momentum corporate

Smooth Bonus Report

Second Quarter 2019

“With us the safest distance between two points is also the smoothest“

>

Looking back over the past quarter

Dear valued investors

Over the last quarter the local share market (FTSE/JSE All share) rose by almost 4%, and the JSE Top 40 stocks rose by 4.6%. Much of the rise in the share market came from a strong performance by stocks such as Naspers (which makes up 21% of the share market and 25% of the JSE Top 40). The local share market performed better over the quarter than many global share markets (MSCI All-Country World index). Although global markets have performed well over the last five years, delivering 11.8% per year, compared to local markets delivering 5.85%, for local markets there is some catching up needed.

The major issues affecting global markets are still Brexit and United States trade tensions with China. In the United Kingdom, Prime Minister Theresa May has been replaced by another Conservative Party candidate, the enigmatic Boris Johnson. This means that Brexit may be delayed further. In the Middle East, Iran's crippling sanctions are attempting to disrupt oil traffic in the key Strait of Hormuz, a critical waterway for about a fifth of the world's crude oil.

South African elections took place on 8 May, where the ruling African National Congress (ANC) party claimed 57.5% of the vote, followed by the Democratic Alliance (DA) with 20.8% and the Economic Freedom Fighters (EFF) with 10.8%. President Cyril Ramaphosa has many challenges, such as turning around the ailing state-owned enterprises, handling corruption and kick-starting the economy.

Herman van Papendorp and Sanisha Packirisamy from Momentum Investments give further market and economic commentary on page 6.

Smooth bonus portfolios

Over the last quarter, there have not been any changes to the Momentum smooth bonus portfolios and underlying managers. The Momentum Smooth-Edge Fund that was launched in February 2019 has a number of new clients seeking to invest. The smooth bonus portfolio is attracting new investors who want to access smoothing at a low cost.

The positive returns from growth asset classes (equities and property) have resulted in rising bonuses on many of our smooth bonus portfolios, but for the bonuses to strengthen further the growth will need to continue. At the end of June, most of our smooth bonus portfolios are fully funded.

Warm regards

Steed Duncan-Smith

Client Relationship Manager
Momentum Corporate

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The value of smooth bonus portfolios

by Darryl Gounden

Introduction

Historically, Smooth bonus media coverage aimed to educate the average investor on smooth bonus portfolios, naturally leading to a simplification of its workings. Although simplicity is necessary to aid investor understanding, it may have come at the expense of appreciating the value smooth bonus portfolios offer.

Smooth bonus portfolios offer the following main benefits:

- Exposure to growth assets
- Smoothing of investment returns
- A guarantee

While each benefit is valuable in isolation, the combination of these benefits is valuable in itself. Smooth bonus investors have the potential to earn inflation-beating returns through high exposure to growth assets while being protected from capital loss by the guarantee. Furthermore, investors are protected from market volatility through the smoothing of investment returns over time. Therefore, smooth bonus portfolios ultimately offer investors the best of both worlds: exposure to growth assets with downside protection.

The value of smooth bonus portfolios can be found in the unique features of these sometimes misunderstood portfolios. These features can be truly appreciated by understanding how they are designed to add value.

Exposure to growth assets

Smooth bonus portfolios typically have a large allocation to growth assets, which can be in excess of 75% of the portfolio. This exposure allows smooth bonus portfolios to target inflation-beating returns, offering investors real investment growth. Historically, the performance of smooth bonus asset portfolios has been competitive when compared to market-linked balanced funds. Market-linked balanced funds, competitors of smooth bonus portfolios and targeted at risk-seeking investors, offers only one of the three main benefits of smooth bonus portfolios, namely the exposure to growth assets. They don't address the issues of market volatility nor do they provide protection against capital loss. This protection can be obtained from more conservative asset portfolios but at a cost.

Conservative investments, such as fixed-interest or money market investments, may offer an alternative to smooth bonus portfolios for more risk-averse investors, but this would be at the expense of the upside potential from the exposure to growth assets. Depending on the risk profile and investment horizon of the investor, if the portfolio construction is too conservative, the investor has a reduced probability of reaching their retirement goals in the long term, a common investment behaviour problem in South Africa that smooth bonus portfolios can address.

Smoothing

The smoothing process gives investors a more comfortable investment experience by offering protection from the volatility of investment markets. The process of smoothing is fairly simple. During periods of good market performance, some investment returns are held back in a reserve and the rest are passed onto policyholders in the form of bonuses. During periods of poor market performance, the investment returns held back in the reserve are used to subsidise bonuses given to clients, ensuring a smoother investment experience and protection from market volatility.

The smoothing process is sometimes viewed negatively since investors in smooth bonus portfolios don't immediately experience the full extent of a market increase. The value of the smoothing process can be seen when markets start falling and the smoothing reserve is able to support positive bonuses. For investors that cannot withstand market volatility, the smoothing process provides the necessary protection and ultimately, peace of mind.

Guarantees

The guarantee offered by smooth bonus portfolios is sometimes seen as one of its more complex features. Guarantees can be either partial or full and can be applied on the capital invested, future bonuses or a combination of the two. If a partial guarantee on capital is purchased, there is a risk of capital loss during severe and sustained adverse market conditions. Similarly, if a partial guarantee on future bonuses is purchased, there is a risk that non-guaranteed bonuses are removed (again, during severe and sustained adverse market conditions). Such bonuses have not been removed from any of Momentum Corporate's smooth bonus portfolios to date. Given the various guarantees that are available in the market, it is important for investors to understand the given guarantees and to make sure that they are aligned with their risk profile and needs.

The guarantees are applicable to certain insured events, referred to as benefit payment events in smooth bonus terms, and can include retirement, resignation, retrenchment, death and disability. This sort of protection cannot be replicated in other market-linked funds.

The guarantees protect investors against losses arising from benefit payment events occurring when the investment market is performing poorly. For example, smooth bonus portfolios can offer an investor close to retirement peace of mind that his or her retirement savings will be protected from any capital loss at retirement. Similarly, for investors working in industries associated with high staff turnover, smooth bonus portfolios offer ideal protection against market volatility. For example, every time a smooth bonus investor changes jobs due to resignation or retrenchment, his or her benefit payment will not be subject to market fluctuations. For investors working in industries that are more susceptible to retrenchment during market downturns, the guarantees that smooth bonus portfolios offer can be extremely valuable.

The guarantee is a promise from the insurer to the investor to pay the fund value when a benefit payment event occurs. The promise from the insurer meets a critical investor need for protection against capital losses due to market volatility. This promise is similar to insurance in the conventional sense, which is essentially an economic service. But like any service provided, it comes at a cost. Smooth bonus portfolios have historically been criticised as the market perceives guarantee charges as excessive. And yes, depending on the guarantee that the smooth bonus portfolio offers, it can be expensive to provide.

The cost that an investor pays for the guarantee can be broken down into two components:

- The cost of providing the guarantee.
- To cost of setting aside the required regulatory capital.

Shareholders incur an opportunity cost by setting aside regulatory capital and therefore require compensation for the loss in potential returns. Part of the charge for the guarantee is, therefore, to compensate shareholders for this. This is not an additional profit to shareholders, but rather compensation for the loss in potential returns that could have been earned had the funds set aside as regulatory capital been used elsewhere.

Market value adjustments

Market value adjustments are one of the most controversial features of smooth bonus portfolios but remain a key feature necessary to protect investors. It is often incorrectly viewed as an exit penalty and seen as one of the major drawbacks of smooth bonus portfolios. Market value adjustments may be applicable on specific disinvestments, which typically includes members electing to switch to another investment option or a retirement fund, terminating their smooth bonus contract. If a market value adjustment is applicable, an investor would receive a lower amount than his or her fund value to reflect the current market-related value of the contract.

Resignations and retirements are voluntary but are considered benefit payments and an investor would receive his or her full guaranteed value in either instance. Therefore, resignations and retirements are not subject to a market value adjustment.

Not offering a market value adjustment opens up the possibility that some investors could select against the portfolio (trying to benefit at the expense of others) by choosing to withdraw their fund value when a market value adjustment would have been applicable. If investors were not subject to a market value adjustment, they would effectively be allowed to withdraw more than what their policy was worth. This withdrawal would negatively impact the bonus potential for the remaining policyholders.

Market value adjustments are therefore not an exit penalty, but rather a key requirement to protect remaining investors against anti-selection and to ensure fairness for all investors.

Disclosure

The Financial Sector Conduct Authority (FSCA) recently issued a draft conduct standard entitled "Conditions for default smooth bonus policies" that aims to increase disclosure around smooth bonus portfolios and the way they are managed. Once the final conduct standard has been published, smooth bonus portfolios would need to comply with the standard to be selected as a default investment portfolio. The level of disclosure around smooth bonus portfolios has greatly improved over the last decade and the final conduct standard would be a new milestone in its evolution. This is a step in the right direction and will hopefully help investors and decision-makers to understand the features of smooth bonus portfolios better.

