MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

24 October 2024

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We have maintained a moderately overweight position in SA bonds and SA equities, funding both positions with SA and offshore cash.

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 November:

- We have maintained a moderately overweight position in SA nominal bonds, supported by valuations and the ongoing rate-cutting cycle.
- We have maintained a moderately overweight position in SA equities based on attractive valuations, improving domestic political and macro landscapes, and potential tailwinds from China's reflationary policies.
- We have moved from neutral to moderately underweight in foreign cash to fund local overweight positions as we expect the Fed to continue with its rate cuts, given cooling inflation. Assets in general appear attractive relative to cash, despite compressed risk premiums, as central banks pivot to easing monetary policies on the back of resilient global growth.

Market overview

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one month. The broader Chinese market, however, continues to experience challenges, particularly in the real estate sector, while labour markets continue to take some strain, with recovery from COVID possibly presenting an obstacle to the economic growth rate target of 5%. The stimulus plan is offering more funding, interest-rate cuts and an easing of the burden for households in terms of mortgage repayments – all in an attempt to restore confidence in the country. The stellar performance of China's equity market pushed the MSCI Emerging Markets Total Return Index up by 6.7% for September and YTD performance by 17.2%. Other emerging economies, such as Brazil and Korea, were down by 3.1% and 3.0% respectively, which in turn dragged down their overall performance slightly.

