MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

18 July 2024

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We have maintained a moderately overweight position in SA bonds and moved to moderately underweight from neutral in offshore cash, 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 August:

- We have maintained a moderately overweight position in SA nominal bonds, as it remains our highest conviction call, supported by valuations, an imminent rate-cutting cycle and the peaking of the USD.
- We have moved from neutral to moderately underweight in offshore cash as the potential return profile is skewed to the upside for the ZAR.

Market overview

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June rate cut by the BOE. For developed market equities, as represented by the MSCI World Index, the best-performing styles for Q2 were Quality and Momentum, while the worst-performing styles were Value and High yield. For SA equities, Growth was the best-performing style and Low volatility was the worst performer. Small caps and real estate put in a strong performance into the month of July, surging on rate-cut bets.

Figure 2: Major market indices' performance in local currency

30 June 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 22 July 2024
FTSE/JSE ALSI Total Return	4.1%	8.2%	5.8%	9.1%	11.0%	10.6%	8.2%	1.1%
FTSE/JSE Capped SWIX Total Return	4.2%	8.2%	5.7%	10.0%	10.1%	8.7%	6.5%	1.1%
S&P 500 Total Return	3.6%	4.3%	15.3%	24.6%	10.0%	15.0%	12.9%	2.0%
STOXX 600 Total Return	-1.2%	1.1%	8.9%	13.7%	6.9%	8.5%	6.9%	0.7%
Nikkei 225 Total Return	3.0%	-1.8%	19.3%	21.5%	13.5%	15.5%	12.2%	0.0%
MSCI World Total Return	2.1%	2.8%	12.0%	20.8%	7.4%	12.3%	9.7%	2.1%
MSCI ACWI Total Return	2.3%	3.0%	11.6%	19.9%	5.9%	11.3%	9.0%	2.0%
MSCI EM Total Return	4.0%	5.1%	7.7%	13.0%	-4.7%	3.5%	3.2%	0.4%
MSCI World Value Index	-0.8%	-1.0%	6.6%	14.8%	6.4%	8.4%	6.7%	3.6%
MSCI World Growth Index	4.8%	6.4%	17.4%	26.6%	7.7%	15.5%	12.5%	0.8%
MSCI World Small Cap Index	-1.9%	-2.7%	1.7%	9.7%	-0.8%	7.4%	6.8%	5.3%
FTSE UK Series FTSE All Share TR	-1.2%	3.7%	7.4%	13.0%	7.4%	5.5%	5.9%	1.0%
MSCI AC Asia Ex. Japan Index	4.3%	7.2%	9.9%	13.2%	-5.5%	3.8%	4.5%	-0.1%
MSCI Europe Excluding United Kingdom Index	-1.1%	0.8%	9.4%	14.3%	7.4%	9.8%	8.2%	0.4%
Shanghai Shenzhen CSI 300 Index	-2.5%	-1.0%	2.1%	-7.7%	-10.8%	0.2%	7.1%	2.5%
Korea Stock Exchange KOSPI Index	6.1%	1.9%	6.2%	11.1%	-3.4%	7.8%	5.4%	-1.2%
