momentum
corporate

Smooth Bonus Report

First Quarter 2020

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

>

Looking back over the past quarter

Dear valued investors

During the first quarter of 2020, there were massive declines in the South African and global equity markets, largely due to the effects of the COVID-19 pandemic. People are dealing with many uncertainties, including how this has affected their retirement savings.

Herman van Papendorp and Sanisha Packirisamy from the macro research team at Momentum Investments give further market and economic commentary on page 6.

The effect of the market collapse on Momentum Corporate smooth bonus portfolios

Like all growth-orientated investment portfolios, the underlying asset classes of smooth bonus portfolios fell dramatically.

In our corporate smooth bonus portfolios, we guarantee that:

- Our bonuses will not be less than 0% after fees
- Benefit payments will be paid at fund value

These are some of the key reasons that many of our clients have invested in our smooth bonus portfolios. Such conditions remain effective during trying economic conditions and materially reduce the anxiety associated with being invested.

The fund value of our clients' investments did not fall. However, the market value (value of the assets backing the investment) decreased. The market value divided by the fund value provides the funding level of our portfolio, and many of our portfolios' funding levels were below 85% (at the end of March) but subsequently strengthened to around 90% (at the end of April). The low funding level is no cause for alarm but does necessitate specific management actions, which are set out below.

Management actions implemented

The following management actions have been taken:

- Our smooth bonus portfolios are temporarily closed to new business. This is to ensure new investments are treated fairly and not allocated to an under-funded portfolio. Current contributions for existing clients will still be accepted into the portfolio.
- Given the low funding levels, shareholders have injected capital on a permanent basis, where necessary, to manage the funding position.
- As funding levels fell from 90% to 85%, the smooth bonus portfolios were de-risked to the extent that the strategic allocation to equities was reduced by 10% of the portfolio value.

Launch of the Momentum Universal smooth bonus range in June 2020

Although we will still be accepting contributions into our existing portfolios, the following new portfolios will be launched with a fully funded position and not have to recover the funding level before starting to deliver positive returns.

Instead of opening new bonus series for each of the Smooth Growth Fund Global (SGF Global), Momentum Multi-Manager Smooth Growth Fund (MMSGF Global) and Smooth-Edge Fund (SEF) portfolios, we will be launching similar solutions which have a 'universal' funding level applicable for all invested clients (unlike the current portfolios that have a scheme/member funding level applicable to each participating retirement fund or member). These portfolios are not the same and there is no intention of merging them in future.

The Momentum Universal Smooth Bonus range is as follows:

- **Momentum Universal Multi-Manager Smooth Growth Fund:** A new portfolio with one 'universal' funding level and the underlying investments managed in the same way as the MMSGF Global.
- **Momentum Universal Smooth Growth Fund:** A new portfolio with one 'universal' funding level and the underlying investments managed in the same way as the SGF Global.
- **Momentum Universal Smooth-Edge Fund:** A new portfolio with one 'universal' funding level and the underlying investments managed in the same way as the SEF.

In these uncertain times, smooth bonus is meeting our investors' needs in providing smoothed returns and removing the volatility that would be experienced in alternative market-linked investment portfolios. Most importantly, smooth bonus gives our investors a smoother ride to their destination of retirement.

If you wish to invest your retirement fund's lump sums and/or contributions into one of the new portfolios, please contact your Momentum servicing representative or me, and we will provide further details.

As we all work together to overcome the COVID-19 pandemic and deal with these challenging times, we hope that you are keeping safe.

Warm regards

Steed Duncan-Smith

Client Relationship Manager
Momentum Corporate

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Sequence of returns risk

Does the order of returns matter?

by Ankia Pietersen

Introduction

The COVID-19 pandemic has caused financial markets worldwide to crash with the FTSE/JSE All-Share Index falling over 35% from 17 January 2020 to 19 March 2020. The widespread fear and uncertainty caused by the pandemic have led to increased volatility in the financial markets.

Retirees nearing or entering retirement are particularly at risk during these times, and they, like all investors, need to understand the risks their investments are subject to. One of the most important, but often overlooked risks is called "sequence-of-returns" risk or "sequence risk".

What is sequence risk?

Sequence risk is the risk that the order (or sequence) of investment returns negatively impacts the investor's portfolio. Sequence risk is mostly present where there are regular withdrawals from a portfolio subject to market volatility (i.e. a market-linked portfolio).

Living annuitants are a good example of such a scenario, where pensioners are particularly exposed to this risk as they make regular withdrawals in the drawdown phase of retirement. When living annuitants draw an income during times when the market is down, they will be forced to sell assets at lower prices. As a result they will need to sell more units in their portfolio to maintain their desired income. It also means there are fewer units available in the portfolio to take advantage of the market recovery when it does happen.

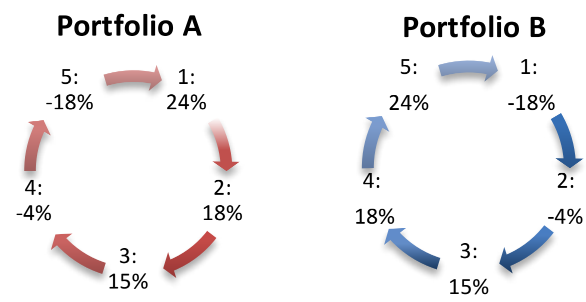
Sequence risk is at its greatest at the start of retirement when a living annuitant's retirement savings is typically at its highest value. Any losses during this period can significantly reduce the value of the portfolio and have a detrimental effect on the probability of the living annuitant's retirement savings "out-living" the pensioner.

It can take several years to recover capital lost during a market crash. The magnitude of the returns when the market recovers would have to be greater than the negative returns during the market crash. To illustrate this point consider investors who lose 20% of their retirement savings. It would require a return of 25% in the next period to restore the retirement savings to its original amount.

Why the sequence of returns matters

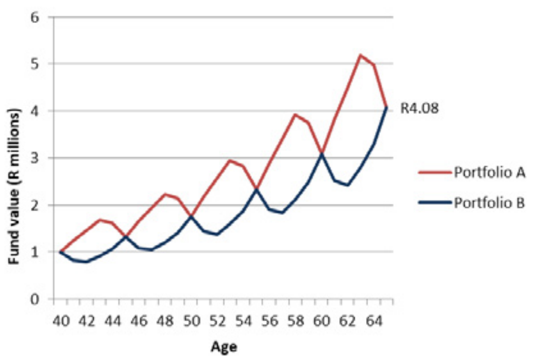
To further demonstrate the effect of sequence risk, let us consider the following example: Two portfolios earn the same average rate of return for 25 years, but the sequence of these returns is reversed. Figure 1 illustrates the returns for each portfolio for five years, with the return path repeating itself every five years. Portfolio A experiences the highest return at the start of the investment period and ends off with the lowest return. The order is reversed for Portfolio B.

Figure 1: Cycle of returns



Consider the case where an investor starts with an initial investment of R1 000 000 and makes no withdrawals from the portfolio for the entire investment period. Both portfolios will have the same value (R4 077 867) after 25 years (see graph 1 below).

Graph 1: Fund performance without cash flows



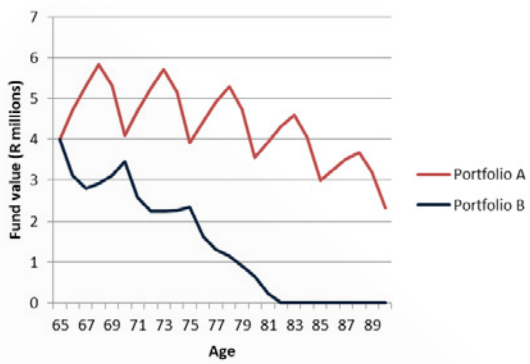
Given that there are no withdrawals, the order (or sequence) of returns is not important, as both portfolios will end up with the same value. This, however, is not a reflection of reality for living annuitants, as they actively withdraw money from the portfolio as a means of income.

In the next section we take a look at how this portfolio performs once we introduce withdrawals into the system.

