MENTENOVA

HOUSEVIEW TACTICAL ASSET ALLOCATION

22 April 2021

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We have maintained our TAA positions over the past month, continuing to stay moderately overweight in SA bonds and foreign equity and moderately underweight in foreign bonds.

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

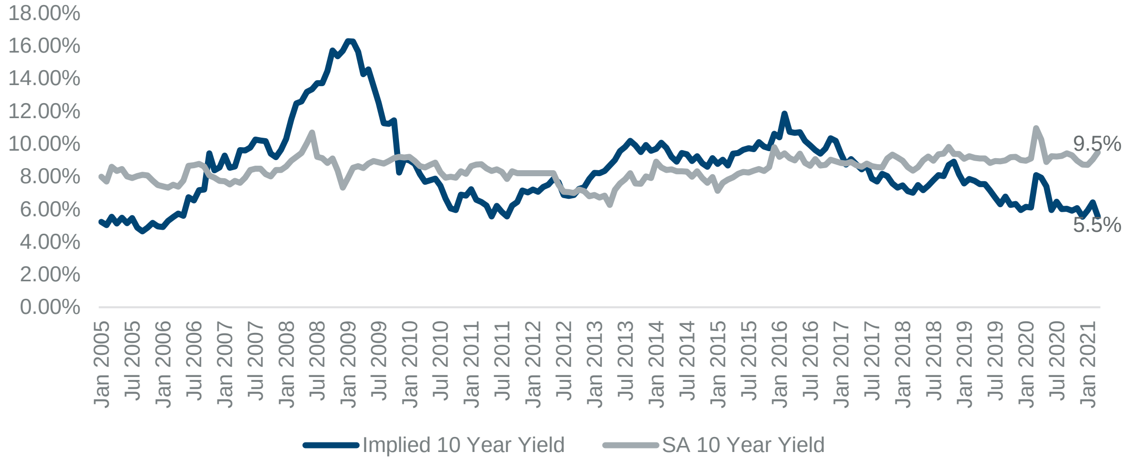
We reiterate our overweight position in local nominal bonds and offshore equity and our underweight position in offshore bonds. Local nominal bonds have become increasingly attractive from a real and hedged yield perspective after the recent bond sell-off. We also continued to prefer offshore equities over offshore bonds as interest rates are likely to remain low in the near term – despite recent yield spikes, improving sentiment and the global economy moving in the right direction, and the vaccine rollout programmes helping to boost growth in the second half of 2021. We have seen how quickly the pandemic situation can change in a country, given the devastating second wave in India. It is crucial for countries, especially emerging markets with slow vaccination rollout programmes to date, to ramp up their vaccine efforts to prevent a similar event unfolding on their doorsteps. We chose to stay neutral in SA inflation-linked bonds, SA equity, SA-listed property and offshore property, with our investment cases for these asset classes remaining largely unchanged over the past month.

TAA Overview

SA bonds	Net outflows of foreigners' holdings of SA bonds continued into April, with net sales of around \$450m over the past month. Furthermore, foreign investors' appetite for local equities grew, with net purchases of around \$298m over the same period. A much stronger economic backdrop in the US and improved business confidence across most of the developed markets supported global risk-on sentiment, with major economies such as the US and China beginning their transition from a post-COVID bounce to trend growth. Three key propellants – continued fiscal and monetary policy support, improved vaccine supply and distribution, and plentiful corporate and consumer deployable cash – should support global equity markets. However, with markets having rallied hard last year, the probability of outsized returns going forward will be less likely. In addition, with concerns centring on rate moves and inflation, be prepared for some speed bumps ahead. For the year to date, as at 28 April 2021, foreign investors had net sold US\$3.0bn and US\$0.6bn worth of local bonds and equities respectively. The 10-year nominal bond remained attractive as it was trading at 9.5%, above the implied 10-year yield of 5.2%. Even adjusting for the March inflation rate of 3.2%, the implied vs actual yield spread still widened from 260 bps to 400bps over the past month. The 10-year nominal yield spread over the US 10-year Treasury yield

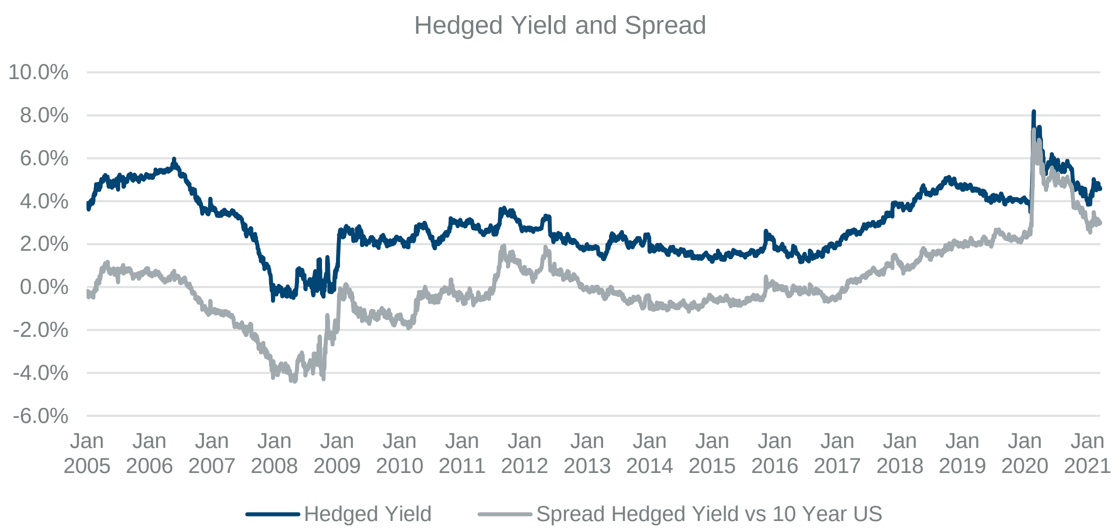
remained relatively steady at 7.74%, exceeding the long-term average by 149 bps. The US dollar-hedged 10-year yield continued to offer value, despite narrowing slightly from 4.9% to 4.6% over the past month. At the same time, the hedged yield premium over the US 10-year yield also narrowed from 330bps to 300bps.

Figure 2: South Africa 10-year nominal yield vs implied yield as at 31 March 2021



Source: Bloomberg

Figure 3: US$-hedged 10-year bond yield over time



Source: Bloomberg

SA nominal bonds also appeared increasingly attractive over Brazilian nominal bonds based on real yield, calculated using reported inflation, with the real yield spread of SA 10-year over Brazilian 10-year increasing from 267bps to 290bps over the past month. The spread of the 10-year bond yields adjusted for expected inflation, based on the Bloomberg survey of economists, also ticked up from 19bps to 80bps over the same period.