Taiwan Stock Exchange Weighted Index	9.3%	14.1%	29.5%	39.8%	13.1%	20.8%	13.5%	-2.5%
NSE Nifty 50 Index	6.8%	8.2%	11.3%	26.9%	16.8%	16.9%	13.8%	2.1%
Ibovespa Brasil Sao Paulo Stock Exchange Index	1.5%	-3.3%	-7.7%	4.9%	-0.8%	4.2%	8.8%	3.2%
Nasdaq-100 Index	6.3%	8.0%	17.5%	30.8%	11.5%	21.8%	18.9%	0.7%
Bloomberg Magnificent 7 Total Return Index	9.7%	16.9%	37.0%	52.1%	24.6%	46.8%		3.4%
S&P ex Magnificent 7	1.2%	-1.0%	8.3%	15.5%	5.3%	9.5%		2.4%
Dow Jones Industrial Average TR	1.2%	-1.3%	4.8%	16.0%	6.4%	10.3%	11.3%	3.4%
STEFI	0.6%	2.1%	4.2%	8.5%	6.5%	6.1%	6.6%	0.5%
ALBI	5.2%	7.5%	5.6%	13.7%	7.6%	7.8%	8.2%	3.3%
IGOV	3.0%	2.4%	1.9%	9.0%	6.9%	6.3%	5.0%	0.9%
WGBI	0.0%	-1.6%	-4.0%	-0.6%	-6.9%	-3.2%	-1.2%	1.6%
Bloomberg Global Inflation-Linked Total Return Index	-0.2%	-0.8%	-2.6%	0.4%	-6.4%	-1.4%	-0.1%	1.8%
Bloomberg US Agg Total Return	0.9%	0.1%	-0.7%	2.6%	-3.0%	-0.2%	1.3%	1.2%
Bloomberg EuroAgg Total Return Index	0.3%	-0.9%	-1.2%	3.6%	-4.5%	-2.3%	0.4%	1.0%
Bloomberg Global Agg Corporate Total Return Index	0.3%	-0.2%	-0.9%	4.9%	-3.7%	0.0%	1.1%	1.6%
Bloomberg US Corporate High Yield Total Return Index	0.9%	1.1%	2.6%	10.4%	1.6%	3.9%	4.3%	1.5%
Bloomberg Pan-European High Yield Total Return Index	0.4%	1.4%	3.2%	11.1%	1.4%	2.7%	3.4%	0.9%
J.P. Morgan EMBI Global Core Hedged EUR	0.5%	-0.1%	1.3%	6.9%	-5.1%	-2.2%	0.5%	1.1%
SAPY Total Return	6.0%	5.5%	9.6%	26.3%	11.7%	0.9%	3.2%	1.7%
MSCI US REIT Total Return	2.9%	0.1%	-0.2%	7.6%	0.2%	3.9%	5.8%	6.8%
S&P Global Property Total Return	0.4%	-1.9%	-2.4%	6.6%	-3.9%	0.1%	2.9%	6.0%
STOXX 600 Real Estate Total Return	-3.6%	-0.4%	-3.2%	24.8%	-8.7%	-2.5%	1.0%	4.3%
FTSE EPRA Nareit Global REITs TR Index	1.2%	-1.4%	-2.9%	5.0%	-2.6%	0.9%	3.5%	6.3%
Crude Oil	5.9%	-1.2%	12.2%	15.4%	4.8%	5.4%	-2.6%	-4.6%
Aluminium	-4.8%	8.0%	5.9%	17.3%	0.0%	7.0%	2.9%	-8.9%
Copper	-4.4%	8.3%	12.2%	15.4%	0.8%	9.9%	3.2%	-4.0%
Gold	0.0%	4.3%	12.8%	21.2%	9.5%	10.5%	5.8%	3.0%
Platinum	-4.1%	9.3%	0.4%	9.9%	-2.5%	3.6%	-3.9%	-4.6%
Nickel	-12.5%	3.0%	4.0%	-16.2%	-2.1%	6.2%	-1.0%	-6.4%
Palladium	6.6%	-3.9%	-11.2%	-20.6%	-29.5%	-8.7%	1.5%	-7.2%
Iron Ore	-5.7%	7.4%	-22.7%	-5.9%	-21.6%	-2.0%	1.2%	-2.2%
Bloomberg Commodity Index Total Return	-1.5%	2.9%	5.1%	5.0%	5.7%	7.2%	-1.3%	-2.5%
USDZAR	-3.2%	-3.6%	-0.9%	-3.5%	8.4%	5.2%	5.5%	0.4%
GBPZAR	-3.9%	-3.4%	-1.2%	-3.9%	5.2%	5.2%	2.4%	2.6%
EURZAR	-4.4%	-4.3%	-3.4%	-5.3%	4.8%	4.0%	3.0%	2.0%
JPYZAR	-5.4%	-9.4%	-12.9%	-13.4%	-4.2%	-2.8%	0.7%	2.8%
Dollar Index Spot	1.1%	1.3%	4.5%	2.9%	4.6%	1.9%	2.9%	-1.5%

