



MENTNOVA

# HOUSEVIEW TACTICAL ASSET ALLOCATION

22 February 2024

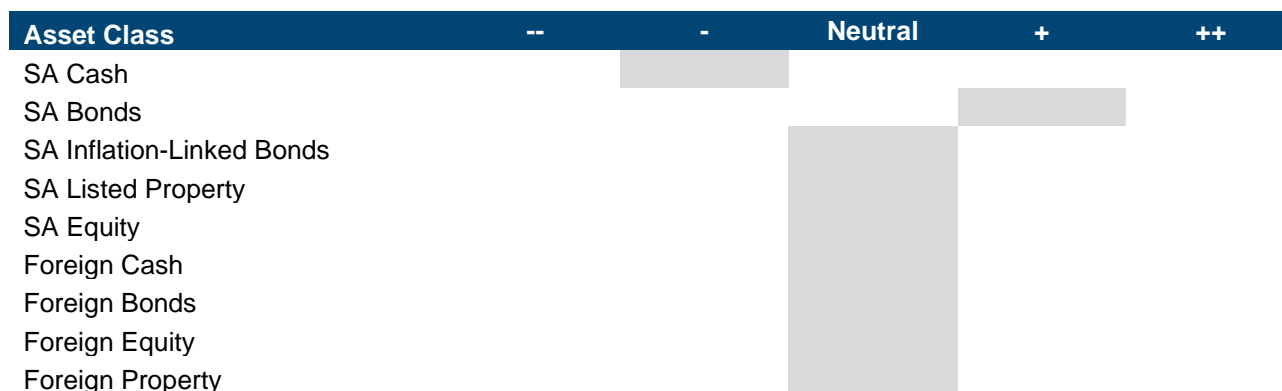




# HOUSEVIEW TACTICAL ASSET ALLOCATION

We have left our TAA views unchanged – moderately overweight in SA bonds, with SA cash being the balancing figure.

**Figure 1: Houseview Tactical Asset Allocation**



## Synopsis

Here is our investment case for March:

- We have maintained our overweight position in SA nominal bonds as this asset class is more attractive than cash and ILBs, based on current yield differentials and real yields. The ZAR has also depreciated by c.5.0% YTD, increasing its value offering for offshore investors.

## Market overview

<b>Market overview</b>	<p>Strong growth data and a less dovish tone from central banks on their rate cut outlooks drove the mixed performance across asset classes in January. The MSCI World Index returned 1.2%, outperforming the MSCI Emerging Markets Index which fell by 4.6% as policy uncertainty and ongoing concerns around the economic outlook for China continued to drag on the equity market. The best performing developed-market equity index was Nikkei 225 which surged by 8.4%, driven by the BOJ's monetary policy outlook, corporate governance reforms and the boost in exporters' earnings due to yen depreciation. The S&amp;P 500 and STOXX 600 delivered very similar returns in January, up 1.7% and 1.5% respectively. Growth stocks also outperformed their value counterparts, up 2.1% vs 0.3% over the same period. SA domestic equities fell by c.3.0% in the first month of 2024 as investors reassessed the timing and quantum of rate cuts for the year. While SA fixed income managed to deliver positive returns for the month, with the ALBI and IGOV returning 0.7% and 0.1%, the World Government Bond Index fell by 1.6%, reversing some of the gains made in 2023 as markets recalibrated rate cut expectations. Rate-sensitive sectors such as listed property and small caps also saw negative returns in January for the same reason, with the exception of the SA-listed property sector which gained 4.1%, thus managing to catch up with global and regional peers over the 5-year and 10-year horizons.</p> <p>Commodities' performance was largely negative for January, despite the Bloomberg Commodity Index managing to end the month with a 0.4% gain, driven mainly by the oil price which rose by 6.1% amid the ongoing Middle East conflict and shipping disruptions in the Suez Canal. Industrial</p>
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metals were the worst performer, while precious metal prices weakened and agricultural products (specifically sugar and cocoa) saw sharp price increases. Weak industrial metal prices contributed to ZAR weakness, with the currency depreciating by 1.8% against the USD. The Dollar Index gained 1.9% against other major currencies as the Fed pushed back on the market's rate cut expectations.

