momentum
corporate

Smooth Bonus Report

Second Quarter 2021

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

Looking back over the past quarter

Dear valued investors

The last quarter had moderate growth from the MSCI World Index (All Countries) at 3,84% and flat returns on the FTSE/JSE All-Share Index. In the local market we saw financials rebound 7,53%, industrials flat at 0,77% and resources down 4,96%.

There was a sudden steep increase in the number of COVID 19 cases that resulted in an 'initial' two-week introduction of adjusted level 4 restrictions.

On the 29th of June 2021 the Constitutional Court announced that Jacob Zuma is to be arrested on contempt of court charges for refusing to testify before the state capture commission. He was given 5 days to surrender himself to police or be collected by police who would then take him to prison. Following his arrest on the 6th of July 2021, unrest ensued in Kwa Zulu Natal and parts of Gauteng that caused severe damage to business, property, and jobs in the affected areas.

The results of the COVID 19 level 4 lock down and the damaging riots will dampen hopes of economic growth in the 3rd quarter.

Herman van Papendorp and Sanisha Packirisamy from the macro research team at Momentum Investments give further market and economic commentary on page 7.

Momentum Corporate smooth bonus portfolios

Our portfolios had strong funding levels going into the 2nd quarter and by the end of the quarter most remained fully funded. Future returns to clients are declared via monthly bonuses and to declare bonuses in line with our inflation related objectives, our asset classes need to deliver in-line with their long-term return expectations. However, with adjusted level 4 COVID 19 restrictions and geopolitical unrest, it has created more uncertainty in how the market will respond.

Issuance of new policy contracts:

Towards the end of the quarter, we sent new policy contracts to all our smooth bonus clients. The new contracts were updated to refer to the Insurance Act No18 of 2017, Policyholder Protection Rules of 2017, Protection of Personal Information Act No. 4 of 2013 (POPIA) and Financial Sector Conduct Authority Conduct Standard 5 of 2020 relating to the eligibility of smooth bonus to be used as an investment portfolio.

Change of portfolio name:

The Momentum Smart Guarantee +3 Fund has a similar structure to Universal smooth bonus range, in that it has one universal funding level for all clients. For this reason, we have changed the portfolio name to the Momentum Universal Smart Guarantee +3 Fund. You can find more detail on the portfolio on page 21 of this report.

If you wish to invest your retirement fund's lump sums or contributions into one of the new 'universal' portfolios launched in June 2020, please contact me or your Momentum servicing representative, and we will provide further details. Our smooth bonus portfolios provide a range of solutions that cater for different needs and risk appetites.

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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Momentum Investments market commentary for the quarter ended June 2021

by Sanisha Packirisamy and Herman van Papendorp

Highlights

Markets

- There are some factors that point to a rising probability of some pullback or correction in equity markets from the second half of 2021.
- However, the massive policy stimulus and liquidity support still prevalent in the financial system, combined with rising profit levels, should limit the magnitude of any equity downside for now. Only as we move closer to expected US interest rate increases in 2023 do we think the downside risk for equity markets would become more pronounced. Therefore, we think the appropriate investment response to any potential near-term pullback or correction in global equity markets would be to remain invested or to 'buy any dip', in anticipation of a quick rebound.
- Similar to the case for global equities, there is still strong fundamental profit support for the South African (SA) equity market. This has kept SA equity valuations in check and underpins attractive forward return expectations.
- SA bond yields remain attractive against their own history, as well as relative to those in developed markets (DMs) and emerging markets (EMs). In the inflation-linked bond (ILB) space, near-term smaller monthly inflation accruals should provide less fundamental support for the asset class until 2Q22.
- Property fundamentals remain weak and valuations have become expensive after the recent strong rally.
- Prospective SA real cash yields remain close to zero, making the asset class unappealing, in our view.

Economics

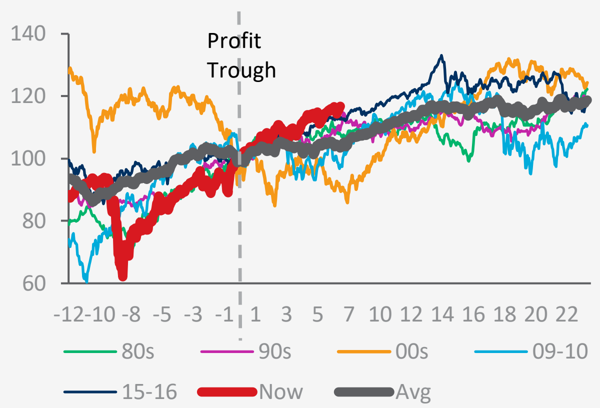
- Global economic growth is supported by faster vaccinations in DMs, as EMs struggle to secure vaccines.
- Demand for commodities continues to exceed supply, creating 'perfect' conditions for elevated commodity prices.
- Consumer price inflation (CPI) is increasing globally on the back of a low base, commodity price increases and consumer behaviour changes. Indications are that the current waves of high commodity prices and CPI are transitory.
- In the US, the transition path from current abundant stimulus via less monetary stimulus ('tapering') to eventual tightening will be formalised when the Federal Reserve members start talking in the coming months about the tapering of its bond purchasing programme.
- Economic growth in SA is expected to surpass 4% this year, mostly due to a low base.
- Reforms aimed at increasing electricity production have brightened the future economic growth outlook somewhat.
- CPI is expected to have peaked in May 2021 and should trend downwards over the course of the year.
- The rand exchange rate strengthened markedly to a level that may be considered as overvalued.
- The repo rate is expected to remain unchanged in 2021, with two increases of 25 basis points expected in 2022.

Local property and SA bonds provided the best returns in second quarter of 2021

In line with the ongoing strong cyclical global economic growth recovery and the resultant favourable profit environment, global equities continued its outperformance of global bonds in the second quarter of 2021. DM equity markets returned 7.9% (in US$), EM equities 5.1% and global bonds 1%. However, returns on global asset classes in rand terms were eroded by the rand's appreciation of 3.4% against the US$ in the quarter.

Among the local asset classes, listed property provided the strongest returns in the quarter (12.1%), followed by SA bonds (6.9%), inflation-linked bonds (3.2%) and cash (0.9%). The FTSE/JSE All Share index was flat in the second quarter of 2021, with sharp pullbacks by the platinum stocks (negative 13.5%) and Naspers/Prosus (around negative 15%) constraining a positive return from Financials (7.5%).

Chart 1: Local asset class returns in 2Q 2021 (%)

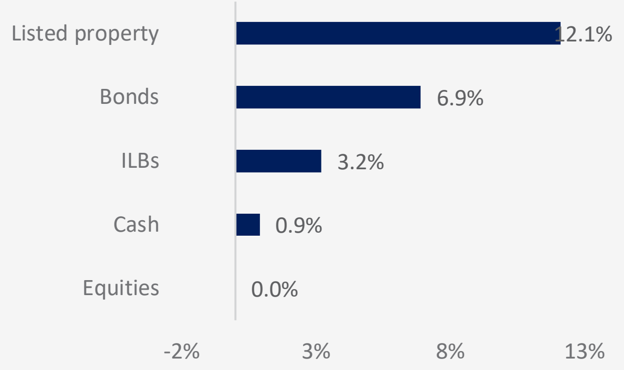


Source: Iress, Momentum Investments

Preference for equities within global asset classes and for SA equities in our portfolios

Research from Citi shows that over the past 50 years global equities typically do well in the year before a corporate earnings trough, as well as in the first year of profit recovery after the trough (see chart 2). Only in the second year of a profit recovery does the equity return profile become erratic, with intermittent periods of drawdowns experienced. As global equities troughed in November last year, historic precedent suggests decent global equity returns could be expected until later in 2021, with more volatility and downside risk from then onwards.

Chart 2: Historical global equity returns in the months before and after profit troughs

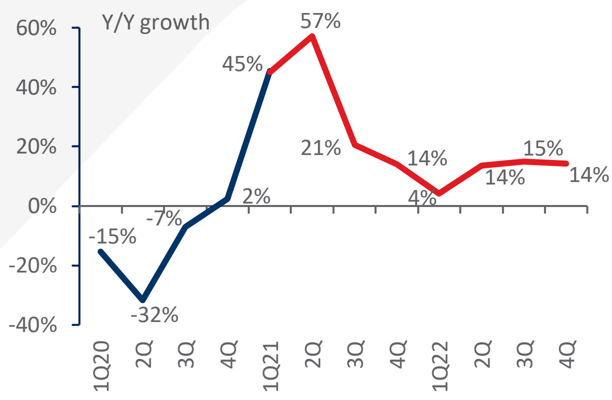


Source: Citi

A big question for global equity market direction is whether profit momentum or the absolute level of profits will be the dominant driving force for returns from now on. For instance, year on year (y/y) US profit growth will likely peak at a very high level in the second quarter of 2021 due to the very low earnings base created a year ago at the height of lockdowns

(see chart 3).

Chart 3: S&P 500 profit growth peaking in second quarter of 2021



Source: Credit Suisse

However, the absolute level of US corporate profits is anticipated to rise further into 2022 as economic recovery unfolds (see chart 4). If markets are able to discard the outsized base effect on profit growth in 2021 and rather focus on the general uptrend in profit levels that is expected to remain intact, equity prices can still go higher.

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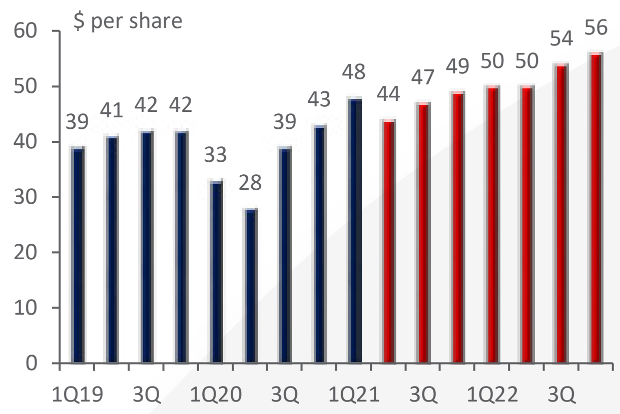
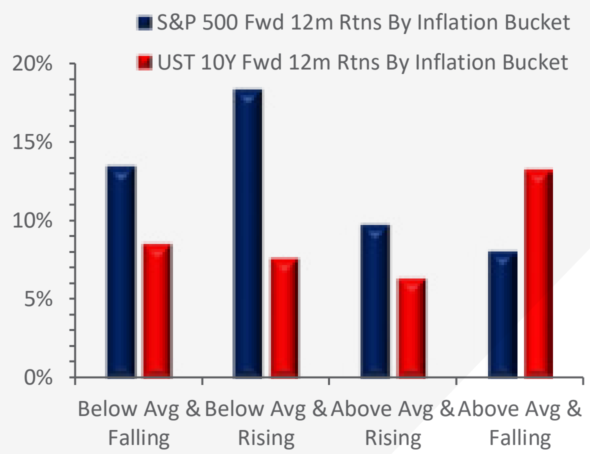
Chart 4: S&P 500 profit level to rise into 2022



Source: Credit Suisse

Another very topical theme in markets at the moment is the rising inflation trends experienced around the world, due to the combination of current accelerating economic growth momentum, supply bottlenecks in a number of products and, again, the low base created for goods and services prices during the height of lockdowns a year ago. Rising inflation in itself is not necessarily a problem for equity returns if this turns out to be a temporary phenomenon but should more aggressive monetary tightening be required due to sustainably higher inflation, this will become a bigger threat to equity valuations and returns. Although the most favourable inflation regime historically for absolute and relative global equity returns is when inflation is below average and rising, global equities also outperform global bonds in the current phase of above average and rising inflation (see chart 5).

Chart 5: Current inflation regime still favours equities over bonds



Source: Morgan Stanley

There are some factors, though, that point to a rising probability of some pullback or correction in equity markets from the second half of 2021. This could firstly be ignited by the possible volatility or instability associated with the initial discussion and eventual announcement in the coming months by the US central bank of its plan to start tapering its asset purchases, most likely early next year. Furthermore, a closing US output gap before the end of 2021, a weak seasonal time period in equity returns from now to September, as well as the historical frequency of drawdowns also point to the potential for some downside risk to equity prices in future months.

Table 1 summarises an analysis by Credit Suisse that shows minor equity pullbacks of 5-10% occurred roughly once a year over the past 30 years and corrections of 10-20% broadly once every three years. If one measures the time elapsed since the last pullback and correction respectively, it indicates that we may soon be due for some drawdown if the average historical precedent repeats itself. However, a full-blown equity bear market (defined as a larger than 20% drawdown) seems unlikely anytime soon, as this comes around only once a decade and last occurred just over a year ago.