Source: Bloomberg

Fixed income had a volatile intra-quarter, as renewed inflation concerns and repricing of rate-cut expectations weighed on this asset class in the first half of Q2. Meanwhile, a softer US labour market and encouraging inflation data in the second half of Q2 managed to offset some of the earlier losses. The SA nominal bonds benchmark, the ALBI Index, gained 5.2% in June and 3.3% into July, significantly outperforming the local inflation-linked bonds benchmark, the IGOV Index and the FTSE World Government Bond Index. The Bloomberg Commodity Index managed to gain 2.9% in Q2, despite falling by 1.5% in June. Industrial metals in general were the top performers for the quarter, while the oil price declined by 1.2% in Q2. In June, some corrections took place: the oil price rebounded on the prospect of strong summer travel and persistent tensions in the Middle East, while metal prices fell amid uncertainty over demand in China and a seasonal slowdown in global consumption. China's slower-than-expected GDP growth rate of 4.7% continued to weigh on global commodity prices into July.

The ZAR managed to appreciate by 3.6% against the USD for the quarter, but it was quite a volatile ride with election optimism, coalition talks, cabinet appointments and GNU vulnerability driving much of the market sentiment. The USD also managed to strengthen by 1.1% against other major currencies as the Fed suggested no immediate rate cuts. The currency has subsequently weakened into the month of July, with Fed cuts looking increasingly imminent as the US labour market continues to slow down.

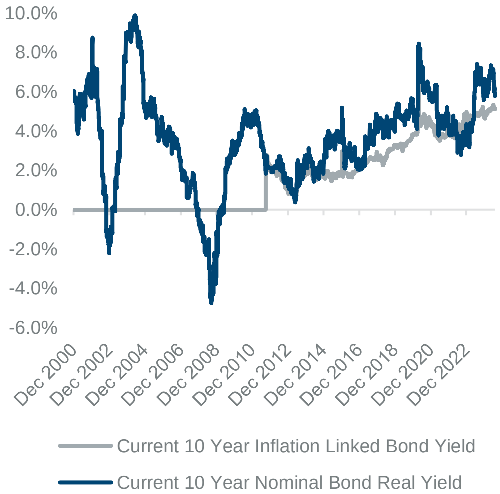
TAA overview – Maintained an overweight position in local nominal bonds and moved into underweight in offshore cash, due to an asymmetric return outlook

SA bonds

After the recent rally, the SA nominal 10-year bond yield spread vs the US treasury equivalent has narrowed to the since-2011 average. It still trades at a c.150bps discount to its implied yield, compensating investors with c.50bps more than the SA 10-year ILB in real yield and offering offshore investors a c.380bps currency hedged-yield spread over US treasury.

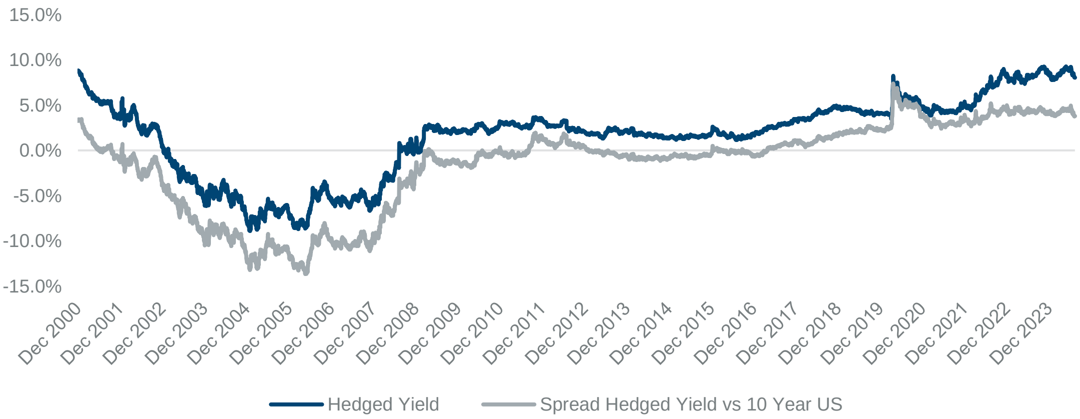
Figure 3: SA 10-year nominal bond vs implied yield

