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

Smoothed Bonus Report

Second Quarter 2022

>

momentum corporate

Looking back over the **past quarter**

Dear valued investors

The past quarter was characterised by global monetary policy tightening, recessionary fears, rising inflation (including an escalation in global energy prices), the Russia-Ukraine war, China's zero COVID policy and a looming global food crisis with the blockade of Ukrainian grain. With all these risks in the system, the direction that both economies and markets will take is uncertain. Many economists are, however, predicting that the market outlook is likely to be bleak over the next 12 to 24 months.

Over the past three months, the MSCI All Countries equity market index was down 5.61% (incorporating a 11% ZAR depreciation relative to USD) with developed markets (MSCI World) down 6.16% and emerging markets (MSCI Emerging Markets) down 0.23%. The South African market also experienced steep declines, with local equities (FTSE/JSE All Share Index) down a massive 11.69%. Resources (FTSE/JSE Resources) declined with 20.69% and financials (FTSE/JSE Financials) fell 15.78%, with Industrials (FTSE/JSE Industrials) holding up stronger, although still down 2.97%.

South Africa benefited from a low inflationary environment over the last decade. Inflation is now rising and jumped to 7.4% in June 2022 from 4.9% in June 2021. The South African Reserve Bank is trying to keep inflation under control and for this reason, the Monetary Policy Committee decided to raise interest rates by 0.50% on 21 May 2022 and by a further 0.75% in July 2022, which brings the prime lending rate to 5.5%.

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

Momentum Corporate smoothed bonus portfolios

The main asset class growth contributor, namely local equities, sustained significant losses. Fortunately, at the start of the quarter many of our smoothed bonus portfolios were very well funded and, in large, were able to ride out the negative market returns and remain either fully funded or close to fully funded.

Markets are generally expected to have a degree of volatility. However, we have seen an increase in volatility over the last few years, and this is expected to persist. It is during times like these where our smoothed bonus portfolios come into their own as they result in a steady bonus pattern with far less fluctuations than investors would otherwise experience. With the traditional Momentum smoothed bonus range, capital guarantees provide further comfort.

Momentum recently launched the Universal Fifty Smooth Return Fund where the focus is on the smoothing of returns instead of investment guarantees. This provides the investor with a cost-effective smoother investment journey and compliments Momentum's smoothed bonus offering.

We look forward to partnering with you to meet your expectations.

Warm regards

Steed Duncan-Smith

Client Relationship Manager
Momentum Corporate

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Relaxation of exchange control measures

Introduction

South African retirement funds have been allowed to invest a portion of their fund's assets offshore since 1995. Back then, the foreign asset exposure limit was 10% of the value of a fund's assets. However, the relaxation of exchange control measures over time has increased this limit.

Ankia Pietersen

Product Development Team Leader
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The most recent relaxation has meant that retirement funds are now allowed to invest up to 45% of their fund's assets offshore. Previously, this limit was 30% with an additional 10% allowance for African assets.

Investing offshore requires a significant amount of expertise and retirement funds will have to evaluate each opportunity by considering its benefits and risks before including it in their portfolio. Some of the key benefits and risks of offshore investment are outlined below.

The benefits of investing offshore

1) **Risk reduction through diversification**

   Investors are often warned not to put all their eggs in one basket and to allow for sufficient diversification in their portfolio to optimise their returns while minimising their exposure to risk. Diversification can be achieved by investing in different currencies, sectors, industries, companies, asset classes and assets.

   Although globalisation has led to greater correlation between global equity markets, as recently shown by the Russia-Ukraine war and the ongoing supply chain disruptions, return correlations between developed and emerging economies should still be lower given the differences in their economic and government policies.

2) **Increase in investment opportunities**

   The JSE has approximately 300 companies listed on the exchange and is one of the most liquid exchanges among emerging markets. However, consistent liquidity can only be found in the largest stocks resulting in a much smaller and less diverse investment universe for retirement funds.

Developed economies such as the United States and Europe offer far more diverse and liquid equity markets as demonstrated by the number of companies listed on each of the exchanges in the table below.

Stock exchange	Approximate number of listed companies*
New York Stock Exchange	>2 400
NASDAQ Stock Exchange	>3 700
Johannesburg Stock Exchange	>300
London Stock Exchange	>1 300

* The number of companies will vary over time.

Global exchanges also allow South African retirement funds to gain exposure to industries which are less well represented in the South African economy, such as IT, vehicle manufacture, biotechnology and pharmaceutical industries.

3) Hedge against inflation and rand depreciation

One of the main arguments for the inclusion of offshore assets in a retirement portfolio is to protect the value of the portfolio against inflation and the depreciation of the rand. A higher inflation rate in South Africa compared to other countries will tend to reduce the value of the rand, which in turn will boost the returns from foreign investments, all else being equal. Many JSE-listed companies generate a large proportion of their revenue offshore and therefore already provide a hedge against rand depreciation.

The risks of investing offshore

1) Introduction of currency risk

Short-term exchange rate fluctuations can have a significant impact on the performance of the offshore component of an investment portfolio. Just as rand depreciation will boost offshore returns, so will a strengthening of the rand decrease offshore returns. It is therefore important to analyse the impact of changes in the exchange rate on the performance of the overall portfolio when deciding how much to invest offshore.

2) Increase in costs

The cost of investing offshore can be significantly higher relative to the fees payable on domestic assets classes. The higher fees are payable to compensate fund managers for the extra time and expertise required to research global investment opportunities. Higher fees will translate into lower net portfolio returns and are therefore an important consideration when making investment decisions.

Summary

Although the JSE has a relatively deep and liquid market, consistent liquidity can only be found in a few of the largest listed companies. This concentration of liquidity causes a lack of diversification in the South African stock market resulting in a smaller investment universe for retirement funds. Given these limitations, the relaxation of the exchange control limits is welcomed as it will give South African fund managers the opportunity to construct efficient portfolios by reducing their exposure to risk through diversification. In addition, fund managers will have more investment freedom and access to more opportunities which could translate into enhanced portfolio returns.

However, care should be taken when considering whether to introduce or increase the offshore allocation of an investment portfolio given that it may result in an increase in the overall portfolio volatility and cost.

Regulation 28 amendments

On 1 July 2022, the National Treasury published amendments to Regulation 28 of the Pension Funds Act, No. 24 of 1956. The purpose of this regulation is to protect the savings of members of a retirement fund. This is done through imposing limits and restrictions on the amount a fund may invest in any one particular asset class.

> The aim of these amendments is to widen the investment universe for retirement funds and to encourage infrastructure investment by explicitly allowing it.

Key changes

1) Infrastructure investment

The amendments introduce a definition of infrastructure to the regulation. It states that the overall investment in infrastructure across all asset classes may not be more than 45% with regard to domestic exposure and an additional limit of 10% is added for the rest of Africa.

The purpose of these amendments is to encourage retirement funds to invest in infrastructure projects as they can, if successful, aid economic growth and provide real returns suitable for retirement fund members' savings.

Investments in infrastructure are mostly accessed through private equity funds. As a result, the private equity and hedge fund asset class has been separated and the limit for private equity increased from 10% to 15% to further facilitate infrastructure investment.

2) Offshore limits

Previously, retirement funds were allowed to invest a maximum of 30% of their assets offshore with an additional 10% available for investment in Africa. The amendments have now combined these two limits into a single limit allowing retirement funds to invest a total of 45% of their assets offshore. The new limit will give fund managers access to a wider range of opportunities in their pursuit of growth and diversification as outlined in the article on the relaxation of exchange control measures.

3) Crypto restrictions

The excessive volatility of crypto assets together with their unregulated nature make investment in these assets inappropriate for retirement. As such, Regulation 28 prohibits retirement funds from investing in crypto assets.

How this will affect your policy

All of the Momentum Corporate Smoothed Bonus Funds are Regulation 28 compliant and will continue to adhere to the limits set forth in the regulation. The strategic asset allocation for the investments underlying our smoothed bonus funds have been reviewed in light of the amendments and are being adjusted where we believe that a change will be in the best interest of the fund's members and aligned with the portfolio's investment objective. Any changes to the strategic asset allocations of the investments underlying our smoothed bonus funds will be communicated to members in due course.

Ankia Pietersen

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Momentum Investments market commentary for the quarter ended **June 2022**

by Sanisha Packirisamy and
Herman van Papendorp

Highlights

Markets

- Financial market volatility will be high with uncertainties around the eventual economic growth impacts of global monetary policy tightening. Although a multitude of leading indicators are pointing to a global growth slowdown, it is unclear how severe the slowdown will be, when it will occur and how long it will last.
- Fighting inflation will likely remain the primary focus of global central banks until inflation reverses downwards. During this period, the fundamental backdrops for both global equities and bonds should remain poor. However, once the inflation trend has clearly reversed, the fundamentals for bonds should improve, while equity fundamentals should stay weak until there is sufficient clarity about the extent of the ensuing growth slowdown.
- After recent sharp market moves, global bonds are now better relative value versus equities and could be a hedge during potential further equity drawdowns, particularly when recession fears rather than interest rate concerns cause equity drawdowns.
- Global property fundamentals remain solid, with property yields at fair value versus real bond yields.
- Due to cheap absolute and relative valuations, South African (SA) equities could either hold up relatively better during global equity drawdowns or at least provide better returns during subsequent recovery phases.
- Not only are SA real bond yields attractive versus global yields, but they are also higher than their historical average. Inflation-linked bonds (ILBs) should receive fundamental support from monthly inflation accruals and break-even widening in the coming months until local inflation peaks. The prospective SA real cash yield has been rising from a low level in line with SA Reserve Bank (SARB) policy rate increases.
- Listed property sector fundamentals remain negative, but there has been some improvement, with property values seemingly stabilising, balance sheets improving and earnings recovering from a low base.

Economics

- Unfavourable inflation surprises have roused risk aversion. A higher level of forecast uncertainty embedded in markets has commanded a higher risk premium, causing central banks to become even more data dependent.
- The Russia-Ukraine war, together with aggressive lockdowns in China, have reignited supply-side concerns and further lifted already-high inflation projections.
- Mounting headwinds threaten to slow the post-pandemic global economic recovery including high inflation, a rebuilding of fiscal buffers and an accelerated unwinding of accommodative monetary policies.
- A more aggressive tightening of financial conditions has ignited fears of a global recession. While a policy-induced slowdown in the global economy is likely, we see the chances of stagflation as being more remote.
- Akin to 2021, household spending is likely to be the primary driver of economic activity this year, while an uncertain political climate and insufficient demand remain significant barriers to investment in SA.
- Surging fuel and food costs are likely to drive headline inflation to around 6.5% on average for this year, before sliding back to below 5% in 2023, with core inflation expected to remain more contained.
- We expect an accelerated global hiking cycle and the fear of higher underlying inflation outcomes to motivate further local interest rate hikes to a peak of 6.25% by the end of the first quarter of next year.