Path dependence in the drawdown phase

Suppose an investor is invested in either of these portfolios during the drawdown phase of their retirement. Let us assume the investor will draw a retirement income of 5% of an initial retirement fund value of R 4 000 000 (this is the accumulated value from the previous example). The income will be increased by 3% per year to allow for inflation. An investor invested in Portfolio B will run out of money by the age of 83, while an investor invested in Portfolio A will have funds available past the age of 100. Graph 3 illustrates the effect the sequence of returns has on the portfolio, and also demonstrates the sustainability of the drawdown for each scenario.

Graph 3: Fund value with annual withdrawals



The above shows how the pensioner's nest egg struggles to recover when a retiree is making constant withdrawals during periods where the investment returns are negative. This increases the likelihood of retirees outliving their retirement savings.

How can the risk be managed for living annuitants?

Although sequence risk cannot be avoided, it can be managed by ensuring a living annuitant's retirement savings are shielded from market volatility.

Given its design, smooth bonus portfolios are well placed to manage sequence risk for living annuitants.

Smooth bonus portfolios reduce the volatility of an investment portfolio through a process called "smoothing". Smoothing does not increase or reduce the underlying returns; it simply changes the pattern of the increases as the insurance company distributes monthly bonuses in a more consistent manner. During periods of strong investment performance, a portion of the investment return is held back in a reserve. This reserve is used to subsidise bonuses during periods of weaker or negative investment performance.

So how would a smooth bonus portfolio provide protection against sequence risk? Withdrawals are made from the pensioner's book value as opposed to the market value account. The book value account is far more stable than the market value account and therefore, to a certain extent protects the pensioner's investment when withdrawals are made during depressed market periods.

A key advantage of the smooth bonus solution is that it provides reduced volatility through the smoothing mechanism and not through a defensive investment strategy. As such pensioners are able to access investment strategies that have higher allocations to growth asset classes than would typically be the case.

The high exposure to growth asset classes gives investors the opportunity to earn inflation-beating returns. Living annuitants can therefore protect the real value of their retirement savings, and earn increases in a way that offers some protection against sequence risk.

An additional benefit is that Momentum Corporate guarantees any capital invested in its smooth bonus portfolios and, depending on the portfolio chosen, future bonuses can be fully or partially guaranteed. These guarantees are applicable on certain insured benefit payment events, which include annuity drawdowns for a post-retirement scheme.

Conclusion

The sequence in which investors earn returns can affect the value of their investment. This is particularly true for living annuitants given that they make regular withdrawals to provide for income in retirement. The sequence of returns can therefore affect the sustainability of the retirement income of living annuitants.

When planning for retirement it is important that living annuitants are aware of all the related risks, including sequence risk, so they can take appropriate action to reduce or mitigate the respective risks. Smooth bonus portfolios, while not immune to adverse market conditions, can significantly reduce sequence risk for living annuitants, while at the same time allowing the annuitants to target inflation-beating returns through solutions that maintain material growth asset exposure. We certainly believe it is an alternative worth considering.

Ankia Pietersen

Product Specialist
Structured Solutions

Momentum Investments market commentary for the quarter ending March 2020

by Sanisha Packirisamy and Herman van Papendorp

Highlights

Markets

- Global financial markets plunged in the first quarter of 2020, as the vicious economic and health shock intensified, sending shares further into correction territory.
- The MSCI Developed Market (DM) Index lost more than a fifth of its value in the first quarter of the year, as the COVID-19 pandemic roiled financial markets. As growth fears deepened in the first quarter of 2020, emerging market (EM) equities tumbled 23.6%, alongside a 23.3% drop in the Bloomberg Commodity Price Index.
- The local equity market rout followed suit, as panic set in. The FTSE/JSE All-Share Index sank 24.1% in the first quarter of the year, dragged lower by a 39.5% collapse in the FTSE/JSE Financials Index and a 25.3% lurch down in the FTSE/JSE Resources Index.
- The JSE Assa All Bond Index fell 8.7% in the quarter, while the JSE Assa Government Inflation-linked Bond Index traded 16.8% weaker for the same period. Meanwhile, the FTSE/JSE SA Listed Property Index nearly halved in value since the end of 2019.
- During the indeterminate time as COVID-19 continues to spread, uncertainty will remain about the ultimate trajectory of the global economy with volatility in financial markets likely staying high, as growth expectations ebb and flow.
- Throughout this risk-off period, defensive asset classes (such as DM bonds, the United States (US) dollar and gold) are likely to trump the returns of risky asset classes (like global equities, credit, EM debt and EM currencies).
- Once the virus effect has played out, global supply chains become unblocked again and isolation measures cease, there will be a significant rebound in economic growth and company profits on the back of a normalisation in economic activity and the lagged effect of massive policy stimulus undertaken during the crisis. This economic rebound will renew risk appetite by global investors and will be discounted by rising risky asset prices ahead of the time. Whether this will occur within weeks, months or quarters depends on how the pandemic plays out.

Economics

- The barrage of measures in fiscal and monetary policy enacted by global policy makers in reaction to COVID-19 should induce a strong lagged cyclical recovery in global growth in the aftermath of COVID-19. Given the unpredictable nature of the spread of COVID-19, there is merit in mapping out alternative, plausible economic trajectories.

- In the V-shaped recovery, or best-case scenario, the globe undergoes a rapid growth slowdown in the first half of 2020, followed by an equally rapid recovery from the middle of 2020, as the virus spread is contained by then, hence, allowing annual growth rates to fully absorb the shock. This scenario necessitates strong public health structures and highly effective policy responses, which ultimately lead to a strong rebound in economic activity.

- In the U-shaped recovery, or base-case scenario, a sluggish upturn follows a more protracted slowdown.

  Disrupted global supply chains are only restored subsequent to the peak in COVID-19 fatalities in the third quarter of 2020, resulting in an economic recovery only taking hold from late 2020 and extending into 2021. While responses to public health in this scenario are sufficient, physical distancing and the control over the movement of citizens persist for additional months, in an attempt to prevent an escalation or resurgence in infections.

- In a protracted U-shaped recovery, or bear-case scenario, a second wave of the COVID-19 outbreak flares up, with quarantine measures extended to more regions and for longer. A re-emergence of disruptions in supply chains is likely under this scenario, and these bottlenecks would prolong the downturn in local demand and exports, negatively affecting corporate profitability and raising corporate credit risks.

High volatility in financial markets, as growth expectations ebb and flow

Global financial markets plunged in the first quarter of 2020, as the vicious economic and health shock intensified, sending shares further into correction territory. The responding bazooka of central bank and government spending plans, nevertheless, slowed the drop in global equity markets late in the quarter.

The CBOE Volatility Index (Vix), or fear gauge, climbed nearly 40 points in the first quarter of the year to 53 points, but touched an intra-quarter high of 83 points. Investor angst led to the MSCI All Country World Index crashing in the middle of the quarter, but strong efforts from policymakers to curb the spread of COVID-19 led a reversal in equity markets at the end of the quarter. The MSCI All Country World Index weathered a 21.4% fall in the first three months of 2020, led weaker by almost equally limp returns from developed and emerging equity markets.

The MSCI DM Index lost more than a fifth of its value in the first quarter of the year, as the COVID-19 pandemic roiled financial markets. US, European and Japanese bourses contributed to the extensive losses in the first quarter of 2020. The Eurostoxx 50 Index haemorrhaged 25.3% in the first quarter of the year, followed by a 19.6% crash in the S&P 500 Index and a 19.2% plunge in the Nikkei 225 Index.

DM government bond yields plummeted further in the first quarter of 2020, as investors retreated to safety. The US 10-year government bond yield rallied 125 basis points to an all-time low of 0.6%, while the German

10-year government bond yield sank nearly 30 basis points deeper into negative territory to negative 0.5%.

As growth fears deepened in the first quarter of 2020, EM equities tumbled 23.6%, alongside a 23.3% drop in the Bloomberg Commodity Price Index. The MSCI Latin America Index nosedived 45.6% in the first three months of the year, as investors lost confidence in Brazil's ability to improve its economic outlook.

This was followed by a 33.9% crash in the MSCI Europe, Middle East and the Africa (EMEA) Index, following a scaling up of measures in

South Africa (SA) and Russia (the two-largest constituents of the MSCI EMEA Index) to fight the COVID-19 pandemic. Losses in MSCI Asia Index trailed at 18.1%, after China eased the lockdown in Hubei, signalling increased control over the outbreak.

