MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

22 August 2024

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We have maintained a moderately overweight position in SA bonds, moved to moderately overweight from neutral in local equity, moved to moderately underweight in offshore bonds, and closed the moderately underweight position 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 September:

- We have maintained a moderately overweight position in SA nominal bonds, as these remain 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 overweight in SA equities based on attractive valuations, improving domestic political and macro landscapes, and further support from USD weakness.
- We have moved from moderately underweight in offshore cash to neutral and have chosen to fund the overweight positions from offshore bonds as recent bond market repricing has indicated a more aggressive rate-cutting outlook than central bank guidance, which is more in line with a potential US recession than the US economic slowdown currently being observed.

Market overview

Market overview	Easing inflationary pressures and softer US labour market data drove heightened expectations of the Federal Reserve cutting rates soon, which saw rate-sensitive sectors rally in July and the month to date in August. Global equities delivered positive returns in general for July, with the MSCI World Index gaining 1.8%, outperforming the MSCI Emerging Markets Index which was up by only 0.4%. Poor performance from China, Taiwan and Korea proved to be a drag on the index, with a weak domestic economy and uncertain future policy direction weighing on the former, and the global tech stock sell-off affecting the latter two. South Africa was one of the top performers in July, supported by the strong gold price and optimism surrounding the GNU, with a weaker dollar adding to a more constructive environment for emerging markets. India and Brazil also outperformed on the strengths of the strong macro landscape. In developed markets, the S&P 500 returned 1.2% in July, on the back of underwhelming tech sector earnings data (despite relatively resilient broader earnings data) and the STOXX 600 returned 1.4%, weighed down by disappointing PMI data and political uncertainties. UK equities outperformed other developed market peers in July, helped by positive economic news and improving business confidence. The Nikkei 225 Index fell by 1.2% over the month, induced by a sharp appreciation

of the yen and, to a lesser extent, global tech weakness. We also saw a rotation from growth to value in July, as the MSCI World Value Index significantly outperformed the MSCI World Growth Index, delivering 4.8% vs the latter's -1.0%. The MSCI World Small Cap Index and global property indices also saw sharp gains in July, spurred by the rate-cutting outlook. Global government bond yields fell across major markets on the back of softer inflation print, with the WGBI returning 2.9% in July. Meanwhile, the local nominal bond benchmark, the ALBI Index, returned 4.0% over the same period, outperforming the local inflation linkers benchmark, the IGOV Index, which returned 1.8%. Commodities had a tough time in July, with the Bloomberg Commodity Index falling by 4.0%. The oil price fell by 6.6%, industrial metals such as aluminium and iron ore saw a sharper decline, and the gold price rose by 5.2%, while the platinum and palladium prices fell by 1.8% and 4.9% respectively. The USD depreciated by 1.7% against other major currencies in July and weakened further by 3.1% into August. The ZAR was roughly flat against the USD in July and strengthened by 2.5% into August but weakened against other major currencies over the past month and a half.