The features of smooth bonus portfolios are in investors' best interest. Investors of all risk profiles may find value in smooth bonus portfolios. It will enable them to enjoy an investment experience that gives them both security and growth potential, the best of both worlds.

Darryl Gounden

Product Specialist
Structured Solutions

Momentum Investments market commentary for the quarter ending 30 June 2019

by Sanisha Packirisamy and Herman van Papendorp

Highlights

- United States (US): Markets are gaining confidence that looser monetary policy is on the horizon, but volatility could spike if the US Federal Reserve (Fed) fails to deliver on interest rate cuts in the near term.
- Euro area: The European Central Bank (ECB) signalled it stood ready to use its available monetary policy tools should inflation expectations and actual inflation outcomes remain significantly below target.
- Japan: Growth surprised sharply to the upside for the first quarter of the year, but the growth backdrop looks less supportive going forward.
- Emerging markets (EMs): Global growth concerns have led to a lowering of interest rates in a number of EMs.
- South Africa (SA): Macroeconomic stimulus cannot alone resolve the country's problem of low trend growth. Microeconomic reforms are needed to boost the country's growth potential.

Global economic developments

US

Markets are gaining confidence that looser monetary policy is on the horizon

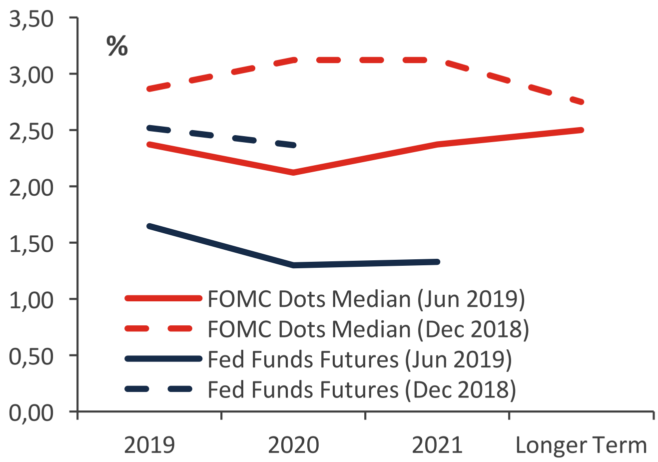
The language around the strength of the economic recovery became less favourable in the June 2019 statement of the Federal Open Market Committee (FOMC) meeting. Previously, the FOMC noted growth was rising at a "solid" rate, but this was downgraded to "moderate" in June. The committee warned uncertainties about the economic outlook had increased and, consequently, removed the wording about being "patient" in determining its future adjustments in the interest rate.

The voting action at the June 2019 meeting was not unanimous, with one member preferring to lower the target range for the Fed funds rate by 25 basis points from the current range of between 2.25% and 2.5%.

At the end of each quarter, FOMC policymakers put forward their projections of where short-term interest rates should head. Accumulated, these views are presented in the Fed's dot plot. Although the median expectation for the benchmark interest rate was unchanged for 2019, eight members indicated they were in favour of interest rate easing in 2019. Nine members indicated they expect the Fed funds rate to approach 2.1% by the end of 2020, in comparison to the previous outlook of 2.6%.

At the end of June 2019, the market was pricing in a 75% chance of an interest rate cut of 25 basis points at the July 2019 interest-rate-setting meeting and a 25% probability of a 50 basis point cut. Despite St. Louis Fed President James Bullard proposing it was a good time for an "insurance cut" (to cushion the economy against weakness and uncertainty), he also admitted that a 50 basis point cut in interest rates in July 2019 would be "overdone".

Chart 1: Shift in US interest rate expectations



Source: Bloomberg, Momentum Investments

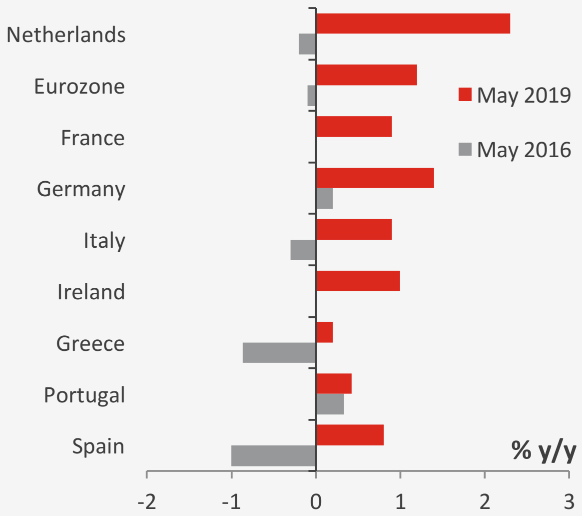
Despite firm economic data (the Bloomberg consensus forecast for growth in 2019 has increased by 0.1% in the past year to 2.5% and only dropped by 0.1% during the same period to 1.8% for 2020), markets have priced in looser monetary policy (see chart 1). If the Fed fails to deliver on interest rate cuts in the near term, in relation to elevated downside risks posed by a slowing global economy, financial markets are likely to be negatively affected.

Euro area

ECB signalled further stimulus is on the horizon if inflation expectations and actual inflation outcomes remain low Growth in the Euro area surprised to the upside for the first quarter of the year, increasing by 0.4% relative to the previous three-month period and was 1.2% higher in comparison to a year ago. Household consumption was the largest driver of growth in the first quarter, in line with the rate of unemployment falling to a 10-year low and real wage growth continuing to support spend. Growth in investment remained robust and net exports made a minor positive contribution, while a dip in inventories detracted from the overall rate of growth.

Nevertheless, an expected slowdown in wage growth and slower employment gains could weigh on household spend in the coming quarters, while weak global growth is expected to undermine growth in exports.

Chart 2: Headline inflation across the Eurozone



Source: Bloomberg, Momentum Investments

Inflation in the region has been below the ECB's 2% target for most of the past six years. Although inflation for the Eurozone climbed from negative 1.2% three years ago to 2.3% in October 2018, the headline rate drifted lower to 1.2% in May 2019, leaving the past three-year average at 1.3%. Inflation in Germany registered at 1.4% in May 2019, while inflation in the periphery continued to lag behind (see chart 2).

Meanwhile, core or underlying inflation (which excludes the effect of volatile food and energy prices) has disappointed at an average of below 1% in the past three years. The average five-year expectation for inflation in five years' time (measured by inflation swaps) dropped sharply from 1.7% in July 2018 (and from 2.2% six years ago) to 1.2% in June 2019, possibly in reaction to more shakier global growth expectations.

In light of heightened uncertainty (relating to the Brexit negotiations, global trade volumes and vulnerabilities in select emerging economies), the ECB announced an extension in its expectations for interest rates to remain steady to the end of the first half of 2020.

In its question and answer session at the June 2019 interest-rate-setting meeting, ECB President Mario Draghi denied any threats to a de-anchoring of inflation expectations, but admitted the slide in inflation expectations, unlike in the Euro area, has started from higher levels elsewhere in the world. Draghi also added that survey-based expectations (in comparison to market-based expectations) were still anchored around 1.6% to 1.7% in the long term.

Draghi stated further policy space existed to cut interest rates "if adverse contingencies were to materialise" and left the door open to further prospects for quantitative easing. He clarified conditions are not comparable with those which emerged seven years ago and that had led to the "whatever it takes" speech, given tighter labour markets and rising wage growth this time around, but he suggested the ECB stood ready to use any monetary policy tools at its disposal.

Japan

Surprisingly firm growth in the first quarter of the year unlikely to last

Real growth in economic activity increased by more than expected at an upwardly revised 2.2% in the first quarter of the year, relative to the consensus expecting a small contraction in the same period. Numbers were revised higher from 2.1%, due to improvements in capital spending.

Nevertheless, momentum in growth is expected to slow into the next quarter's reading. Real consumption activity dropped markedly towards the end of the first quarter, suggesting a weaker trend in consumption spend is likely to follow. Subdued consumer sentiment corroborates the view of slowing consumption spend. Japan's consumer confidence index dropped below consensus to 39.4 points in May 2019, remaining below the long-term average reading of 42.2 points for the fifth consecutive reading.