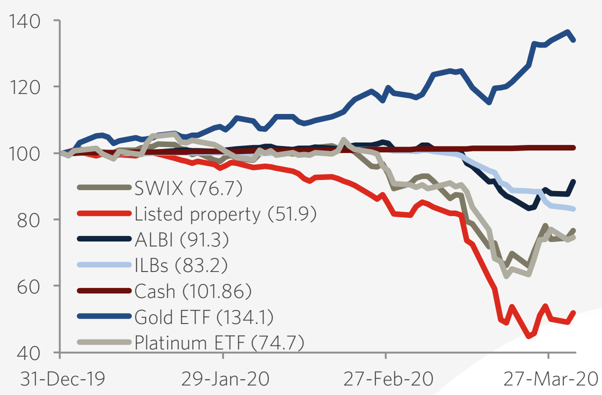
Risk appetite worsened towards EMs in the first three months of the year, with the JP Morgan EM Bond Index (Embi) spread ending the first quarter of 2020 nearly 300 points higher. Argentina, Indonesia and Russia were among the countries which experienced the largest deterioration in credit default swap (CDS) spreads since the end of 2019.

The local equity market rout followed suit, as panic set in. The FTSE/JSE All-Share Index sank 24.1% in the first quarter of the year, dragged lower by a 39.5% collapse in the FTSE/JSE Financials Index and a 25.3% lurch down in the FTSE/JSE Resources Index. In SA's fixed income markets, the SA 10-year government bond yield sold off 186 basis points since the end of 2019. The bulk of the sell off was generated in March 2020, when yields spiked more than 180 basis points. The JSE Assa All Bond Index fell 8.7% in the quarter, while the

JSE Assa Government Inflation-linked Bond Index traded 16.8% weaker for the same period.

Meanwhile, the FTSE/JSE SA Listed Property Index nearly halved in value since the end of 2019 (see chart 1).

Chart 1: Returns from local asset classes (%)



Source: Iress, Momentum Investments, data up to 31 March 2020

An adverse shock to risk appetite caused by the virus and further downgrades of SA's sovereign rating by Moody's (to Ba1) and Fitch (to BB) rating agencies caused the rand to spike to historic levels. The rand weakened by 21.6% against the US dollar, 20.4% against the euro and 16.4% against the pound in the first quarter of the year. SA's five-year CDS spread shifted nearly 260 points above levels seen at the end of 2019.

During the indeterminate time as COVID-19 continues to spread, uncertainty will remain about the ultimate trajectory of the global economy, with volatility in financial markets likely staying high, as growth expectations ebb and flow. Throughout this risk-off period, defensive asset classes (such as DM bonds, the US dollar and gold) are likely to trump the returns of risky asset classes (like global equities, credit, EM debt and EM currencies).

Once the effect of the virus has played out, global supply chains become unblocked again and isolation measures cease, there will be a significant rebound in global economic growth and company profits on the back of normalisation in economic activity and the lagged effect of massive policy stimulus undertaken during the crisis. This economic rebound will ignite renewed risk appetite by global investors and will be discounted by rising risky asset prices ahead of the time. Whether this will occur within weeks, months or quarters depends on how the COVID-19 pandemic plays out.

In terms of a possible timeline, a sustainable rebound in the returns from riskier asset classes will only be fundamentally justified once an infection peak is in the offing, with a subsequent economic recovery then on the horizon.

Research from Bank of America shows that equity bear markets linger for a while after the initial 20% drop (reached on 12 March 2020), with further downside for about three to four months. If the history of the equity bear market is any guide, this would point to a possible bottoming in equity markets around the middle of 2020.

The meaningful adjustments in asset prices in February and March 2020 intimate that some degree of a dire economic outcome is at least already discounted by global equities, government bonds, credit, commodities and currencies. Research from JP Morgan has further shown valuations of risky asset classes are now cheap against history (with DM credit, SA bonds and EM currencies being the cheapest), while defensive asset classes are now expensive (with the US dollar, DM bonds and gold the priciest).

At the 9 April 2020 equity market close in the US, the S&P 500 Index was down 18% from its 19 February 2020 peak, which is still less than the median (28%) and average (31%) drawdowns experienced in the past 25 equity bear markets, and much smaller than the peak-to-trough declines in the 2001 dot-com bear market (35% down), the 1973 oil crisis (48% down) and the global financial crisis (GFC) bear market (52% down). This would suggest that not all the potential economic growth downside is reflected in the US equity market, particularly if the economic growth scenario trajectory turns out to be anything worse than a short-lived dip in global demand.

Mapping out alternative economic trajectories given the unpredictable spread of COVID-19

Globally, policymakers have responded aggressively in an attempt to avoid a prolonged economic crisis from the COVID-19 pandemic. In some countries, the fiscal responses unleashed exceed the stimulus triggered in the GFC. As COVID-19 induces a supply-side shock to the global economy through its effect on world-wide supply chains and an idiosyncratic demand-side shock, where large parts of the global economy are in lockdown mode and not spending on discretionary items, the typical demand-side stimulus responses of monetary and fiscal policies are unlikely to prove very effective during the crisis. However, the barrage of measures in fiscal and monetary policy enacted by global policy makers in reaction to COVID-19 should induce a strong lagged cyclical recovery in global growth in the aftermath of COVID-19.

Given the unpredictable nature of the spread of COVID-19, there is merit in mapping out alternative, plausible economic trajectories.

In the first scenario, a V-shaped recovery, or best-case scenario, is considered. In our view, this is a scenario in which the globe undergoes a rapid slowdown in growth in the first half of 2020, followed by an equally rapid recovery from the middle of 2020, as the virus spread is contained by then, hence, allowing annual growth rates to fully absorb the shock. This scenario necessitates strong public health structures and highly effective policy responses, which ultimately lead to a strong rebound in economic activity.

The Harvard Business Review claims most prior epidemics followed a V-shaped economic trajectory. For this scenario to unfold, either a pharmaceutical breakthrough is required or government measures need to prove effective in containing the spread of the virus, by the second quarter of 2020, so quarantines are quickly lifted and disruptions in supply chains are limited to the first half of the year, with normal production resuming around the middle of 2020.

Under a V-shaped scenario, SA growth would still suffer from constraints in electricity supply and weak consumer and business sentiment. In light of an escalation in the number of COVID-19 infections, President Cyril Ramaphosa announced an escalation of containment measures to slow the progression of the disease. In a V-shaped scenario, these measures would be expected to hit discretionary spend and business output, and would leave the SA economy with a still-sizeable contraction in growth of about 3% in 2020.

Meanwhile, the plunge in international oil prices would translate into downward pressure on headline inflation, with a muted pass through from rand weakness (as struggling retailers clamber to protect volume growth) and would likely keep inflation well within the target band in the medium term. After executing 125 basis points worth of easing since the start of 2020, the Sarb would likely pause its interest-rate-cutting cycle after another 100 basis points of cuts by the third quarter of 2020.

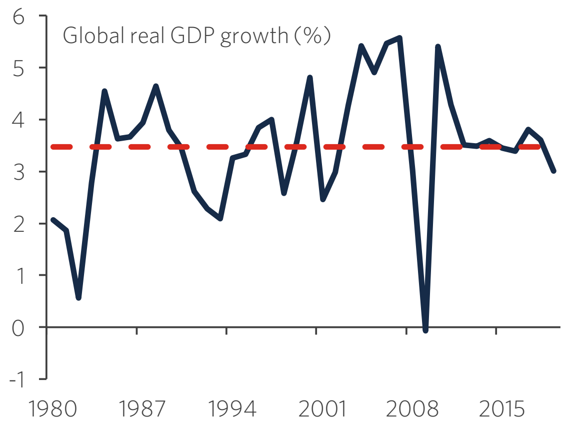
In this environment, SA's current account deficit ratio is likely to remain close to its long-term average of around 3.0% of gross domestic product (GDP). SA's fiscal deficit ratio is nevertheless expected to expand to high single digits, due to fiscal stimulus measures because of COVID-19, strained revenue collection and difficulty in achieving the planned cuts in wage bills in the public sector. Subsequently, following Moody's ratings downgrade of SA's sovereign rating to junk and a further notch downgrade by Fitch, this scenario includes a further rating downgrade by Standard and Poor's (S&P) in 2020.