Figure 2: Major market indices' performance in local currency

31 July 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 26 August 2024
FTSE/JSE ALSI Total Return	3.9%	9.2%	9.9%	9.0%	10.9%	12.0%	8.5%	1.9%
FTSE/JSE Capped SWIX Total Return	4.1%	9.4%	10.1%	10.0%	10.7%	10.3%	6.8%	1.9%
S&P 500 Total Return	1.2%	10.0%	16.7%	22.1%	9.6%	15.0%	13.2%	1.8%
STOXX 600 Total Return	1.4%	3.5%	10.4%	12.9%	6.7%	8.7%	7.2%	0.2%
Nikkei 225 Total Return	-1.2%	2.0%	17.9%	20.1%	15.0%	14.9%	11.7%	-2.5%
MSCI World Total Return	1.8%	8.6%	14.0%	18.9%	7.4%	12.6%	10.1%	2.1%
MSCI ACWI Total Return	1.6%	8.2%	13.4%	17.6%	6.3%	11.6%	9.3%	2.1%
MSCI EM Total Return	0.4%	5.0%	8.1%	6.7%	-2.3%	3.8%	3.0%	2.0%
MSCI World Value Index	4.8%	7.4%	11.8%	15.8%	7.9%	9.5%	7.3%	1.9%
MSCI World Growth Index	-1.0%	9.8%	16.2%	21.9%	6.3%	15.1%	12.6%	2.3%
MSCI World Small Cap Index	6.9%	9.7%	8.7%	11.7%	1.6%	8.7%	8.0%	0.4%
FTSE UK Series FTSE All Share TR	3.1%	4.4%	10.8%	13.5%	8.3%	5.8%	6.3%	-0.1%
MSCI AC Asia Ex. Japan Index	-0.1%	5.9%	9.9%	6.6%	-3.0%	4.2%	4.1%	2.0%
MSCI Europe Excluding United Kingdom Index	0.6%	3.4%	10.1%	12.9%	6.8%	9.8%	8.5%	0.3%
Shanghai Shenzhen CSI 300 Index	0.6%	-2.4%	2.7%	-11.8%	-8.3%	0.1%	6.1%	-3.2%
Korea Stock Exchange KOSPI Index	-0.9%	3.2%	5.4%	7.4%	-2.7%	8.7%	5.0%	-2.6%
Taiwan Stock Exchange Weighted Index	-2.6%	10.5%	26.1%	32.9%	12.9%	19.4%	13.1%	0.4%
NSE Nifty 50 Index	4.0%	11.1%	15.8%	28.1%	18.2%	19.2%	14.0%	0.5%
Ibovespa Brasil Sao Paulo Stock Exchange Index	3.0%	1.4%	-4.9%	4.7%	1.6%	4.6%	8.6%	7.2%
Nasdaq-100 Index	-1.6%	11.3%	15.6%	23.9%	9.9%	20.8%	18.6%	0.9%
Bloomberg Magnificent 7 Total Return Index	-0.6%	19.0%	36.2%	43.7%	23.3%	45.4%		0.2%
S&P ex Magnificent 7	3.0%	6.9%	11.6%	15.6%	5.6%	9.9%		2.1%
Dow Jones Industrial Average TR	4.5%	8.5%	9.5%	17.2%	7.5%	11.1%	12.0%	1.1%
STEFI	0.7%	2.1%	4.9%	8.6%	6.6%	6.1%	6.6%	0.6%
ALBI	4.0%	10.2%	9.7%	15.6%	8.7%	8.8%	8.5%	2.6%
IGOV	1.8%	4.0%	3.8%	9.4%	7.3%	6.7%	5.2%	1.5%
WGBI	2.9%	3.9%	-1.2%	1.9%	-6.5%	-2.6%	-0.8%	3.0%
Bloomberg Global Inflation-Linked Total Return Index	2.6%	4.4%	-0.1%	2.2%	-6.8%	-0.9%	0.2%	2.6%
Bloomberg US Agg Total Return	2.3%	5.1%	1.6%	5.1%	-2.6%	0.2%	1.6%	1.9%
Bloomberg EuroAgg Total Return Index	2.0%	2.4%	0.8%	5.5%	-4.3%	-2.2%	0.5%	0.6%
Bloomberg Global Agg Corporate Total Return Index	2.4%	4.6%	1.5%	6.4%	-3.3%	0.4%	1.4%	2.6%
Bloomberg US Corporate High Yield Total Return Index	1.9%	4.0%	4.6%	11.1%	2.2%	4.2%	4.6%	1.6%
Bloomberg Pan-European High Yield Total Return Index	1.3%	2.8%	4.6%	11.1%	1.6%	2.8%	3.5%	0.9%
J.P. Morgan EMBI Global Core Hedged EUR	1.8%	4.1%	3.1%	6.9%	-4.7%	-2.1%	0.6%	2.4%
SAPY Total Return	4.4%	10.8%	14.4%	28.8%	13.5%	2.0%	3.5%	7.0%
MSCI US REIT Total Return	6.3%	14.4%	6.0%	11.2%	0.6%	4.9%	6.5%	5.5%
S&P Global Property Total Return	6.0%	9.5%	3.5%	8.4%	-2.7%	1.2%	3.4%	5.2%
STOXX 600 Real Estate Total Return	4.2%	5.7%	0.9%	17.8%	-9.4%	-1.8%	1.5%	4.9%
FTSE EPRA Nareit Global REITs TR Index	6.0%	11.5%	3.0%	7.6%	-2.1%	1.9%	4.1%	5.6%
Crude Oil	-6.6%	-8.1%	4.8%	-5.7%	1.9%	4.4%	-2.7%	0.9%
Aluminium	-9.3%	-11.6%	-3.9%	0.4%	-4.0%	4.9%	1.4%	11.0%
Copper	-3.9%	-7.7%	7.8%	4.5%	-1.8%	9.3%	2.6%	0.7%
Gold	5.2%	7.1%	18.6%	24.6%	10.5%	11.6%	6.7%	2.9%
Platinum	-1.8%	4.4%	-1.3%	2.6%	-2.4%	2.5%	-3.9%	-1.6%
Nickel	-4.1%	-14.2%	-0.2%	-25.9%	-5.7%	2.5%	-1.2%	1.3%
Palladium	-4.9%	-2.9%	-15.6%	-27.8%	-29.6%	-9.4%	0.6%	3.6%
Iron Ore	-6.4%	-12.2%	-27.6%	-14.1%	-18.9%	-4.0%	0.3%	-5.0%
Bloomberg Commodity Index Total Return	-4.0%	-3.9%	0.9%	-5.2%	3.6%	6.5%	-1.2%	1.1%
USDZAR	0.1%	-3.1%	-0.9%	2.0%	7.6%	4.9%	5.4%	-2.5%
GBPZAR	1.7%	-0.2%	0.5%	2.1%	4.8%	6.1%	2.6%	-0.1%
EURZAR	1.1%	-1.6%	-2.3%	0.5%	4.4%	4.4%	3.2%	0.5%
JPYZAR	7.3%	1.8%	-6.5%	-3.4%	-3.1%	-1.7%	1.5%	1.2%
Dollar Index Spot	-1.7%	-2.0%	2.7%	2.2%	4.1%	1.1%	2.5%	-3.1%