Figure 4: SA bond yields vs EM peers as at 28 April 2021

	South Africa	India	Indonesia	Russia	Mexico	Brazil	Turkey
10 Year Yield	**9.22%**	**6.05%**	**6.52%**	**7.00%**	**6.85%**	**9.07%**	**18.59%**
Inflation	3.2%	5.5%	1.37%	3.3%	4.7%	6.1%	16.2%
Inflation Expectation	4.10%	6.20%	2.20%	4.65%	3.80%	4.88%	14.25%
10 Year Real Yield	**6.02%**	**0.53%**	**5.15%**	**3.70%**	**2.18%**	**2.97%**	**2.40%**
10 Year Real Yield based on inflation expectation	5.12%	-0.15%	4.32%	2.35%	3.05%	4.19%	4.34%
Currency Risk Premium	**4.64%**	**2.94%**	**3.47%**	**3.78%**	**3.64%**	**4.60%**	**12.76%**
Sovereign Risk Premium	**2.97%**	**1.51%**	**1.44%**	**1.62%**	**1.60%**	**2.86%**	**4.22%**
US 10 Year Yield	1.61%	1.61%	1.61%	1.61%	1.61%	1.61%	1.61%
S&P Rating - Foreign Currency	**BB-**	**BBB-**	**BBB**	**BBB-**	**BBB**	**BB-**	**B+**
Moody's Rating - Foreign Currency	**Ba2**	**Baa3**	**Baa2**	**Baa3**	**Baa1**	**Ba2**	**B2**

Source: Bloomberg

Some investors have worried that the size of the US stimulus and further stimulus, combined with pent-up consumer savings, could lead to a significant pickup in inflation, potentially prompting the Federal Reserve to tighten its policy. The Fed does not believe inflation will be sustainably above target and still expects not to raise rates before 2024, despite upgrading its growth forecasts for this year and expecting unemployment to decline to 4.5% by the end of this year and 3.5% by the end of 2023.

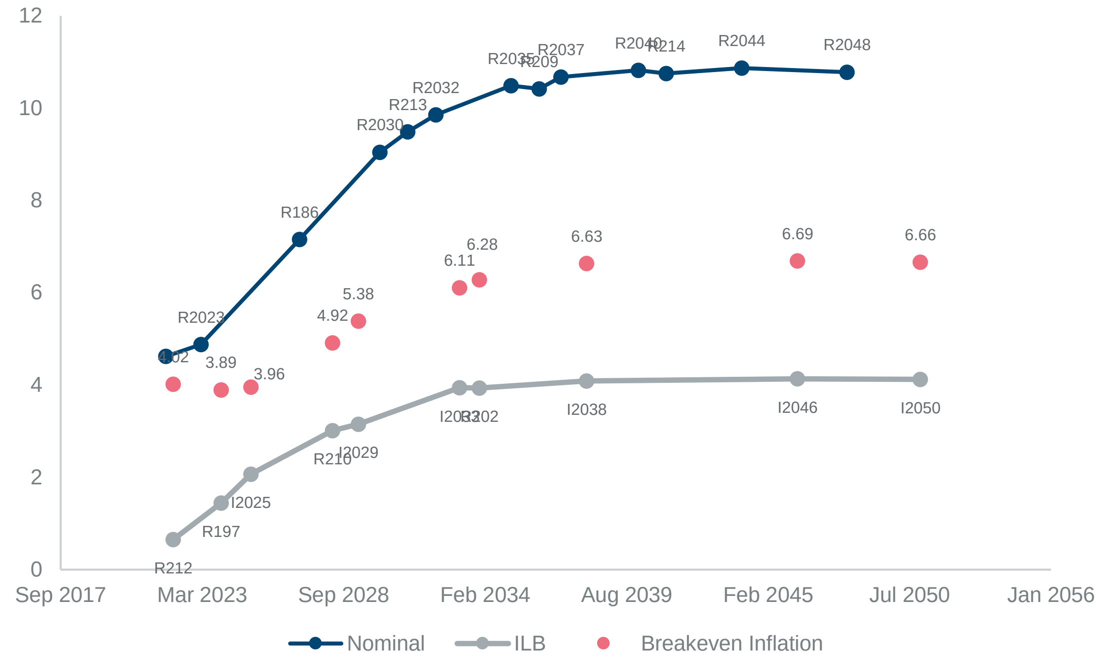
For emerging markets, the slower vaccine rollout compared to developed markets and the catastrophic second wave currently savaging India, which is attributed to a double-mutant variant, are causing concern – not just about regional economic recovery, but also the global pandemic alleviation effort. For South Africa, commodity price gains have bolstered the country's investment case. However, the slow vaccine rollout and potential load-shedding pose potential risks and constraints to the country's growth initiatives, with public sector wage disputes intensifying and increasing the implementation risk of the targeted budget consolidation exercise. We maintained our overweight position in local nominal bonds mainly based on valuations, which continued to appear appealing from a real yield and hedged yield perspective.

SA inflation-linked bonds

The IGOV Index outperformed the ALBI again in March, returning 0.6% vs -2.5% as inflation concerns made investors favour this asset class over nominal bonds. However, for the month to date, as at 28 April 2021, it returned 1.1%, underperforming against the ALBI, which delivered 2.5% over the same period. This was partly driven by the 3.2% March CPI figure published on 21 April, which slightly missed the market expectation of 3.3%.

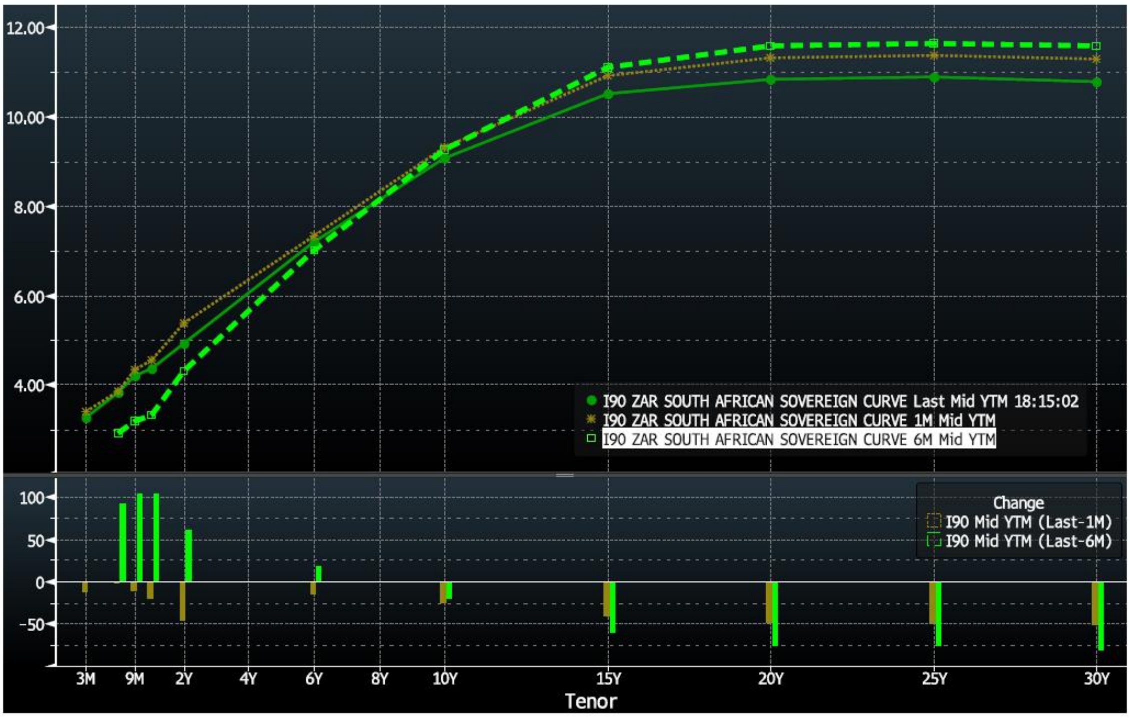
Breakeven inflation increased by c.50bps on the shorter end and decreased by c.10bps on the longer end of maturities, driven by near-term inflation expectations. Nominal yield curves flattened slightly over the past month, while inflation-linked bond yield curves shifted lower.

