momentum
investments

# Q2:
## houseview
quarter ended 30 June 2017

## SA asset class returns

110
105
100
95
90

2017/03/31
2017/04/13
2017/04/26
2017/05/09
2017/05/22
2017/06/04
2017/06/17
2017/06/30

—SWIX (100) —Listed property (100.9) —ALBI (101.5) —ILBs (100.9) —Cash (101.9) —Gold ETF (97.8) —Platinum ETF (95.3)

Source: I-Net, Momentum Investments

The table below indicates Momentum Investments views on the outlook and one-year forecasts for key economic variables and asset classes. For a more detailed analysis, read the expanded houseview at the end of this document.

| | One-year projection | Weighting bias |
|---|---|---|
| Growth | 0.8% (2017 average) | Expect a very modest growth recovery from 2016 levels, as agricultural output recovers and the global synchronised recovery tugs exports higher. A highly-uncertain political and economic environment has further shattered business and consumer confidence. |
| Inflation[1] | 5.1% | Additional weather-induced food disinflation expected, but a higher degree of exchange rate volatility against a noisy political backdrop poses a significant upside risk to the expected inflation trajectory. |
| Currency[2] | R13.78 per US $1 | The rand has benefited from the global hunt for yield and improving fundamentals across commodity exporters, but it still faces political risks and remains vulnerable to capital outflows. |
| Interest rates[3] | 6.5% repo (10 % prime) | Rising real interest rates should allow the South African Reserve Bank (SARB) to consider easing monetary policy, but cuts may be delayed into early 2018 as the SARB errs on the side of caution, taking note of high event risk which may negatively impact the currency and subsequently the outlook for inflation. |
| Cash[4] | 7.6% | Decent risk-adjusted returns are expected in a low-return environment, but re-investment risk rises as the local interest rate cycle peaks. |
| Government bonds[5] | 8.8% | Emerging market (EM) bond markets are benefiting from the hunt for yield and SA government bonds have been no exception. SA bonds generally perform well in the run-up to interest rate cuts and from current (low) levels of business confidence. |
| Inflation-linked bonds (ILBs) | 5.9% | We continue to favour nominal bonds over inflation-linked bonds (ILBs). A declining inflation profile is fundamentally negative for ILBs. |
| Listed property[6] | 13.5% | Strong property returns expected from the current property rating. Relative valuation against bonds has improved meaningfully. |
| Equity[7] | 12.3% | Turnaround hinges on improved policy certainty. Significant improvement in valuations due to a flat market over the past three years. |
| Global equities[8] | 19.4% | Synchronised recovery in global growth and earnings, combined with policy stimulus, continues to support equities. Valuations still favour equities over bonds. |
| Global bonds[9] | 5.3% | Stretched net long position in US treasuries signals waning buying power. Yields remain sanguine despite the US Federal Reserve (Fed) signalling additional interest rate hikes and rising supply from Fed tapering. |
| Global cash | 7.6% | Notwithstanding likely additional interest rate increases in the US, globally, interest rates continue tracking close to historical lows. As such, we expect the rand view to be the dominant driver of local currency returns. |

[1] Based on a blended combination of top-down (changes in the output gap, labour cost and foreign exchange dynamics) and bottom-up (view on sector-specific pricing power effects) models.
[2] We start with our view on the US dollar (driven by our views on global risk appetite, growth differentials and rate differentials). We then determine our view on SA's current account balance (driven by expected change in net export prices and volumes, as well as change in net income and dividend payments). Finally, we take a view on the net impact of the change in net foreign capital inflows. Inflation differentials are not a driver of a one-year view on the rand.
[3] Based on our view of projected inflation and growth.
[4] Based on a combination of the one-year NCD rate and the current SA repo rate.
[5] Based on our view on the evolution of the yield curve, anchored by our short-rate view (for net capital gain or loss), adjusted for running yield of ten-year SA government bond benchmark (for income yield).
[6] Based on our bond yield and inflation forecasts and expected distribution growth.
[7] Based on our earnings estimates and the implied change in market rating associated with this expected earnings from our rating model.
[8] A blend of expected returns from the US, other developed markets and emerging markets.
[9] A blend of expected returns from sovereign, high-grade and high-yield fixed-income instruments.

## What we expect will happen... (Quarter July 2017 to September 2017)

| Growth | Inflation | The currency | Interest rates | Cash | Government bonds |
|---|---|---|---|---|---|
| Higher agricultural output and improved growth in SA's key trading partners should boost domestic economic activity. However, only a modest recovery is expected from 2016 levels. Businesses remain reluctant to invest and hire in a highly uncertain political and economic environment, while onerous debt levels, stringent lending conditions, gloomy job prospects and higher taxes have dulled consumer sentiment. | Double the average rainfall at the beginning of the year should result in a bumper maize crop, aiding the drop in food inflation. Nevertheless, with inflation expectations remaining close to the upper end of the inflation target, the central bank has warned of little room to manoeuvre should adverse shocks materialise. As such, the currency remains a key upside risk to the inflation profile in a highly uncertain political environment. | The ongoing global hunt for yield supported the rand through a period of weaker-than-expected growth and negative ratings action. The local currency benefited alongside other EM currencies, which have gained on the back of an improvement in macro fundamentals. Nonetheless, further negative ratings action in SA and heightened political tensions point to further negative rand risks. | Ongoing disinflation is expected to lead to a rise in real interest rates. This should allow the SARB to consider easing monetary policy by a cumulative 50 basis points. Interest rate cuts are however likely be deferred into early 2018 as rand risks (in light of continued political uncertainty) continue to provide an upside threat to the inflation trajectory. | Domestic cash is expected to deliver decent risk-adjusted returns in a low-return environment. However, re-investment risk is set to increase in response to a likely peak being reached in the local interest rate cycle. | SA nominal bonds are benefiting alongside EM bond markets in the current global hunt-for-yield environment. SA bonds generally perform well in the run-up to interest rate cuts and from around the current low level of business confidence. A further expected decline in SA inflation should also underpin the bond market into 2018. |

## What we expect will happen... (Quarter July 2017 to September 2017)

| Inflation-linked bonds (ILBs) | Listed property | Equities | Global equities | Global bonds | Global cash |
|---|---|---|---|---|---|
| We continue to favour nominal bonds over ILBs, as lower expected inflation is fundamentally negative for ILBs. | Listed property's relative valuation against nominal bonds has improved meaningfully since 2015 and is now close to its five-year average. We expect strong property returns from the current rating. | SA equity valuations have improved meaningfully. A profit rebound is expected from the current low base, due to the market trading sideways over the past three years. The market remains supported by higher commodity prices and a synchronised global recovery, but a turnaround in confidence is key to unlock performance in SA equities. | Synchronised global growth and earnings, combined with policy stimulus, should support global equities. Earnings trends and valuations now favour non-US regions. A decent yield pick-up is expected for European equities and fundamental support remains in place for Japanese equities. A growing positive growth differential between EM and developed markets should continue to support EM outperformance. | Global bond valuations relative to global equities remain expensive. A stretched net long position in US treasuries signals waning buying power. Despite rising supply from Fed tapering and the central bank continuing to signal additional interest rate hikes, US treasury yields remain at too sanguine levels. | Even though interest rates are expected to climb further in the US, globally, interest rates are still tracking close to historical lows. As such, we expect the rand view to be the dominant driver of local currency returns. |

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