momentum

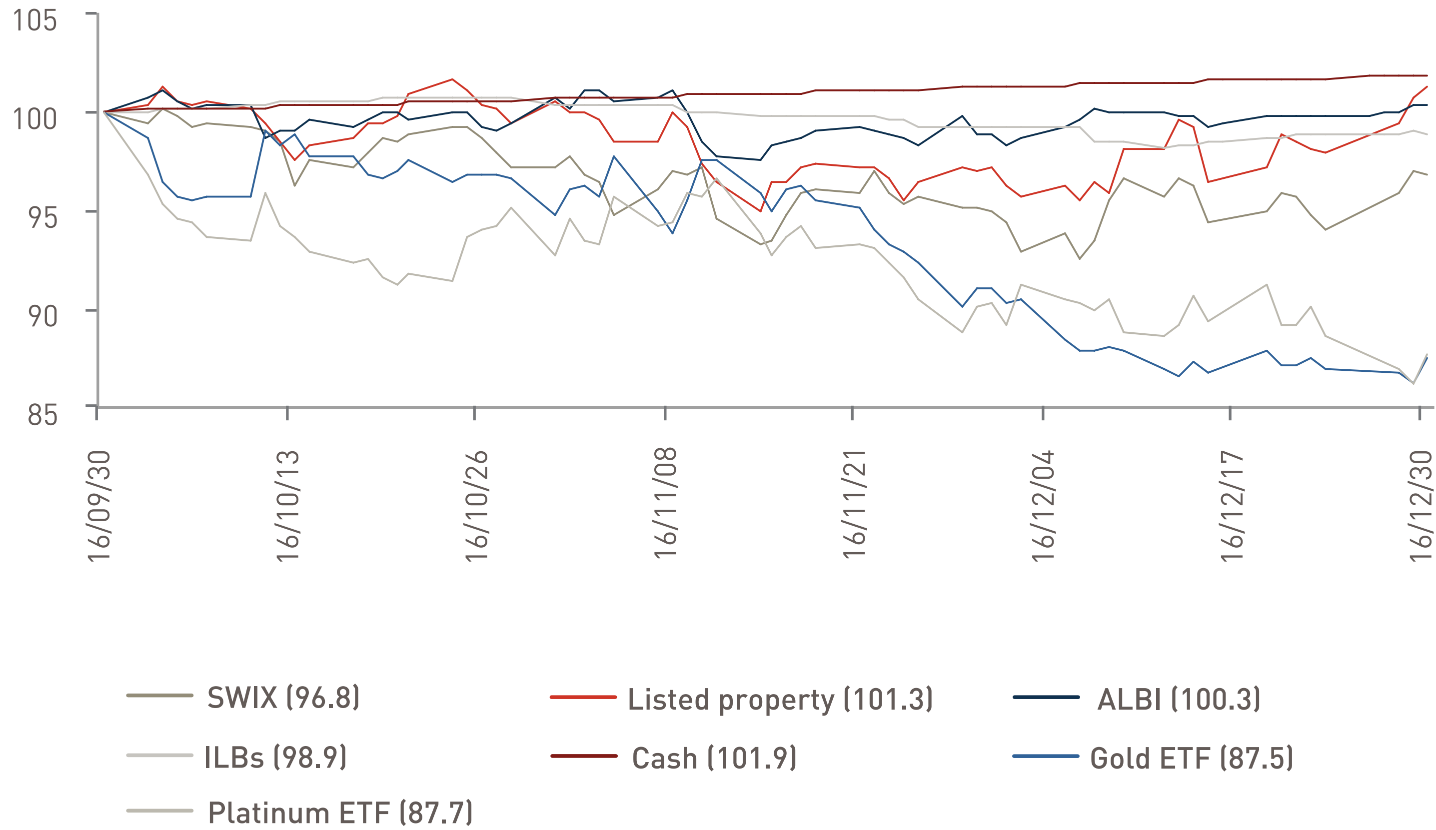
investments

Q4:

houseview

quarter ended 31 December 2016

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 house view at the end of this document.

	One-year projection	Weighting bias
Growth	1.2% (2017 average)	Real economic growth likely bottomed in 2016. Higher anticipated global growth, a mild commodity price uptick, dissipating energy supply constraints and a reversal of the drought impact is expected to drive a marginal uptick in SA growth in 2017.
Inflation[1]	4.8%	Higher rainfall expected to turn food price headwind into a tailwind. Renewed rand weakness, above-inflation wage settlements and stubborn inflation expectations remain key sources of upside risk to the SA inflation trajectory.
Currency[2]	R14.00 per US$1	The rand has benefited from improving fundamentals across commodity exporters, but the currency still faces political risks and vulnerability to foreign capital flows.
Interest rates[3]	6.5% repo (10% prime)	In the absence of renewed rand weakness, an expected moderation in inflation should allow the SA Reserve Bank to ease monetary policy in the second half of the year, while sticky inflation expectations and risks to capital inflows prevent earlier cuts.
Cash[4]	7.7%	Decent risk-adjusted returns are expected in a low-return environment, but re-investment risk rises as the local rate cycle peaks.
Government bonds[5]	11.3%	Despite some erosion from higher core developed market (DM) yields, we still see carry trade support for SA bonds.
Inflation-linked bonds	7.2%	We continue to favour nominal bonds over inflation-linked bonds. Despite narrowing, the inflation premium still looks too high in our view.
Listed property[6]	23.5%	High property returns are expected if the current rating holds, but decent returns are still expected even if the rating folds further.
Equities[7]	14.7%	Higher commodity prices and a marginal uptick in domestic growth are expected to drive the recovery in earnings. Valuations have improved meaningfully.
Global equities[8]	12.1%	Global equities are likely to benefit from reflationary policies and healthy shareholder distributions. Although valuations favour global equities over global bonds, valuations could constrain absolute returns in this asset class.
Global bonds[9]	1.9%	The transition from deflation to reflation should be fundamentally negative for global bonds.
Global cash	3.4%	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... (January 2017 to March 2017)