Figure 5: SA nominal and real yields as at 19 April 2021



Source: Bloomberg

Figure 6: SA nominal yields as at 19 April 2021



Source: Bloomberg

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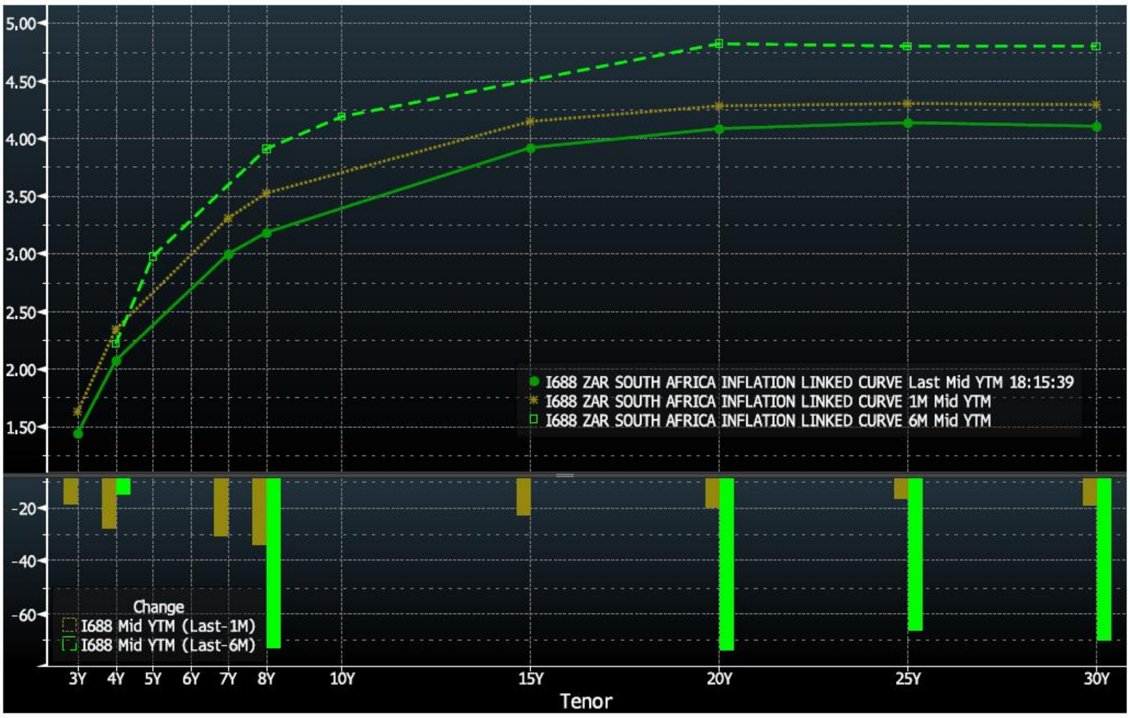
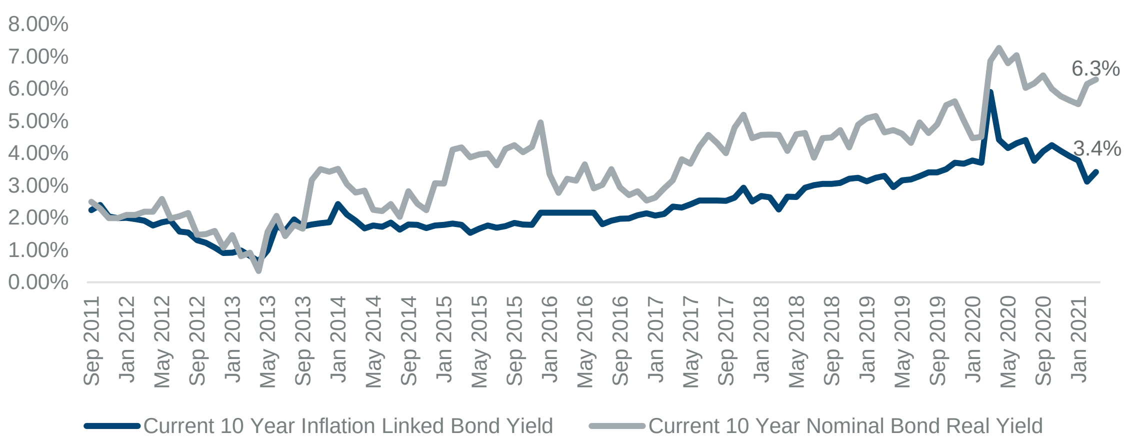
Figure 7: SA inflation-linked yields as at 19 April 2021



Source: Bloomberg

The spread between the 10-year nominal bond real yield and the 10-year inflation-linked bond yield widened from 272bps to 320bps from February to March.

Figure 8: 10-year real yield of nominal bond vs inflation-linked bond as at 31 March 2021



Source: Bloomberg

What we have observed is the divergence between core inflation and overall inflation, with a very similar trend observed in the US as well. Utilities and fuel price increases will likely drive short-term overall inflation towards the upper target band, eating into household disposable income. Meanwhile, core inflation in SA, which excludes food, non-alcoholic drinks, fuel and electricity, slowed to 2.5%, the lowest level since 2009. Tepid core inflation indicates lacklustre discretionary consumption demand and limited underlying price pressures. The forward rate agreement (FRA) rates indicated that the market expects interest rates to rise by less than 25bps by the end of 2021. We reiterate our neutral stance on inflation-linked bonds as we expect demand to remain under pressure in the face of higher transportation and utility costs, which weigh heavily on consumers' pockets, while the labour market and the broader economy slowly recover from the pandemic-induced fallout.

SA equities

Major equity indices continued to make solid gains for the month of March and trend higher into April. Even countries such as Japan and those in the EU, where vaccine rollout progress has been lagging that of the UK and the US, have performed well, returning 1.4% and 6.4% in local currency respectively for the month of March. Investors remain hopeful that countries that are leading in the inoculation race will be able to achieve a sustained reopening of their economies. Even countries making slower progress on the vaccine rollout front would benefit from a global demand rebound. The European stock market also has a higher weight in the financial sector, which would benefit from steeper yield curves.

Over the past two months, developed markets' equity performance in ZAR was diluted by the resilient performance of the rand. The JSE managed to deliver a solid performance in March and the month to date, bolstered by global risk-on sentiment and a rally in resources. Accelerated vaccine rollout programmes have shortened the time needed to inoculate 75% of the US and global populations respectively from 5 months to 3 months, and from 3.3 years to 17 months, according to Bloomberg's COVID-19 vaccine tracker. At the same time, we continued to see strong net inflows into the developed markets, while net inflows into emerging markets were concentrated in China and India.

