momentum

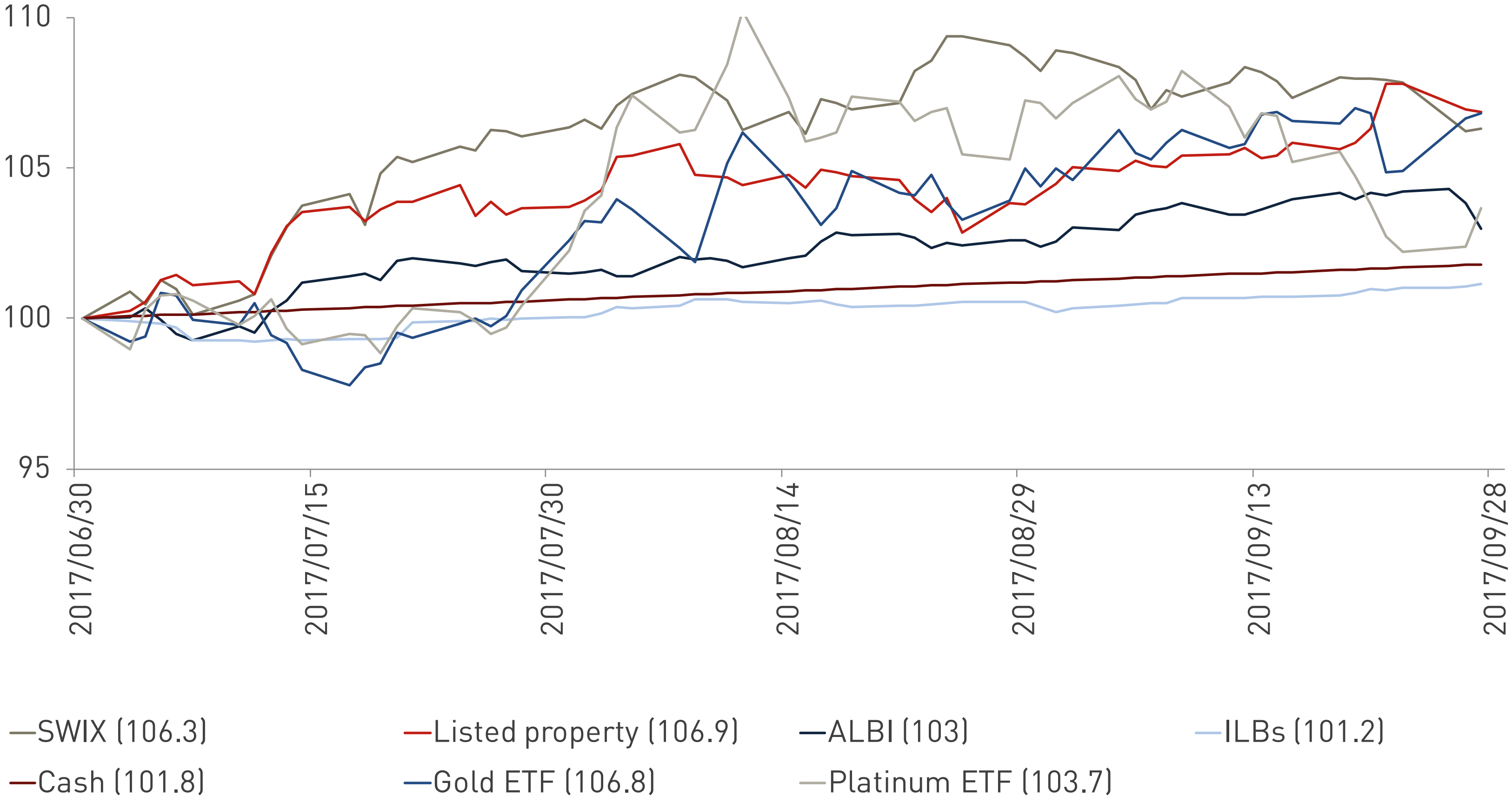
investments

Q3:

