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

Smoothed Bonus Report

Third Quarter 2022

momentum
corporate

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Looking back over the **past quarter**

Dear valued investors

Steed Duncan-Smith

Client Relationship Manager
Momentum Corporate

Global monetary policy tightening, recessionary fears, rising inflation, Russia-Ukraine War, and China's COVID zero policy have been exacerbated including an escalation in global energy prices with Europe scrambling to find new sources of energy supply. Fortunately, the lifting of the blockade on Ukrainian grain will assist in alleviating some of the global food shortages.

Both Italy and the United Kingdom now have new leadership. In Italy, Gergia Meloni is the new Italian Prime Minister after her far right-wing coalition won the general election. In the United Kingdom, Liz Truss won a Conservative leadership contest to become the Prime Minister. Then her newly appointed Chancellor of the Exchequer (Finance Minister), Kwasi Kwarteng, swiftly announced a radical package of unfunded tax cuts. The United Kingdom's bond and equity markets did not react well to the new fiscal package (which included an unprecedent energy support bill intended to manage the rising cost of energy) and just 44 days later Liz Truss was forced to resign. After what has been described as a circus and a short leadership contest, on the 25th of October 2022, Rishi Sunak was sworn in as the next Prime Minister of the United Kingdom.

Over the quarter, the MSCI All Countries equity market index returned 1,90% with developed markets (MSCI World) up 2,90% and emerging markets (MSCI Emerging Markets) down -4,46%. The South African equity market followed emerging market declines, with local equities (FTSE/JSE All-Share Index) down 1,92%. Local equity markets were driven by falls in financials (FTSE/JSE Financials) down 4,22%, Industrials (FTSE/JSE Industrials) holding up stronger although still down 1,27% and resources (FTSE/JSE Resources) down 0,32%.

The South African Reserve Bank (SARB) continued its path towards interest rate normalisation. A second 75 basis point increase in a row leaves interest rates at 6,25% and continued inflationary pressures mean that more increases are expected.

Herman van Papendorp and Sanisha Packirisamy 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 bonus rates declared over the last year to September 2022 have improved considerably from previous years. However, returns in growth asset classes (equities and property) have declined for a second quarter in a row. This has put strain on our funding levels and where underfunded the focus is now to restore them to fully funded positions.

Whilst markets are generally expected to have a degree of volatility, we have however seen a material increase in this level over the last few years and it is expected to persist. This is where our smoothed bonus portfolios come into their own as they result in a steady bonus rate pattern with far less fluctuations than investors would otherwise experience. With the Momentum Corporate smoothed bonus range, there is further comfort provided by the capital guarantees.

Momentum recently launched the Universal Fifty Smooth Return (UFSRF) Fund. The UFSRF is a smoothed bonus portfolio where the focus is more on the smoothing of returns than the 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

Contents

Stagflation and the benefits of smoothed bonus portfolios in such an environment

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Introduction

Stagflation, a period where slow economic growth and high unemployment rates coincide with high levels of inflation, is a concept that was largely unknown until the 1970s. The reason for this was that most economists believed that unemployment and inflation were inversely correlated, which stems from the assumption that since an increase in demand for goods and services will drive up prices (high inflation), it would also encourage businesses to hire more employees thereby lowering the unemployment rate.

The cause of stagflation is widely debated, with many economists believing that rising oil prices are a key contributor. As the price of oil rises, the cost of goods rise. However, as the rise is not strictly due to an increase in demand, it does not necessarily mean that businesses will employ more people. As a matter of fact, it may have exactly the opposite effect, where the increase in the price of goods makes certain products unaffordable, which drives down demand and could lead to companies laying off employees resulting in high unemployment rates.

Other causes of stagflation that have received airtime include poor economic policies. The regulation of goods and/or labour, for example implementing price fixes on certain goods and wage ceilings can help control prices in the short term, but once these controls are relaxed, it opens up the risk of a rapid increase in prices, leading to unusually high levels of inflation.