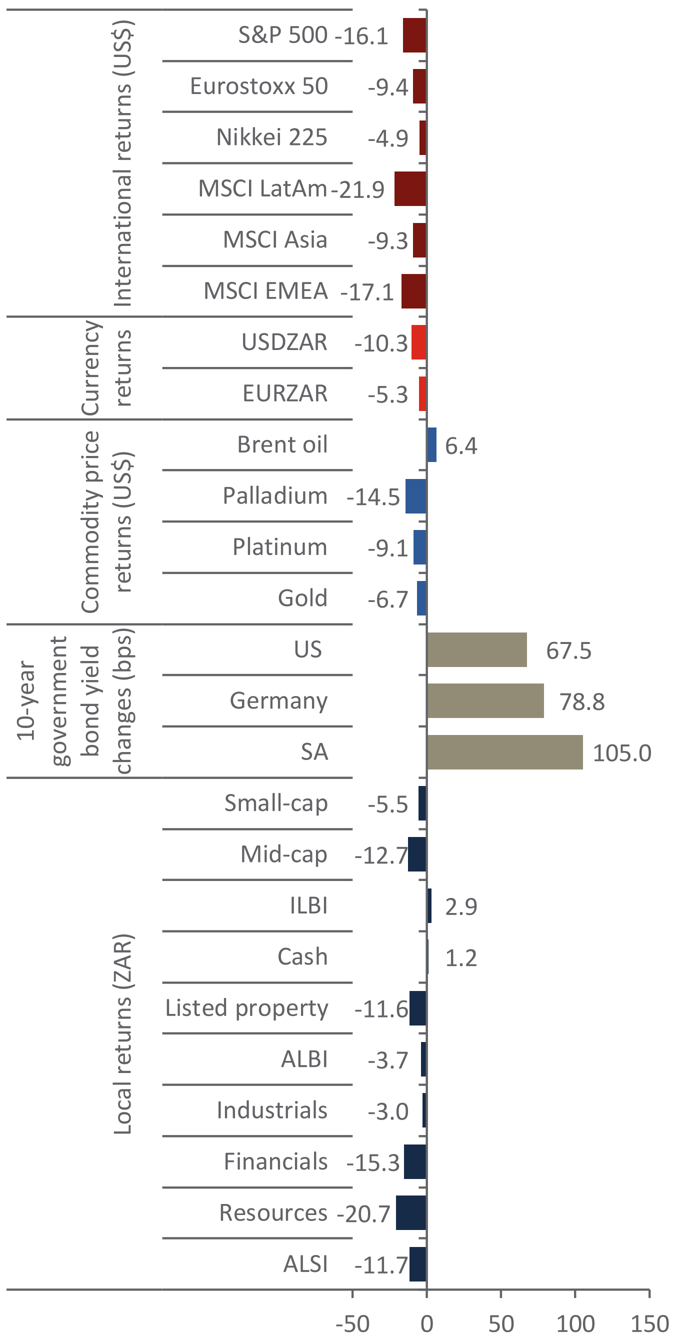
Financial markets faced a perfect storm of challenges in the first half of the year

At the start of the year, many believed that hard lockdowns were a thing of the past and few imagined that Russia would launch a full-scale invasion of Ukraine. Market participants had little line of sight into how far inflation would surge and how aggressively central banks would respond to defend price stability and maintain credibility.

These risks have raised uncertainty in markets and have left investors with a larger-than-usual margin of forecast error. Despite elevated geopolitical uncertainty in the second quarter of the year, buffered by Russia's invasion of Ukraine, the CBOE Volatility Index, or fear gauge, rose to only 35 points intra-quarter and retraced to 29 points by the end of last month.

A tough environment left investors with nowhere to hide in the second quarter of the year, with global equities extending losses and bond yields rising further. Global equities plunged 15.7% in the second quarter, dragged down by poor performance in both developed markets (DMs) and emerging markets (EMs). The MSCI DM Index tanked 16.2% in the quarter, with equity markets in the United States (US) experiencing larger losses. The S&P 500 Index tumbled 16.1% (see chart 1), led weaker by technology, communication services and consumer discretionary stocks, while utilities and consumer staples outperformed in the quarter. European equities weakened into the end of the quarter as concerns over slowing growth mounted amid rising inflation prospects and the likelihood of more aggressive central bank action. JPMorgan noted that positioning in Eurostoxx 50 futures remained extremely bearish. The Eurostoxx 50 Index closed out the quarter 9.4% in the red.

Chart 1: Quarterly asset class returns (%)



Source: Iress, Momentum Investments

Japanese equities were down the least in the DM composite by 4.9% for the second quarter of the year given a delayed economic reopening relative to the US and Europe, providing the equity market with some support. Although a weaker yen has boosted shares of exporting companies in the past, this time around rising import costs have been damaging for smaller manufacturers and they are not in a strong enough position to fully pass on cost increases. Divergent monetary policy with the US suggests yen weakness may persist in the coming quarters as Japanese officials maintain accommodative policy settings to encourage growth in domestic demand. This is in contrast to policymakers in the US who are tightening their stance to stamp out demand-led inflation in an overheating economy.

The extent of negative equity market performance across the EM composite in the second quarter of the year varied. The MSCI Latin America (LatAm) Index sank 21.9% in line with higher risk aversion and softening commodity prices. The Bloomberg Commodity Price Index fell 5.7% over the same period. The MSCI Europe, Middle East and Africa Index (EMEA) faltered by 17.1% on the fallout from the Russia-Ukraine war. Meanwhile, losses in the MSCI Asia Index were more limited at 9.3% in the corresponding period.

The yield on the US 10-year government bond rose by an additional 68 points in the second quarter after rising 83 basis points in the first quarter as investors speculated over more aggressive action by the US Federal Reserve (Fed) to quell soaring inflation. The German 10-year government bond yield also increased over this period by 79 basis points to 1.4%.

Alongside intensifying geopolitical pressures and rising risk aversion, the JP Morgan EM Bond Index (EMBI) spread experienced an uptick and ended June 2022 at 460 points. Argentina (a weakening of 309 points), South Korea (86 points) and Romania (76 points) were among the countries to experience the largest deterioration in credit default swap (CDS) spreads since the end of March 2022, while Russia (100 points) experienced the largest improvement in spreads over the same period.

The local equity market shadowed global trends and posted a loss of 11.7% for the second quarter of the year. A fall in resource and financial shares drove losses in the FTSE/JSE All Share Index. The FTSE/JSE Resources Index plunged 20.7% on the back of a 14.5% fall in the international price of palladium, a 9.1% drop in the price of platinum and a 6.7% dip in gold prices. During this period, the price of Brent crude oil shot up 6.4% due to tightening sanctions against Russian oil supply as well as cuts to Libyan oil production.

The FTSE/JSE Financials Index erased 15.3% of its value in the second quarter of the year, while the FTSE/JSE Industrials Index shed 3%.

The FTSE/JSE Mid-cap index was down 12.7% in the quarter while losses were more sheltered for small-cap equities at 5.5%.

Russia's invasion of Ukraine initially hurt EM bonds, but Vanguard notes that EM debt still managed to be fairly resilient in the face of such a significant shift in geopolitics. In SA's fixed income markets, the 10-year government bond yield sold off 105 basis points and the JSE Assa All Bond Index retraced 3.7% in the quarter. The JSE Assa Government ILB Index meanwhile traded 2.9% firmer for the same period, in line with a rise in local inflation.

The FTSE/JSE SA Listed Property Index shed 11.6% during the second quarter of the year. Despite some improvement in the listed property market in SA, including a stabilisation in property values and an improvement in balance sheets, sector fundamentals remain negative. Headwinds continue to plague the office sector with high vacancy rates a function of hybrid work models.

Despite initial resilience to the Russia-Ukraine war, the rand weakened in response to rising risk aversion, softer commodity prices, downgraded global growth prospects, spiralling global inflation and more hawkish central bank rhetoric during the second quarter of the year. The rand was the fifth-worst performing currency from its EM peer group in the second quarter of the year, losing 10.3% against the US dollar and 5.3% against the euro. The Chilean peso (depreciation of 14.4% against the US dollar), Hungarian forint (12.2% weaker), Turkish lira (12.1% weaker) and Argentine peso (11.4% weaker) were among the worst-performing currencies against the US dollar in the quarter. SA's five-year CDS spread drifted 107 points higher in the quarter and ended the second quarter at 317 points.

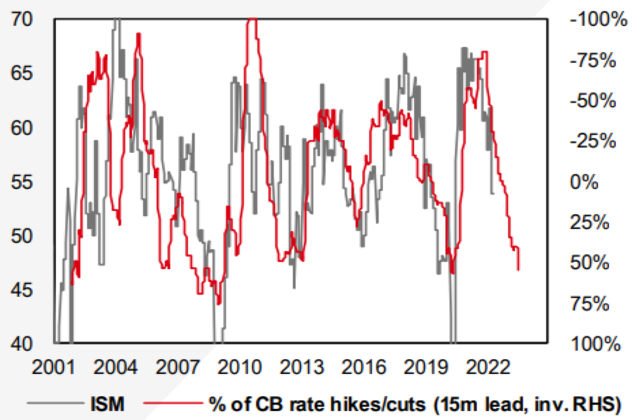
Financial markets grappling with uncertainties about rate rises and growth slowdown

As global central banks progress on their respective interest rate tightening paths in 2022, financial markets are grappling with a multitude of uncertainties. Firstly, with global inflation continually exceeding expectations in the past year, views are widely divergent on the timing and level of the ultimate inflation peaks across countries, as well as the steepness of inflation's subsequent downward trajectories. As such, market expectations of the speed and magnitude of the monetary tightening needed to stem inflationary pressures continue to ebb and flow, inducing market volatility.

Furthermore, related to the changing views about the terminal interest rates required to reverse the rising inflation trends around the world, there are uncertainties about the eventual economic growth impacts of monetary policy tightening across economies. A multitude of leading indicators are pointing to a coming global growth slowdown. Apart from the typical lagged impact on economic growth from widespread interest rate rises (see chart 2) and the broader tightening in overall global financial conditions around the world, economic activity going forward is also likely to be undermined by high prevailing inventory levels, falling order books and the detrimental impact on demand from high product prices. It seems inevitable that global growth will be slowing in the coming quarters, but it is unclear how severe the slowdown will be, when it will occur and how long it will last.

Until inflation has clearly reversed downwards, fighting inflation will likely remain the primary focus of global central banks. During this period, the fundamental backdrops for both global equities and bonds should remain poor. However, once the inflation trend has reversed, the fundamentals for bonds should improve, while equity fundamentals should stay weak until there is sufficient clarity about the extent of the ensuing growth slowdown and the latter has been fully discounted by equity markets.

Chart 2: Central bank policy tightening pointing to global growth slowdown

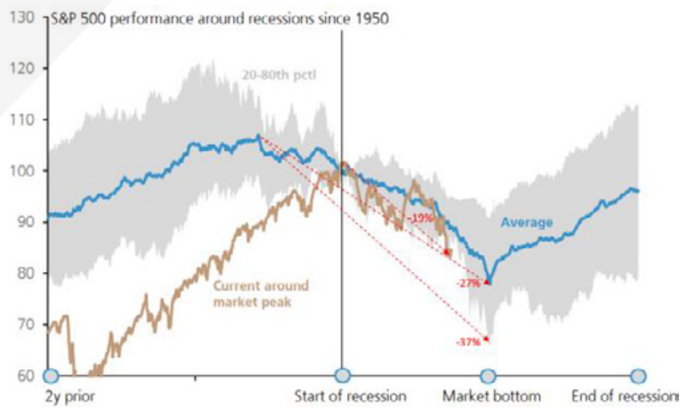


Source: HSBC

So far in 2022, global equity valuations have derated on the back of rising real rates discounting monetary policy tightening, comprising both rising interest rates and the transition from quantitative easing (QE) to quantitative tightening QT). However, despite increasing signs of prospective economic growth and profit slowdowns, consensus profit projections have not yet adjusted downwards to reflect this. As such, current equity valuations based on future earnings forecasts probably look cheaper than they are. In addition, as the policy of QE has inflated equity valuations since the global financial crisis (GFC), some analysts argue that a policy reversal to QT could push valuations down toward lower pre-QE averages.

