%	1.1%	8.7%	5.3%	5.3%	0.5%
WGBI	0.0%	-1.8%	1.7%	-2.5%	-6.5%	-2.0%	-0.5%	1.5%
Bloomberg Global Inflation-Linked Total Return Index	1.7%	-1.8%	2.6%	-3.8%	-4.1%	-0.7%	0.9%	0.8%
Bloomberg US Agg Total Return	-0.4%	-0.8%	2.1%	-0.9%	-4.0%	0.8%	1.5%	0.2%
Bloomberg EuroAgg Total Return Index	-0.3%	0.2%	2.2%	-3.6%	-5.4%	-1.9%	0.8%	-0.2%
Bloomberg Global Agg Corporate Total Return Index	0.8%	0.1%	3.5%	2.1%	-3.5%	0.5%	1.6%	1.2%
Bloomberg US Corporate High Yield Total Return Index	1.7%	1.7%	5.4%	9.1%	3.1%	3.4%	4.4%	1.0%
Bloomberg Pan-European High Yield Total Return Index	0.5%	1.8%	4.8%	8.7%	1.6%	1.6%	3.7%	0.6%
J.P. Morgan EMBI Global Core Hedged EUR	2.0%	1.2%	2.5%	3.8%	-5.4%	-1.8%	0.9%	1.2%
SAPY Total Return	0.9%	0.7%	-4.4%	10.0%	11.3%	-3.5%	1.5%	-0.4%
MSCI US REIT Total Return	5.0%	2.7%	5.5%	-0.1%	8.9%	4.6%	6.4%	3.3%
S&P Global Property Total Return	3.5%	0.8%	1.1%	-4.0%	3.2%	0.3%	3.5%	3.8%
STOXX 600 Real Estate Total Return	-1.0%	-4.5%	-9.0%	-19.8%	-9.1%	-7.5%	1.0%	6.2%
FTSE EPRA Nareit Global REITs TR Index	3.3%	0.9%	2.6%	-2.2%	6.3%	1.7%	4.5%	3.9%
Crude Oil	3.1%	-6.1%	-12.8%	-34.8%	22.1%	-1.2%	-3.1%	6.6%
Aluminium	-4.2%	-10.8%	-9.5%	-12.0%	9.9%	0.2%	2.0%	5.8%
Copper	2.8%	-7.5%	-0.7%	0.7%	11.4%	4.6%	2.1%	4.3%
Gold	-2.2%	-2.5%	5.2%	6.2%	2.5%	8.9%	4.5%	1.9%
Platinum	-9.2%	-8.9%	-15.6%	1.1%	3.0%	1.2%	-3.8%	7.7%
Nickel	-0.4%	-13.9%	-31.8%	-10.0%	16.9%	6.6%	4.1%	0.0%
Palladium	-10.1%	-15.9%	-31.4%	-36.6%	-14.1%	5.2%	6.4%	3.9%
Iron Ore	10.0%	-11.1%	-3.0%	-6.3%	3.4%	12.4%	-0.6%	1.5%
Bloomberg Commodity Index Total Return	4.0%	-2.6%	-7.8%	-9.6%	17.8%	4.7%	-1.0%	3.3%
USDZAR	-4.4%	5.9%	10.6%	15.8%	2.8%	6.5%	6.7%	-3.9%
GBPZAR	-2.4%	9.1%	16.3%	20.8%	3.6%	5.7%	4.8%	-1.0%
EURZAR	-2.4%	6.7%	12.9%	20.6%	1.8%	5.1%	4.8%	-1.2%
JPYZAR	-7.8%	-2.5%	0.5%	8.8%	-6.7%	1.0%	2.7%	-0.1%
Dollar Index Spot	-1.4%	0.4%	-0.6%	-1.7%	1.9%	1.7%	2.2%	-2.9%

Source: Bloomberg

Tactical views

Relative play on local nominal and inflation-linked bonds as inflation cools

We prefer local nominal bonds over inflation-linked bonds for two reasons. The first reason is that the 10-year nominal bond is being traded at a slight discount to its implied yield, while the 10-year inflation-linked bond yield is at a premium to its implied real yield, as shown in Figures 3 and 4.