These theories are largely based on what transpired in the world economy during the 1970s, when stagflation was 'discovered'. During this period frequent recessions drove up unemployment rates and crude oil prices nearly tripled due to the Organisation of Arab Petroleum Exporting Countries' oil embargo, when oil shipments from the middle East to several Western countries as well as South Africa were ceased. To add to this, government budget deficits were at an all-time high due to military spending on several wars and programmes to eliminate poverty.

Although the cause of stagflation remains uncertain, it is commonly agreed that a stagflationary environment will be accompanied by economic volatility and poor investment returns.

Is the world heading towards another period of stagflation?

The war between Russia and Ukraine has been a major contributor in driving up crude oil prices, as Russia is the third biggest producer of gas and oil in the world. With the planet still recovering from the COVID-19 pandemic, the conflict has compounded the slowdown in the global economy. The International Monetary Fund (IMF) has reported that global growth is expected to slump from 6% in 2021 to 3.2% in 2022 and 2.7% in 2023. Conversely, global inflation is forecast to rise from 4.7% in 2021 to a staggering 8.8% in 2022, although it is expected to decline to 6.5% again in 2023.

According to the Department of Statistics South Africa (Stats SA), the headline inflation rate for South Africa reached its highest level of 7.8% in 13 years in July 2022. Even though this has slowed down towards the end of the quarter, it is still much higher than the targeted level of 3% to 6% per annum. The unemployment rate in South Africa stood at 33.9% at the end of June 2022. The youth unemployment rate paints an even more dire picture, as it is currently sitting at 46.5%.

The current economic situation is similar to what transpired in the 1970s in a few key aspects, particularly persistent supply-side disturbances fuelling inflation. For example, the rise in crude oil prices is eerily similar to the price jump in 2022. Another similarity is the prospect for weakening growth in both periods. This can be seen above with the almost 3% drop in economic growth in the last year. In both situations emerging markets also faced vulnerabilities such as the tightening of monetary policy to rein in inflation.

However, the current situation also differs from the 1970s in various ways, for instance the strong dollar is a sharp contrast to its severe weakness, the increases in commodity prices are smaller than they were in the 1970s, central banks across the globe now have clear mandates for price stability and global inflation is expected to moderate next year, although it will likely remain above inflation targets in many economies.

It is therefore uncertain whether the world is entering a period of stagflation, as even economists are divided on the matter. One thing is, however, certain: the world is much closer to a period of stagflation than it has been in the recent past. Whether it happens, remains to be seen. But investors will have to acknowledge the risk and take investment decisions to guard against the current period of high volatility and uncertainty in the world economy, as well as the possibility of stagflation.

The benefits of smoothed bonus portfolios

Smoothed bonus portfolios have until recently only been viewed as viable options for conservative investors or investors who are close to retirement. However, the benefits offered by smoothed bonus products are very attractive in the current economic circumstances and will become even more so should there be a period of stagflation. Smoothed bonus portfolios provide stable returns and guarantees on policyholder's investments while protecting the policyholder against market volatility via a smoothing of returns process.

Investors investing in a 100% capital-protected smoothed bonus portfolio receive a guaranteed return of their net capital invested plus net vested bonuses added at the date of a policy benefit event (for example, death, disability, resignation, retirement, etc.). Having a guaranteed return of capital (0% return guarantee) could seem trivial in some circumstances, but in the current economic turmoil combined with a potential period of stagflation looming, such a guarantee is like gold dust.

A smoothed bonus portfolio will be expected to achieve higher returns when compared to investing in a unit-linked product or directly in the market during a period of stagflation, due to the guarantees offered on smoothed bonus portfolios. The reason for this is that the concept underlying a smoothed bonus portfolio implies a smoothed return which is when a portion of the underlying returns will be held back during strong positive performance in the market and used to boost investment returns during periods where returns are low, known as market contraction.