UBS analysed the historical behaviour of the US equity market around the start of recessions since 1950 (see chart 3). On average, the peak-to-trough decline in US equities amounted to 27%, with the worst fall of 37%. At the worst point of the current US equity drawdown, the fall was around 24%. Simplistically, one could proxy the probability the equity market was attaching to a recessionary outcome at the low point as around 89% (ie 24%/27%) assuming the average outcome, or around 65% (ie 24%/37%) in the worst outcome. Although the US equity market thus already discounted a decent likelihood that a recession would be forthcoming at the low point, the equity drawdown so far does not fully reflect a recessionary outcome, particularly since the recent bounce from the bottom.

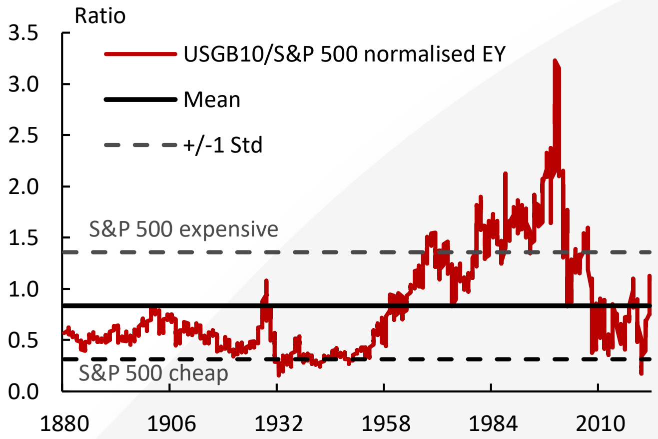
Chart 3: US equity performance around recession onsets



Source: UBS, Momentum Investments

After recent sharp market moves, global bonds are now better relative value versus equities (see chart 4) and could be a hedge during potential further equity drawdowns, particularly if equity drawdowns are caused by recession fears rather than interest rate concerns.

Chart 4: Normalised earnings yield gap points to better relative value from global bonds



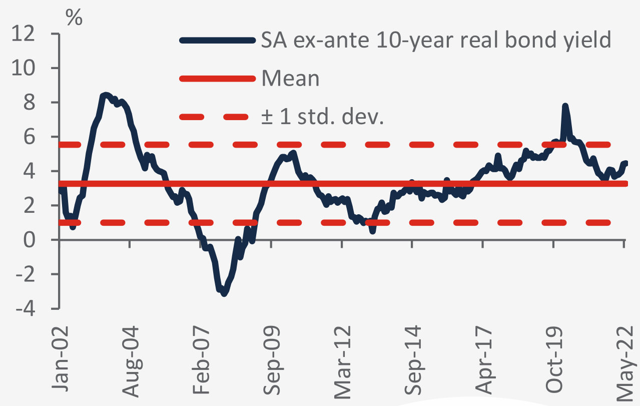
Source: IRESS, Momentum Investments

Global property fundamentals remain solid, with strong US rental growth across sectors outside Office (the Industrial and Apartments sectors are seeing the highest rents and rental growth on record), US vacancy rates outside Office at historical lows and US real estate investment trust (REIT) balance sheets strengthening since the GFC. Not only has REIT sensitivity to interest rates declined since the GFC with the interest cover ratio halving, but REITs have also locked in low interest rates into the future with the average debt maturity profile now more than seven years, from five years in the GFC. Furthermore, the US REIT earnings recovery resumed in the first quarter of 2022. The global property yield is currently at fair value, with the yield spread to the real US yield now at its historical average after the recent sharp rise in the US real yield. An added attraction is that US property historically provided inflation protection to portfolios, outperforming equities during higher inflation periods.

SA equity valuations remain cheap against EM and DM equities. SA equities could thus either hold up relatively better during global equity drawdowns or at least provide better returns during subsequent recovery phases. Even assuming a conservative below-consensus 8% earnings growth in the next year, the SA equity market now trades more than one standard deviation below its average since 1999 and more than three standard deviations below its average since 2013. Even with conservative earnings and rating assumptions from current cheap valuations, SA equities show good forward return prospects across our envisaged scenarios.

Outside of Russia and Turkey, EM real bond yields are attractive relative to DM. Within EM, SA real yields are among the highest, with part of SA's high real yield differential due to a fiscal risk premium. Not only are SA real bond yields attractive versus global yields, but they are also higher than their historical average (see chart 5). ILBs should receive fundamental support from monthly inflation accruals and break-even widening in the coming months until local inflation peaks. The prospective SA real cash yield has been rising from a low level in line with SARB policy rate increases but remains almost one standard deviation below its historical average.

Chart 5: SA ex-ante real bond yield



Source: IRESS, Momentum Investments

The SA listed property sector's fundamentals remain negative, with rising vacancies, falling escalations, negative rental reversions and sharp rises in operating costs leading to lower rental growth expectations. But there has been some improvement recently, with property values seemingly stabilising, balance sheets improving and earnings recovering from a low base.

There is always a strategic rationale for gold as a portfolio risk diversifier due to its safe-haven characteristics in a risk-off environment and its limited correlation with other asset classes. However, with the fundamental driver for gold being the opportunity cost of holding a non-interest-bearing asset, at the current US real bond yield of around 70 basis points, the current spot gold price looks more than 50% too high. Tactically, gold is thus not an attractive asset class now.

Cloudy with a chance of a deeper slowdown

Russia's invasion of Ukraine has taken its toll on the world economy. Outside of a major humanitarian crisis affecting millions, the war has triggered a new round of shocks to commodity and trade markets given the importance of the two countries in the supply of wheat, corn, fertilisers, natural gas and oil.

Moreover, a spike in geopolitical risk has rattled financial markets and unnerved investors.

Growth and inflation were beginning to normalise as pandemic-induced global supply chain disruptions began to unwind. However, the war, together with aggressive lockdowns in China, leading to the closure of some of the world's busiest container ports, have reignited supply-side concerns.

Consequently, expected inflation for much of the developed and EM world, which was already at elevated levels, has ratcheted higher for this year and next. A year ago, the median estimate for DM inflation for 2022 (as captured by Bloomberg) measured at 2.1%. The latest survey for June 2022 has seen this figure climbing to 7.3%. Similarly, expected inflation for 2022 for the EM composite has risen from 3.6% a year ago to 5.6% in June this year.

Global growth prospects have simultaneously been marked lower. The war-induced commodity shock has lowered consumption prospects as higher energy costs threaten to eat into consumers' wallets. This is particularly true for countries in the Euro area which are highly reliant on Russian oil and gas.

Though higher commodity prices have added to inflationary pressures and further dampened the growth outlook, the trend of rising inflation and weakening growth already took hold in the second half of 2021. Pandemic-stricken global supply chains had pushed inflation projections higher even before Russia had invaded Ukraine in February 2022, while more hawkish rhetoric from major central banks had led analysts to scale back growth prospects on the expectation of tighter financial conditions.

Despite sizeable revisions to growth and inflation projections, to date, more could be on the horizon. The momentum behind the Citi Economic Surprise Index, which monitors the difference between consensus expectations for high frequency data releases and realised outcomes, has started to become less positive for many developed and emerging economies. In some cases, such as the US and China, high-frequency data on economic activity has surprised negatively. This raises the chances of additional downgrades to expected growth outcomes for this year. Lower business and consumer confidence has trimmed growth prospects in the US, while aggressive lockdowns in China, in response to clusters of COVID-19 outbreaks, have hit economic activity, leaving growth predictions for the year well below Chinese authorities' annual growth target of around 5.5% for 2022.

Moreover, inflation outcomes have continued to surprise analysts to the upside. The extent of surprises has been particularly large for the Eurozone, where food and fuel costs have surged on the back of the region's high reliance on Russian oil and gas supplies. The strong link between the annual change in commodity prices and inflation surprise indices further explains the unfavourable inflation surprises registered in many EMs. Unfavourable inflation surprises have underpinned uncertainty and risk aversion in financial markets and have acted as an additional catalyst in spurring volatility in financial markets. A higher level of forecast uncertainty embedded in markets has commanded a higher risk premium and has caused central banks to become even more data dependent.

A mounting number of headwinds threatens to slow the post-pandemic global economic recovery. Firstly, higher-than-anticipated inflation threatens to erode consumers' cash pile, threatening the growth outlook. With policymakers' initially benign view on inflation being proven wrong, a more aggressive unwinding of conventional monetary policy poses a second major headwind to economic growth. A simultaneous unwinding of bloated central bank balance sheets has heralded the end of ultra-cheap money and could add to the bumpy growth path ahead. HSBC has shown that with the expected ratio of central banks hiking compared to those who are cutting interest rates, manufacturing sentiment should drop into contractionary territory with a 15-month lag. This could, however, trigger broader recessionary conditions.

Finally, governments in DMs and EMs are being increasingly challenged by the imperative to rebuild fiscal buffers which were eroded during the onset of the COVID-19 pandemic, when fiscal authorities offset restrictions on mobility by shoring up economic activity.

Investors are becoming increasingly concerned about central banks turning hawkish. The Bank of America Merrill Lynch Global Fund Manager Survey for June 2022 sees this as the main tail risk facing financial markets (32% of survey respondents consider this to be the biggest tail risk to markets). This is followed by 25% of respondents who view the potential for a global recession to be the largest downside risk to markets. These concerns overshadow anxiety over the COVID-19 pandemic and the Russia-Ukraine war, which dominated market fears in previous months. In April 2020, more than 55% of surveyed investors noted COVID-19 as the main risk facing markets, but this has since dropped to 3%. Similarly, more than 45% of respondents noted the war as the biggest red flag for markets in March earlier this year, relative to 6% in June 2022.

The likelihood that major central banks will be forced to hike interest rates more aggressively to rein in blistering inflation has ignited fears of a global recession. While we acknowledge the likelihood of a policy-induced slowdown in the global economy, we do not think it is inevitable that the US Fed will necessarily hike the economy into a so-called prolonged hard landing. Research by Goldman Sachs shows that out of the 14 interest rate hiking cycles in post-war history in the US, 11 resulted in a recession. However, they note that monetary policy was not the primary culprit in eight of these instances. During the '50s and '60s, fiscal troubles tipped the economy into recession, while oil shocks were to blame in the '70s and '80s. A fallout in financial markets and the pandemic were behind the latest two recessions.

Goldman Sachs nevertheless warns that based on historical precedent, the current overshoot in core inflation points to a one-in-five chance of avoiding a recession over two years. Chances drop further to one-in-seven if the tightening in interest rates effectively reverses three-quarters or more of the inflation overshoot.

However, Goldman Sachs also points out that private sector financial balance sheets have greatly benefited from aggressive quantitative easing measures following the onset of the COVID-19 pandemic. Should growth conditions falter and businesses start to shed workers, healthy balance sheets should prevent households from curbing spending as sharply as they would have in the absence of these financial buffers.

The World Bank has warned that above-average inflation and below-average growth could persist for several years. Though they caution a replay of '70s-style stagflation could grip the global economy, they also point out important differences this time around. Firstly, the US dollar is much firmer today than in the '70s. Secondly, oil prices have only reached two-thirds of their level in 1980 once adjusted for inflation and thirdly, major financial institutions are sitting on far healthier balance sheets than in the '70s. We would also add that labour markets are far tighter today. RMB Morgan Stanley has shown that employment expectations are the highest they have been in the European Union and the United Kingdom since data was collected. Likewise, US job openings have not been as high as they are today since data began in 2000. Moreover, Citi has noted that the Michigan Survey and the Survey of Professional Forecasters reported much higher longer-dated inflation projections in the run-up to the '70s and '80s, whereas longer-dated inflation projections today suggest inflationary dynamics are likely to be far less entrenched. Although shorter-dated inflation expectations (of a year or less) have reacted sharply to elevated oil prices, expectations further out (three years or more) are tethered closer to longer-term averages.

