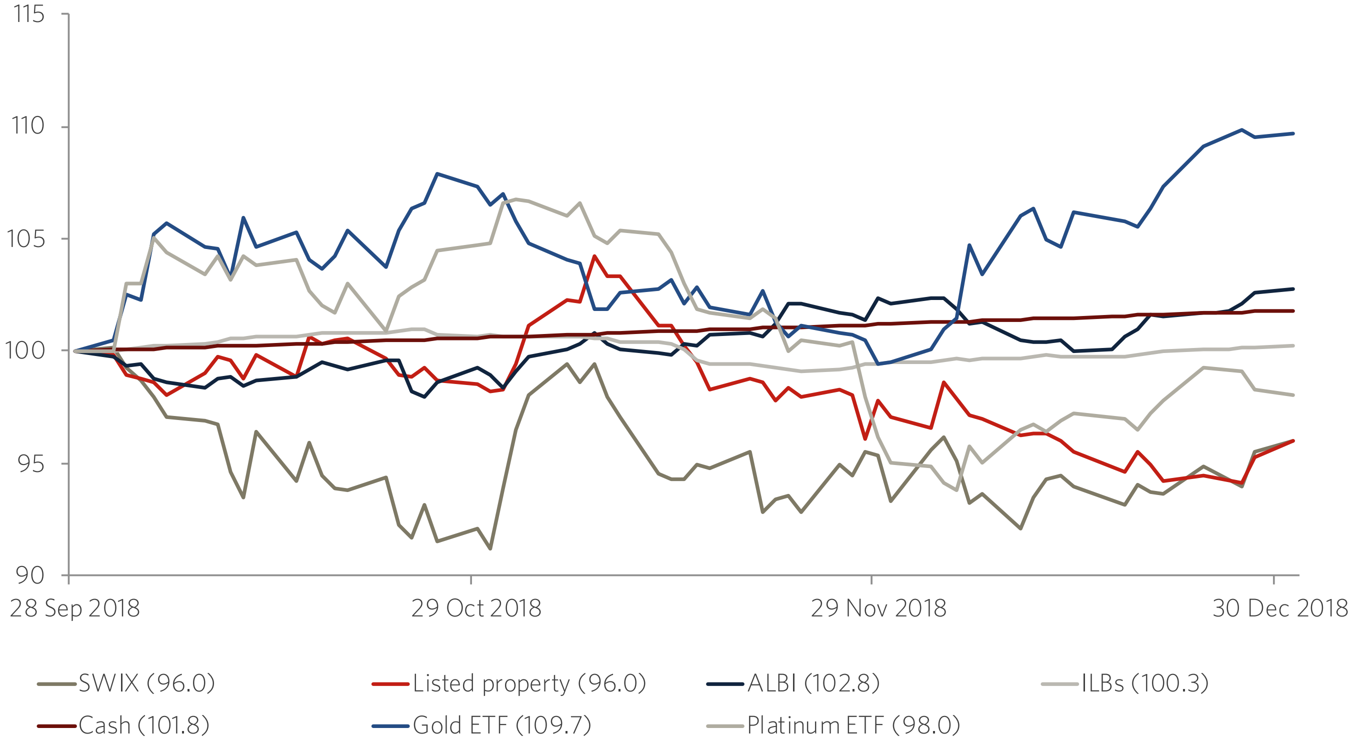
# Houseview

January 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 houseview at the end of this document.