Stagflation is most definitely a period of market contraction and policyholders will thus benefit from smoothed returns during years of minimal economic growth. This is compared to a direct investment in the market, where the policyholder will have no such benefits and will be subject to the same fall that the market experiences.

Conclusion

Whether we are in for a repeat of the 1970's stagflation period remains to be seen. However, with the current uncertainty in the market and poor worldwide economic outlook, smoothed bonus solutions are becoming more relevant for everyday investors. Protecting your investment against market volatility and generating stable returns in an unstable environment should be a key objective for any investor and at the moment a smoothed bonus portfolio is the ideal vehicle to do just that.

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

by Sanisha Packirisamy and Herman van Papendorp

Highlights

Markets

- An envisaged macro environment of peaking inflation, high wage growth and a slowing economy are problematic for future corporate sales, margins and profit growth and as such is not providing a favourable underlying fundamental backdrop for global equities.
- As quantitative easing (QE) was an important positive United States (US) equity return driver since the global financial crisis (GFC), one should expect that a period of quantitative tightening (QT) should at least have some negative implication for global equity returns in the coming years.
- For risky assets, it does matter whether the global economy experiences a recession or not. History has shown that equity drawdowns were much bigger (and of longer duration) in recessions than in non-recessionary slowdowns.
- Risky assets typically bottom during US recessions once they start discounting interest rate cuts, not before the start of recessions, hence indicating that it is unlikely that equity markets have already bottomed during the current bear market unless a recession can be avoided.
- As the risk for global recession rises, the defensiveness of US bonds and cash within a diversified portfolio becomes more attractive, while the relative valuation of US bonds to equities are now also fair to cheap versus history.
- Global property fundamentals remain solid, but global property yields are currently expensive versus investment-grade bonds, capping the return potential of the asset class.
- 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. We are approaching a period of low monthly inflation accruals which should become less supportive for inflation-linked bonds (ILBs). The prospective SA real cash yield has been rising from a low level in line with policy rate increases and is now only slightly below its historical average.
- The potential for meaningful SA listed property return upside from undervalued levels needs to be weighed against some remaining negative fundamental factors.

Economics

- Investors are concerned about inflation remaining stickier for longer, tighter global financial conditions and the potential for the world economy to enter a deep economic slumber on the back of tighter monetary policy.
- Inflation could prove to be stickier for longer in markets where the inflation genie has escaped the bottle. In the United Kingdom (UK) and US, inflation has become far more broad-based in nature and as such it may take longer for inflation to get back to 2% even after food and fuel price pressures have eased.
- As more favourable base effects kick in for food and energy inflation and as the transmission mechanism of higher interest rates begins to weigh on demand and weaken inflation, the US Federal Reserve (Fed) should pay more attention to the growth outlook and could begin easing interest rates even if inflation has not yet reached target.
- The cost-of-living crisis has reinforced inequality within countries and across regions and threatens to inflame social tensions. This has added an additional layer of concern in emerging markets (EM), especially those which are on the brink of a fiscal crisis.
- In SA, inflation pressure is mostly visible at a headline level. We expect headline inflation to decelerate from below 7% this year to around 5% next year. However, fears of inflation persistence could see the SA Reserve Bank (SARB) hiking interest rates by a further 50 basis points. We continue to view the forward-rate agreement (FRA) market as overly aggressive and see hikes to that extent as detrimental to growth.
- Growth in SA is set to slow to around 2% this year and decelerate further to around 1.5% next year on slowing growth in household consumption and exports, due to higher interest rates and softer growth globally.

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Elevated inflation, tighter monetary policy and growth fears weighed on financial markets

Central banks worldwide have adopted an aggressive approach to monetary policy to rein in soaring inflation. This sharp tightening in global financial conditions has triggered concerns over the health of the global economy. The Bloomberg median consensus expectation for a recession in the US in one year's time has climbed from 15% at the start of the year to 50% at the end of the third quarter. The probability for a recession in the UK has gone from 15% to 60% over this timeframe, while the risk for a recession in Germany ranks the highest at 77.5% from 17.5% at the start of the year.