Figure 9: Major indices and asset class returns in ZAR

31 March 2021 (ZAR)	1M	3M	YTD	1 Year	3 Year (annualised)	5 Year (annualised)	10 Year (annualised)	MTD 28 April 2021
FTSE/JSE ALSI Total Return	1.6%	13.1%	13.1%	54.0%	9.7%	8.2%	10.9%	2.2%
FTSE/JSE Capped SWIX Total Return	3.7%	12.6%	12.6%	54.2%	4.3%	4.4%		2.3%
S&P 500 Total Return	1.6%	6.8%	6.8%	29.7%	25.6%	16.4%	23.1%	1.9%
STOXX 600 Total Return	0.8%	4.6%	4.6%	21.6%	14.2%	8.6%	14.0%	2.2%
Nikkei 225 Total Return	-4.9%	0.9%	0.9%	26.6%	20.0%	14.4%	19.4%	-2.2%
MSCI World Total Return	0.6%	5.7%	5.7%	28.3%	22.1%	14.1%	19.5%	1.7%
MSCI ACWI Total Return	0.0%	5.3%	5.3%	28.8%	21.3%	13.9%	18.6%	1.5%
MSCI EM Total Return	-4.1%	3.0%	3.0%	31.8%	15.1%	12.6%	12.5%	0.4%
STEFI	0.3%	0.9%	0.9%	4.6%	6.4%	6.8%	6.3%	0.3%
ALBI	-2.5%	-1.7%	-1.7%	17.0%	5.5%	8.7%	8.2%	2.5%
IGOV	0.6%	4.7%	4.7%	16.8%	2.3%	3.5%	6.5%	1.1%
WGBI	-4.7%	-5.1%	-5.1%	-15.6%	9.9%	2.2%	9.9%	-1.8%
SAPY Total Return	1.2%	6.4%	6.4%	34.4%	-12.9%	-9.0%	4.4%	12.8%
MSCI US REIT Total Return	1.7%	9.4%	9.4%	14.2%	17.9%	5.4%	17.3%	3.1%
S&P Global Property Total Return	0.1%	6.0%	6.0%	11.7%	13.1%	5.4%	15.3%	1.5%
STOXX 600 Real Estate Total Return	-1.6%	-5.1%	-5.1%	6.6%	7.8%	2.5%	13.1%	5.2%
Crude Oil	-6.5%	23.4%	23.4%	131.7%	4.0%	10.0%	1.7%	2.4%
Aluminium	-0.1%	12.4%	12.4%	20.2%	11.2%	7.9%	6.2%	4.9%
Copper	-5.8%	13.8%	13.8%	47.2%	17.7%	12.7%	7.3%	8.7%
Gold	-1.5%	-10.0%	-10.0%	8.3%	8.8%	6.7%	1.8%	4.3%
Platinum	-3.1%	11.4%	11.4%	36.2%	16.7%	4.1%	3.9%	-0.5%
Nickel	0.0%	0.0%	0.0%	0.0%	5.2%	7.7%	0.0%	0.0%
Palladium	9.9%	8.0%	8.0%	-7.8%	51.0%	36.2%	22.3%	8.0%
Iron Ore	-9.2%	1.5%	1.5%	58.6%	46.3%	23.8%		17.2%
USDZAR	-2.3%	0.6%	0.6%	-17.2%	7.7%	0.0%	8.1%	-3.7%
GBPZAR	-3.2%	1.4%	1.4%	-8.1%	7.1%	-0.8%	6.5%	-2.6%
EURZAR	-5.0%	-3.5%	-3.5%	-11.9%	5.9%	0.6%	6.1%	-0.4%
JPYZAR	-5.9%	-6.1%	-6.1%	-19.6%	6.2%	0.3%	5.1%	-1.7%

Source: Bloomberg

Figure 10: ETF net flows into developed and emerging market ETFs for the week ending 19 April 2021

View Countries | Show Netflow | Market DM | In Millions of USD

Map View | Details | Historical

Country	1D	1W	1M	3M	YTD	1Y	3Y
1) Americas	-3,242	+20,201	+74,204	+196,479	+217,683	+532,021	+1,186,762
10) United States	-3,499	+19,483	+71,952	+188,484	+208,083	+511,953	+1,143,754
11) Canada	+222	+568	+1,387	+5,027	+6,290	+14,477	+36,460
12) North America*	+35	+150	+865	+2,967	+3,310	+5,590	+6,548
2) Europe	+80	+424	+1,064	+3,012	+2,878	+6,270	+8,368
20) United Kingdom	+88	+378	+1,216	+3,169	+3,572	+7,635	+20,209
21) Italy	+2	+196	+392	+1,468	+1,284	+1,344	-351
22) Sweden	--	-36	+24	+91	+137	+1	-574
23) Denmark	--	--	0	+26	+40	+188	+223
3) Asia Pacific	+90	+698	+3,864	+14,333	+16,339	+59,312	+149,775
30) Japan	+33	+1,488	+4,970	+11,062	+14,663	+54,455	+124,561
31) Australia	+51	+89	+449	+573	+774	+7,150	+15,482
32) South Korea	-77	-793	-1,339	+1,361	+563	-5,954	+4,165
33) Taiwan	--	+2	+28	+266	+289	+311	+304
4) Africa & Middle East	--	-7	-32	+110	+222	+411	+794
40) Israel	--	-7	-32	+110	+222	+411	+794

*Regionally Focused Funds

View Countries | Show Netflow | Market EM | In Millions of USD

Map View | Details | Historical

Country	1D	1W	1M	3M	YTD	1Y	3Y
1) Americas	-21	-185	-367	-26	+51	-880	+7,270
10) Brazil	-36	-192	-337	+375	+287	-1,983	+3,964
11) Latam Region*	+40	+30	+102	-8	+57	+861	+479
12) Peru	--	--	0	0	0	0	0
13) Argentina	--	--	-12	-4	-4	-18	-142
2) Europe	-5	+3	+18	-33	-81	+488	-1,780
20) Eastern Europe*	--	--	0	+5	+9	+16	-166
21) Hungary	--	--	--	0	0	0	+1
22) Romania	--	--	--	--	--	0	+2
23) Turkey	--	+3	+15	+26	-18	+123	+325
3) Asia Pacific	+1,257	+6,375	+7,431	+27,357	+26,493	+26,347	+64,239
30) China	+1,192	+6,346	+7,290	+25,252	+24,224	+21,122	+51,232
31) Taiwan	-19	-23	-124	+1,324	+1,408	+4,038	+7,352
32) India	+81	+65	+227	+636	+700	+712	+4,918
33) Hong Kong	--	--	+20	+187	+205	+241	+245
4) Africa & Middle East	+1	+7	-8	-112	-77	-189	+1,439
40) Saudi Arabia	--	-1	-1	-15	+11	-61	+1,293
41) U.A.E.	--	+6	-6	+10	+11	-14	+20
42) African Region*	--	--	+1	-1	+3	-1	-31

