



MENTANOVA

# HOUSEVIEW TACTICAL ASSET ALLOCATION

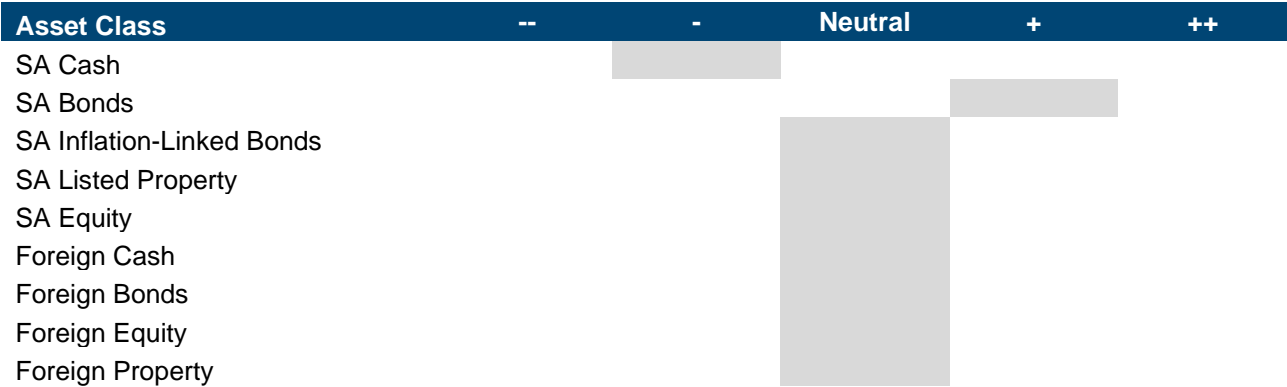
19 March 2024



# 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 April:

- We have maintained our overweight position in SA nominal bonds as this asset class is more attractive than cash and to a lesser extent is favoured over ILBs, based on current yield differentials and real yields.

## Market overview

<b>Market overview</b>	<p>While fixed-income markets faced pressure in February as investors deferred expectations for interest rate cuts into 2024, stock markets in general gained on the back of resilient economic indicators and robust earnings reports. The MSCI World Index returned 4.3% for the month, slightly outperformed by the MSCI Emerging Markets Index which delivered 4.8% over the same period. China saw a rebound during February, underpinned by policy rate cuts and better-than-expected economic data. Both South Korean and Taiwanese equities continued to benefit from the AI thematic investing. The S&amp;P 500 Index was up 5.3% in February, driven by ongoing economic strength in the US. Eurozone stocks also advanced as business activity in the region improved but lagged other developed markets. The Japanese equity market rallied by 8.0% in February as corporate governance reforms, the return of inflation, earnings strength, the BOJ's accommodative monetary policy and subdued political risk were appreciated by the markets, in a historic year for elections in which nearly half the world's population is set to go to the polls. The same trends largely continued into the month of March.</p> <p>Locally, SA equities fell by c.2.5% in February, underpinned by a weak commodities market, a lack of catalysts for economic growth, concerns about political uncertainty and the strengthening of the US dollar which weighed on emerging market currencies and investor sentiment towards South Africa. SA equities recovered somewhat into March, gaining c.1.0%. They are lagging other major equity indices in their respective local currency terms but are on a par with global peers if one takes into account the ZAR appreciation for the month to date. SA nominal and inflation-linked bonds underperformed against the World Government Bond Index (WGBI) in ZAR</p>
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terms in February due to positive currency translation effect as the rand depreciated from R18.67/\$ to R19.20/\$. The ZAR managed to recover to R18.99/\$ into March, with the negative currency translation effect resulting in the ALBI Index performing in line with the WGBI for the month to date. The IGOV outperformed both local and global nominal government bonds in ZAR terms as the SA CPI ticked up for the second consecutive month to 5.6% in February.

The listed property market saw great regional divergence and volatility, with US REITs' performance exceeding expectations in February due to underlying economic resilience, while the European real estate valuations slumped due to concerns about slower interest rate cuts and the underlying economy. Some corrections took place into March, driven by a reversal of these same factors.

The Bloomberg Commodity Index fell by 1.5% in February on the balance of higher livestock and energy prices but weaker agriculture, precious and industrial metals prices. Commodities' performance was largely positive for the month to date in March. The Dollar Index gained 0.9% against other major currencies in February as the Fed pushed back on the market's rate cut expectations and was nearly flat into March. The ZAR saw some swings, weakening by 2.8% against the USD in February but making some recovery into March.