Figure 2: Major market indices' performance in local currency

30 September 2024 (Local Currency)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 20 October 2024
FTSE/JSE ALSI Total Return	4.0%	9.6%	15.9%	23.9%	14.7%	13.7%	9.4%	1.2%
FTSE/JSE Capped SWIX Total Return	4.0%	9.6%	15.9%	25.4%	12.4%	11.9%	7.6%	1.2%
S&P 500 Total Return	2.1%	5.9%	22.1%	36.4%	11.9%	16.0%	13.4%	1.8%
STOXX 600 Total Return	-0.3%	2.6%	11.7%	19.2%	7.5%	8.5%	7.1%	0.5%
Nikkei 225 Total Return	-1.2%	-3.5%	15.2%	21.2%	11.0%	13.9%	11.0%	2.8%
MSCI World Total Return	1.9%	6.5%	19.3%	33.0%	9.6%	13.6%	10.7%	0.9%
MSCI ACWI Total Return	2.4%	6.7%	19.1%	32.3%	8.6%	12.7%	9.9%	0.6%
MSCI EM Total Return	6.7%	8.9%	17.2%	26.5%	0.8%	6.1%	4.4%	-1.3%
MSCI World Value Index	1.8%	9.7%	17.0%	28.1%	10.0%	10.3%	7.9%	0.9%
MSCI World Growth Index	2.0%	3.5%	21.5%	37.8%	8.6%	16.2%	13.0%	0.9%
MSCI World Small Cap Index	1.9%	9.5%	11.4%	25.4%	2.7%	9.5%	8.5%	0.3%
FTSE UK Series FTSE All Share TR	-1.3%	2.3%	9.9%	13.4%	7.4%	5.7%	6.3%	1.4%
MSCI AC Asia Ex. Japan Index	8.4%	10.5%	21.5%	29.3%	0.9%	6.9%	5.7%	-1.2%
MSCI Europe Excluding United Kingdom Index	-0.4%	2.1%	11.7%	20.3%	7.9%	9.6%	8.3%	0.2%
Shanghai Shenzhen CSI 300 Index	21.1%	17.9%	20.3%	12.1%	-3.8%	3.4%	7.4%	-2.2%
Korea Stock Exchange KOSPI Index	-3.0%	-7.3%	-1.3%	7.2%	-3.5%	6.9%	4.6%	0.0%
Taiwan Stock Exchange Weighted Index	0.0%	-2.0%	26.9%	39.3%	13.4%	19.3%	13.5%	5.7%
NSE Nifty 50 Index	2.3%	7.8%	20.1%	33.2%	15.2%	19.2%	14.0%	-3.7%
Ibovespa Brasil Sao Paulo Stock Exchange Index	-3.1%	6.4%	-1.8%	13.1%	5.9%	4.7%	9.3%	-1.0%
Nasdaq-100 Index	2.6%	2.1%	20.0%	37.5%	11.9%	22.0%	18.5%	1.3%
Bloomberg Magnificent 7 Total Return Index	6.5%	5.4%	44.4%	62.5%	25.2%	47.2%		-0.9%
S&P ex Magnificent 7	1.4%	8.0%	17.0%	29.2%	8.1%	11.0%		1.9%
Dow Jones Industrial Average TR	2.0%	8.7%	13.9%	28.8%	10.0%	11.8%	12.0%	2.3%
STEFI	0.7%	2.1%	6.4%	8.6%	6.9%	6.1%	6.6%	0.4%
ALBI	3.9%	10.5%	16.7%	26.1%	11.1%	9.8%	9.1%	-2.7%
IGOV	0.7%	4.8%	6.9%	13.5%	7.8%	7.2%	5.4%	-0.8%
WGBI	1.6%	7.0%	2.7%	11.0%	-4.4%	-2.1%	-0.1%	-2.2%
Bloomberg Global Inflation-Linked Total Return Index	1.7%	6.0%	3.2%	12.0%	-4.8%	-0.5%	0.8%	-1.6%
Bloomberg US Agg Total Return	1.3%	5.2%	4.4%	11.6%	-1.4%	0.3%	1.8%	-1.4%
Bloomberg EuroAgg Total Return Index	1.2%	3.7%	2.5%	9.2%	-3.3%	-2.1%	0.5%	0.3%
Bloomberg Global Agg Corporate Total Return Index	1.8%	6.3%	5.3%	14.6%	-1.5%	1.0%	2.0%	-1.5%
Bloomberg US Corporate High Yield Total Return Index	1.6%	5.3%	8.0%	15.7%	3.1%	4.7%	5.0%	-0.1%
Bloomberg Pan-European High Yield Total Return Index	1.0%	3.7%	7.0%	13.0%	2.4%	3.1%	3.8%	0.6%
J.P. Morgan EMBI Global Core Hedged EUR	1.7%	5.9%	7.3%	17.0%	-2.9%	-1.2%	1.2%	-0.8%
SAPY Total Return	5.0%	18.7%	30.0%	51.3%	16.0%	5.4%	4.3%	-1.2%
MSCI US REIT Total Return	2.7%	16.1%	15.8%	34.4%	5.0%	5.5%	7.8%	0.4%
S&P Global Property Total Return	3.9%	16.4%	13.6%	30.1%	1.4%	2.5%	5.0%	-1.6%
STOXX 600 Real Estate Total Return	4.6%	13.1%	9.4%	33.4%	-4.8%	-1.7%	2.2%	-1.8%
FTSE EPRA Nareit Global REITs TR Index	3.3%	16.2%	12.9%	30.4%	2.4%	2.8%	5.5%	-0.9%
Crude Oil	-8.9%	-16.9%	-6.8%	-24.7%	-3.0%	3.4%	-2.7%	1.8%
Aluminium	6.7%	3.4%	9.5%	11.3%	-3.0%	8.7%	2.9%	0.0%
Copper	6.4%	2.4%	14.8%	18.8%	3.2%	11.4%	4.0%	-2.1%
Gold	5.2%	13.2%	27.7%	42.5%	14.5%	12.3%	8.1%	3.3%
Platinum	5.6%	-1.4%	-1.0%	8.1%	0.5%	2.1%	-2.8%	3.4%
Nickel	4.4%	1.3%	5.4%	-6.4%	-1.2%	0.1%	0.6%	-3.4%
Palladium	3.5%	2.7%	-8.8%	-19.6%	-19.4%	-9.8%	2.6%	8.1%
Iron Ore	8.6%	1.1%	-21.8%	-11.8%	-5.1%	2.1%	2.5%	-9.8%
Bloomberg Commodity Index Total Return	4.9%	0.7%	5.9%	1.0%	3.7%	7.8%	0.0%	-1.9%
USDZAR	-3.1%	-5.1%	-6.0%	-8.7%	4.6%	2.7%	4.3%	2.0%
GBPZAR	-1.3%	0.4%	-0.8%	0.1%	4.4%	4.4%	2.4%	-0.6%
EURZAR	-2.4%	-1.3%	-4.6%	-3.8%	3.3%	3.1%	3.0%	-0.6%
JPYZAR	-1.3%	6.4%	-7.3%	-5.1%	-3.9%	-3.0%	1.6%	-2.2%
Dollar Index Spot	-0.9%	-4.8%	-0.5%	-5.1%	2.3%	0.3%	1.6%	2.7%