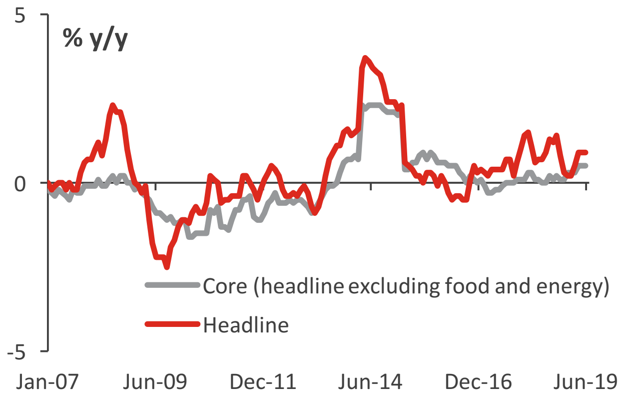
In addition, inventories, which have contributed positively to growth in the past three quarters, should reverse course and detract from growth in the second quarter of the year.

Moreover, the robust contribution from net exports is unlikely to be repeated for the second quarter of the year. During the first quarter of 2019, a larger fall in imports relative to exports boosted the overall contribution from net exports. The Macquarie Group, however, warns Japan's economy remains highly leveraged to the global cycle and should the trade war between the US and China escalate, medium-term prospects for the Japanese economy are likely to be dented.

Although Prime Minister Shinzo Abe has twice pushed back the planned hike in the consumption tax from 8% to 10%, government has maintained it will go ahead with its plan to raise the rate in October 2019, unless the economy faces a shock on the scale of the global financial crisis. Government previously increased the rate from 5% to 8% in 2014, which led to a recessionary outcome. Notwithstanding a better-than-expected growth print, speculation of a delay in the tax hike has remained high, in line with weakness in the economy, prompted by a slowdown in exports to its largest trading partner, China.

Meanwhile, inflation at a headline level remains well below the Bank of Japan's (BoJ) 2% target at 0.9% for June 2019 (see chart 3). The ten-year breakeven rate of inflation dipped to 0.2% in June 2019 reinforcing weak inflation expectations. As such, Momentum Investments expects monetary policy conditions to remain highly accommodative for an extended period.

Chart 3: Subdued inflation pressures in Japan



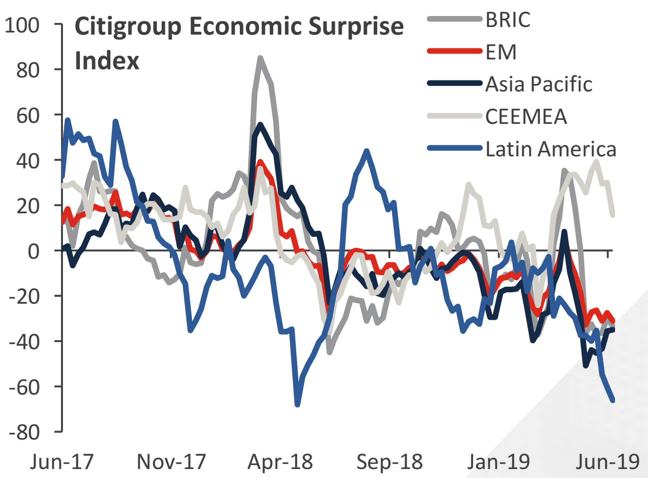
Source: Bloomberg, Momentum Investments

EMs

Global growth concerns have led to a lowering of interest rates in a number of EMs

Growth data disappointed in the EM composite for the past quarter (see chart 4). Discouraging activity data out of Brazil drove a further deterioration in the economic surprise index for the Latin American region.

Chart 4: Growth data disappointed in EMs



Source: Bloomberg, Momentum Investments, BRIC = Brazil, Russia, India and China, CEEMEA = Central and Eastern Europe, Middle East and Africa

A growth tracker run by Capital Economics suggests growth in EMs slowed to 3.3% in year-on-year (y/y) terms in the first quarter of 2019, which is the weakest pace in three years. Data from Capital Economics showed a slide in growth in retail sales for Latin America and Emerging Europe to 0% and 2% for the latest three-month period ending April 2019, while retail sales volumes grew by 6% for the same period in Emerging Asia. Growth in industrial production volumes was highest in Emerging Asia, at 4% for the corresponding period, but lower at 2% for Emerging Europe and negative 2% for Latin America.

An intensification of the trade war between the US and China has led to negative spill overs for EMs. Growth in aggregate EM exports in US dollar terms sank to 0% from 15% in January 2018. Export volumes contracted mildly in Latin America and Emerging Asia in the first quarter of the year, but growth was positive at 5% for Emerging Europe.

The Bloomberg consensus has downward adjusted its expectation for growth in EMs in 2019 from 5.1% a year ago to 4.7% in June 2019. Similarly, forecasts have been pruned for 2020 from 5.2% a year ago to 4.9% in June 2019.

Capital Economics' measure of aggregate EM headline inflation lifted to a seven-month high of 3.8% y/y in May 2019. Nevertheless, subdued fuel inflation suggests a softer inflation outlook for the region.

The Bloomberg consensus forecasts a dip in EM inflation from 3.7% in 2019 to 3.5% in 2020.

In the past six years, more EM central banks have cut interest rates than those that have raised interest rates. In June 2019, Russia, Chile, India and Sri Lanka lowered interest rates. Russia cut interest rates by 0.25% to 7.5%, citing easing inflation and milder growth, and signalled further cuts for the year. Meanwhile, Chile cut interest rates by a larger 50 basis points to 2.5% on the back of rising global trade tensions, which could negatively affect Chinese copper demand from the country. India cut interest rates for a third time this year by 25 basis points to 5.75% in response to growth in the economy falling to its lowest level in five years. The Reserve Bank of India signalled the possibility of additional easing should growth disappoint further.

Local economic developments

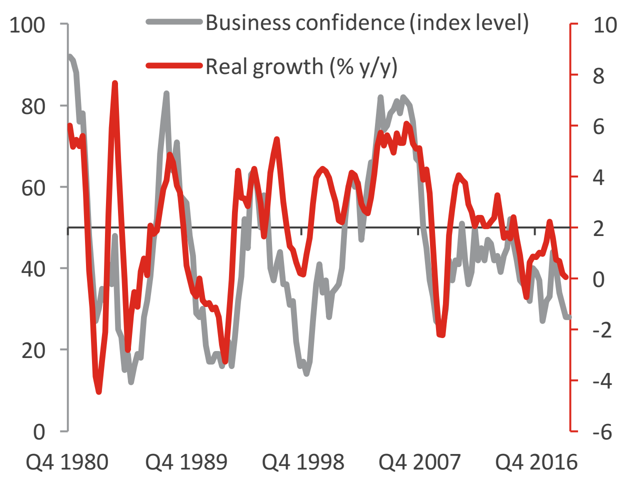
Macroeconomic stimulus cannot alone resolve the country's problem of low trend growth

In a recent speech by the adviser to the governors of the South African Reserve Bank (SARB), Fundi Tshazibana

warned struggling commodity prices, a slowing in global growth momentum and risks to a further escalation in global trade tensions would result in less supportive global conditions for SA's growth profile in the medium term.

Moreover, the speech highlighted concerns around the sharp broad-based contraction in local growth in the first quarter of the year. In addition, depressed business confidence (which stagnated at 28 index points in the second quarter reading, significantly below the neutral level of 50 according to the Bureau of Economic Research, see chart 5), the potential for further shortages in electricity supply and lofty debt levels at a number of key state-owned enterprises remain downside risks to the outlook for growth locally.

Chart 5: Growth and the Business Confidence Index



Source: Bloomberg, Momentum Investments, data up to Q2 2019 for business confidence and up to Q1 2019 for growth

The SARB noted monetary policy has been accommodative, but acknowledged the degree of accommodation has declined in the past 10 months in particular. The SARB attributes this decline to lower-than-expected inflation (due to declining nominal wage growth, lower imported inflation and a drop in meat prices), which has allowed real interest rates to rise.

Should interest rates drop in the near term, Momentum Investments anticipates the cutting cycle to be shallow, given the structural nature of SA's projected low growth profile. The SARB recognises inflation in SA remains elevated relative to its trading partners and ascribes this to pricing practises, market structure and supply-side rigidities that need to be addressed through the implementation of structural reforms.

The SARB is of the view macroeconomic stimulus could cause higher inflation, further currency depreciation and higher interest rates, rather than growth in investment and employment. Where structural constraints are prominent, the SARB sees the effectiveness of monetary policy being impeded. As such, the SARB believes monetary policy space needs to be created by microeconomic reforms, which raise potential growth.

Financial market performance

Global markets

Global equity markets recovered strongly in June 2019 with the MSCI All Country World Index up 6.5% in the month, after plummeting 5.9% in May 2019, on hopes for a positive breakthrough in the ongoing trade negotiations between the US and China at the G20 Summit in Osaka, Japan.

US President Donald Trump agreed to hold off on new tariffs and allowed Huawei to once again purchase US products. Increased concern over global risks lifted expectations for further monetary policy easing by major central banks, which boosted risk appetite further. With intra-quarter volatility, the index was only up 2.4% for the second quarter of the year.

