MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

19 September 2024

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We have maintained a moderately overweight position in SA bonds and SA equity, and have closed with a moderately underweight position in offshore bonds, with SA cash being the balancing figure.

Figure 1: Houseview Tactical Asset Allocation

Asset Class	--	-	Neutral	+	++
SA Cash		X			
SA Bonds				X	
SA Inflation-Linked Bonds			X		
SA Listed Property			X		
SA Equity				X	
Foreign Cash			X		
Foreign Bonds			X		
Foreign Equity			X		
Foreign Property			X		

Synopsis

Here is our investment case for October:

- We have maintained a moderately overweight position in SA nominal bonds, as these remain our highest conviction call, supported by valuations, the start of the rate-cutting cycle and the peaking of the USD.
- We have maintained a moderately overweight position 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 bonds to neutral. Despite our previous preference for local bonds over offshore bonds, given the latter's more attractive yields and the expectation of cyclical USD weakness as the rate-cutting cycle begins, we see a more turbulent market environment ahead as the market tries to determine whether the 50bps cut by the Fed will reaccelerate the US economy or pave the way for a recession. Therefore, we chose to maintain offshore neutrality.

Market overview

Market overview	The month of August was shaped by significant volatility, as the publication of US economic data was underwhelming and the Bank of Japan raised interest rates to roughly 0.25%, which ignited a sharp sell-off at the beginning of the month across major global equity markets. During this period, the S&P 500 Index fell 6.1% (that is, the 3-day trading performance into the month of August) but quickly rebounded and closed at 2.4% for the month. This brought the year-to-date performance to 19.5%. As the month drew to a close, markets rebounded, with more aggressive policy easing by the Fed being priced in. This came in the wake of the Fed announcing a cut of 50bps in interest rates at the September FOMC meeting. As the month wrapped up, the prospects of lower interest rates and stronger Q2 earnings data helped equity markets rebound, while in global markets the MSCI World Index closed 2.7% higher over the month. Local equity markets achieved positive returns, with the FTSE/JSE All Share Index and the Capped SWIX at 1.7% and 1.3% respectively, largely driven by mixed-sentiment data along with rate-sensitive sectors concealing the resource sector's weak performance. Emerging markets closed the month in positive territory, with the MSCI Emerging

Markets Index returning 1.6%. This represented a shift from initial fears of a US recession, as Sahm's indicator had been triggered by the unemployment rate approaching 4.2%. Brazil's performance stood out this month at 6.5%, which was largely driven by the strengthening of the country's currency. China's and Korea's weak performance detracted from the overall index performance, with Korea affected by tech stocks being hit hard (memory-related stocks). Japanese stocks also experienced much volatility over the month, showing a moderate decline of 1.1%. This was due to the sharp movement in the yen, which appreciated over the course of the month. Property, another interest rate-sensitive asset class, rallied over the month, with the Global REIT Index up 6.4% and the SAPY Index, one of the top asset class performers locally, rallying by 8.4%.

As the BoJ raised rates by 25bps, this led to an unwinding of carry trade positions that relied on a cheaper yen to purchase other higher-yielding assets. This resulted in a sharp sell-off in equity markets early in the month as well as a spike in the VIX Volatility Index. While global bonds rallied, with the WGBI Index up 2.3% due to weaker economic signals, the ISM Manufacturing Index's fall and job reports showing the smallest payroll increase and cooling inflation reinforced the case of rate cuts by the Fed. Locally, the ALBI rallied by 2.4% as a result of the positive election outcomes and the promise of GNU reforms, as well as declining US Treasury yields. As a result, foreign investors continued to be net buyers of SA bonds.