Figure 3: SA 10-year nominal bond yield

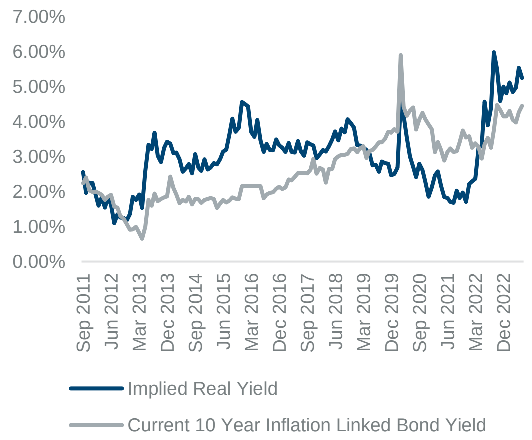
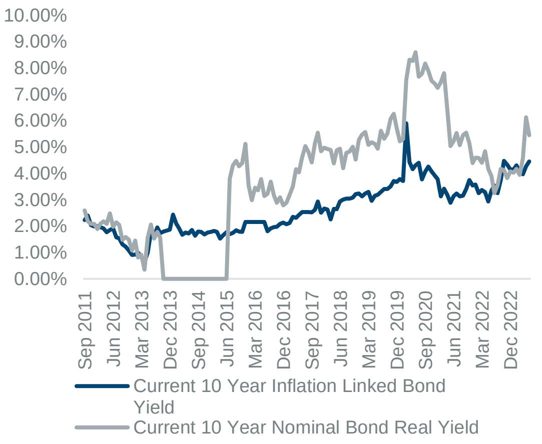


Figure 4: SA 10-year inflation-linked bond yield

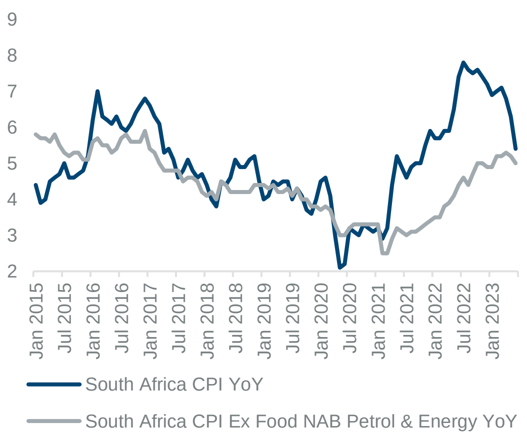


Source: Bloomberg

With headline inflation cooling and core inflation, despite its stickiness, also coming down, our second reason for adopting this relative position is that the real yield of the 10-year nominal bond is higher than that of the 10-year inflation-linked bond, as shown in Figure 5, while our nominal bonds compensate investors more for inflation over the longer maturities, as shown in Figure 7.

Figure 5: SA 10-year nominal and inflation-linked bond real yield

Figure 6: SA CPI and core CPI YoY



Source: Bloomberg

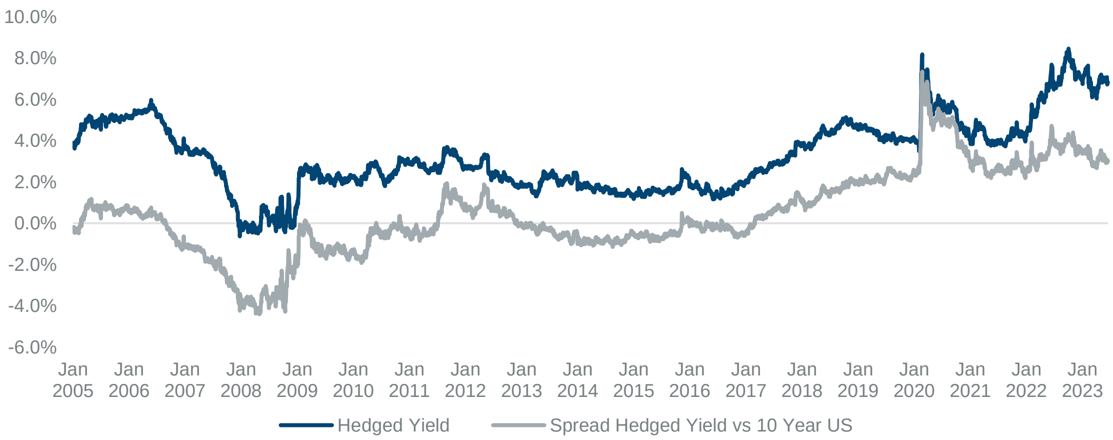
Figure 7: SA nominal and inflation-linked bonds relative value table

