MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

20 June 2024

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We have moved back to a moderately overweight position in SA bonds from neutral, 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

Here is our investment case for July:

- We have moved from neutral to a moderately overweight position in SA nominal bonds as it is our highest conviction call, supported by valuations, an imminent rate-cutting cycle and the peaking of the USD.

Market overview

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South African assets rebounded into the month of June, due to the generally favourable election outcome. The ZAR strengthened by c.4.0% against the USD. Commodity prices retreated in June due to factors such as increasing supplies of nickel, global demand worries, the USD's moderate comeback, which weighed on the oil price, and iron ore taking a hit from expected caps on China's crude steel output.

Figure 2: Major market indices' performance in local currency

31 May 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 18 June 2024
FTSE/JSE ALSI Total Return	1.0%	7.3%	1.6%	6.3%	8.6%	10.7%	8.0%	4.0%
FTSE/JSE Capped SWIX Total Return	0.9%	6.9%	1.5%	9.7%	7.5%	8.5%	6.4%	4.0%
S&P 500 Total Return	5.0%	3.9%	11.3%	28.2%	9.6%	15.8%	12.7%	4.1%
STOXX 600 Total Return	3.3%	6.4%	10.1%	17.8%	7.9%	9.7%	6.9%	-0.5%
Nikkei 225 Total Return	0.2%	-1.1%	15.9%	26.9%	12.3%	15.6%	12.3%	0.0%
MSCI World Total Return	4.5%	4.0%	9.8%	25.5%	7.2%	13.3%	9.7%	2.3%
MSCI ACWI Total Return	4.1%	4.0%	9.1%	24.1%	5.6%	12.2%	9.0%	2.4%
MSCI EM Total Return	0.6%	3.6%	3.5%	12.8%	-5.9%	3.9%	3.0%	3.4%
MSCI World Value Index	3.3%	4.2%	6.4%	19.9%	3.4%	6.8%	3.6%	-2.5%
MSCI World Growth Index	5.7%	3.3%	11.6%	27.4%	6.7%	15.0%	10.7%	4.7%
MSCI World Small Cap Index	4.6%	2.9%	3.0%	17.1%	-1.8%	7.1%	5.4%	-3.4%
FTSE UK Series FTSE All Share TR	2.4%	9.9%	8.7%	15.4%	7.9%	6.5%	5.9%	-0.9%
MSCI AC Asia Ex. Japan Index	1.6%	5.4%	4.8%	9.3%	-8.8%	1.9%	1.8%	2.7%
MSCI Europe Excluding United Kingdom Index	3.9%	5.7%	10.2%	15.9%	6.1%	8.5%	5.3%	-2.9%
STEFI	0.7%	2.1%	3.5%	8.5%	6.4%	6.0%	6.6%	0.4%
ALBI	0.8%	0.2%	0.3%	13.0%	6.2%	7.2%	7.8%	5.1%
IGOV	-0.8%	-0.4%	-1.1%	7.1%	5.2%	5.7%	4.9%	2.5%
WGBI	1.1%	-1.1%	-3.9%	-0.6%	-7.2%	-2.7%	-1.1%	0.9%
Bloomberg Global Inflation-Linked Total Return Index	2.0%	0.5%	-2.4%	2.3%	-6.8%	-1.0%	0.0%	1.0%
Bloomberg US Agg Total Return	1.7%	0.0%	-1.6%	1.3%	-3.1%	-0.2%	1.3%	1.8%
Bloomberg EuroAgg Total Return Index	0.0%	-0.1%	-1.5%	2.9%	-4.4%	-2.0%	0.4%	0.9%
Bloomberg Global Agg Corporate Total Return Index	1.9%	0.7%	-1.2%	5.4%	-3.7%	0.5%	1.2%	1.0%
Bloomberg US Corporate High Yield Total Return Index	1.1%	1.3%	1.6%	11.2%	1.8%	4.2%	4.3%	0.9%
Bloomberg Pan-European High Yield Total Return Index	1.0%	1.4%	2.8%	11.1%	1.4%	3.1%	3.4%	0.3%
J.P. Morgan EMBI Global Core Hedged EUR	1.8%	1.3%	0.8%	8.4%	-5.0%	-1.7%	0.5%	1.1%
SAPY Total Return	0.2%	-1.4%	3.4%	20.3%	10.7%	0.2%	3.0%	7.9%
MSCI US REIT Total Return	4.7%	-0.8%	-3.0%	9.9%	0.1%	3.6%	5.7%	1.8%
S&P Global Property Total Return	2.9%	0.9%	-2.8%	9.9%	-3.7%	0.5%	3.1%	0.1%
STOXX 600 Real Estate Total Return	5.2%	11.6%	0.4%	28.2%	-7.2%	-2.4%	1.5%	-3.2%
FTSE EPRA Nareit Global REITs TR Index	4.0%	0.2%	-4.0%	7.2%	-2.6%	1.1%	3.5%	0.6%
Crude Oil	-7.1%	-2.4%	5.9%	12.3%	5.6%	4.8%	-2.9%	4.5%
Aluminium	2.4%	19.1%	11.3%	18.1%	2.2%	8.1%	3.7%	-6.3%
Copper	0.5%	18.2%	17.3%	24.1%	-0.7%	11.5%	3.9%	-3.7%
Gold	1.8%	13.8%	12.8%	18.6%	6.9%	12.3%	6.4%	0.1%
Platinum	10.7%	18.0%	4.7%	4.0%	-4.4%	5.5%	-3.3%	-5.9%
Nickel	2.2%	10.2%	18.8%	-4.6%	2.6%	10.3%	0.2%	-12.3%
Palladium	-4.1%	-3.2%	-16.7%	-33.0%	-31.3%	-7.1%	0.9%	-2.7%
Iron Ore	-0.6%	-6.2%	-18.0%	9.8%	-18.7%	1.8%	1.6%	-5.5%
Bloomberg Commodity Index Total Return	1.8%	8.0%	6.8%	10.9%	6.9%	8.2%	-1.1%	0.0%
USDZAR	0.1%	-2.1%	2.3%	-4.7%	11.0%	5.2%	5.9%	-4.0%
GBPZAR	2.1%	-1.2%	2.8%	-2.4%	7.0%	5.4%	3.1%	-4.3%
EURZAR	1.8%	-1.7%	1.0%	-3.3%	6.7%	4.6%	3.5%	-5.0%
JPYZAR	0.3%	-6.6%	-7.9%	-15.6%	-1.6%	-2.4%	1.4%	-4.4%
Dollar Index Spot	-1.5%	0.5%	3.3%	0.3%	5.2%	1.4%	2.7%	0.6%