Source: Bloomberg

We saw similar trends and dynamics persisting up to the month to date in August, although there was significant intra-month volatility. The BOJ increased its interest rate to c.0.25%, from the previous range of 0% to 0.1%, on 31 July. This spurred the yen to appreciate by nearly 7.0% and triggered the rapid unwinding of yen-funded carry trade, which led to a dramatic sell-off in global markets and the VIX Index spiking from 16.36 to 38.57. However, it had fully recovered by mid-August as the BOJ had sent dovish signals to reassure the market that it would not hike rates when markets are unstable. Overall, we remain cautious as monetary policies normalise, economies slow down and the US election approaches.

TAA overview

SA bonds

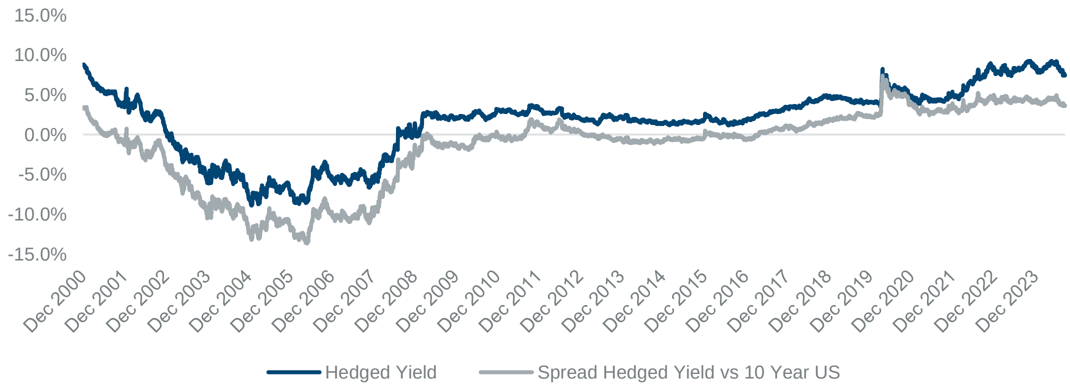
Softer July inflation in South Africa led the narrowing of the SA-US inflation differential from 2.2% to 1.7%, resulting in the SA 10-year government bond trading at 226bps spread over the implied 10-year yield. At the same time, it is compensating investors with c.130bps more than the SA 10-year ILB in real yield and offering offshore investors a c.360bps currency-hedged yield spread over the US 10-year treasury.

