momentum
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Momentum Investments Classic Factor Portfolio Range

quarterly commentary to end March 2020

Assessing investment returns in an outcome-based investment context

The Momentum Investments Classic Factor Portfolio Range is managed in terms of our outcome-based investing philosophy, where we design the portfolios to maximise the probability of achieving the inflation-plus return target of each portfolio over the relevant period, while continuing to meet the portfolios' risk targets. To achieve this, our portfolio management approach conceptually starts at an (multi) asset class level, then progresses to the identification of specific investment strategies within each asset class (if appropriate) and finally ends up in the selection of (potentially more than one) investment mandates awarded to investment managers that will implement the desired investment strategies.

Given this outcome-based investing framework, when assessing the returns of the Momentum Investments Classic Portfolio Range, it is important to start with looking at the returns from the portfolios against their inflation-related targets. This allows us to answer the question: did we achieve our target over the most recent relevant period? We then assess these returns relative to this target in terms of the following:

- The returns provided by the asset classes included in the portfolios
- The returns from the building blocks that provide the asset class exposure for the portfolio against their asset class (or strategic) benchmark. This in turn is explained by:
    - The returns from the investment strategies (or styles) used in the building block (if any)
    - The returns from the investment managers that were awarded the mandates used in each of the building blocks

This quarterly review thus starts with the assessment of the investment returns generated by the portfolios against their targeted investment outcomes over the most recent periods. The next section focuses on the economic environment and the returns generated by the asset classes (beta) for the most recent quarter, measured against our average real return expectations for each asset class. We review the returns from the building blocks and the underlying investment managers against their strategic investment benchmarks.

Momentum Investments Classic Factor Portfolio Range returns

The respective inflation objectives of the portfolios have been difficult to attain, given the low return from growth asset classes for the last five years. However, the portfolios managed to outperform their respective benchmarks for most periods.

Economic overview

News of the emergence and worldwide spread of the COVID-19 virus has resulted in a very negative investment effect across global financial markets. The result of uncertainty regarding shorter-term economic growth and company profits intensified and subsequently resulted in developed market shares losing more than a fifth of their value in the first quarter of the year, with emerging market equities falling by a similar magnitude. The SA equity market followed suit, shedding 24.1% in the first quarter of the year, before experiencing some relief in April. The SA listed property index nearly halved in value since the end of 2019, as investors took a grim view on the sector as a whole. Traditionally, defensive asset classes provided some support relative to equities and property, but, in absolute terms, local government bonds fell 8.7% in the quarter, while inflation-linked bonds traded 6.9% weaker for the same period. Emerging market currencies also took a battering and the rand weakened more than 20% for the quarter.

The sharp sell off experienced across financial markets has been short in terms of trading days, yet severe in terms of magnitude, but the meaningful adjustments in asset prices in February and March 2020 suggest that some degree of a dire economic outcome is to some extent already discounted by numerous growth-orientated asset classes, including equity and property. These asset classes now look exceptionally cheap against their own histories.

As the spread and containment of the COVID-19 pandemic evolve across the globe, we should expect uncertainty to remain about the ultimate trajectory of the global economy, with volatility in financial markets likely to stay high in the near term. Once the virus effect has played out, global activity resumes to a degree of normality and isolation measures start to ease, there will be a rebound in economic growth and company profits on the back of the lagged effect of massive policy stimulus undertaken during the crisis. This economic rebound should renew risk appetite by global investors and will be discounted by rising risky asset prices ahead of the time. The recent market experience has similarities to when the tech bubble burst in 2001 and global financial crisis took hold of economies in 2008, albeit that the underlying cause and severity of those crashes were evidently not the same.

The barrage of fiscal and monetary policy measures enacted by global policy makers in reaction to COVID-19 should induce a strong lagged cyclical recovery in global growth in the aftermath of COVID-19. In our U-shaped recovery (base case), a sluggish upturn follows a more protracted slowdown. Disrupted global supply chains are only restored subsequent to the peak in COVID-19 fatalities in the third quarter of 2020, resulting in an economic recovery only taking hold from late 2020. While responses to public health in this scenario are sufficient, physical distancing and the control over the movement of citizens persist for additional months in an attempt to prevent a resurgence in infections.

