momentum
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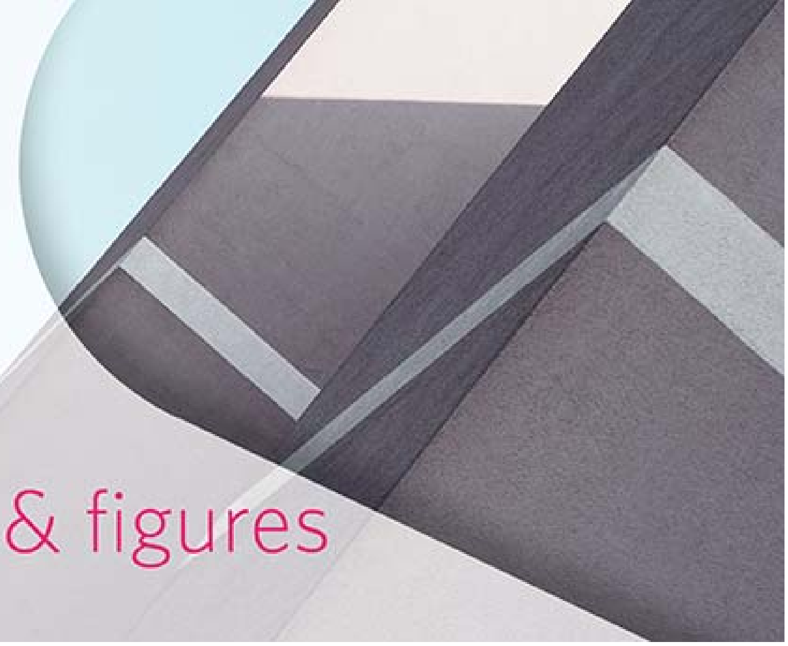

moment
of portfolio facts & figures

Momentum Investments Flexible Factor Portfolio Range

quarterly commentary to end September 2020

Assessing investment returns in an outcome-based investment context

The Momentum Investments Flexible 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 Flexible 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 Flexible 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 over all periods.

Economic overview

The strength of the global economic upturn will be reliant on the success of vaccination campaigns and efficient distribution of vaccines worldwide but the road to recovery remains uneven and uncertain. Diversified economies that are less exposed to contact-intensive activity will likely fare better, while concentrated and services-related economies are likely to require further support. Continued fiscal stimulus and accommodative monetary policy are crucial, in our view, in keeping the world economy afloat and will lessen lasting economic damage from the crisis.

Improved global growth, still ultra-easy policy settings and a positive vaccine outcome should provide general support for more risky assets like global equities. Safe-haven asset classes like global bonds are nevertheless likely to face headwinds in a cyclical recovery phase, with bonds facing the additional challenge of somewhat higher inflation.

Meanwhile in South Africa (SA), muted confidence, a strained fiscus, ongoing electricity shortages and a flare up in infections will contain the anticipated growth recovery in 2021. After contracting at an expected 8,1% in 2020, growth is likely to increase to 2% in 2021, before slowing to 1,6% in 2022. Efforts to arrest the increase in government's debt burden through higher growth will likely be constrained and could lead to further negative rating actions later in 2021. While near term inflation pressures are likely tilted to the downside, we see inflation rising in the medium term from an expected average of 3,2% in 2020 to 3,9% in 2021 and 4,7% in 2022. We are projecting a shift higher in interest rates in the second half of 2021 given the SA Reserve Bank's warning against the constraints of fiscal dominance and the dangers of running negative real interest rates for too long.

It looks like the stars are finally aligning for SA equities, with a strong expected profit recovery in 2021 providing fundamental support on top of an envisaged conducive global risk-on environment, while a more favourable valuation underpin after years of poor performance should enhance potential upside. SA real government bond yields remain compelling, in sharp contrast to zero real cash yields. In the inflation-linked bond space, the expected rise in SA inflation should provide a positive fundamental underpin. SA listed property share prices have been decimated, with valuations at rock-bottom levels relative to history, but it is likely that the weaker fundamental environment has already been discounted by share prices in the sector.

Portfolio management

During the latter half of 2020, we undertook an extensive review of our portfolios in the context of the expected medium-term return environment and implemented several practical and incremental enhancements to them in the last quarter of 2020.