Figure 4: SA 10-year nominal bond vs ILB real yield



Source: Bloomberg

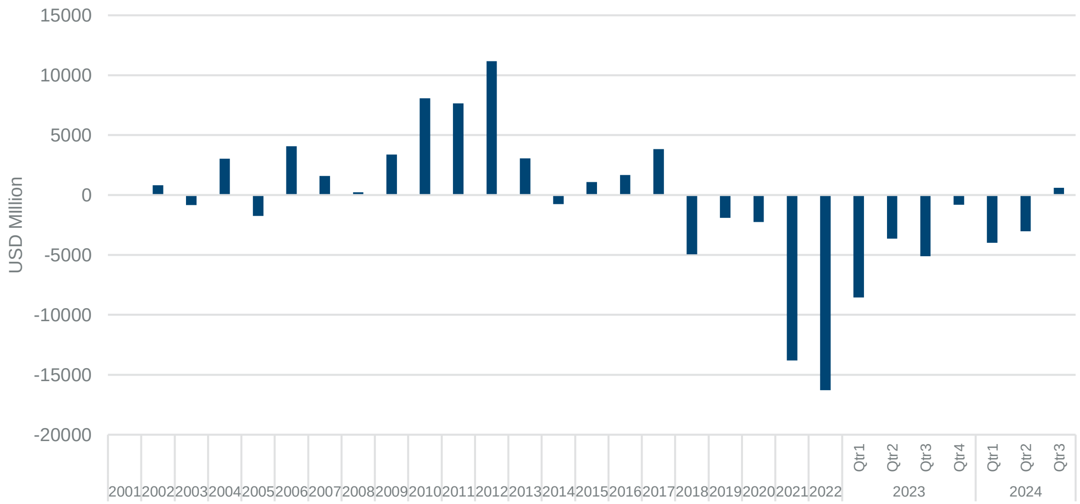
Figure 5: SA 10-year nominal bond hedged-yield and hedged-yield spread



Source: Bloomberg

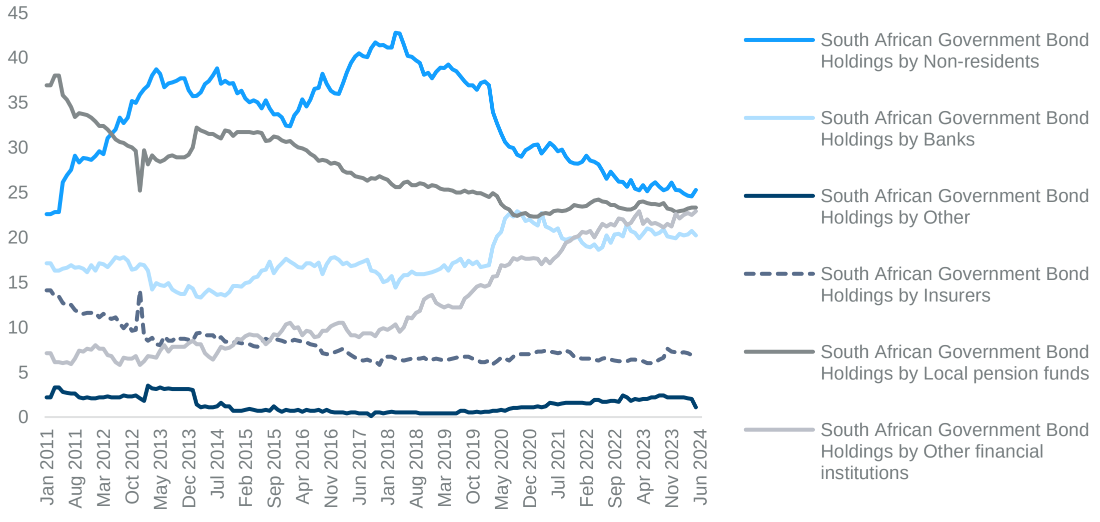
Moreover, this is the first time in a quite a while that we are seeing foreign investors net buying our local bonds. There are also some nascent signs of an increase (or at least no further reduction) in holdings of SA bonds by non-residents, as shown in Figures 6 and 7, as election overhang dissipates and the SA economy is poised for better underlying economic growth and stability over the coming years, all else being equal.

