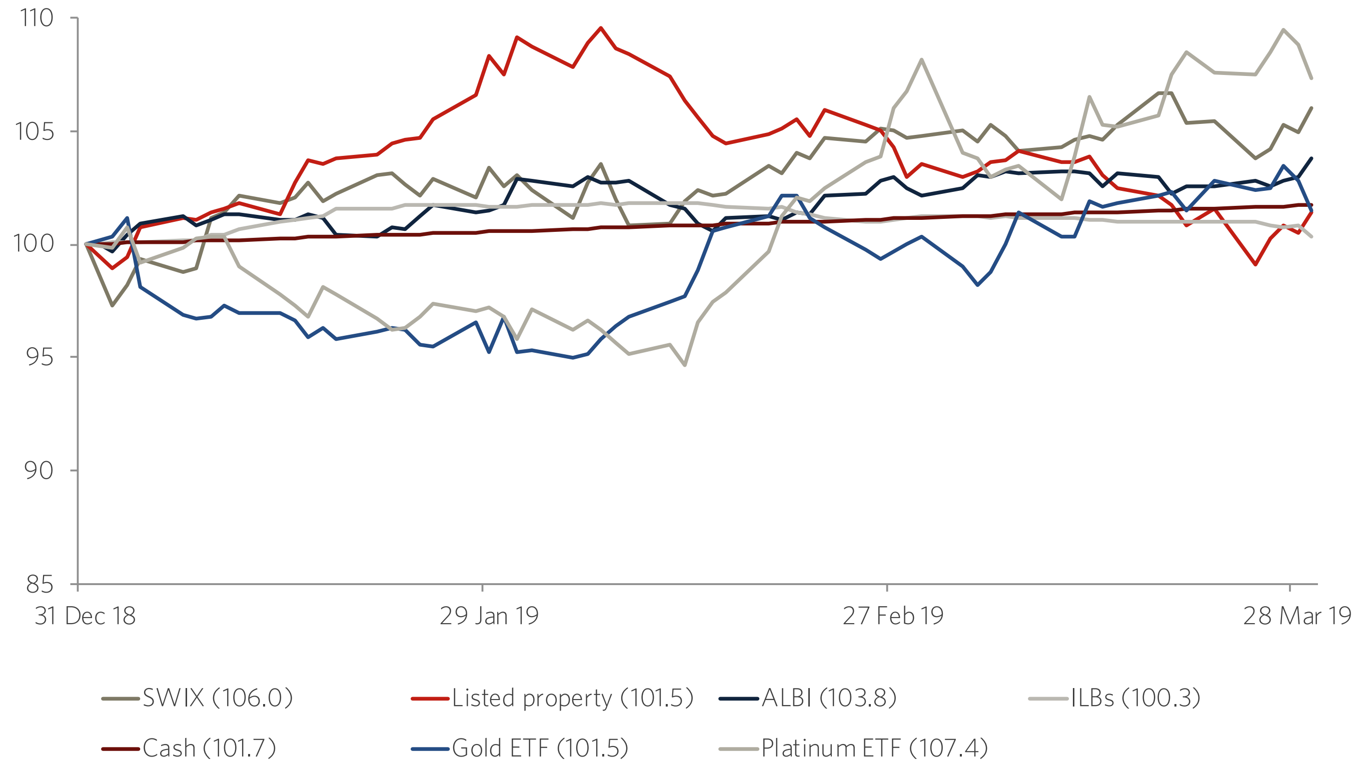
Houseview

April 2019

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 house view at the end of this document.