Table 1: S&P 500 drawdowns in past 30 years

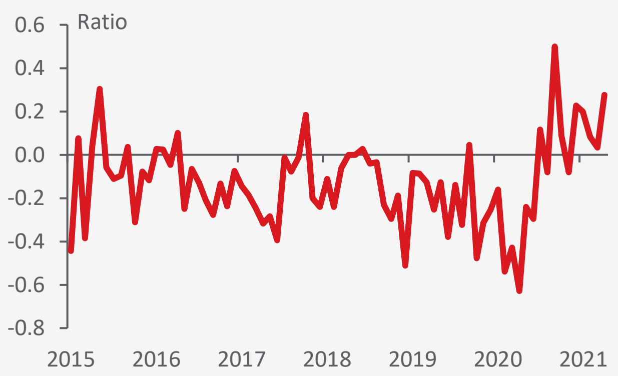
Drawdowns	Bear markets	Corrections	Minor pullbacks
Definition	>20% fall	10%-20% fall	5%-10% fall
Number of instances	3	11	35
Implied frequency (months)	120	33	10
Previous occasion	19 Feb '20 to 23 Mar '20	20 Sep '18 to 24 Dec '18	2 Sep '20 to 23 Sep '20
% fall	33.9%	19.8%	9.6%
Months since previous trough	15	30	9

Source: Credit Suisse

The massive policy stimulus and liquidity support still prevalent in the financial system, combined with rising profit levels, should limit the magnitude of any equity downside for now. Only as we move closer to expected US interest rate increases in 2023 do we think the downside risk for equity markets would become more pronounced. Therefore, we think the appropriate investment response to any potential near-term pullback or correction in global equity markets would be to remain invested or to 'buy any dip', in anticipation of a relatively quick recovery in performance after any drawdown.

Similar to the case for global equities, there is also still strong fundamental profit support for the South African equity market. Since South African corporate earnings bottomed at the beginning of 2021, the upward trend in earnings revisions have continued unabated, with company profit upgrades currently outpacing downgrades by around 30% (see chart 6).

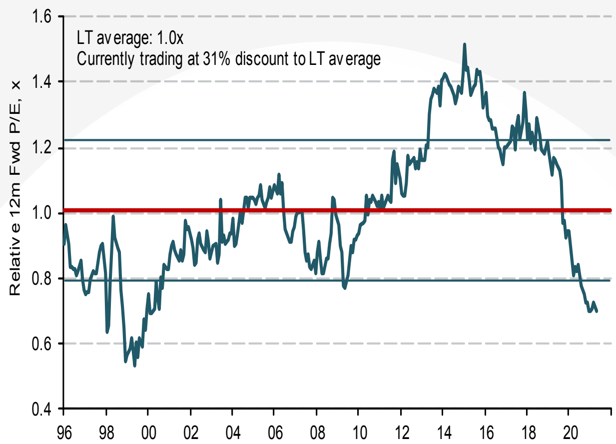
Chart 6: FTSE/JSE ALSI earnings upgrade/downgrade revisions ratio



Source: SBG Securities

This has kept South African equity valuations in check and underpins attractive forward return expectations, both in absolute terms and relative to both emerging market EM and DM equities.

Chart 7: MSCI SA/EM 12-month forward P/E ratio

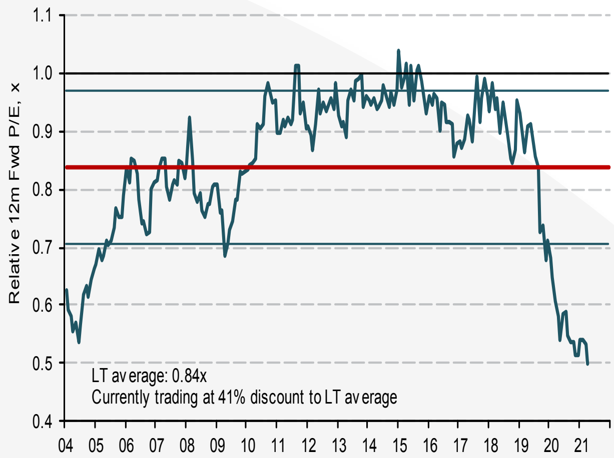


Source: SBG Securities

Whereas the South African equity market traded in line with EM equities on a forward P/E basis in the past

25 years, it now trades at a large 30% discount to EM (see chart 7). Even more so, while South Africa traded at 16% discount to DM forward P/Es historically, it now trades at a huge 50% discount (see chart 8).

Chart 8: MSCI SA/DM 12-month forward P/E ratio



Source: SBG Securities

Assuming consensus earnings growth of 34% in the next year, the South African equity market's forward P/E is now slightly below its average since 1999 and more than two standard deviations below the average since 2013 when the Naspers effect started inflating the overall South African equity market's valuations (see chart 9). This should support the forward return potential for South African equities from current levels.

Chart 9: SA forward P/E not expensive

Source: Citi

In summary, while were are cognisant of the potential for a pull-back or correction in global and South African equities during the remainder of 2021, which could constrain the magnitude of returns from here onward, we are comfortable that the fundamental support from easy monetary and fiscal policy settings and decent corporate profits would limit the potential downside risk for equities as an asset class and still justify a preference for equities within global asset classes and particularly for attractively-valued local equities in our portfolios.

In contrast, fundamentals point to higher US bond yields. These include a strong economic recovery, rising consensus inflation expectations and more net bond supply. With global bond valuations expensive, the asset class is no viable alternative to equities. Central banks are likely to remain strongly committed to keeping interest rates at very low levels even as inflation drifts upwards, particularly with the shift to average inflation targeting in the US. In such a very low interest rate environment global cash exposure should be limited, although some rand weakness could boost rand returns from global cash.

SA bond yields remain attractive against their own history, as well as relative to those in developed and emerging markets, with part of the high real yield differential due to a fiscal risk premium. Current SA real bond yields and yield spreads are attractive on a multiple-sigma basis against historical averages. In the inflation-linked bond (ILB) space, near-term smaller monthly inflation accruals should provide less fundamental support for the asset class until 2Q22. There is limited scope for further break-even widening with peaking inflation.

Property fundamentals remain weak, with rising vacancies, rental holidays and negative rental reversions the order of the day. Listed property values have declined by 8% so far, but we think total declines should be 10%-20% peak-to-trough. Listed property is now the most expensive against bonds in five and a half years, trading at a 46% premium to bonds compared to a 5% to 10% premium historically.

Due to aggressive SA Reserve Bank rate cuts in 2020 in response to COVID-19, prospective SA real cash yields have fallen close to zero, which is almost one and a half standard deviations below its historical average. This makes the real return available to investors from local cash unappealing.

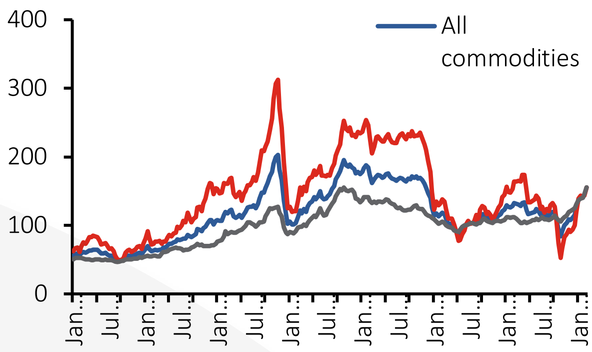
The stars are aligned for higher global economic growth, commodity prices and inflation

The last time global economic growth exceeded 6%, the rate expected this year, was in 1973. Back then the world economy was characterised by strong industrial production growth, a scarcity of resources, rising commodity prices, increasing consumer price inflation and expectations of higher interest rates. This situation sounds very familiar to what is playing out now, almost 50 years later.

Circumstances, however, differ markedly from what transpired in 1973. For instance, the Organisation of Petroleum Export Countries (OPEC) at the end of 1973 decided to stop supplying oil to several countries, which increased the price of oil by about 300%.

In 2021, however, for different reasons as in 1973, the stars aligned for strong increases in the prices of almost all commodities (see chart 10). The question is whether these stars will remain aligned, as this will to a large degree influence the timing of monetary policy tightening, more specifically interest rate increases in the United States.

Chart 10: Commodity price indices over time



Source: IMF, Momentum Investments

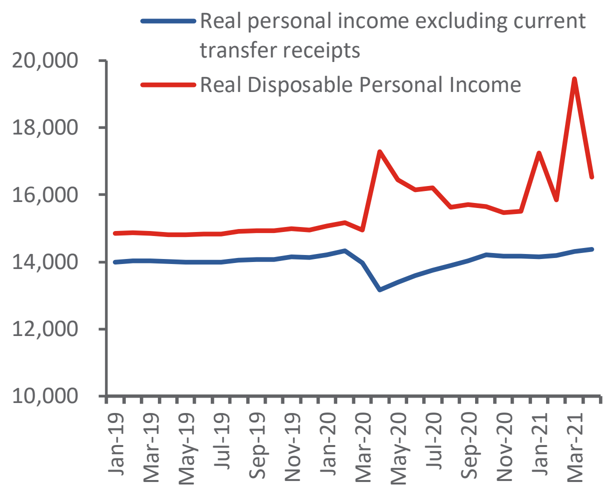
Identification of the factors responsible for the current strong increases in commodity prices should provide an indication of whether the stars will remain aligned.

Firstly, extraordinary fiscal stimulus and monetary easing contributed to surging demand for goods manufactured from commodities. Secondly, COVID-19 vaccines were rapidly developed, which contributed to a faster reopening of economies. This increased demand contributed to faster economic recoveries in especially developed economies, which also secured the majority of available vaccines. Thirdly, supply was constrained as commodity producers were not ready to satisfy the surging demand. Fourthly, supply was even more disrupted by insufficient shipping and air cargo capacity as they were not able to cope with the strong demand. In addition, bottlenecks at harbours delayed deliveries even further. Fifthly, manufacturers of micro-chips, which are used in many household goods, new vehicles and in other applications, closed some of their factories during lockdown. It took time for these factories to reopen and get up to speed as they are also dependent on some of the commodities. This created a huge backlog in supply.

In short, demand outstripped supply, contributing to a wave of increasing commodity prices. It is worthwhile noting that, depending on the chosen base of calculation, some of the price increases expressed in percentage terms could be exaggerated. For instance, if price increases are calculated from April 2020, when global lockdowns were in full force and commodity prices tumbled, price increases seem elevated. However, if price increases are calculated from January 2020, before the COVID-19 pandemic started, they do not look as high. As an example, the 'All Commodity Price Index' as measured by the International Monetary Fund (IMF) was 85% higher in May 2021 compared to the low point established in April 2020, whereas it was 29.9% higher compared to January 2020, before the outbreak of the pandemic and institution of lockdowns. Similarly, the energy index, which includes the prices of oil, was 194.2% higher in May 2021 compared to April 2020. However, the increase measured from January 2020 was 21.9%. The same numbers for the non-energy index are 47.3% and 36.2%.

The next question to be answered, is whether the factors responsible for the high increases in commodity prices are of a repetitive or transitory nature. At this stage, a new round of fiscal stimulus in the US does not seem likely, especially as households' real monthly income excluding stimulus transfers is on an increasing trend (see chart 11).

Chart 11: Real personal income in the US gained traction



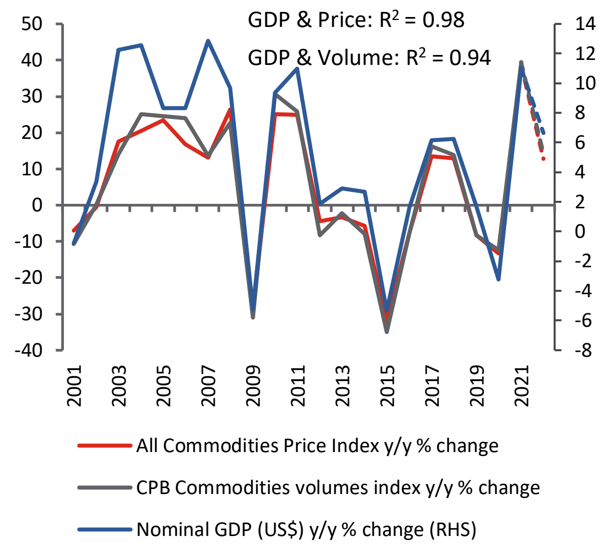
Source: Federal Reserve Bank of St. Louis, Momentum Investments

As for the pace of administering vaccines, it has slowed in some countries such as the US, but is accelerating in others, especially in Europe. Although vaccinations are increasing in Asia, many EMs struggle to secure vaccines. Vaccinations assisted with the introduction of relaxed lockdown rules in most economies where economic operations are almost back at pre-COVID-19 levels, except for some services. Consequently, demand growth for commodities should occur at a decelerating pace.

