momentum
corporate

Smooth Bonus Report

Third Quarter 2020

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

>

Looking back over the past quarter

Dear valued investors

The coronavirus slump has hobbled South Africa's already weak economic growth. However, an easing in the daily rate of new COVID-19 cases and a slowing in fatalities led to the easing of lockdown restrictions, allowing for the bulk of the economy to resume activities. Nevertheless, sticky unemployment and bankruptcies, particularly concentrated in small and medium businesses, as well as ongoing electricity supply constraints, will dampen the recovery.

Weak growth has limited South Africa's ability to deal with a growing budget deficit and a rising debt burden. Flagging growth and subdued inflation suggest the South African Reserve Bank will keep interest rates steady into the first half of 2021, before raising rates in the third quarter on a mild growth recovery, fiscal woes and longer-term inflation risks.

Our portfolios derive longer-term returns from growth asset classes; but during the quarter the FTSE/JSE All-Share Index was flat and the FTSE/JSE SA Listed Property Index returned a negative 14%. Over the last year the Rand has depreciated by 23% against the US Dollar, although it recovered some of that ground by appreciating by 2.75% over the last quarter. Global equities fared better with the MSCI Developed Index being up 3.75% over the last quarter, even whilst experiencing a -4.94% return during September 2020.

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

Momentum Corporate smooth bonus portfolios

The low returns from growth asset classes have affected the bonuses that we have been declaring on our portfolios. We construct many of our portfolios to deliver real returns over the longer-term and those returns comes from growth asset classes. Even though returns from growth asset classes was disappointing, it is important to remain invested and maintain the exposure to these asset classes.

Through these challenging times, our smooth bonus portfolios have not provided any negative bonuses, and our clients benefit from 100% of their fund value on benefit payments such as death, disability, retirement and resignation. Many of our portfolio funding levels remain in the 90% to 95% range.You can find more detail in the specific sections of this report.

If you wish to invest your retirement fund's lump sums or contributions into one of the new 'Universal' portfolios that we launched in June, please contact me or your Momentum servicing representative, and we will provide further details. In our range of smooth bonus portfolios, we provide for different investment philosophies and approaches. The Momentum Universal Smooth Edge portfolio is built to deliver smoothed returns (targeting CPI+4%) at a total cost close to 1% per annum.

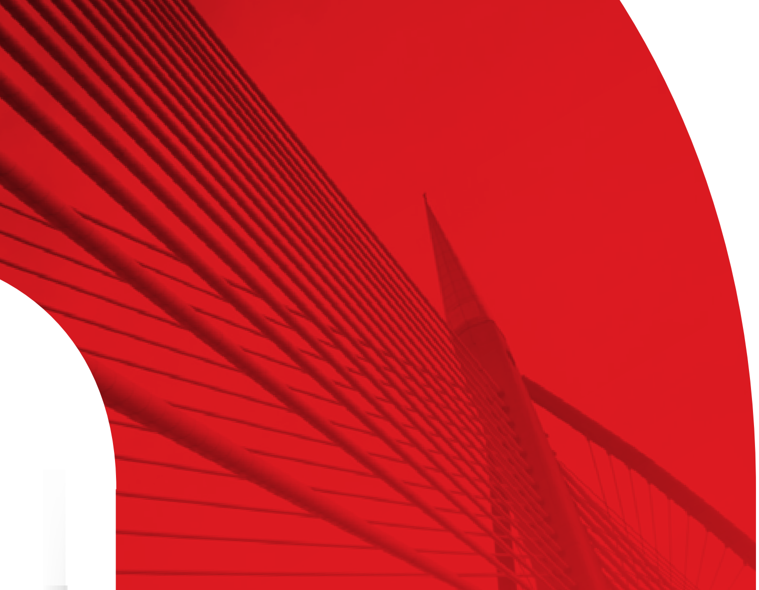
As we all work together to overcome the COVID-19 pandemic and deal with these challenging times, we hope that you are keeping safe.

Warm regards

Steed Duncan-Smith

Client Relationship Manager
Momentum Corporate

Contents



Smooth Bonus – A winner in uncertain times

by Prinesan Govender

Introduction

The year 2020 has been one characterised by uncertainty, both in our daily lives and in the economy. The COVID-19 pandemic has led to over a million deaths worldwide and wreaked havoc in the global and local economy. According to the Medium-Term Budget Policy Statement, the economy is expected to contract by 7.8% in 2020, while at the height of the market crash, the FTSE/JSE All-Share Index plunged 35% between February and March 2020. Smooth bonus portfolios were developed with this type of investment uncertainty in mind. In various advertisements for smooth bonus portfolios, it is often touted as a haven during theoretical future market crashes. This year afforded an opportunity to showcase the benefits of smooth bonus portfolios during real economic and investment market turbulence. The implications of individuals investing in a linked (not smoothed) portfolio can be detrimental especially if insured events such as death or even normal retirement occur at inopportune times.

Exposure to growth assets

Momentum Corporate's smooth bonus portfolio range gives you access to growth asset classes that are available at a lower level of risk than what would otherwise be possible. The importance of having exposure to these asset classes is to increase the probability to earn a positive real return in the long run. Real return is defined as the difference between the nominal return (the actual return) and the inflation over that period. Therefore, a positive real return is required to ensure that your money is not eroded by inflation. Our range of smooth bonus portfolios has long term return objectives that exceed the Consumer Price Index (CPI). The downside of having direct access to growth asset classes (as opposed to via a smoothing mechanism) is the accompanying increased volatility of returns. Recessionary conditions and market crashes exacerbate this volatility.

Market highlights

Global markets plunged in early 2020 as fears over the coronavirus intensified. These fears were epitomized by the market performance for the first quarter of 2020. According to Momentum Investments' macro research team, there was a decline of 19.6% in the S&P 500 Index, a 19.2% decline in the Nikkei 225 Index and a 25.3% drop in the Eurostoxx 50 during the first quarter of 2020 (all in US dollars). As fear (and the virus itself) entered South Africa, coupled with a reaction to the US slashing interest rates, the JSE market rout commenced and within the first quarter, wiped off 24.1% (ZAR) on the FTSE/JSE All-Share Index. The contagion effect was well and truly in place affecting most major markets. Countries went into lockdown, leading to suppressed global demand. Oil prices also dropped to record lows as a sign of oversupply in the market.

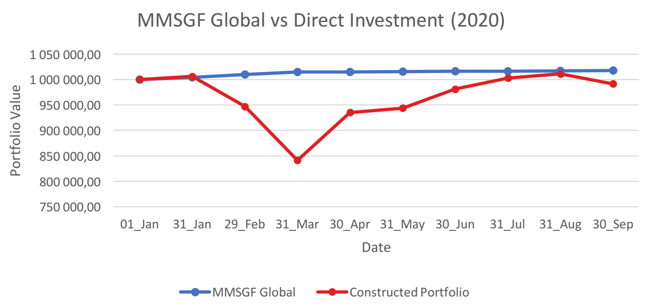
At the end of March 2020, Moody's Investors Service cut South Africa's national scale credit rating to Ba1 (below investment grade) due to weak business confidence and investment, unreliable electrical supply and ongoing structural rigidities in the labour market. A week later, Fitch Ratings followed suit, cutting South Africa to BB, citing the burgeoning debt position. The downgrade led to the rand breaching the R19 to the US dollar mark (a depreciation of 35% since the start of the year). The JSE ASSA All Bond Index fell 8.7% in the first quarter due to a yield spike (and hence price falls) caused by the downgrades. The FTSE/JSE SA Listed Property Index plunged by almost 50% in the first quarter, highlighting the effect of the rout on the property market. Investors looked to calmer waters and fled to bonds. This increased demand for bonds and hence lowering bond yields. Monetary policy also affected bond yields. Looking to stimulate demand and mitigate deflationary pressures, countries lowered interest rates which lead to increasing bond prices and hence lower bond yields. The events during the first quarter of 2020 emphasised the volatile nature of growth asset classes and the extent to which this volatility could affect a portfolio constructed via direct investment.

MMSGF Global vs direct investment

The Multi-Manager Smooth Growth Fund Global (MMSGF Global) is Momentum Corporate's largest smooth bonus portfolio and is appropriate for investors seeking downside protection and decreased volatility. There is also a guarantee that our bonuses will never be less than 0% after fees and benefit payments will be paid at fund value. For the investor, this means that sudden market crashes will not reduce your benefit payment.

To illustrate the benefit of our portfolio in a flash crash environment, we have constructed an alternate portfolio to use as a comparison. This simple portfolio will aim to roughly resemble the underlying asset classes and hence, demonstrate the value of our smoothing mechanism versus direct investment in these asset classes.

The graph below illustrates this comparison while the table displays the composition of our constructed portfolio.



Portfolio	Weight	Benchmark
Local Equities	45.00%	FTSE/JSE Capped Shareholder Weighted All Share Index
Global Equities	25.00%	MSCI All Country World Index
Local Bonds	15.00%	BEASSA All Bond Index
Local Cash	4.00%	Short Term Fixed Interest Composite Index
Local Direct Property	5.00%	50% FTSE/JSE SA Listed Property Index / 50% BEASSA All Bond Index
Global Bonds	2.00%	Citigroup World Government Bond Index
Local Listed Property	2.00%	FTSE/JSE SA Listed Property Index
Global Direct Property	2.00%	FTSE **EPRA/NAREIT Global
Total	100.00%	

*** European Public Real Estate Association / National Association of Real Estate Investment Trusts*

An investor with a portfolio value of R1 000 000 at the start of the year could either have the funds invested in a smooth bonus portfolio such as the MMSGF Global (Investor A) or via direct investment through the constructed portfolio (Investor B). The relevant benchmark performances were used to calculate a return for the constructed portfolio.

Investor A suffered no loss in fund value (even at the height of the market downturn) as there were no negative bonuses. This demonstrates the value of smoothing and in fact, between 1 January 2020 and 31 March 2020, Investor A would earn 1.46%, taking their fund value to R1 014 569. This is in contrast to Investor B who would have lost 15.86% of their fund value, resulting in a fund balance of R841 380 at the end of March 2020. The graph above includes asset charges for Investor A but is gross of the policy fee. The portfolio return for Investor B is on a gross basis. However, Investor A will still earn 1.37% between 1 January 2020 and 31 March 2020, considering policy fees on the highest end of the scale for MMSGF Global.

The markets started to recover from April 2020 onwards. However, as of 30 September 2020, it was still deemed to be insufficient to recover any fund value losses. The year-to-date return as at 30 September 2020 was 1.77% for Investor A (1.50% after fees on the highest end of the scale) and -0.83% for Investor B (ignoring fees). The fund value losses for Investor B may well be recovered with time, but it is the uncertainty surrounding the time frame of this recovery, and the unfavourable volatility, that is of concern to the investor. The month-on-month volatility for MMSGF Global was 0.22% compared to 6.23% for the constructed portfolio. There is no denying the fact that a portion of future positive returns will be held back through the smoothing mechanism to subsidise this crash and reserve for future crashes. However, the peace of mind and middle ground that is offered by smooth bonus funds makes it a winner in these scenarios and it enables investors to have some insurance against drastic falls in the market.