*Regionally Focused Funds

Source: Bloomberg

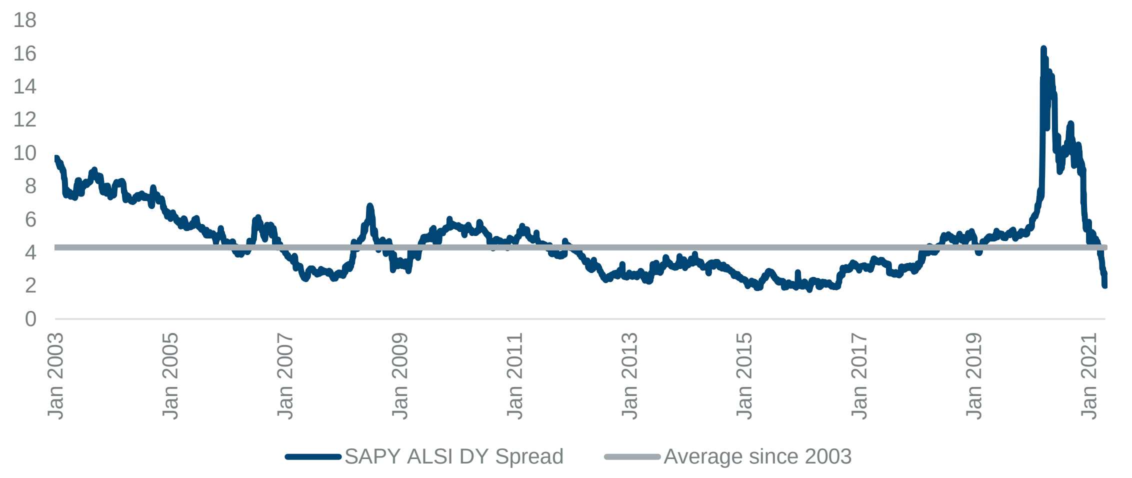
SA equity valuations based on price ratios and dividend yields suggested moderate underweight. Sentiment remains upbeat, with the SA PMI index jumping from 53 in February to 57.4 in March. Yet employment in the manufacturing sector remains weak, with the employment index hardly moving, from 44.1 to 44.4, over the same period, evidencing a still-contracted labour market in the manufacturing space. Total and residential building plans delivered two consecutive months of year-on-year gains, up 5.9% and 42.4% respectively in January and up 20.4% and 18.6% respectively in February.

Retail sales in constant prices jumped from -4.8% in January to 4.93% in February, year on year. Total and new car sales were up 31.8% and 23.4% respectively in March year on year, due to the base effect, and up 17.8% and 12.6% respectively month on month over the same period as demand recovered in the wake of further economic reopening.

On the trade front, export and import growth year on year improved from 9.1% and -5.7% respectively in January to 17.5% and 4.0% respectively in February. Private credit extensions

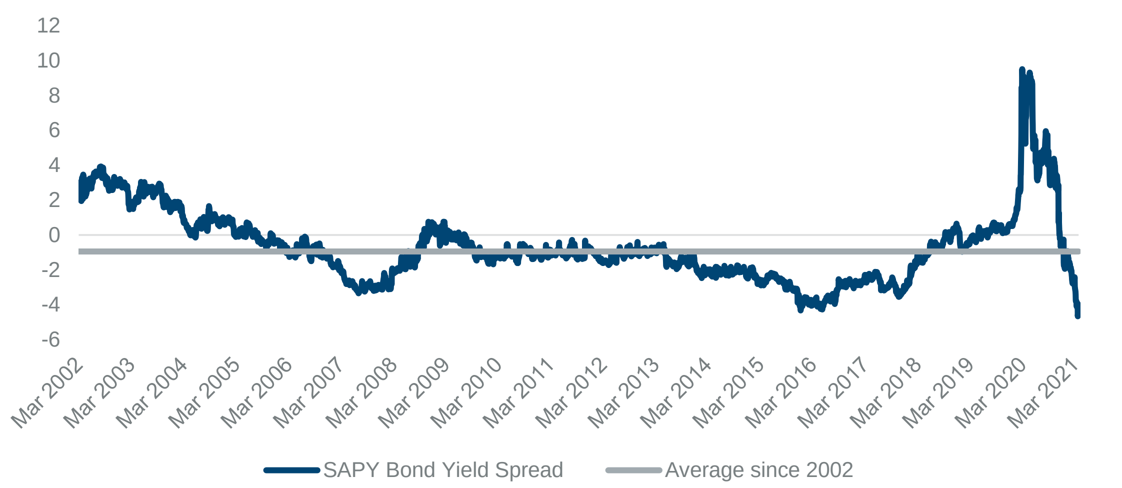
	remained lacklustre, declining from 3.26% in January to 2.62% in February year on year. We reiterate our neutral position in SA equities as valuation and fundamentals remained largely unchanged over the past month, with some improvements in the economics. However, the sustainability of the recovery trend is yet to be seen. While global sentiment and monetary policies remain supportive, energy constraints and a slow vaccine rollout are some of the downside risks to the country's growth recovery trajectory.
SA-listed property	SA-listed property delivered a strong performance in the month to date in April, returning 12.8% as at 28 April 2021, and performed similarly to the ALSI Index in March 2021, at 1.2% vs 1.6%. The yield spread relative to SA equities fell significantly below its long-term average, while the yield spread relative to the 10-year bond fell to an all-time low from its long-term average. The SAPY dividend yield continued to trend below its rolling 1-year and 5-year averages.