Similar trends persisted into the month of February, with equity markets buoyed by strong growth data (mainly the US and Japan's economic and corporate earnings data), signs of the global manufacturing sector bottoming out and the Chinese government taking more stimulus actions. The combination of strong economic data and less optimistic rate cut outlooks was less favourable for fixed income. SA equities and the ZAR suffered from rising inflation and anaemic domestic economic growth, despite an attractive yield differential.

**Figure 2: Major market indices performance in local currency**

31 January 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 26 February 2024
FTSE/JSE ALSI Total Return	-2.9%	7.5%	-2.9%	-2.6%	10.5%	10.6%	8.7%	-1.3%
FTSE/JSE Capped SWIX Total Return	-2.8%	8.3%	-2.8%	-2.0%	10.5%	7.8%	7.2%	-1.2%
S&P 500 Total Return	1.7%	16.0%	1.7%	20.8%	11.0%	14.3%	12.6%	4.8%
STOXX 600 Total Return	1.5%	12.3%	1.5%	10.1%	9.7%	8.9%	6.9%	2.1%
Nikkei 225 Total Return	8.4%	17.8%	8.4%	35.6%	11.7%	14.1%	11.4%	8.1%
MSCI World Total Return	1.2%	16.2%	1.2%	17.6%	8.6%	12.0%	9.7%	3.9%
MSCI ACWI Total Return	0.6%	15.3%	0.6%	15.3%	6.6%	10.7%	9.0%	4.0%
MSCI EM Total Return	-4.6%	7.1%	-4.6%	-2.5%	-7.1%	1.4%	3.2%	5.1%
MSCI World Value Index	0.3%	13.2%	0.3%	5.6%	6.7%	5.1%	3.8%	0.5%
MSCI World Growth Index	2.1%	18.6%	2.1%	27.1%	6.0%	13.8%	10.5%	5.1%
MSCI World Small Cap Index	-2.8%	16.3%	-2.8%	2.2%	0.0%	5.6%	5.2%	1.4%
FTSE UK Series FTSE All Share TR	-1.3%	6.2%	-1.3%	1.9%	8.4%	5.5%	5.5%	0.8%
MSCI AC Asia Ex. Japan Index	-5.4%	3.6%	-5.4%	-8.7%	-11.3%	-0.9%	1.6%	5.0%
MSCI Europe Excluding United Kingdom Index	2.0%	13.4%	2.0%	9.6%	7.6%	7.6%	5.2%	1.9%
STEF	0.7%	2.1%	0.7%	8.2%	5.8%	6.0%	6.5%	0.6%
ALBI	0.7%	7.1%	0.7%	7.3%	7.4%	7.8%	8.4%	-1.3%
IGOV	0.1%	7.3%	0.1%	8.2%	8.1%	6.2%	6.0%	-1.0%