A second U-shaped economic recovery is considered, as our base-case scenario, in which a delayed and sluggish upturn follows a more protracted slowdown. Under the U-shaped scenario, in our view, disrupted global supply chains are only restored subsequent to the peak in COVID-19 fatalities in the third quarter of 2020, resulting in an economic recovery only taking hold from late 2020 and extending into 2021.

While responses to public health in this scenario are sufficient, physical distancing and the control over the movement of citizens persist for additional months in an attempt to prevent an escalation or resurgence in infections.

Under this scenario, announced global efforts in fiscal and monetary policy are only likely to benefit growth from the fourth quarter of 2020 and are expected to facilitate a recovery into 2021. According to the International Monetary Fund (IMF), world growth troughed at negative 0.1% in 2009, after the GFC, while the average, since 1980, printed closer to 3.5% (see chart 2).

Chart 2: Global growth has averaged 3.5% historically



Source: IMF, Momentum Investments

Global growth in this U-shaped environment is likely to fall to negative 2.3% in 2020, before recovering to 2.9% in 2021. Growth on a sectoral basis will differ substantially, in our view. Areas such as tourism, hospitality and the airline industry will experience a permanent loss in demand during COVID-19, which is largely irrecoverable, while other discretionary-spending sectors could see delayed demand until after the crisis.

Growth in the US is unlikely to escape a meaningful contraction in this scenario of about 5%, as shocks to the real economy, through the crash in financial markets and enforced social isolation, would weigh heavily on household demand in the interim. Despite extensive interest-rate cuts and additional liquidity-easing measures by the US Federal Reserve, as well as government stimulus packages, discretionary consumer spending would be negatively affected well into the third quarter of 2020, by dashed consumer sentiment and restrictions on the movement of people.

Although the European region already started to underperform towards the end of 2019, under a U-shaped recovery, we would expect additional European governments to impose more stringent restrictions on the movement of citizens, to curb the spread of the virus, resulting in a sharper contraction in economic activity of about 6.5% in 2020. While Hubei in China is in the early stages of its recovery, a lower-than-usual availability of migrant workers may delay the full resumption of activity at manufacturing plants. With inventories being drawn down, a shortage of critical inputs may delay China from operating at full capacity, leaving growth in 2020 at about 1%. Moreover, McKinsey warns "the unpredictability of the timing and extent of the demand rebound will mean confusing signals for several weeks".

Under a U-shaped scenario, SA growth crumples to about negative 5.0%, as discretionary spending and business output is hit harder under the nationwide lockdown. Exports would stay weaker for longer, due to lower global demand, while downtrodden consumer and business confidence as well as ongoing constraints in electricity supply would dampen local demand.

Suppressed international oil prices would translate into downward pressure on inflation, leaving the headline figure at about 3% in 2020, while a muted pass through from a more depreciated currency would likely keep inflation well within the target band in the medium term. In addition to implementing 125 basis points worth of easing since the start of 2020, the Sarb would likely cut interest rates further to around 3% by early 2021.

Even with a dramatic decline in exports, the current account would likely narrow relative to its long-term average in response to lower demand in imports.

A worsening global economic outlook extending to SA for longer, additional COVID-19 fiscal stimulus measures, sharply weaker revenue collection and increased difficulty in achieving the planned public sector wage bill cuts in this scenario would likely lead to the fiscal deficit ratio expanding to the low teens. Further staggered downgrades in SA's sovereign ratings by Fitch, Standard and Poor's (S&P) and Moody's in 2020 and 2021 become likely in this scenario.

In our analysis, we also consider a protracted U-shaped recovery in which a second wave of the COVID-19 outbreak flares up globally and in SA, with quarantine measures extended to more regions and for longer.

In addition, new cases could rise in other parts of the world, despite changes in seasons, dragging out the peak in global infection rates.

A re-emergence of disruptions in supply chains are likely under this scenario and these bottlenecks would exacerbate and prolong the downturn in local demand and exports.

This would, in turn, negatively affect corporate profitability, with corporate credit risks rising as a consequence.

Historically, the US underwent a protracted U-shaped recovery in the 1970s, when unemployment and inflation remained high for years. In 1980, the US experienced a double-dip or W-shaped recovery, where the economy dropped twice before a full recovery was achieved.

An extended outbreak of COVID-19 in the Eurozone and the US in a protracted U-shaped scenario would place their healthcare systems under significant pressure. A fall in demand would be experienced in a wider array of service sectors rather than just the travel and tourism industries, and disruptions in supply chains would be more extensive.

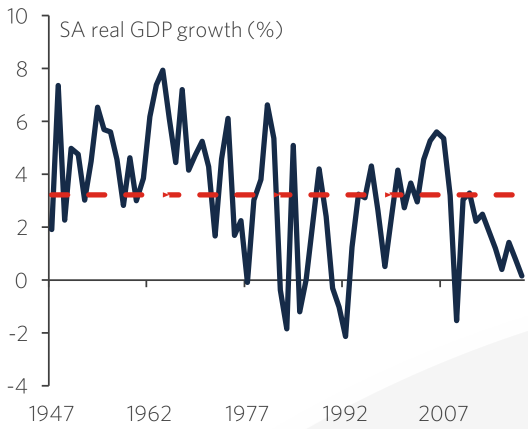
Severe restrictions on normal economic activity would prolong the downturn in economic activity well into 2021, with the rebound in growth more drawn out. Under a protracted U-shaped recovery, the global weighted-average interest rate would likely reach a new low, while stronger fiscal responses from DMs and EMs would be enacted. Although monetary and fiscal policymakers would step up their stimulus efforts in such a scenario, consumers may be more inclined to increase their savings and could remain wary of discretionary spending.

Nevertheless, policy easing could prevent a further tightening in financial conditions and keeping accommodation in place could aid a gradual recovery in demand later in 2021.

A dragged out economic recovery would cap the recovery in business and consumer sentiment, leading firms to delay spending on fixed investment projects and the hiring of new workers, exacerbating the length of the slowdown in global economic activity through second-round effects.

Under a protracted U- or W-shaped scenario, the damage to the SA economy would be far more severe than any period observed historically (see chart 3).

Chart 3: SA growth has averaged 3.2% historically



Source: Sarb, Momentum Investments

Delayed recovery in aggregate global demand would send the economy into a more profound slumber in 2020, with a recovery in global demand only beginning in earnest later in 2021. SA growth would plummet to about negative 7.5% in 2020 under an extended nationwide lockdown, compounded by negative global growth signals. Consumer and business confidence would dip markedly lower from already-decimated levels. The damage to discretionary spending and business output would be more pronounced, while exports would remain weaker for longer due to prolonged weakness in global demand.

Suppressed international oil prices would translate into downward pressure on headline inflation, while a muted pass through from an even more depreciated currency would likely keep inflation below 3% in 2020 and 2021, as demand is quelled under this scenario. In addition to implementing 125 basis points worth of easing since the start of 2020, the Sarb would cut interest rates to 2.25% by the end of the year.

In this scenario, the current account deficit ratio would likely narrow substantially on the back of vastly weaker import demand. However, the fiscal deficit ratio would rise beyond the mid-teens, in our opinion, as a stretched out recovery in the global environment bears negatively on SA's economic trajectory. Accelerated COVID-19 measures for fiscal stimulus, immense pressure on revenue collection and little chance of achieving the planned cuts in the public sector wage bill, in this scenario, would likely lead to a chain of downgrades by the three major rating agencies.

Keeping our focus on our clients' long-term investment goals

While investment returns in the short term will be negatively affected by the destructive effect of

COVID-19 on growth asset classes, history has shown that long-term returns are largely unaffected by these kinds of events, which in retrospect are barely discernible on longer-term graphs of returns from asset classes and, hence, turn out to be far less significant than they are deemed at the time.

We remain steadfast in our mission to keep our focus on our clients' long-term investment goals by not overreacting to short-term events in a way that could have a detrimental effect on the probability of attaining these goals. As such, our overriding guiding principle is to encourage our clients to stay invested throughout all market cycles, rather than attempt the timing of markets at times like this, when there is a virus outbreak.

Selling into market weakness locks in paper losses and also exposes investors to the risk that they miss any eventual rebound in markets, if they have not reinvested by that point. Although investors often feel the behavioural urge to at least 'do something' to their portfolios during uncertain times, history shows that the more prudent and lucrative investment strategy during these events is actually to 'stay invested'.