Figure 6: SA bonds net sales to foreigners



Source: Bloomberg

Figure 7: SA government bond holdings



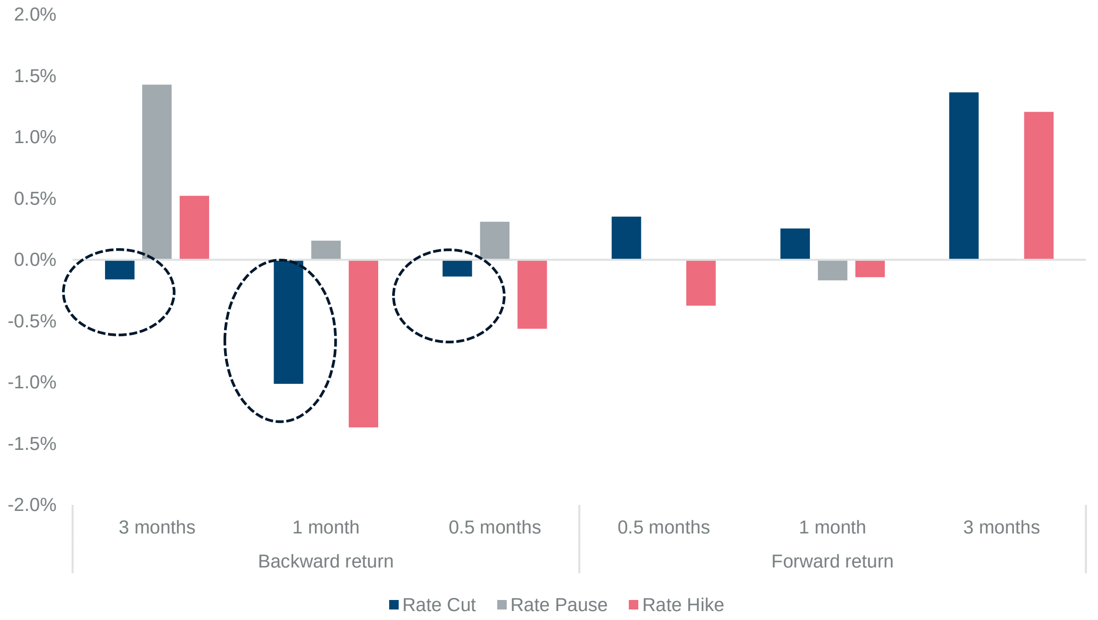
Source: Bloomberg

We have therefore maintained our moderately overweight position in SA bonds, as it remains attractive from a valuation perspective and yield has room to fall further, given the imminent Fed rate cuts on the back of an economic slowdown and US inflation approaching the 2.0% target. In addition, while the political landscape may drive short-term volatility, any positive news on effective policy implementation in SA that is conducive to growth could further enforce the upbeat sentiment.

Offshore cash

The ZAR was trading at R17 to the USD in early 2023 and then depreciated to R18.5 and traded above R18 to the USD for most of the time leading up to the election. Despite the promising SA election result, the rand has not shown a significant recovery. One possible reason is that the market is concerned about the stability of the GNU and is pricing in the risk in the exchange rate. Looking beyond the very short term, we believe there is more appreciation potential for the ZAR as we approach the start of the Fed's rate-cutting cycle, on top of the fact that the SA political landscape has definitely improved from the way it was two months ago. In addition, historical data from 1990 shows that the USD tends to depreciate against other major currencies leading up to the rate-cutting cycle, as shown in Figure 8. We have therefore moved from neutral to moderately underweight in offshore cash as there is a higher probability of the ZAR strengthening than weakening against the USD, despite short-term noises being made.

Figure 8: USD performance vs Fed rate decisions



Source: Bloomberg, results based of federal reserve's fund rate decisions as of 1990, positive means the USD appreciation against other major currencies

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