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

29 February 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 25 March 2024
FTSE/JSE ALSI Total Return	-2.4%	-3.4%	-5.3%	-2.9%	7.5%	9.3%	7.9%	1.2%
FTSE/JSE Capped SWIX Total Return	-2.3%	-2.3%	-5.0%	-2.0%	7.8%	7.0%	6.4%	1.0%
S&P 500 Total Return	5.3%	12.0%	7.1%	30.5%	11.9%	14.8%	12.7%	2.5%
STOXX 600 Total Return	2.0%	7.4%	3.5%	10.2%	9.6%	8.5%	6.6%	3.4%
Nikkei 225 Total Return	8.0%	17.2%	17.1%	45.7%	12.8%	15.1%	12.3%	3.2%
MSCI World Total Return	4.3%	10.8%	5.6%	25.6%	9.2%	12.2%	9.6%	2.7%
MSCI ACWI Total Return	4.3%	10.0%	5.0%	23.8%	7.3%	11.0%	8.9%	2.6%
MSCI EM Total Return	4.8%	3.9%	-0.1%	9.2%	-5.9%	2.3%	3.4%	1.8%
MSCI World Value Index	2.5%	8.1%	2.5%	11.3%	5.9%	5.1%	3.6%	1.6%
MSCI World Growth Index	6.0%	13.0%	8.1%	37.2%	7.9%	14.4%	10.5%	1.7%
MSCI World Small Cap Index	3.4%	10.0%	0.3%	7.8%	-0.6%	5.5%	5.0%	1.0%
FTSE UK Series FTSE All Share TR	0.2%	3.3%	-1.1%	0.6%	7.8%	5.0%	5.0%	4.1%
MSCI AC Asia Ex. Japan Index	5.6%	3.2%	-0.4%	3.2%	-10.1%	-0.3%	1.8%	1.1%
MSCI Europe Excluding United Kingdom Index	2.4%	8.4%	4.3%	10.5%	7.6%	7.2%	4.9%	2.4%
STEFI	0.7%	2.1%	1.4%	8.3%	6.0%	6.0%	6.5%	0.6%
ALBI	-0.6%	1.6%	0.1%	7.6%	7.2%	7.8%	8.1%	-1.3%
IGOV	-0.8%	1.5%	-0.7%	6.9%	7.2%	6.1%	5.6%	0.2%
WGBI	-1.3%	1.2%	-2.8%	2.5%	-6.9%	-2.0%	-0.9%	0.2%
Bloomberg Global Inflation-Linked Total Return Index	-0.9%	1.4%	-2.9%	2.7%	-5.7%	-0.6%	0.3%	0.8%
Bloomberg US Agg Total Return	-1.4%	2.1%	-1.7%	3.3%	-3.2%	0.6%	1.4%	0.6%
Bloomberg EuroAgg Total Return Index	-1.1%	1.9%	-1.4%	5.6%	-4.6%	-1.4%	0.7%	0.7%
Bloomberg Global Agg Corporate Total Return Index	-1.3%	2.3%	-1.9%	6.8%	-3.8%	0.9%	1.3%	0.8%
Bloomberg US Corporate High Yield Total Return Index	0.3%	4.0%	0.3%	11.0%	1.8%	4.2%	4.3%	1.0%
Bloomberg Pan-European High Yield Total Return Index	0.4%	4.3%	1.4%	10.7%	1.5%	3.0%	3.5%	0.4%
J.P. Morgan EMBI Global Core Hedged EUR	0.9%	4.2%	-0.5%	7.2%	-4.8%	-1.7%	0.9%	1.8%
SAPY Total Return	0.8%	15.3%	4.9%	17.6%	14.8%	0.6%	3.7%	-0.8%
MSCI US REIT Total Return	2.0%	7.4%	-2.2%	5.6%	4.9%	4.4%	6.4%	-1.3%
S&P Global Property Total Return	0.2%	5.0%	-3.7%	3.0%	-0.8%	0.7%	3.6%	1.0%
STOXX 600 Real Estate Total Return	-7.7%	-0.4%	-10.0%	-2.0%	-6.7%	-4.0%	0.9%	6.8%
FTSE EPRA Nareit Global REITs TR Index	-0.1%	5.1%	-4.2%	1.6%	1.2%	1.5%	4.2%	0.3%
Crude Oil	2.3%	1.0%	8.5%	-0.3%	8.1%	4.8%	-2.6%	3.7%
Aluminium	-2.3%	1.6%	-6.5%	-6.1%	1.1%	3.1%	2.4%	4.4%
Copper	-1.3%	0.3%	-0.8%	-5.2%	-2.2%	5.5%	1.9%	4.5%
Gold	0.2%	0.4%	-0.9%	11.9%	5.6%	9.3%	4.4%	6.2%
Platinum	-4.6%	-5.3%	-11.3%	-7.9%	-9.6%	0.2%	-4.8%	2.8%
Nickel	10.3%	7.5%	7.8%	-28.0%	-1.5%	6.4%	1.9%	-5.3%
Palladium	-3.6%	-6.2%	-14.0%	-33.3%	-25.9%	-9.3%	2.5%	6.5%
Iron Ore	-9.4%	-8.1%	-12.6%	-1.5%	-11.4%	7.1%	-0.1%	-10.3%
Bloomberg Commodity Index Total Return	-1.5%	-3.7%	-1.1%	-3.9%	7.2%	5.7%	-1.8%	3.0%
USDZAR	2.8%	1.9%	4.6%	4.6%	8.3%	6.4%	6.0%	-1.7%
GBPZAR	2.2%	1.8%	4.0%	9.8%	4.8%	5.3%	3.0%	-1.5%
EURZAR	2.6%	1.0%	2.8%	6.8%	4.4%	5.3%	3.4%	-1.3%
JPYZAR	0.6%	0.6%	-1.5%	-5.1%	-3.4%	0.2%	1.9%	-2.5%
Dollar Index Spot	0.9%	0.6%	2.8%	-0.7%	4.7%	1.6%	2.7%	0.1%