On supply disruptions, bottlenecks, delivery capacity and working backlogs away, S&P estimates that it will take about a year for things to clear. This means that current supply problems are transitory in nature.

This is confirmed by our analysis which shows a strong relationship between nominal gross domestic product (GDP), commodity prices and commodity volumes. Using the International Monetary Fund's estimates of nominal GDP growth slowing from 11% in 2021 (6% in real terms) to 6.6% in 2022 (4.4% in real terms), this suggests the growth rate in the 'All Commodity Price Index' should slow considerably (see chart 12). Put differently, for the 'All Commodity Price Index' to continue growing at its current pace, economic growth must accelerate from the estimated 6% of 2021.

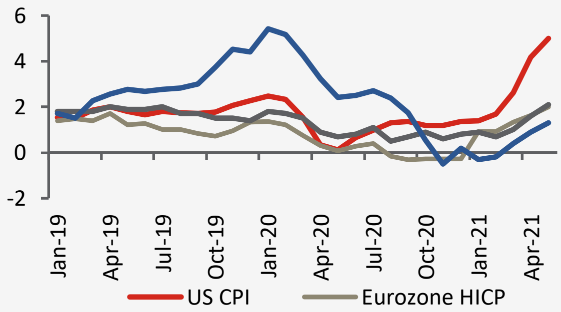
Chart 12: Pace of commodity price increases should decelerate



Source: IMF PCPS, CBP World Trade Monitor, Momentum Investments

Nevertheless, increasing commodity prices are showing up in rising consumer price inflation around the world. Year on year (y/y) CPI in the major world regions has been on an increasing path since the beginning of the year (see chart 13).

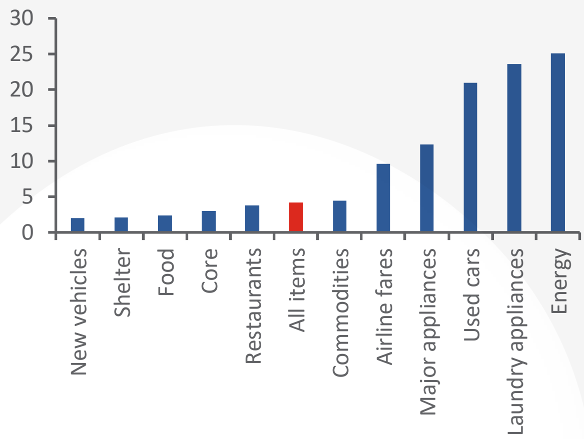
Chart 13: CPI increasing on a low base and higher commodity prices



Source: Federal Reserve Bank of St. Louis, Momentum Investments

However, closer scrutiny reveals most of the increase in CPI accrues from the low base, high fuel prices and a few items driven by consumer behaviour changes, some of them related to the scarcity of microchips. Chart 14 shows the highest y/y change in April US CPI emanated from energy (including fuel), household appliances, used cars and airline fares.

Chart 14: US April 2021 CPI driven by behaviour changes emanating from commodity shortages



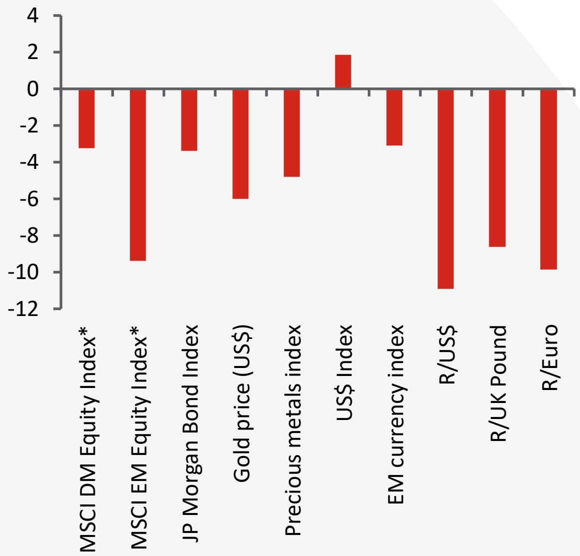
Source: Federal Reserve Bank of St. Louis, Momentum Investments

Household appliances and used car prices were driven up by behaviour changes resulting from the shortage of microchips. Consumers were compelled to buy used cars as the production of new cars dwindled due to the scarcity of microchips. The demand for major appliances with microchips also exceeded supply, which drove prices up. Airline ticket prices increased as airlines were not ready for reopening and had to pay higher wages to attract staff who are fearful of contracting COVID-19. The effects of the low base, high fuel price increases and some behaviour changes on CPI are also prevalent in other world regions such as China, Japan, the Eurozone and United Kingdom.

The analysis indicates that the current wave of commodity price increases (except for oil) and high global CPI seem to be of passing nature. Fuel prices may, however, remain elevated as strong economic growth, albeit lower than in 2021, is expected next year, while OPEC will regulate oil supply. However, indications are that when the effect of the low base and high commodity prices pass sometime next year, CPI should decline to lower rates of increase in many countries. Some price stickiness may, however, keep CPI around target levels, which would bring tighter monetary policy in play.

In the US, the transition path from current abundant stimulus via less monetary stimulus ('tapering') to eventual tightening will be formalised when the Federal Reserve members start talking in the coming months about the tapering of its bond purchasing programme. Chart 15 shows how markets reacted previously when taper talk started on 22 May 2013.

Chart 15: Markets adjust when taper talk starts



**Change in May/June 2013; Change in May only for other variables*

Source: IMF PCPS, Investing.com, Momentum Investments

Although taper talk is expected this year, and actual tapering next year, current indications are that the Federal Reserve may only start raising interest rates in 2023. As part of their rate hiking decision-making process, the Federal Reserve members have adopted a new and broader definition of full employment that may take a bit longer to achieve and hence prolongs the time frame before the first interest rate increase. Henceforth they will monitor several labour market indicators and not just the unemployment rate. Full employment means that all demographic groups should reach this goal, namely all income-, population-, age- and gender groups, while the participation rate must also be higher.

In sum, global economic growth is expected to increase this year and decelerate next year (see table 2). The current wave of commodity price increases is expected to slow down as the pace of economic growth slows and supply normalises. This should reduce the pressure on CPI to increase next year (see table 3).

Table 2: Estimates of global economic growth rates

	2021 (%)	2022 (%)
USA	7.2	4.7
Eurozone	4.4	4.8
UK	6.8	5.6
Japan	1.9	2.1
China	8.3	6.6

Source: Momentum Investments

Table 3: Estimates of global CPI (y/y %)

	2020	2021	2022
USA*	1.2	3.6	2.4
Eurozone**	0.3	1.8	1.2
UK	0.9	1.7	1.8
Japan	0.0	-0.1	0.6
China	2.5	1.6	2.1

**PCE Core inflation; **HICP inflation*

Source: Momentum Investments

South Africa's economic outlook improved on the back of some reforms, but more is needed

South Africa's economic growth rate may exceed 4% in 2021, the first time since 2007. However, most of the growth will emanate from a low base resulting from the downward-adjusted contraction of 7.1% (previously 7%) last year. In addition, South Africa's mining sector is benefitting from the current wave of high commodity prices, which encouraged more production. Total mining production for the first four months of this year was 3.3% higher compared to the same period in 2019 (before the COVID-19 pandemic).

The outlook for post 2021 has nevertheless brightened somewhat on the back of some 'unexpected' reforms announced by the government, which boils down to relinquishing some of its controls over the economy. These reforms, which includes more electricity supply, should not only remove some of the constraints that have held economic growth back for more than a decade, but also assist in reducing the government's debt burden. Should the benefits from these reforms materialise, it will over time improve the country's credit rating.

However, right now, the country is grappling with the highly transmissible Delta variant which induced a third wave of COVID-19 infections. This compelled the authorities to introduce adjusted level 4 restrictions for an initial two weeks, extended by another two weeks. Another issue holding an opening of the economy back is slow vaccination rates. Although the vaccination rate is picking up, it is not fast enough to reach herd immunity by the end of the year. For herd immunity to be reached by the end of 2021, more than 220 000 people have to be vaccinated daily over the next six months, which requires a doubling of the current effort.

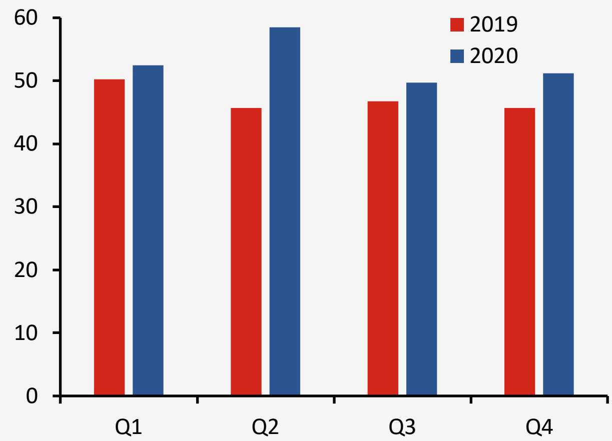
Given vaccine shortages and delays, Deutsche Bank estimates it more likely for herd immunity to be reached by May 2022.

The adjusted level 4 restrictions will have a negative impact on economic growth in the third quarter of 2021. It should, however, not be as severe as the effect level 4 had on the economy last year as companies learned to adjust quickly to restrictions. For instance, the economy managed quarterly growth rates of 5.8% and 4.6% respectively in the fourth quarter of 2020 and first quarter of 2021 despite the effects of the second wave and adjusted level 3 restrictions, which were about as restrictive as the current adjusted level 4 restrictions.

Household consumption expenditure should experience some headwinds from the adjusted level 4 restrictions as it was not accompanied by special grants to low-income groups. However, with employment in the formal sector picking up and more employees receiving full salaries, consumption expenditure should continue on its recovery path and may reach pre-pandemic levels by the end of 2022. Spending on durable and non-durable goods have already surpassed pre-COVID-19 levels in the first quarter of 2021. In contrast, spending on semi-durable goods was about 13% lower compared to pre-pandemic levels, mostly on account of less purchases of clothing and footwear, while spending on services was also below pre-pandemic levels as some services are still off-limits.

In addition, households have accumulated deposits which will at some stage be used for spending. Individual short-term deposits (deposits excluding money in cheque and savings accounts, as well as in medium- and long-term instruments) were 10.5% higher at the end of 2020 compared to the end of 2019. Chart 16 shows 2020 short-term deposits expressed as a percentage of disposable income increased considerably compared to 2019. Although disposable income declined by 1.6% compared to 2019, the increase in deposits outperformed the decline in disposable income, meaning individuals have accumulated savings to spend. This should happen as fears diminish, the economy opens again, and the country closes in on herd immunity.

Chart 16: Individual short-term deposits as percentage of quarterly disposable income increasing



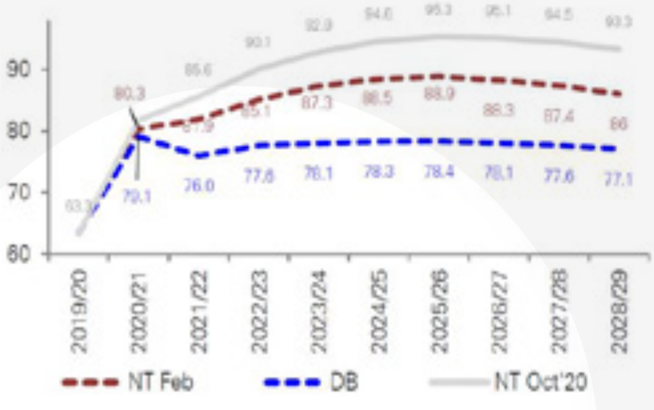
Source: South African Reserve Bank, Momentum Investments

Source: South African Reserve Bank, Momentum Investments

Government finances are improving, but will take years to recover even if the right choices are made. At this early stage of the new fiscal year, it seems as if the government is heading for another huge revenue overrun (despite excise duty losses emanating from level 4 restrictions) compared to the National Treasury's (NT) estimate in the 2021-22 budget. The South African Revenue Service (SARS) improved capacity on collections, while higher company income tax receipts (stemming from profits boosted by high commodity prices) and recovering individual income should also support government revenue.

However, it seems as if civil servants may receive an increase between 4% and 5% in salaries this year, despite the 'three-year salary freeze' announced by the minister of finance in his budget speech. But, as pointed out by Deutsche Bank, such increase will not cost the government the full R23 billion that such increase would normally entail. The government already made provision for an increase of 1.5% in the February budget, and that the additional cost in the form of a 'once-off' monthly cash bonus will, according to Deutsche Bank, cost around R16.7 billion. This will, however, depend on unions accepting the government's wage offer. Lower fiscal deficits than estimated by NT in the next three years are therefore still on track. Deutsche Bank did an analysis showing that higher nominal GDP growth, coupled with lower debt service costs, may lead to a primary budget surplus by 2023-24 (NT projected a primary deficit for an additional two years) and a debt to GDP ratio peaking below 80% in 2025-26 (see Chart 17) compared to NT's projected 88.9% in the February 2021 budget.

