

moment of portfolio facts & figures

Momentum Investments Target Factor Portfolio Range

quarterly commentary to end September 2020

Assessing investment returns in an outcome-based investment context

The Momentum Investments Target 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 Target 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 Target Factor Portfolio Range Portfolio returns

The portfolios within the Momentum Investments Target Factor Portfolio Range outperformed their strategic benchmarks for the quarter and year to September 2020. The respective inflation objectives of the portfolios have, however, 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 all periods.

Economic overview

High-frequency data releases and sentiment indicators indicate that a strong bounce back in global economic activity in the third quarter of the year may fizzle out prematurely. The recovery has shown signs of being unbalanced. Businesses have become less pessimistic about the outlook for the economy and corporate earnings, whereas consumer behaviour appears to continue to reflect the uncertainty of COVID-19.

Ongoing stimulus is likely necessary to support financial markets and underpin confidence for sustained economic growth. With the blurring of fiscal and monetary policy, it is not clear what will force governments to rein in spending. This raises an additional concern of central banks becoming more vulnerable to political interference. Moreover, inflation expectations are also at risk of becoming unanchored down the line.

Even as further restrictions are lifted on the local economy, electricity shortages, policy uncertainty, lingering unemployment, an anticipated rise in bankruptcies, a slow pace of reform and soaring government debt will continue to restrain spending and investment, thereby limiting South Africa's (SA) recovery to a below-consensus 2.0% in 2021, in our view, from a contraction of around 8.0% in 2020.

Electricity tariffs pose the main upside risk to inflation in the near term. We anticipate an average headline inflation rate of just above 3% for 2020, rising mildly to just below 4% in 2021. Interest rates are expected to remain unchanged until the second half of 2021 when the SA Reserve Bank begins to unwind negative real interest rates to avoid endangering the savings industry and broader financial stability.

Portfolio management

The portfolios recorded positive returns for the quarter on the back of strong global and local equity returns and benefitted from being overweight local and global equity as well as underweight local property. Being underweight inflation-link bonds detracted from returns.

We continue to manage the portfolios with caution, given that we expect market volatility during final quarter of 2020 and, therefore, still have protection strategies on local equity. Towards the end of the quarter, we also reduced the global property and global equity exposures and trimmed the local equity positions across the portfolios. We have also been incrementally increasing the cash exposures, as a risk-mitigation mechanism, given significant global political and key local economic events in the final quarter.

We continue to monitor these exposures and developments daily, with a view to provide the optimal risk-adjusted outcome to you as well as the assurance that your investments are being actively managed in a prudent and responsible manner.

Asset class returns

The returns for the asset class benchmarks for the third 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 (3.11%) 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	Q3 2020 returns	Nominal returns for the previous 12 months	Real returns for previous 12 months*	Expected real return (p.a.)
Local equity (Capped Swix)	1.01%	-5.02%	-8.12%	5.75%
Local bonds (Albi)	1.45%	3.58%	0.49%	3.25%
Local property (Sapy)	-14.14%	-46.07%	-49.17%	7.00%
Local ILBs (Ilbi)	1.21%	-1.92%	-5.02%	2.75%
Local cash (Stefi)	1.16%	6.20%	3.11%	1.25%
Global equity (MSCI ACWI)	4.53%	22.88%	19.78%	6.50%
Global bonds (WGBI)	-1.32%	17.47%	14.37%	-0.25%
Global property	-8.50%	-5.38%	-8.47%	4.00%
US dollar/rand**	-3.44%	10.70%		
SA CPI*	2.01%	3.11%		

*CPI is to end August 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 investing philosophy starts at the asset class level and then goes down to an investment strategy (if appropriate) and investment mandate choice 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 FTSE/JSE All Share (Alsi), Shareholder Weighted (Swix) and the Capped Shareholder Weighted (Capped Swix) Indices remained relatively flat at 0.67%, negative 0.33% and 1.0% respectively during the quarter. FTSE/JSE Financials increased 2.2% for the quarter, while FTSE/JSE Resources and Industrials were down 4.5% and 1.9% respectively. The rand strengthened by 3.6% to R16.75/\$ during the quarter. Iron Ore increased by 20.3% to \$118/t and Brent Crude oil increased by 1.29%, ending on \$42/bbl. Copper increased 11.1% to \$6668/t. Gold increased by 5.9% to \$1886/oz, Platinum at \$893/oz was up 7.7% along with Palladium which increased by 18.9% to \$2311/oz. The VIX Index (Volatility or 'Fear' Index) decreased by 13.4% to 26.4 during the quarter, but remained elevated due to geo-political uncertainty and fears of a second wave of COVID-19.

During the quarter, the building block achieved a return of 0.5%, which was marginally below the return of the Capped Swix.

The Momentum Systematic Strategies Portfolio outperformed the benchmark for the quarter, producing a return of 1.26%. At quarter end, the portfolio was overweight the resource sector and underweight the financial sector. Within the resource sector, the portfolio was overweight gold, platinum and general mining shares and, within the industrial sector, it was

underweight industrial goods and services. Within the financial sector, the portfolio was underweight banks and diverse financial services shares.