Portfolio management

Diversification and risk management remains our best weapon in times like these and our portfolios have a healthy allocation to alternative asset classes and differentiated strategies, which helped absorb some of the market shock recently experienced. These include allocations to direct property, private equity and real assets, which are less affected by daily market moves and sentiment changes. Leading into 2020, we expressed our risk view by remaining underweight local property in favour of local equity and overweight cash in favour of local inflation-linked bonds and, where regulations allowed, we maintained an overweight exposure to global asset classes, which allowed the portfolios to benefit from rand weakness and added diversification benefits.

Given the extreme market returns, it is virtually impossible for anyone to reach their real growth targets and the severity of the market movements have resulted in our portfolios experiencing absolute drawdowns with the bulk of the decline concentrated in March. Depending on the risk profile and accompanying asset class mix, the shorter-term effect would have been dampened by as much as two thirds, so the more conservative portfolios provided members closer to retirement some level of protection.

In this environment, we continued managing the portfolios in terms of an outcome-based risk-mitigating process and looked for opportunities to protect portfolios, while still harnessing the available opportunity set towards our longer-term investment goals. In navigating our portfolios in this crisis environment where all asset classes start behaving in the same way, we implemented protection strategies to mitigate risk and we gave our investment managers appointed to our underlying mandates more flexibility to take advantage of any opportunities that may arise.

At the start of April, there was quite a rapid recovery in investment markets, with almost every asset class experiencing solid gains by staying the course, while managing the risks in our portfolios, they benefitted from this short-term recovery. We positioned prudently, with sufficient levels of protection and diversification to provide risk mitigation, while, at the same time, continue to benefit from changes in sentiment and the knock-on effects of globally synchronised stimulus packages in the medium to longer term. We continue to monitor these exposures and developments daily with a view to provide the optimal risk-adjusted outcome to clients as well as the assurance that their investments are being actively managed in a prudent and responsible manner.

Asset class returns

The returns for the asset class benchmarks for the first quarter of 2020 are reported in the first column of the table below. The next column highlights the returns for these asset classes for the previous year. These one-year returns are then converted into real returns by deducting inflation (4.63%) for the year. The final column in the table contains the returns above inflation we expect to get (on average) for these asset classes for a full market cycle.

Asset class	Q1 2020 returns	Nominal returns for the 12 months	Real returns for 12 months*	Expected real return (p.a.)
Local equity (Capped Swix)	-26.58%	-24.53%	-29.16%	5.75%
Local bonds (Albi)	-8.72%	-2.99%	-7.62%	3.25%
Local property (Sapy)	-48.15%	-47.91%	-52.54%	7.00%
Local ILBs (Ilbi)	-16.82%	-15.23%	-19.86%	2.75%
Local cash (Stefi)	1.69%	7.21%	2.58%	1.25%
Global equity (MSCI World)	0.42%	9.92%	5.29%	6.50%
Global bonds (WGBI)	27.94%	29.27%	24.64%	-0.25%
Global property	-8.50%	-5.38%	-10.01%	4.00%
US dollar/rand**	27.52%	23.18%		
SA CPI	**1.50%**	**4.63%**		

* A positive/negative value here reflects the effects of a depreciation/appreciation of the rand against the US dollar on global asset class returns in rand terms. As the rand gets weaker/stronger, the returns of global investments get better/worse from a local investor's perspective.

The table above highlights the challenges growth asset classes experienced in the last year.

Building block return assessment

As explained above, our outcome-based investment philosophy starts at the asset class level and then goes down to an investment strategy (if appropriate) and investment mandate level within each asset class. We thus construct building blocks that reflect our selected investment strategies and managers that were awarded the mandates to implement these to either improve on the returns of the asset class or manage its risk profile.