Chart 17: Lower government debt to GDP ratio



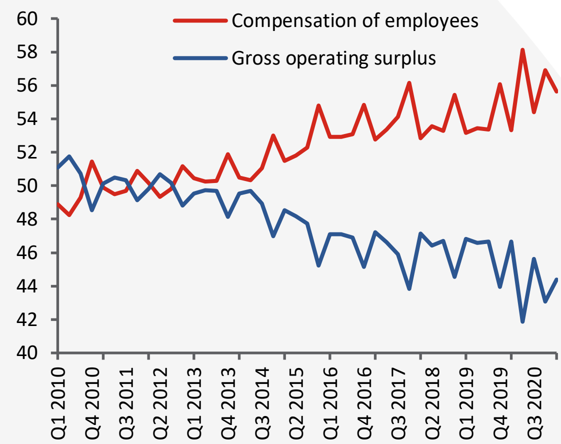
Source: Deutsche Bank

As for gross fixed capital formation, the immediate outlook is not for a strong improvement. As chart 18 shows, companies continued to receive a smaller portion of real national income over the past seven years, which had a negative impact on their investment decisions. Since 2014, the split of real national income increased in favour of employees. In the first quarter of 2021, some 55% of real national income accrued to compensation of employees and 45% to gross operating surplus, compared to a 50/50 division in 2013 to 2014.

However, president Ramaphosa's announcement to lift the licensing cap for private companies to self-generate power from 1MW to 100MW should attract some large investments in the electricity sector. Various sources reported that mines can relatively quickly generate up to 1 600MW and private companies 5 000MW over a five-year period. This may put an end to load shedding in the next two years and increase potential economic growth, which in turn should boost employment.

Ramaphosa's announcement in his State of the Nation address of a policy of localisation (import substitution) may also attract further investments. However, research by Intelllidex shows that although it is possible to substitute 20% of non-petroleum goods imports for domestically produced goods within five years, this will require sector- and industry-specific reforms to not reduce quality and increase prices.

Chart 18: Workers receiving a growing share of national income



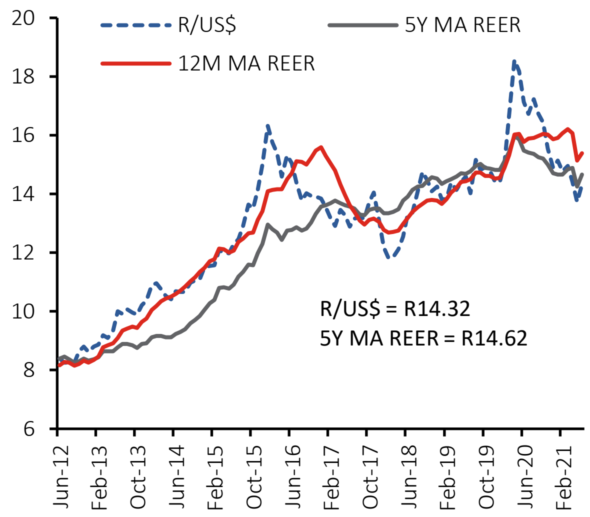
Source: South African Reserve Bank, Momentum Investments

Inventory accumulation continued in the first quarter of 2021, contributing 8.7 percentage points to the quarter on quarter seasonally adjusted and annualised growth rate of 4.5% (measured from the expenditure side).

The external sector started the year where it ended in 2020, registering a current account surplus in the first quarter of 2021. Although exports are increasing in nominal terms, thanks mainly to high commodity prices and a services sector which remained mostly closed, import volumes started to grow faster than exports. Export volumes contracted by 0.9% in the first quarter of 2021 on a seasonally adjusted and annualised basis from the fourth quarter of 2020, whereas real imports expanded by 26.5%. Collectively, the external sector subtracted 7 percentage points from the growth rate in the first quarter of 2021.

Nevertheless, the current account surplus continued to support the rand exchange rate. The rand also received assistance from high commodity prices (export receipts) and a weaker US$, which contributed to the rand strengthening to an overvalued position when analysed on a five-year and 12 month moving average (MA) real effective exchange rate (REER) basis (see chart 19).

Chart 19: Rand overvalued on a five-year and 12month MA REER basis on 30 June 2021



Source: Federal Reserve Bank of St. Louis, Momentum Investments

The stronger rand assisted in keeping imported CPI lower. This was not enough though to prevent an increase in CPI, as low base effects and higher fuel prices pressured y/y CPI to 5.2% in May 2021 from 4.4% in April 2021 and 2.2% in May 2020. However, core CPI, which excludes the effect of food and energy prices, showed a 0% increase on a month-on-month basis. This means there is no sign yet of second-round price increases. Furthermore, if the effect of the low base is removed from the calculation of headline CPI, it would have been 3.7% y/y in May 2021, the same as in April 2021.

Most of the future consumer price inflation pressures, apart from higher fuel prices, are expected to emanate from other administered prices such as municipal rate increases. Municipal rate increases are expected to add 0.2 percentage points to CPI in July/August. Nevertheless, headline CPI is expected to have reached its peak in May 2021 and should, notwithstanding high municipal rate increases, drift downwards from here. As for future inflation, at this stage it seems as if headline CPI will average around 4.5% in the next two years. Table 4 provides a summary of the factors that are expected to put upward and downward pressure on headline CPI next year.

Table 4: Expected pressure points on CPI next year

More pressure on CPI in 2022	Less pressure on CPI in 2022
Rentals and OER*	Food
Municipal rates	Fuel
School fees	Less base effects
Medical insurance	Low CPI expectations
Weaker rand	Negative output gap

Source: Stats SA, Momentum Investments

Although things can change quickly when the US Federal Reserve announces changes in its 'tapering policy' which may cause the rand exchange rate to depreciate, research by the South African Reserve Bank has shown the pass-through from a weaker rand to CPI has weakened in recent times. We therefore don't expect headline CPI to increase excessively in the next two years and for interest rates to remain unchanged this year, only starting to increase next year. Table 5 provides a summary of our economic forecasts.

Table 5: Economic outlook for the next two years

Economic indicator	2021F	2022F
GDP (Expenditure)	4.4%	2.1%
Household consumption expenditure	3.9%	2.4%
Government consumption expenditure	0.07%	0.06%
Gross Capital Formation (including inventories)	13.5%	4.2%
Gross Fixed Capital Formation	0.03%	1.2%
Exports	7.9%	6.2%
Imports	8.5%	6.9%
Current account balance (% of GDP)	2.9%	-0.2%
Fiscal balance (% of GDP, fiscal years)	-8.3%	-6.9%
Headline inflation (average)	4.2%	4.5%
Core inflation (average)	3.2%	3.9%
Interest rates (repo rate end of the year)	3.5%	4.0%
Real interest rates (average)	-0.7%	-0.6%
Rand/US dollar - average (Year-end)	14.39 (14.63)	15.09 (15.53)

Sanisha Packirisamy
Economist
Momentum Investments

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

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

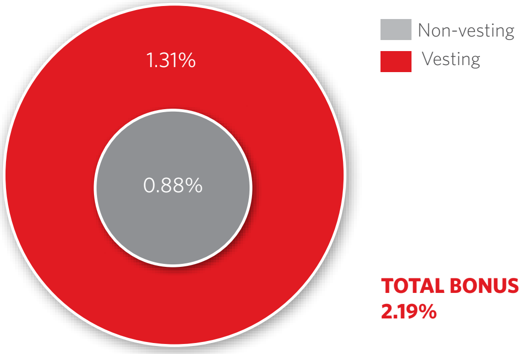
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	100% - 105%	1.02% [1]	5.17% [1]

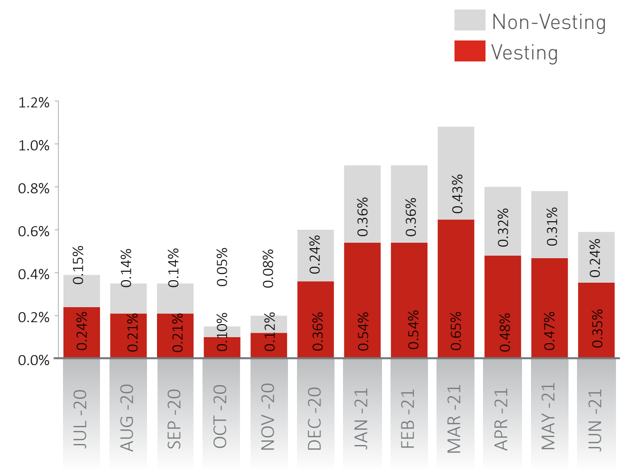
[1]Based on back-tested bonuses and returns

Performance

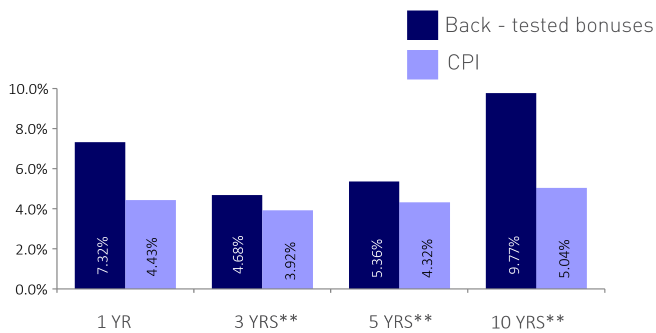
The total bonus* for the past quarter on the Universal Multi-Manager Smooth Growth Fund is shown below.



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



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

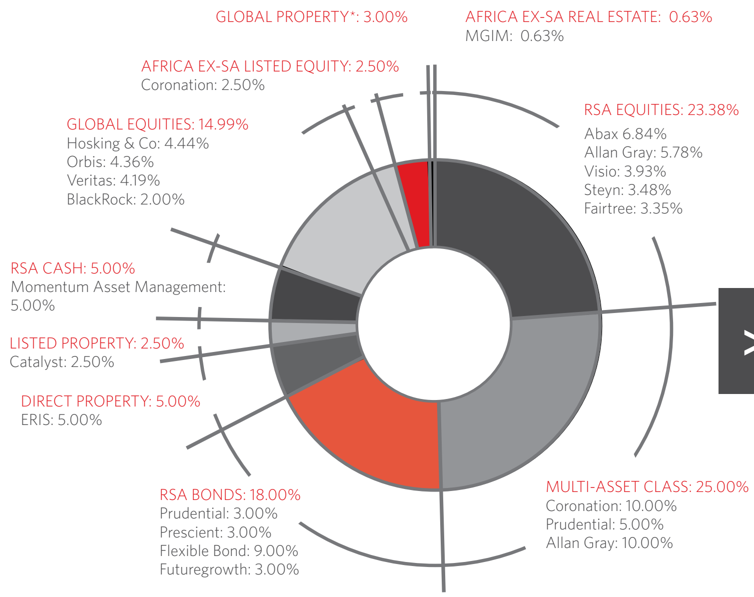


CPI figures are lagged by two months

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

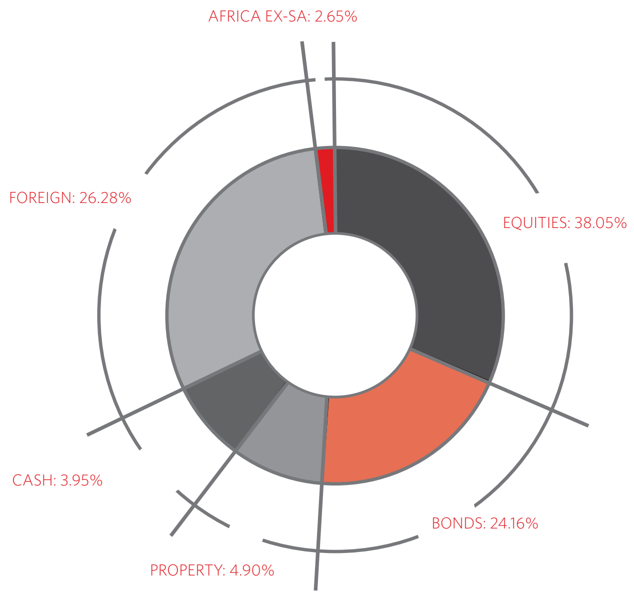
Asset Allocation

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 below.