Some of the more poignant changes included a revised strategic asset allocation that took into account the low-return environment investors face. The return target is expressed as a range relative to inflation (the Consumer Price Index or CPI) to clearly indicate that the expected return may vary, depending on prevailing market and economic conditions. This moves away from a point expectation, which sometimes is misunderstood to be a guarantee.

We would also like to re-emphasise that our outcome-based investing philosophy is not solely about the return but the interplay of several components, which encompasses three pillars, namely time horizon, risk budget and a resultant return target.

Asset class returns

The returns for the asset class benchmarks for the fourth 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 (3,17%) 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	Q4 2020 returns	Nominal returns for the previous 12 months	Real returns for previous 12 months*	Expected real return (p.a.)
Local equity (Capped Swix)	11,48%	0,58%	-2,60%	5,75%
Local bonds (Albi)	6,71%	8,65%	5,48%	3,25%
Local property (Sapy)	22,19%	-34,49%	-37,66%	7,00%
Local ILBs (Ilbi)	5,08%	4,15%	0,98%	2,75%
Local cash (Stefi)	0,97%	5,39%	2,22%	1,25%
Global equity (MSCI ACWI)	0,51%	22,42%	19,25%	6,50%
Global bonds (WGBI)	-9,68%	14,47%	11,30%	-0,25%
Offshore property	-0,37%	-4,80%	-7,97%	4,00%
US dollar/rand**	-12,31%	4,95%		
SA CPI*	**0,43%**	**3,17%**		

*CPI is to end November 2020

** 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.

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 multiple balanced building block

The multiple balanced building block returned 9,90% for the quarter, with the equity allocation driving most of this return. During the quarter, we removed the Prescient balanced portfolio and re-allocated these investments to the remaining investment managers.

The Coronation mandate had a strong quarter (11,8%) to close out the year and delivered a very credible real return for the calendar year 2020 (8,4%), benefitting from value-adding asset allocation decisions and strong alpha in the local equity building block. The portfolio performed well against its peer groups and benchmarks over all meaningful periods. Equity exposure was increased meaningfully after the sell off, given the breadth and attractiveness of the value on offer. Major holdings include Naspers, British American Tobacco, Quilter, Bidcorp, Textainer and Aspen. During the last few quarters, Coronation increased the weighting in the banks (predominantly FirstRand), life insurers (Momentum Metropolitan Holdings and Sanlam) and several others.

The Abax Balanced Fund recovery continued in the fourth quarter, with the portfolio delivering 9,7% for the quarter. This was mainly driven by African Rainbow Capital (CTR 1%) and Banks (CTR: 2,2%). The addition to property in the third quarter also contributed to returns in the fourth quarter. Abax had 55% invested in SA equity and close on to 25% in local bonds. Abax is comfortable with the positioning and will add or reduce equity exposure when opportunities present themselves.

Foord returned 8,2% for the quarter, with equities contributing most to returns, with financials, industrials and resources all advancing. Core holdings in FirstRand, Anheuser-Busch InBev and BHP Group advanced, partially offset by declining British American Tobacco and hospital companies Mediclinic and Netcare. Fixed interest securities were positive, as the yield curve fell and flattened. The low listed property weighting detracted this quarter, but protected capital for the full year, with the sector down 34% in 2020. The core holding Capital & Counties contributed to the return, as did niche warehousing and distribution company, Stor-Age.

Ninety One Asset Management also benefited from its healthy equity exposure and returned 10,7% in the final quarter. The allocation to general miners, Anglo American and BHP Group, and platinum shares, Impala Platinum and Sibanye-Stillwater, performed well for the quarter. Returns were further enhanced by holdings in South African banks (Capitec Bank, FirstRand and Standard Bank) and financial services provider, Sanlam. During the quarter, Ninety One continued to increase the holdings in select cyclical exposures at the expense of more defensive exposures. The investment manager also took some profits, by trimming holdings in British American Tobacco and Prosus, while topping up positions in SA banks and The Foschini Group, as the earnings revisions profiles appear to be troughing and valuation levels offered a good entry point. It maintained the material allocation to local sovereign bonds, and the asset class remains the preferred play in the local fixed income spectrum.