Tougher outlook ahead for SA

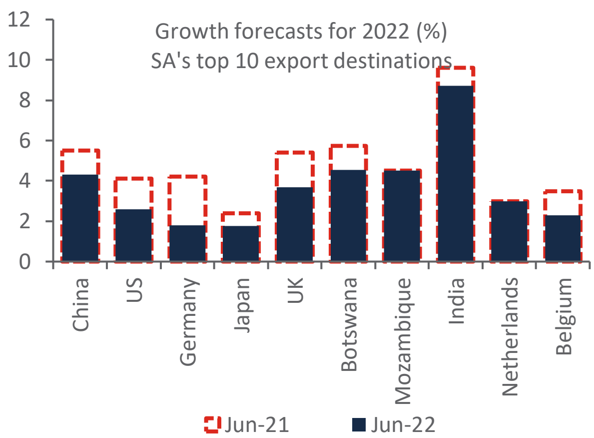
Although base effects continue to contribute to growth outcomes globally, HSBC has shown that the shadow effects of growth into 2022 are more limited in SA's case. Although real gross domestic product (GDP) in SA recovered to pre-pandemic levels in the first quarter of the year, the recovery has not been uniform. Agriculture has outperformed pre-pandemic levels by 34%, while construction has lagged by 24%. Outside of construction, activity in mining, manufacturing, utilities, trade and transport remain below pre-pandemic levels.

Employment gains have been more muted relative to the improvement in economic activity since the COVID-19 pandemic. Pedestrian growth and persistent uncertainty have prompted companies to scale back on fixed investment spending and operate with leaner staff. Employment levels remain lower than pre-pandemic levels in all sectors except for jobs in the agriculture sector, which have grown marginally relative to levels recorded in the first quarter of 2019.

Akin to 2021, household spending is likely to be the primary driver of economic activity this year. Healthy household balance sheets at an aggregate level, a mild recovery in employment, a further recovery in wage growth and some improvement in credit growth should support household spending this year.

We are less optimistic about fixed investment providing major support to economic growth this year given that nearly 80% of manufacturers in SA believe that an uncertain political climate is hindering investment prospects in SA. Moreover, 60% of manufacturers rate insufficient demand as a significant barrier to investment in the country.

Chart 6: Growth prospects in many of SA's top 10 export destinations have been scaled back



Source: BER, Momentum Investments

A more robust post-pandemic recovery and a brighter near-term fiscal outlook likely led to positive revisions in the outlook on the sovereign rating for SA. An increased incidence of loadshedding (by the end of June 2022, more than half of the possible 90 days encountered loadshedding since Eskom's winter plan was implemented at the start of April) continues to impede a faster economic recovery. Although Codera Analytics has shown that SA's electricity intensity started to drop off even before the global financial crisis, Nedbank suggests that the gap between demand and supply will remain in place until 2025. Additionally, headwinds to growth in SA's top 10 export destinations point to softer demand for SA's exports (see chart 6). As such, we expect the SA economy to grow at 2.2% in 2022 and 1.6% in 2023.

Standard and Poor's (S&P) positively surprised markets by shifting its outlook on SA's BB- foreign currency sovereign rating to positive. The rating agencies appear to have built in some room for disappointment on the fiscal side. However, our concerns are longer term in nature. Weak structural growth, deficient municipal finances, unstable state-owned enterprises and rising pressure on social spending threaten the medium- to longer-term outlook for SA's fiscal and debt position.

Fitch has shown that while SA outperforms its peers on metrics such as governance and contribution to world GDP, it underperforms on growth and public finances. As such, we think it is more likely that the outlook on the sovereign ratings reverses in the medium term leaving SA vulnerable to further downgrades as the country loses ground relative to its peer group.

Resurgent commodity prices were largely behind the better-than-expected outcome on near-term fiscal dynamics. In addition, firm commodity prices propelled rand strength in the first quarter. However, the rand slid as geopolitical risks resurfaced when Russia began its invasion of Ukraine. A paring back of global growth prospects and a softening in commodity prices kept the local unit under pressure since.

Although the currency has depreciated sharply since the end of the first quarter of the year, pass through into the inflation basket is likely to remain muted. RMB Morgan Stanley has shown that retailer margins for discretionary retail and food products remain high.

As such, retailers could absorb further cost increases without necessarily passing these on to the consumer. In our view, this limits the potential for second-round broad-based price increases in the local economy.

Rising price pressures have mostly hit the local economy at a headline level. The Russia-Ukraine war has affected the global grains and vegetable oils trade, while severe flood damage in KwaZulu-Natal and rising input costs have added a layer of price pressure.

The hit to food prices is felt disproportionately. Although food contributes 15.3% to the overall consumer basket, this proportion varies widely by expenditure decile. The bottom 30% of spenders in SA apportion anywhere between 40% and 50% of total spending on food, whereas the top 30% of spenders in the economy spend around 10% to 20% on food items.

The international price of oil poses an additional upside risk to the inflation basket. Global oil markets are likely to remain volatile given the low level of inventories and uncertainty around additional bans on oil imports from Russia.

Underlying measures of inflation such as core inflation (headline excluding food and fuel) and the trimmed mean (excluding the most volatile prices each month) remain significantly lower than headline inflation. However, these measures have been drifting higher since the middle of June 2020 and have, on average, approached the midpoint of the 3% to 6% inflation target.

Surging fuel and food costs are likely to drive headline inflation to around 6.5% on average for this year, before sliding back to below 5% for next year, while we expect core inflation to remain more contained, closer to the midpoint of the target range.

Trends in the inflation basket since January 2019 show that inflation in electricity, education, insurance, water and transport costs have spent the most time trending above 6%. However, many of these costs are regulated. As such, the monetary policy transmission mechanism has a limited effect on the demand for and prices of these goods and services.

Nonetheless, elevated international oil prices, the consequent feedthrough into food prices and an accelerated hiking cycle globally are likely to support a further normalisation in local interest rates to curb inflation expectations.

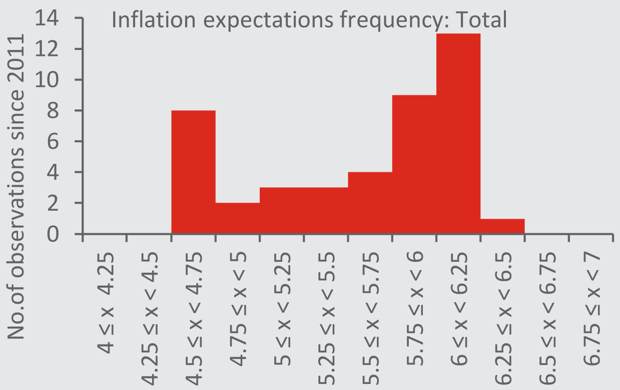
In our view, the level of SARB interest rate normalisation and the extent to which the interest rate hikes are frontloaded remain a function of the Monetary Policy Committee's view on the degree to which current global inflation shocks are likely to filter through and become entrenched in the local setting.

The SARB has warned against the potential for inflation expectations to become unhinged, resulting in higher wage inflation and broader-based price pressures in the economy. It has emphasised the high economic price tag of reining in inflation once it has been left untamed to reach levels that are not consistent with price stability.

An analysis of the Bureau of Economic Research's (BER) longer-dated inflation expectations time series from 2011 shows a high degree of central bank credibility, with most quarterly observations coming in below 6.25% (see chart 7). For now, longer-dated

inflation expectations remain comfortably within the inflation target but the SARB is concerned that high food and fuel inflation may trigger higher wage demands, culminating in higher second-round price pressures.

Chart 7: Longer-dated inflation expectations have been reasonably well anchored since 2011



Source: BER, Momentum Investments

As such, ongoing weakness in the local currency, the SARB's fear of higher underlying inflation outcomes and the recovery in overall economic activity to pre-pandemic levels are likely to motivate the SARB to hike interest rates by 50 basis points at the next (21 July 2022) rate-setting meeting. We expect additional hikes to follow, with the repo rate reaching 6.25% by the end of the first quarter of next year. Nevertheless, we continue to view the interest rate expectations embedded in the forward-rate agreement market as being too aggressive given our inflation forecasts and the dampening effect of higher interest rates on economic activity.

Sanisha Packirisamy

Economist
Momentum Investments

Herman van Papendorp

Head: Macro Research and Asset Allocation
Momentum Investments

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

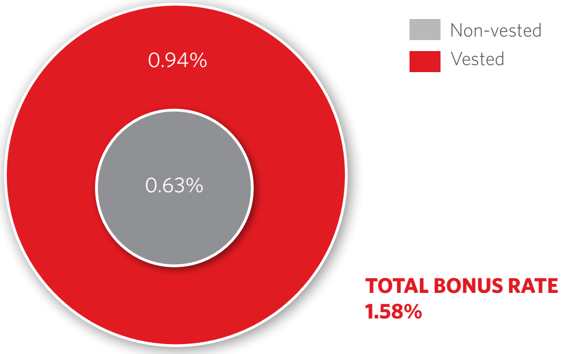
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	92.5% - 97.5%	R378.57m	0.96% [1]	10.03% [1]

