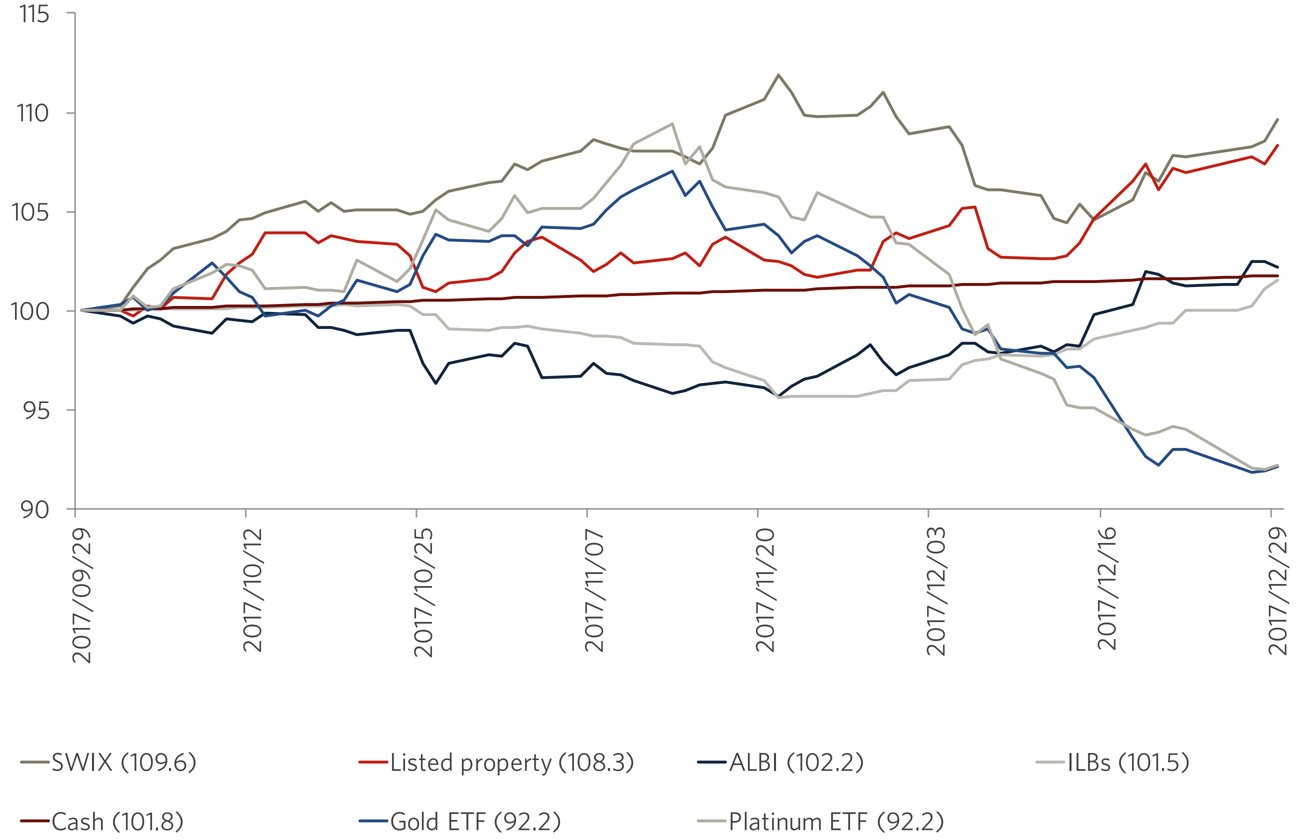
Q4: Houseview

quarter ended 31 December 2017

momentum
investments

SA asset class returns



Source: I-Net, Momentum Investments

Houseview summary

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 (Q1 2018 – Q4 2018)	1.4%	Raised hopes of an economic revival, but structural reforms are needed to shift the country to a higher growth plane over time.
Inflation [1]	4.8%	Even after factoring in a mildly depreciating currency trajectory from current levels, inflation should still remain comfortably within the target band in upcoming months.
Currency [2]	R12.48 per US$1	Positive political developments have driven the local currency firmer, but the rand remains vulnerable to negative swings in global and local sentiment.
Interest rates [3]	6.50% repo (10.0 % prime)	Although the potential for a sovereign ratings downgrade still lingers, falling inflation likely leaves room for further modest monetary policy easing in the first half of 2018.
Cash [4]	7.3%	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]	9.1%	A global hunt for yield and well-behaved local inflation give local bond support.
Inflation-linked bonds (ILBs)	7.4%	We continue to favour nominal bonds over ILBs, as lower expected inflation is fundamentally negative for ILBs.
Listed property [6]	10.3%	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]	9.7%	A political risk premium has held SA equities back in recent years, hence political improvement would support returns.
Global equities [8]	10.6%	The most synchronised global recovery since 2010 has caused the strongest positive profit recovery since then, while central bank equity support should remain in place for most of 2018.
Global bonds [9]	5.9%	Global bond valuations remain extremely expensive, while bond yields can't ignore negative fundamentals indefinitely.
Global cash	4.0%	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 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 instrument

What we expect will happen... (Quarter January 2018 to March 2018)

Growth	Inflation	Currency
The outcome of the ruling party's 54th National Conference has rekindled hope for sufficient reform to propel the economy to a higher growth plane over time. Resilient global growth and a modest recovery in commodity prices should help real growth reach 1.4% in 2018, with the domestic demand trajectory relying heavily on the extent of the recovery in sentiment.	Even after factoring in a mildly depreciating currency trajectory from current levels, inflation should still remain comfortably within the target band in upcoming months. Nonetheless, wage settlements, in the run up to the public sector wage negotiations, and elevated oil prices pose upside risks to the inflation forecast.	A sharper-than-expected slowdown in China or a faster pace in developed market monetary policy tightening could trigger emerging market-wide currency weakness, whereas a perception of a shift to the left in SA policy could see the rand weakening in isolation. Taking this and the expectation of a resilient global economy into account, Momentum Investments expects some depreciation in the currency during 2018 and 2019.