Effect on labour force entrants and leavers

There is already a retirement savings crisis in South Africa, with the National Treasury indicating in 2019 that only 6% of the country's population was on track for a comfortable retirement. According to Statistics South Africa, there are about 1.4 million employed people between the age of 55 and 64. A portion of this group would have been scheduled to retire during 2020. This group could have lost 15.86% of their retirement savings had they retired at the end of March 2020 by being invested in the constructed portfolio. Additionally, the COVID-19 pandemic has put a lot of businesses under severe financial distress, leading to many employees being offered early retirement and ending up in a similar predicament. At the other end of the scale, there are 769 000 employees between the ages of 15 and 24 who could have suffered capital losses had they been invested in a linked solution such as the constructed portfolio and triggered an insured benefit payment (payment made on death, disability, resignation, etc.). The reason for this is that they may not have had enough time to accumulate any funds to create a buffer before the crash.

Conclusion

The presence of downside volatility is one of the biggest risks that should be considered when planning for retirement. Smooth bonus portfolios help mitigate this and other risks, and as illustrated in this article, can assist in cushioning the blow caused by investment and economic fallout. These portfolios ensure exposure to growth asset classes while also catering to a lower risk profile. With possible fallout from the US election results and fears of a second wave of COVID-19, smooth bonus portfolios offer a viable alternative to a volatile financial future.

Prinesan Govender

Product Specialist
Structured Solutions

Momentum Investments market commentary for the quarter ending 30 September 2020

by Sanisha Packirisamy and Herman van Papendorp

Highlights

Markets

- The messaging from global fiscal and monetary authorities remained highly accommodative during the third quarter of 2020 and underpinned robust quarterly gains in global equity markets. United States (US) and Asian markets outperformed, while European and Latin American markets trailed behind.
- The local equity market ended the quarter broadly flat. The FTSE/JSE Resources Index had the strongest performance in the quarter, while marginal losses were observed in the FTSE/JSE Industrials and Financial Indices.
- The JSE Assa All Bond Index climbed 1.5% in the quarter, while the JSE Assa Government Inflation-linked Bond Index traded 1.2% firmer for the same period. Meanwhile, the FTSE/JSE SA Listed Property Index lost 14.1% since the end of June 2020.
- Ongoing stimulus is likely necessary to support financial markets and underpin confidence for sustained economic growth. Sentiment and positioning are suggestive of equity complacency and could act as constraints to future global equity returns. In our view, the potential for higher taxes and increased regulation, stemming from the outcome of the upcoming US election, and virus and vaccine developments pose a threat to equity returns going forward. Relative to global bonds, global equity valuations rank as the most attractive since the Second World War.
- South African (SA) local shares staged a massive underperformance against SA global shares since the bottom in markets. We remain cautious in the near term on SA equities given short-term global risks, but we are more positive beyond that.
- SA government bond yields look attractive relative to those in developed markets (DMs) and emerging markets (EMs), but part of the high real yield differential is due to a fiscal risk premium. Our preference remains for SA nominal bonds over inflation-linked bonds and cash on a one-year basis.
- We remain cautious in the interim on SA listed property in view of near-term global market risks, but the return profile is asymmetric to the upside beyond that.

Economics

- Although COVID-19 infections have been steadily rising in countries which previously had the spread of the disease under control, governments have not re-imposed the most stringent forms of lockdown. The rate of fatalities and hospitalisations have not increased to the same extent as with the first wave of infections, with the rise mostly concentrated among the younger age cohorts or asymptomatic cases.
- High-frequency data releases and sentiment indicators nonetheless imply that a strong bounce back in global economic activity in the third quarter of the year may fizzle out prematurely.
- The economic recovery has shown signs of being unbalanced. Businesses have become less pessimistic about the outlook for the economy and corporate earnings, whereas consumer sentiment and behaviour appear to continue to reflect the uncertainty of COVID-19.
- Fiscal expansions in the DM composite are expected to push the debt-to-gross domestic product (GDP) ratio from 120% in 2019 to 147% in 2020, raising concerns over how governments will service this mountain of debt and how the related surge in bond issuance will affect markets and longer term growth.
- With the blurring of fiscal and monetary policy, it is not clear what will force governments to rein in spending. This raises an additional concern of central banks becoming more vulnerable to political interference. Moreover, inflation expectations are also at risk of becoming unanchored.
- Even as further restrictions are lifted on the economy, ongoing electricity supply shortages, crippling policy uncertainty, lingering unemployment, an anticipated rise in bankruptcies, a slow implementation of structural reform policies and soaring government debt will continue to hold back spending and investment and underscore weak trend growth, thereby limiting SA's recovery to a below-consensus 2% in 2021 in our view, from a contraction of around 8% in 2020.

- The price of electricity tariffs is the main source of upside risk to the inflation forecast in the near term. We anticipate an average headline inflation rate of just above 3% for 2020, rising mildly to just below 4% in 2021.
- We see interest rates remaining unchanged until the second half of 2021 when the SA Reserve Bank (Sarb) begins to unwind negative real interest rates to avoid endangering the savings industry and broader financial stability.

Global policy support has underwritten the performance in financial markets

The messaging from global fiscal and monetary authorities remained highly accommodative during the third quarter of 2020 and underpinned robust quarterly gains in global equity markets. Investors were encouraged during the quarter by the reopening of economies and stimulus efforts which buoyed sentiment. The CBOE Volatility Index (Vix), or fear gauge, was relatively stable throughout and ended the quarter four points lower.

Global equity markets rose 8.1% with US and Asian markets outperforming, while European and Latin American markets trailed behind. The Global All Country World Index rose 8.1% in the third quarter of 2020, with similar gains in DMs and EMs. The MSCI DM Index gained 7.9% in the same period, supported by a bounce of 8.9% in the S&P 500 Index which gained on signs of an economic recovery and loose monetary policy. US consumer discretionary shares and distribution companies fared well, while airline and energy shares continued to struggle. This was followed by a 4.7% uptick in the Nikkei 225 Index, notwithstanding a strengthening in the yen and a change in leadership, while the Eurostoxx 50 Index slipped 0.7% in the quarter. The poor relative performance of European stocks was largely attributable to a rise in COVID-19 infections in several countries and a reintroduction of localised restrictions to economic activity, to help curb the spread of the disease. Energy and financial shares were amongst the poorest performers in the quarter, while materials, consumer discretionary, automotive and luxury goods shares staged a decent performance.

The MSCI EM Index shot 9.6% higher in the third quarter of 2020, supported by a firm 11.9% performance in Asian shares, which were driven by gains in the Indian, South Korean and Taiwanese equity markets. The MSCI Europe, Middle East and Africa Index inched 1.8% higher, while the MSCI Latin America Index shed 1.3% in the same quarter.

Government bond yields were mixed during the quarter against a generally risk-on backdrop. The US 10-year government bond yield was little changed by the end of the quarter, despite election uncertainty beginning to build and broad disappointment with an unchanged policy by the US Federal Reserve, while the German 10-year government bond yield dropped a further seven points in the quarter.

As investor fears subsided in the third quarter of 2020, the JP Morgan EM Bond Index (Embi) spread narrowed by around 36 points. Malaysia, Chile and Romania were among the countries to experience the largest improvement in credit default swap (CDS) spreads since the end of June 2020, while a further deterioration in spreads was noted in Russia, Thailand and Turkey.

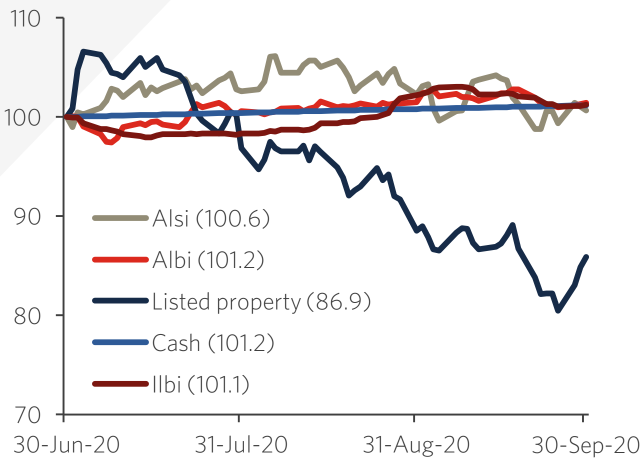
The local equity market ended the quarter broadly flat (up 0.7%). The FTSE/JSE Resources Index had the strongest performance in the quarter and added 6%, in line with a robust performance in the Bloomberg Commodity Index, which increased 9.1% in the quarter. The international price of gold and platinum lifted 5.9% and 7.7%, respectively, in the corresponding period, while Brent crude oil prices fell by a marginal 0.4%. The FTSE/JSE Industrials Index dipped 2.3% in the quarter, while the FTSE/JSE Financials Index shed a lesser 1.6% in the third quarter of 2020.

In SA's fixed income markets, the 10-year government bond yield rallied by a mere seven basis points.

The JSE Assa All Bond Index climbed 1.5% in the quarter, while the JSE Assa Government Inflation-linked Bond Index traded 1.2% firmer for the same period.

Meanwhile, the FTSE/JSE SA Listed Property Index lost 14.1% since the end of June 2020 (see chart 1).

Chart 1: Returns from local asset classes (%)



Source: Iress, Momentum Investments

Following the risk-on mood, the rand strengthened by 3.6% against the US dollar in the third quarter of 2020. However, the rand weakened by 0.7% against the euro and 0.5% against the pound in the same period. SA's five-year CDS spread shifted 12 points higher in the quarter but remained significantly below the high of 497 points in early April 2020.

US equity markets experienced their greatest equity rally of all time since bottoming in March 2020. However, in the real economy, growth momentum stalled after an initial bounce. As such, ongoing fiscal and monetary stimulus is likely necessary to support financial markets and underpin confidence for sustained economic growth. Sentiment and positioning, which typically act as contrarian indicators, are suggestive of equity complacency and could act as constraints to future global equity returns. In our view, the potential for higher taxes and increased regulation, stemming from the outcome of the upcoming US election, and virus and vaccine developments pose a threat to equity returns going forward.

In our opinion, global bonds remain expensive. Relative to global bonds, global equity valuations rank as the most attractive since the Second World War or the Great Depression. Central bankers have acted aggressively in response to the COVID-19 pandemic by slashing already-low interest rates, relaxing capital requirements and expanding quantitative easing programmes. With the expectation of mild rand strength in the coming year, from current levels, global cash returns will likely not be meaningful.

Major sections of the SA equity market have displayed a disparate performance this year. SA local shares have staged a massive underperformance against SA global shares since the bottom in markets. Assuming growth in earnings of 13% in the next year, the SA equity market is now one standard deviation expensive against its average since 1999 and a third of a standard deviation cheap against the average since 2013. We remain cautious in the near term given short-term global risks, but we are more positive beyond that.

SA government bond yields look attractive relative to those in DMs and EMs, but part of the high real yield differential is due to a fiscal risk premium. Current SA real bond yields and yield spreads remain attractive on a multiple-sigma basis against historical averages.