Source: Bloomberg

The momentum of local equities continued into September, with the FTSE/JSE ALSI Total Return Index up by 4% for the month, driven mainly by assorted data and events, the South African Reserve Bank (SARB) adopting a cautionary stance, and a 25bps reduction in interest rates. The cautionary approach was an indication of the still-present risk in the economy, with rising housing costs, higher electricity prices, and continued geopolitical tensions and policy uncertainties all translating into an unpredictable economy. The strong gains in SA equities were a result of strong performance in the resources and industrial sectors, slower inflation prints in

	August to 4.4% YoY, improved domestic sentiment, attractive valuations and China's new policy announcement. After months of pressure from the rate-hiking cycle, rumours of rate cuts became a reality, with both the Fed and SARB lowering interest rates. This benefited the global fixed-income market, with strong gains seen for the month – notably, the Bloomberg Global Aggregate Index was up by 1.7% – bringing the 3-month performance to 7%. Locally, SA bonds continued to show momentum, with the All-Bond Index (ALBI) up by 3.9%, supported by declining yields, softer inflation prints and the SARB's rate-cut decision. The currency market produced a consistent performance, with the rand appreciating against major currencies, supported by the favourable interest-rate differential between South Africa and the United States and the announcement of China's fiscal stimulus. The rand appreciated by 3.1% against the dollar, with YTD performance being 6%. The rand also appreciated against the euro and the pound by 2.4% and 1.3% respectively. The dollar's spot index was down by 0.9%. Commodities showed visible strength in September, particularly iron ore (up by 8.6%) and aluminium and copper (up by 6.7% and 6.4% respectively), with the soft metals benefiting from the rising optimism over China's economic outlook. Gold (up by 5.2%) experienced tailwinds from the rate cut, which is a good hedging mechanism. However, Brent crude oil prices plummeted (down by 8.9%) for the month due to the imbalance in supply and demand. Tensions in the Middle East remain a key factor that could induce elevated volatility for this asset class in the coming months.

TAA overview

SA bonds	Over the past month, SA inflation continued to cool, with September headline and core inflation declining from 4.4% and 4.3% to 3.8% and 4.1% respectively. PPI inflation also cooled from 4.2% to 2.8% in August, pointing to a further slowdown in goods inflation. Together with the tanking of the oil price to $68/barrel and the stabilising of world food prices, we expect a sustained moderation in inflation in the short term, which in conjunction with the Fed easing cycle will provide more room for the SARB to cut rates in November. Our investment case for SA bonds remained unchanged. We maintained our moderately overweight position as it remains attractive from a valuation perspective in terms of actual vs implied yield, real yield relative to ILB and global EM peers and currency-hedged yield. This is despite the recent pull back due to the market repricing in rate-cut expectations on the back of resilient US economic data. In addition, the growing appetite among foreign investors for SA assets, as indicated by the improving ETF flows to South Africa over the past three months, is encouraging. The Minister of Finance, Enoch Godongwana, will table the Medium-Term Budget Policy Statement (MTBPS) on 30 October. Investors strongly anticipate that the MTBPS will set out more detailed spending plans under the Government of National Unity, and how the administration will approach fiscal consolidation and the allocation of resources to accelerate the implementation of structural reforms aimed at supporting economic recovery. Over the short term, the new two-pot retirement system should provide a boost to the fiscus through tax