WGBI	-1.6%	7.6%	-1.6%	0.4%	-7.3%	-2.0%	-0.6%	-1.4%
Bloomberg Global Inflation-Linked Total Return Index	-2.0%	7.5%	-2.0%	0.4%	-6.1%	-0.5%	0.5%	-1.7%
Bloomberg US Agg Total Return	-0.3%	8.2%	-0.3%	2.1%	-3.2%	0.8%	1.6%	-1.6%
Bloomberg EuroAgg Total Return Index	-0.3%	5.8%	-0.3%	4.5%	-4.8%	-1.3%	0.9%	-1.2%
Bloomberg Global Agg Corporate Total Return Index	-0.6%	9.6%	-0.6%	4.8%	-3.8%	1.2%	1.6%	-1.3%
Bloomberg US Corporate High Yield Total Return Index	0.0%	8.4%	0.0%	9.3%	1.9%	4.4%	4.5%	0.3%
Bloomberg Pan-European High Yield Total Return Index	1.0%	7.0%	1.0%	10.4%	1.6%	3.3%	3.7%	0.5%
J.P. Morgan EMBI Global Core Hedged EUR	-1.4%	9.3%	-1.4%	3.4%	-6.0%	-1.7%	1.2%	0.7%
SAPY Total Return	4.1%	21.1%	4.1%	15.8%	17.7%	-0.7%	4.1%	0.8%
MSCI US REIT Total Return	-4.1%	16.3%	-4.1%	-1.4%	5.5%	4.1%	6.7%	0.4%
S&P Global Property Total Return	-3.8%	15.7%	-3.8%	-1.9%	0.2%	0.6%	4.0%	-0.5%
STOXX 600 Real Estate Total Return	-2.5%	23.9%	-2.5%	4.0%	-4.9%	-2.8%	2.4%	-6.5%
FTSE EPRA Nareit Global REITs TR Index	-4.0%	16.4%	-4.0%	-2.7%	2.6%	1.6%	4.8%	-0.9%
Crude Oil	6.1%	-6.5%	6.1%	-3.3%	13.5%	5.7%	-2.6%	1.0%
Aluminium	-4.4%	1.3%	-4.4%	-13.8%	4.9%	3.6%	2.9%	-4.4%
Copper	0.6%	6.1%	0.6%	-6.7%	3.1%	6.9%	2.0%	-1.7%
Gold	-1.1%	2.8%	-1.1%	5.8%	3.3%	9.1%	5.1%	-0.4%
Platinum	-7.0%	-1.6%	-7.0%	-9.1%	-5.1%	2.3%	-3.9%	-4.5%
Nickel	-2.2%	-10.4%	-2.2%	-46.8%	-3.1%	5.3%	1.4%	5.8%
Palladium	-10.8%	-12.6%	-10.8%	-40.6%	-24.0%	-6.1%	3.4%	-2.5%
Iron Ore	-3.6%	7.0%	-3.6%	7.8%	-6.6%	9.9%	0.1%	-7.3%
Bloomberg Commodity Index Total Return	0.4%	-4.2%	0.4%	-7.1%	10.0%	6.2%	-1.1%	-2.4%
USDZAR	1.8%	0.2%	1.8%	7.3%	7.2%	7.1%	5.3%	3.2%
GBPZAR	1.8%	4.6%	1.8%	10.6%	4.5%	6.4%	2.6%	3.2%
EURZAR	0.2%	2.5%	0.2%	6.9%	3.2%	5.9%	3.0%	3.6%
JPYZAR	-2.0%	3.5%	-2.0%	-4.9%	-4.2%	0.9%	1.6%	0.6%
Dollar Index Spot	1.9%	-3.2%	1.9%	1.2%	4.5%	1.6%	2.4%	0.5%