Central banks' commitment to reining in inflation at the expense of growth has elicited investor panic, leading to a broad selloff in assets across the risk spectrum. According to Bloomberg, global equities and bonds have lost a record US$36 trillion for the first three quarters of the year. This marks a steeper decline than those experienced during the GFC and the COVID-19 pandemic. Bloomberg and the Bank of America Merrill Lynch attribute this to a significant withdrawal of liquidity in the global economy since August 2021. Since then, the globe has experienced a cumulative 294 interest rate hikes and US$3.1 trillion in quantitative tightening.

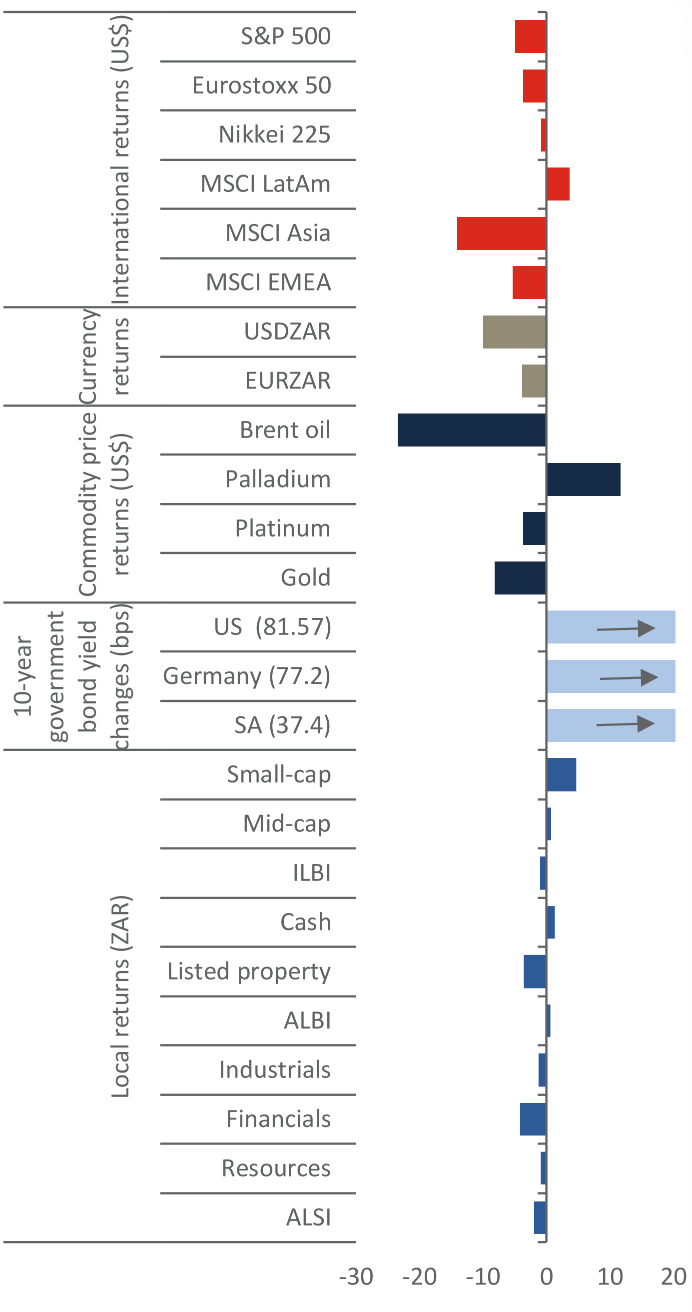
Although volatile conditions did not reflect a spike in the CBOE Volatility Index, or fear gauge, which only increased three points intra-quarter to 32 points at the end of September 2022, the Merrill Lynch Option Volatility Estimate (MOVE), which captures a yield curve-weighted index of the normalised implied volatility on one-month Treasury options, rose substantially from 84 points at the start of the year to 148 at the end of the third quarter. This is the highest level of volatility captured since the onset of the pandemic. With the VIX remaining below levels observed during past bear market cycles, there is concern among investors that equity markets have not yet fully priced in the risk of a global recession.