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

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

Source: Bloomberg

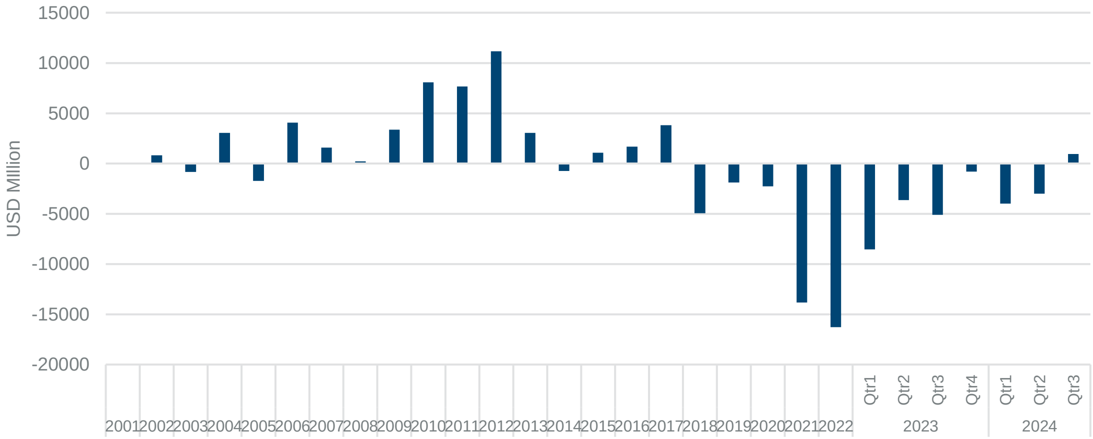
Figure 5: SA 10-year nominal bond-hedged yield and hedged-yield spread



Source: Bloomberg

In addition, we continue to see positive net flows from foreign investors into our local bonds, increasing the net flow for the quarter from USD 605m a month ago to USD 936m as the market remained largely optimistic about the potential turnaround of the SA economy under the GNU. Moreover, easing inflationary pressure also saw the increasing appeal of SA nominal bonds compared to other emerging market peers.

Figure 6: SA bonds net sales to foreigners



Source: Bloomberg

Figure 7: Emerging markets 10-year government bond yields

	South Africa	India	Indonesia	Mexico	Brazil	Turkey
10 Year Yield	**10.75%**	**6.86%**	**6.64%**	**9.51%**	**11.52%**	**28.65%**
Inflation	4.6%	3.5%	2.13%	5.6%	4.5%	61.8%
Inflation Expectation	5.90%	6.60%	3.70%	5.50%	4.60%	54.00%
10 Year Real Yield	**6.15%**	**3.32%**	**4.51%**	**3.94%**	**7.02%**	**-33.13%**
10 Year Real Yield based on inflation expectation	4.85%	0.26%	2.94%	4.01%	6.92%	-25.35%
Currency Risk Premium	**3.91%**	**2.16%**	**1.58%**	**3.83%**	**5.09%**	**21.17%**
Sovereign Risk Premium	**3.03%**	**0.89%**	**1.25%**	**1.87%**	**2.63%**	**3.68%**
US 10 Year Yield	3.81%	3.81%	3.81%	3.81%	3.81%	3.81%
S&P Rating - Foreign Currency	**BB-**	**BBB-u**	**BBB**	**BBB**	**BB**	**Bu**
Moody's Rating - Foreign Currency	**Ba2**	**Baa3**	**Baa2**	**Baa2**	**Ba2**	**B1**

Source: Bloomberg

Our investment case for SA bonds remained unchanged. We maintained our moderately overweight position as it remains attractive from a valuation perspective, while the 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, any positive news on effective domestic policy implementation and improving energy security would reinforce the upbeat sentiment.

SA equity

We moved from neutral to moderately overweight in SA equities due to their attractive valuation, with the support of emerging market assets in the face of dollar weakness.

While SA equities have been trading at the current level of discount relative to US equities for some time and may continue to trade at a discount due to AI premium and relative growth prospects of the economies, we are hopeful that some of the idiosyncratic constraints to domestic economic growth, such as electricity shortages and poor transportation infrastructure, can be significantly improved through stable economic policy and reconstruction under the new unity government. On the global front, the economic surprise indices also indicated that economic data releases from emerging markets are more in line with market expectations compared to significant disappointments in the major economies. In addition, forward EPS growth revisions over the past three months have been reasonable, despite post-election optimism.