Local equity building block

The first quarter of 2020 delivered the worst absolute quarterly returns in equity markets locally and globally, since the Global Financial Crisis of 2008/2009, as fears of COVID-19 spread across the globe. The Alsi declined 21.4% for the quarter, the Swix fell 23.3% and the Capped Swix declined by 26.6%. This is a large contrast to the previous quarter, when the Alsi delivered 4.6%, the Swix 4.8%, and the Capped Swix 5.3%. All three months of 2020 reflected negative returns, with March delivering the most significant decrease.

The negative return from the equity markets came from negative returns across SA industrials, resources and financials. The FTSE/JSE Financial Index was most negatively affected (negative 39.5%), dragged down by the returns from banks (negative 42.6%) and the property shares (negative 51.0%). The FTSE/JSE Resource Index returned negative 25.3%, weighed down by FTSE/JSE Industrial Metals (negative 29.6%), and FTSE/JSE Industrials fared the best with a negative return of 8.4%.

The worst-performing major equity sectors for the quarter were property, industrial engineering, mining, travel & leisure, general retailers, banks and insurers. While still recording negative returns, food producers, tobacco, food retailers and healthcare outperformed the broader market. While as volatile as most other shares within the period, index heavyweight Naspers outperformed the broader market and ended positively for the quarter.

The five-year return for the SA equity market is of course unsatisfactory for investors, with the ALSI delivering a negative 0.1% compound annual return, failing to outperform the cash and Albi return, which returned 7.2% and 5.2%, respectively

During the quarter, the building block achieved a return of negative 26.13%, taking the return for the past year to negative 22.49%, which was 2.04% ahead of the Capped Swix. The outperformance for the quarter and year was driven largely by the allocation to quality strategies.

Foord was the top-performing investment manager for the quarter. The portfolio delivered a return of negative 18.67%, outperforming the benchmark by 7.9 % for the quarter.The holding in physical gold ETF Newgold and a high cash weighting protected investor capital, as did the lower allocation in financials. The low allocation to the resource sector was positive, but offset by Sasol, which was the largest detractor at a share level. The low allocation to telecommunications also added value, with no holding in large benchmark share MTN, which underperformed materially

Blue Alpha had an impressive quarter as well, as the portfolio returned negative 20.3% compared to the Capped Swix's return of negative 26.6%. For the year, the portfolio outperformed as well, returning negative 19.6% compared to the Capped Swix's negative 24.5%. The portfolio outperformed the market. Large contributors to returns were having no exposure to interest-rate-sensitive instruments, being overweight high-quality local cyclicals. At a share level, having no exposure to Sasol, Absa and Nedbank added to returns. Changes during the quarter included selling out of Anheuser Busch and MTN, buying Vodacom and increased exposure to

British American Tobacco. The investment manager continued to focus on higher-quality local companies and expects the next 18 months to prove challenging for local markets.

Truffle produced a return of negative 23.68% for the quarter, outperforming its benchmark by 2.9% and outperformed the benchmark by 7.33% for the year. Being overweight the defensive tobacco and gold sectors contributed to returns. The investment manager took advantage of the extreme market volatility and purchased Capitec in March, after it was sold down aggressively by more than 50% in two days. It managed to purchase a sizeable holding, which the investment manager then sold after a 40% recovery in its share price. Before Sasol's collapse in February, Truffle sold down the position, given concerns regarding the investment manager's level of over indebtedness. This decision added significant value, as Sasol shares proceeded to collapse by 82% after the announced price war between Russia and the Saudis. Being underweight MTN contributed to returns, as it underperformed due to its exposure to the oil-dependent Nigerian market. As Financials sold off aggressively, being underweights Sanlam and Nedbank benefited, but being overweight Barclays Africa Group detracted from returns. The falling PGM basket price negatively affected PGM miners, which detracted from returns for the year to date. Despite this, Truffle maintained being overweight albeit at a reduced weighting due to the attractive free cash flow yields and strong balance sheets. Defensive shares, which the investment manager felt were overly expensive and hence, underweight including Shoprite, Vodacom and Clicks detracted from returns.