Global equities dipped 6.1% in the third quarter, dragged lower by EMs and developed markets (DMs). The MSCI EM Index sank 11.8% in the quarter, driven weaker by Asian markets while equity markets in Latin America ended the quarter in the black. The MSCI Asia Index crashed 14.2% during the quarter as COVID-19-related lockdowns continued to hamper China's economic recovery. This was followed by the MSCI Europe, Middle East and Africa Index (EMEA) which lost 5.6% over the same period. Meanwhile, the MSCI Latin America Index fared better and ended the quarter 2.2% higher.

In the DM composite, losses were largest for European equity markets but more limited for Japanese equities. The Eurostoxx 50 Index slid 4.4% in the third quarter of the year as a mounting energy crisis, higher interest rates and elevated inflation weighed on markets. Bloomberg calculates that European equity funds have seen outflows for 29 consecutive weeks marking investor pessimism. While European equity valuations have fallen below their long-term average, Bloomberg notes they have not yet reached the lows experienced during the previous crisis.

Over in the US, Bloomberg notes the performance in the S&P 500 Index for the first three quarters of the year registered as the third worst performance since 1931. The monthly drop in the S&P 500 Index was the worst since March 2020 and the 4.9% decline in the third quarter followed losses in both the first and second quarter of the year. The last time the S&P 500 Index experienced three consecutive quarterly declines was during the GFC.

Chart 1: Quarterly asset class returns (%)



Source: Iress, Momentum Investments

10-year government bond yield changes indicated in brackets

Japanese equities were down the least in the DM composite by 0.8% for the third quarter of the year. Although a weaker yen has boosted shares of exporting companies in the past, this time around offshoring and rising import costs have been damaging for smaller manufacturers and they have not been in a strong enough position to fully pass on cost increases.

The New York Times reported that this year, so far, has been the most devastating period for global bonds since 1926. The yield on the US 10-year government bond rose by an additional 82 points in the third quarter to 3.8% as investors speculated over more aggressive action by the Fed to quell soaring inflation. The German 10-year government bond yield also increased over this period by 77 basis points to 2.1%. UK gilts experienced huge losses in the final week of the quarter forcing the Bank of England to intervene by purchasing long-term government bonds.

Alongside rising risk aversion, the JP Morgan EM Bond Index (EMBI) spread experienced an uptick of eight points and ended September 2022 at 467 points. Bulgaria experienced the largest quarterly widening in credit default swap (CDS) spreads of 147 points as the nation faces its fourth political vote in 18 months. Rising energy costs and different views towards Russia have led to a fragmentation in the Bulgarian political landscape. Chile (50 points), Hungary (43) and Thailand (40) followed Bulgaria with the largest deterioration in CDS spreads, while the CDS spread in Argentina experienced an improvement of 59 points.

The local equity market fared better than its global counterparts but still lost 1.9% over the quarter. Losses were driven by the FTSE/JSE Financials Index which closed the quarter 4.2% weaker. The FTSE/JSE Resources Index edged 0.9% lower in the same period largely in line with a sideways movement in the Bloomberg Commodity Index. The international price of gold fell 8.1% in the quarter, followed by a 3.6% fall in the international price of platinum. Palladium prices, on the other hand, shot up 11.7% in the quarter. Despite Russia's Nord Stream pipeline being offline and notwithstanding production cuts from the globe's largest suppliers of oil, softer global energy demand and growing recession fears drove a 23.4% drop in Brent crude oil prices in the third quarter of the year.

The FTSE/JSE Industrials Index performed well into the first half of September 2022, but the index shed 8.8% in the second half of the month, leaving the quarterly performance down at 1.3%.