We expect break-evens to continue to narrow into the end of the year and only see them expanding in line with rising inflation as 2021 progresses. As such, monthly inflation accruals are only expected to become supportive again in 2021. Our preference remains for SA nominal bonds over inflation-linked bonds and cash on a one-year basis. Aggressive interest rate cuts have driven prospective SA real cash yields down to one standard deviation below historical averages.

In SA listed property, share prices, at the time of writing, imply a 32% decline in property values compared to our base case assumption of a fall of 25% over three years and a worse case decline of 30%. The relative rating of listed property to bonds is at historical extremes and the price to net asset value (NAV) ratio is cheap even with an assumed 20% to 30% drop in NAV. We remain cautious in the interim in view of near-term global market risks, but the return profile is asymmetric to the upside beyond that.

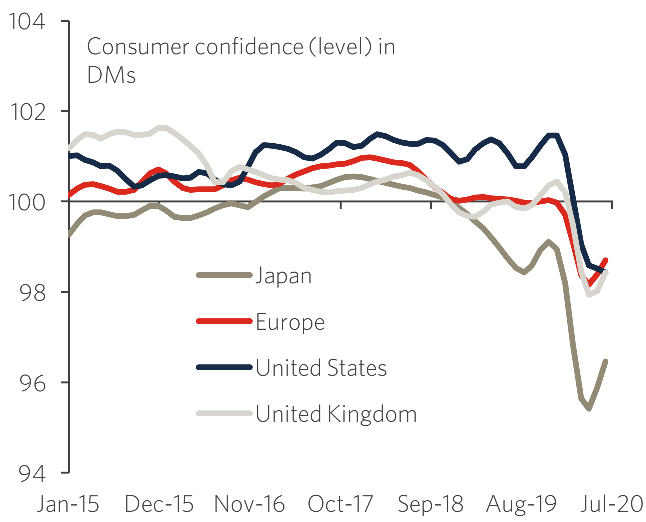
Global economy stirs from the COVID-19 coma

The COVID-19 pandemic has hit the entire world, with the disease tide rising in some areas and falling in others in recent weeks. New cases have risen sharply in areas where social distancing measures were adopted late, such as Latin America, which was the new epicentre of the crisis at the time of writing, accounting for almost half of all deaths each day.

COVID-19 infections have been steadily rising in countries which had previously had the spread of the disease under control, partly because of the easing of travel restrictions being eased. Nonetheless, governments have not re-imposed the most stringent forms of lockdown in countries such as Spain, France, Italy and the United Kingdom. This is justified by the rate of fatalities and hospitalisations not having increased to the same extent as with the first wave of infections, with the rise mostly concentrated among the younger age cohorts or asymptomatic cases.

Despite the lower likelihood of returning to more stringent levels of lockdown, high-frequency data releases and sentiment indicators are indicating that the strong bounce back in global economic activity in the third quarter of the year, following a general ease in lockdown restrictions, may fizzle out prematurely. The economic recovery following the lockdown-imposed economic slump in the second quarter of the year has shown signs of being unbalanced. On the whole, businesses have become less pessimistic about the outlook for the economy and corporate earnings, whereas consumer sentiment, surveyed by the Organisation for Economic Co-operation and Development (OECD), and consumer behaviour appear to continue to reflect the uncertainty of the disease evolution (see chart 2) and have led consumers to pull back on spending on non-essentials.

Chart 2: Consumers remain hesitant



Source: OECD, Momentum Investments

Although fiscal support has been the largest and fastest in peacetime, not all of this additional stimulus has landed in the real economy. Private savings rates have soared and may remain high well into 2021. According to the Peterson Institute of International Economics, cash transfers and unemployment benefits in the US are likely to prop up private US savings to their highest level since the Second World War. Although the narrowest form of money supply has surged to more than 38% year on year (y/y), growth in bank loans to businesses and consumers peaked at 10% y/y and has since rolled over. Bank lending criteria have also tightened up to levels last seen in the global financial crisis (GFC) as banks grow cautious on default rates.

Moreover, further rounds of business closures and layoffs could stall the recovery in the unemployment rate and act as a further constraint to consumer spending. According to Yelp Inc., more than half of the small business closures (including restaurants, retail and beauty industries, bars and fitness centres) that were considered temporary when the COVID-19 pandemic erupted are now being considered permanent. Although the National Federation of Independent Business showed some areas of improvement for small businesses in August 2020 (which according to JP Morgan account for nearly half of employment in the US), many were still struggling and remained uncertain about future conditions.

Funding for the temporary jobless benefit payments is running out, but the chances of another round of fiscal stimulus before the November 2020 US elections have dropped in response to a partisan split over a smaller package proposed by Republicans. This sign of policy fatigue could keep household incomes under pressure and impair prospects for consumption spending and growth, particularly as economies are fast running out of monetary policy room.

Even without this additional fiscal package, the Bank for International Settlements expects the US fiscal deficit to swell from 7% in 2019 to 24% in 2020. Fiscal expansions in the rest of the DM composite are expected to push the debt-to-GDP ratio from 120% in 2019 to 147% in 2020 (higher than experienced during the Second World War) raising concerns over how governments will service this mountain of debt and how the related surge in bond issuance will affect markets and longer term growth.

With the blurring of fiscal and monetary policy (triggered by initiatives ranging from yield curve control and central bank purchases in Japan to funding for lending in the UK and central bank purchases of corporate debt in the euro area), it is not clear what will force governments to rein in spending, particularly with central banks being forced to mop up the additional debt issued by governments. This raises an additional concern of central banks becoming more vulnerable to political interference and could also risk inflation expectations from becoming unanchored.

In our view, the latter poses less risk in the near to medium term given counteracting disinflationary forces such as ageing populations, excess savings, lower wages, spare capacity and technological innovation that reduce costs. The Federal Reserve Bank of San Francisco admitted that despite the longest economic expansion on record before the COVID-19 outbreak, the personal consumption expenditure deflator measure of inflation stayed below the 2% target for most of the past decade. With much of the world facing the zero-lower bound in interest rates, the US Federal Reserve has adopted an average inflation targeting approach to mitigate the limited use of conventional policy tools in a low interest rate environment.

As we shift closer to the November 2020 US presidential election, it appears as though both candidates favour looser monetary policy, but the outlook for fiscal policy could be dependent on the makeup of Congress.

BBVA Research suggests that in a 'blue wave' scenario, where the Democrats take control of the White House, Senate and the House of Representatives, a more progressive agenda, including key tax and spending policies, is likely to be pursued. The scope of regulatory policy would likely alter, while foreign policy objectives would be overhauled to include support for strategic trade deals and a less aggressive stance against China. Democrats would further feel empowered to reshuffle heads of government agencies, in our view.

In the scenario where Democratic presidential nominee, Joe Biden, wins the presidency, the Democrats regain control of the House of Representatives, but the Senate is retained by the Republicans, bipartisanship politics could mean little movement outside of areas where there is common ground. In a more forceful approach, this partial victory for the Democrats could be viewed as an endorsement to shift away from policies pushed in the last four years and may even result in blocking of appointments and a choking of international agreements.

Should President Donald Trump secure a second term in the presidency, the Republicans retain the Senate and the Democrats cling to the House of Representatives, there would be co-operation in basic areas and some chance of passing legislation on immigration and infrastructure. But if neither party makes concessions, there would be an increase in reliance on executive actions and legal challenges and rulings.

In a 'red wave' scenario (deemed a lower probability based on current polling suggesting a high probability of the Democrats controlling Congress and the White House), the Republicans secure the White House, the Senate and the House of Representatives. This defeat of the Democrats would embolden President Trump and he would likely double-down on some of his more controversial promises, including reshaping immigration. A continuation of the disruption to the global order through an increasingly protectionist stance is also probable under this scenario.

BBVA Research investigated presidential terms from the 1950s and found that while stock prices were significantly lower during periods of unified governments (where both branches of government are controlled by the same party), GDP, employment and real per capita income growth were much higher than with divided governments. Moreover, consumer and small business confidence were higher under a unified government, possibly signalling that unity and progress, regardless of party affiliation, are viewed as positives.

Despite similar inflation outcomes under a unified and divided government, nominal long-term interest rates were slightly higher in the periods of a divided government, reflecting higher uncertainty and risk perception.

Flailing growth and fiscal troubles haunt SA

Already-weak growth outcomes in SA were hobbled by the COVID-19 pandemic and the ensuing lockdown. Even as further restrictions are lifted on the economy, ongoing electricity supply shortages, crippling policy uncertainty, slow implementation of structural reform policies and soaring government debt will continue to hold back spending and investment and underscores weak trend growth.

Economic Research Southern Africa and the Sarb have shown that economic growth in the aftermath of the GFC was primarily led by consumption and services. Total consumption (including household and government spending) surged 25% since 2009, while fixed investment registered only 5% higher by the end of the period. Household and government consumption have climbed to an 84% share of GDP in this period, while the GDP share of fixed investment has fallen to below 18%, a level last observed in 2005. On a sectoral basis, the tertiary sector (mainly services) has grown around 23%, while the primary (agriculture and mining) and secondary (manufacturing, construction and utilities) sectors are only between 2% and 6% larger than they were in 2009.

In the International Monetary Fund's (IMF) SA country report published in July 2020, it noted the deep contraction in economic activity anticipated for 2020 would have lingering negative effects on growth levels and as such the IMF did not project recovery to 2018 levels in its medium-term forecasts to 2023.

BNP Paribas has shown that while it took SA GDP 20 quarters to recover to pre-crisis levels in the early 1990s recession, two quarters in the late 1990s Asian crisis and seven quarters in the GFC, fixed investment lagged the recovery at 23 quarters, 15 quarters and 19 quarters, respectively. Growth in the asset base in the private sector has not kept pace with the depreciation and amortisation of fixed assets. However, with 72% of manufacturers, surveyed by the Bureau of Economic Research in the third quarter of 2020, ascribing insufficient demand as a constraint to outlaying capital and a near-record 85% attributing a lack of investment activity to policy uncertainty, we may not be able to rely on private fixed investment to bail out poor growth outcomes. While government's infrastructure interventions under the Infrastructure Investment Committee are encouraging, lingering uncertainty remains over timelines and the day-to-day management of the infrastructure projects. The 50 bankable projects and 16 special projects in the pipeline amounting to R360 billion will have to be fast-tracked to ensure a speedier macro recovery.

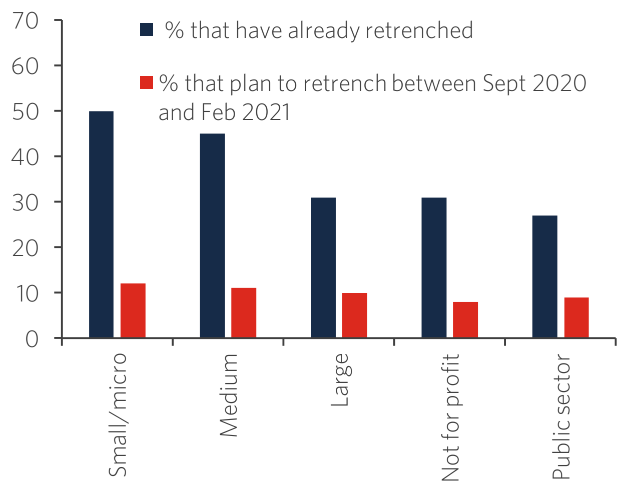
Although government has provided COVID-19 support to the business sector through the loan guarantee scheme, by the middle of August 2020, the scheme had only lent out R13.4 billion to qualifying businesses. In its best-case scenario, the Banking Association of SA expects total loans to reach R43 billion despite changes being made to the eligibility for the loans and to improve the terms of the loans.