Local property building block

The Sapy and the FTSE/JSE All Property Index (Alpi) recorded total returns of 22,19 and 23,62% respectively for the quarter ended December, with the historic yield of the Sapy at 8,95% at 31 December 2020. However, it should be noted that many companies have reduced, deferred or cancelled dividend payments in the aftermath of the COVID-19 pandemic.

2020 was a tough year for the local listed property sector. Similar to its global peers, the listed property sector bore the full brunt of the COVID-19-induced lockdowns. New regulations put further pressure on landlords, placing the onus on local real estate investment trusts (Reits) to advance negotiations with tenants. Ultimately, landlords granted rental concessions worth millions, while government provided relief to tenants. Additionally, the listed shares continued paying the required minimum of 75% of their distributable earnings to maintain their Reit status.

Underlying property valuations took a knock in 2020 – pushing loan-to-value ratios up. This culminated in poor returns with Sapy recording total returns of negative 34,5% for the calendar year.

Property, however, ended the year with a strong rally in the last quarter (22% for Sapy and 24% for Alpi). However, this late flourish was not enough to offset the sell off experienced earlier in the year. What was apparent in the fourth quarter was that the equity market rally was marked by a rotation out of ‘pandemic winners’, being shares in growth and quality companies into small cap and value shares, whose returns had lagged throughout the year. This theme was evident in the real estate sector as well. The rotation drove share prices of Reits that had significantly underperformed throughout the year higher. For the quarter ended December 2020, Fortress B’s share price rose by 100,67%; EPP N.V., 89,56%; Hyprop, 80,11%; Arrowhead, 78,46%; Attacq, 65,67%; and Vukile Property Fund, 63,93%.

The key focus in the medium term will be the strengthening of balance sheets, while achieving consistent earnings growth (and retaining Reit status).

The building block returned 23,6%, which was above the benchmark return.

Meago returned 21,5% for the quarter. Being overweight Attacq and Redefine as well as underweight Growthpoint and Fortress A were the largest contributors to returns. Being underweight Hyprop, Fortress B and Vukile was the largest detractor.

The Momentum Listed Property Portfolio returned 19,6%. Being underweight Hyprop, EPP N.V., SA Corporate and Fortress B drove the underperformance of the building block relative to the benchmark. Being overweight NEPI Rockcastle Plc, Sirius real estate, Attacq and Resilient contributed to the return.

Catalyst was the stand-out performer for the quarter, returning 25,7%. Being underweight Investec Australia, which underperformed the benchmark, and overweight Hyprop and Arrowhead-B, which outperformed the benchmark, contributed to the return relative to the benchmark. Being underweight EPP, Redefine and Attacq, which outperformed the benchmark, detracted from returns relative to the benchmark.

Local flexible income building block

The fourth quarter of 2020 was a strong quarter for local fixed income asset classes, as markets recouped some of the losses incurred in the first half of 2020. Risk and uncertainty remained elevated, but this was largely set aside in the quarter. Listed property led the way off its very depressed base, delivering 22,19%. Nominal bonds (Albi) performed well, returning 6,71%, closely followed by inflation-linked bonds (Igov) at 5,47%. An ever-declining cash return (Stefi) of 0,97% was a distant laggard.

For the quarter, the flexible income building block yielded 2,7%, outperforming the benchmark by 1,4%. It underperformed the benchmark (11,5%) for the year, as it returned 7,49%. For the three-year period, it did not manage to outperform the benchmark either (8,5% compared to the Albi (1 to 3 years) at 9,4%). The building block had a very high exposure of 76,2% in shorter-dated instruments, with a maturity less than one year (mainly floating-rate notes).

For the quarter, cash, as measured by the Stefi, delivered 1,0% and the Albi returned 6,7%. The bulk of the Albi return was generated by the 12+ years sector (8,7%). However, the building block only had a 6,4% allocation to this sector.

For the year, cash delivered 5,4% and the Albi returned 8,7%. The allocation to inflation-linked bonds (4,9%) and listed property (0,6%) detracted from the return, as these asset classes delivered 3,9% and negative 34,5% respectively. The building block had a modified duration of 1,4 years, which was shorter than the Albi (1 to 3 years) at 2,0 years.

Local inflation-linked bond building block

Inflation-linked bonds were caught up in the euphoria this quarter, as global risk-on sentiment, triggered by COVID-19 vaccine announcements and a Democrat win in the US elections caused inflows into emerging market fixed income investments and substantial yield compression ensued. This was a welcome reprieve for this asset class, which has endured a prolonged period of underperformance.

