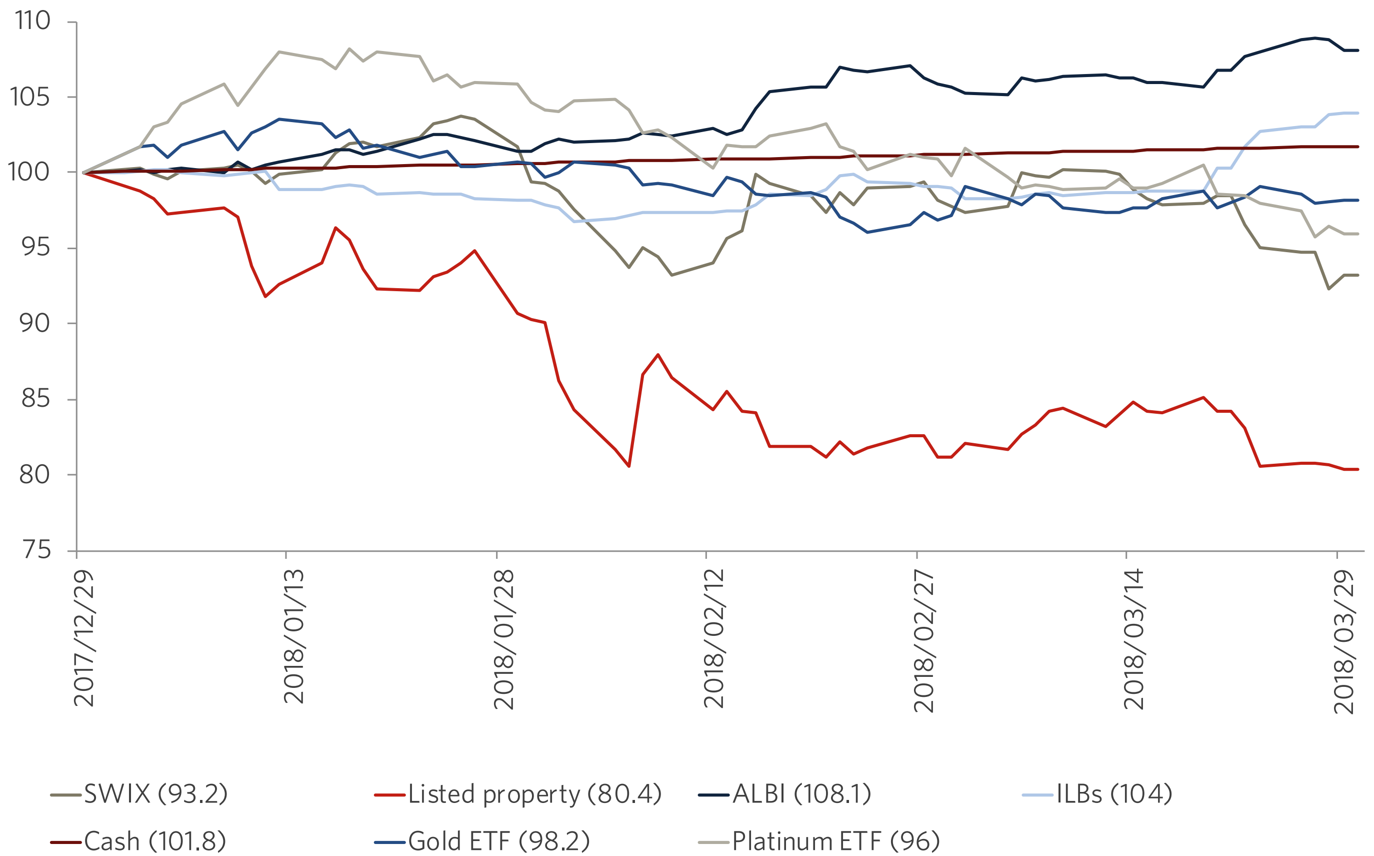
Houseview

April 2018

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 (Q2 2018 – Q1 2019)	1.6%	Sustained business and consumer confidence is necessary for a revival in investment and consumption spend.
Inflation [1]	4.7%	Likely near a bottom, but projected to remain well within the target band for the foreseeable future.
Currency [2]	R12.45 per US$1	Positive political and economic momentum has 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)	A closing output gap and rising inflation, to above the mid-point of the target band in the medium term, limits room for additional monetary policy easing.
Cash [4]	7.1%	Domestic cash is expected to deliver comparable absolute returns to domestic fixed income, but superior risk-adjusted returns.
Government bonds [5]	7.2%	Although a global hunt for yield should continue to underpin emerging market bond markets, there should be limited further local inflation support for the SA bond market during the remainder of 2018.
Inflation-linked bonds (ILBs)	6.5%	The expected real return from nominal bonds remains larger than those for ILBs beyond the very short end of the maturity spectrum.
Listed property [6]	14.6%	After a massive Ramaphosa/Resilient-driven derating versus bonds in the past four months, we expect good property returns from the current valuation, even with only a slight rerating versus bonds.
Equities [7]	12.1%	The 'Ramaphoria' effect should support the profit growth of domestically oriented companies in SA, while expected moderate rand weakness should enhance globally generated profits.
Global equities [8]	12.6%	A move from a 'goldilocks' environment for equities (strong growth and low inflation) to reflation (strong growth and rising inflation) during the last phase of the equity bull market should become less positive for equities and will likely correspond with higher volatility.
Global bonds [9]	5.6%	Negative fundamentals and very expensive valuations should continue to constrain the returns from global bonds.
Global cash	7.9%	While interest rates are rising in the US, globally, interest rates are still tracking close to historical lows. As such, we expect the rand view to remain the dominant driver of local currency returns for global cash.

[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 April 2018 to June 2018)

Growth	Inflation	Currency
Recent upward growth revisions suggest the domestic economy escaped a technical recession in 2017. Although a sharp revival in sentiment is encouraging, a marked growth recovery depends on sustained higher levels of confidence, based on a continued implementation of structural reforms.	Underlying measures of inflation and inflation expectations are well-contained and should help headline inflation remain comfortably within the target band for the foreseeable future, even after factoring in a mildly depreciating currency trajectory from current levels. Although inflation risks have abated since the start of the year, wage agreements in the public sector and international oil prices continue to pose upside risks to the inflation trajectory.	Higher commodity prices, a weaker United States (US) dollar and renewed sentiment remain in favour of a stronger rand. However, emerging market (EM) currencies remain vulnerable to a sharper-than-expected slowdown in China or a faster pace in developed market monetary policy tightening. A perception of a shift to the left in SA policy (including a heated land reform debate) could see the rand weakening in isolation.