Figure 2: Major market indices' performance in local currency

31 August 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 12 September 2024
FTSE/JSE ALSI Total Return	1.4%	9.6%	11.4%	16.1%	12.0%	12.8%	8.7%	-2.1%
FTSE/JSE Capped SWIX Total Return	1.3%	9.8%	11.5%	17.0%	10.4%	11.2%	6.9%	-2.0%
S&P 500 Total Return	2.4%	7.4%	19.5%	27.1%	9.4%	15.9%	13.0%	-0.9%
STOXX 600 Total Return	1.5%	1.8%	12.1%	17.6%	6.5%	9.3%	7.1%	-2.5%
Nikkei 225 Total Return	-1.1%	0.6%	16.6%	20.7%	13.5%	15.5%	11.7%	-4.7%
MSCI World Total Return	2.7%	6.7%	17.1%	25.0%	7.4%	13.7%	10.1%	-1.3%
MSCI ACWI Total Return	2.6%	6.6%	16.3%	24.0%	6.3%	12.7%	9.3%	-1.4%
MSCI EM Total Return	1.6%	6.1%	9.9%	15.5%	-2.7%	5.2%	2.9%	-2.1%
MSCI World Value Index	2.9%	7.0%	15.0%	22.5%	8.3%	10.8%	7.5%	-1.5%
MSCI World Growth Index	2.5%	6.4%	19.1%	27.5%	6.0%	15.9%	12.5%	-1.1%
MSCI World Small Cap Index	0.5%	5.4%	9.3%	16.7%	1.0%	9.5%	7.7%	-2.8%
FTSE UK Series FTSE All Share TR	0.5%	2.4%	11.3%	17.0%	7.5%	6.6%	6.1%	-1.6%
MSCI AC Asia Ex. Japan Index	2.0%	6.3%	12.0%	16.1%	-3.1%	5.5%	4.2%	-1.9%
MSCI Europe Excluding United Kingdom Index	1.8%	1.3%	12.1%	17.8%	6.7%	10.4%	8.5%	-2.7%
Shanghai Shenzhen CSI 300 Index	-3.3%	-5.1%	-0.7%	-9.2%	-9.4%	-0.4%	5.8%	-4.4%
Korea Stock Exchange KOSPI Index	-3.5%	1.7%	1.8%	6.8%	-3.8%	8.6%	4.7%	-3.8%
Taiwan Stock Exchange Weighted Index	0.6%	7.0%	26.9%	37.2%	12.3%	19.9%	13.0%	-2.6%
NSE Nifty 50 Index	1.4%	12.6%	17.4%	32.9%	15.4%	19.7%	13.8%	0.6%
Ibovespa Brasil Sao Paulo Stock Exchange Index	6.5%	11.4%	1.4%	17.5%	4.6%	6.1%	8.3%	-1.5%
Nasdaq-100 Index	1.2%	5.8%	17.0%	27.3%	8.8%	21.6%	18.1%	-0.7%
Bloomberg Magnificent 7 Total Return Index	-0.4%	8.6%	35.6%	44.1%	20.2%	46.1%		1.1%
S&P ex Magnificent 7	3.4%	7.7%	15.3%	22.0%	6.1%	11.0%		-1.3%
Dow Jones Industrial Average TR	2.0%	7.9%	11.7%	22.1%	7.7%	11.8%	11.8%	-1.1%
STEFI	0.7%	2.1%	5.6%	8.5%	6.7%	6.1%	6.6%	0.3%
ALBI	2.4%	12.0%	12.3%	18.6%	9.0%	9.1%	8.5%	1.5%
IGOV	2.2%	7.2%	6.1%	11.3%	7.7%	7.2%	5.3%	1.0%
WGBI	2.3%	5.2%	1.1%	5.7%	-5.7%	-2.6%	-0.6%	1.2%
Bloomberg Global Inflation-Linked Total Return Index	1.6%	3.9%	1.4%	5.7%	-6.2%	-1.0%	0.3%	0.8%
Bloomberg US Agg Total Return	1.4%	4.8%	3.1%	7.3%	-2.1%	0.0%	1.6%	1.6%
Bloomberg EuroAgg Total Return Index	0.4%	2.8%	1.2%	5.6%	-4.0%	-2.4%	0.4%	0.9%
Bloomberg Global Agg Corporate Total Return Index	1.9%	4.7%	3.4%	9.6%	-2.5%	0.4%	1.6%	1.2%
Bloomberg US Corporate High Yield Total Return Index	1.6%	4.6%	6.3%	12.6%	2.5%	4.5%	4.7%	0.4%
Bloomberg Pan-European High Yield Total Return Index	1.3%	3.0%	5.9%	12.2%	2.0%	2.9%	3.6%	0.1%
J.P. Morgan EMBI Global Core Hedged EUR	2.3%	4.7%	5.5%	11.4%	-4.3%	-1.7%	0.8%	0.6%
SAPY Total Return	8.3%	19.7%	23.8%	38.2%	13.8%	4.4%	4.0%	2.9%
MSCI US REIT Total Return	6.4%	16.4%	12.8%	22.0%	2.1%	5.5%	6.8%	2.3%
S&P Global Property Total Return	5.7%	12.5%	9.4%	18.5%	-1.5%	2.2%	3.9%	1.5%
STOXX 600 Real Estate Total Return	3.7%	4.1%	4.6%	23.0%	-9.0%	-1.7%	1.6%	4.7%
FTSE EPRA Nareit Global REITs TR Index	6.2%	13.8%	9.3%	18.2%	-0.6%	2.7%	4.5%	2.4%
Crude Oil	-2.4%	-3.5%	2.3%	-9.3%	2.6%	5.5%	-2.7%	-8.7%
Aluminium	6.8%	-7.7%	2.6%	10.8%	-3.4%	6.9%	1.6%	-1.3%
Copper	0.1%	-8.0%	7.9%	9.6%	-1.0%	10.3%	2.8%	-0.2%
Gold	2.3%	7.6%	21.3%	29.0%	11.3%	10.5%	6.9%	2.2%
Platinum	-5.0%	-10.5%	-6.3%	-4.3%	-2.9%	-0.1%	-4.2%	5.7%
Nickel	1.2%	-15.0%	0.9%	-17.5%	-5.4%	-1.6%	-1.2%	-4.1%
Palladium	4.4%	5.8%	-11.9%	-21.1%	-26.8%	-8.8%	0.7%	8.4%
Iron Ore	-0.6%	-12.2%	-28.0%	-16.4%	-14.7%	1.6%	1.0%	-10.3%
Bloomberg Commodity Index Total Return	0.0%	-5.5%	0.9%	-4.4%	3.7%	7.0%	-1.1%	-0.3%
USDZAR	-2.1%	-5.2%	-3.0%	-5.6%	7.1%	3.2%	5.3%	-0.1%
GBPZAR	-0.1%	-2.3%	0.4%	-2.2%	5.4%	4.8%	2.8%	-0.3%
EURZAR	0.0%	-3.3%	-2.3%	-3.7%	4.8%	3.4%	3.5%	0.2%
JPYZAR	0.5%	2.0%	-6.1%	-6.0%	-2.6%	-3.1%	1.7%	2.9%
Dollar Index Spot	-2.3%	-2.8%	0.4%	-1.9%	3.2%	0.6%	2.1%	-0.3%

