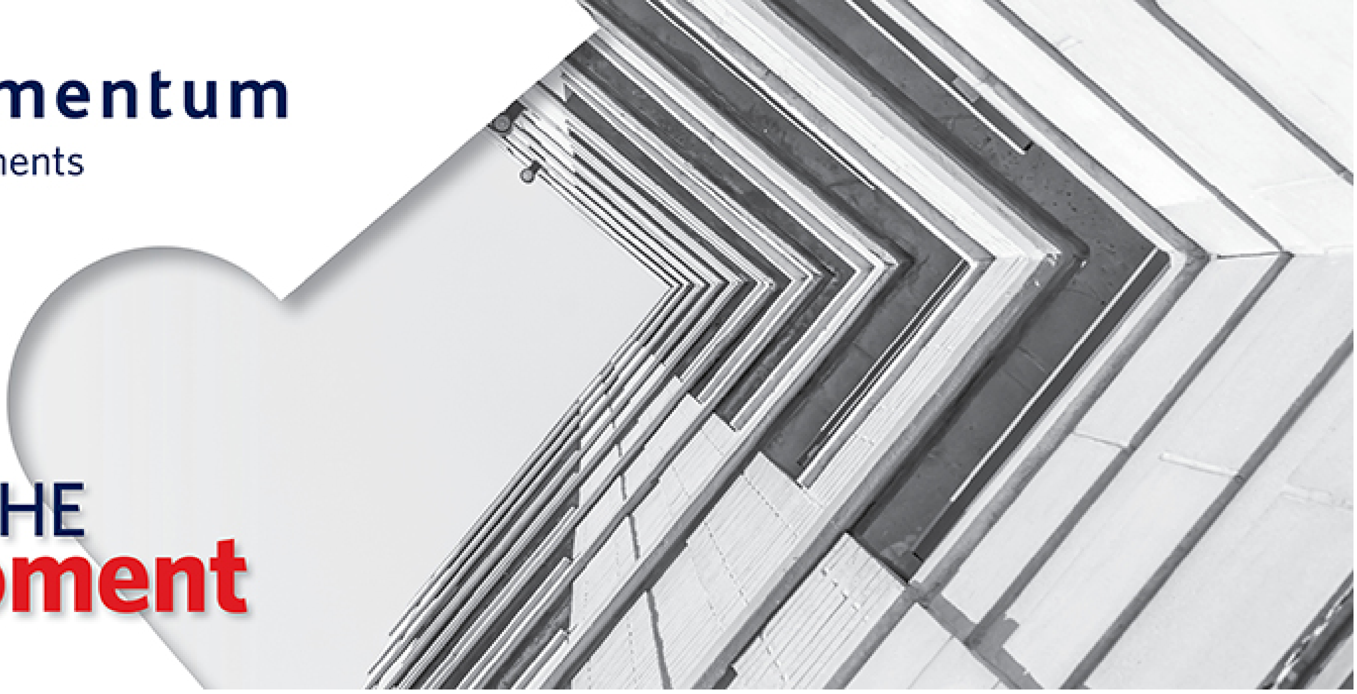
momentum
investments



IN THE
moment

How a diversified solution protects you in a crisis

As the COVID-19 crisis developed and panic gripped markets, growth asset classes sold off aggressively in March, with a flight to cash and perceived safe-haven asset classes such as US treasuries.

"The pace and magnitude of the selloff, moving from a bull to bear market, was unprecedented. It took the S&P 500 index a mere 16 days to lose more than 20%," said Jako De Jager, head of retail portfolio solutions at Momentum Investments.

Momentum Investments held its first virtual Outcome Matters event for 2020 on 13 May 2020, and De Jager provided an overview of how the investment team positioned their multi-asset-class funds to weather the economic storm.

"This led to global risk appetite for emerging markets souring, triggering significant sell-offs in emerging-market equities and bonds, which in turn weighed negatively on emerging-market currencies. Matters were exacerbated in South Africa with Moody's downgrading the sovereign rating of the country to junk," he added.

De Jager elaborated on the framework they use to construct their investment funds. "A central philosophy of our approach is to guard against knee-jerk reactions and stay the course. The markets have recovered almost 20% off the lows seen in March 2020, which underscores the value of this philosophy."

"Going into the crisis, we were positioned neutral on growth versus defensive asset classes, but within growth assets, we felt more comfortable with an overweight position on local equity compared to local property," De Jager explained. "While this positioned our funds better in terms of our risk analysis, we were also overweight cash relative to nominal and inflation-linked bonds, as this provided us with a margin of safety. Finally, given the well-documented risks within the South African economy, we were overweight global compared to local asset classes."

Using the Momentum Focus and Target Fund of Funds as examples, De Jager explained that the team uses an outcome-based investing approach to construct funds, with asset allocation guided by clients' risk appetites and investment objectives. "Higher risk funds could, of course, be more volatile in the short term, while more defensive funds, though not immune to market shocks, do provide some cushioning and tend to be less volatile in the short term."

De Jager also provided detail on some of Momentum Investments' active fund management activities, as they navigated through the eye of the storm. "We have further reduced our property exposure, given that the outlook for local property has deteriorated even more since the start of the year."

"From a currency perspective, we believe the rand has been oversold and, to be prudent, we switched some of our global holdings into rand-based defensive asset classes.

We have also implemented a currency hedge on a portion of the remaining global asset classes, should the rand strengthen from the current oversold levels."

Looking ahead, De Jager said the team spends significant time trying to understand the various scenarios, which could play out in the global economy in the next six to 18 months. "Forecasting with complete certainty is difficult, if not impossible, but what has been true in past crises is that markets do not reflect fundamentals. While we have experienced a V-shaped recovery in terms of equity markets, we have no clear idea yet of what that will look like from an economic recovery perspective.

"For a V-shaped economic recovery, we would need some form of vaccine and for lockdowns to be lifted very quickly, without any second-round infections. This is the best-case scenario, but we think there is a low probability of this scenario playing out in reality."

A much more realistic scenario, according to De Jager, is a U-shaped recovery, with real economic recovery only happening in the final quarter of 2020. "Our bear-case scenario is a protracted U- or W-shaped recovery, where the economy recovers, but reinfections result in the implementation of additional lockdowns down the line. Economic recovery under this scenario only takes place in 2021."

In closing, De Jager noted that from a multi-asset-class fund perspective, it is important to understand how these funds have reacted in the past to market disruptions. "As no market crisis is the same, the path to recovery may differ. What is the same, however, is that there will be a recovery. While it may take time, staying the course ultimately remains the best form of defence," he concluded.