The FTSE/JSE Mid-cap index ended the quarter 0.7% higher while small-cap equities powered ahead at 4.7%.

The Financial Times calculated a record outflow of US$70 billion from EM bond funds for the first three quarters of the year in line with slowing growth and reduced appetite for risk. Only seven weeks in the year, so far, have recorded net inflows. In SA's fixed income markets, the 10-year government bond yield sold off 37 basis points. The JSE Assa All Bond Index gained 0.6% in the quarter, while the JSE Assa Government ILB Index retraced 1% in the same period.

The FTSE/JSE SA Listed Property Index slumped a further 3.5% in the third quarter of the year, reflecting increased concerns over slower growth against the backdrop of higher inflation and the expectation of additional monetary policy tightening.

EM currencies tumbled during the quarter in response to rising risk aversion. The rand was the third-worst performing currency from its EM peer group in the third quarter of the year, losing 10% against the US dollar and 3.8% against the euro. The Hungarian forint (depreciation of 9.8% against the US dollar) and South Korean won (8.7% weaker) were among the worst-performing currencies against the US dollar in the quarter.

SA's 10-year CDS spread drifted 40 points higher in the quarter and ended the second quarter at 430 points.

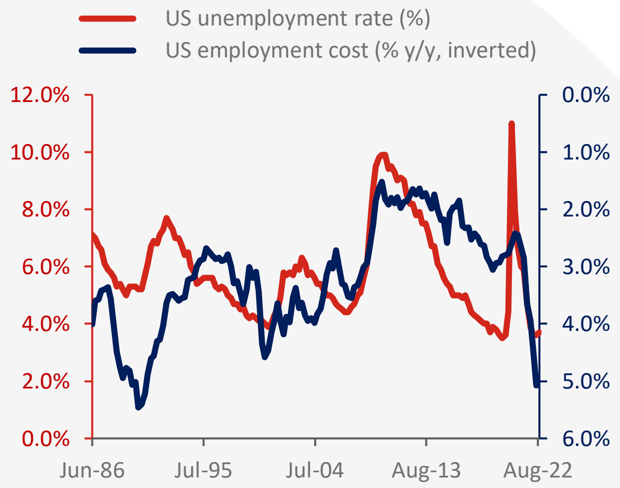
Financial markets grappling with uncertainties about rate rises and growth slowdown

Global central banks have been constantly confirming that they remain steadfast in their determination to fight multi-decade-high inflation levels through tighter monetary policy, with the short-term negative implications of policy actions for economic growth currently of secondary concern. Until inflation has shown a clear downtrend, it thus seems likely that higher global interest rates and a transition from QE to QT will remain the order of the day.

Even for the US, which looks to be at the forefront of the inflation cycle and likely past the peak of headline inflation, a pivot to interest rate cuts still looks some way off. Meaningfully lower global inflation most likely will need much lower wage growth around the world (and as such a rising unemployment rate) to eradicate some of the tightness in labour markets and the prevailing strong pricing power of labour (see chart 2).

Such an envisaged macro environment of peaking inflation (albeit currently only in the US as yet), high wage growth and a slowing economy is problematic for future corporate sales, margins and profit growth and as such is not providing a favourable underlying fundamental backdrop for global equities. However, although the leading macro signals suggest a deceleration in earnings growth over the coming months, consensus downward earnings revisions have barely begun, pointing to potential downside risk for profit expectations in the pipeline.

Chart 2: Higher unemployment needed to quell wage growth



Source: IRESS, Momentum Investments

Earlier this year, chairman of the Fed Jerome Powell suggested that QT would go on for two to two and a half years, implying that the Fed's US$9 trillion balance sheet would shrink by roughly US$2.5 trillion during this period. According to calculations by Société Générale, this would be equivalent to 300 basis points of Fed tightening. We have shown in previous reports that QE was an important positive US equity return driver since the GFC, explaining around 39% of US equity returns. As such, reverse logic would suggest that QT should at least have some negative implication for global equity returns in the coming years.