[1]Based on back-tested bonus rates and returns

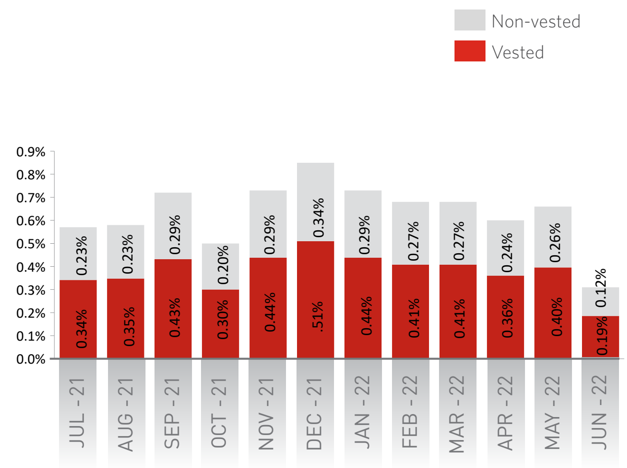
Performance

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

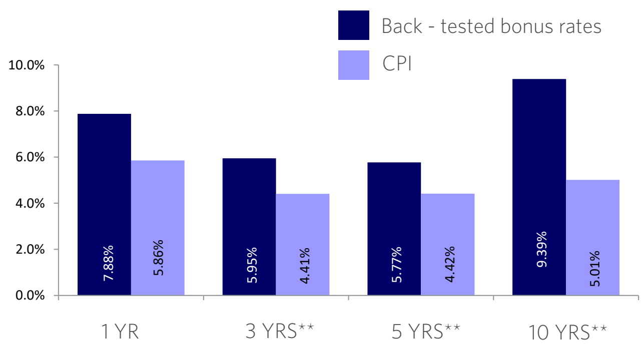


TOTAL BONUS RATE 1.58%

The chart below shows the monthly bonus rates* for the past 12 months



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

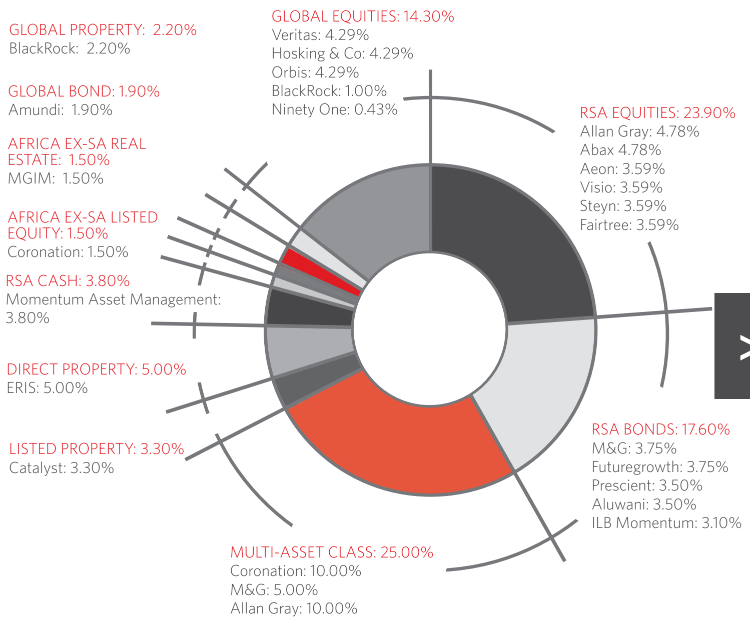


CPI figures are lagged by two months

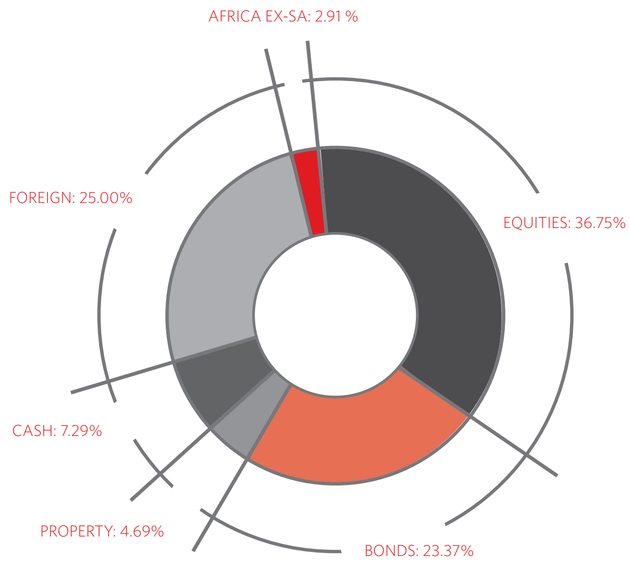
* Bonus rates are net of underlying asset charges but are gross of the policy fee
** Annualised

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.



Partially Vesting Smoothed Bonus Range

Universal Smooth Growth Fund

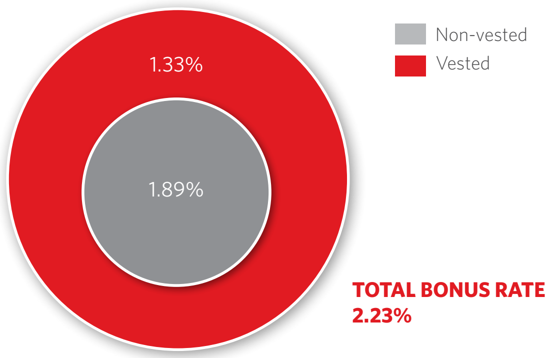
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	95% - 100%	R329.7m	1.11% [1]	8.96% [1]

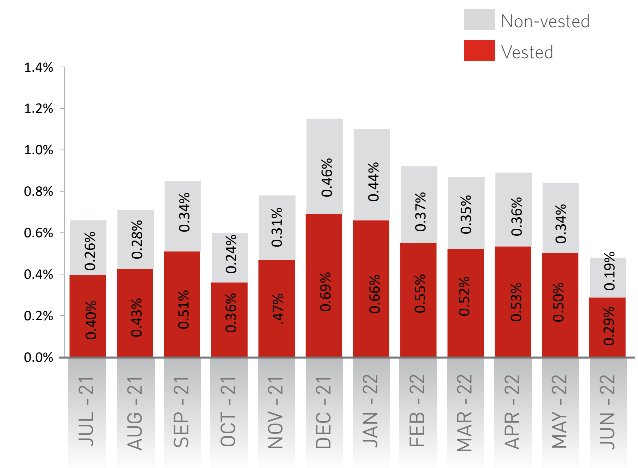
[1]Based on back-tested bonus rates and returns

Performance

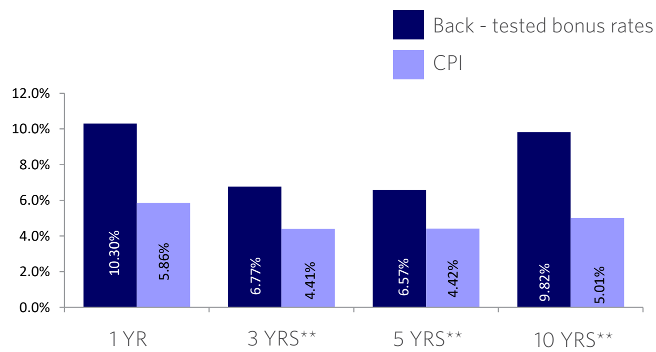
The total bonus rate* for the past quarter on the Universal Smooth Growth Fund is shown below.



The chart below shows the monthly bonus rates* for the past 12 months



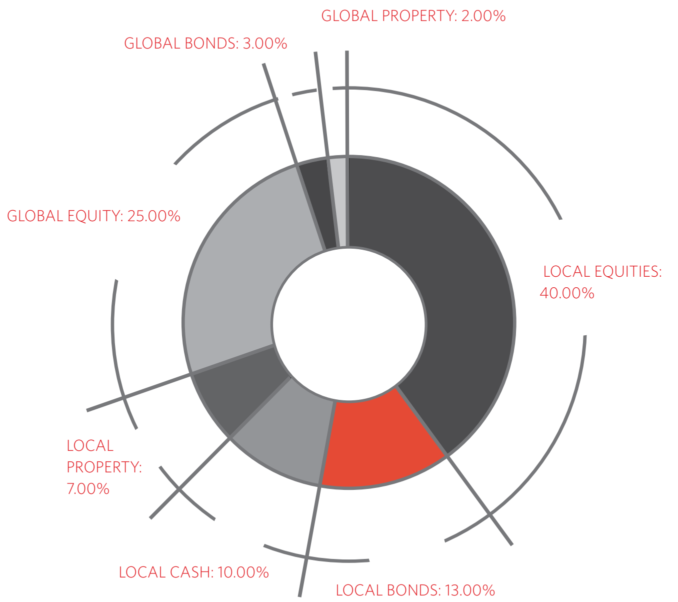
The chart below shows the long term bonus* performance of the Universal Smooth Growth Fund against CPI



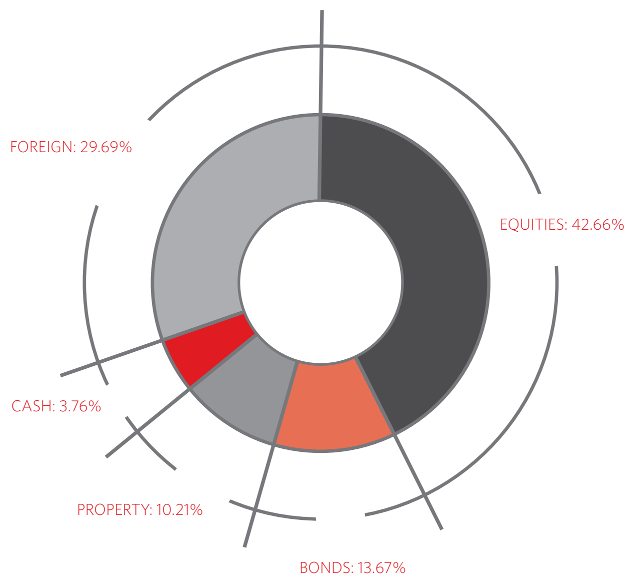
CPI figures are lagged by two months

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



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

Partially Vesting Smoothed Bonus Range
Universal Smooth-Edge Fund

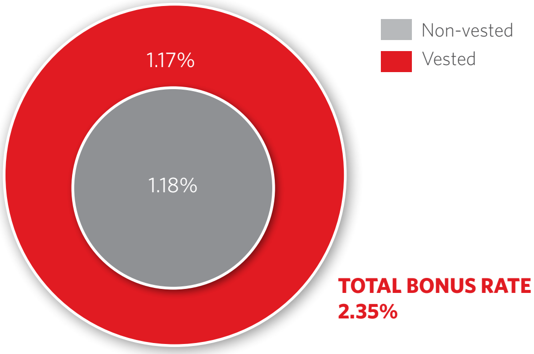
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	95% - 100%	R482.8m	1.28% [1]	10.70% [1]

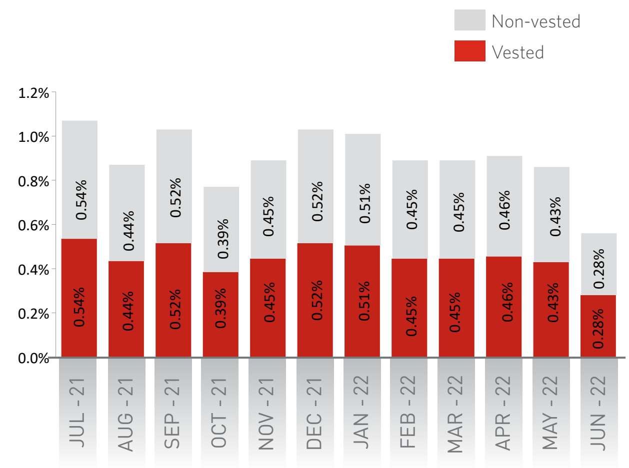
[1]Based on back-tested bonus rates and returns

Performance

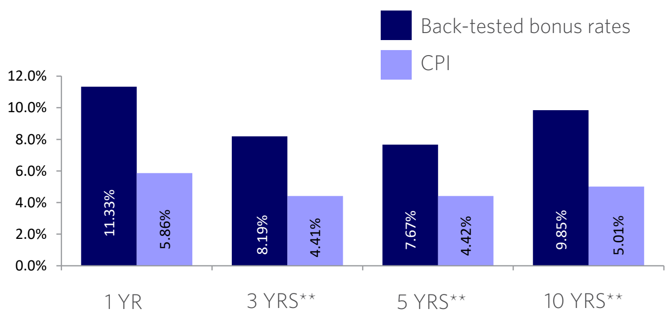
The total bonus rate* for the past quarter on the Universal Smooth-Edge Fund is shown below.



The chart below shows the monthly bonus rates* for the past 12 months



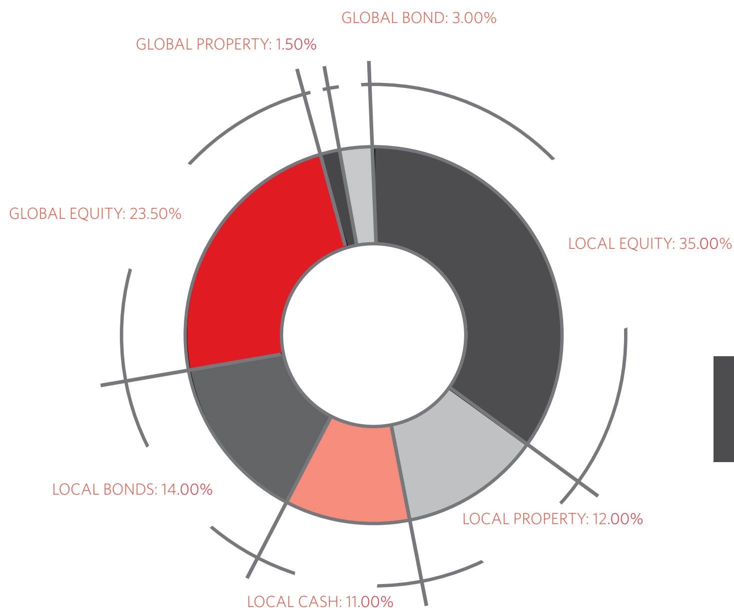
The chart below shows the long term bonus* performance of the Universal Smooth-Edge Fund against CPI



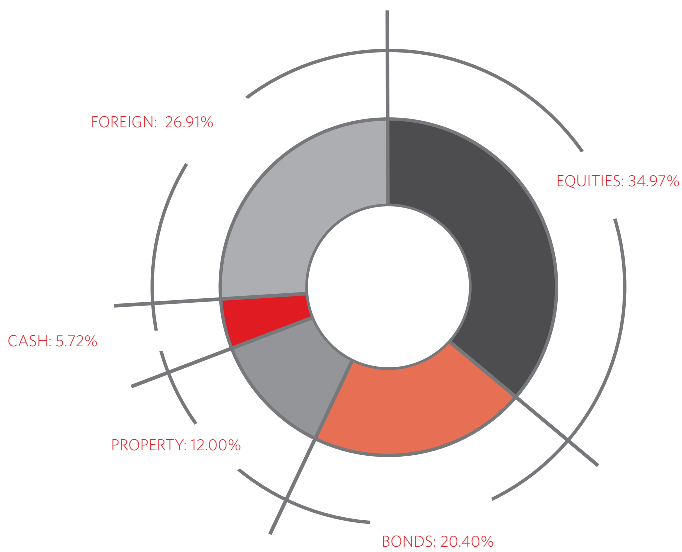
CPI figures are lagged by two months

Asset Allocation

The strategic asset allocation of the portfolio is shown below.