Fairtree had a disappointing quarter, returning negative 31.28% for the quarter, which was 4.7% below the benchmark. The investment manager still outperformed the benchmark by 1.9% for the year, however. During the first quarter, the portfolio's return was positively affected by positions in Naspers (11.5%), Prosus (17.2%), AngloGold (1.4%) and New Palladium (58.9%), while positions in Impala (negative 46.1%), Northam (negative 43.9%), Sibanye (negative 52.2%) and FFB (negative 69.3%) detracted from returns.

The Satrix Momentum strategy delivered a return of negative 26.36%, outperforming the benchmark by 0.22% for the quarter. For the past year, the portfolio has delivered a return of negative 19.13%, outperforming the benchmark by 5.4%. Throughout the quarter, the momentum factor held on to outperform the market, continuing its positive alpha contribution from the previous year. The portfolio strategy was in line with the Capped SWIX benchmark for the first quarter of 2020. The strategy's positive contribution to returns was largely attributed to the low-scoring momentum share, Sasol and being underweight Nedbank, Absa and Redefine, as well as being overweight Clicks, which had a very high momentum score. In terms of underperformance contributors, these included being underweight Prosus and Naspers

Prudential delivered a return of negative 28% for the first quarter of 2020, underperforming its benchmark by 1.7%. For the year ending 31 March 2020, the portfolio returned negative 29%, underperforming its benchmark by more than 4%. Being overweight British American Tobacco was the largest relative contributor to returns for the quarter. Being underweight the property sector also contributed to returns, helped by the lack of exposure to Redefine Properties. This was the second-largest contributor to relative returns. The largest detractor from relative returns for the quarter was being overweight Sasol.

The Perpetua fund returned -30.1% for the first quarter versus -26.6% for the benchmark over the same period. The overweight positions in British American Tobacco, Tiger Brands and Reinet all contributed positively to relative performance. Detractors from relative performance include our underweight positions in Naspers and Prosus as well as the overweight position in Nampak. The underweight exposure in the property counters and the food and drug retailers through the quarter also contributed positively to relative returns. In terms of portfolio positioning, the portfolio was overweight industrials and underweight resources, and remains marginally underweight financials. In terms of industry exposure, the portfolio was overweight the food producers and general retailers and underweight software & computer services and mining. Food producers held up better than the market, due to their defensive nature and cheap starting valuations. The portfolio's largest overweight positions relative to the benchmark included Tiger Brands, British American Tobacco and Woolworths. Perpetua believes these shares were good quality businesses trading at meaningful discounts to their fundamental value.

The value smart beta strategy managed by Momentum Asset Management was assertively positioned to have a material tilt towards shares that exhibit strong value qualities, including price-to-book and price-to-sales ratios as well as earnings and dividend yields. It produced a return of negative 30.52%, underperforming the benchmark by 3.95% for the quarter. It was overweight the financial sector, underweight the industrial sector and marginally overweight the resources sector. Within the resources sector, it was overweight general mining companies and underweight gold and platinum mining shares. Within the industrial sector, it was underweight media, retail and healthcare companies. Within the financial sector, the fund was overweight banking and insurance companies. During the quarter, MTN and Sasol were sold and Resilient and Ninety One were included in the portfolio.

The quality strategy portfolio managed by Momentum Asset Management was assertively positioned to have a material tilt towards shares that exhibit strong quality qualities, including profitability and also stability and credibility of profits. It produced a return of negative 21.70%, outperforming the benchmark by 4.88%. At quarter end, the portfolio's equity exposure was 99.0%. It was moderately underweight resources, industrials and financials, which funded a 5.1% futures exposure. Within the resource sector, the fund was underweight gold mining shares and overweight basic materials stocks. Within the industrial sector, it was overweight retail shares and food and beverage shares, while it was underweight personal and household goods and industrial goods as well as services shares. Within the financial sector, the fund was overweight insurance companies and underweight banks and property stocks. During the quarter, Investec and Sasol were sold and Hyprop was introduced into the portfolio.

Local property building block

In line with global equity markets, the South African listed property sector, as measured by the Sapy benchmark, ended the first quarter of 2020 down with significant capital losses. The expected damaging effects of the COVID-19 pandemic on industries (including real estate markets) and on global economic growth drove equity markets lower during the quarter.