The total return from inflation-linked bonds could 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 was the monthly accrual from the yield on the bonds and the inflation uplift. This component of the total return was a substantial 2,6% this quarter, with a 1,7% from inflation uplift and around 0,9% from yield accrual. The second component of the return was determined by the move in real yields of the bonds. Real yields moved substantially lower across the curve by around 25 basis points on average. The short end led the way but was closely followed by the long end of the yield curve. This move yielded capital gains of 2,9%.
These components combined thus explained the index (Igov) total return of 5,5%.

For the quarter, the building block yielded 5,2% against the benchmark Igov (5,5%).

For the year, the building block yielded a return of 2,4%, compared to the benchmark of 3,9%. It had a modified duration of 9,7 years, compared with the Igov of 9,4 years. The investment manager was slightly overweight the 7-12-year and the 12-plus-years sectors and substantially underweight the 3-7-years sectors.

Local cash building block

For the quarter, the building block returned 1,3% compared to 0,97% for the Stefi benchmark.

The repo rate is anchored at historical lows of 3,50%. Cash as an asset class is thus not a very attractive alternative in the fixed income environment relative to nominal bonds and inflation-linked bonds. The local credit market performed relatively well for the period and continues to show signs of returning to normal after the unprecedented shock it experienced in the first half of 2020. Primary issuance ticked up substantially, albeit across a narrower diversity of borrowers, as investors continue to be selective across sectors and issuers. High-quality borrowers are well sought after with some of their credit spreads back to tighter levels than in the pre-COVID-19 environment.

For the year, the building block returned 6,9% against the Stefi benchmark of 5,4%. It 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 fair degree of liquidity, while also providing above benchmark yields.

Local absolute strategies building block

The absolute strategies building block benefited from the rally in local asset classes and returned a respectable 8% for the quarter. During the quarter, we reduced the allocation further to the more conservative strategies within the building block.

The Sentio Absolute Return Fund showed a solid return of 9,4% during the quarter, with all asset classes contributing. Top contributions came from the portfolio's exposure to Impala, Sibanye Stillwater, NEPI Rockcastle, Firstrand, Anglo America and Naspers. However, positions in gold shares and BTI detracted. In Fixed Income, the portfolio was overweight duration at the beginning of the quarter (especially at the long end of the curve, due to attractive valuations) and benefitted from bull flattening during the period. The portfolio remains focused on analysing any potential investment proposition not only for its return potential but also weighing it against the risk it is bringing to the overall portfolio.

Prudential also had a solid quarter and significantly outperformed the objective. The portfolio returned an impressive 10,3% in the final quarter as all SA asset classes contributed towards returns, with South African equities contributing the most. In terms of specific equity exposure, among the strongest equity contributors to absolute returns for the quarter were the portfolio's holdings in resources shares like Implats and Anglo American, as well as SA banks including Absa, Standard Bank, FirstRand and Investec, plus Multichoice. The main detractors from absolute returns were holdings in Gold Fields and British American Tobacco. Prudential is maintaining its overweight positions to equity and bonds and underweight positions to local property and cash.

Tantalum recorded a return of 7,7% for the quarter. The positions in Naspers and Prosus, and resources companies such as BHP Group, Northam Platinum, Anglo American and Anglo Gold contributed to returns, while positions in Sasol, Tsogo Sun Gaming, Barloworld, Liberty and Remgro detracted. Tantalum has increased its positions to South African-focused companies (SA Inc.), predominantly taken through banks and insurers, where it feels that too much pessimism is priced in. Within fixed income, Tantalum continues to prefer nominal bonds over cash, given the attractive real yields being offered by nominal bonds.

The real return component, which is the conservative strategy and more focused on capital protection, returned 5,9% for the quarter. Despite underperforming the other strategies, we believe this is a respectable return, given the strong emphasis on capital protection in the short to medium term.
Absa Asset Management returned 5,8% for the quarter, but remains very conservatively positioned, given its concerns around equity valuations. The investment manager has equity protection in place given its nervousness around global equity valuations. The portfolio has a healthy allocation to fixed income instruments, specifically floating-rate notes.