Source: Bloomberg

## TAA overview – no changes in positions

### SA bonds

#### Maintaining a moderately overweight position in SA bonds

Our preference for local nominal bonds over cash remains in place. The relative attractiveness of local nominal bonds continues. The spread between the current and implied yield narrowed slightly from 204bps to 191bps over the past month. SA nominal bonds offer close to a 150bps real yield spread over the inflation-linked equivalents. While the Brazilian 10-year bonds are trading at very attractive real yields and enjoy a better S&P credit rating, SA nominal bonds real yields have increased and are becoming more competitive compared to last month.



Figure 3: SA 10-year nominal bond vs ILB real yield



Figure 4: EM bond yields

	South Africa	India	Indonesia	Mexico	Brazil	Turkey
<b>10 Year Yield</b>	<b>11.69%</b>	<b>7.10%</b>	<b>6.62%</b>	<b>9.31%</b>	<b>10.85%</b>	<b>26.44%</b>
Inflation	5.1%	5.1%	2.57%	4.9%	4.5%	64.9%
Inflation Expectation	5.90%	6.60%	3.70%	5.50%	4.60%	53.80%
<b>10 Year Real Yield</b>	<b>6.59%</b>	<b>2.00%</b>	<b>4.05%</b>	<b>4.43%</b>	<b>6.34%</b>	<b>-38.42%</b>
10 Year Real Yield based on inflation expectation	5.79%	0.50%	2.92%	3.81%	6.25%	-27.36%
<b>Currency Risk Premium</b>	<b>3.85%</b>	<b>1.76%</b>	<b>1.11%</b>	<b>3.37%</b>	<b>4.18%</b>	<b>18.26%</b>
<b>Sovereign Risk Premium</b>	<b>3.56%</b>	<b>1.06%</b>	<b>1.24%</b>	<b>1.66%</b>	<b>2.39%</b>	<b>3.90%</b>
US 10 Year Yield	4.28%	4.28%	4.28%	4.28%	4.28%	4.28%
<b>S&amp;P Rating - Foreign Currency</b>	<b>BB-</b>	<b>BBB-u</b>	<b>BBB</b>	<b>BBB</b>	<b>BB</b>	<b>Bu</b>
<b>Moody's Rating - Foreign Currency</b>	<b>Ba2</b>	<b>Baa3</b>	<b>Baa2</b>	<b>Baa2</b>	<b>Ba2</b>	<b>B3</b>

Source: Bloomberg, as at 19 Feb 2024

While SA bonds represent an attractive opportunity, with a combination of high yields and undervalued currencies, global investors' appetite is yet to turn around. Currency volatility may deter some offshore investors but this can be managed if they hedge their currency exposure, with SA 10-year nominal bonds able to offer a spread of c.400bps over the US 10-year equivalent.

Figure 5: SA 10-year nominal bond hedged yield

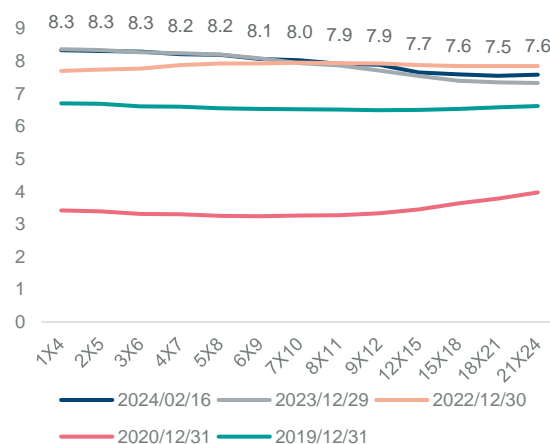
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10 Year Nominal Yield	11.65%	11.36%	11.69%
1 Year ZAR Hedge Cost	3.29%	3.49%	3.28%
USD Yield FX Hedged	8.36%	7.86%	8.41%
vs. US 10 Year Nominal Yield	4.14%	3.90%	4.13%

Source: Bloomberg

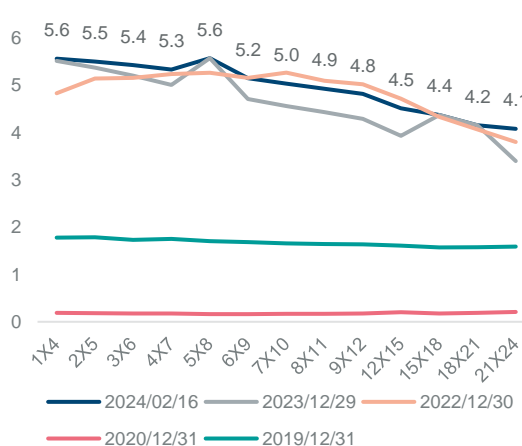


The short-term performance of SA bonds can be volatile due to rate outlooks. For example, the re-pricing of rate cut expectations has dented this asset class's performance YTD, with the US FRAs suggesting that the market has revised its 160bps cuts for 2024 to 100bps over the past month, which is more in line with the Fed's guidance. SA rate cut expectations were less aggressive to start with, while the revision was also more muted – from 85bps cuts to 60bps cuts over the same period. Fiscal fundamentals, concerns over potential further rating downgrades, a chronic shortage of domestic savings and low productivity are areas where any improvements will attract offshore capital inflows over the medium to long term. Tactically, we prefer this asset class over cash at the current yield level, but further upward corrections will depend on more structural reforms.

**Figure 6: SA FRAs**



**Figure 7: US FRAs**



Source: Bloomberg



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