In South Africa, the United Kingdom and some parts of Central Eastern Europe, governments have imposed lockdowns and regulations limiting human interaction – some of which include barring large gatherings in work places and shopping centres. In addition, governments have prohibited trading in goods deemed as non-essential. In what was already a challenging operating environment in South Africa, COVID-19 has added to the uncertainty around the ultimate effect it will have on property fundamentals, valuations and the recovery period.

As such, the Sapy declined by 48.15% in the first quarter of 2020, with most of the sell off escalating significantly in March. The sector materially underperformed the Swix (negative 23.3%), inflation-linked bonds (negative 16.8%), the Albi (negative 8.7%) and cash (1.7%) for this period.

The building block underperformed benchmark for the quarter by 0.27% and 0.39% for the year ending 31 March 2020.

The component managed by Momentum Asset Management declined by 46.96%, outperforming the Sapy (negative 48.15%) by 1.19%. Being underweight Hyprop, Fortress and SA corporate real estate as well as being overweight equites, Sirius and Stor-Age were the largest contributors to the outperformance relative to the benchmark for the period. Key detractors from returns were largely because of being overweight retail shares, namely Mas Real Estate, Vukile and Nepi Rockcastle. In absolute terms, the sell off in Redefine, Growthpoint Nepi Rockcastle and Vukile accounted for just more than half of the losses during the quarter. The current portfolio positioning resembles the companies the investment manager was comfortable with, given the economic environment.

Catalyst underperformed by 0.68% and 0.85% for the quarter and year respectively. Being overweight Nepi Rock and cash, which outperformed the benchmark, contributed to relative returns. Being underweight Attacq, Redefine and Fortress B, which underperformed the benchmark, also contributed to returns relative to benchmark. However, being overweight Hyprop & Vukile, which underperformed the benchmark, and underweight Investec Australia, Sirius & Equites, which outperformed the benchmark, deracted from returns. In the short term, the investment manager expects real estate companies to pay out as little dividends as they can to preserve their balance sheets. Catalyst's view is that the sub-sectors most exposed to the short-term effect of the economic 'shutdown' are hospitality and retail. Retail is the largest sub-sector in the SA listed property sector. Retail sales in malls are already negatively affected and closure of non-essential services within malls will have a materially negative effect on mall owners in the short term.

Meago underperformed for the quarter by 0.45%. The largest positive contributors to returns were being underweight Hyprop, Hospitality B, Vukile and overweight Nepi. The largest detractors from returns were being underweight Storage, Sirius and Liberty 2 Degrees and overweight Attacq and Investec Property Fund.

Local flexible bond building block

The first quarter of 2020 was the worst on record for local fixed income asset classes, as event risks in the form of the COVID-19 pandemic and the Moody's rating downgrade to sub-investment grade caused massive increases in yields and corresponding negative total returns.

Cash (Stefi) was the only asset class to deliver positive returns, while nominal bonds (Albi) and inflation-linked bonds (Igov) lagged significantly, with returns of negative 8.72% and negative 6.85%, respectively. The listed property index (Sapy) was by far the worst-performing asset class, returning negative 48.15%. Risk premia moved to extreme levels and this, coupled with a complete lack of liquidity in the market, caused a dislocation in yields from any reasonable valuation assumption.

For the quarter, the building block yielded negative 12.66% compared to the Albi's negative 8.72% Measured over an appropriate investment term of three years, the building block yielded a mere 3.3% compared to the Albi's 5.3% and, for the five-year period, it yielded 5.3% compared to 5.2% generated by the Albi.

Yields were up around 1.5% for March, liquidity evaporated and there was a complete dislocation in the market, which prompted Sarb to announce a bond-buying programme to restore stability to the local market. This bought a relative calm and yields started to decline.