The effective asset allocation of the portfolio is shown alongside.



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

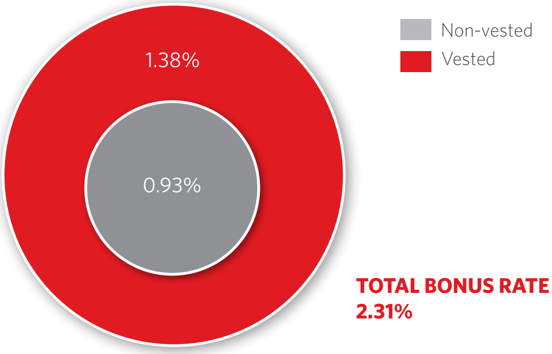
Partially Vesting Smoothed Bonus Range
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

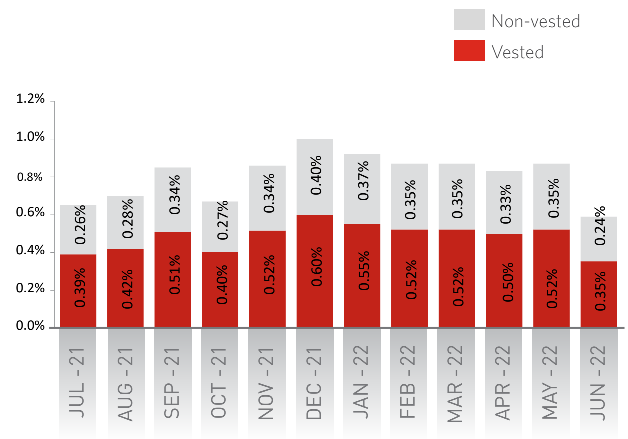
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	95% - 100%	R7.7bn	1.14%	5.44%

Performance

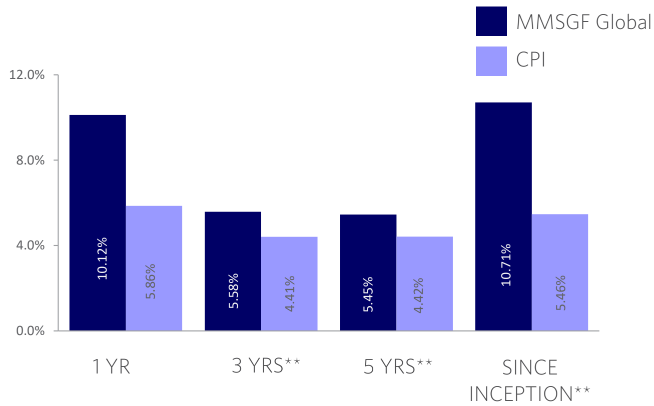
The total bonus rate* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



The chart below shows the monthly bonus rates* for the past 12 months



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



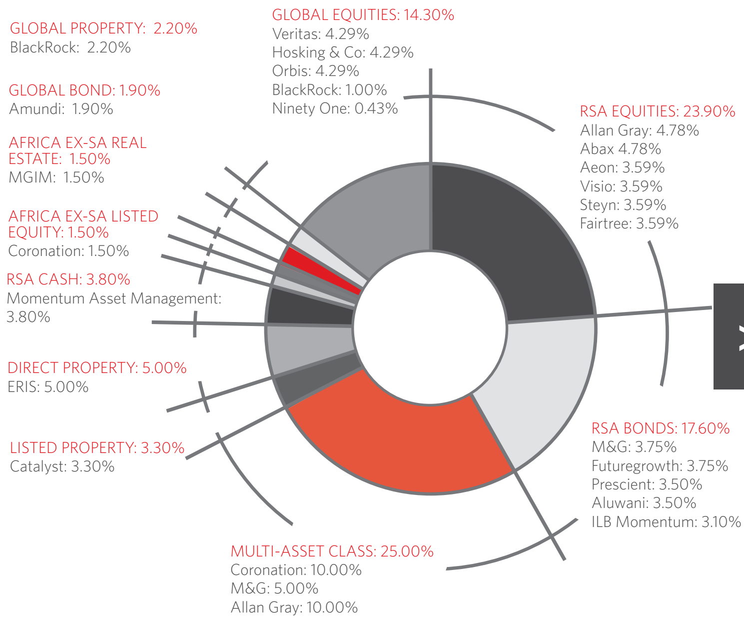
CPI figures are lagged by two months

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

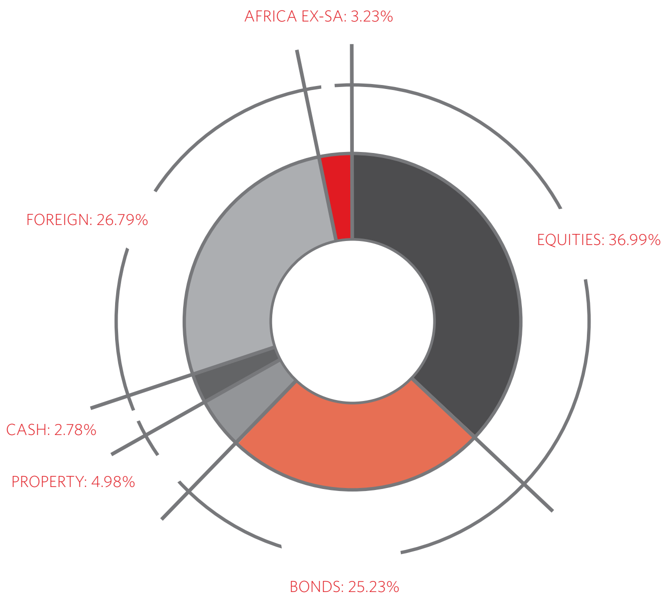
** Annualised

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.



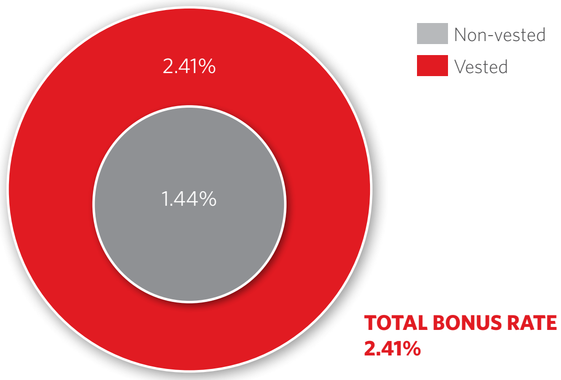
Partially Vesting Smoothed Bonus Range
Smooth Growth Fund Global

Fund Snap Shot

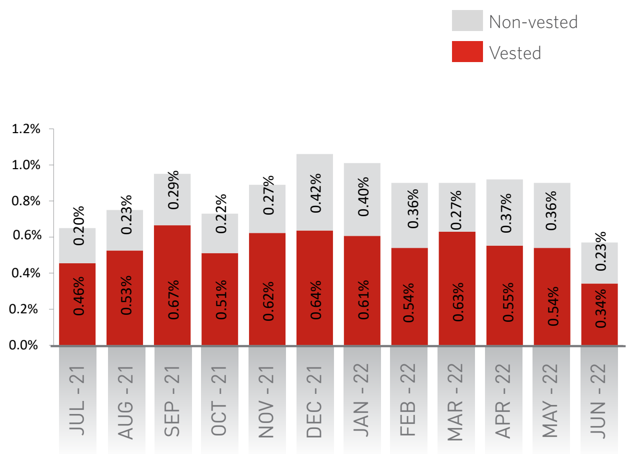
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	97.5% - 102.5%	R1.7bn	1.17%	3.81%

Performance

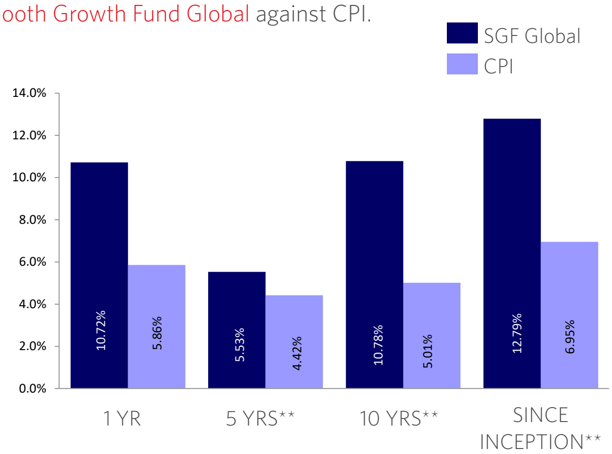
The total bonus rate* for the past quarter on the Smooth Growth Fund Global is shown below.



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



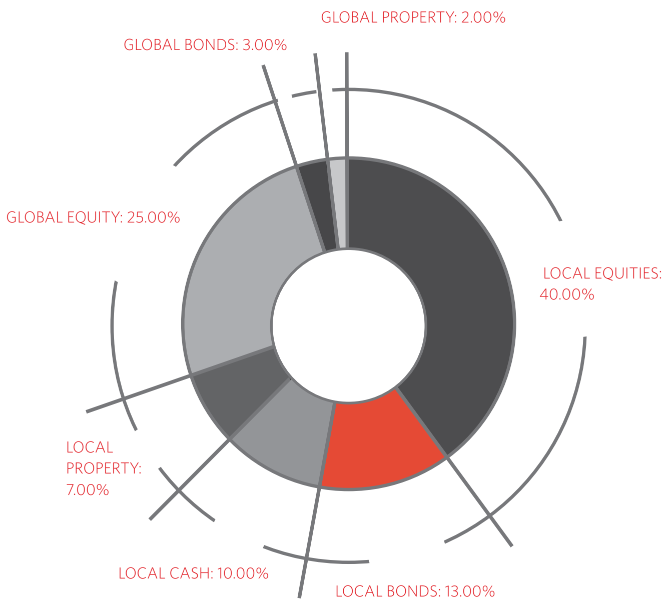
The chart below shows the long term bonus* performance of the Smooth Growth Fund Global against CPI.