Using existing bonds without adjustments	**5 years**	**10 years**	**15 years**	**20 years**	**25 years**
Nominal bond yield	9.12%	11.05%	12.06%	12.39%	12.34%
Less: real bond yield	4.27%	4.89%	4.97%	4.98%	4.99%
Equals: implied breakeven rate	4.85%	6.16%	7.08%	7.41%	7.35%
Less: adjustment for inflation risk premium	0.60%	0.90%	0.90%	1.00%	1.10%
Equals implied average inflation compensation embedded in nominals	4.25%	5.26%	6.18%	6.41%	6.25%

Source: Bloomberg

Lastly, for global investors, our USD-hedged, 10-year yield continued to offer a 300bps spread over the US 10-year nominal bonds, as shown in Figure 8. While our nominal bonds may not be as attractive to investors, from a valuation point of view, as Brazilian 10-year nominal bonds, our currency is one of the worst-performing among our EM peers for the year to date, despite the recent month's recovery. If there is any positive development on the power front and a decline in geopolitical risk, investor appetite may return.

Figure 8: SA hedged yield and spread



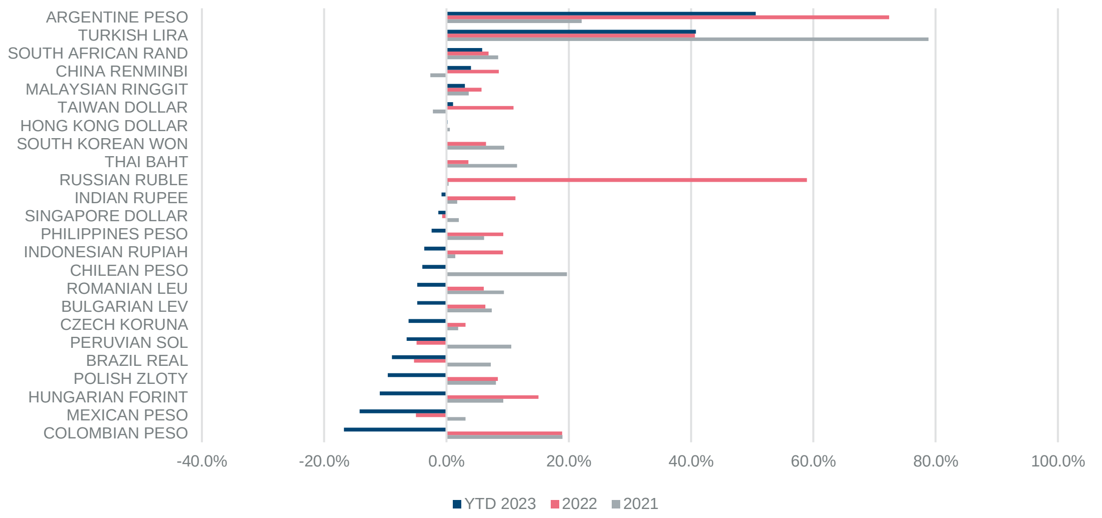
Source: Bloomberg

Figure 9: SA and EM peer bond yields

	South Africa	India	Indonesia	Mexico	Brazil	Turkey
10 Year Yield	**11.78%**	**7.09%**	**6.18%**	**8.76%**	**10.81%**	**17.02%**
Inflation	6.3%	4.8%	3.52%	5.1%	3.2%	38.2%
Inflation Expectation	6.00%	6.60%	3.86%	5.60%	5.00%	45.15%
10 Year Real Yield	**5.48%**	**2.28%**	**2.66%**	**3.70%**	**7.65%**	**-21.19%**
10 Year Real Yield based on inflation expectation	5.78%	0.49%	2.32%	3.16%	5.81%	-28.13%
Currency Risk Premium	**4.41%**	**1.71%**	**0.85%**	**3.09%**	**4.11%**	**8.34%**
Sovereign Risk Premium	**3.54%**	**1.55%**	**1.50%**	**1.84%**	**2.87%**	**4.85%**
US 10 Year Yield	3.83%	3.83%	3.83%	3.83%	3.83%	3.83%
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 10: SA and EM currency performance with YTD as at 17 July 2023