While we have seen consumption accounting for the bulk of economic activity in the past decade, the COVID-19 pandemic is likely to put a dampener on spending going forward. The University of Cape Town argues that COVID-19 relief distress grants have lessened the likelihood of a spike in SA's already elevated Gini coefficient, which measures income inequality. The COVID-19 grant managed to bring several uncovered households, operating in the informal sector, into the system and is said to have aided more than 60% of the population. Spending by the ninth and tenth expenditure deciles were buffered by savings, but the data reveals the seventh and eighth deciles were hit the hardest. This is less surprising when considering the outcome of the National Income Dynamics Study: Coronavirus Rapid Mobile Survey (Nids-Cram), which claims that 75% of the population live in households where monthly per capita income is less than the minimum wage of R3 500. Despite the additional grant support, the Nids-Cram Survey shows a reversal in gains achieved in reducing child hunger since the GFC given the severity of the economic decline during the COVID-19 pandemic.

Moreover, a report by the United Nations (UN) warns that more than a third of the middle class (classified as a monthly mean household expenditure per capita of R4 656) are likely to transition from the middle class into vulnerability considering the adverse income effects of the pandemic. The UN also cautioned that households whose employment type changed from permanent to contract employment had a 44% chance of falling into poverty.

The Nids-Cram Survey for April and May 2020 showed that female, less educated and lower-income workers faced the highest rate of job losses during the most stringent levels of lockdown, while Redflank Management Consultants highlighted that small/micro and medium enterprises retrenched the most workers. Meanwhile, employees at large firms or the public sector appeared to have been better insulated from the wounding economic effects of COVID-19 (see chart 3).

Chart 3: Looming job losses



Source: BeyondCOVID, Redflank, Momentum Investments

Elevated and rising public debt, heightened scrutiny by the major rating agencies and high premiums on debt have limited SA's fiscal room to manoeuvre, constraining growth further. While SA's social grant system was expanded during a period of high economic growth, there is a concern whether this is still sustainable in a low growth environment. The OECD notes that SA has one of the strongest redistributive budgets with 68% of government spending allocated to social objectives (including education, health, social grants and basic services). SA's extensive grant coverage has become an important source of financial support and has reduced the country's share of the population with 60% or less than the median disposable income from 45% to 32%. This has lent credence to an extension of social grant top-ups or a fiscally-neutral form of a basic income grant. This will, however, require a reprioritisation of expenditure given government's stretched finances.

In government's passive scenario, in which it takes no steps to counter weaker growth and higher spending, government debt is expected to exceed 100% of GDP by 2022. Reforms, including curbing the wage bill, improving the efficiency of spending and reducing state transfers to ailing state-owned enterprises (SoEs), are crucial to guarantee the sustainability of government debt in SA.

SA's burgeoning government wage bill, at 12% of GDP, is one of the highest in the OECD grouping. Per capita remuneration in the public sector has increased by an annual average of 3.1% in the last decade. While the share of public sector workers of total employment is not extreme on a global comparison, the proportion ranks as high on an EM comparison. While government promises to cut the government wage bill by R160 billon over the next three years, organised labour and government remain in a deadlock over R37.8 billion in salary increases for the 2020/21 financial year.

Government's exposure to SoEs, which excluding the independent power producers stood at 7.5% of GDP in the 2019/20 financial year, represents a further threat to debt sustainability. The OECD notes that the governance failures behind the SoEs have been reflected in inefficiencies, corruption and financial mismanagement. Moreover, SA's Auditor General reported R94.6 billion in wasteful, irregular and unauthorised expenditure at all levels of government in the 2018/19 financial year.

As such, SA ranks poorly on Transparency International's index of public integrity, control of corruption measure and overall corruption perceptions index. With many key investigations not progressing to the stage of prosecution, public confidence has not yet been restored. The University of Johannesburg-Human Sciences Research Council Democracy Lockdown Survey, which collated responses between 3 and 17 July 2020, recorded a drop in support for the president's handling of the COVID-19 outbreak from 85% in April/May 2020 to 61%. The decline ranged from 15% among residents in informal settlements (to 71%) and among students (to 62%) to a 49% decline to 41% among white adults.

Political trust is a crucial ingredient to restore the social compact between government, business, labour and civil society, in our view. After a delay of six months, the National Economic Development and Labour Council (representing all social partners) has eventually agreed to an economic plan for SA. However, lingering unemployment, an anticipated rise in bankruptcies and ongoing electricity supply constraints limits SA's recovery to a below-consensus 2% in 2021 in our view, from a contraction of around 8% in 2020.

SA's wide output gap is representative of spare capacity in the system. Accordingly demand price pressures are largely absent. Even though the rand has experienced the fifth worst sell-off from its EM peers year to date, the weakness in the currency has not translated into higher retail prices. Downward pressure on household incomes, triggered by retrenchments and pay cuts, together with an excess supply of housing stock on the market will likely keep rental inflation at bay for some time. This leaves the price of electricity tariffs as the main source of upside risk to the inflation forecast in the near term. We anticipate an average headline inflation rate of just above 3% for 2020, rising mildly to just below 4% in 2021.

Although the nature of the COVID-19 pandemic has complicated the effect of the monetary policy mechanism on growth given the disruptions to demand and supply, lower interest rates are expected to help indebted consumers and provide a marginal boost to despondent businesses and consumers. We see interest rates remaining unchanged until the second half of 2021 when the Sarb begins to unwind negative real interest rates to avoid endangering the savings industry and broader financial stability.

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

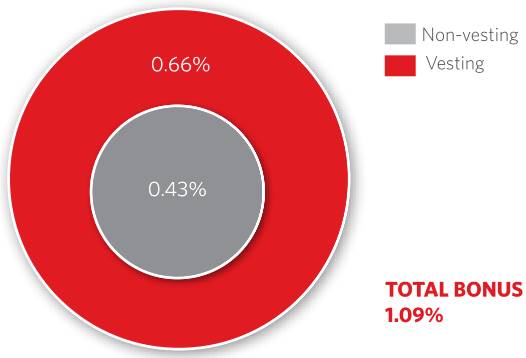
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	97.5% - 102.5%	1.05% [1]	1.31% [1]

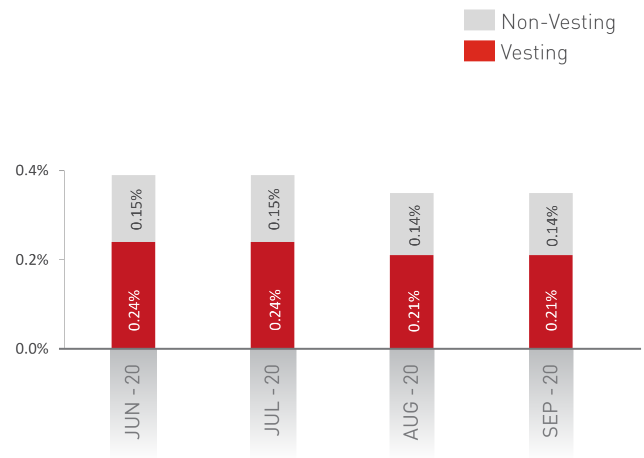
[1]Based on back-tested bonuses and returns

Performance

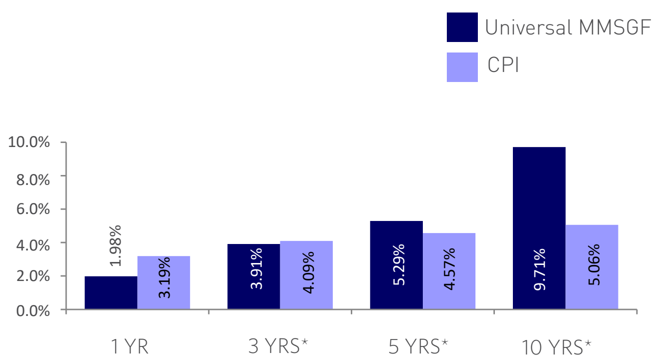
The total bonus* for the past quarter on the Universal Multi-Manager Smooth Growth Fund is shown below.



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

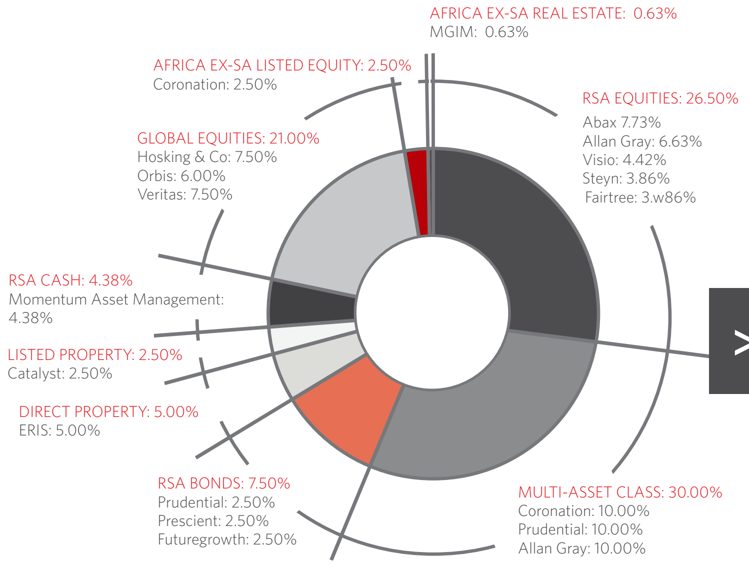


CPI figures are lagged by two months

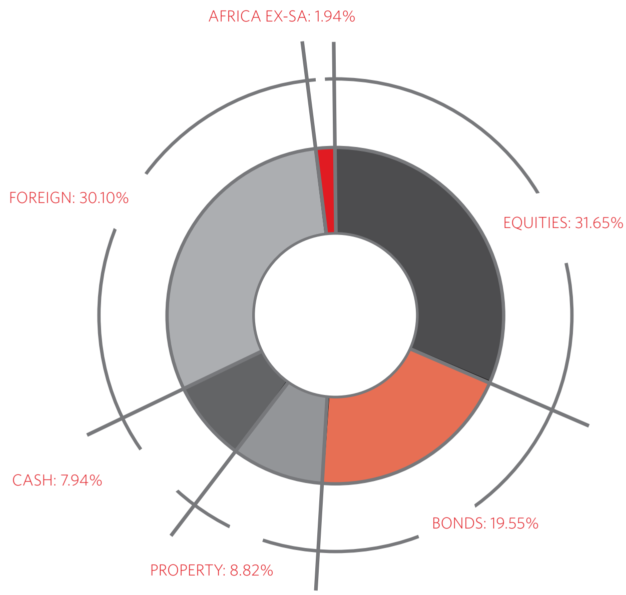
* Annualised

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 Smooth Bonus Range

Universal Smooth Growth Fund

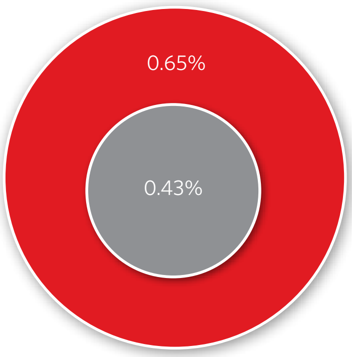
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	95% - 100%	0.92% [1]	0.42% [1]