It is in times like these that we remain deeply anchored in our outcome-based investing philosophy and process, where we are unwavering in our belief that a well-constructed diversified portfolio is the most efficient way to achieve the long-term investment outcomes for our clients and, in these uncertain and volatile market environments, we continue to vigilantly manage the risk in our portfolios and look for opportunities to harness the available opportunity set towards achieving our long-term investment goals.

Sanisha Packirisamy
Economist
Momentum Investments

Herman van Papendorp
Head: Macro Research and Asset Allocation
Momentum Investments

Partially Vesting Smooth Bonus Range

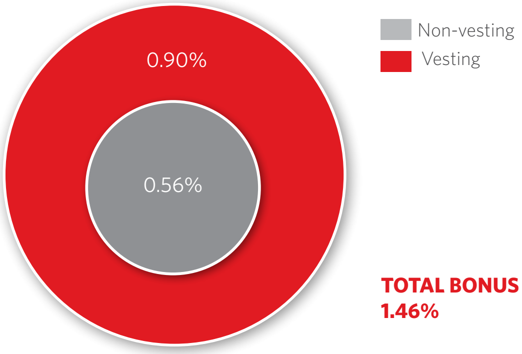
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

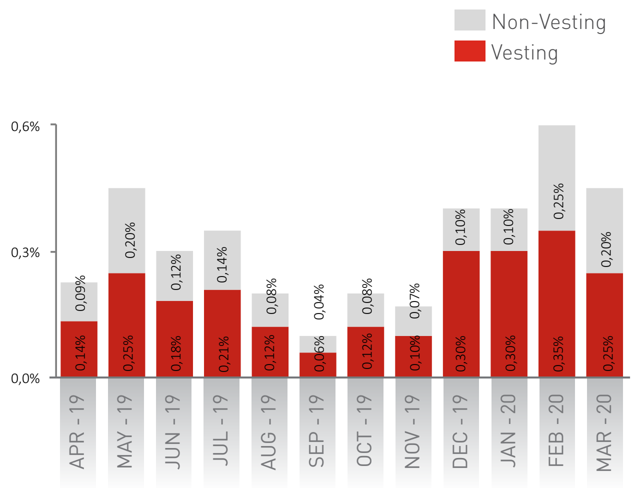
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	80% - 85%	R12.2bn	0,84%	-1,81%

Performance

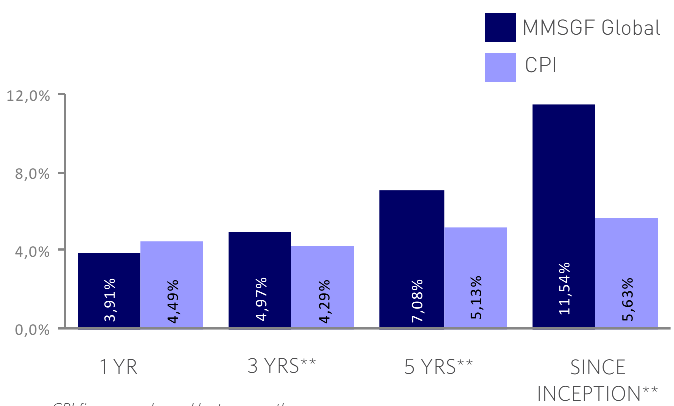
The total bonus* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



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



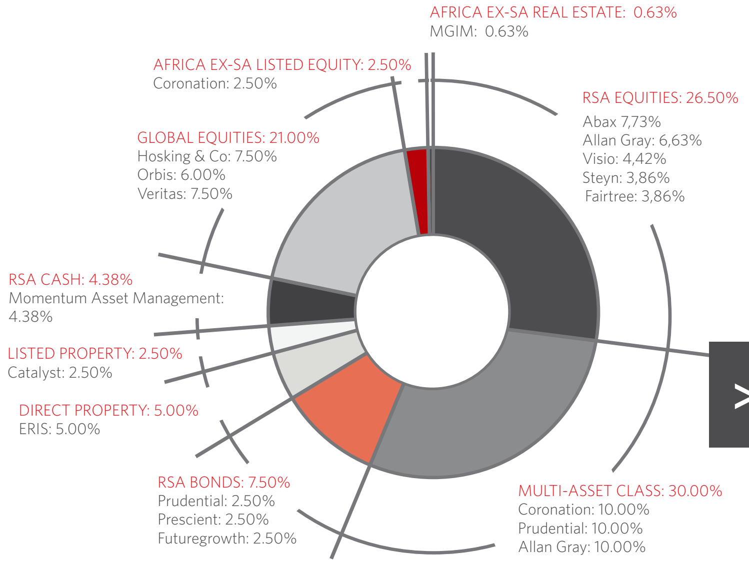
CPI figures are lagged by two months

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

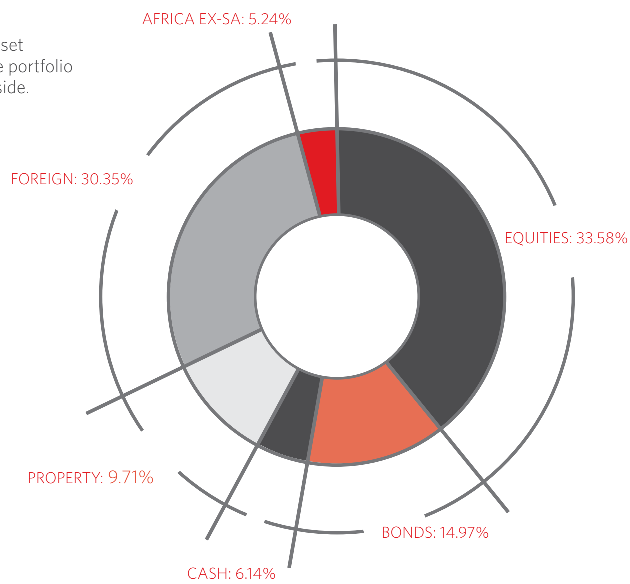
** Annualised

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 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-in-class multi-manager smooth bonus portfolios with independent governance provide just that.

Partially Vesting Smooth Bonus Range

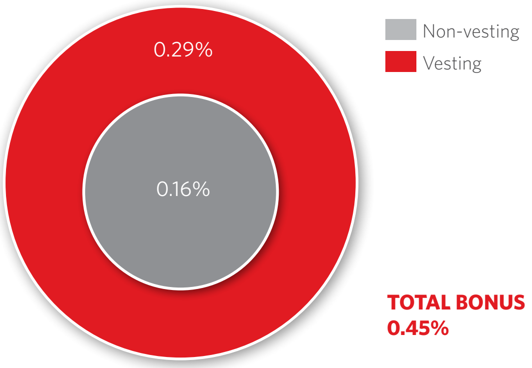
Multi-Manager Smooth Growth Fund Local

Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	75% -80%	R169m	1,33%	-5,85%