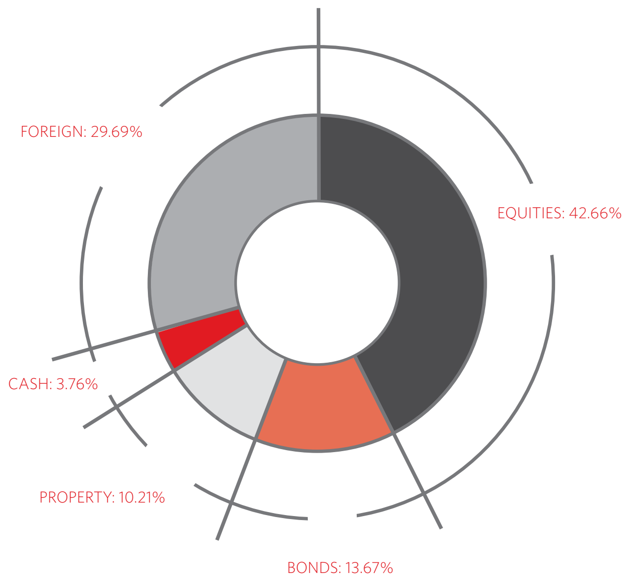
CPI figures are lagged by two months

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



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

** Annualised

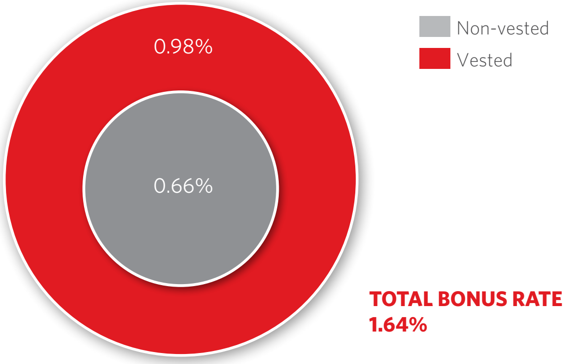
Partially Vesting Smoothed Bonus Range
Multi-Manager Smooth Growth Fund
Global Bonus Series 2020 *(previously MMSGF Local)*

Fund Snap Shot

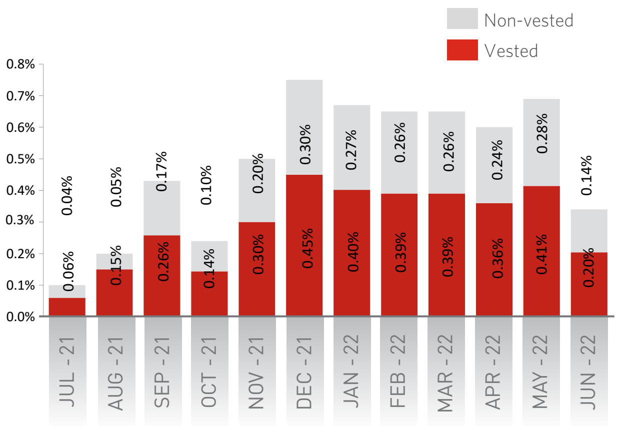
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	92.5% - 97.5%	R128.3m	0.84%	2.53%

Performance

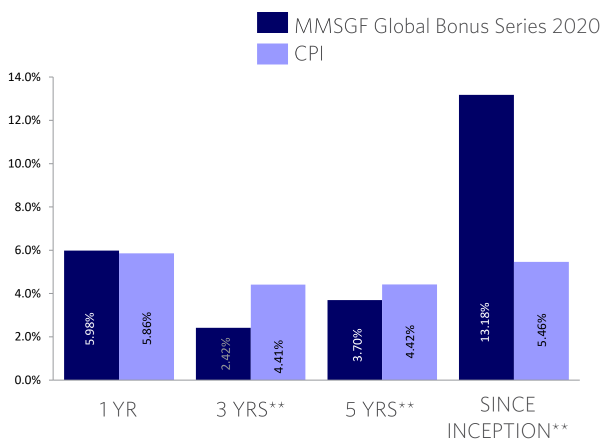
The total bonus rate* for the past quarter on the MMSGF Global Bonus Series 2020 is shown below.



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



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



CPI figures are lagged by two months

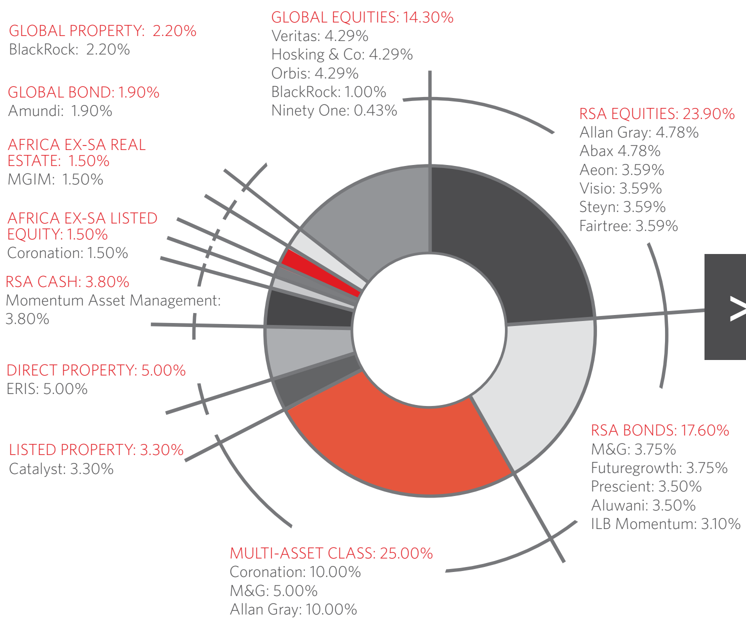
* Bonus rates are net of underlying asset charges but are gross of the policy fee

** Annualised

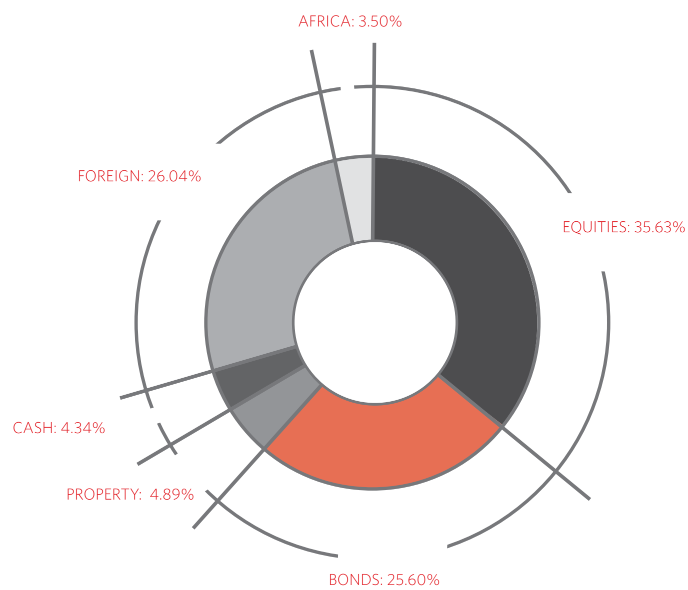
Asset Allocation

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).



The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smoothed Bonus Range
Smooth-Edge Fund

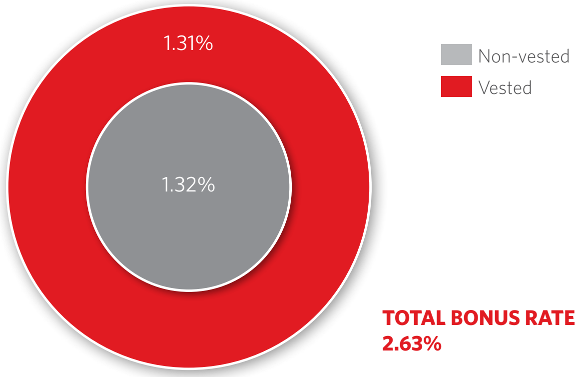
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	97.5% - 102.5%	R106.3m	1.34% [1]	10.70% [1]

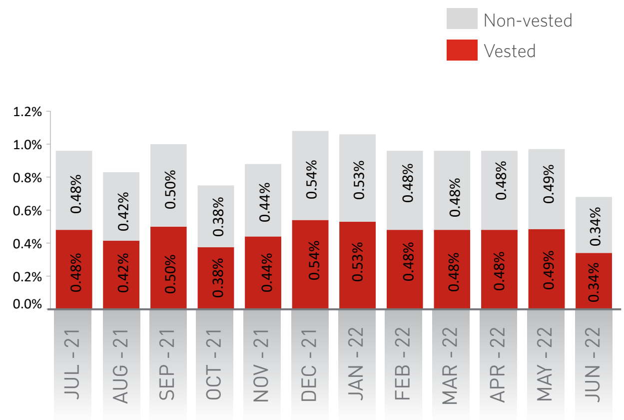
[1]Based on back-tested bonus rates and returns

Performance

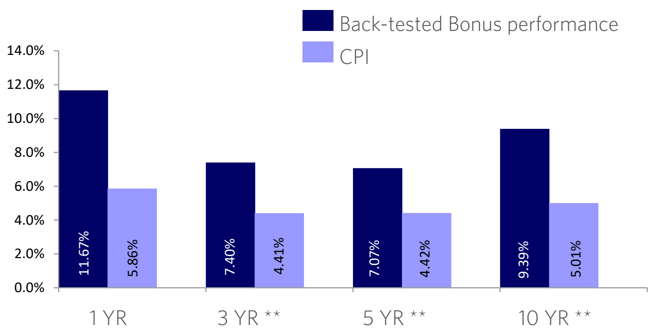
The total bonus rate for the past quarter on the Smooth-Edge Fund is shown below.



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



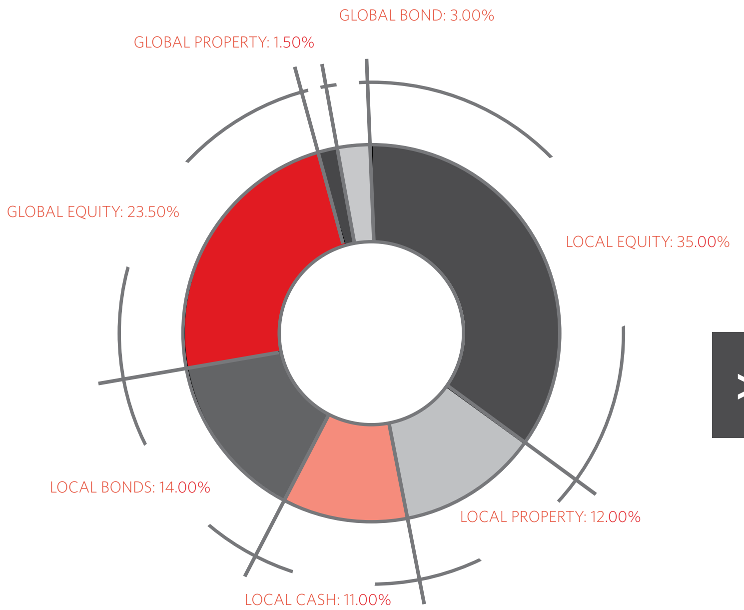
The chart below shows the long term back-tested bonus rates* performance of the Smooth-Edge Fund against CPI



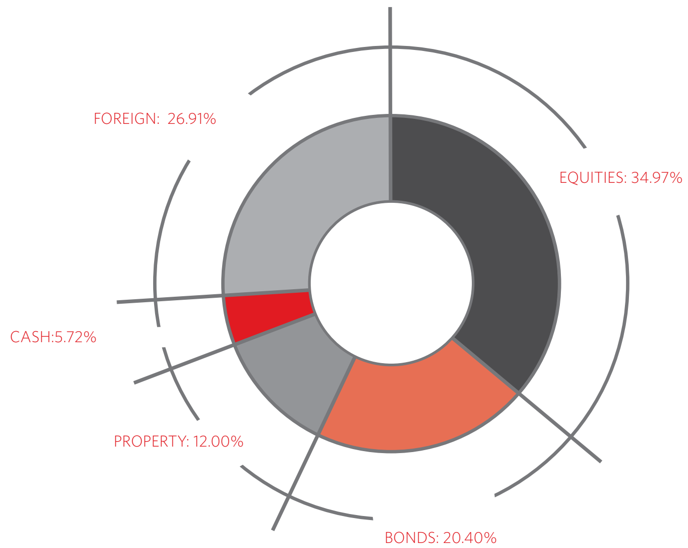
CPI figures are lagged by two months

Asset Allocation

The strategic asset allocation is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