Figure 11: SAPY yield spread relative to FTSE/JSE All Share Index



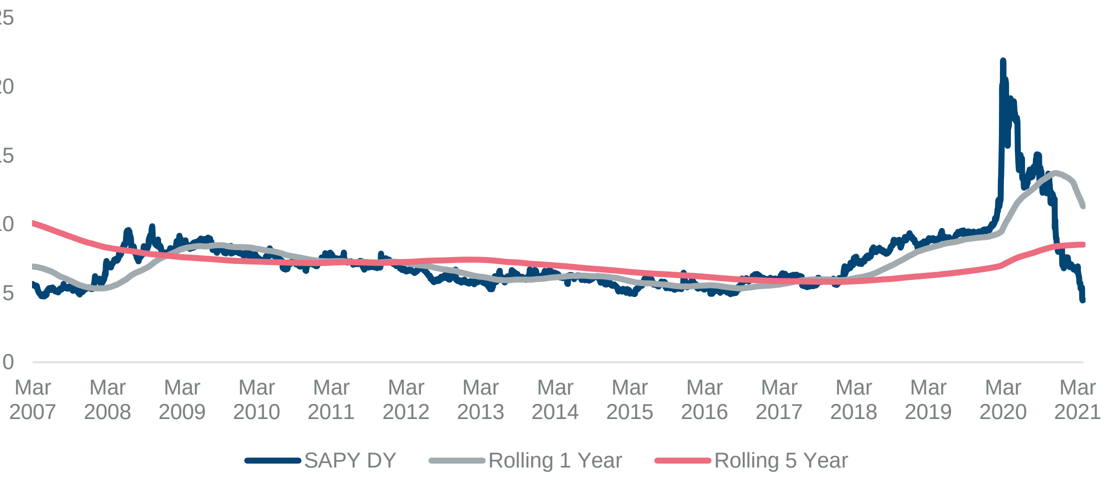
Source: Bloomberg

Figure 12: SAPY yield spread relative to 10-year bond



Source: Bloomberg

Figure 13: SAPY yield relative to rolling 1-year and rolling 5-year averages



Source: Bloomberg

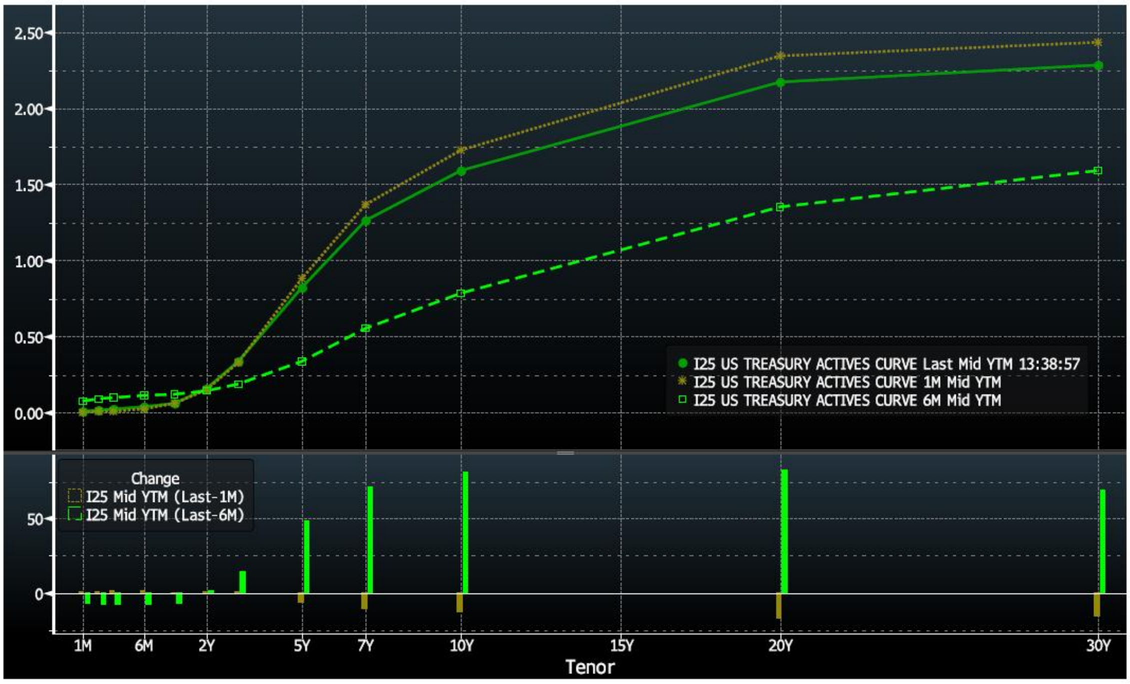
As we have seen with SA equities, near-term business and consumer sentiment are making a steady recovery as infection rates remain low as the second wave subsides, despite a slower-than-peers vaccine rollout programme. The structural and secular challenges facing the local property sector have remained largely unchanged, with an oversupply of offices, an elevated rent-to-sales ratio, and the pandemic further accelerating the transition from bricks-and-mortar stores to online shopping. According to FNB Property Insights for Q1 2021, sales activities have been the weakest for the office sector and brokers expect the latter to remain the weakest property sector in the short term. This is unsurprising as many office workers have continued to work largely from home and corporates (from small to big) have been reviewing their space requirements for a post-COVID world.

Figure 14: Property sales activity near-term expectations

Source: FNB Property Insights Activity Q1 2021

	We choose to stay neutral in SA property as we continue to believe that any further, significant rally in the SAPY Index is contingent on sustainable improvements in economic conditions and consumer demand. While short-term sentiment has improved, it is difficult to justify an overweight position, given the current level of valuation.
Offshore bonds	The 10-year vs 2-year Treasury spread narrowed slightly from 146bps to 144bps and the yield curve flattened slightly over the same period. The yield on the 10-year US Treasury bond fell to 1.61% this week, following our TAA meeting, after the Federal Reserve announced its decision to keep rates unchanged to provide continued support for economic recovery until the labour market fully recovers.

Figure 15: US yield curve as at 19 April 2021



Source: Bloomberg

We reiterate our moderate underweight position in offshore bonds. Monetary policy remains supportive and despite recent US Treasury yield spikes, interest rates remain very low from a historical standpoint. This still points to the relative attractiveness of equities over bonds, especially over nominal bonds as reflation bets or inflation concerns increase short-term volatilities.

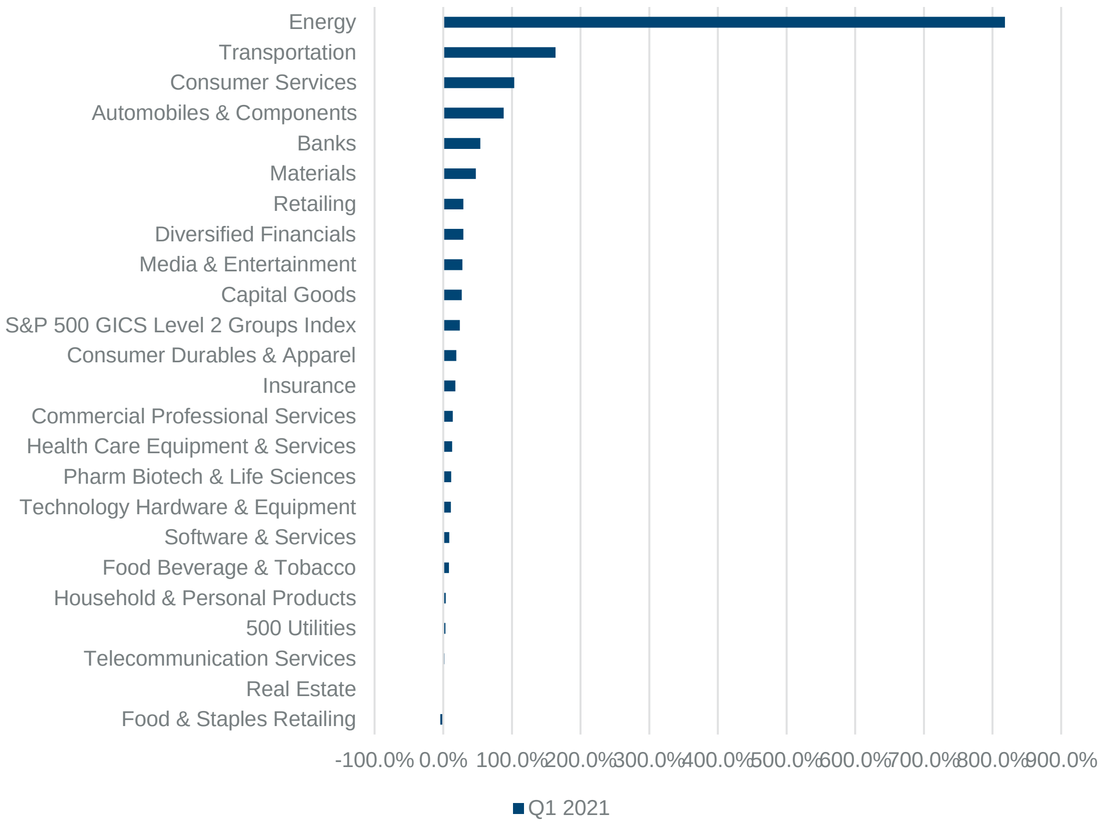
Offshore equities	Valuation scores for offshore equities remained largely unchanged over the past month, favouring local equities over offshore equities. Sentiment in the US continued to lead that of the EU and Japan. The University of Michigan Consumer Sentiment Index climbed from 83 in March to 86.5 in April. The Conference Board Consumer Confidence Index and the Bloomberg US Weekly Consumer Comfort Index also improved, from 91.3 in February to 109.7 in March and from 49.4 in March to 53.9 in April respectively. Manufacturing confidence was resilient, with business activity and the production outlook jumping from 17.2 and 19.9 in February to 28.9 and 48 in March respectively. Sentiment in the EU also made some notable gains. Consumer confidence improved from -14.8 in