houseview

quarter ended 30 September 2017

SA asset class returns



Source: I-Net, Momentum Asset Management

The table below indicates Momentum's 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 (Q4 2017 – Q3 2018)	0.5%	Short-run fiscal and monetary policies offer limited scope to boost domestic demand, but better global growth prospects should tug export growth higher.
Inflation[1]	5.3%	Weak growth, food disinflation and recent currency appreciation are expected to pull inflation lower in the near term, before an upward trajectory resumes.
Currency[2]	R13.70 per US$1	Rising commodity prices and a global hunt for yield in a 'risk-on' environment have benefited the rand, but the local unit still faces political risks and remains vulnerable to capital outflows.
Interest rates[3]	6.25% repo (9.75 % prime)	A steadily recovering global macro backdrop, an improvement in the inflation trajectory, a meaningful shift lower in inflation expectations and muted domestic confidence justifies further monetary policy easing in the current interest rate cycle.
Cash[4]	7.2%	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 further reduction in local interest rates.
Government bonds[5]	8.2%	SA bonds are attractive relative to other emerging market (EM) bonds on a risk/return basis, but domestic politics and ratings pose a threat.
Inflation-linked bonds (ILBs)	6.1%	We continue to favour nominal bonds over ILBs, as lower expected inflation is fundamentally negative for ILBs.
Listed property[6]	11.8%	Listed property's relative valuation against nominal bonds has improved meaningfully and is now trading close to its five-year average. We expect good property returns from the current rating.
Equities[7]	10.1%	Domestic equity valuations have improved meaningfully due to a flat market in recent years and a profit rebound from a low base.
Global equities[8]	12.8%	'Goldilocks' conditions (synchronised global growth coupled with mild inflation) should support earnings growth. Valuations still favour global equities over global bonds.
Global bonds[9]	6.1%	Global bonds are constrained by euphoric flows, rising net issuance, an imminent rebound in inflation and market complacency around interest hike expectations.
Global cash	3.5%	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.

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 negotiable certificate of deposit (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 October 2017 to December 2017)

Growth	Inflation	The currency	Interest rates	Cash	Government bonds
SA growth started to decouple from global activity around 2010 and the gap is widening. A muddled outlook on the future of economic policy in SA is stifling domestic confidence and prohibiting a more meaningful economic recovery. Short-run fiscal and monetary policies offer limited scope to boost domestic demand, but better global growth prospects should tug export growth higher.	A bumper maize crop and rising slaughtering rates should see food inflation declining further in the near term. Although average five-year inflation expectations have fallen to their lowest level on record since 2011, the rand and electricity tariffs remain as key upside threats to the inflation outlook.	Rising commodity prices and a global hunt for yield in a 'risk-on' environment have benefited the rand, but the prospect of a further sovereign ratings downgrade, negative political events and global monetary policy tightening currently cloud the outlook for the rand's trajectory against major currencies.	A steadily recovering global economy, an improving inflation trajectory, a meaningful shift lower in inflation expectations and still muted confidence justifies up to 50 basis points of easing before the end of the first quarter in 2018. The likelihood and timing of the cuts will depend on the outcome of upcoming high risk events, including the medium-term budget, sovereign ratings reviews and the ruling party's elective conference.	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 further reduction in local interest rates.	SA nominal bonds are benefiting alongside EM bond markets in the current global 'hunt-for-yield' environment. SA bonds are attractive relative to other EM bonds on a risk/return basis, but domestic politics and ratings pose a threat. The expected decline in SA inflation into early 2018 should provide a major bond underpin.

What we expect will happen... (Quarter October 2017 to December 2017)

Inflation-linked bonds	Listed property	Equities	Global equities	Global bonds	Global cash
Breakevens are expected to compress further in line with falling inflation. 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 trading close to its five-year average. We expect good property returns from the current rating.	SA equity valuations have improved meaningfully due to a flat market in recent years and an earnings rebound from a low base. Nevertheless, political tensions have shattered domestic confidence, which remains negative for locally-produced earnings.	'Goldilocks' conditions (synchronised global growth coupled with mild inflation, which is keeping policy tightening moderate) should support earnings growth. European and Japanese equity markets are favoured over the US market, where performance and valuations are at historical extremes. Rising relative earnings growth, falling inflation and current US dollar weakness remain supportive of EM equities.	Global bonds are constrained by euphoric flows, rising net issuance, an imminent rebound in inflation and market complacency around US interest rate hike expectations. Valuations still favour global equities over global bonds. A higher equity risk premium provides better protection than fixed income risk premia.	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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