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

** Annualised

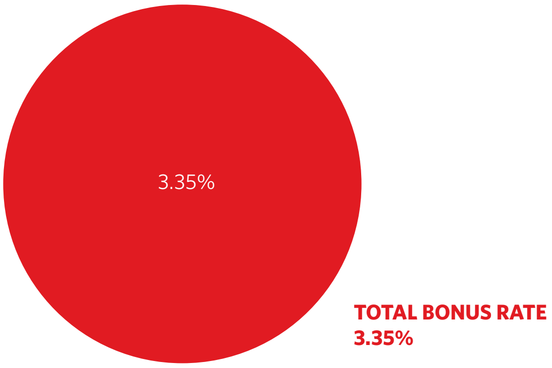
Fully Vesting Smoothed Bonus Range
Universal Smart Guarantee+3 Fund

Fund Snap Shot

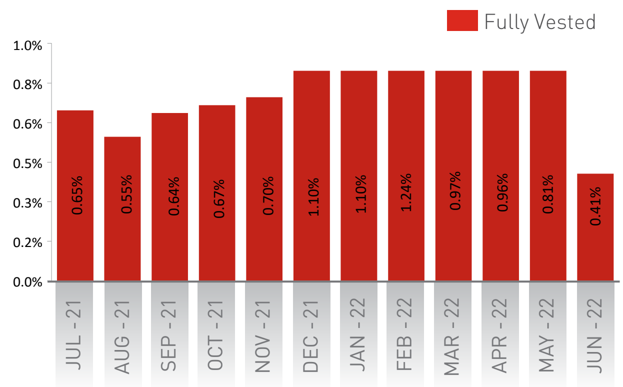
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	92.5% - 97.5%	R558.3m	1.19%	4.70%

Performance

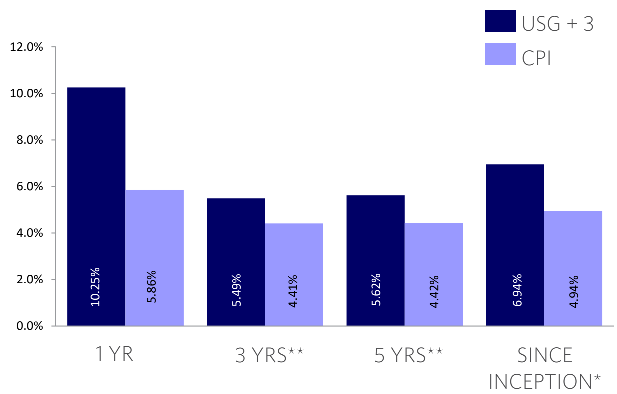
The total bonus rate* for the past quarter on the Universal Smart Guarantee +3 Fund is shown below.



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



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

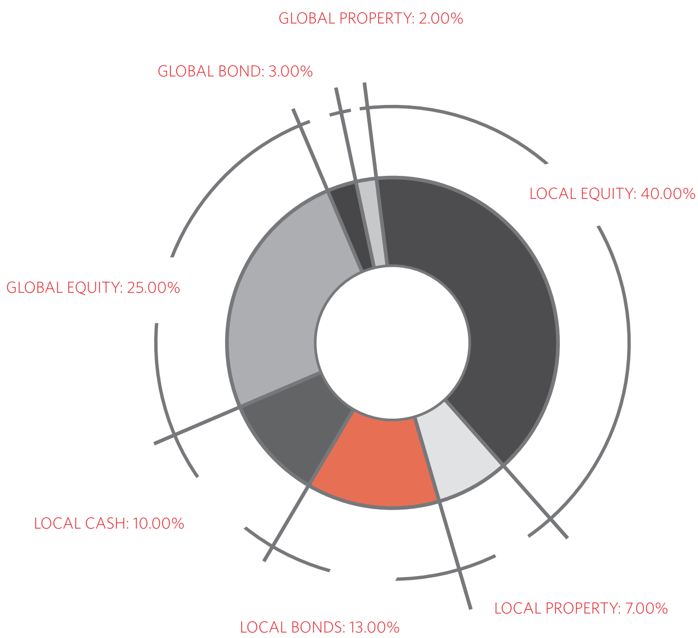


CPI figures are lagged by two months

* Bonus rates 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 (Momentum Dynamic Hedging Reference Portfolio) is shown alongside.



For bonus declarations, 90% of the underlying asset returns of the bonus generating portfolio are smoothed over a three-year period as per the smoothing formula.

The liability driven investment strategy employed includes a dynamic protection overlay to secure the guarantee. As a result, the value of the underlying asset portfolio is sensitive to changes in asset values (and interest rates) and the effective asset allocation will reflect both the bonus generating portfolio and the dynamic protection overlay.

USG +3: Bonus rates to be declared

Given that the monthly bonus rates are based on the weighted average of the previous 36 months' returns of the bonus generating portfolio, it is possible to calculate the future bonus rate that will be declared under various future investment return assumptions. Assuming zero returns over the following 34 months (there is a 2 month lag), around **4.05%** will still be declared.

Fully Vesting Smoothed Bonus Range

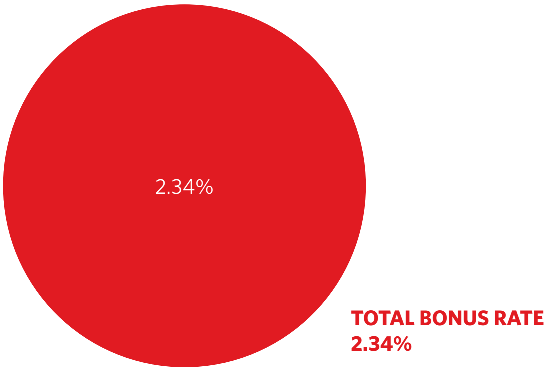
Multi-Manager Secure Growth Fund

Fund Snap Shot

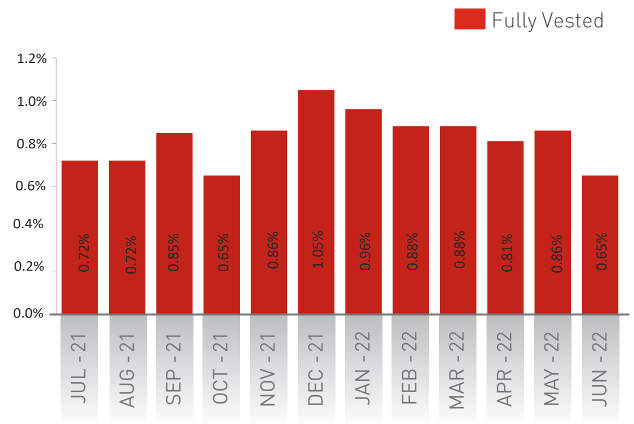
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	102.5% - 107.5%	R75.5m	1.12%	5.27%

Performance

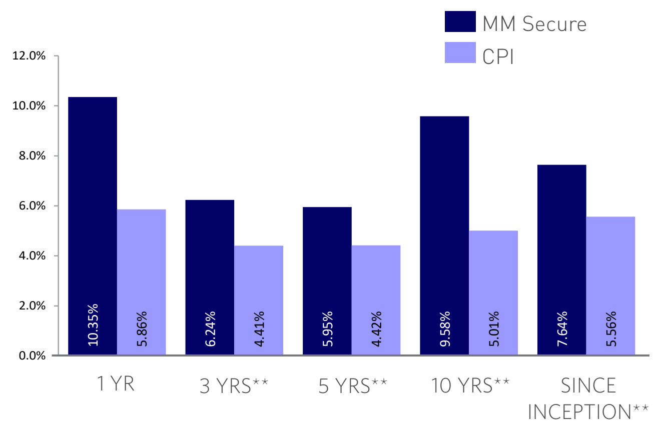
The total bonus rate* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



The chart below shows the monthly bonus rates* 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

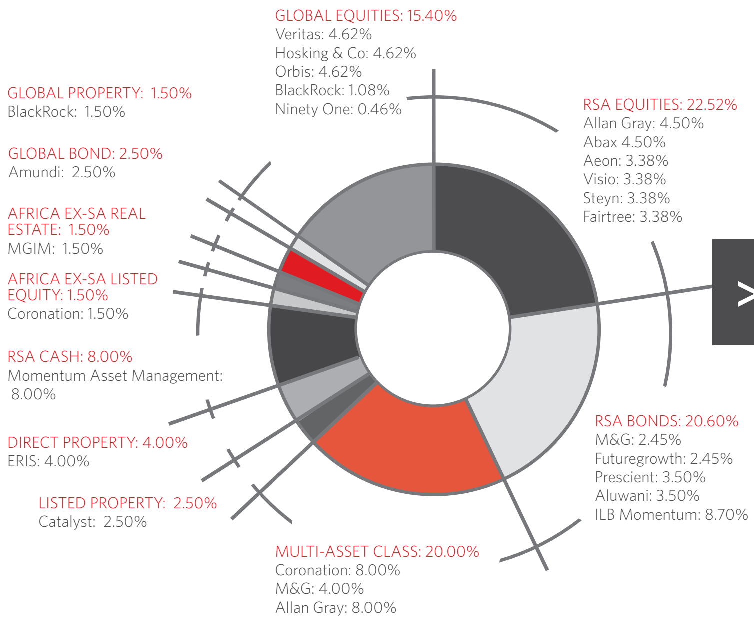
* Bonus rates are net of underlying asset charges but are gross of the policy fee

** Annualised

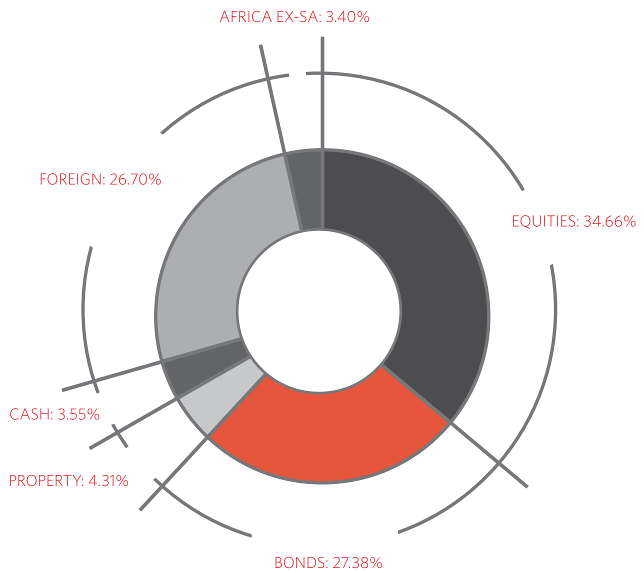
Asset Allocation

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.



The effective asset allocation of the portfolio is shown alongside.



Smoothed Bonus Portfolios Key Features

Vesting	Fund	Fund Return Objective	Manager	Mandate Type	Guarantee on Policy Benefits[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 rate 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 rate 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 rate 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 rate 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 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 rate 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. Policy benefits include but are not limited to death, disability, resignation or retirement. The full list policy benefits is outlined as well as other terms and conditions specified in the client policy contracts.
2. Market value adjustments may be applied on member switches out, terminations and other non-policy benefits 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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