Figure 8: PE ratio of ALSI vs S&P 500

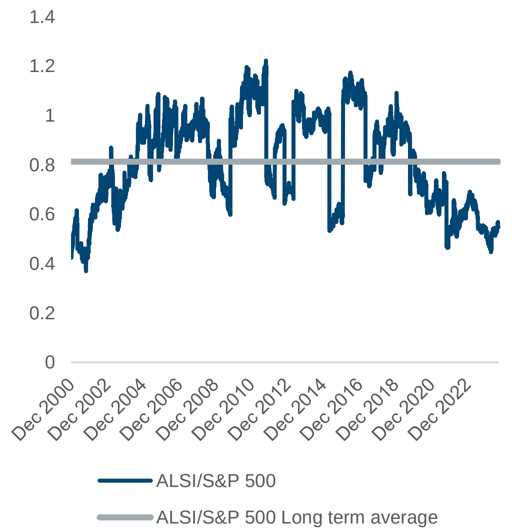
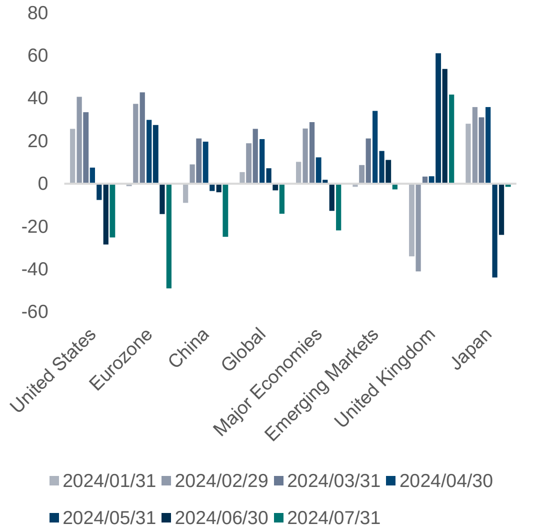
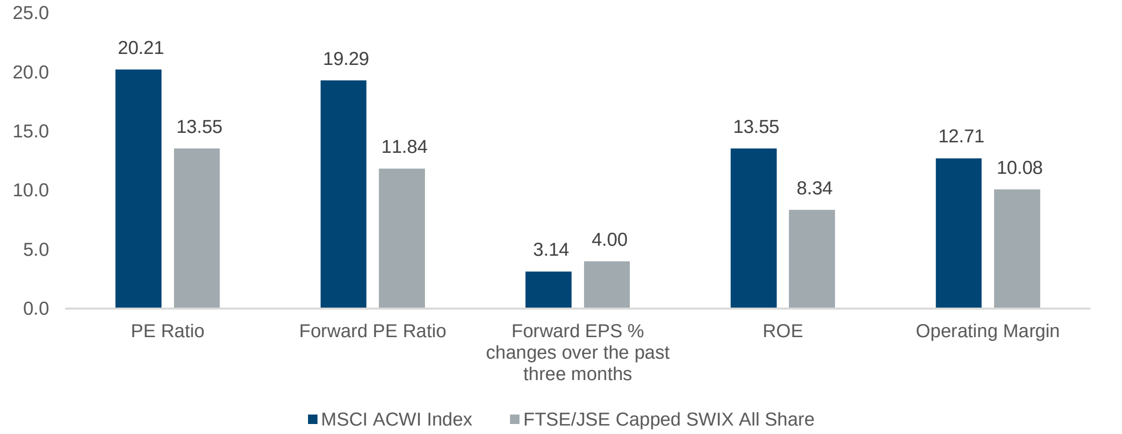


Figure 9: Economic surprise indices



Source: Bloomberg

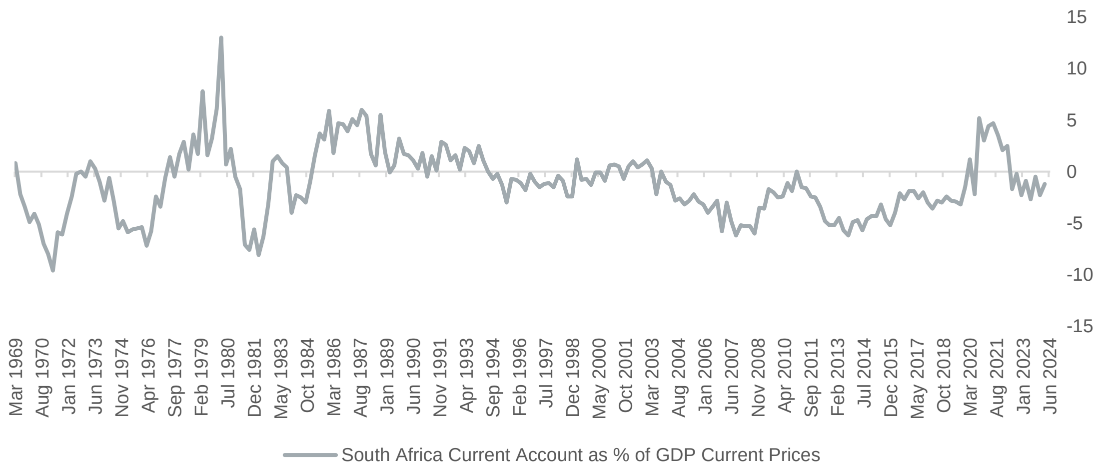
Figure 10: MSCI ACWI and FTSE/JSE Capped SWIX All Share



Source: Bloomberg

Our view on the currency remains that there is a higher probability of the ZAR strengthening than weakening against the USD, despite potential short-term corrections. Historical analyses show that the USD tends to depreciate against other major currencies leading up to a rate-cutting cycle. Together with improving domestic fundamentals, such as the stabilisation of the current account balance and fiscal consolidation, our base view is that USD weakness should be supportive of emerging market assets.