**Asset class has not been awarded any mandates*

The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smooth Bonus Range

Universal Smooth Growth Fund

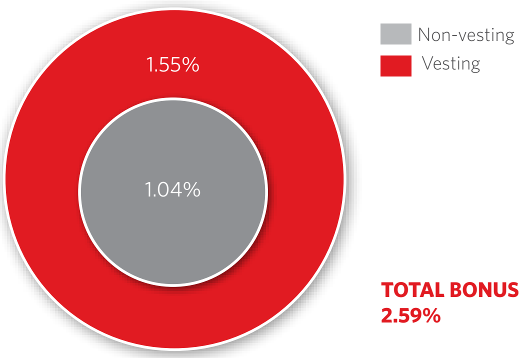
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	100% - 105%	0.97% [1]	4.18% [1]

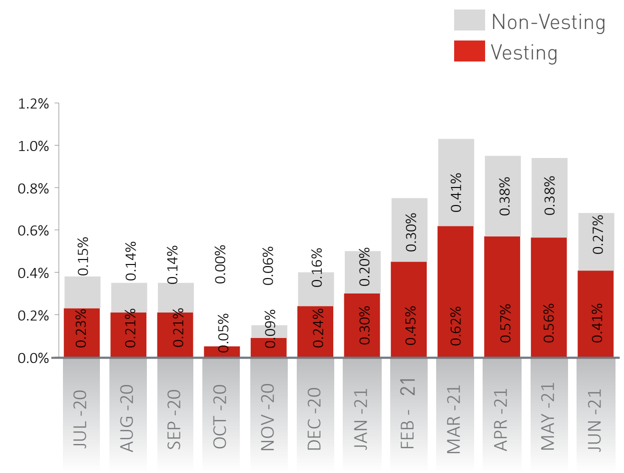
[1]Based on back-tested bonuses and returns

Performance

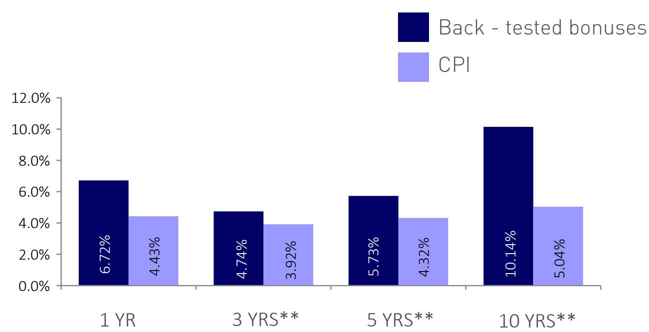
The total bonus* for the past quarter on the Universal Smooth Growth Fund is shown below.



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



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



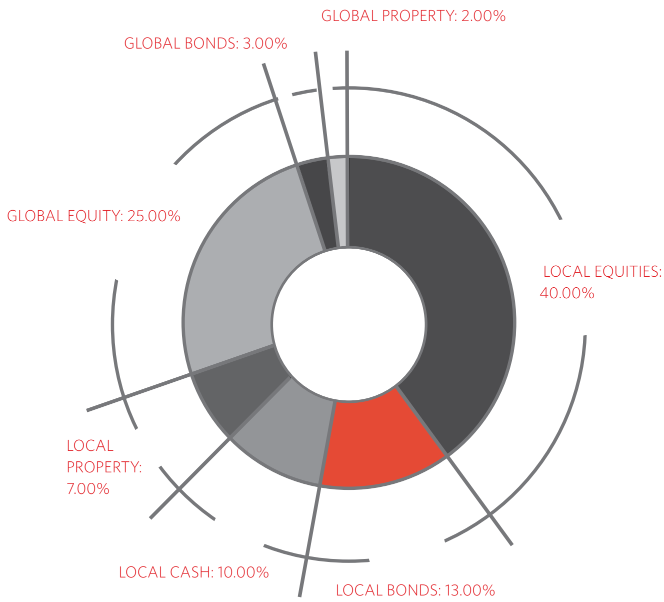
CPI figures are lagged by two months

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

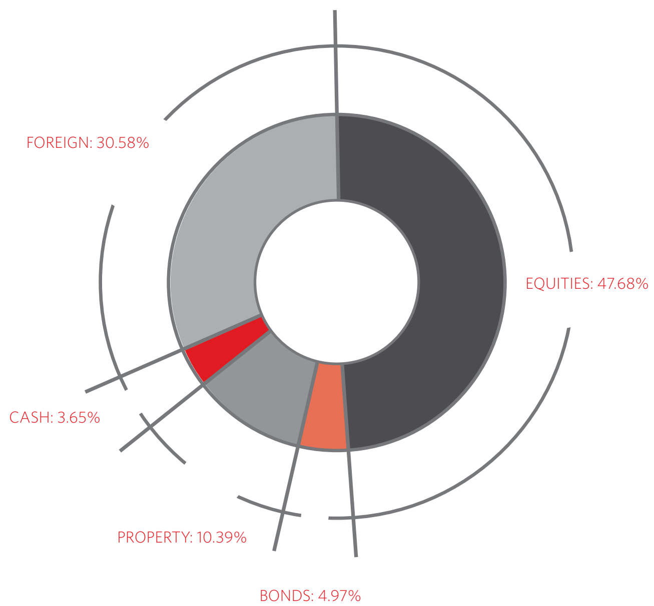
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smooth Bonus Range
Universal Smooth-Edge Fund

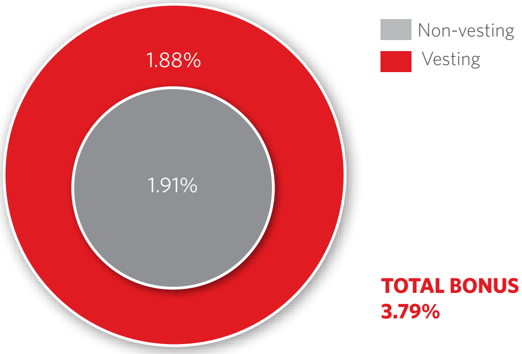
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	105% - 110%	1.22% [1]	6.62% [1]

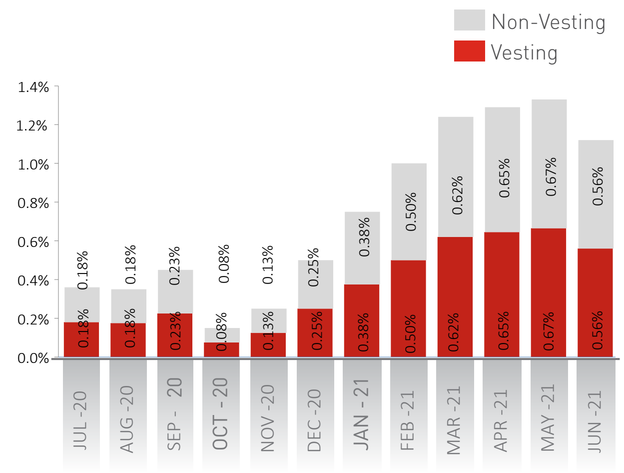
[1]Based on back-tested bonuses and returns

Performance

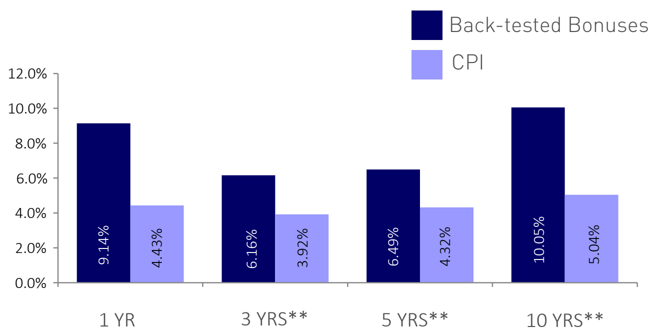
The total bonus* for the past quarter on the Universal Smooth-Edge Fund is shown below.



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



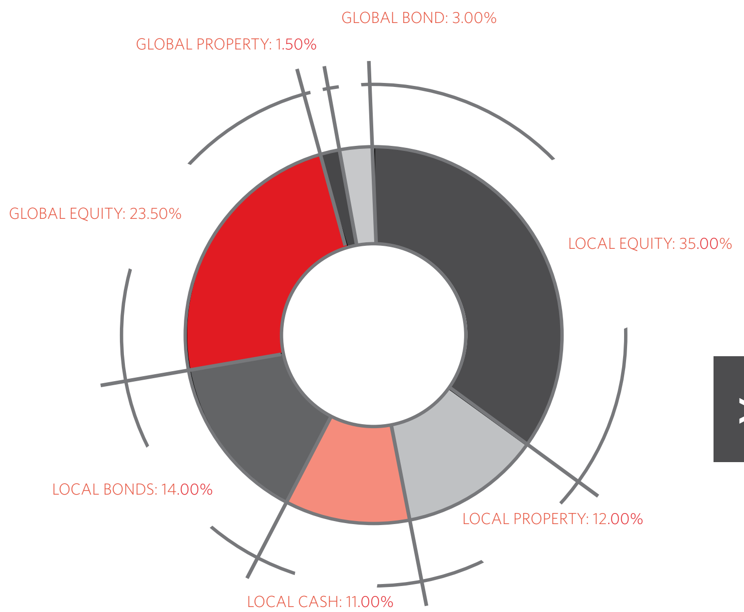
The chart below shows the long term bonus* performance of the Momentum Universal Smooth-Edge Fund against CPI



CPI figures are lagged by two months

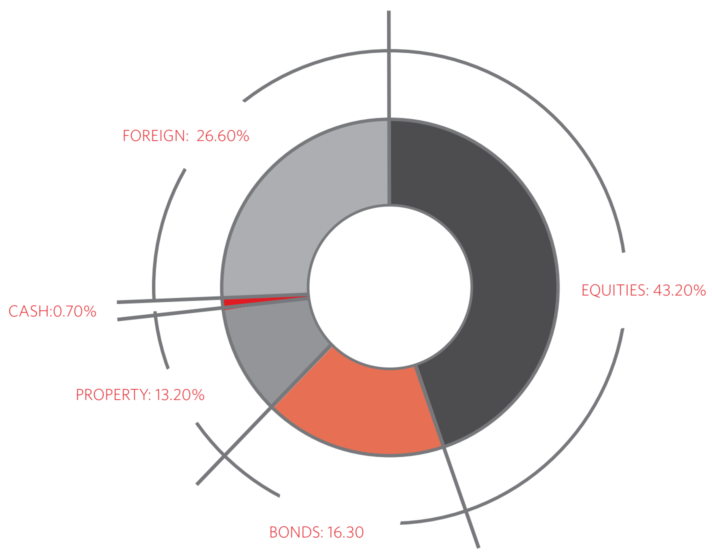
Asset Allocation

The strategic asset allocation of the portfolio is shown below.



*Inflation-linked bonds

The effective asset allocation of the portfolio is shown alongside.



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

Partially Vesting Smooth Bonus Range

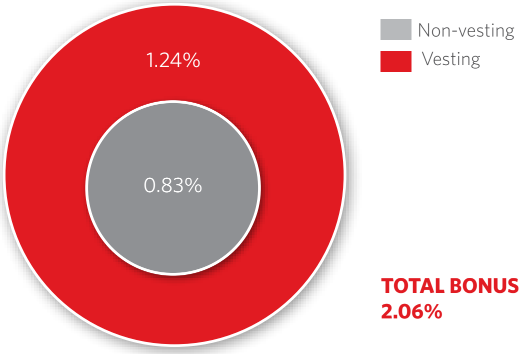
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

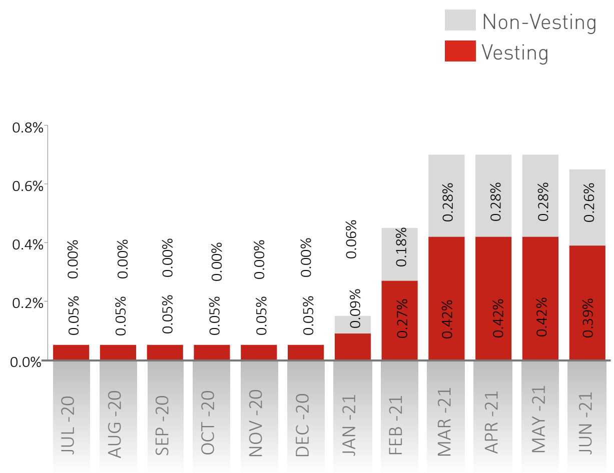
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	100% - 105%	R10.6bn	0.81%	4.98%

Performance

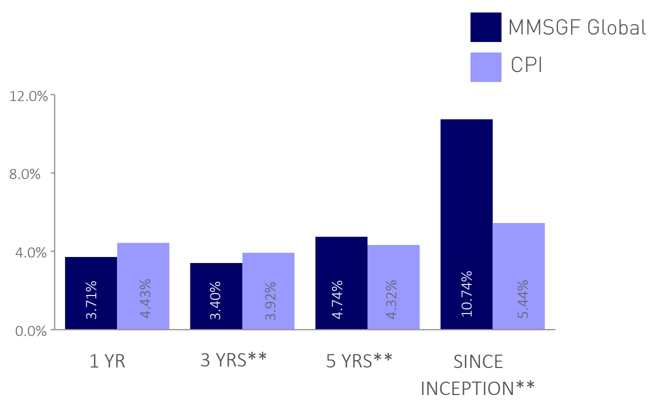
The total bonus* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



