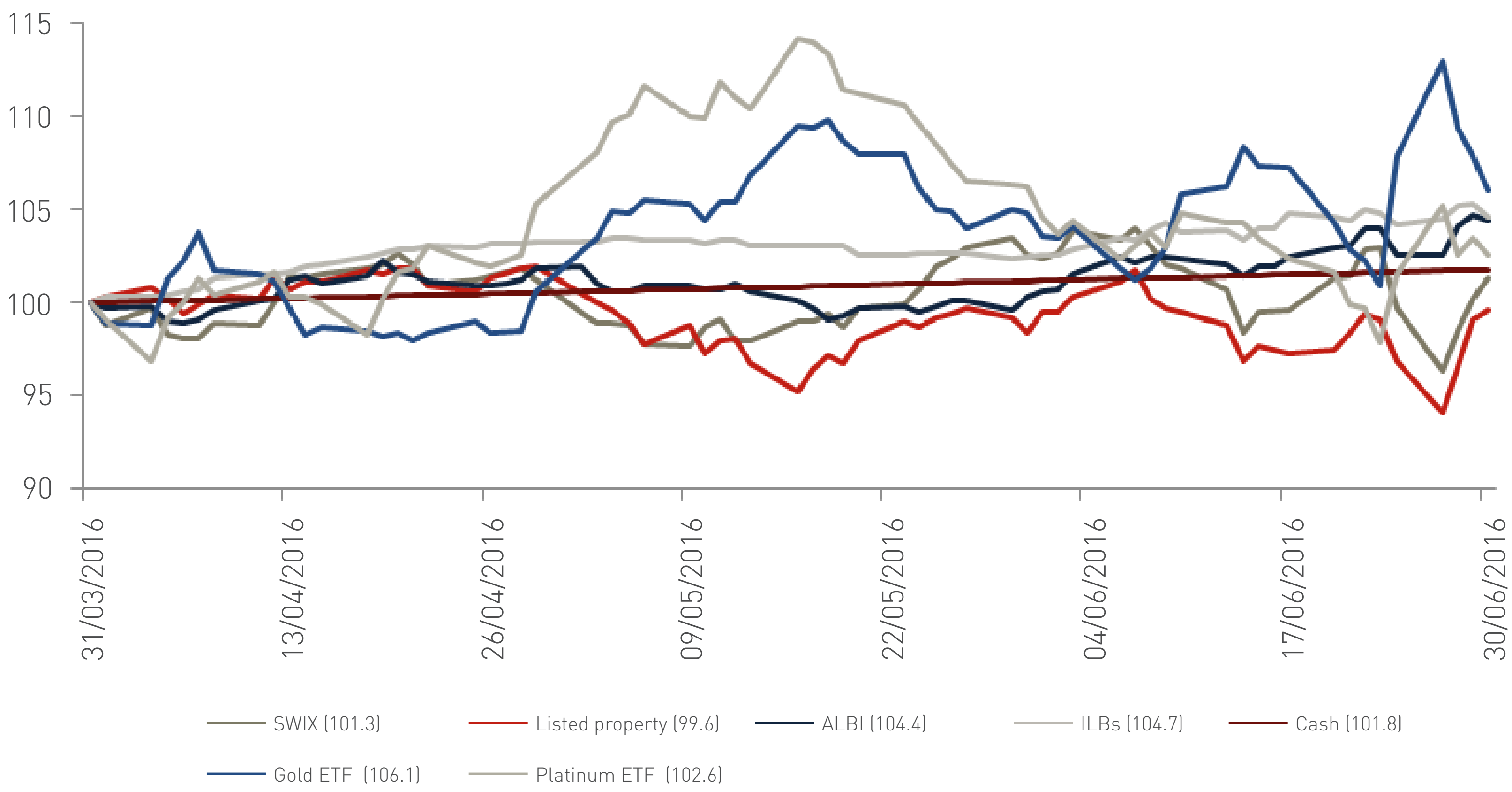
momentum investments

Q2:

houseview

quarter ended 30 June 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 houseview at the end of this document.