Source: Bloomberg

TAA overview – Revert to overweight in local nominal bonds as election uncertainty overhang dissipates

SA bonds

SA bonds still have additional upside potential after the post-election rebound

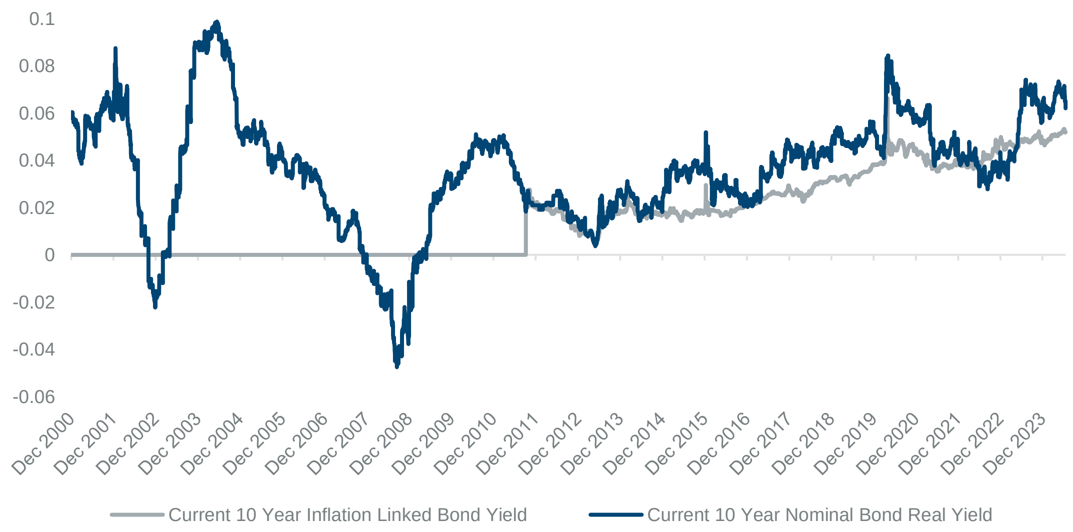
We moved our TAA positions to SAA weights for the month of June, purely to manage the risk of election disappointment. Our base case was more or less in line with the scenario of the ANC achieving 45%–50% of the votes, which was priced in by the market. However, the tail risk was too big to ignore, where the ANC might lose its majority and form a coalition with opposition parties such as the EFF and MK. The probability of this scenario is very low, but its impact would be profound and would be viewed extremely negatively by the market. On the balance of risks, we therefore decided to close our only active position at the time – moderately overweight in SA bonds – by moving it to neutral until there is more certainty about the election outcome. It turns out that the election result was more of a right-tail event – the best outcome from the market standpoint – and was well received, as reflected in SA assets performance in June.