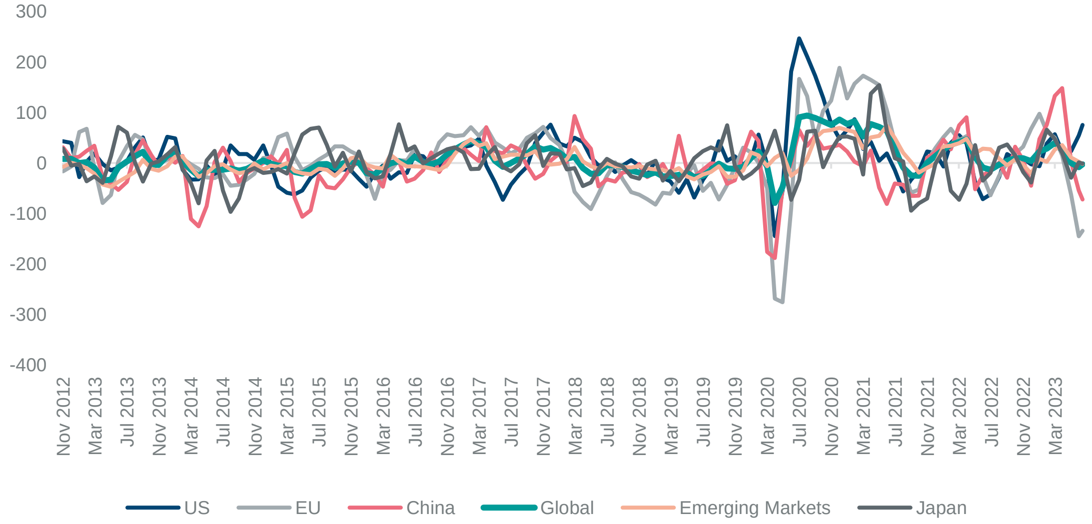


Source: Bloomberg

Slowing growth, cooling inflation but labour market and consumers remained resilient

Economic data from the US was much more upbeat than that of the other geographies, with the EU and China falling short of market expectations, as shown in Figure 11. Broadly speaking, the manufacturing sectors remained largely in the contractionary zone, which translated into goods deflation, thus boding well for a cooling in inflation. However, the latest services PMI numbers, despite being in the expansionary zone, show some softness, which has dragged down composite PMI numbers, as shown in Figures 12 and 13. More specifically, the SA manufacturing PMI dropped from 49.2 in May to 47.6 in June, while the Eurozone HCOB Manufacturing PMI and services PMI dropped from 44.8 and 55.1 in May to 43.4 and 52 respectively in June. However, the US ISM Services PMI jumped from a neutral level of 50.3 in May to 53.9 in June.