[1]Based on back-tested bonuses and returns

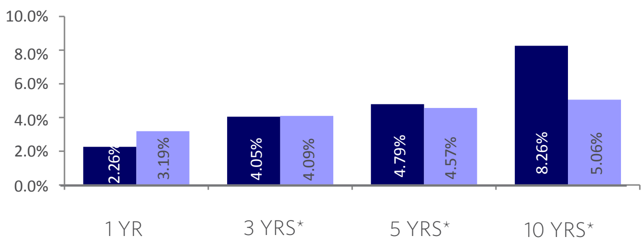
Performance

The total bonus* for the past quarter on the Momentum 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 Momentum Universal Smooth Growth Fund against CPI

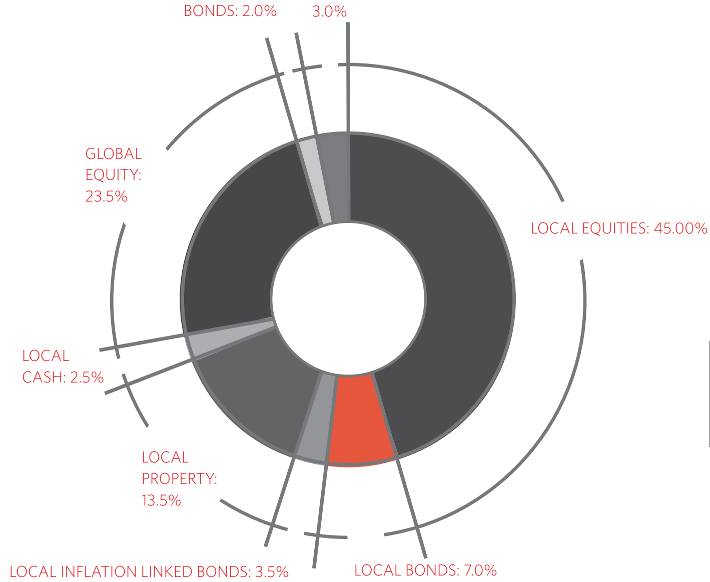


CPI figures are lagged by two months

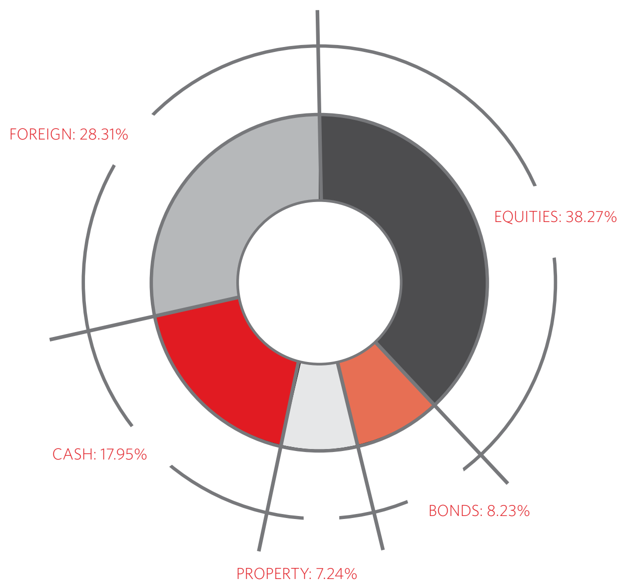
* Annualised

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

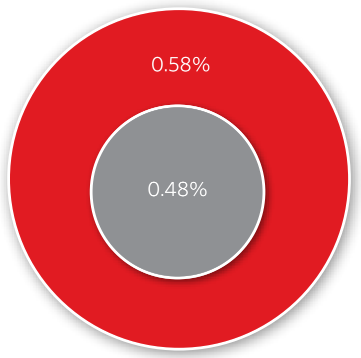
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	97.5% - 102.5%	1.07% [1]	3.75% [1]

[1]Based on back-tested bonuses and returns

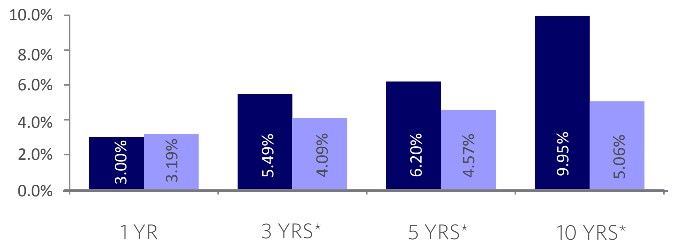
Performance

The total bonus* for the past quarter on the Momentum 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

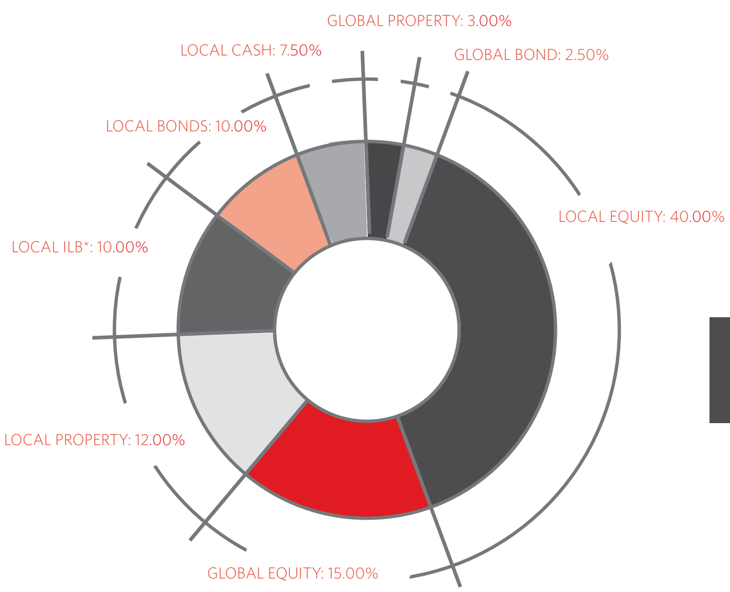


CPI figures are lagged by two months

** Annualised

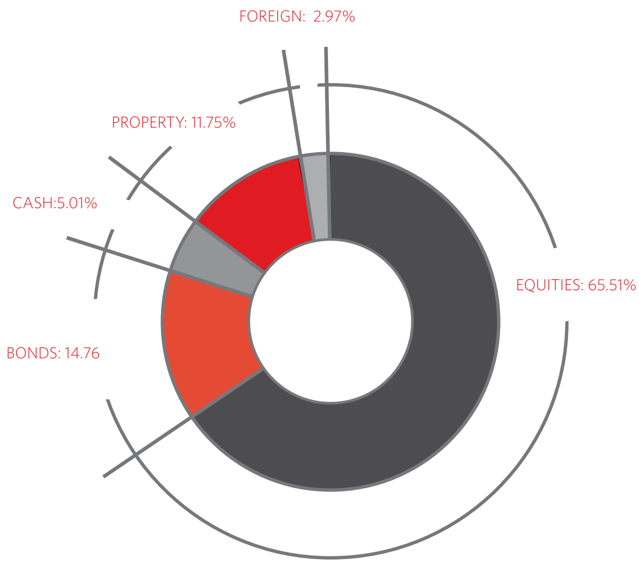
Asset Allocation

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.



*Inflation-linked bonds

The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smooth Bonus Range

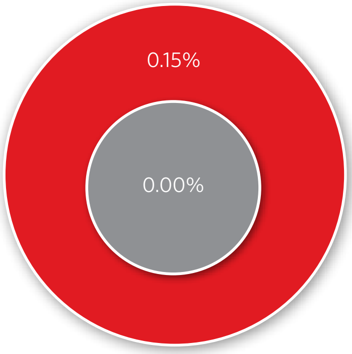
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

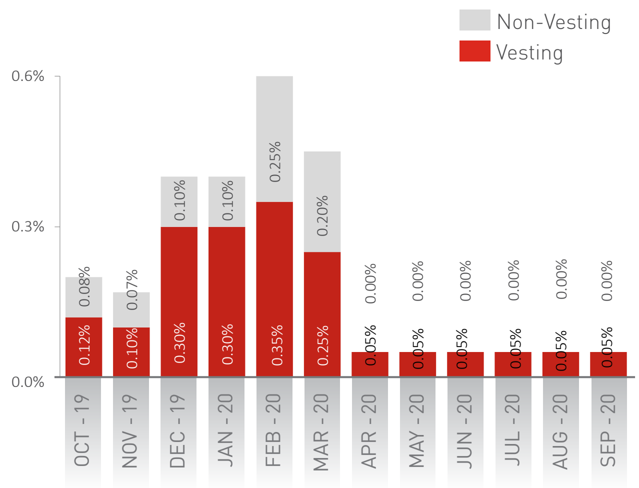
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	90% - 95%	R11.1bn	0.90%	1.00%

Performance

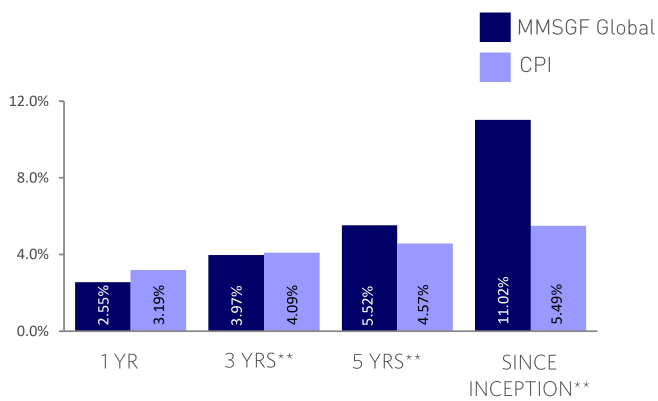
The total bonus* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