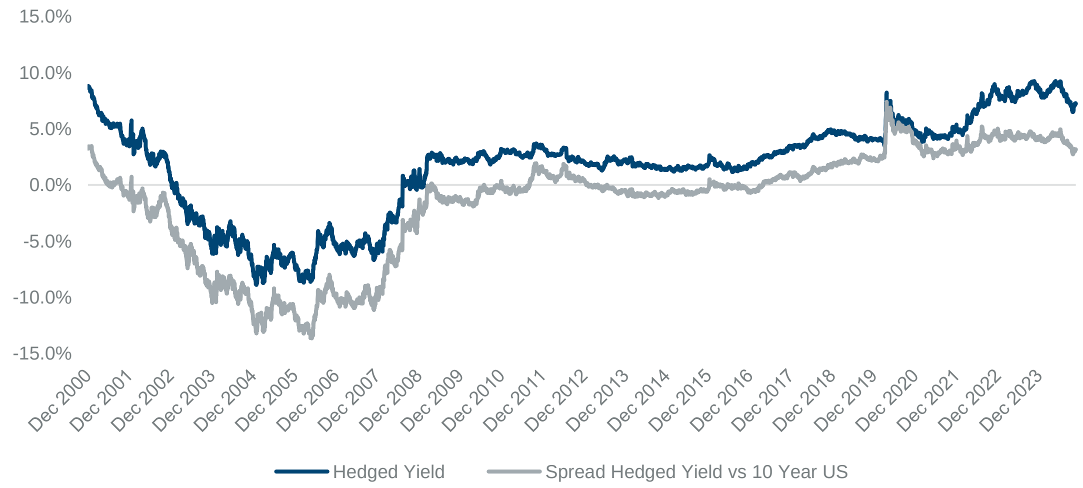
collection on withdrawals, but sustained higher economic growth remains a challenge that needs to be tackled in order to drive meaningful debt reduction.

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

Figure 6: Emerging markets 10-year government bond yields

	South Africa	India	Indonesia	Mexico	Brazil	Turkey
10 Year Yield	**10.65%**	**6.82%**	**6.68%**	**10.09%**	**12.72%**	**29.90%**
Inflation	3.8%	5.5%	1.84%	4.6%	4.4%	49.4%
Inflation Expectation	4.70%	4.80%	2.70%	4.72%	4.27%	59.00%
10 Year Real Yield	**6.85%**	**1.33%**	**4.84%**	**5.51%**	**8.30%**	**-19.48%**
10 Year Real Yield based on inflation expectation	5.95%	2.02%	3.98%	5.37%	8.45%	-29.10%
Currency Risk Premium	**3.51%**	**1.71%**	**1.26%**	**3.83%**	**5.93%**	**22.07%**
Sovereign Risk Premium	**2.93%**	**0.90%**	**1.21%**	**2.05%**	**2.58%**	**3.62%**
US 10 Year Yield	4.21%	4.21%	4.21%	4.21%	4.21%	4.21%
S&P Rating - Foreign Currency	**BB-**	**BBB-u**	**BBB**	**BBB**	**BB**	**B+u**
Moody's Rating - Foreign Currency	**Ba2**	**Baa3**	**Baa2**	**Baa2**	**Ba1**	**B1**

Source: Bloomberg

SA equity

We also maintained a moderately overweight position in SA equities due to their attractive valuation, and the support from the dollar peaking and the start of the rate-cutting cycle. The economic surprises indices continued to indicate better emerging markets performance relative to developed markets performance in general. The two-pot retirement system may boost near-term SA consumer spending, which is good for 2025 earnings, as the Treasury has estimated withdrawals to be within the range of R20bn to R40bn.

Figure 7: PE ratio of ALSI vs S&P 500

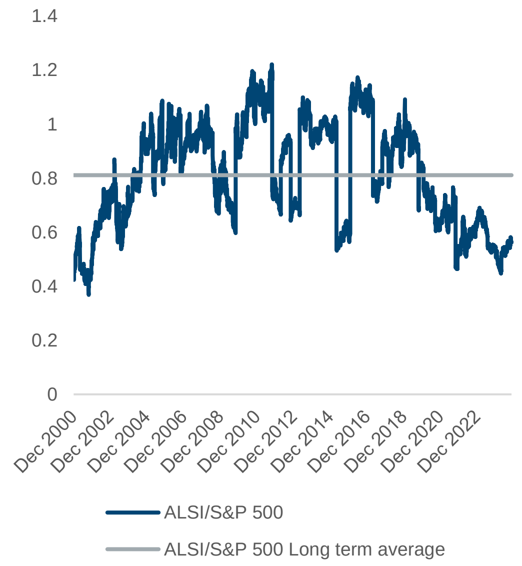
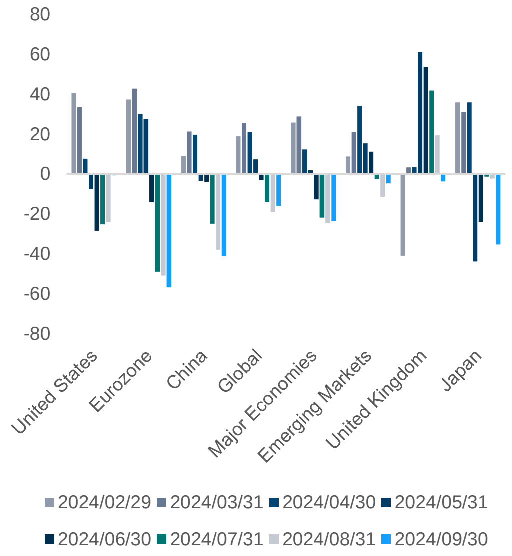