February to -10.8 in March, slightly below the long-term average of -10.05. The region's economic sentiment also improved from 93.4 to 100.9 over the same period. The business climate trended higher from -0.14 in February to 0.29 in March. Sentiment in Japan was more mixed, depending on the survey, with much smaller improvements compared to the US and EU.

The macro data indicated improvements in the US and EU economies. US retail sales surged 27.7% year on year in March and 8.2% month on month. Industrial production improved from -4.77% in February to 1.02% in March year on year. US import growth year on year continued to show consecutive improvements, from 3.18% in January to 4.98% in February, but exports weakened from -7.43% to -10.0% over the same period. The services PMI continued in expansionary mode, jumping from 55.3 in February to 63.7 in March. The US labour market continued to make small gains, with the unemployment rate ticking lower to 6.0% in March and the economy adding 517k jobs in March, below the market expectation of 550k. Initial jobless claims and continuing jobless claims continued to trend lower into April but missed market expectations from time to time. The probability of a recession in the next 12 months, according to the New York Fed, dropped from 9.59% to 6.26% over the past month.

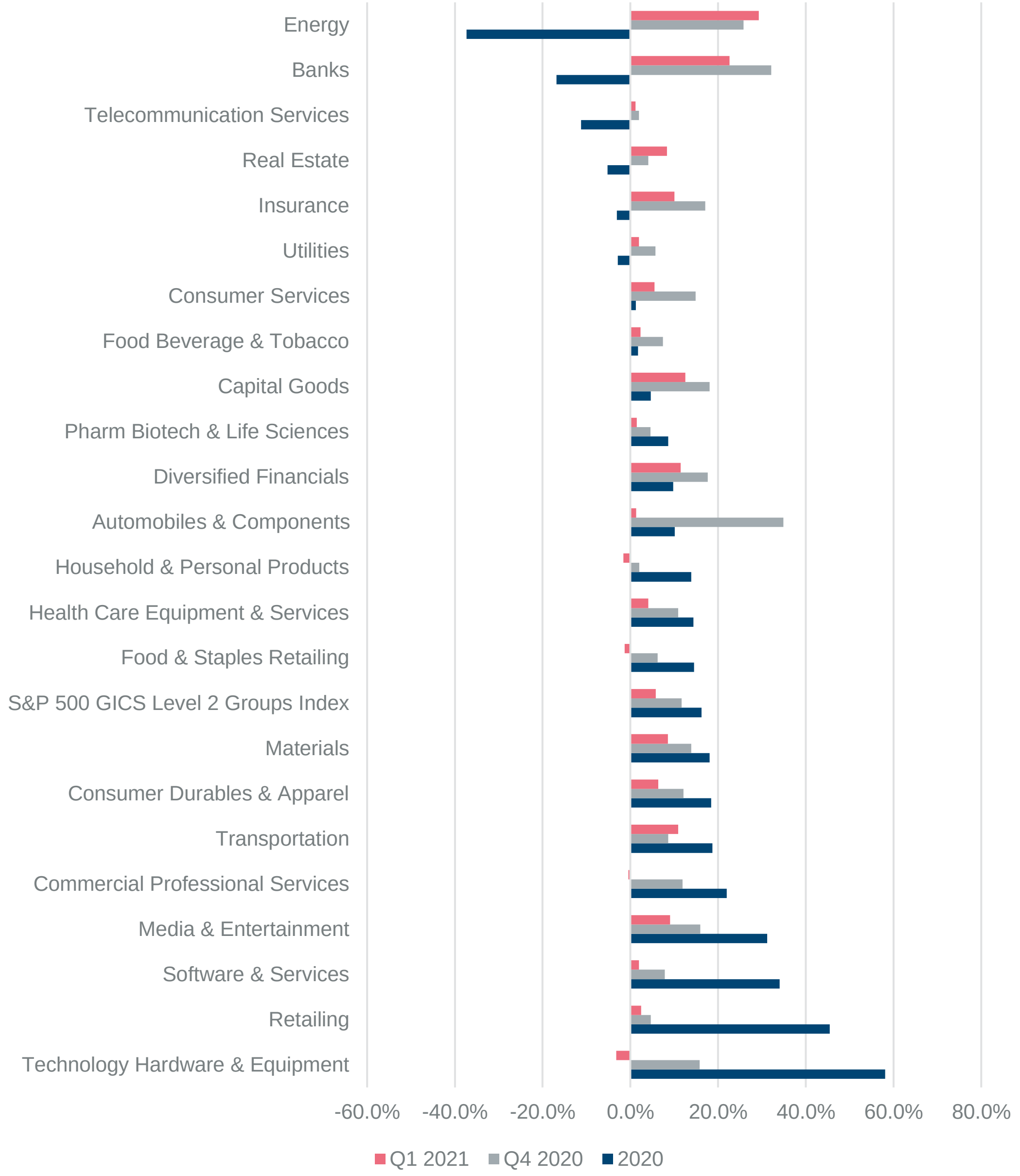
Recent sector rotations, driving the outperformance of last year's laggards, were also underpinned by an improving earnings outlook in sectors that suffered most in 2020.

Figure 16: S&P 500 GICS Level 2 Indices Q1 2021 earnings estimate revision



Source: Bloomberg

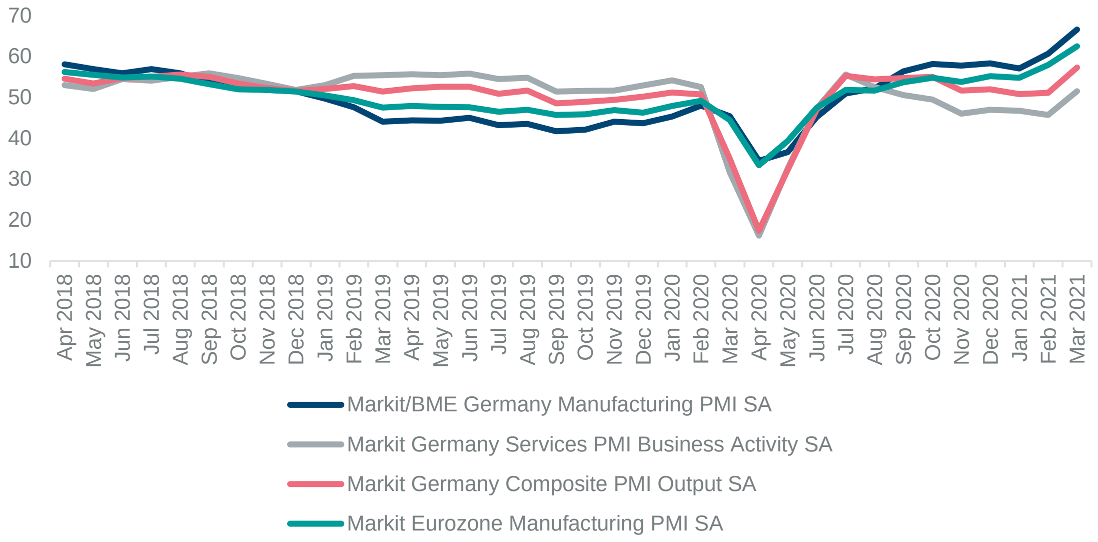
Figure 17: S&P 500 GICS Level 2 indices returns