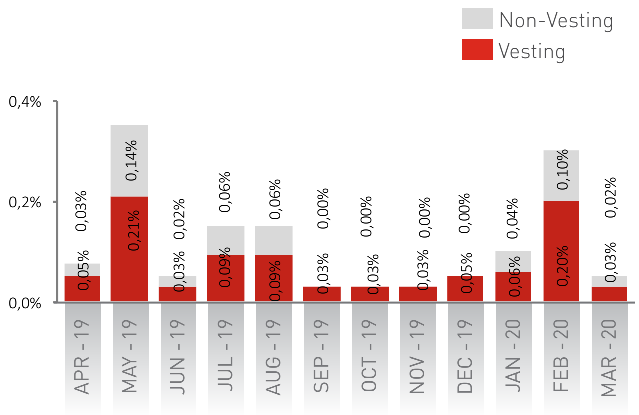
Performance

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

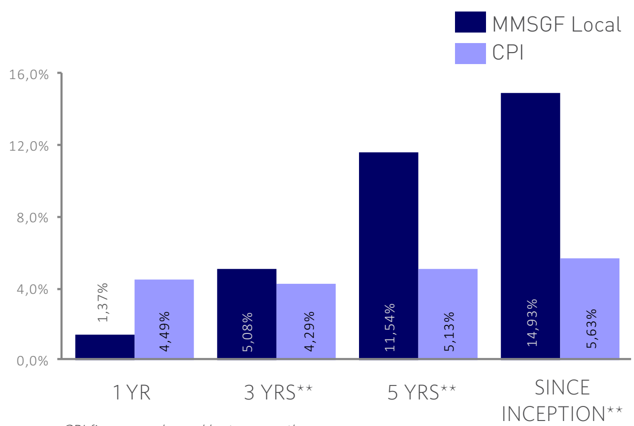


TOTAL BONUS 0.45%

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



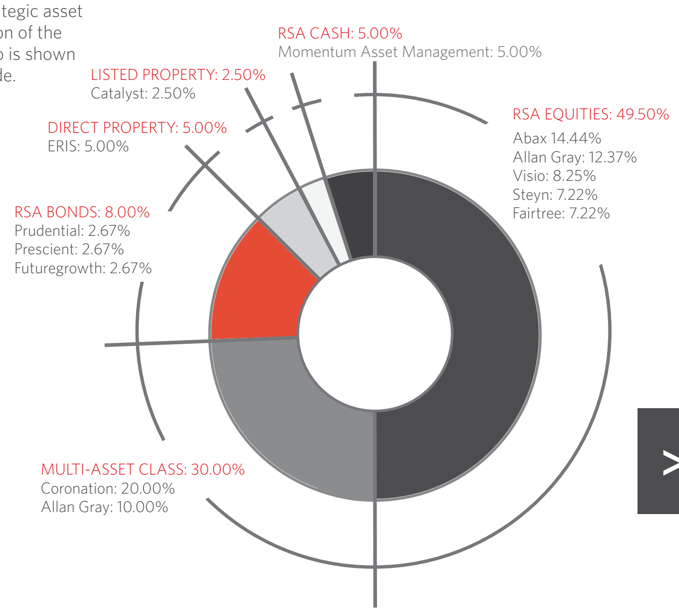
CPI figures are lagged by two months

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

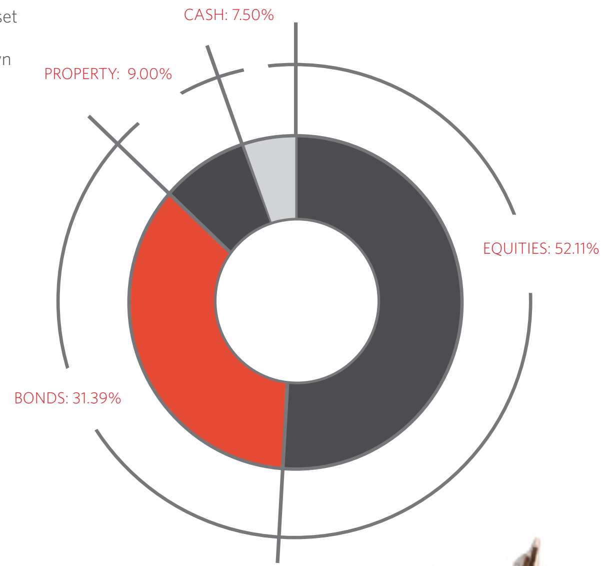
** Annualised

Asset Allocation

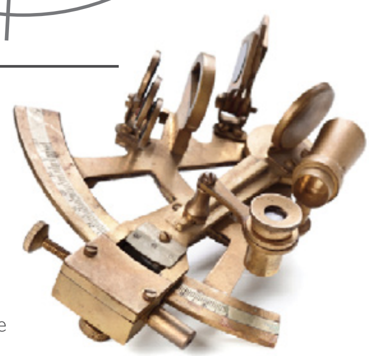
The strategic asset allocation of the portfolio is shown alongside.



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.



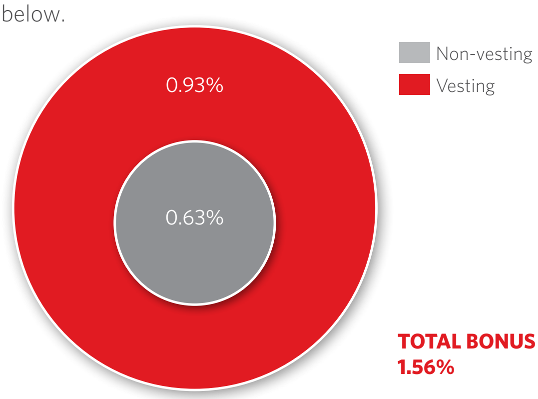
In the new world, Trustees,Professional Financial Advisors and members need certainty on their journey to financial wellness. Expert guidance from the thought leaders means knowing where you're heading and how to get there.

Partially Vesting Smooth Bonus Range
Smooth Growth Fund Global

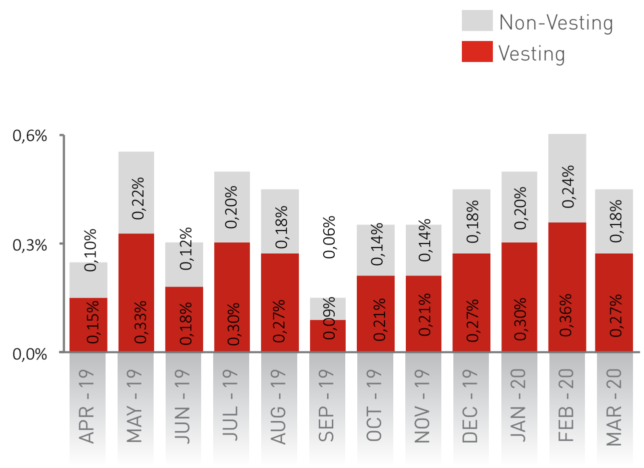
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	80% - 85%	R2bn	0,75%	-1,53%

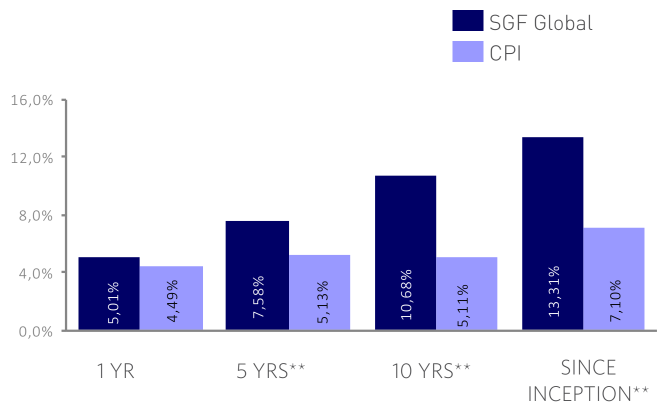
The total bonus* for the past quarter on the Smooth Growth Fund Global is shown below.



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.