Figure 11: Economic surprise indices



Source: Bloomberg

Figure 12: Global manufacturing PMI

	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
Global Manufacturing PMI	52.2	51.1	50.3	49.8	49.4	48.8	48.6	49.1	50	49.6	49.6	49.6	48.8
Developed Markets	52.5	51.3	50.3	50.1	48.8	47.8	47.3	48.1	48.1	48.4	48.5	47.6	46.3
Emerging Markets	51.7	50.8	50.2	49.4	49.8	49.7	49.8	49.9	51.6	50.7	50.5	51.4	51.1
Eurozone	52.1	49.8	49.6	48.4	46.4	47.1	47.8	48.8	48.5	47.3	45.8	44.8	43.4
France	51.4	49.5	50.6	47.7	47.2	48.3	49.2	50.5	47.4	47.3	45.6	45.7	46
Germany	52	49.3	49.1	47.8	45.1	46.2	47.1	47.3	46.3	44.7	44.5	43.2	40.6
Italy	50.9	48.5	48	48.3	46.5	48.4	48.5	50.4	52	51.1	46.8	45.9	43.8
Spain	52.6	48.7	49.9	49	44.7	45.7	46.4	48.4	50.7	51.3	49	48.4	48
Greece	51.1	49.1	48.8	49.7	48.1	48.4	47.2	49.2	51.7	52.8	52.4	51.5	51.8
Ireland	53.1	51.8	51.1	51.5	51.4	48.7	48.7	50.1	51.3	49.7	48.6	47.5	47.3
Australia	56.2	55.7	53.8	53.5	52.7	51.3	50.2	50	50.5	49.1	48	48.4	48.2
Sweden	53.7	53.1	50.6	49.2	46.8	45.9	45.9	46.8	47	45.7	45.5	40.6	44.8
Denmark	71.3	38	48	49.8	52.1	45.9	51.2	54.9	44.1	44.3	44.2	45.7	45.7
UK	52.8	52.1	47.3	48.4	46.2	46.5	45.3	47	49.3	47.9	47.8	47.1	46.5
US	52.7	52.2	51.5	52	50.4	47.7	46.2	46.9	47.3	49.2	50.2	48.4	46.3
Japan	52.7	52.1	51.5	50.8	50.7	49	48.9	48.9	47.7	49.2	49.5	50.6	49.8
China	51.7	50.4	49.5	48.1	49.2	49.4	49	49.2	51.6	50	49.5	50.9	50.5
Indonesia	50.2	51.3	51.7	53.7	51.8	50.3	50.9	51.3	51.2	51.9	52.7	50.3	52.5
South Korea	51.3	49.8	47.6	47.3	48.2	49	48.2	48.5	48.5	47.6	48.1	48.4	47.8
Taiwan	49.8	44.6	42.7	42.2	41.5	41.6	44.6	44.3	49	48.6	47.1	44.3	44.8
India	53.9	56.4	56.2	55.1	55.3	55.7	57.8	55.4	55.3	56.4	57.2	58.7	57.8
Brazil	54.1	54	51.9	51.1	50.8	44.3	44.2	47.5	49.2	47	44.3	47.1	46.6
Mexico	52.2	48.5	48.5	50.3	50.3	50.6	51.3	48.9	51	51	51.1	50.5	50.9
Russia	50.9	50.3	51.7	52	50.7	53.2	53	52.6	53.6	53.2	52.6	53.5	52.6
South Africa	52.2	47.6	52.1	48.2	50	52.6	53.1	53	48.8	48.1	49.8	49.2	47.6