| | One-year projection | Weighting bias |
|---|---|---|
| Growth (Q1 2019 – Q4 2019) | 1.4% | The political realities of a fractious ruling party have stymied the pace of progress in South Africa (SA). While government is working to fix some challenges, policy uncertainty in a number of areas has suppressed a recovery in confidence. |
| Inflation [1] | 5.2% | Little sign of underlying inflationary pressures. However, the rand, international oil prices and electricity tariffs remain upside threats to the inflation trajectory. |
| Currency [2] | R13.77 per US$1 | A weakening in the country's terms of trade (export prices relative to import prices) and authorities' slow economic progress in alleviating the country's employment and poverty challenges will cap rand appreciation prospects in the medium term. |
| Interest rates [3] | 7.0% repo (10.5 % prime) | The SA Reserve Bank's (SARB) preference to anchor inflation expectations closer to the midpoint of the target will allow for more flexibility in dealing with exogenous shocks. With an early interest rate hike in place, there is little pressure to engage in an aggressive hiking cycle. |
| Cash [4] | 7.6% | Current real cash yields look attractive on a risk-adjusted basis. Yields are currently tracking at 43 basis points above their post-inflation-targeting average. |
| Government bonds [5] | 10.2% | Current ex-ante real government bond yields are running at 115 basis points above their post-inflation-targeting average. The yield spread premium with the US has once again shifted higher. |
| Inflation-linked bonds (ILBs) | 7.6% | Break-evens are likely to expand with rising domestic inflation in 2019, but nominal bonds are more attractive on a one-year view. |
| Listed property [6] | 17.2% | Good property returns are expected from the low base created in 2018. The asset class is at its cheapest against bonds in seven years. |
| Equities [7] | 14.8% | SA equities have de-rated over the past five and a half years. Moreover, sentiment is close to panic territory, which has, historically, been good for future returns. |
| Global equities [8] | 9.9% | The main threat to risk assets is a decline in global liquidity, but valuations still favour global equities over global bonds for now (although less so in the United States (US)). |
| Global bonds [9] | 3.8% | Higher global bond yields are anticipated, as core inflation shifts higher in response to rising wage growth. |
| Global cash | 5.6% | Higher US interest rates and US dollar weakness are expected to be the main drivers of global cash 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 2019 to March 2019)

### Growth

In the likely absence of another commodity or credit boom, reinvigorating confidence will be an important driver for growth. Consumers' ability to spend should lift marginally on reduced fiscal drag adjustments, an improvement in growth in household net wealth and an uptick in the household credit impulse. However, for corporates to play a more active role in shaping the economy and creating jobs, government must pursue efforts to improve the ease of doing business.

### Inflation

Although subdued services inflation, muted food price pressures and a dulled rate of currency pass-through have kept inflation outcomes surprising to the downside in recent months, the rand, international oil prices and electricity tariffs are still viewed as the major upside threats to the inflation outlook. Recent dry conditions in the country's maize-producing areas are likely to add pressure to food prices later in the year.

### Currency

The risk of a sovereign downgrade by Moody's and poor macro fundamentals leave the rand vulnerable to a shakier global environment and a deterioration in sentiment towards perceived-riskier emerging markets (EMs). A brief strengthening in the rand, in reaction to an expected market-friendly outcome in the national elections in 2019, is likely. However, the rand should experience a mild deterioration in the medium term in response to a weakening in the country's terms of trade and slow economic progress in alleviating the country's challenges.

### Interest rates

With an early interest rate hike already in place, this reduces the need for the SARB to engage in an aggressive interest rate hiking cycle in the absence of a faster-than-anticipated normalisation of monetary policy in developed markets (DMs) or broad-based negative sentiment towards EMs.

### Cash

Current real cash yields look attractive on a risk-adjusted basis. Yields are currently tracking at 43 basis points above their post-inflation-targeting average.

### Government bonds

Real yield differentials between EM and DM remain attractive. SA yields are already discounting a rise in domestic inflation. Current ex-ante real bond yields are running at 115 basis points above their post-inflation-targeting average and the yield spread premium with the US has once again shifted higher.

### 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 seven years. Good property returns are expected from the low base created in 2018. Although there is downward pressure on escalations and distribution growth, the outlook for retail supply and vacancies (outside of office) looks less problematic.

### Equities

SA equities have de-rated over the past five and a half years as share prices have lagged earnings by 11% since mid-2017. Sentiment is close to panic territory, which has been good for future returns historically. The trailing price-to-earnings ratio, excluding Naspers, has shifted to the cheaper side of fair value.

### Global equities

The main risk to global risk assets is a decline in global liquidity. Valuations still favour global equities over global bonds, but less so for the US. Even though growth in forecasted earnings per share has been cut aggressively, profit cuts have not always been fatal for global equity performance historically.

### Global bonds

Global bond yields have dipped recently on a positive oil price shock and prospects for lower growth. However, higher global bond yields are anticipated as core inflation shifts higher in response to rising wage growth.

### Global cash

Interest rates are approaching neutral in the US. But higher US interest rates and US dollar weakness are expected to be the main drivers of global cash 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 Investments (Pty) Ltd) 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.

Reasonable steps have been taken to ensure the validity and accuracy of the information in this document. However, Momentum Investments (Pty) Ltd does not accept any responsibility for any claim, damages, loss or expense, howsoever arising out of or in connection with the information in this document, whether by a client, investor or intermediary. The content used in this document is sourced from various publications, the Internet and Momentum Investments (Pty) Ltd. For further information, please visit us at www.momentuminv.co.za.

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