Source: Bloomberg



## TAA overview – no changes in positions

### SA bonds

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

We maintain our preference for local nominal bonds over cash, as the relative attractiveness of local nominal bonds remains intact. The spread between the current and implied yield widened from 191bps to 220bps over the past month. SA nominal bonds continued to offer close to a 150bps real yield spread over the inflation-linked equivalents.

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



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.430bps over the US 10-year equivalent.

**Figure 4: SA 10-year nominal bond hedged yield**

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10 Year Nominal Yield	11.36%	11.69%	11.82%
1 Year ZAR Hedge Cost	3.49%	3.28%	3.35%
USD Yield FX Hedged	7.86%	8.41%	8.47%
vs. US 10 Year Nominal Yield	3.90%	4.13%	4.32%

Source: Bloomberg

However, Brazilian 10-year bonds are trading at very attractive real yields with a better S&P credit rating against a strong macro landscape with less political uncertainty, which suggests that offshore investors would prefer the latter over SA government bonds.

**Figure 5: EM bond yields**

	South Africa	India	Indonesia	Mexico	Brazil	Turkey
<b>10 Year Yield</b>	<b>11.82%</b>	<b>7.03%</b>	<b>6.63%</b>	<b>9.22%</b>	<b>10.79%</b>	<b>26.98%</b>
Inflation	5.3%	5.1%	2.75%	4.4%	4.5%	67.1%
Inflation Expectation	5.90%	6.60%	3.70%	5.50%	4.60%	54.00%
<b>10 Year Real Yield</b>	<b>6.52%</b>	<b>1.94%</b>	<b>3.88%</b>	<b>4.82%</b>	<b>6.29%</b>	<b>-40.09%</b>
10 Year Real Yield based on inflation expectation	5.92%	0.43%	2.93%	3.72%	6.19%	-27.02%
<b>Currency Risk Premium</b>	<b>4.26%</b>	<b>1.83%</b>	<b>1.26%</b>	<b>3.51%</b>	<b>4.31%</b>	<b>18.81%</b>
<b>Sovereign Risk Premium</b>	<b>3.41%</b>	<b>1.04%</b>	<b>1.22%</b>	<b>1.56%</b>	<b>2.33%</b>	<b>4.02%</b>
US 10 Year Yield	4.15%	4.15%	4.15%	4.15%	4.15%	4.15%
<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 15 Mar 2024

Although South African bonds present an appealing opportunity, characterised by high yields and undervalued currencies, global investors remain hesitant to embrace them fully. This hesitation stems from a lingering sense of apprehension about the country's fiscal fundamentals, coupled with concerns surrounding the broader economic landscape and the uncertainty of the upcoming election outcome – all of which contribute to subdued sentiment towards South Africa. The short-term performance of South African bonds may exhibit volatility, influenced by persistent inflation and uncertain rate outlooks.

From a tactical standpoint, we favour this asset class over cash, given the current yield levels. However, substantial upward corrections in the future will hinge on the implementation of more comprehensive structural reforms within the South African economy. These reforms are crucial for bolstering investor confidence and fostering a more favourable investment climate in the long term.



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