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



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



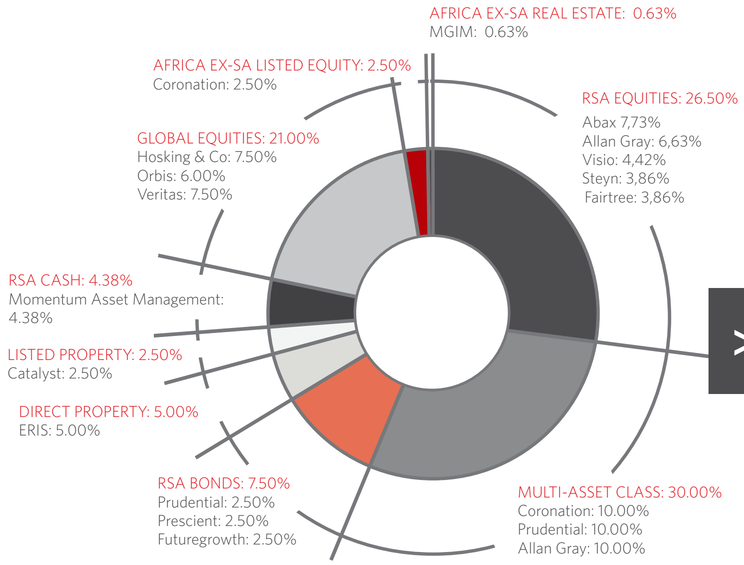
CPI figures are lagged by two months

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

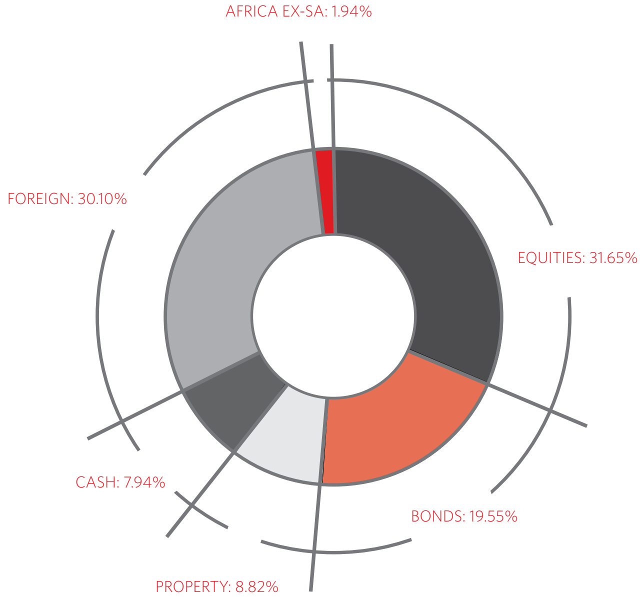
** Annualised

Asset Allocation

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



The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smooth Bonus Range

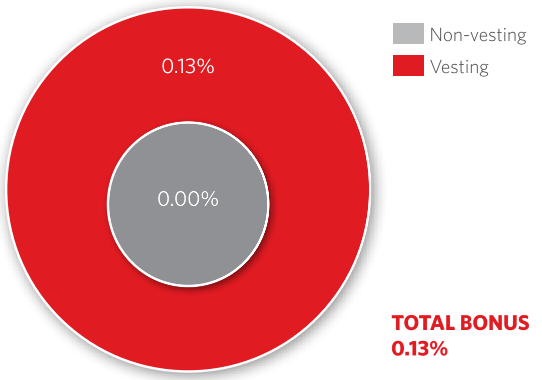
Smooth Growth Fund Global

Fund Snap Shot

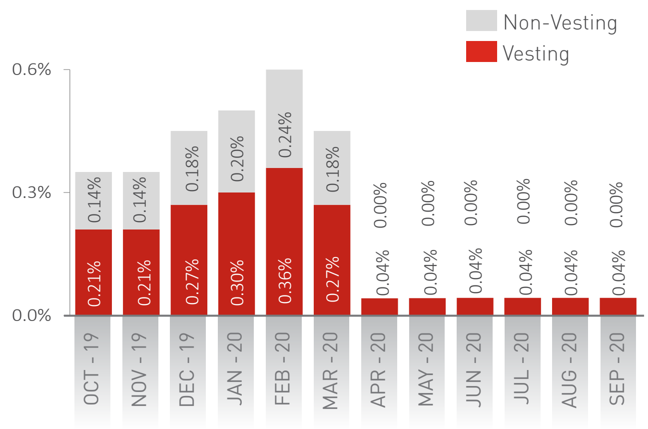
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	90% - 95%	R1.9bn	0.86%	1.07%

Performance

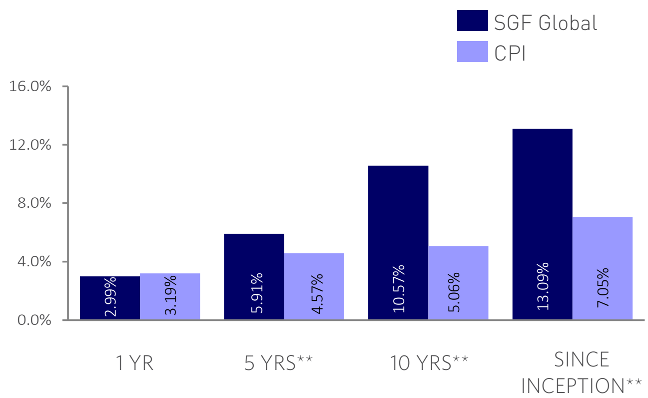
The total bonus* for the past quarter on the Smooth Growth Fund Global is shown below.



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



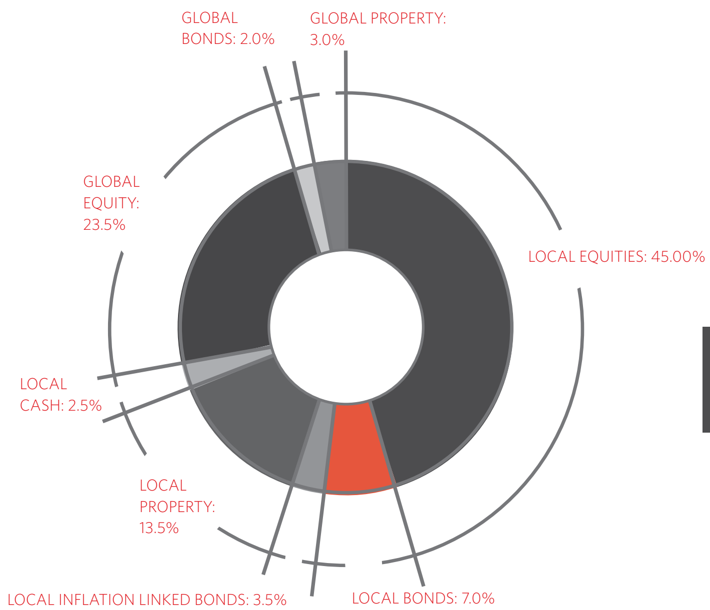
The chart below shows the long term bonus* performance of the Smooth Growth Fund Global against CPI.



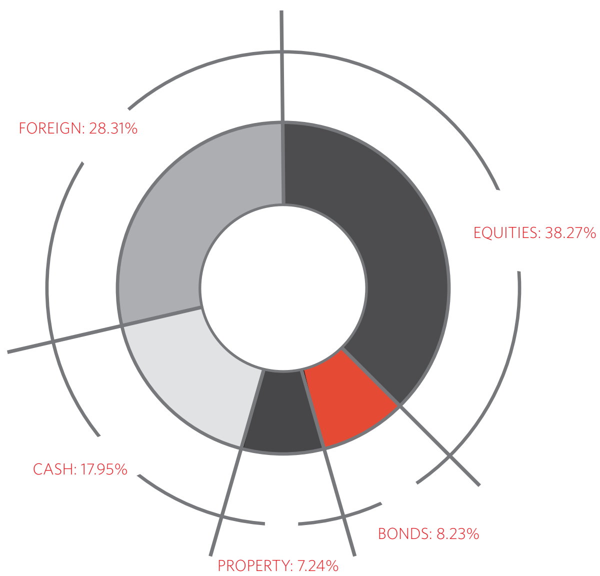
CPI figures are lagged by two months

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



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

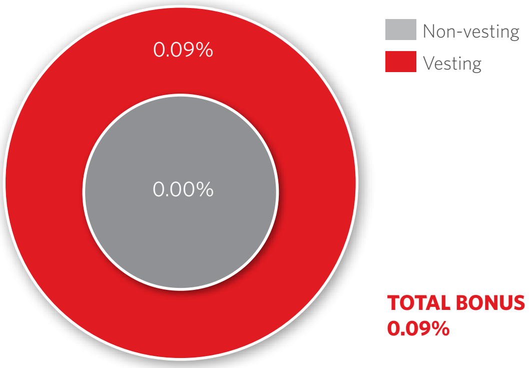
Multi-Manager Smooth Growth Fund Local

Fund Snap Shot

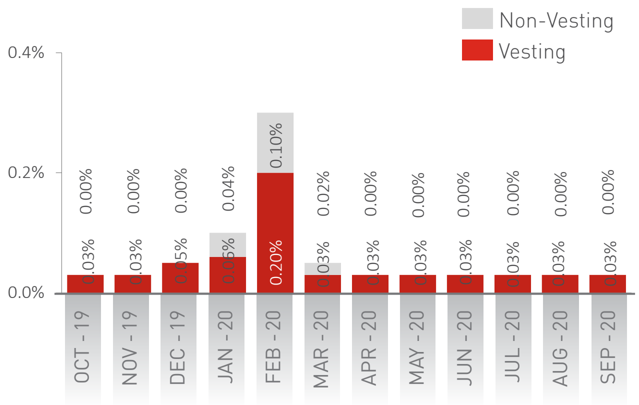
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	85% -90%	R149m	1.07%	-2.42%

Performance

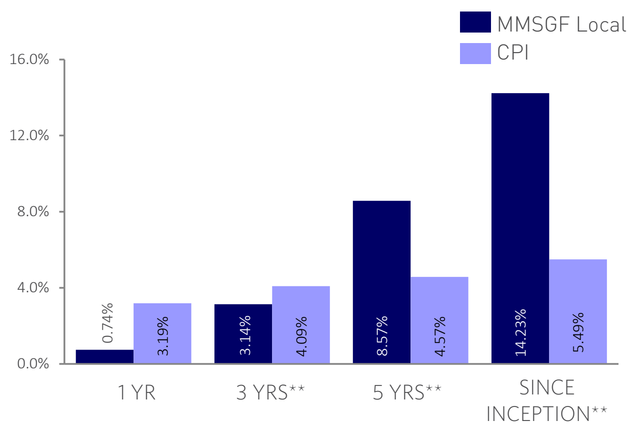
The total bonus* for the past quarter on the Multi-Manager Smooth Growth Fund Local is shown below.