Prescient had a large exposure to cash and shorter-dated instruments at the start of the quarter, but, as these events unfolded, rapidly added exposure to the longer-dated area of the yield curve. Coronation, on the other hand, started off the quarter with being overweight the 12-plus-years sector and this area of the yield curve delivered the weakest return (negative 11.2%) of all the maturity buckets. Ultimately, the incorrect positioning on the yield curve and the allocation to listed property (3.5%) detracted the most from returns. Preference shares also detracted from returns, albeit that the allocation to this asset class was a mere 2.1%. The allocation to inflation-linked instruments (almost 15%) contributed positively to the relative returns of the building block.

At the end of the quarter, the building block had a duration position of 7.3 years compared to the Albi of 6.5 years. Duration was increased by both managers during the quarter under review. On aggregate, the building block was overweight the 12-plus-years sector and underweight all the other sectors.

Local flexible income building block

For the quarter, the flexible income building block yielded 2.0%, underperforming the benchmark by 1.2%. It also underperformed the benchmark (6.8%) for the year, as it returned 6.3%. For the three-year period, the building block managed to marginally outperform the benchmark (8.33% compared to the Albi (1 to 3 years) at 8.27%). The building block had a very high exposure of 78.5% in shorter-dated instruments with a maturity less than one year (mainly floating-rate notes).

Cash, as measured by the Stefi, delivered 7.3% and the Albi returned negative 8.72%%. The allocation to inflation-linked bonds (8.4%) and listed property (0.5%) detracted from the return. The building block had a modified duration of 1.3 years, which is shorter than the Albi (1 to 3 years) at 2.5 years.

Local inflation-linked bond building block

Inflation-linked bonds were among the asset classes most affected by a lack of liquidity and panic selling by investors. They went into the quarter on the back foot as lack of inflation in the local economy and elevated issuance by the government continues to plague them. The risk events during the quarter were simply the last straw that broke the camel's back. Real yields rose an average 65 bps for the quarter, but at one stage were up a whopping 200 bps, to trade above 6% real, decoupling from any logical valuation anchor, in our view. At the end of the quarter, the long end yields were at 5% real.

The total return from inflation-linked bonds can be divided into two components – the monthly accrual and the mark-to-market of the capital value, due to the move in the real yields. The first component of return is the monthly accrual from the yield on the bonds and the inflation uplift. This component of the total return was on the low side at 1.40% this quarter, with 0.4% from inflation uplift and around 1.0% from yield accrual. The second component of the return is determined by the move in real yields of the bonds. Real yields moved substantially higher during the quarter, thereby generating capital losses of about 8.3%. These components combined thus explain the index (Igov) total return of negative 6.9%.

For the quarter, the building block yielded a negative 7.9% against the benchmark Igov (negative 6.9%). For the year, it yielded a return of negative 5.6%, compared to the benchmark of negative 5.1%. The building block had a modified duration of 8.2 years, compared with the Igov of 8.6 years. The investment manager was slightly overweight the 1-3-years, 3-to-7-years sectors and 7-to12-years sectors and underweight the 12-plus-years sector (39.8% compared to the Igov at 55.0%).

Local cash building block

For the quarter, the building block delivered a return of 2.0% compared to 1.7% for the Stefi benchmark.

The local credit market had performed well up to now; perhaps too well, as it was buffered by excess demand rather than fundamentally based investment rationale. But clearly the backdrop sketched above poses significant risk and uncertainty for the credit market and spreads began to widen meaningfully during March. The stability of the local credit market is thus being tested and the widening credit spreads added to investor woes. This degree of volatility comes as a complete shock to traditionally stable income building blocks. Investment managers are focused on capital preservation and, to this extent, the well-diversified building block does provide some level of comfort. However, the risks are much higher than they were three months ago.

For the year, the building block delivered a return of 8.6% against the Stefi benchmark of 7.2%. The building block consistently met its objective of capital preservation, by maintaining positive returns on a one-year rolling basis. Both investment managers had a high exposure to floating-rate notes, which provided a high degree of liquidity, while also providing excellent yields, notably in 2019 pre the event risks mentioned above.