Developed market (DM) equities outperformed EM equities for the quarter ended June 2019. The MSCI DM Index climbed 2.8% for the quarter, while the MSCI EM Index slid 0.6% in the same period. During the month, however, the two indices performed similarly, springing 6.6% and 6.2% higher, respectively.

Higher returns on the MSCI EM Index were corroborated by a 4-point reprieve in the CBOE Volatility index (Vix) in June 2019 and a 2.7% rise in the Bloomberg Commodity Price Index.

The MSCI DM Index benefitted from stronger returns in the US and European equity markets, while Japanese markets brought up the rear. The S&P 500 Index rallied 7.0% in June 2019 after a significant 6.4% dip in May, leaving the quarterly return at 3.1%. Despite poor data for US durable goods hinting at a negative hit from unfavourable trade tariffs, optimism over a favourable outcome for the negotiations between the US and China boosted US shares. President Trump had previously indicated the failure of reaching a deal with China would result in the application of tariffs on another US$300 billion worth of Chinese goods.

Earlier in the month, Mexico reached a deal with the US to curb migration, thereby avoiding tariffs on Mexican goods exported to the US. Moreover, a more dovish outlook on monetary policy provided optimism in the US equity market.

The Eurostoxx 50 Index rose 6.0% in the month, recouping losses of 5.1% made in May 2019 European shares were buoyed in June 2019 on comments made by Draghi that the €2.6 trillion quantitative easing programme could be revived, if the inflation trajectory did not improve. Headline inflation averaged 1.8% in the Euro area for the past year, but dropped to an average of 1.4% for the last three months. Meanwhile, core inflation remained stubbornly low at 1% on a three-month and one-year average. Moreover, Draghi warned about "lingering softness" in growth in the economy, further raising expectations for an easier monetary policy stance in the Euro area. Quarterly returns in the Eurostoxx 50 Index outperformed US and Japanese equities (negative 0.8%) at 4.7%.

The Nikkei 225 Index lagged the DM composite and finished the month only 3.5% higher on yen strength, which hurt exporters. The BoJ left interest rates unchanged at the latest meeting, but BoJ Governor Haruhiko Kuroda hinted at "additional monetary easing steps" if "the momentum for achieving our price target is lost".

Ten-year government bond yields in the US dipped to their lowest level since 2016 during June 2019, as weaker global growth fears triggered expectations of lower global central bank rates. In its June 2019 statement, the US Fed scrapped its reference to "patient" in describing its stance of future interest rate moves, downgraded its assessment of economic activity from "solid" to "moderate" and forecasted a bigger miss on its 2% inflation target for 2019.

In Germany, 10-year government bond yields slipped to their lowest level on record in the month, as shaky economic data drove investors into safe asset classes.

Meanwhile, Bitcoin made a comeback on news that tech giant, Facebook, would be launching its own cryptocurrency, the Libra. This vote of confidence boosted expectations for future demand of Bitcoin, causing a rally from US$4 400 at the start of April 2019 to a peak of US$12 893 during the final week of June 2019.

EM equities were slightly down in the quarter (negative 0.6%), in line with a 2.1% dip in commodity prices, but the MSCI EM Index partly offset losses of 7.3% in May 2019, by increasing by 6.2% in June 2019. During the quarter ended June 2019, returns were firmest in MSCI Europe, Middle East and the African (EMEA) region at 5.1%, followed by gains in the MSCI Latin American Index of 3.9%, while the MSCI Asian Index lost 2.4%. Returns for these three regions were closer in line for the month, with the MSCI Latin American Index up 6.2%, while the MSCI Asia and MSCI EMEA indices posted gains of 6.4% and 5.8%, respectively.

Sentiment improved towards EMs in June 2019. The JP Morgan EM Bond Index (EMBI) spread dropped seven points in the month, reversing a similar rise the month before. The EMBI spread was stable for the quarter, with the largest quarterly deterioration observed for Argentina (22 points), while Romania staged the biggest improvement (23 points).

The JPMorgan EM Currency Index weakened by 0.5% in the quarter. Notable gains for the quarter were made in the Argentine peso (17.4%), Russian ruble (5.9%) and SA rand (4.7%), while the South Korean won weakened by 1.4%. A similar picture emerged for the month, with the biggest gains being made in the Argentine peso (10.4%), Colombian peso (5.6%) and Chilean peso (4.9%), while the rand was the fifth-best-performing EM currency at 4%.

Local markets

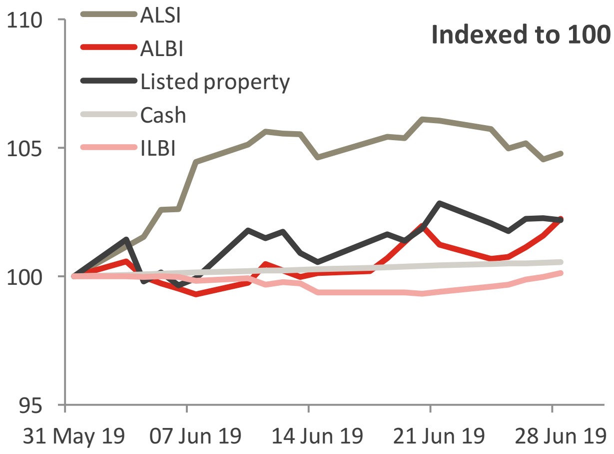
The FTSE/JSE All-Share Index rose 3.9% in the quarter, supported by returns on financial (5.4%) and industrial shares (4.0%). In June 2019, SA equity markets followed global markets higher and ended the month 4.8% up (see chart 6). Resources were the largest contributor to returns in the month. The FTSE/JSE Resources Index soared 10.2% in the month on higher gold prices. The dollar price of gold increased by 7.9% in the month, responding to investors seeking protection against rising uncertainty. The dollar price of platinum picked up 2.5% in the same period.

Oil prices also rose during the month (2.8%), on tensions between the US and Iran. Media reports intimated the US had prepared for strikes on Iranian military targets after Tehran shot down a surveillance drone belonging to the US. In addition, the US Senate has blocked further military deals with Saudi Arabia, stoking further geopolitical tensions.

The FTSE/JSE Industrials Index gained 3.8% in June 2019. Retailers were up by a lesser 0.8% in the month. Gains in the FTSE/JSE Financial Index were more muted for June 2019 at 1.3%. Bank shares were up 0.5% in the corresponding period.

The SA 10-year government bond yield rallied 30 basis points in June 2019 and ended the month at 8.7%. The JSE ASSA All Bond Index lifted 2.2% in the month, while the JSE ASSA Government Inflation-linked Bond Index (ILBI) underperformed at negative 0.1%. Meanwhile, the FTSE/JSE SA Listed Property Index increased by 2.2% in June 2019.

Chart 6: Returns from local asset classes (%)



Source: IRESS, Momentum Investments, data up to 30 June 2019

The SA rand traded firmer in the second half of the month, as dovish DM central bank rhetoric and hopes of positive trade talks between the US and China supported the local currency. The rand strengthened by 1.6% against the euro and 3.0% against the sterling by the end of June 2019. SA's five-year corporate default swap (CDS) spread similarly narrowed by 34 points in the month.

Sanisha Packirisamy

Economist
Momentum Investments

Herman van Papendorp

Head: Macro Research and Asset Allocation
Momentum Investments

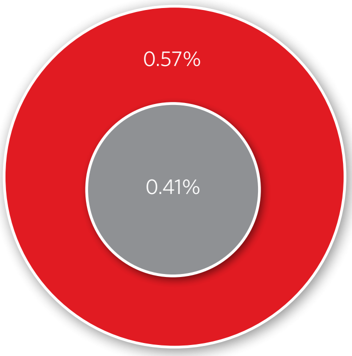
Partially Vesting Smooth Bonus Range
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

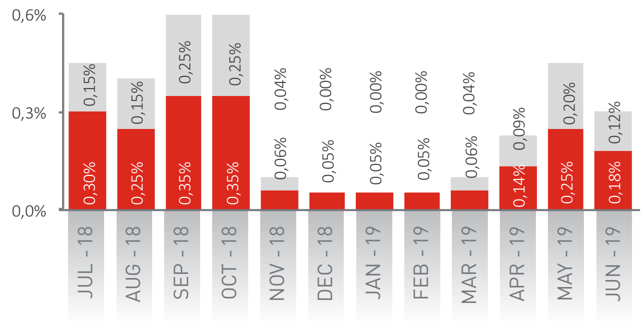
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	97.5% - 102.5%	R12.4bn	0,84%	4,47%