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



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



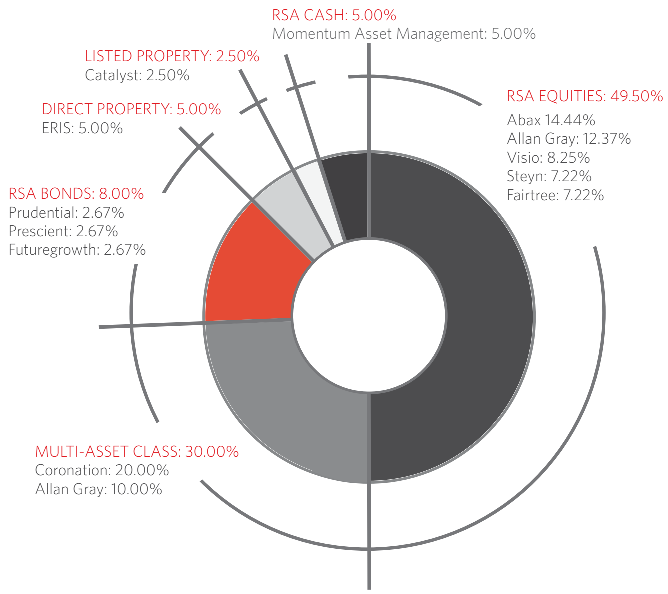
CPI figures are lagged by two months

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

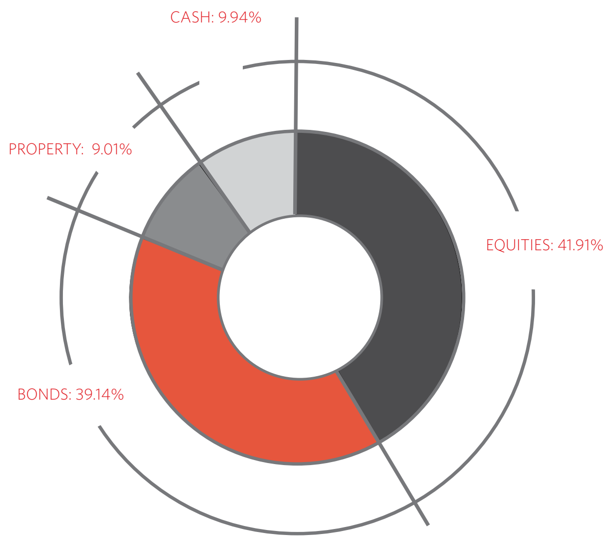
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smooth Bonus Range
Smooth-Edge Fund

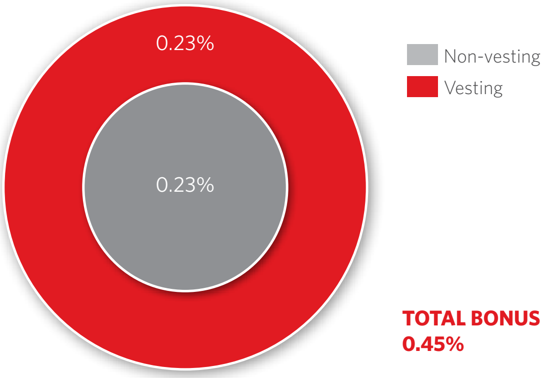
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	95% - 100%	R98m	0.93% [1]	3.76% [1]

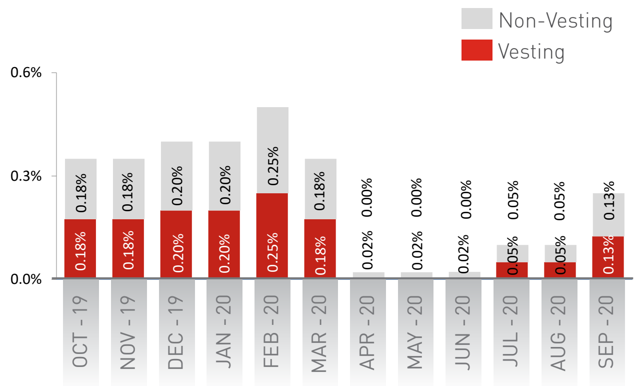
[1]Based on back-tested bonuses and returns

Performance

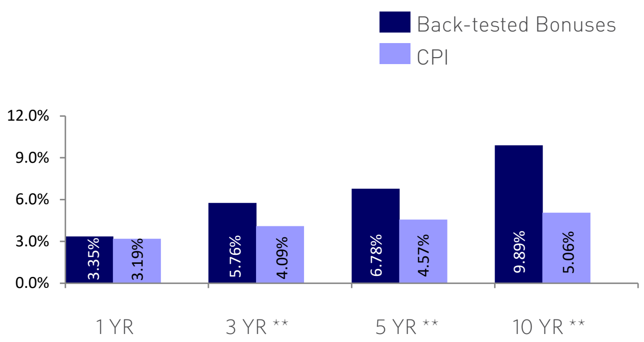
The total bonus for the past quarter on the Momentum Smooth-Edge Fund is shown below.



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



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



CPI figures are lagged by two months

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

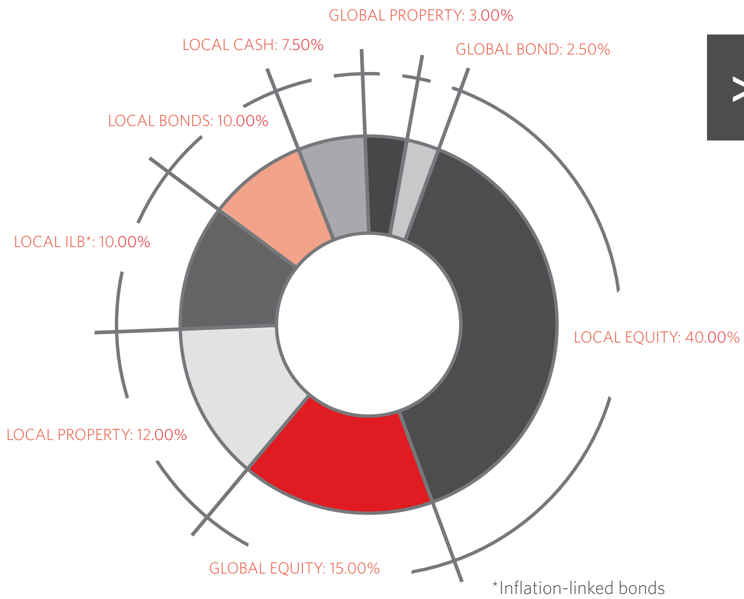
** Annualised

Asset Allocation

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

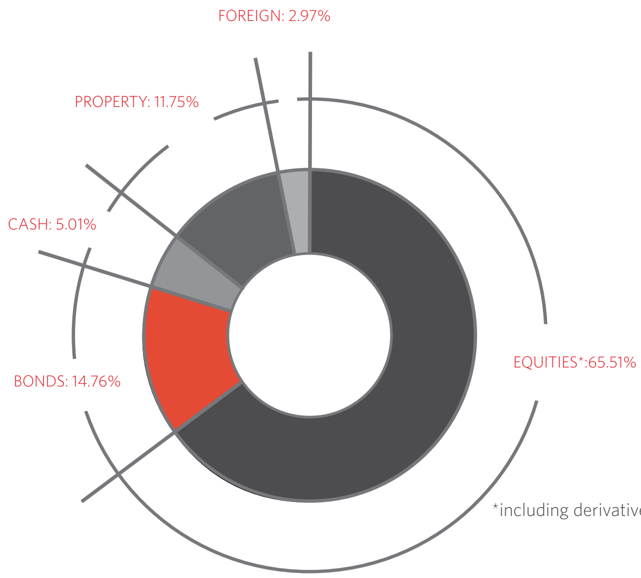
Not only does this solution offer members inflation-beating investment return prospects and protection from market volatility, but the significantly lower capital charge means more money goes directly to the members' retirement savings to bolster their retirement outcomes.

The strategic asset allocation is shown alongside.



*Inflation-linked bonds

The effective asset allocation of the portfolio is shown alongside.



*including derivatives

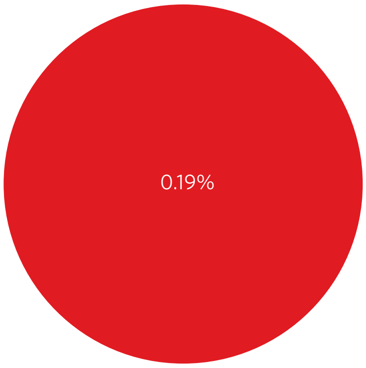
Smart Guarantee + 3 Fund

Fund Snap Shot

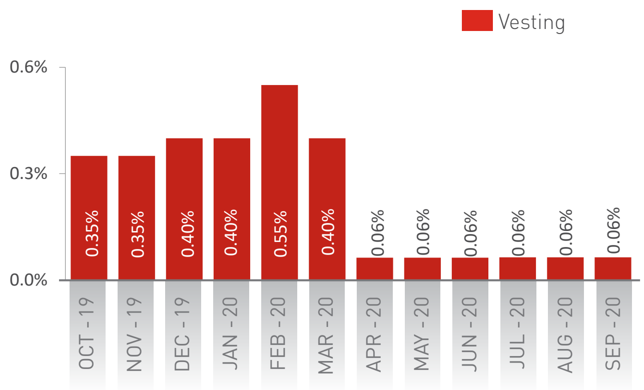
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	90% - 95%	R423m	0.96%	0.44%

Performance

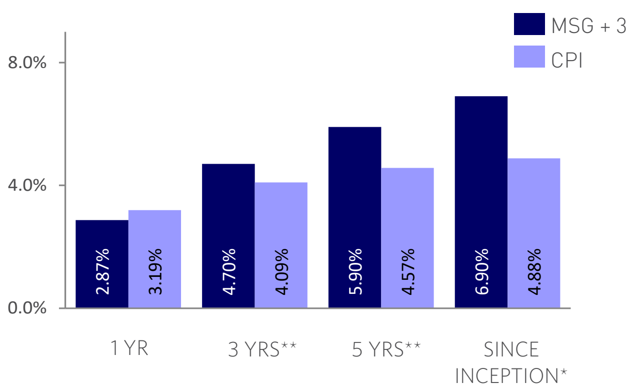
The total bonus* for the past quarter on the Smart Guarantee + 3 Fund is shown below.



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



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



CPI figures are lagged by two months

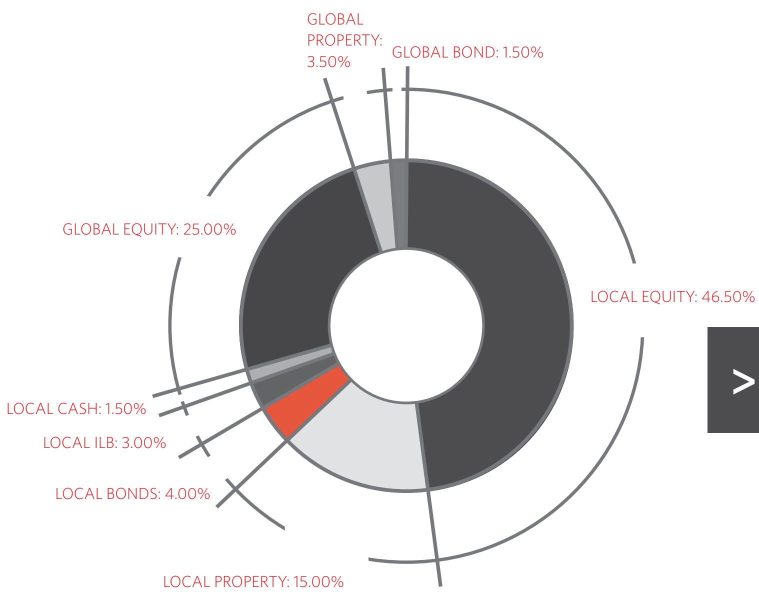
1 year performance is at 30 September 2016

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

** Annualised

Asset Allocation

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



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

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

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

MSG +3: Bonuses to be declared

Given that the monthly bonuses are based on the weighted average of the previous 36 months' returns of the bonus generating portfolio, it is possible to calculate the future bonuses that will be declared under various future investment return assumptions. We previously provided estimates of the bonuses to be declared assuming zero returns over the next 34 months (since there is a two month lag). The bonus generating portfolio however suffered negative returns during the first quarter of 2020 as a result of the Covid-19 pandemic, which led to a drastic fall in the funding level. Although the bonus generating portfolio and funding level have somewhat recovered since the lows experienced during the first quarter, further recovery from current levels is required before bonuses above the minimum level can be declared