Source: Bloomberg

Retail sales growth year on year in the EU improved from -5.2% in January to -2.9% in February. The Eurozone and Germany manufacturing PMIs and Germany services PMI surged further into the expansionary zone in March. Retail sales in Japan remained soft at -1.5% in February year on year. Industrial production ticked up from -5.3% to -2.0% year on year from January to February. Exports and imports continued to make small gains.

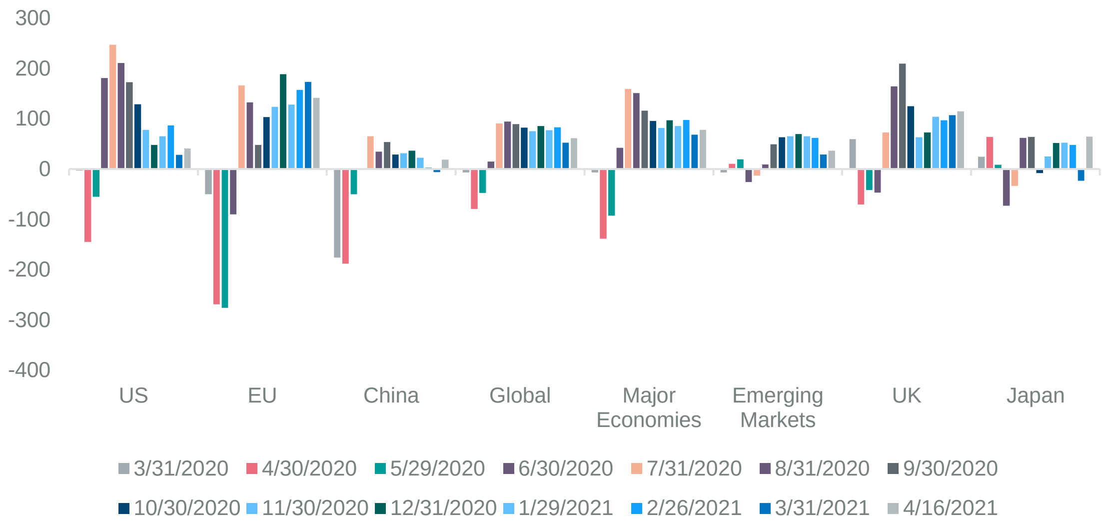
Figure 18: Eurozone and Germany PMIs



Source: Bloomberg

In the Asia-Pacific region, we observed the Chinese manufacturing and non-manufacturing PMI improving from 50.6 and 51.4 to 51.9 and 56.3 respectively from February to March. The operating margin for the S&P 500 improved from 9.96% to 10.43% from December 2020 to March 2021. The operating margin for the STOXX 600 and the NIKKEI 225 remained flat over the same period. The debt-to-equity ratio for the STOXX Europe 600 industrials, however, dropped from 118.6 in November 2020 to 103.3 in March, while the leverage ratio of the other two regions remained largely unchanged. The economic surprise index remained in positive territory for most major economies, showing that the reported economic figures largely exceeded market expectations.

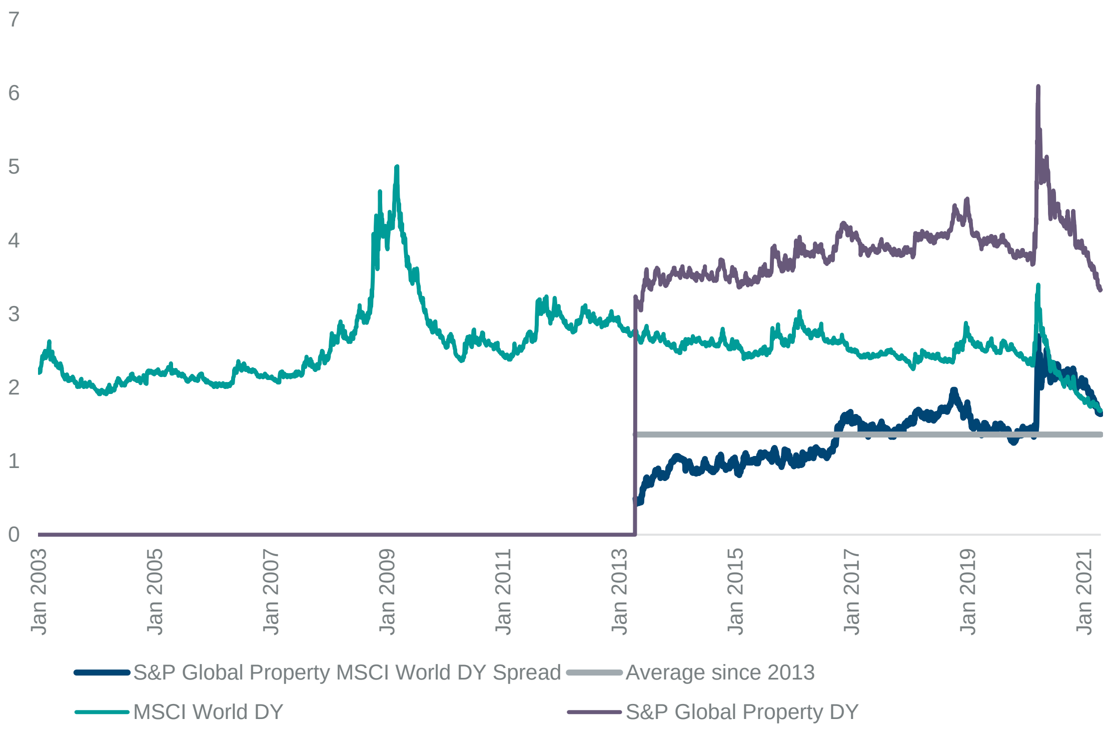
Figure 19: Economic surprise indices



Source: Bloomberg

	Our views on offshore equities have remained unchanged. We continue to favour offshore equities over offshore bonds as near-term yields are likely to remain low in the wake of supportive policies and vaccine optimism.
Offshore property	From a valuation perspective, global property appears to be cheaper than the MSCI World Index based on dividend yield spread, albeit covering a short history. We chose to stay neutral in offshore property as we have not seen significant changes in the fundamentals of the commercial property market over the past month, apart from housing prices rallying in many parts of the world in 2020/2021 due to historically low interest rates and remote working.

Figure 20: S&P Global Property dividend yield spread relative to the MSCI World Index



Source: Bloomberg

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