Figure 11: South Africa current account as % of GDP current prices

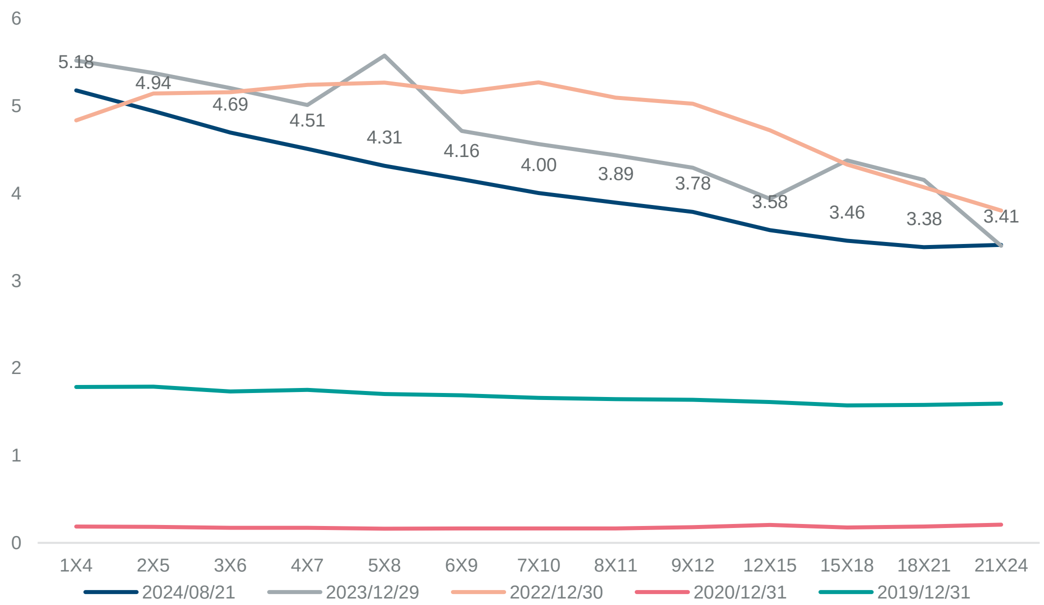


Source: Bloomberg

Offshore bonds

The US 10-year treasury yield declined from 4.29% in late July to 3.78% when we had the TAA meeting. The US FRA rates suggest that the market is pricing in rate cuts in September and almost three rate cuts this year, with 140 to 160bps cuts from now until June 2025. While the Fed is yet to publish a fresh set of economic projections at the upcoming FOMC meeting, currently the market is pricing in more rate cuts this year and next year than the Fed estimation. The extent of repricing in the US treasury market seems to be more consistent with a US hard landing scenario, but to date, economic data releases confirm a slowdown in the US economy rather than a recession. Geopolitics and macro situations are very fluid at this stage; therefore, any significant developments there can create enormous shocks to the global economy. We will closely monitor the market but at this stage, we prefer SA bonds over offshore bonds, given their more attractive yields and the expectation of cyclical USD weakness as the rate-cutting cycle begins.

Figure 12: US forward rate agreement rates



Source: Bloomberg

Offshore cash	Looking beyond the very short term, we continue to believe that there is more appreciation potential for the ZAR as we approach the start of the Fed's rate-cutting cycle and SA's improved political landscape. Our base case is that the MPC (rate announcement on 19 September) should cut the rate in sync with that of the FOMC (meeting to be held on 17 to 18 September). However, there is a low probability that the MPC may cut the rate deeper than the FOMC. Over the past month, the ZAR has appreciated against the USD from around R18.20 to R17.70. Given the ongoing Russian/Ukraine conflict and Middle East tensions, the upcoming US election and the heightened intra-month volatilities observed over the past few months, we prefer to stay neutral in offshore cash and to rather fund the overweight positions from offshore bonds and local cash.

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