Growth	Inflation	The currency	Interest rates	Cash	Government bonds
Domestic demand to remain under pressure as poor hiring intentions and household indebtedness burden consumers, while elevated political uncertainty delays fixed investment plans. We anticipate a mild recovery for the year as a whole as higher anticipated global growth, a mild commodity price uptick, dissipating domestic energy supply constraints and a reversal of the drought impact are expected to drive SA growth prospects marginally higher.	The inflationary impact of a previously weaker currency on the consumer basket is expected to have peaked late in 2016. Moreover, an improvement in maize planting conditions should drive inflation lower this year. Nevertheless, renewed rand weakness (in response to resurgent political tensions or adverse changes to global trade policy), above-inflation wage settlements and stubborn inflation expectations remain key sources of upside risk to the inflation profile.	The rand has benefited from improving macro fundamentals across commodity-exporting countries. However, elevated domestic political tensions and uncertainty surrounding the timing and extent of United States (US) President Trump's fiscal and trade policies leaves the rand vulnerable to a potential reversal in foreign capital inflows.	In our view, the hurdle to interest rate cuts remains high in the near term. Inflation expectations continue to trend close to the top end of the inflation target band, while the domestic currency remains vulnerable to a potential reversal in foreign capital inflows. Nonetheless, an expected moderation in inflation should allow the SA Reserve Bank to ease monetary policy in the second half of the year.	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.	Unlike developed markets (DM), central banks across emerging countries have leeway to cut interest rates in response to falling inflation. Despite some erosion from higher core DM yields, SA bonds remain supported by the carry trade.

What we expect will happen... (January 2017 to March 2017)

Inflation-linked bonds	Listed property	Equities	Global equities	Global bonds	Global cash
Despite narrowing, the inflation premium remains too high, leaving us favouring nominal bonds over inflation-linked bonds. Based on our view on domestic inflation, inflation carry is expected to dwindle going forward.	Listed property's relative valuation against nominal bonds improved meaningfully over the course of 2016. We expect high property returns if the current rating holds, while decent property returns are still likely even if the rating folds further.	Local equity valuations have improved meaningfully, but remain expensive relative to its own history. Higher commodity prices and a recovery in domestic growth are expected to drive an anticipated recovery in earnings.	Global equities should benefit from reflationary policies and healthy shareholder distributions, but valuations could constrain absolute returns. Within DM equities, Euro Area and Japan are expected to outperform the US, while signs of trade protectionism and US dollar strength could dilute gains in emerging market equities, despite the benefit of a reflationary environment.	Even after the recent sell off in yields, global bonds are not cheap relative to their own history or global equities. In addition, the transition from deflation to a reflationary environment should be fundamentally negative for global bonds.	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.

Disclaimer:
The document should not be seen as an offer to purchase any specific product and is not to be construed as advice or guidance in any form whatsoever. Investors are encouraged to obtain independent professional investment advice before investing in any of Momentum Asset Management (Pty) Ltd's ("MomentumAM") products. Investors should be aware that investing in a financial product entails a level of risk which depends on the nature of the investment. The merits of any investment should be considered together with the investor's specific risk profile and investment objectives. Past performance is not necessarily a guide to future performance. Fluctuations in exchange rates and underlying investments may cause the value of international investments or underlying investments, if included in the mandate, to go up or down. Illustrations are not guaranteed but are for illustrative purposes only.

The Conflict of Interest Management Policy and the Complaints Resolution Policy and Procedure may be accessed on www.momentuminv.co.za or may be requested from the Compliance Department. Some authorised representatives of MomentumAM may be rendering financial services under supervision. MomentumAM may not request or induce in any manner a client to waive any right or benefit conferred on the client by or in terms of any provision of the FAIS General Code of Conduct, or recognise, accept or act on any such waiver by the client.

Momentum Asset Management (Pty) Ltd
268 West Avenue Centurion 0157 PO Box 7400 Centurion 0046
www.momentum.co.za/assetmanagement
Registration number: 1987/004655/07, VAT No. 4200149096, is an authorised financial services provider, FSP licence number 623 and an approved Retirement Fund Administrator (No. 24/34).