Fully Vesting Smooth Bonus Range

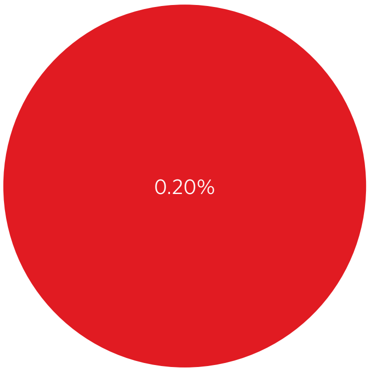
Multi-Manager Secure Growth Fund

Fund Snap Shot

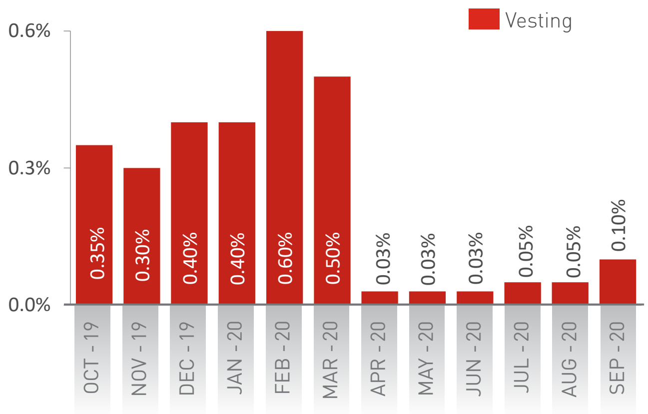
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	97.5% - 102.5%	R91m	0.76%	1.07%

Performance

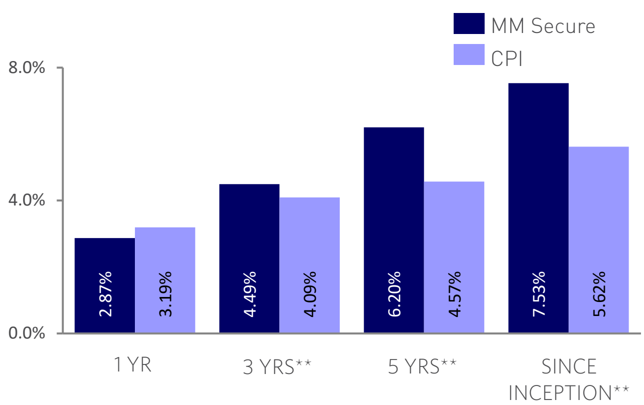
The total bonus* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



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



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



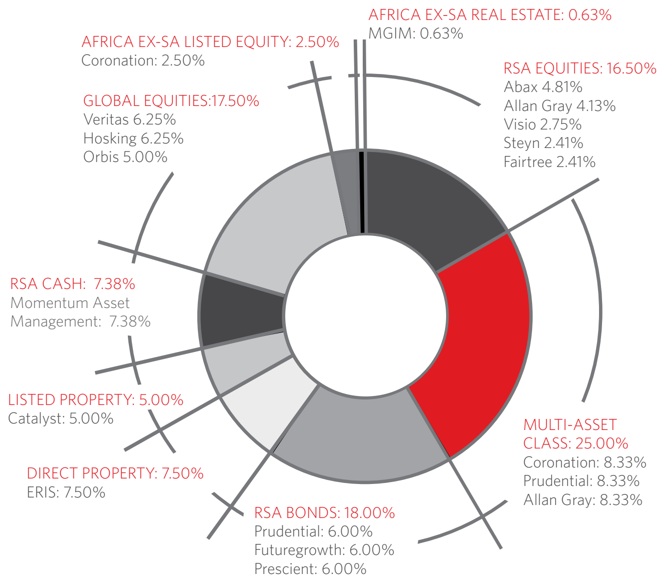
CPI figures are lagged by two months

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

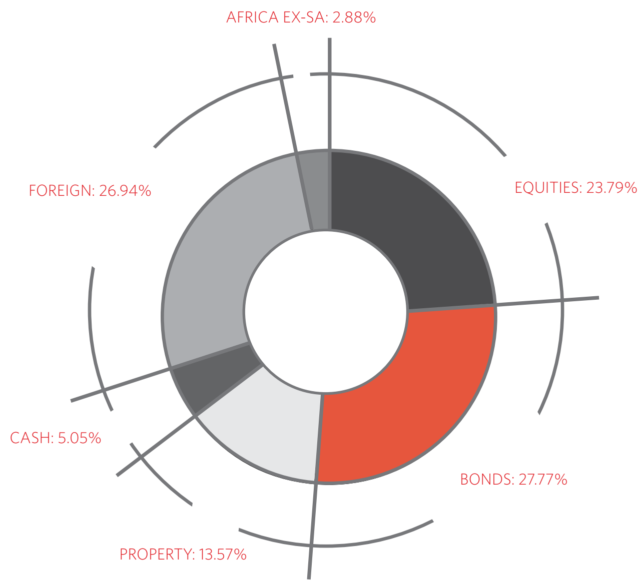
** Annualised

Asset Allocation

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



The effective asset allocation of the portfolio is shown alongside.



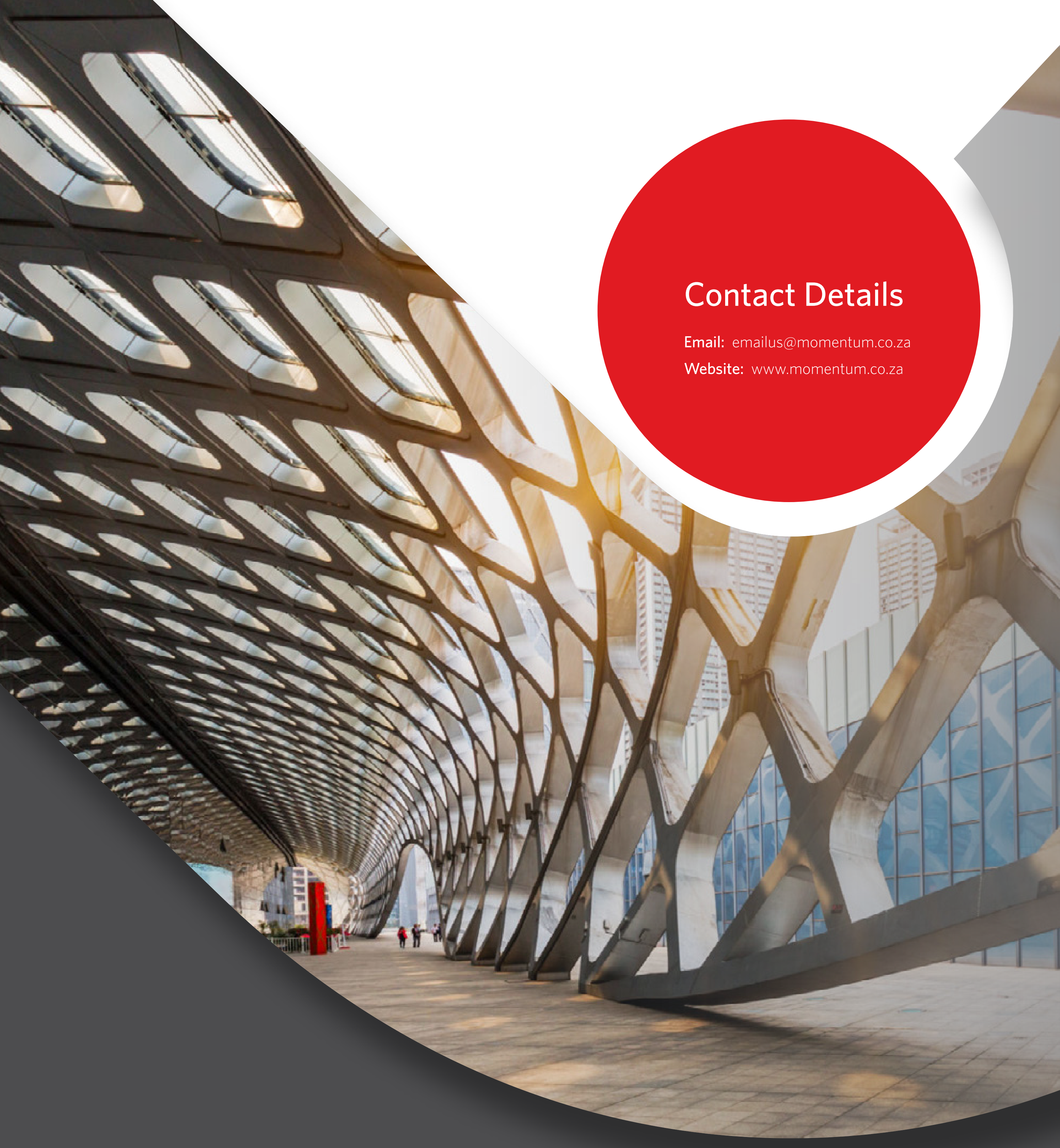
Smooth Bonus Portfolios Key Features

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 underly- ing asset charges over a 5 year time horizon	Multi-Manager	Moderate Balanced	100% of net capital invested and vested bonus declared (net of the Policy fee)	Yes	0.90% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	January 2004
	Universal Multi-Manager Smooth Growth Fund								June 2020
	Multi-Manager Smooth Growth Fund Local	CPI + 4% pa, net of the policy fee and underly- ing asset charges over a 5 year time horizon	Multi-Manager	Moderate Balanced	100% of net capital invested and vested bonus declared (net of the Policy fee)	Yes	0.90% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	January 2004
	Smooth Growth Fund Global	CPI + 4% pa, net of the investment management fee and underlying asset charges over a rolling 6 year period	Momentum Investments	Moderate Balanced	100% of capital invested and vested bonus declared (net of the investment management fee)	Yes	0.90% pa	0.45% of the first R10m, 0.35% of the next R40m, 0.25% of the excess above R50m[3]*	January 1989
	Universal Smooth Growth Fund								June 2020
	Smooth-Edge Fund	CPI + 4% pa, net of the investment management fee and underlying asset charges over a rolling 5 year period	Momentum Investments	Moderate Balanced	100% of net capital invested and vested bonus declared (net of the Investment management fee)	Yes	0.60% pa	0.25% pa[3]*	February 2019
	Universal Smooth-Edge Fund								June 2020
Fully Vesting	Multi-Manager Se- cure Growth Fund	CPI + 2% pa, net of the policy fee and underlying asset charges over a 5 year time horizon	Multi-Manager	Moderate Conservative Balanced	100% of net capital invested and total bonus declared (net of the Policy fee)	Yes	1.40% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	November 2007
	Smart Guarantee +3 Fund	CPI + 3% pa, net of theinvestment management fee and underlying asset charges over a 7 year time horizon	Insurer Liability Driven Investment	Moderate Conservative Balanced	100% of net capital invested and total bonus declared (net of the Investment management fee	Yes	0.50% pa	0.75% pa[3]*	October 2013

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

KEY:

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



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