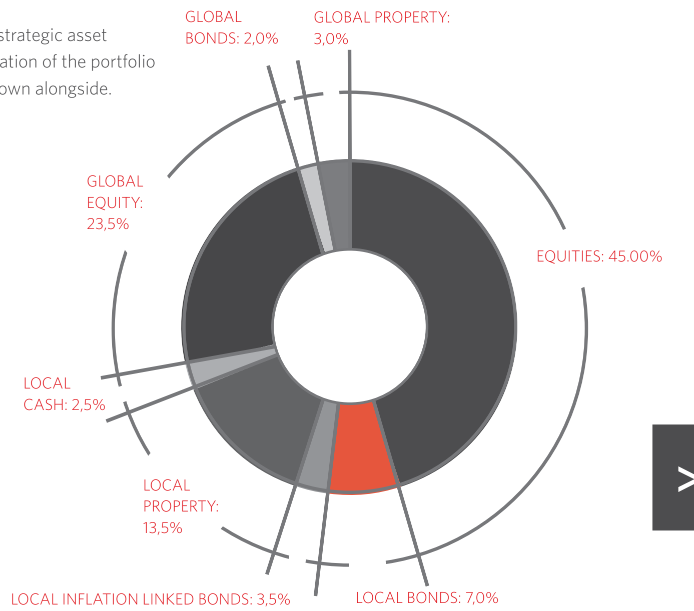
CPI figures are lagged by two months

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

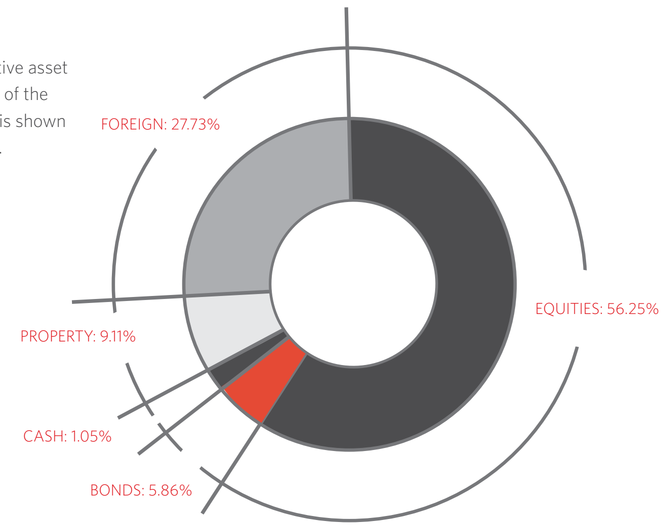
** Annualised

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

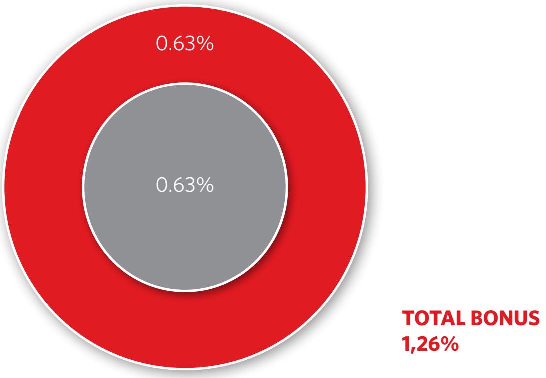
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	85% - 90%	R85m	0.84% [1]	1.66% [1]

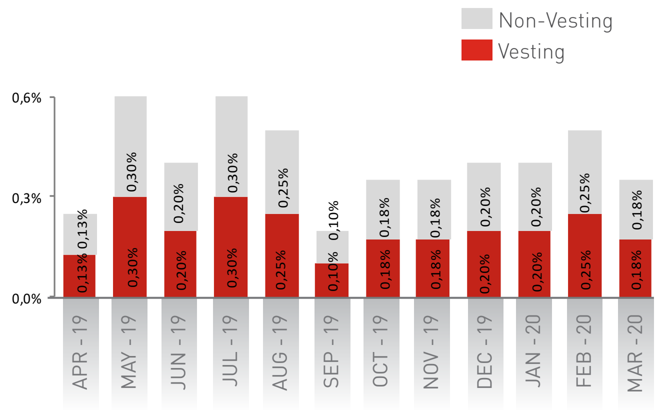
[1]Based on back-tested bonuses and returns

Performance

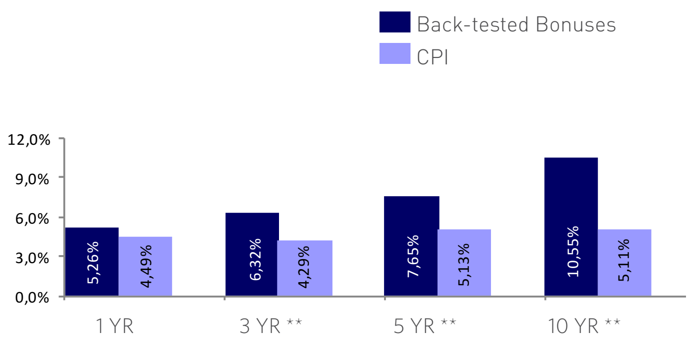
The total bonus for the past quarter on the Momentum Smooth-Edge Fund is shown below.



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

* The bonuses and back-tested bonuses are gross of the investment management fee

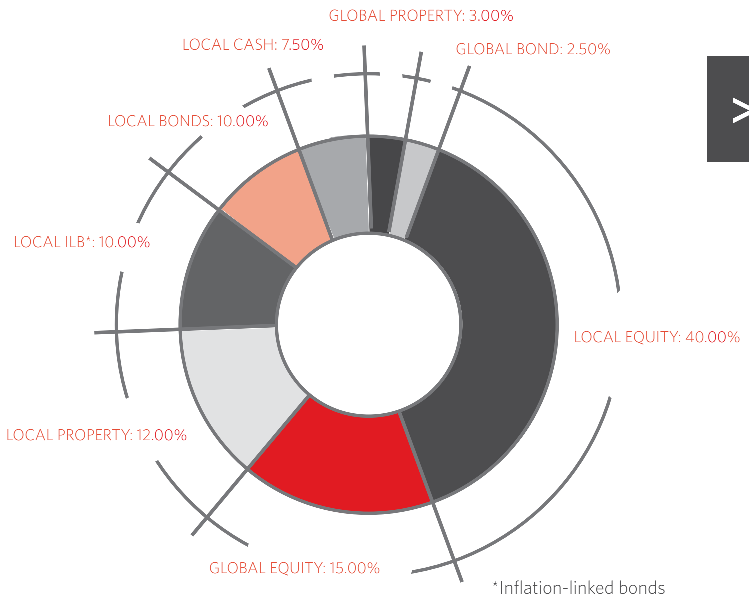
** Annualised

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.

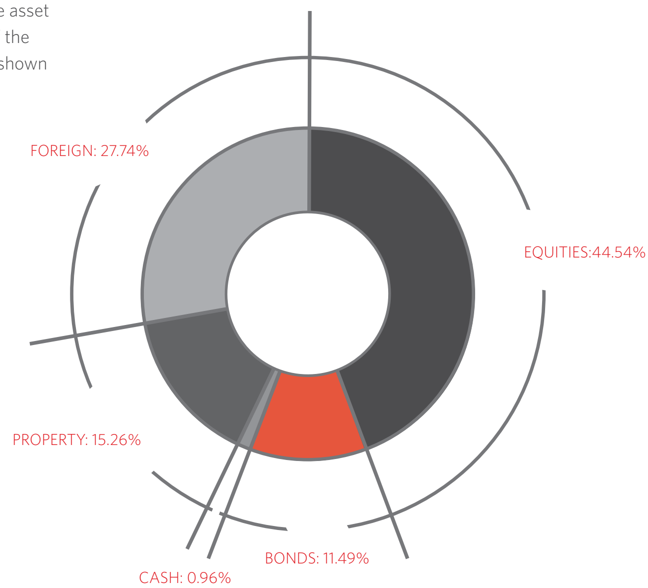
Not only does this solution offer members inflation-beating investment return prospects and protection from market volatility, but the significantly lower capital charge means more money goes directly to the members' retirement savings to bolster their retirement outcomes.

The strategic asset allocation is shown alongside.



*Inflation-linked bonds

The effective asset allocation of the portfolio is shown alongside.



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.

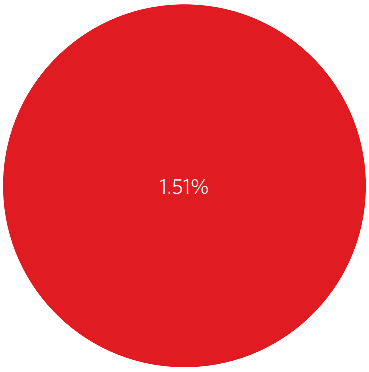
Fully Vesting Smooth Bonus Range
Multi-Manager Secure Growth Fund

Fund Snap Shot

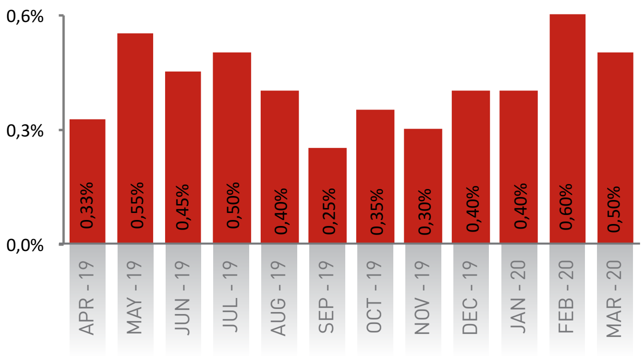
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	85% - 90%	R100m	0,60%	-1,32%