Prescient delivered a return of 7,2% for the quarter. Prescient is concerned that local equity valuations are becoming stretched, while preference shares, listed property, nominal bonds and ILBs still offer value. The investment manager therefore has only 10% of equity, which is protected with the bulk of the portfolio invested across fixed income.

Moderate hedge solution building block

The moderate hedge solution returned 4,71% for the quarter, bringing the one-year return to 1,39% after the deduction of all fees. This solution is diversified across strategies and within strategies. While all strategies contributed to returns for the past quarter, the fixed income arbitrage component was the biggest contributor to returns for the year.

Aggressive hedge solution building block

The aggressive hedge solution returned 6,66% for the fourth quarter, bringing the one-year number to negative 0,47%. Within the solution, the alternative beta allocation returned 2,92% for the year, driven primarily by the limited drawdown experienced in March/April. The 50%/50% Capped Swix/Stefi returned 6,08% for the quarter and 2,46% for the last year. A resource bias in the building block drove returns during the quarter, which was also the case for most of the year. Macro-thematic investment managers and investment managers able to trade the volatility in the equity markets performed well.

Portable alpha solution building block

The portable alpha solution returned 14,68% for the quarter, bringing the one-year number to negative 2,87% after the deduction of fees. This compared to the Capped Swix, which returned 11,08% for the quarter and negative 2,44% for the past year. Beta exposure across the solution was reduced in the middle of March in an effort to reduce market exposure across investor portfolios. As such, it was more conservatively positioned for the rally, which started in the middle of March 2020. The beta exposure level was at 100% at the end of the second quarter and will remain at 100%. The alpha construct performed extremely well for the second half of the year to close the gap created by the beta mismatch.

Global equity building block

Markets continued to rally in the final quarter of what was an extraordinary year, spurred on by optimism around the vaccine rollout, a last-minute Brexit trade deal and the US Presidential election. However, COVID-19 cases rose sharply in much of the world, especially Europe, triggering renewed restrictions and fuelling fears of further economic damage to come in the short term.

Stock markets again delivered strong gains, with the key US equity market rising to all-time highs. The MSCI World Index returned 14% in the quarter, led by Asia Pacific ex-Japan with gains of 19%. The UK and US returned 11% and 12% respectively. Emerging markets returned 20%, led by Emerging Latin America with 35%. China underperformed, gaining 11%, but remained one of the best performers for the year, up 30%, having recovered successfully from the virus.

The news of several successful vaccine trials and the subsequent roll out of mass vaccination campaigns across the world contributed to the strong quarter. The other big uncertainty hanging over markets in recent months, namely the US election,

fear of a contested result and a period of chaos in the world's dominant economy, was also lifted. With the substantial reduction in uncertainty delivered by the vaccine news and Brexit deal, the prospects for 2021, in terms of a strong economic recovery and further progress in equity markets, have improved significantly.
Against this backdrop, the global equity building block returned 0,5% for the quarter, outperforming its MSCI AC World Index benchmark, which returned 1,1% for the same period. For the year, the building block returned 20,1%, outperforming the benchmark return of 19,9%.

Global active building block

The building block returned negative 0,6% for the quarter, outperforming it benchmarks return of negative 3,5%. For the past year, the return was 16,9%, while the benchmarks return was 20,4%.

For the quarter, Ninety One returned negative 1,4%, Allan Gray returned 1,15% and Foord returned negative 3,4%.

Global property building block

The global property building block returned negative 2,6% for the quarter, which was below the benchmark return of negative 1,8%. Rand strength and tighter restriction measures across the developed world were the major reasons for the negative returns.

Global fixed income building block

The global bond building block returned negative 9,1% for the quarter, which was ahead of the benchmark return of negative 9,4%. Global bond yields rose during the quarter, as news flow relating to the US elections, Brexit trade deal and positive news around a vaccine all contributed to further support of an economic recovery and provided an underpin for global equity.

Conclusion

We are confident that the portfolios are appropriately positioned for the current economic and market conditions. We are cautiously optimistic that economic conditions across the globe will improve through the year, which could provide an underpin for growth asset classes. We are, however, mindful that certain asset classes and sectors had significant returns since April 2020, and could possibly be reaching fair value. We are therefore actively managing the portfolios and will take the necessary actions when warranted. We will make sure the portfolios are sufficiently diversified across asset classes, mandates and strategies.