Source: Bloomberg

In the case of commodity markets, aluminium and palladium were up 6.8% and 4.4% for the month. Aluminium's performance was largely driven by increased demand from construction companies, as it has become a favourable material for construction. Even though gold was up by only 2.3% MoM, it continued to be one of the best performers of the year to date, returning 21.3%, which was largely driven by the uncertain geopolitical climate, central bank fiscal uncertainty and (now) falling interest rates, making gold and other safe havens more appealing.

Over the month, the rand strengthened against the USD by 2.1%, mostly driven by dollar weakness, as seen in the Dollar Spot Index which was down 2.3%.

TAA overview

SA bonds

Inflation in South Africa softened to 4.4% in August, below both the market expectation and the 4.5% midpoint of the South African Reserve Bank's target range, with US inflation also declining from 2.9% to 2.5%. This led to a slight widening of the SA-US inflation differential from 1.7% to 1.9% over the past month. Together with the falling yield, resulting in the SA 10-year government bond trading at 169bps, from 226bps the previous month, spread over the implied 10-year yield. At the same time, it is compensating investors with c.105bps more than the SA 10-year ILB in real yield and offering offshore investors a c.296bps currency-hedged yield spread over the US 10-year Treasury.

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

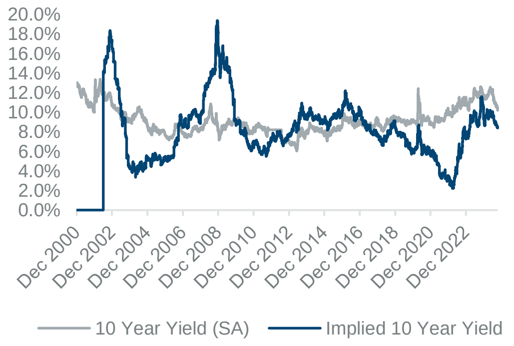
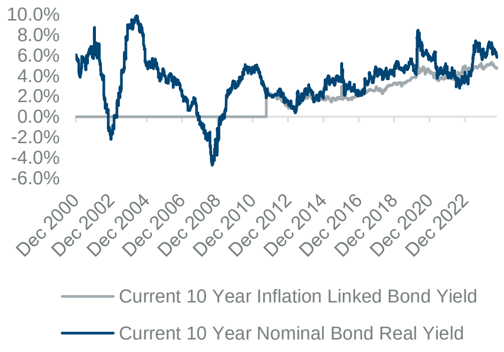