The Momentum Value Smart Beta Portfolio produced a return of negative 0.6%, underperforming the benchmark return of 1%. The portfolio was overweight the financial sector, underweight the industrial sector and a marginally underweight the resources sector. Within the resource sector, the portfolio was mainly overweight general mining companies and underweight gold and platinum shares. Within the industrial sector, the portfolio was underweight media and retail companies and overweight telecommunication companies. Within the financial sector, the portfolio was overweight insurance companies.

The Momentum Quality Strategy Portfolio produced a return of negative 0.6%, underperforming the benchmark. The portfolio was underweight the resource sector. Within the resource sector, the portfolio was underweight gold mining shares and overweight the industrial sector. Within the sector, it was overweight food and beverage as well as retail shares, while it was underweight industrial goods and services shares. The portfolio was underweight the financial sector. Within the sector, the portfolio was overweight insurance companies and underweight banks and property shares.

Local property building block

The third quarter of the year was abuzz with activity, as it coincides with the period during which some of the real estate investment trusts (Reits) report their June financial results. This reporting period provided valuable insights into the operating conditions tenants faced during various levels of the lockdown, and how Reits navigated the environment. As expected, the key takeaway from the results was that the outbreak of COVID-19 had a significant effect on tenant operations. Owing to the lockdowns, many tenants could not operate at the same level of capacity they did before the outbreak of the pandemic. These trading conditions have negatively affected tenant cash flows and their ability to service operating commitments such as rental expenses. To alleviate the cash flow pressures faced by tenants during the period, Reits provided some rental relief to tenants which came in the form of rental discounts or deferrals. Most of the relief packages were directed towards retail tenants (including SMME retail operators, gyms and sit-down restaurants) as their businesses were directly affected by lockdowns.

Office and industrial sector tenants received minimal rental relief, as many continued to trade throughout the lockdown, albeit at interrupted levels. A marked improvement in operating activity was noted in the third quarter relative to where operating activity was in the second quarter of the year. This improvement follows the relaxation of lockdown regulations, as the country moved from alert level 3 regulations from beginning June, to alert level 2 regulations in August and, recently, alert level 1 regulations, which took effect from 21 September 2020. Rental collection metrics are also off the lows from the second quarter, and the picture today is very pleasing across all sectors, although rental collections are not at the 95% to 100% range we are accustomed to.

Notwithstanding these improved conditions, the SA listed property sector index (Sapy) ended the quarter near similar levels to those seen at the height of the lockdowns in March and April. During the quarter ended September 2020, the Sapy declined by 14.1%.

The building block returned negative 14.5%, which was marginally below the benchmark return.

Local bond building block

There was much less volatility in the third quarter of 2020 for local fixed income asset classes, after what happened the previous quarter. However, uncertainty remains elevated and this is reflected in the returns for the period. Nominal bonds led the way with the Albi delivering 1.45%, marginally outperforming cash as measured by the Stefi (1.16%). ILBs, as measured by the Igov, continued to lag, delivering 1.00% and listed property (Sapy) yet again delivered negatives returns of 14.14%.

For the quarter, the portfolio yielded 0.9%, thus underperforming the Albi benchmark (1.59%). The portfolio (1.7%) also underperformed the benchmark for the year (3.6%).

A combination of large repo rate cuts and high long bond yields has led to a substantial steepening in the yield curve. The investment manager is of the view that the excess yield at the long end of the yield curve provides meaningful compensation for duration risk. In the short term, this was not the case though. This sector of the Albi was the weakest-performing area on the yield curve (negative 2.6%, while the Albi returned 3.6%), thus illustrating the significant effect incorrect positioning on the yield curve could have on the portfolio's overall returns. The portfolio had a small exposure to inflation-linked bonds (2.2%) and this detracted from the overall returns for this period. The portfolio had a modified duration slightly longer than the Albi (6.8 compared to 6.4).

Local cash building block

For the quarter, the portfolio delivered a return of 1.5% compared to 1.2% for the Stefi benchmark.

There was further easing in the repo rate, but only a 0.25% cut at the July meeting, which was followed by a pause at the September meeting. The repo rate was anchored at historical lows of 3.50%. The Jibar rate is at 3.35%. The forward rate agreements curve indicates that the market does not expect any further interest rate moves from current levels in 2020. Credit spreads have started to compress strongly during the latter part of the quarter and the exposure to non-government issuers has been decreased somewhat.

For the year, the portfolio delivered a return of 7.8% against the Stefi benchmark of 6.2%. The portfolio 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 excellent yields.

Local inflation-linked bond building block

Inflation-linked bonds continue to experience high volatility and low liquidity, weighing on their prospects. However, real yields were a lot more stable this quarter, as inflation seems to have bottomed and is moving up slightly.