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



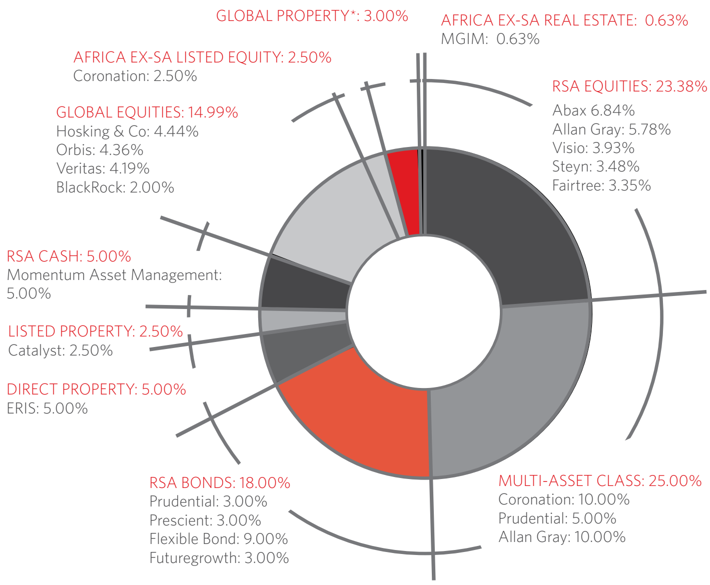
CPI figures are lagged by two months

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

** Annualised

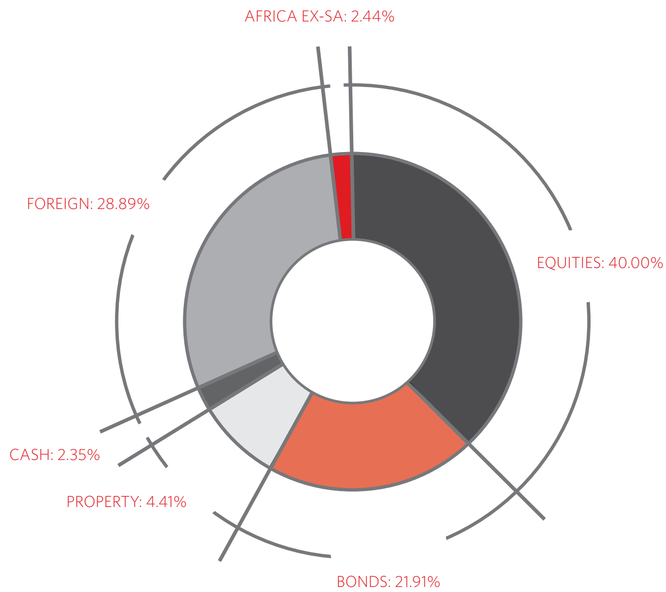
Asset Allocation

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.



**Asset class has not been awarded any mandates*

The effective asset allocation of the portfolio is shown alongside.



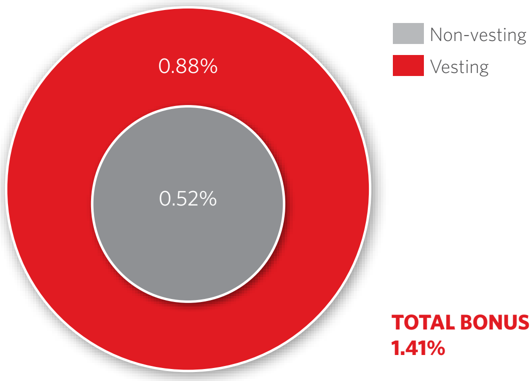
Smooth Growth Fund Global

Fund Snap Shot

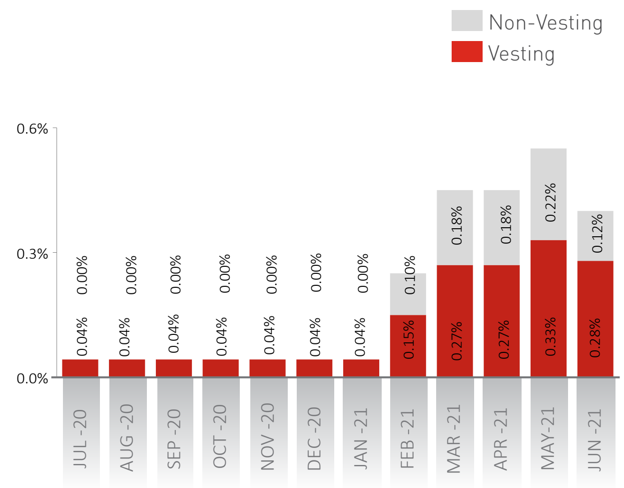
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	102.5% - 107.5%	R1.8bn	0.69%	3.81%

Performance

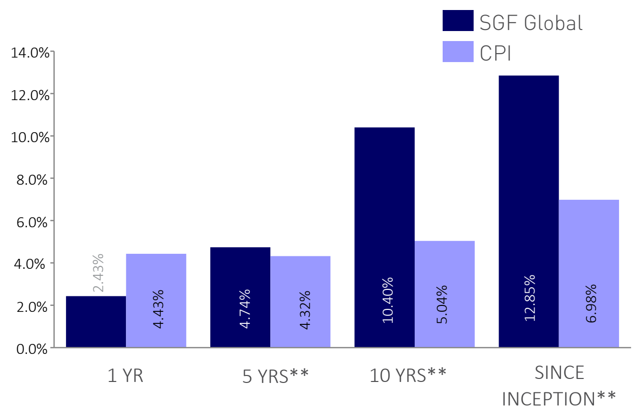
The total bonus* for the past quarter on the Smooth Growth Fund Global is shown below.



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.



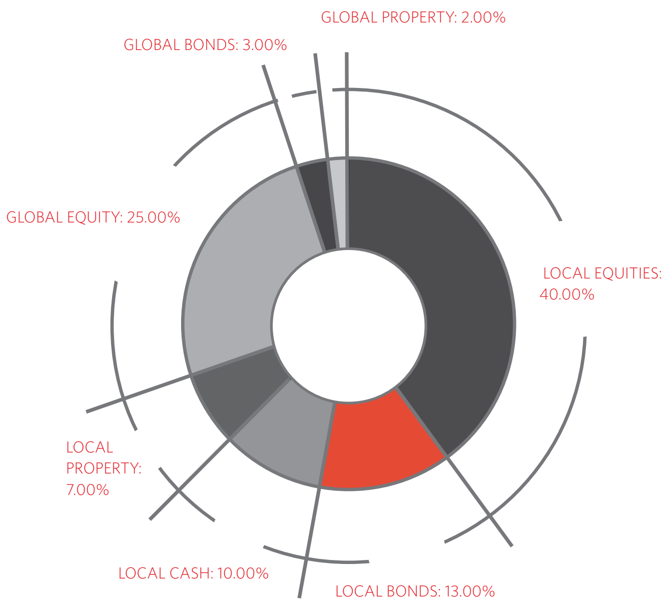
CPI figures are lagged by two months

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

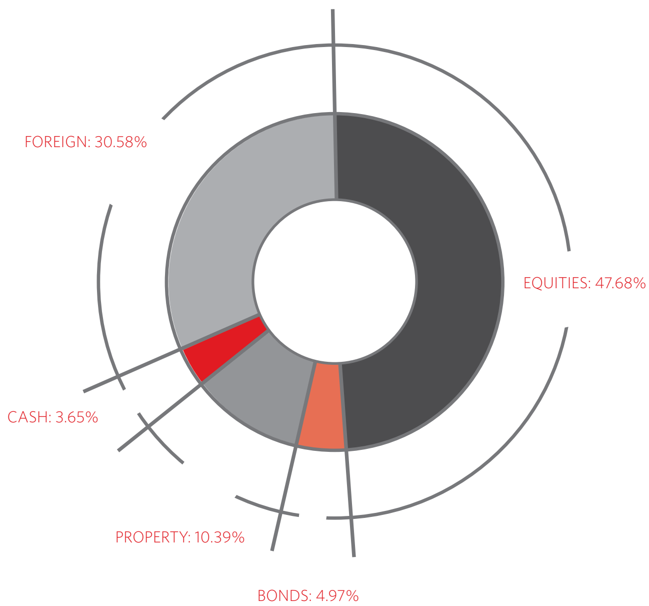
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



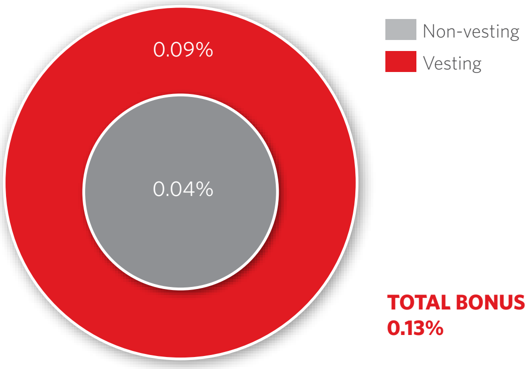
Partially Vesting Smooth Bonus Range
Multi-Manager Smooth Growth Fund Global Bonus Series 2020 *(previously MMSGF Local)*

Fund Snap Shot

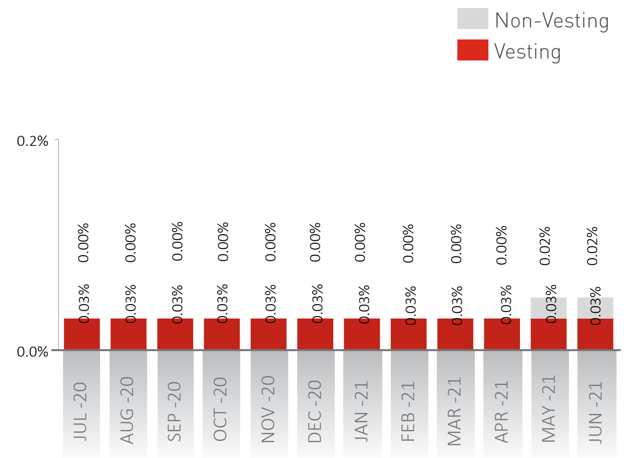
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	95% -100%	R142.2m	0.32%	2.05%

Performance

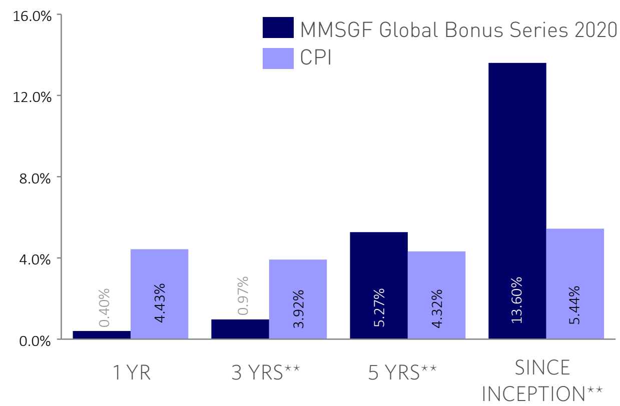
The total bonus* for the past quarter on the MMSGF Global Bonus Series 2020 is shown below.