Performance

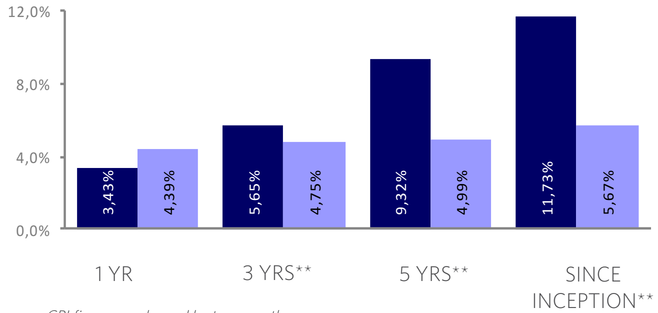
The total bonus* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



The chart below shows the monthly bonuses* for the past 12 months



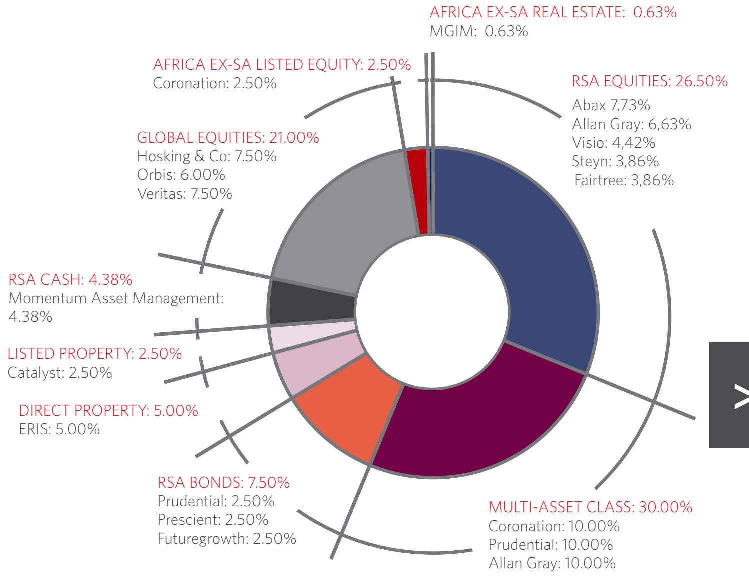
The chart below shows the long term bonus* performance of the Multi-Manager Smooth Growth Fund Global against CPI



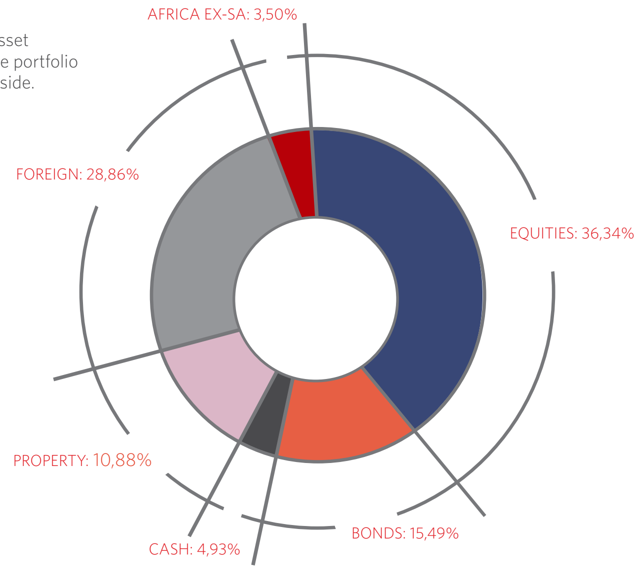
CPI figures are lagged by two months

Asset Allocation

The Africa ex-SA Real Estate allocation is expected to increase gradually over the next 5 years to a total of 2.50%, in line with drawdown notices from Momentum Global Investment Management (MGIM). The strategic asset allocation of the portfolio is shown below.



The effective asset allocation of the portfolio is shown alongside.



In the new world, Trustees, Professional Financial Advisors and members need clear directions to stay on track within the turbulent retirement fund environment. Our best-of-breed multi-manager smooth bonus portfolios with independent governance provide just that.

* Bonuses are net of underlying asset charges but are gross of the policy fee
** Annualised

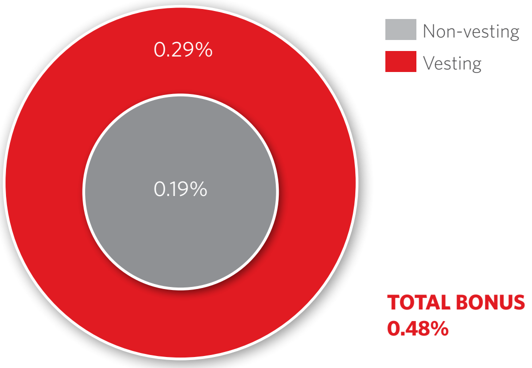
Partially Vesting Smooth Bonus Range
Multi-Manager Smooth Growth Fund Local

Fund Snap Shot

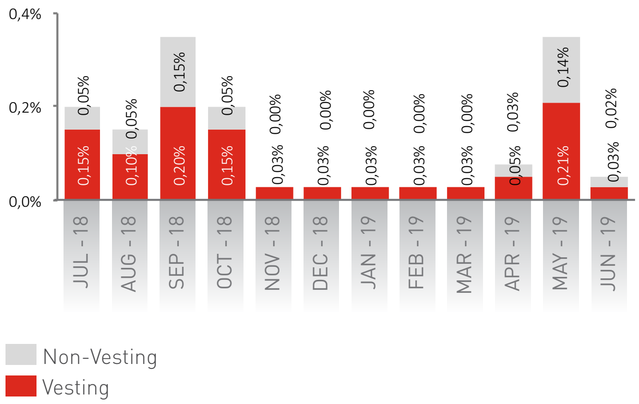
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	95% - 100%	R185m	1,52%	3,03%

Performance

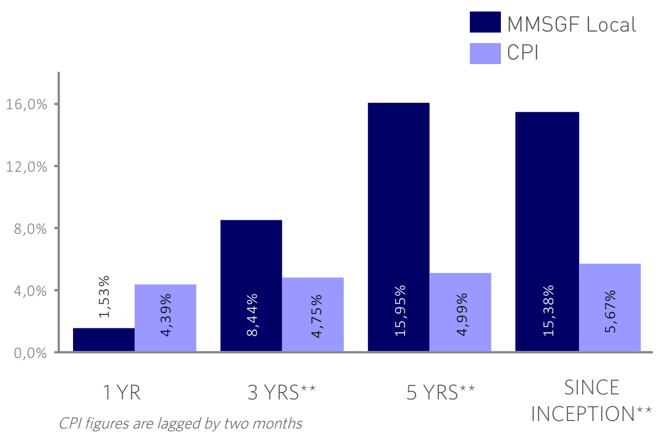
The total bonus* for the past quarter on the Multi-Manager Smooth Growth Fund Local is shown below.



The chart below shows the monthly bonuses* for the past 12 months.



The chart below shows the long term bonus* performance of the Multi-Manager Smooth Growth Fund Local against CPI

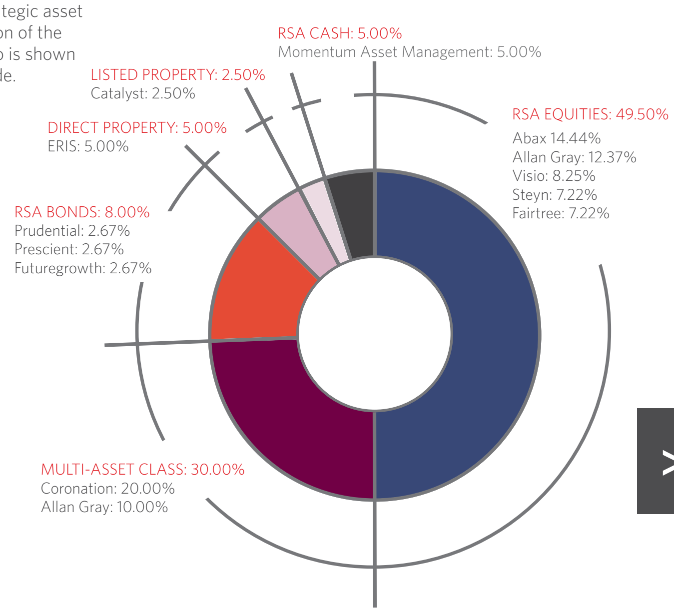


CPI figures are lagged by two months

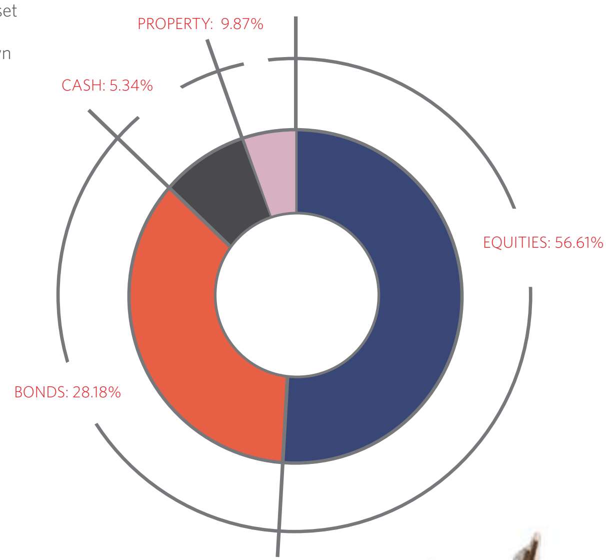
* Bonuses are net of underlying asset charges but are gross of the policy fee
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



From as early as 150 B.C navigators could find their latitude, but ships were lost in shipwrecks because it was impossible to determine longitude. Thanks to **the 17th century sextant**, the navigator could measure the angle between the moon and a celestial body, calculating the exact time at which this distance would occur. Knowing the time meant knowing the longitude.