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 mere 0.35% this quarter, with a 0.60% from inflation uplift and around 0.95% 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 in the short-end maturities, but marginally higher in the long end of the yield curve, thereby generating capital gains close to 0.65%. These components combined thus explain the index (Igov) total return of 1.00%.

For the quarter, the portfolio yielded 1.9% against the benchmark Igov (1.0%).

For the year, the portfolio yielded a return of negative 1.23%, compared to the benchmark of negative 2.4%. It had a modified duration of 8.64 years, compared with the Igov of 8.50 years. The investment manager was slightly overweight the 12-plus-years sector and underweight all the other sectors.

Commodities building block

The broad Bloomberg Commodities Index (in US dollar terms) rallied 25% from 30-year lows in sync with the global equity bounce in the third quarter of 2020. This was largely due to global systemic factors, notably aggressive stimulatory monetary policies in response to the virus-driven global economic downturn, as well as optimism on the speed and nature of economic recovery.

For South African investors, commodities were a tale of two 'sectors' this quarter. South African agricultural commodities, driven by local supply and demand idiosyncrasies, enjoyed powerful bull markets rising between 40% and 50% in the quarter. However, the second-quarter bounces by the globally traded, US dollar-priced energy and metal sectors lost momentum in the third quarter, also in sync with the global equity markets. Crude oil and gold fell by 15% and 10% respectively, while platinum fell 20%. The downturn in these two sectors was compounded by a 15% rally in the rand compared to the US dollar late in the second quarter.

The building block returned 5,8% for the quarter, outperforming the Stefi's 1,2%.

Local real return portfolio

The real return building block returned 1.7% for the quarter, outperforming the internal strategic asset allocation benchmark, which returned 0.4%. For one and three years, it returned 2.6% and 6.3% per year respectively, relative to the benchmark returns of negative 3.2% and 1.5%, respectively. The inflation plus 3% target was up 5% and 6.7% for one and three years.

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

Absa remains conservatively positioned, with 14% of the portfolio invested in growth asset classes and 86% in defensive asset classes, returning 1.9% for the quarter. The investment manager's expectation was that third-quarter GDP growth throughout most of the world was positive. The key risks, however, are that fourth-quarter growth could slow and overall growth for 2020 could disappoint to the downside. The investment manager is keenly watching growth markets, poised to take up any investment opportunities as they develop, for longer-term superior returns.

Prescient is predominantly invested in fixed interest asset classes, given the attractive yields available in this space, with longer-term bonds trading above 11%, longer-dated real yields for ILBs approaching 5%, and preference shares yielding in the region of 10%. The portfolio favours fixed interest exposure over equity to limit downside risk in the portfolio. The portfolio returned 0.6% for the quarter.

Global equity building block

Despite a sharp setback during September, risky asset classes made further gains in the third quarter, building on the recovery, which began in late March. Wall Street, particularly tech stocks and other clear beneficiaries of the pandemic, again led the way, with the S&P500 returning 8.8%. Chinese markets also performed strongly, with the CSI 300Index up 10% and, this, with a weak dollar, helped push emerging markets to a return of 9.6%, outpacing the MSCI Developed Market Index, up 7.9%. European markets were weighed down by increasing concerns about a damaging second wave of COVID-19 and rising anxiety about the Brexit discussions ahead of key deadlines in October.; Europe ex UK returned only 1.4% in euro terms, while the UK market fell 4.3% in pound terms. The underperformance of the UK, which was also held back by the dominance in the index of energy and financials, sectors which were severely damaged by the effect of the pandemic, were stark: so far this year the market is down 21% compared with a rise in the US of 5%.

Driving markets were two key factors. First was the continuing economic recovery from the pandemic-induced collapse in the early months of the year. This was sharper than many predicted and in turn resulted in corporate profits generally coming in ahead of expectations, although clearly not across all sectors. Second was the extraordinary support provided by the major central banks, which continued to purchase assets on a substantial scale, while keeping interest rates close to or below zero, and provide guidance, which points to a long period ahead of ultra-loose policy.

Against this backdrop, the building block outperformed its MSCI AC World Index benchmark for the past quarter, returning 4.4% relative to 3.7% for the benchmark

Global property building block

The global property building block returned negative 3.4% for the quarter, which was below the benchmark return of negative 1.8%. Rand strength and tighter restriction measures, specifically in the UK and Europe, were the major reasons for the negative returns.

Global fixed income building block

The global bond building block returned negative 1.8% for the quarter, which was below the benchmark return of negative 1.5%.

Despite the continued COVID-19 uncertainty and expectations that the virus's economic effect will be longer lasting than initially envisioned, markets remained beholden to central banks and government stimulus packages. The US Federal Reserve now foresees ultra-low policy rates remaining in place until 2023, which has anchored US Treasury yields to date (US ten year at 0.65%), dampened volatility and encouraged investors to seek out higher yields within corporate credit (US credit outperformed government bonds by 1.7% in the third quarter and high yield outperformed by 4.5%) or other riskier asset classes.

Conclusion

It's only natural to be concerned when investment markets experience the volatility that 2020 has. 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 portfolios during this period.