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



The chart below shows the long term bonus* performance of the MMSGF Global Bonus Series 2020 against CPI



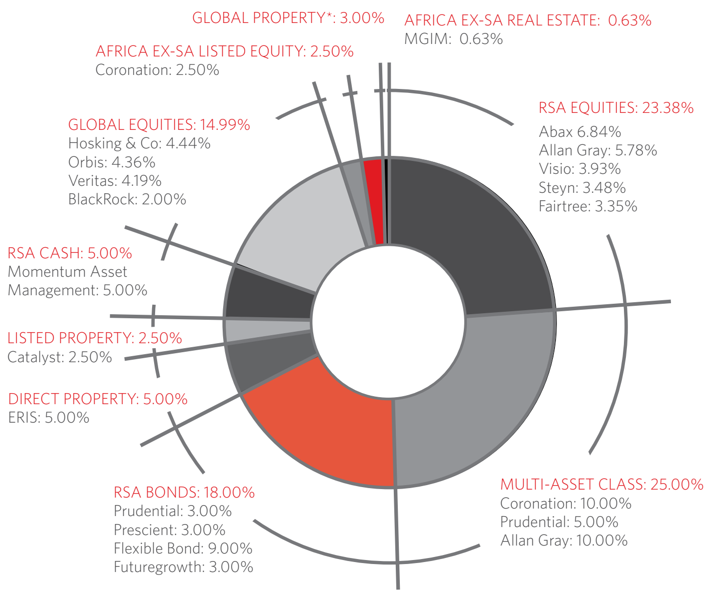
CPI figures are lagged by two months

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

Asset Allocation

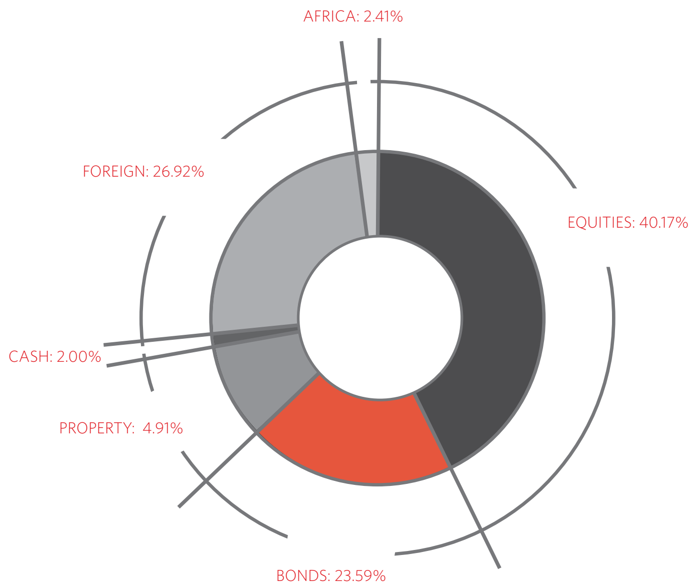
The strategic asset allocation of the portfolio is shown alongside.

The Africa ex-SA Real Estate allocation is expected to increase gradually over the next 5 years to a total of 2.5% in line with drawdown notices from Momentum Global Investment Management (MGIM).



Asset class has not been awarded any mandates

The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smooth Bonus Range

Smooth-Edge Fund

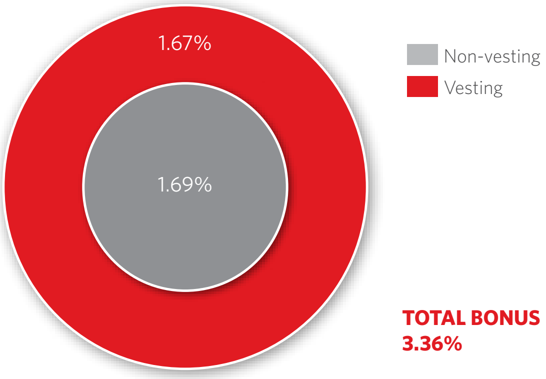
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	102.5% - 107.5%	R95.70m	1.13% [1]	6.62% [1]

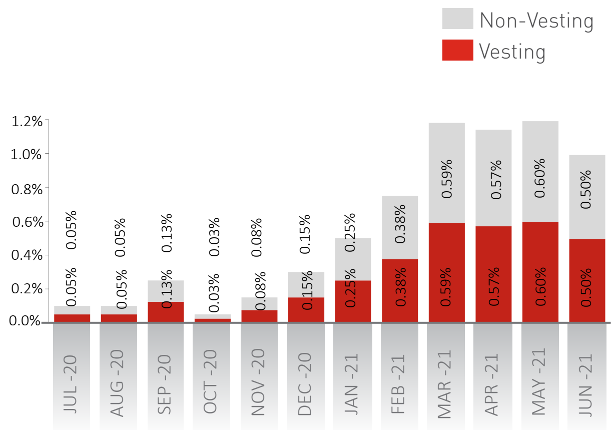
[1]Based on back-tested bonuses and returns

Performance

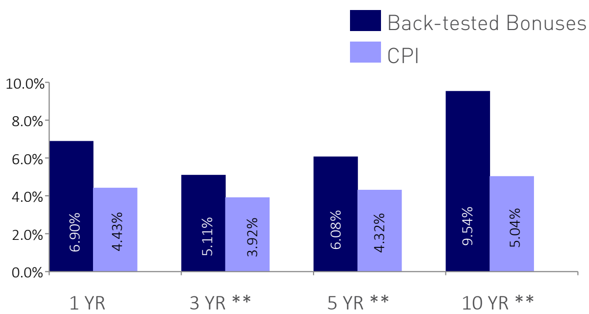
The total bonus for the past quarter on the Momentum Smooth-Edge Fund is shown below.



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



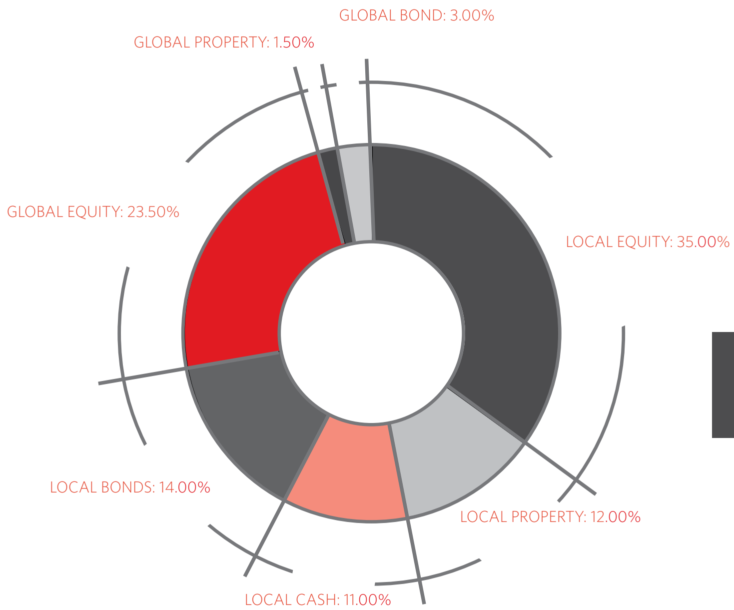
CPI figures are lagged by two months

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

** Annualised

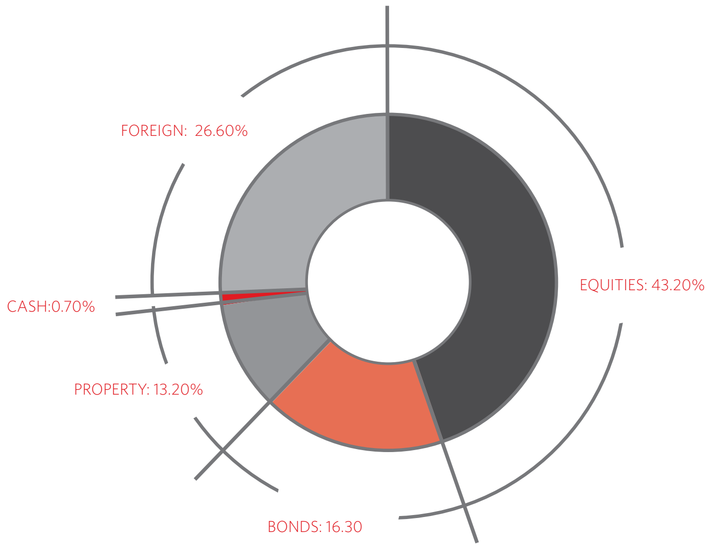
Asset Allocation

The strategic asset allocation is shown alongside.



*Inflation-linked bonds

The effective asset allocation of the portfolio is shown alongside.



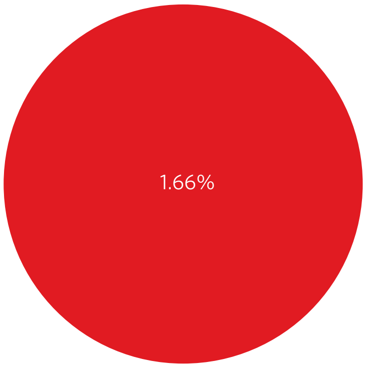
Universal Smart Guarantee+3 Fund

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%	R438.6m	0.73%	5.39%

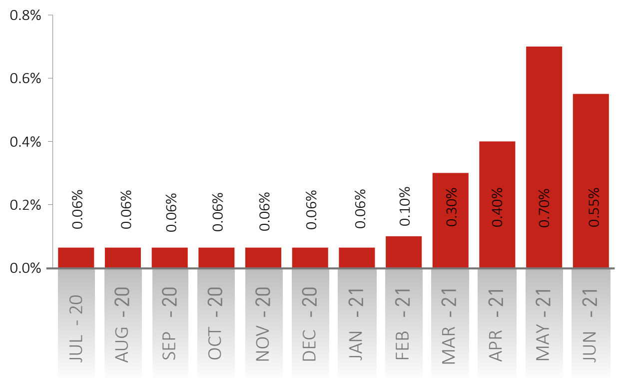
Performance

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

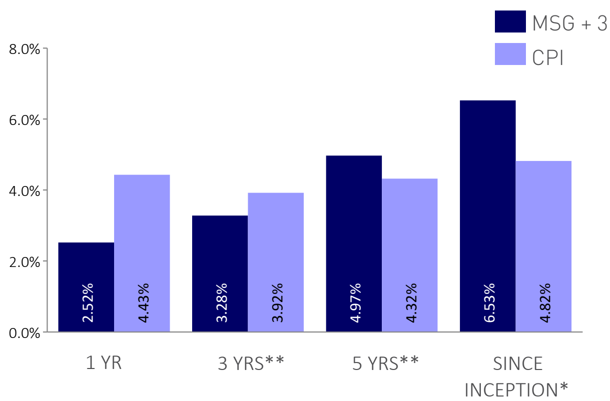


TOTAL BONUS 1.66%

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.

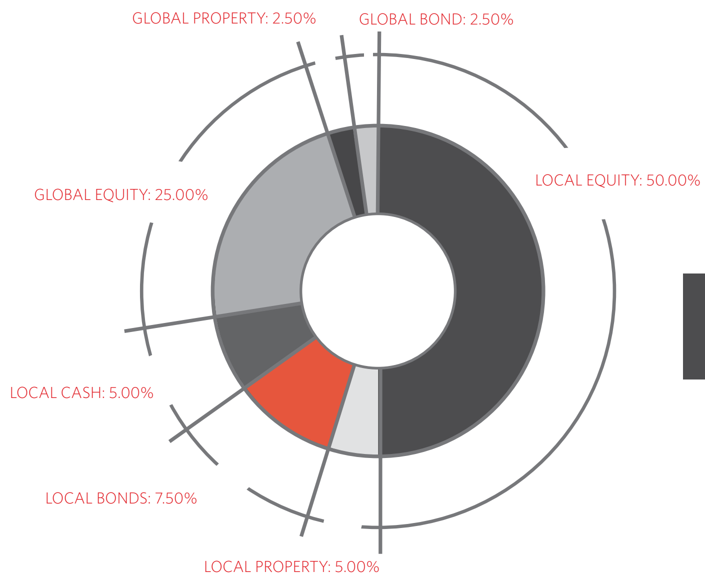


CPI figures are lagged by two months

* 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. Assuming zero returns over the following 34 months (there is a 2 month lag), around **11.49%** of bonuses will still be declared.

Fully Vesting Smooth Bonus Range

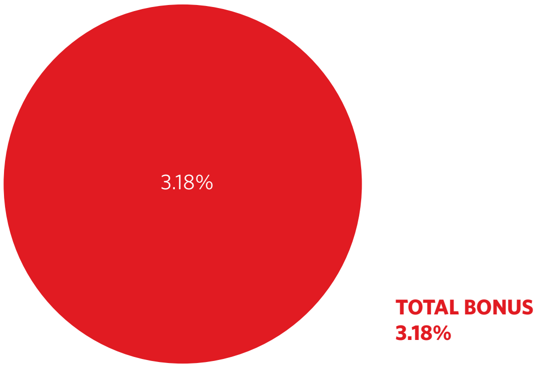
Universal Smart Guarantee +3 Bonus Series 2020

Fund Snap Shot

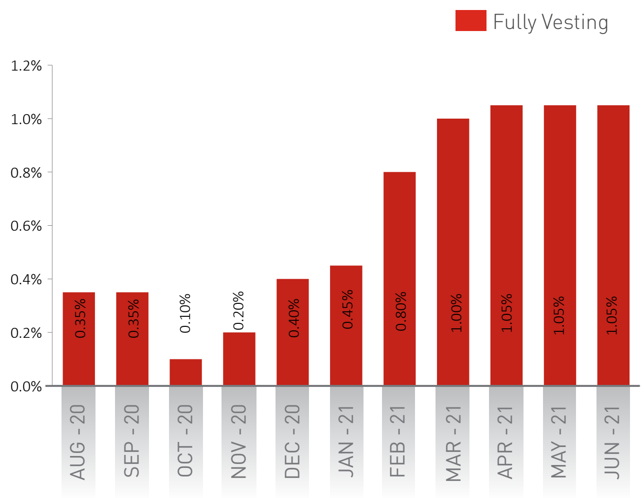
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
August 2020	100% - 105%	R64m	-	4.49%

Performance

The total bonus* for the past quarter on the Universal Smart Guarantee +3 Bonus Series 2020 is shown below.