Performance

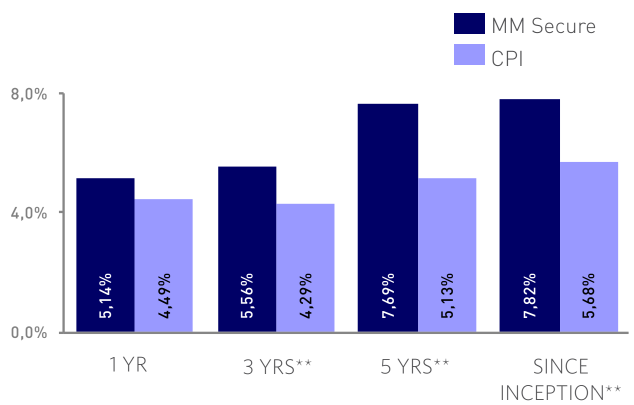
The total bonus* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



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



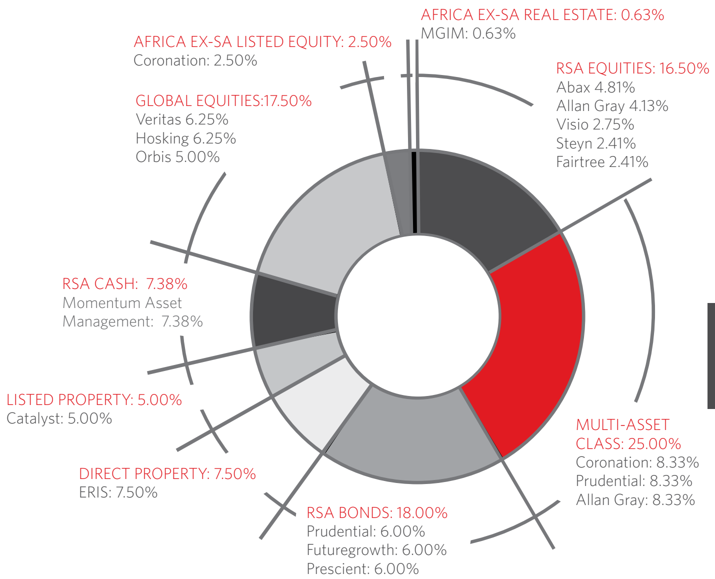
CPI figures are lagged by two months

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

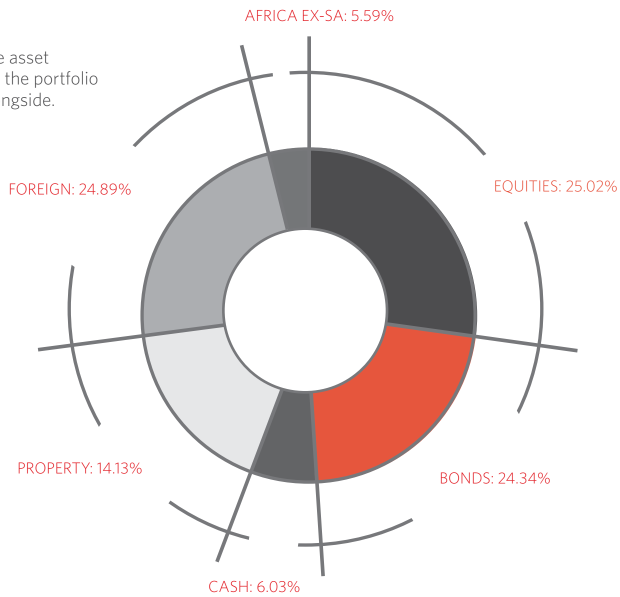
** Annualised

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.

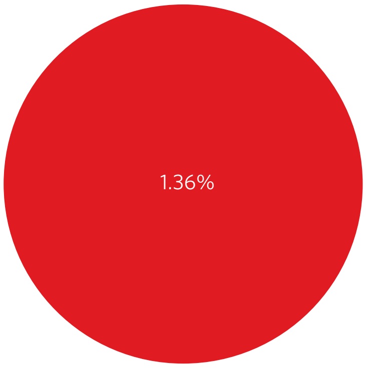
Fully Vesting Smooth Bonus Range
Smart Guarantee + 3 Fund

Fund Snap Shot

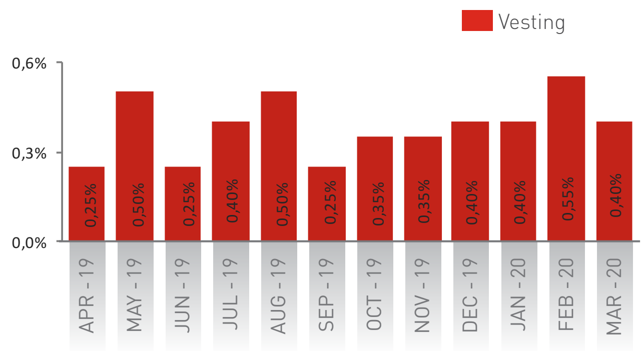
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	80% - 85%	R349m	0,82%	6,12%

Performance

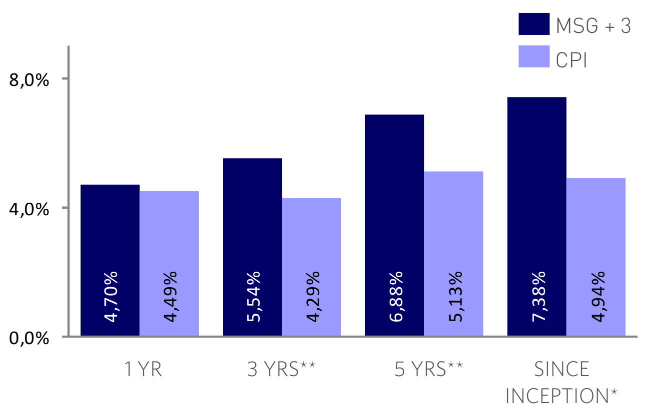
The total bonus* for the past quarter on the Smart Guarantee + 3 Fund is shown below.



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.

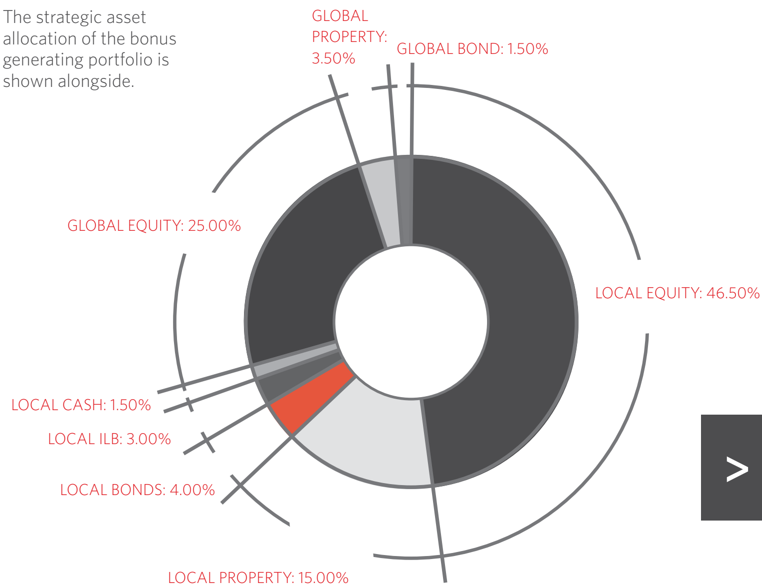


CPI figures are lagged by two months

* 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 insurer 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.

MSG +3: 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. We previously provided estimates of the bonuses to be declared assuming zero returns over the next 34 months (since there is a two month lag). The bonus generating portfolio however suffered negative returns during the first quarter of 2020 as a result of the Covid-19 pandemic, which led to a drastic fall in the funding level. The bonus generating portfolio and funding level must therefore recover from current levels before bonuses above the minimum level can 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	Fund Return Objective	Manager	Mandate Type	Guarantee on Benefit Payments[1]	Market Value Adjustment on Voluntary 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	Insurer Liability Driven Investment	Moderate Conservative 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, but excludes net priced asset fees and performance fees where applicable.

KEY:

1. Benefit payments generally refer to resignation, retirement, death and disability. 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 and performance fees may be deducted from the underlying assets.

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