Despite the recent rally, SA nominal bonds remain attractive from a real-yield, implied-yield spread and hedged-yield perspective.

While short-term market movements will hinge on economic data releases, there is increasing evidence to suggest that inflation will moderate over the coming months. The current balance between economic growth and inflation appears favourable for the US economy, akin to the macro landscape of the late 1990s. Despite potential near-term corrections, US equities are supported by strong fundamentals in key tech stocks and a resilient 'buy the dip' mentality among investors. Offshore bonds are also expected to benefit from cooling inflation and potential rate cuts. The Eurozone and Chinese economies have shown signs of stabilisation, with the Eurozone's recovery steadier and China likely to require a substantial stimulus to bolster consumer and investor confidence amid multi-decade-high real interest rates. This environment leans towards higher risk tolerance, which favours equities over bonds, although downside risks to growth outweigh upside surprises in inflation. However, currency dynamics, particularly the potential appreciation of the ZAR, driven by strong sentiment, a bullish commodity cycle, expected Fed rate cuts and improved policy certainty in South Africa, have contributed to a neutral offshore allocation strategy.

In our assessment of South African assets, we favour nominal bonds over inflation-linked bonds. Yet, given the duration spread and liquidity constraints of inflation-linked bonds, funding the moderately overweight position in SA bonds through cash is a better option, as we approach the rate-cutting cycle. While listed properties may benefit from rate cuts, their fundamentals remain unchanged, and the asset class does not adequately compensate for the additional risk over SA bonds. We acknowledge the potential of South African equities to outperform offshore equities, with low-carbon initiatives, AI infrastructure investments, and ongoing geopolitical and fiscal fragilities bolstering the commodity cycle in the medium to long term. However, the market has already priced in the optimism from the recent elections into earnings outlooks, although fundamental and macro indicators are yet to demonstrate a meaningful recovery with the cabinet talks yet to be finalised.

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

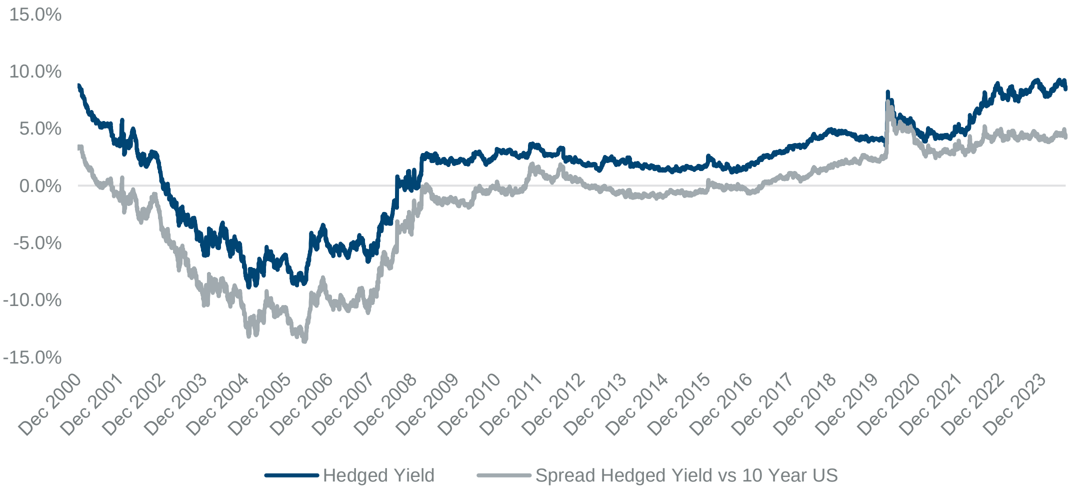


Source: Bloomberg

Figure 4: SA 10-year nominal bond vs implied yield

Source: Bloomberg

Figure 5: SA 10-year nominal bond hedged-yield and hedged-yield spread



Source: Bloomberg

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