Interest rates	**Cash**	**Government bonds**
More aggressive easing in monetary policy is unlikely given a closing output gap, the expected rise in inflation projections above the mid-point of the target band in the medium-term and lingering political uncertainty, as the 2019 national elections draw near.	Domestic cash is expected to deliver comparable absolute returns to domestic fixed income, but superior risk-adjusted returns. However, re-investment risk is set to increase with any further reduction in local interest rates.	The global hunt for yield continues to underpin EM debt markets – unlike in developed markets (DMs), meaningfully positive real yields are available in EMs for global investors. Unfortunately, with SA inflation bottoming, there should be limited further inflation support for the SA bond market during the remainder of 2018. In addition, ex-ante real yields and the SA/US yield spread premium have now fallen to around historical averages, likely limiting future capital returns for local bonds.
Inflation-linked bonds	**Listed property**	**Equities**
With break-evens likely to expand with rising inflation, the fundamental underpin for SA inflation-linked bonds (ILBs) should improve going forward. However, the expected real return from nominal bonds remains larger than those for ILBs beyond the very short end of the maturity spectrum.	The combination of a large Ramaphosa-driven bond market rally since November last year (yields down 125 basis points) and the big Resilient-driven property sector sell-off since then have caused the listed property sector to now trade at the cheapest relative rating to local bonds in five years. To put this into context, the 39% relative derating of listed property to bonds in the four months since November 2017 has surpassed the 30% relative derating seen in the four months to December 2008 during the global financial crisis.	With the 'Ramaphoria' effect continuing to underpin positive consumer, business and investor sentiment, it is not a surprise that SA's leading economic growth indicators are pointing upwards. The resultant expected corporate sales and margin recovery should support the profit growth of domestically oriented companies in SA, while expected moderate rand weakness should enhance globally generated profits.
Global equities	**Global bonds**	**Global cash**
There are, as yet, few signs of the imminence of an equity bear market, although a move from a 'goldilocks' environment for equities (strong growth and low inflation) to reflation (strong growth and rising inflation) during the last phase of the equity bull market should be less positive for equities and will likely correspond with higher volatility.	The late-cycle fundamentals of positive growth momentum, rising inflation, fiscal stimulus and increasing net bond supply remain negative for bonds. In addition, global bond valuations remain very expensive.	While interest rates are rising 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 for global cash.

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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
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Momentum Investments (Pty) Ltd
268 West Avenue Centurion 0157 PO Box 7400 Centurion 0046
www.momentum.co.za/collectiveinvestments
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