	One-year projection	Weighting bias
Interest rates[1]	7.5% repo (10.75% prime)	While lacklustre growth and the expectation of a decelerating inflation trajectory in 2017 suggest a narrowing window for further interest rate increases, SA's sizeable twin deficits and sticky inflation expectations point to a possible rate rise before this year is up.
Inflation[2]	5.8%	Previous unfavourable movements in the currency and sharply higher food prices are expected to propel headline inflation higher over the course of the next two quarters, before staging a recovery in 2017 as better weather conditions drive food inflation lower.
Currency[3]	R16.35 per US $1	Soft commodity prices, vulnerability to capital flows and poor domestic macro fundamentals could keep the currency weaker in the near term, whereas firmer commodity prices are likely to drive a rand recovery over the medium-term.
Cash[4]	7.8%	Cash returns are attractive in relative risk-adjusted terms against the low absolute returns expected from the other asset classes and against the backdrop of a rising domestic interest rate cycle.
Government bonds[5]	7.4%	With emerging market and domestic risk factors having pushed local bond spreads to multi-year highs, there is now meaningful carry trade support for SA government bonds.
Inflation-linked bonds (ILBs)	6.5%	A too-high inflation premium currently discounted by inflation-linked bonds (ILBs) point to downside return risk. Looking expensive against vanilla bonds.
Listed property[6]	-1.6%	Expected to de-rate from current expensive valuation levels. Fundamentally, the sector faces headwinds from lower domestic growth and a further potential interest rate hike, which should negatively impact occupancy rates and trading densities.
Equity[7]	10.6%	Earnings recovery remains dependent on a sustainable rally in commodity prices. On a risk-adjusted basis, equity returns look less favourable against other asset classes, unless an unchanged rating is assumed.
Global equity[8]	14.6%	Supportive policy and improving macro data remains supportive of global equities, while relative valuations remain superior to fixed interest and cash.
Global bonds[9]	6.1%	Although global bonds currently benefit from a low global risk appetite, extreme valuations are likely to constrain longer-term returns.
Global cash	8.6%	Globally, interest rates are still tracking at historical lows. As such, we expect the rand view to be the dominant driver of local currency returns.

1 Based on our view of projected inflation and growth.
2 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.
3 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.
4 Based on the current level of interest rates.
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... (Quarter July 2016 to September 2016)

Interest rates	Inflation	The currency	Cash	Government bonds	Inflation-linked bonds
A still-rising inflation trajectory, stubbornly-high inflation expectations and recent comments by the South African Reserve Bank (SARB) - suggesting that monetary policy remains highly accommodative - imply that a further 25 basis point hike later this year is still likely. However, the SARB is unlikely to raise interest rates more aggressively due to subdued growth expectations and depressed confidence levels flagging a shallow growth recovery.	Although subdued demand has limited the impact of currency pass-through, resulting in inflation either meeting expectations or surprising positively over 80% of the time since January 2015, drought-inflicted food price shocks are likely to drive inflation higher over the remainder of the year. Nonetheless, an expectation of better weather conditions should lead food (and headline) inflation lower over the course of 2017.	Although hopes of further global monetary policy easing have driven emerging market currencies firmer since Brexit, near-term risks prevail. The lingering risk of a credit rating downgrade and soft commodity prices point to the likelihood of the SA rand trading with a weakening bias over the next year. Thereafter, the rand should strengthen in line with currencies of other net commodity-exporting nations as the commodity supply-demand imbalance corrects over the medium-term.	Cash returns are attractive in relative risk-adjusted terms against the low absolute returns expected from the other asset classes and against the backdrop of a rising domestic interest rate cycle.	With emerging market and domestic risk factors having pushed local bond spreads to multi-year highs, there is now meaningful carry trade support for SA government bonds.	Inflation-linked bonds (ILBs) are currently looking very expensive relative to vanilla bonds, given that ten-year break-evens are currently pricing in a too high inflation premium.

What we expect will happen... (Quarter June 2016 to September 2016)

Property	Local equities	Global equities	Global bonds	Global cash
Listed property is expected to de-rate from current expensive valuation levels. Fundamentally, the sector faces headwinds from lower growth and a further potential interest rate hike, which should negatively impact occupancy rates and trading densities. Barring any financial engineering, this should lead to a slowdown in distribution growth per share.	Earnings recovery remains dependent on a sustainable rally in commodity prices. Currently, a firm US dollar and extended speculative long commodity positions are a risk. SA equities are expensive relative to their own history and relative to other asset classes. On a risk-adjusted basis, equity returns look less favourable against other asset classes, unless an unchanged rating is assumed.	Supportive policy and improving macro data remains supportive for global equities, while relative valuations remain attractive. With equities yielding more than government bonds in all major developed markets, global equities can now be viewed as both a growth and income asset class.	Return differentials are very much in favour of US treasuries relative to German bunds. As a result, European investors have continued to pile into US treasuries, driving yields to all-time lows. Although global bonds currently benefit from a low global risk appetite, extreme valuations are likely to constrain longer-term returns and offer less long-term value relative to equities.	Globally, interest rates are still tracking at historical lows. As such, we expect the rand view to be the dominant driver of local currency returns.

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Momentum Asset Management, 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).

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