Figure 8: Economic surprise indices



Source: Bloomberg

We also saw that the stimulus packages put forth by the PBoC and various ministries in China had a profound impact on Chinese equity markets and that the MSCI China Index rallied by just over 30% initially before settling at 16% as the market re-assessed the effectiveness of these measures. These policies definitely underscore the economic challenges that China faces as it struggles to reach its 5% growth target. Yet the positive news is that the Chinese government is committed to striving to achieve this target.

Various monetary policy stimulus measures and policy changes were aimed at stabilising and reviving the property sector as Chinese households have c.70% of their wealth locked in this asset class. Cutting the reserve requirement ratios, cutting the loan prime rate, increasing the debt ceiling for local government and providing funding to entice institutional investors to invest in equity may provide some financial support for local governments and corporates and induce a short-term boost in equity markets. However, we believe that more fiscal stimulus is required to restore Chinese consumer confidence. This is because the effectiveness of monetary stimulus may be limited in the face of low demand for loans and structural issues that need to be addressed, such as a high youth unemployment rate of 17.6%, an aging population, low birth rates, low rental yields, regional property demand and supply imbalances, a fragile social safety net, and declining rates of productivity growth and disposable income growth.

Apart from fiscal stimulus, we also believe that proper implementation is key. Just 10 days prior to the announcement of the monetary stimulus, China began a process of extending the retirement age by three years and raising the minimum contribution period for employees to receive a monthly basic pension from 15 years to 20 years. For someone retiring beyond 2024, the rough impact in today's money amounts to 288k yuan. Despite the government stating that increasing the contribution period and delaying the retirement age could augment people's monthly pension by 30%, the consumer reaction is generally negative and online social media discussions on the topic have largely been muted.

On a different note, China's local government debt phenomenon is well known, impacting not only the financial system but also downstream suppliers. Li Daokui, a professor at Tsinghua University and a government policy adviser, in an interview on 14 October, described local governments' accounts payable arrears to enterprises as 'shocking', saying that they owed companies and employees the equivalent of 10% of the country's GDP. While the Ministry of Finance announced a higher debt ceiling to allow local governments to swap out their hidden debts, it remains to be seen whether local governments will use the additional liquidity to fund unsustainable projects just to boost short-term growth or pay back their debts.

With the Fed cutting rates, there was more room for the PBoC to cut rates with limited impact on the yuan. Should these stimulus packages be effective in turning around China's lacklustre growth trajectory, South Africa definitely stands to benefit as a key commodity exporter to China. However, without fundamental, meaningful improvements, massive liquidity injections may pave the way for the next equity or property market bubble. Over and above its domestic economic challenges, China is facing mounting tariffs, restricted access to advanced computer chips, increasing geopolitical pressure from friendshoring (evidenced by increasing trade between countries with similar geopolitical stances), offshore airlines cutting off flights to China, and the need to spend more on national security and other initiatives, such as the Belt and Road Initiative, to secure key strategic partnerships and sustain its economic and political influence. Over the short term, we believe that the fundamental shift in Beijing's views on macroeconomic risks should be net positive for the economy and Chinese equities, amid elevated geopolitical headwinds.