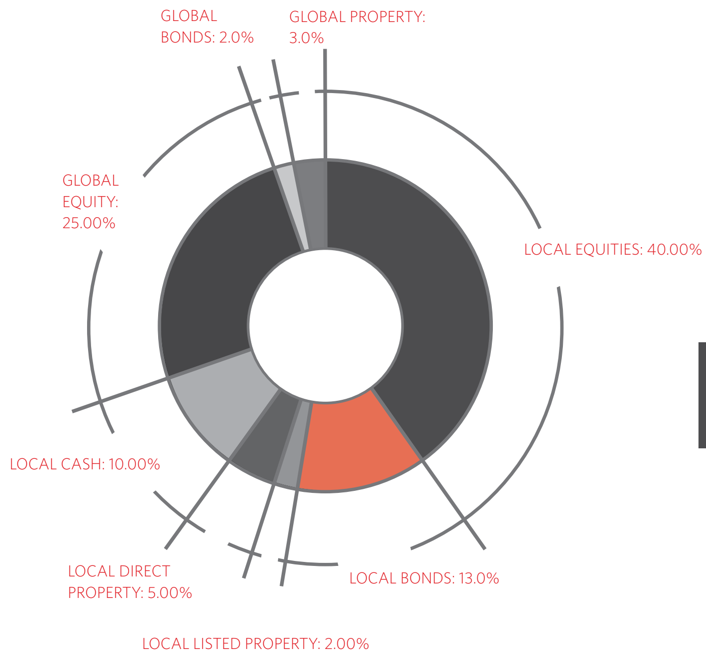
The chart below shows the actual monthly bonuses* for the past 11 months.



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

Asset Allocation

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



The Smart Guarantee +3 Bonus Series 2020 uses the Momentum Enhanced Growth portfolio as the bonus generating portfolio.

For bonus declarations, 90% 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.

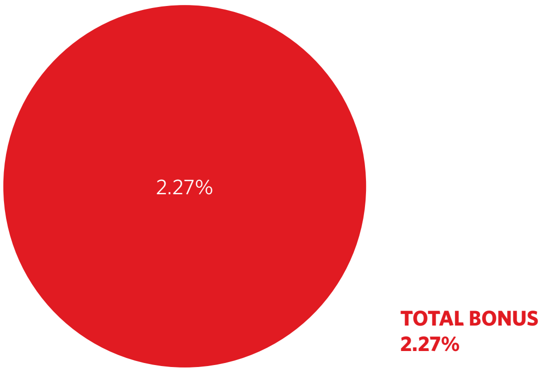
Fully Vesting Smooth Bonus Range
Multi-Manager Secure Growth Fund

Fund Snap Shot

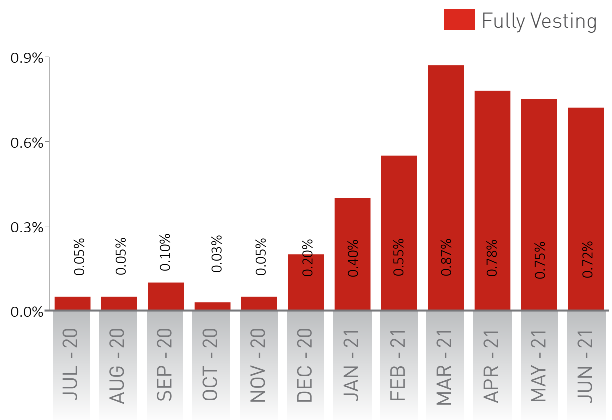
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	105% - 110%	R90m	0.85%	4.88%

Performance

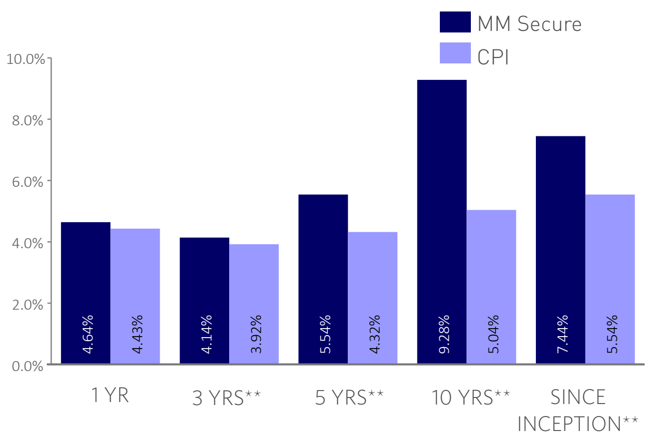
The total bonus* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



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



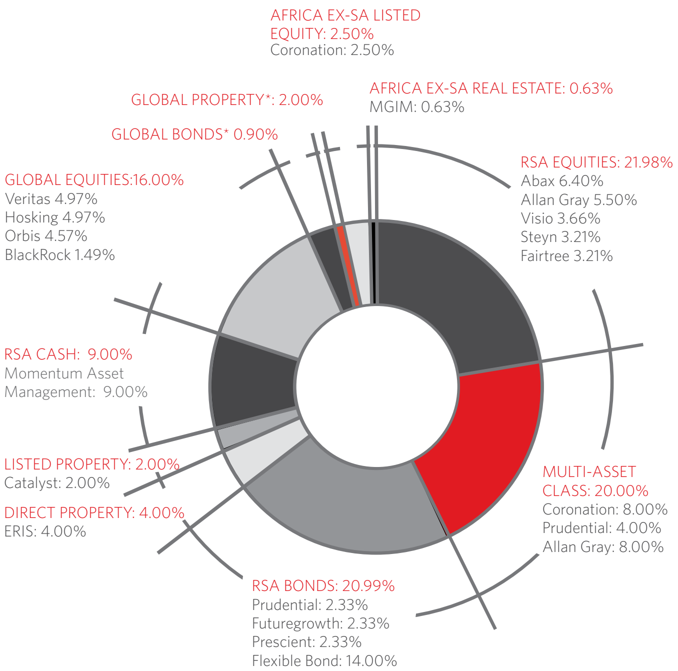
CPI figures are lagged by two months

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

Asset Allocation

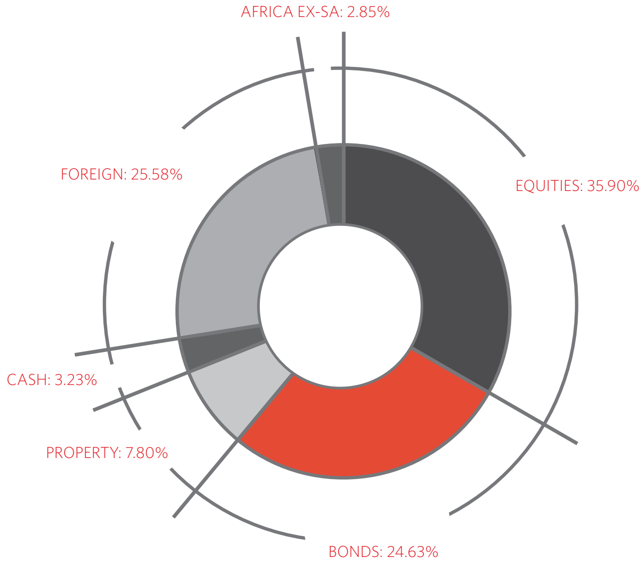
On 1 December 2020, changes were made to the strategic asset allocations.

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.



**Asset class has not been awarded any mandates*

The effective asset allocation of the portfolio is shown alongside.



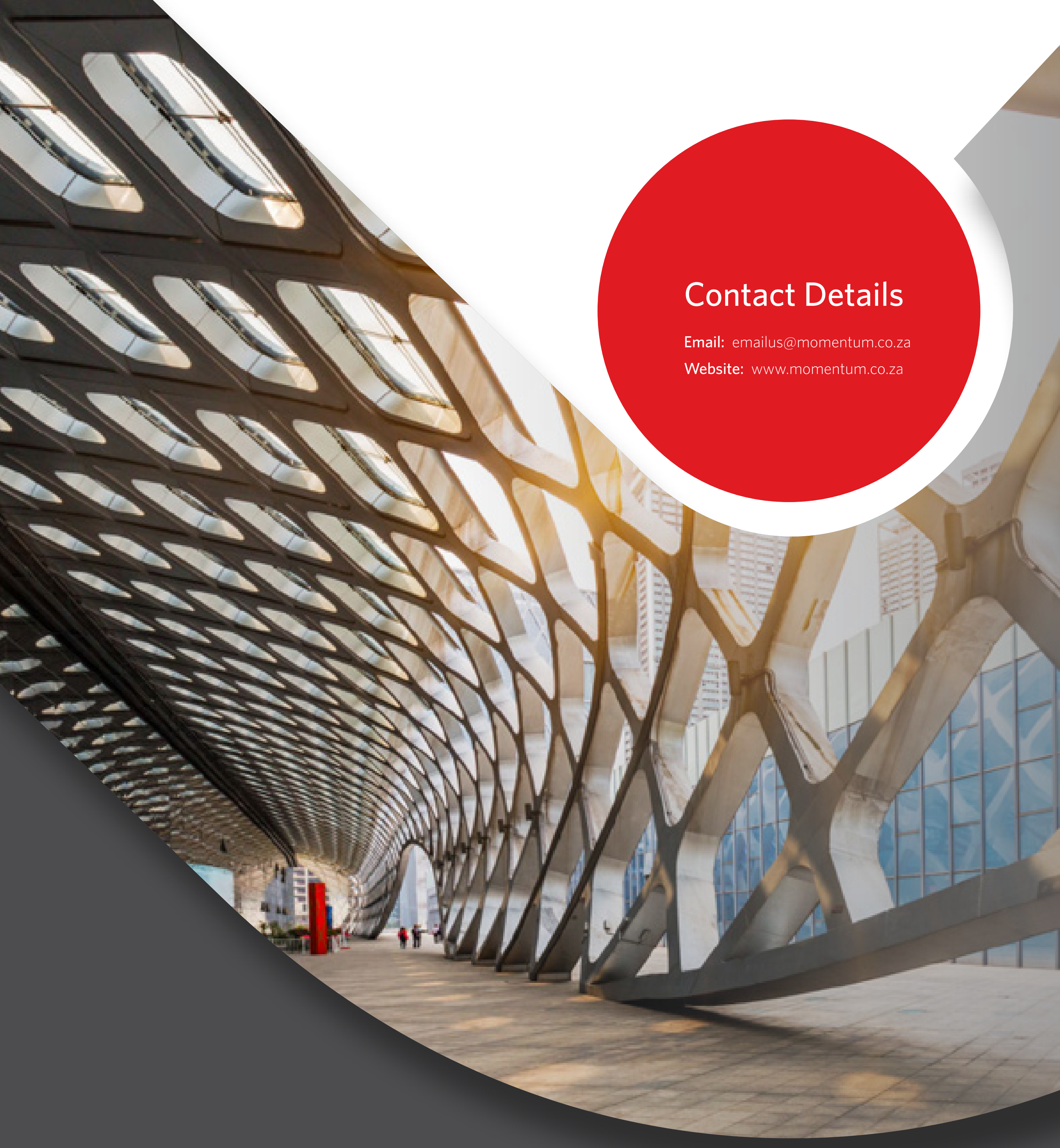
Smooth Bonus Portfolios Key Features

Vesting	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 the long term	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
	Universal Multi-Manager Smooth Growth Fund								June 2020
	Multi-Manager Smooth Growth Fund Global Bonus Series 2020								January 2004
	Smooth Growth Fund Global	CPI + 4% pa, net of the investment management fee and underlying asset charges over the long term	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
	Universal Smooth Growth Fund								June 2020
	Smooth-Edge Fund	CPI + 4% pa, net of the investment management fee and underlying asset charges over the long term	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
	Universal Smooth-Edge Fund								June 2020
Fully Vesting	Multi-Manager Secure Growth Fund	CPI + 2% pa, net of the policy fee and underlying asset charges over the long term	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
	Universal Smart Guarantee +3 Fund	CPI + 3% pa, net of theinvestment management fee and underlying asset charges over the long term	Insurer Liability Driven Investment	Insurer Liability Driven Investment	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
	Universal Smart Guarantee +3 Fund 2020 Bonus Series	CPI + 3% pa, net of the investment management fee and underlying asset charges over the long term	Insurer Liability Driven Investment	Insurer Liability Driven Investment	100% of net capital invested and total bonus declared (net of the Investment management fee)	Yes	0.50% pa	0.75% pa[3]*	August 2020

*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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