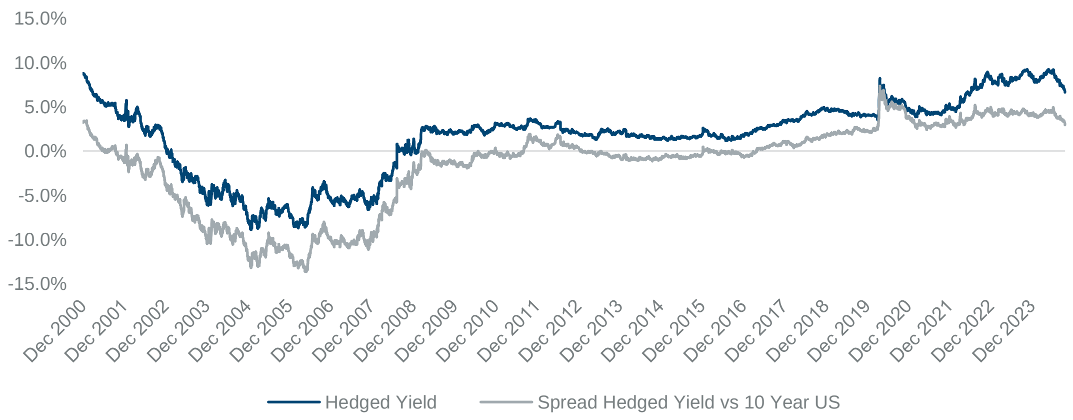


Figure 4: SA 10-year nominal bond vs ILB real yield



Source: Bloomberg

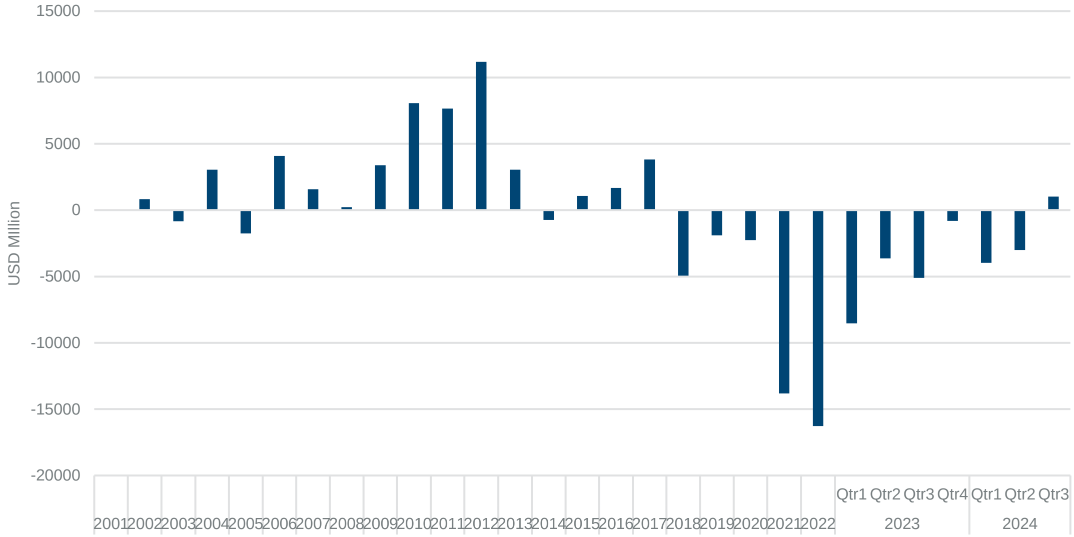
Figure 5: SA 10-year nominal bond-hedged yield and hedged-yield spread



Source: Bloomberg

	In addition, over the past month we have continued to see positive net flows from foreign investors into our local bonds, increasing the net flow for the quarter from USD936m to USD1102m. This was as the market priced in rate-cut expectations and remained largely optimistic about the potential turnaround of the SA economy under the GNU. Moreover, easing inflationary pressure also saw the growing 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	**10.19%**	**6.78%**	**6.56%**	**9.17%**	**12.06%**	**28.88%**
Inflation	4.4%	3.7%	2.12%	5.0%	4.2%	52.0%
Inflation Expectation	4.85%	4.80%	2.80%	4.70%	4.20%	58.90%
10 Year Real Yield	**5.79%**	**3.13%**	**4.44%**	**4.18%**	**7.82%**	**-23.09%**
10 Year Real Yield based on inflation expectation	5.34%	1.98%	3.76%	4.47%	7.86%	-30.02%
Currency Risk Premium	**4.62%**	**2.55%**	**2.15%**	**4.36%**	**6.81%**	**22.45%**
Sovereign Risk Premium	**1.87%**	**0.52%**	**0.70%**	**1.11%**	**1.54%**	**2.72%**
US 10 Year Yield	3.70%	3.70%	3.70%	3.70%	3.70%	3.70%
S&P Rating - Foreign Currency	**BB-**	**BBB-u**	**BBB**	**BBB**	**BB**	**B+u**
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 continued to be attractive from a valuation perspective, despite a modest decline in discount, and with further support from USD weakness and foreign investors' appetite for this asset class.