In the new world, Trustees,Professional Financial Advisors and members need certainty on their journey to financial wellness. Expert guidance from the thought leaders means knowing where you're heading and how to get there.

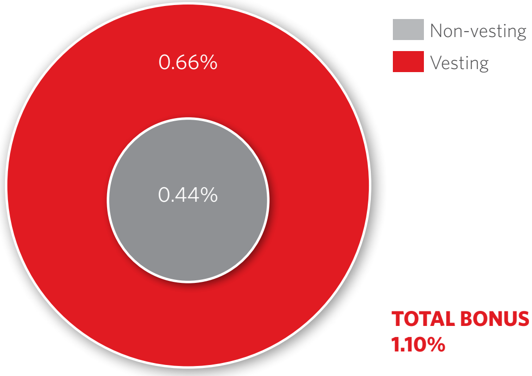
Partially Vesting Smooth Bonus Range
Smooth Growth Fund Global

Fund Snap Shot

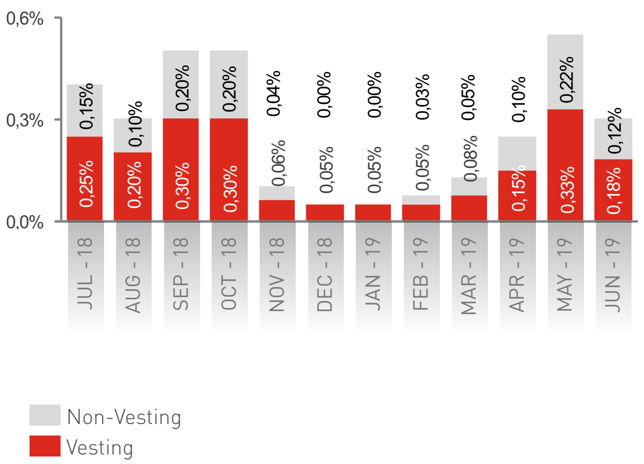
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	100% - 105%	R2.1bn	0,80%	4,43%

Performance

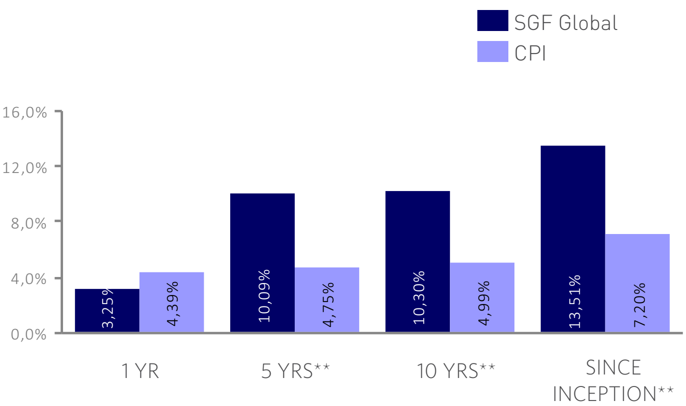
The total bonus* for the past quarter on the Smooth Growth Fund Global is shown below.



The chart below shows the monthly bonuses* for the past 12 months.



The chart below shows the long term bonus* performance of the Smooth Growth Fund Global against CPI.



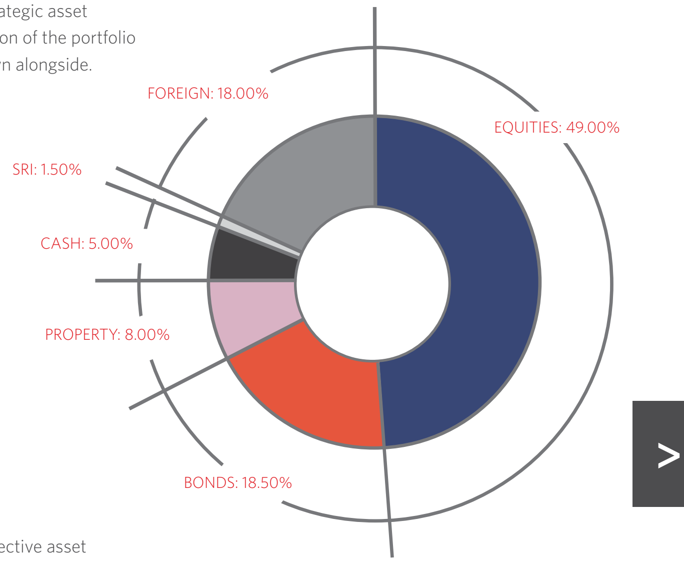
CPI figures are lagged by two months

* Bonuses are net of underlying asset charges but are gross of the Investment Management Fee

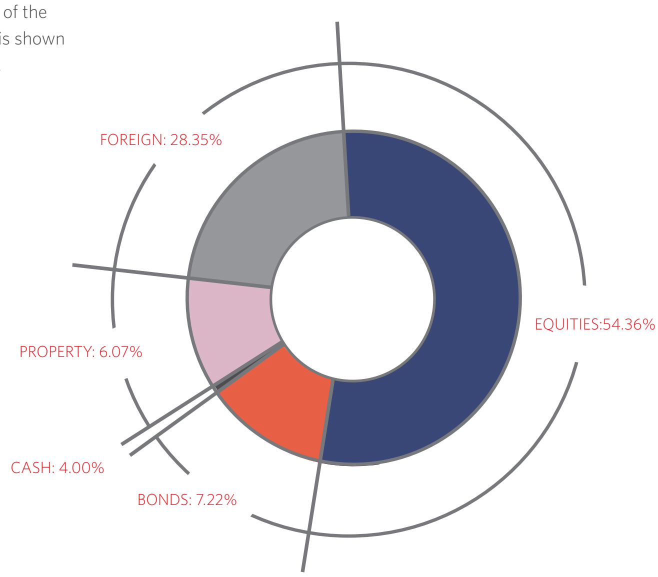
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



The engine order telegraph is used by the pilot on the bridge to instruct the engine room below to power the vessel at the right speed. By moving the handle to a different position on the dial, a bell would ring in the engine room and move their pointer to the same position - a fast and very handy way of powering the vessel away from trouble.

In a world where Trustees, Professional Financial Advisors and employees are looking for greater certainty, Momentum's continuous capital guarantee on benefit payments and smooth inflation-beating returns will result in plain sailing.

Partially Vesting Smooth Bonus Range
Smooth-Edge Fund

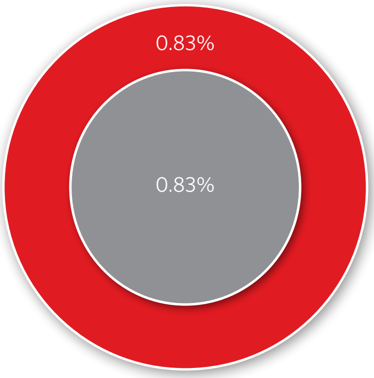
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	100%- 105%	R25m	0.78% *	5.88% *

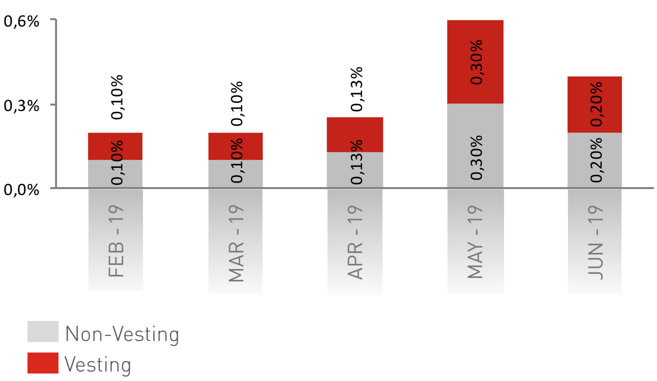
*Based on back-tested bonuses and returns

Performance

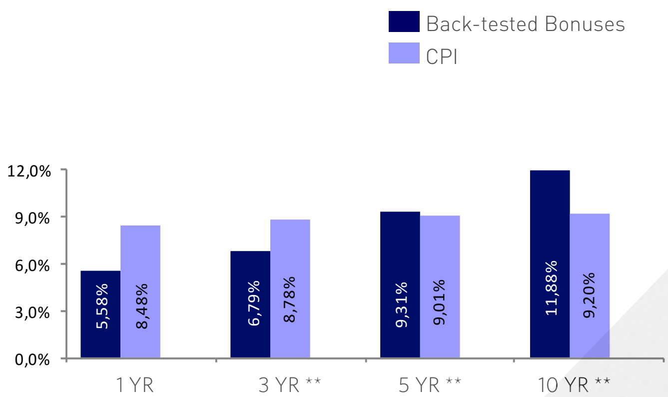
The total bonus* for the past quarter on the Momentum Smooth-Edge Fund is shown below.