	One-year projection	Weighting bias
Growth (Q2 2019 – Q1 2020)	1.4%	Further bouts of loadshedding could hinder shorter-term growth prospects, while the implementation of some regulatory and governance reform should underpin a modest growth recovery in the medium term.
Inflation [1]	5.3%	Muted underlying measures of inflation are suggestive of little demand-pull pressures. Muted global inflation and lower services inflation pose downside risks to the inflation outlook, while administered prices and the rand still act as the major upside threats.
Currency [2]	R13.82 per US$1	While the rand could strengthen into elections in the short term, poor macro fundamentals leave the local unit vulnerable to external shocks and a deterioration in emerging market (EM) sentiment in the medium to longer term.
Interest rates [3]	6.75% repo (10.25% prime)	If the downward trajectory in inflation expectations is sustained, it should remove the South African Reserve Bank's (SARB) tightening bias, resulting in a steady interest outlook.
Cash [4]	8.1%	Current ex-ante real cash yields look attractive on a risk-adjusted basis, tracking at 42 basis points above their post-inflation-targeting average.
Government bonds [5]	9.4%	Real yields in SA appear very attractive relative to the country's investment grade peer group. SA's yield spread premium with the United States (US) is currently 81 basis points higher than the average recorded since inflation targeting.
Inflation-linked bonds (ILBs)	7.5%	Break-evens are likely to expand with rising domestic inflation in 2019, but nominal bonds are relatively more attractive on a one-year view.
Listed property [6]	13.8%	Good property returns are expected from the low base created in 2018. The asset class is at its cheapest against bonds in ten years.
Equities [7]	13.8%	The trailing price to earnings (P/E) ratio excluding Naspers remains on the cheap side of fair value. Historical data supports prospective SA equity returns from the current low five-year trailing return level.
Global equities [8]	7.0%	Higher equity volatility should be anticipated, but a rethink in the US Federal Reserve's (Fed) monetary policy stance could support good equity performance for some time after the inversion of the yield curve.
Global bonds [9]	2.5%	Equity risk premiums favour equities over bonds globally, but more so outside of the US. Equities look cheap relative to bonds on a valuation basis.
Global cash	0.7%	In the absence of meaningful rand weakness, global cash returns will likely not be meaningful.

[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 2019 to June 2019)

Growth

Further bouts of loadshedding could hinder near-term growth prospects, while the implementation of some regulatory and governance reform should underpin a modest recovery in the medium term. For consumers, dampened confidence, higher taxes and tariffs should detract from positive wage and credit growth, while businesses are expected to defer investment spend until demand and regulatory and economic certainty improves.

Inflation

There are few signs of demand-pull inflationary pressures in the local economy. Lower services and underlying inflation, together with muted global price pressures, pose downside risks to the inflation trajectory, while administered prices and the rand still act as the main upside risks.

Currency

Even though the rand could strengthen into the elections, particularly if a favourable outcome for the future of growth-enhancing structural reform arises, poor macro fundamentals continue to leave the local unit vulnerable to external shocks and a deterioration in EM-wide sentiment.

Interest rates

Previously sticky inflation expectations of the price setters in the economy (namely businesses and labour) have finally adjusted lower. If this downward trajectory is sustained, this should remove the SARB's tightening bias and allow for interest rates to remain steady. It is likely still too early to lower the repo rate in the interest of maintaining an attractive real interest rate profile and to counter loose fiscal policy.

Cash

Current ex-ante real cash yields look attractive on a risk-adjusted basis. Yields are tracking at 42 basis points above their post-inflation-targeting average.

Government bonds

SA boasts the highest real yield of its investment grade peer group. Ex-ante real yields are 95 basis points above the post inflation-targeting average and the SA/US yield spread premium is currently 81 basis points higher than the average since inflation targeting.

Inflation-linked bonds (ILBs)

Break-evens are expected to expand in line with a rising inflation trajectory, but nominal bonds are favoured on a one-year view relative to the expected return projected for ILBs.

Listed property

Listed property is at its cheapest rating against SA government bonds in ten years. Good property returns are expected from the low base created in 2018, even at an unchanged relative rating to bonds and real distribution growth of negative 2%.

Equities

Most shares are trading significantly below their highs after performing poorly for the past five years. Historical data supports prospective SA equity returns from the current low five-year trailing return level. The trailing price to earnings (P/E) ratio excluding Naspers remains on the cheap side of fair value.

Global equities

Higher equity volatility should be anticipated, but a rethink in the US Fed's monetary policy stance could support good equity performance for some time after the inversion of the yield curve. Traditionally, the US equity market has peaked 13 months after the inversion of the yield curve and an eventual recession has typically followed the inversion by 18 months.

Global bonds

Equity risk premiums favour equities over bonds globally, but more so outside of the US. US equities look fair to slightly cheap relative to bonds on a valuation basis, with relative valuations even more in favour of equities outside the US.

Global cash

A notable pivot in the Fed's stance on monetary policy in the past quarter suggests the next move in interest rates is more likely to be down than up. In the absence of meaningful rand weakness, global cash returns will likely not be meaningful.

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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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