Source: Bloomberg

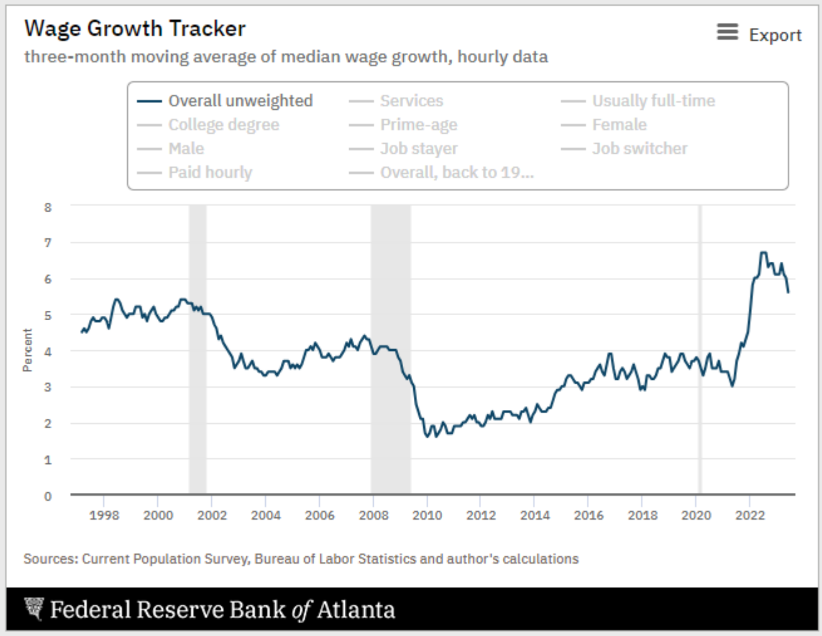
Figure 13: Global composite PMI

	Jun-22	Jul-22	Aug-22	Sep-22	Oct-22	Nov-22	Dec-22	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
Global Composite PMI	53.5	50.8	49.3	49.7	49	48	48.2	49.8	52.1	53.4	54.2	54.4	52.7
Global Services PMI	53.9	51.1	49.2	50	49.2	48.1	48.1	50.1	52.6	54.4	55.4	55.5	54
Developed Markets	52.5	49	46.9	49.3	48.5	47.3	47.1	48.4	51.1	52.6	53.7	53.7	52.2
Emerging Markets	55.2	54	53.4	50.1	49.8	49	50.1	51.9	53.9	54.6	54.9	55.6	53.6
Eurozone	52	49.9	48.9	48.1	47.3	47.8	49.3	50.3	52	53.7	54.1	52.8	49.9
France	52.5	51.7	50.4	51.2	50.2	48.7	49.1	49.1	51.7	52.7	52.4	51.2	47.2
Germany	51.3	48.1	46.9	45.7	45.1	46.3	49	49.9	50.7	52.6	54.2	53.9	50.6
Italy	51.3	47.7	49.6	47.6	45.8	48.9	49.6	51.2	52.2	55.2	55.3	52	49.7
Spain	53.6	52.7	50.5	48.4	48	49.6	49.9	51.6	55.7	58.2	56.3	55.2	52.6
Ireland	52.8	52.9	51	52.2	52.1	48.8	50.5	52	54.5	52.8	53.5	51.9	51.4
Australia	52.6	51.1	50.2	50.9	49.8	48	47.5	48.5	50.6	48.5	53	51.6	50.1
Sweden	60.3	57.2	56.9	53.5	54	51.9	51	49.9	46.1	47.8	49.1	47.6	45.8
UK	53.7	52.1	49.6	49.1	48.2	48.2	49	48.5	53.1	52.2	54.9	54	52.8
US	52.3	47.7	44.6	49.5	48.2	46.4	45	46.8	50.1	52.3	53.4	54.3	53.2
Japan	53	50.2	49.4	51	51.8	48.9	49.7	50.7	51.1	52.9	52.9	54.3	52.1
China	55.3	54	53	48.5	48.3	47	48.3	51.1	54.2	54.5	53.6	55.6	52.5
India	58.2	56.6	58.2	55.1	55.5	56.7	59.4	57.5	59	58.4	61.6	61.6	59.4
Brazil	59.4	55.3	53.2	51.9	53.4	49.8	49.1	49.9	49.7	50.7	51.8	52.3	51.5
Russia	50.4	52.2	50.4	51.5	45.8	50	48	49.7	53.1	56.8	55.1	54.4	55.8

Source: Bloomberg

Turning to the labour market, unemployment rates for major economies remained at historical lows. Wage growth remained significantly above inflation targets. In the UK, average weekly earnings growth 3m year on year in the UK rose from 6.5% in April to 6.9% in May, while in the US, the Atlanta Fed median wage growth tracker continued to show wages growing at 6%. For inflation to fall sustainably to the inflation target of 2.0% in the US, wage growth needs to fall significantly from the current level. The cooling of the US's headline inflation year on year to 3.0% was mainly driven by the favourable base effects, such as a -17.0% year on year change in energy prices. Core inflation has largely been sticky. While a moderation in shelter inflation may help it to cool, the housing market has been quite resilient, with historically low numbers of vacancies. We would not expect central banks such as the Fed to prematurely cut rates as this would lower bond yields, leading to more lending as it tries to manage the second-round effects of elevated labour costs, which could prolong the period of high inflation.

Figure 14: Federal Reserve Bank of Atlanta wage growth tracker



Source: Federal Reserve Bank of Atlanta

There were two main drivers that led to the delayed onset of the slowdown. The first one was the accumulated household savings during the Covid period and the fiscal support programmes that provided a further economic buffer for US consumers, such as the impact of the Inflation Reduction Act of 2022, the drawdown of the strategic fuel reserve, the moratorium on student loan repayments, the supplemental nutrition assistance programme, and reduced co-payments for certain medications for the lower-income group in the population. The second one was that a significant portion of the mortgages were the fixed-rate variety, where consumers took advantage of the very low interest rates during the Covid period. In the UK, the share of fixed-rate mortgages increased from 16% to 63% over the 10 years from 2012 to 2022. Meanwhile, the share of floating-rate mortgages fell from 71% to 13% over the same period. The same occurred in the US, as shown in Figures 15 and 16, resulting in limited impact of the high interest rates on consumers.