Figure 9: China household savings less loans

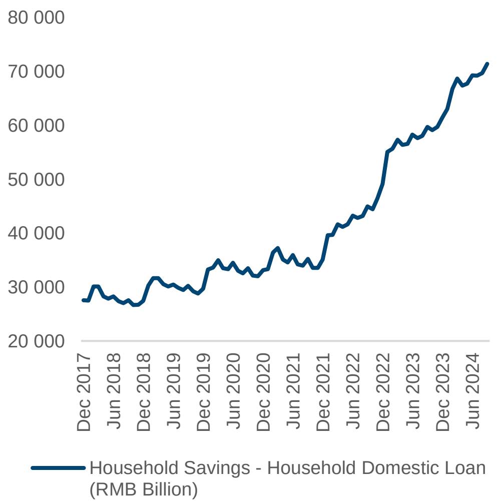
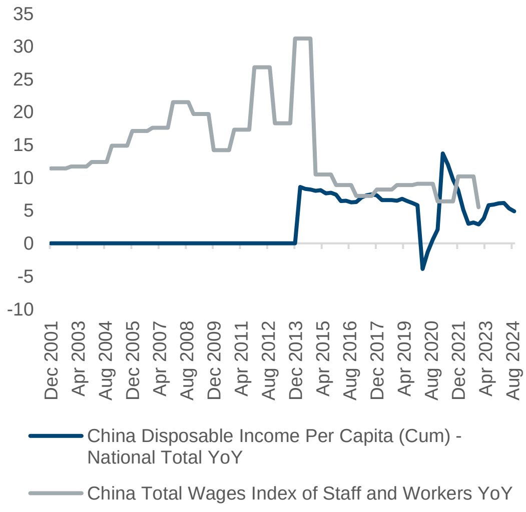


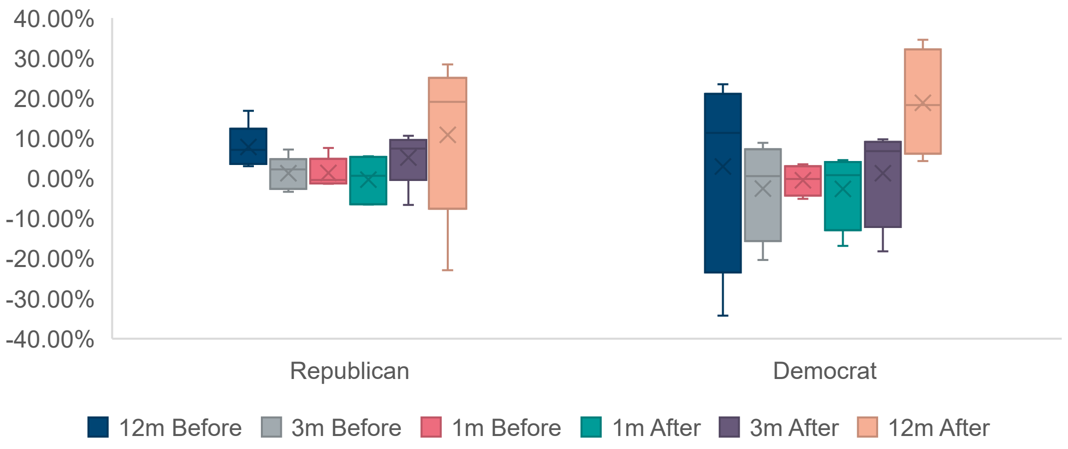
Figure 10: China disposable income YoY



Source: Bloomberg

	Figure 11: China labour productivity YoY  *Source: CEIC* **Figure 12: China CPI YoY and real interest rate**  *Source: Bloomberg*
Foreign cash	The latest US economic data prompted the market to price in a shallower rate-cutting cycle, while the supply and demand dynamic in US treasuries seems to favour equities over bonds. In addition, over the past 9 US elections since 1984, excluding the 2020 election, a Republican win tends to deliver forward 1-month and 3-month US equity returns with less downside and less variability. Given the recent offshore bonds sell-off and diversification benefits from low correlations between offshore bonds and equities, and the fact that the Fed may continue with its cutting cycle as declining oil prices and goods disinflation persist, we will refrain from underweighting foreign bonds but rather fund the local overweight positions with offshore cash as 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 volatilities induced by the upcoming US election.

Figure 13: S&P 500 returns around US elections



Source: Bloomberg

CONTACT

YANNI YANG, CFA®, FRM, CAIA
C +27 84 802 3784 **T** +27 11 447 7716
F 086 272 1177 **E** yyang@mentenova.co.za

NEO SITHOLE, BSc (Hons)
C +27 60 685 2419 **T** +27 11 447 7716
F 086 272 1177 **E** nsithole@mentenova.co.za

ERIK LABUSCHAGNE, BSc (Hons)
C +27 60 519 5812 **T** +27 11 447 7716
F 086 272 1177 **E** elabuschagne@mentenova.co.za

3rd Floor, Oxford & Glenhove Building 2,
114 Oxford Road, Rosebank, Johannesburg
www.Mentenova.co.za