Local absolute strategies building block

For the quarter, the absolute strategies building block returned negative 12.7%, 3.1% above its internal strategic benchmark, which returned negative 15.8%. For the year, and for four years, which is the relevant measurement period, the building block outperformed the strategic benchmark, returning negative 8.6% and negative 2.2% relative to the benchmark returns of negative 12.4% and 0.8%, respectively. The inflation plus 4% target, however, was up 8.6% for the year and 8.7% per year for the last four years.

Tantalum returned negative 17.2%, relative to the internal strategic benchmark, (negative 15.8%). Going into March, the investment manager believed that listed equities presented the most value and the portfolio had begun accumulating positions on a measured basis in shares such as Remgro, Barlows, RMH and Truworths. These positions unfortunately cost the portfolio in the quarter, with the most significant detractor from returns being Sasol, which fell sharply with the oil price collapse, and is facing a potential rights issue at the worst possible time, as its Lake Charles capex only just came to an end. Positive contributors to returns in the month were few and far between. Naspers and Prosus held up very well (although the portfolio was underweight the benchmark), as did Assore (only recently added and which received an offer to buy out minorities), Anglogold, and BHP. The investment manager increased nominal bond exposure but is still cautious on corporate bonds.

Sentio was down 14.2% for the quarter, adding some alpha over the internal strategic benchmark.
Derivative hedges and positions in Naspers, Prosus, BTI and Rhodes Foods contributed positively, while positions in Sasol, Sanlam and MTN were among the main detractors in equities. Given the significant sell off of 400bps in bonds, the investment manager slowly extended duration and was slightly overweight duration with optionality to protect the portfolio during a sell off, while participating in a bond rally. Sentio still expects significant volatility in the short term, as the market is correctly focused on the war against the virus and another significant sell off cannot be ruled out in the coming months. The portfolio therefore maintains a balanced 'barbell' exposure with higher exposure to gold and defensive asset classes offset with cheaper cyclical exposure, tilted toward lower beta defensive equities.

Prudential lost 21.9% for the quarter. However, the investment manager had the conviction that the portfolio was well positioned to achieve its risk and return objectives. Prudential saw exceptionally attractive valuations across a wide range of the asset classes with an overweight position in local equities, focusing on high-quality businesses that can survive reduced earnings and cash flows for an extended period. The investment manager also favoured resource sharess, with exposure to global growth and foreign currency earnings. The portfolio was even further underweight local property, reflecting significant macroeconomic uncertainty exacerbated by the pandemic.

The portfolio was overweight nominal bonds, while neutral to ILBs, as Prudential believed the long-term prospects of nominal bonds and local equities were higher in the medium term, and more liquid than ILBs.

Absa Investment Management ended the quarter defensively positioned, following the stress the markets experienced in March. The investment manager's view was that bonds appeared attractive relative to inflation and cash – with selection based on duration and yield curve level crucial, however. In Absa's view, property should best be seen within the lens of a paradigm shift and was therefore underweight the asset class. Equity remained under pressure, as fundamentals came to bear and further earnings revisions were expected. The portfolio was down 3.3% for the quarter, which was 10.5% ahead of the internal strategic asset allocation benchmark.

Prescient reduced longer-dated optionality given increased volatility and a rise in the cost of protection. While interest-bearing asset classes contributed to returns, equity, property and preference shares detracted. The portfolio was down 9.2% for the quarter, which was 5.5% ahead of the internal strategic asset allocation benchmark.

On a look-through basis, the building block was underweight equities, property and inflation-linked bonds, while overweight bonds and cash.

Commodities building block
During the first quarter of 2020, demand for commodities directly involved in economic growth, i.e. base metals (including PGMs) and energy, fell dramatically, as did their prices. One of the conventional safe havens in times of uncertainty, gold, performed well, despite shakeouts during the March liquidity crises.

The commodities building block returned 7.71% for the quarter on the back of a bullish gold market and significant rand weakness.

Global equity building block
During the first quarter of 2020, global stocks, as measured by the MSCI All Countries World Index and MSCI World Index returned negative 21.4% and negative 21.0% (in US dollar terms) respectively. At a regional level, US equities returned negative 19.6%, European equities returned negative 24.3%, Japanese equities returned negative 16.8% and emerging markets equities returned negative 23.6% for the period. Sector returns from the MSCI World Index was negative across all sectors, most notably energy, financials and materials. The sectors that were the least negative for the quarter included healthcare, utilities and information technology.