Figure 15: Share of US mortgages by vintage

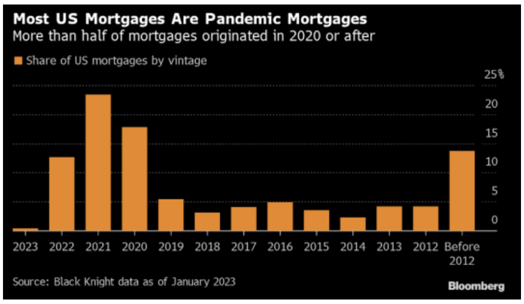
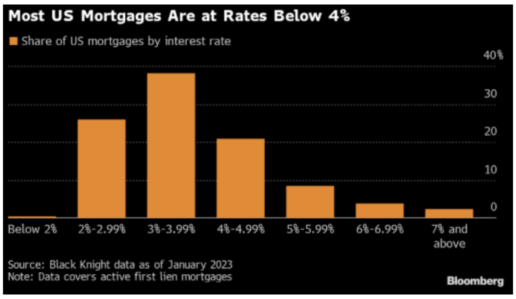


Figure 16: Share of US mortgages by interest rate

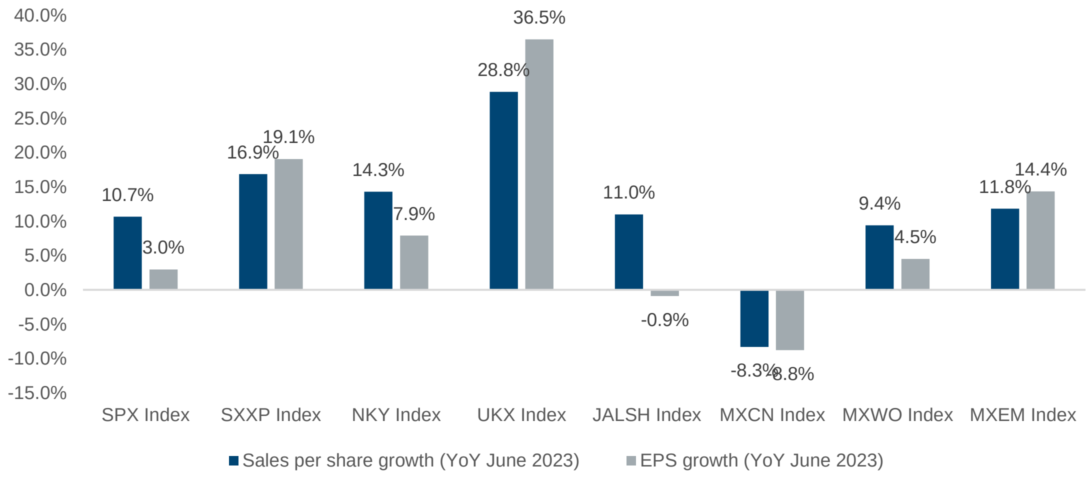


Source: Bloomberg

Cooling inflation, fiscal programmes, positive real wage growth, tight labour markets and minimal impact of rate hikes on mortgages have boosted consumer sentiment and retail sales' resilience in the developed markets over the past year. Some of this is about to change such as the student loan repayments start up again in September. Many students who have graduated since 2020 have not had to make any payments towards their student loans until now. Students who took out loans are more vulnerable, as over 50% of them took on bank card debt during the pandemic while around 40% of them also took on auto loans over the same period.

Turning to corporate earnings, Q2 was largely positive as there was a pick-up in the percentage of S&P 500 companies reporting earnings above the Bloomberg estimates. However, negative operating leverage was evident in the S&P 500 (SPX), Nikkei 225 (NKY), JSE All Share (JALSH), MSCI China (MXCN) and MSCI World (MXWO), as shown in Figure 17.

Figure 17: Sales and earnings per share (EPS) growth for major equity indices



Source: Bloomberg

Our investment case for offshore equity has remained the same, while economic and earnings data has largely been upbeat. Headwinds in the form of negative operating leverage and new debt ceiling deals, resulting in the reduction of fiscal support measures and reduced liquidity, will continue to weigh on consumer sentiment and finances as well as companies' earnings outlook. There is a risk to the perfect scenario currently priced in by the market, and near-term future inflation and earnings data will come with high stakes. We have remained moderately overweight in offshore bonds. We see this asset class offering diversification benefits in the event of a recession as correlations between the US treasury and S&P 500 have been declining. We have also preferred short-term bonds for their income potential. Moreover, while we may see a few more hikes in the short term, the end of the rate-hiking cycle is even closer, especially in the US. We have also maintained our moderately overweight position in offshore cash as, in the event of a significant dent in global risk sentiment, foreign exchange movements often cushion the returns in ZAR terms.

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