The chart below shows the actual monthly bonuses* for the past 2 months.



The chart below shows the long term back-tested bonuses* performance of the Smooth-Edge Fund against CPI



CPI figures are lagged by two months

*Bonuses are net of underlying asset charges but are gross of the Investment Management Fee

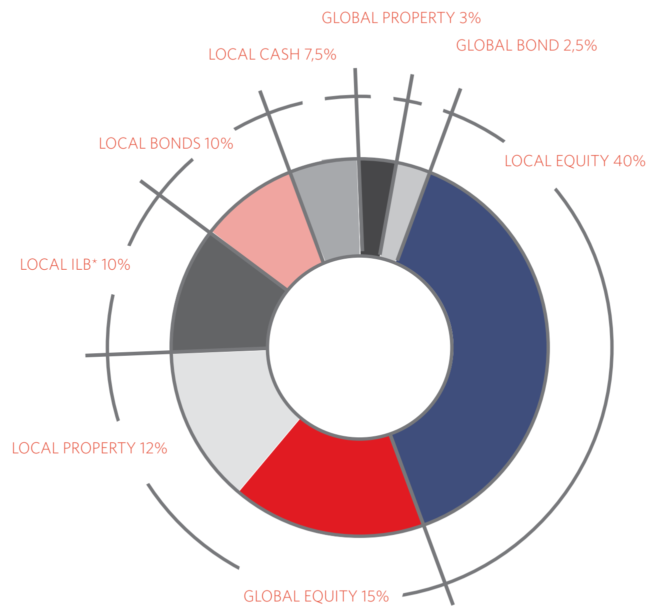
** Annualised

Asset Allocation

The Momentum Smooth-Edge Fund is a new generation smooth bonus solution offering a low-cost, 100% capital guarantee on benefit payments, along with Momentum Corporate's proven smoothing capabilities. In addition to the 100% capital guarantee, on average 50% of bonuses will also be guaranteed on benefit payments.

Not only does this solution offer members inflation-beating investment return prospects and protection from market volatility, but the significantly lower capital charge means more money goes directly to the members' retirement savings to bolster their retirement outcomes.

The strategic asset allocation is shown alongside.



*Inflation-linked bonds

Clarity is a key need of Trustees, Professional Financial Advisors and employees. Our transparent approach to bonus declarations and capital guarantees provide peace of mind on the journey to financial wellness.

Fully Vesting Smooth Bonus Range

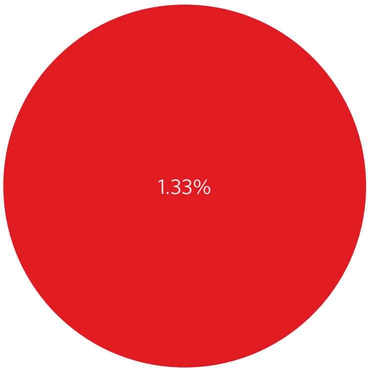
Multi-Manager Secure Growth Fund

Fund Snap Shot

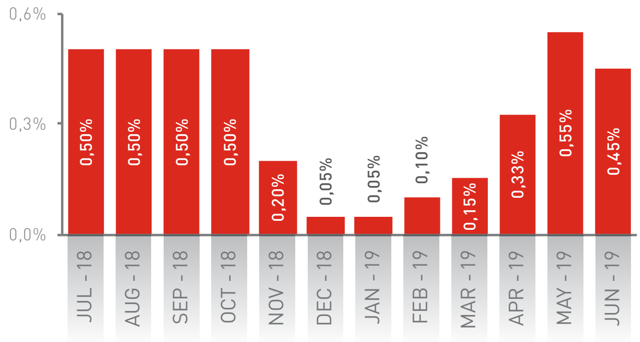
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	100% - 105%	R106.9m	0,67%	4,25%

Performance

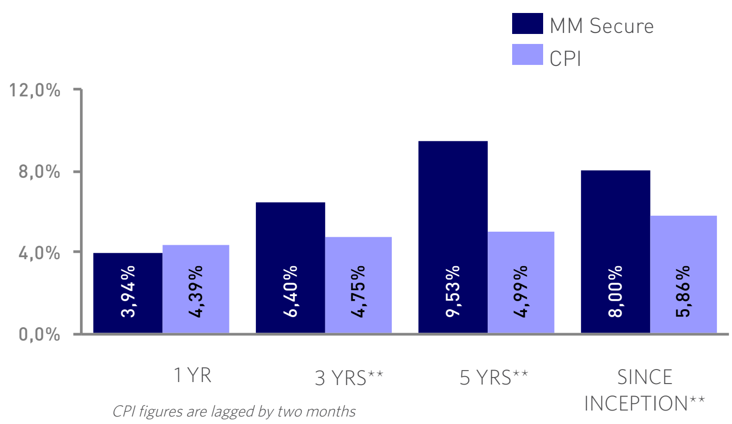
The total bonus* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



The chart below shows the monthly bonuses* for the past 12 months.



The chart below shows the long term bonus* performance of the Multi -Manager Secure Growth Fund against CPI



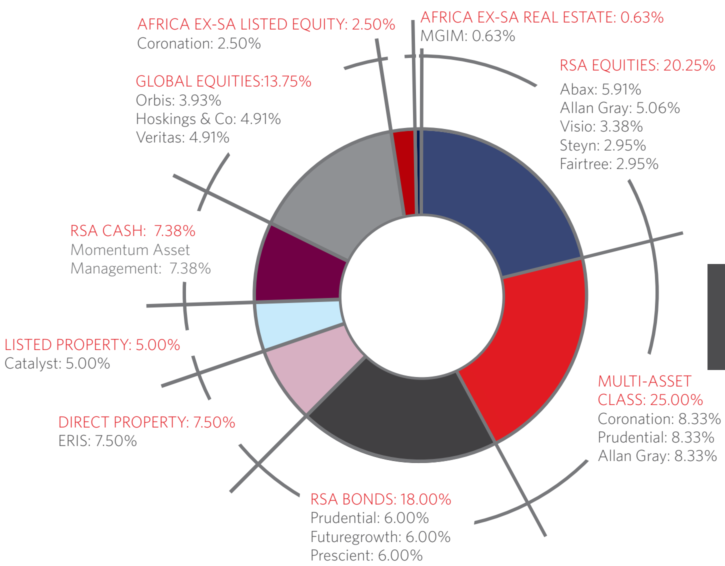
CPI figures are lagged by two months

* Bonuses are net of underlying asset charges but are gross of the policy fee

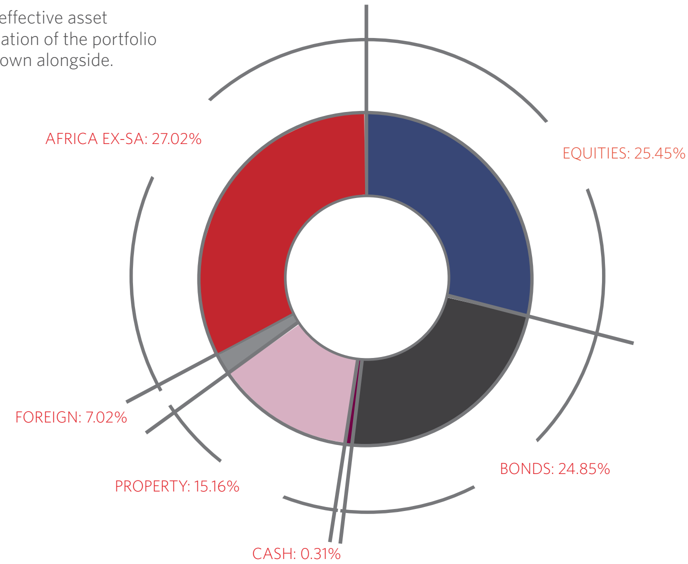
** Annualised

Asset Allocation

The Africa ex-SA Real Estate allocation is expected to increase gradually over the next 5 years to a total of 2.50%, in line with drawdown notices from Momentum Global Investment Management (MGIM). The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



We recognizing that in the new world, nothing less than 100% certainty will do. As a result, our rigorous portfolio construction inspires investor confidence in the prospective investment performance of the Fund.