SA equity	We maintained a moderately overweight position in SA equities due to their attractive valuation, with the support of emerging market assets in the face of dollar weakness and rate cuts. We still see ample room for SA equities to narrow the discount, as we remain hopeful about the domestic growth turnaround and the relative outperformance of emerging markets over developed

markets, as suggested by the economic surprise indices. We also see that net sales of local equity to foreigners have been improving over the past few months.

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

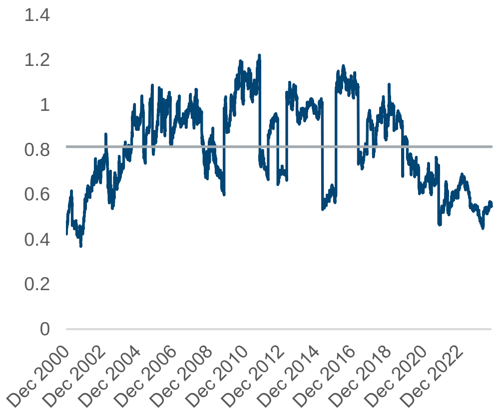
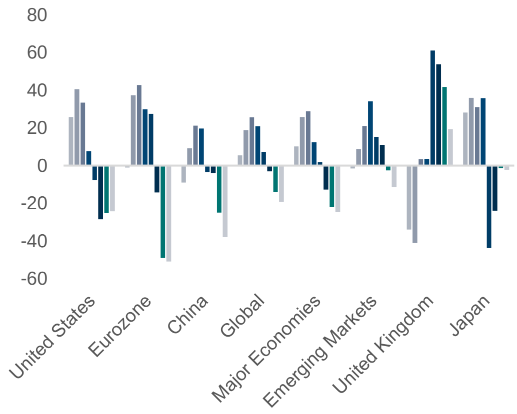
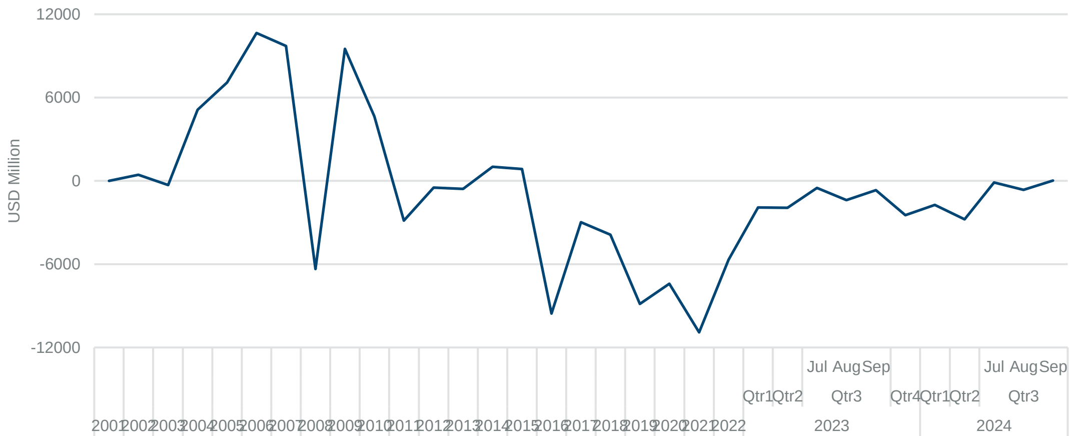


Figure 9: Economic surprise indices



Source: Bloomberg

Figure 10: SA equity net sales to foreigners



Source: Bloomberg

While 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, given that the rand is trading at R17.5 to the USD, we adopted more of a neutral stance on offshore cash. Historical analyses show that the USD has a greater tendency to depreciate against other major currencies leading up to a rate-cutting cycle than during the cycle.

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