The global equity building block returned negative 5.3% (in rand terms) for the quarter, which was below the benchmark return of negative 3.1%.

The main cause of underperformance for the quarter came from our value investment managers, with all three detracting in relative terms to the index. Value as a style continued its poor returns generally, with the broad MSCI Value Index underperforming by 5.9% this quarter. Our largest allocation was to the Robeco Value sleeve, which suffered from being overweight consumer, financial and energy stocks. Within the consumer-related sectors, a preference for traditional retailers compared to ecommerce names was negative, as these stocks rely on footfall and many non-essential stores have had to close completely. Losses from Contrarius were dominated by energy and retailers. Within energy, offshore drillers suffered from the surprise oil price decline, as supply has become plentiful. While these names face challenges in the short term, the largest positions in the fund have enough resiliency to survive depressed oil prices and are expected to benefit longer term from the renewed pressure on higher-cost US shale producers. Hotchkis and Wiley also experienced losses in energy and financials, but have been increasing the quality of their portfolio in recent weeks away from riskier names within these sectors.

Among our quality-orientated investment managers, returns were mixed, but the style detracted in aggregate predominantly due to Paradice and Artisan. Artisan has more of a modest value style skew and losses came from the investment manager's holdings in banks as well as exposure to the travel industry, which it has now reduced. Paradice suffered from additional headwinds related to small/mid caps and emerging markets, which generally underperformed due to the extreme liquidity pressures seen during March. On a more positive note, Morgan Stanley outperformed, as the investment manager had been building positions in defensive healthcare names, which generally held up well, along with maintaining allocations to the highest-quality businesses within IT Software and Consumer Staples. Exposure to riskier areas such as financials were limited to the most resilient names, and the investment manager had no exposure to hospitality, travel or more cyclical sectors.

Our growth allocation outperformed for the quarter, with Jennison, Rainier and Granahan all exceeding returns for the benchmark. Jennison was the largest contributor and top performer, benefitting from strong returns from a number of technology names in areas such as ecommerce and online streaming, which were less affected by the lockdowns imposed by governments across the world. Granahan also owned a number of these names in areas such as telemedicine and online learning, which were similarly insulated from recent shocks and will likely emerge from this crisis with a stronger competitive position. The only detractor from our growth investment managers was Robeco, which suffered from being overweight small/mid caps and relative underperformance in the Information Technology sector.

While returns for the quarter were challenging across markets generally, we remain firmly committed to our active and style-balanced approach to equity investing. Several of our investment managers have been particularly active in recent times, finding some excellent opportunities, which have not been on offer since the 2008 financial crisis. The recovery potential across many positions remains strong, while the overall portfolio retains enough diversification to offer protection through any further market volatility.

Global property building block

The global property building block was affected by the general risk-off environment and in particular the closure of many retail centres as well as many industrial properties across the globe. The global property building block recorded a negative return of 8.2%, compared to the benchmark return of negative 8.6%.

Global fixed income building block

The quarter was dominated by developments in the COVID-19 outbreak, which spread outside of China, driving a risk-off market sentiment. In this environment, equities sold off drastically, with the S&P 500 Index experiencing its largest weekly fall since 2008. With equities selling off, developed market government bond yields rallied in a flight to quality. German bund yields fell considerably and the US 30-year traded below 1.5% for the month. Corporate bonds lagged government bonds, particularly high yield. US dollars and the Japanese yen were the best-performing currencies, as investors sought safe-haven asset classes.

The global bond building block returned 27.9% for the quarter, which was below the benchmark return of 31.5%.

Conclusion

It's only natural to be concerned when investment markets experience sharp drawdowns. The key during uncertain and volatile times like these is to remain invested and not to succumb to emotional reactions and to look beyond short-term fears. The portfolio managers are continually assessing how best to manage your well-diversified portfolio during this period.