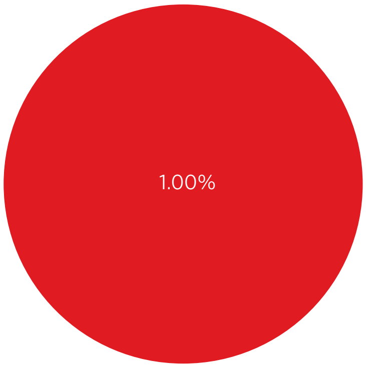
Fully Vesting Smooth Bonus Range
Smart Guarantee + 3 Fund

Fund Snap Shot

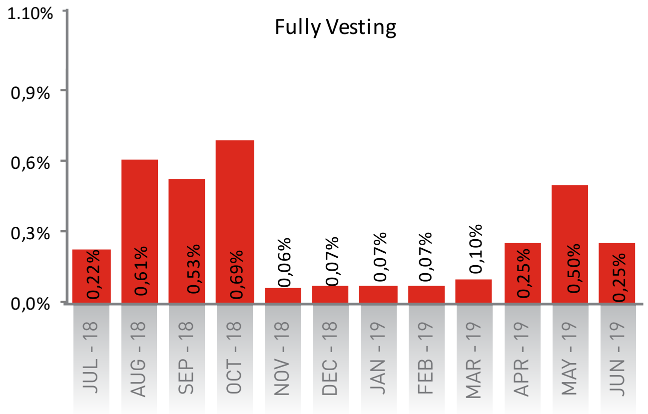
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	97.5% - 102.5%	R408.m	0.87%	4,77%

Performance

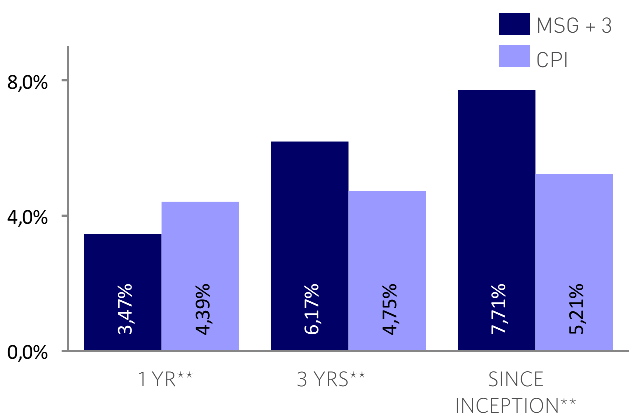
The total bonus* for the past quarter on the Smart Guarantee + 3 Fund is shown below.



The chart below shows the actual monthly bonuses* for the past 12 months.



The chart below shows the long term bonus* performance of the Smart Guarantee +3 Fund against CPI.



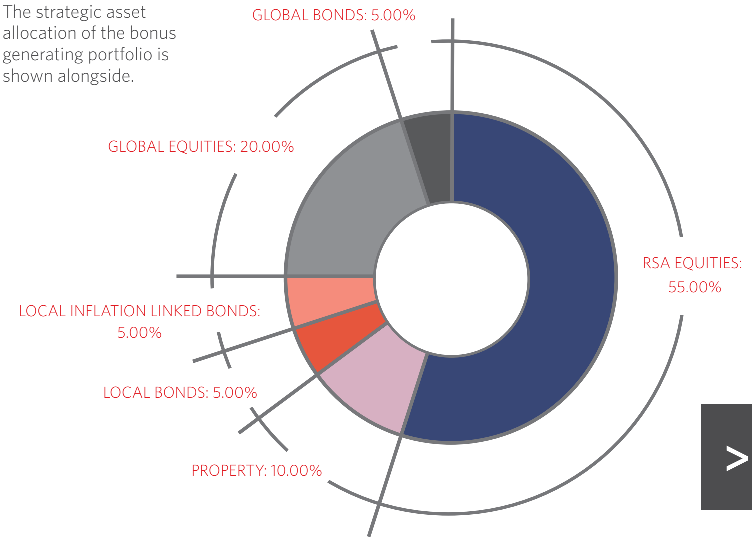
CPI figures are lagged by two months

* Bonuses are net of underlying asset charges but are gross of the investment management fee

** Annualised

Asset Allocation

The strategic asset allocation of the bonus generating portfolio is shown alongside.



For more information on the bonus generating portfolio, Momentum MoM Enhanced Factor 7, please refer to our website: https://www.momentum.co.za/for/business/products/funds-at-work/fund-fact-sheets

For bonus declarations, 85% of the underlying assets returns of the bonus generating portfolio are smoothed over a three-year period as per the smoothing formula. The liability driven investment strategy includes a dynamic protection overlay to secure the guarantee.

As a result, for disinvestments other than guaranteed benefit payments the underlying assets value is sensitive to both asset values and interest rates and the effective asset allocation will reflect both the bonus generating portfolio and the dynamic protection overlay.

Bonuses to be declared

Given that the monthly bonuses are based on the weighted average of the previous 36 months' returns of the bonus generating portfolio, it is possible to calculate the future bonuses that will be declared under various future investment return assumptions. Assuming zero returns over the following 34 months (there is a 2 month lag), around **4.85%** of bonuses will still be declared.

Prior to the introduction of the compass, position, destination, and direction at sea were primarily determined by the sighting of landmarks, supplemented with the observation of the position of celestial bodies. On cloudy days, even the Vikings were at a loss for which way to go.

Because the compass is used for calculating heading, it provides a much improved navigational capability. And on our compass, security is the number one moral imperative.

Smooth Bonus Portfolios Key Features

		Fund Return Objective	Manager	Mandate Type	Guarantee on Benefit Payments[1]	Market Value Adjustment on Specified Exits[2]	Capital Charge	Policy Fee or Investment Management Fee*	Inception Date
Partially Vesting	**Multi-Manager Smooth Growth Fund Global**	CPI + 4% pa, net of the policy fee and underlying asset charges over a 5 year time horizon	Multi-Manager	Moderate Balanced	100% of net capital invested and vested bonus declared (net of the Policy fee)	Yes	0.90% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	January 2004
Partially Vesting	**Multi-Manager Smooth Growth Fund Local**	CPI + 4% pa, net of the policy fee and underlying asset charges over a 5 year time horizon	Multi-Manager	Moderate Balanced	100% of net capital invested and vested bonus declared (net of the Policy fee)	Yes	0.90% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	January 2004
Partially Vesting	**Smooth Growth Fund Global**	CPI + 4% pa, net of the investment management fee and underlying asset charges over a rolling 6 year period	Momentum Investments	Moderate Balanced	100% of capital invested and vested bonus declared (net of the investment management fee)	Yes	0.90% pa	0.45% of the first R10m, 0.35% of the next R40m, 0.25% of the excess above R50m[3]*	January 1989
Partially Vesting	**Smooth-Edge Fund**	CPI + 4% pa, net of the investment management fee and underlying asset charges over a rolling 5 year period	Momentum Investments	Moderate Balanced	100% of net capital invested and vested bonus declared (net of the investment management fee)	Yes	0.60% pa	0.25% pa[3]*	February 2019
Fully Vesting	**Multi-Manager Secure Growth Fund**	CPI + 2% pa, net of the policy fee and underlying asset charges over a 5 year time horizon	Multi-Manager	Moderate Conservative Balanced	100% of net capital invested and total bonus declared (net of the Policy fee)	Yes	1.40% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	November 2007
Fully Vesting	**Smart Guarantee +3 Fund**	CPI + 3% pa, net of the investment management fee and underlying asset charges over a 7 year time horizon	Liability Driven Investment by Momentum Investments	Moderate Balanced	100% of net capital invested and total bonus declared (net of the investment management fee)	Yes	0.50% pa	0.75% pa[3]*	October 2013

*Investment management fee includes underlying local manager fees, excludes net priced asset fees and performance fees where applicable.

KEY:

1. Benefit payments generally refer to resignation, retirement, death, disability and dismissals. Specific benefit payments and terms and conditions are specified in client policy contracts.
2. Market value adjustments may be applied on member switches out, terminations and other non-benefit payments if a client is underfunded.
3. Depending on the underlying mandates that are negotiated with asset managers, net unit priced fees are and performance fees may be deducted from the underlying assets.

Contact Details

Email: emailus@momentum.co.za
Website: www.momentum.co.za