Interest rates	Cash	Government bonds
Although the SA Reserve Bank cited the potential for a sovereign ratings downgrade and higher international oil prices as risks, falling inflation potentially leaves room for further modest monetary policy easing in the first half of 2018.	Further declines in local interest rates facilitated by falling inflation would increase the reinvestment risk for SA cash and make the asset class less attractive as an investment destination.	A global hunt for yield underpins emerging debt markets – in contrast to developed markets, meaningfully positive real yields are available in emerging markets. Well-behaved local inflation also gives bond support. With both ex-ante real yields and the SA/US yield spread premium above historical averages, this points to the ongoing presence of a political risk premium in local yields.

Inflation-linked Bonds	Listed property	Equities
Breakevens are expected to compress further in line with falling inflation. We continue to favour nominal bonds over inflation-linked bonds (ILBs), as lower expected inflation is fundamentally negative for ILBs. The expected real return from nominal bonds is larger than those for ILBs beyond the very short end.	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.	A political risk premium has held SA equities back in recent years, hence political improvement would support returns. Globalisation of the local equity market has made overall SA valuations expensive, but the median SA stock trades in line with EM. The SA ex-Naspers forward price-earnings P/E is at the biggest discount to emerging markets in 15 years.

Global equities	Global bonds	Global cash
The most synchronised global recovery since 2010 has caused the strongest positive profit recovery since then, while central bank equity support should remain in place for most of 2018. The higher-beta equity markets of Japan and emerging markets should benefit most from the global growth recovery, as well as from more supportive monetary policy conditions than prevalent in the US.	Global bond valuations remain extremely expensive, while bond yields can't ignore negative fundamentals indefinitely, viz. rising inflation, rising rates, rising growth and rising net G3 bond supply.	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.

MMI Group Limited
268 West Avenue Centurion 0157 PO Box 7400 Centurion 0046 South Africa
Tel +27 (0)12 671 8911 Fax +27 (0)12 675 3911 client@momentum.co.za www.momentum.co.za
Refer to the Momentum website for directors and company secretary details   Reg. no. 1904/002186/06
Momentum, a division of MMI Group Limited, an authorised financial services and credit provider   FSP6406

Momentum Investments (Pty) Ltd
268 West Avenue Centurion 0157 PO Box 7400 Centurion 0046
www.momentum.co.za/collectiveinvestments
Registration number: 2010/021352/07

momentum
investments