While it looks reasonably certain that the global economy will experience a slowdown in the next year on the back of tighter monetary policy and the negative discretionary spending impact of high inflation, the extent of the decline is still very much unclear. For risky assets, like equities, it does matter whether the global economy experiences a recession or not. History has shown that equity drawdowns were much bigger (and of longer duration) in recessions than in non-recessionary slowdowns (see table 1).

Table 1: Equity drawdowns larger and longer in recessions

Historical performance of global equity corrections (peak to trough, % decline)

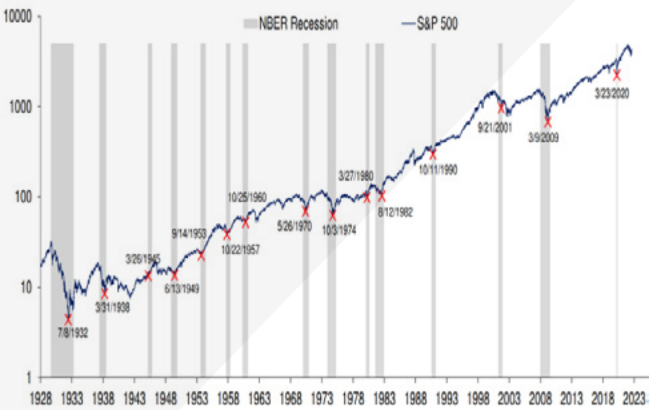
	Mean decline	Median decline	Days
All periods	-19%	-12%	220
Non recessions	-13%	-11%	101
Recessions	-36%	-33%	418

Source: MRB Partners

Furthermore, risky assets typically bottom during US recessions once they start discounting rate cuts, not before the start of recessions (see chart 3), hence indicating that it is unlikely that equity markets have already bottomed during the current bear market unless a recession can be avoided.

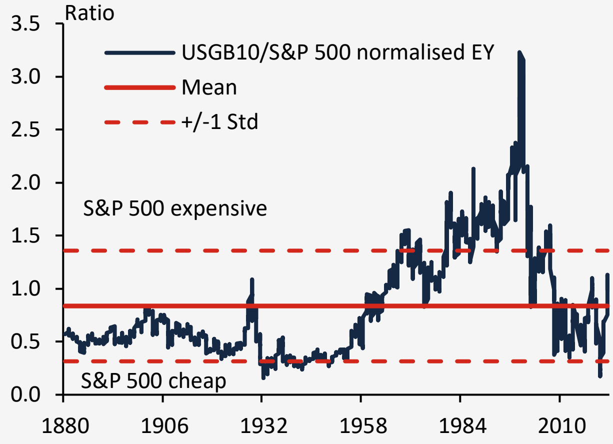
Although global bond valuations remain expensive in absolute terms, the relative valuation of US bonds to equities are now fair to cheap versus history (see chart 4). Furthermore, as the risk for global recession rises, the defensiveness of US bonds and cash within a diversified portfolio becomes more attractive. Global cash exposure in a rising interest rate environment is also becoming a lot more interesting and is starting to provide a viable alternative to global equities and bonds in the current environment.

Chart 3: US equity market typically only bottoms during recessions, not before



Source: Deutsche Bank

Chart 4: US bonds now cheap versus equities on a normalised earnings yield gap basis



Source: IRESS, Momentum Investments
Data up to August 2022

Global property fundamentals remain solid, with strong US rental growth across sectors outside Office, US vacancy rates outside Office around 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. Added attractions are that US property historically provided inflation protection to portfolios, outperforming equities during higher inflation periods, while also providing diversification benefits to a multi-asset portfolio. However, the global property yield is currently expensive versus investment-grade bonds, with the yield spread below its historical average, capping the return potential of the asset class.

There is possible downside risk to SA corporate earnings from recent lower commodity prices and rising domestic interest rates. However, even assuming a conservative below-consensus 6% earnings growth in the next year, the SA equity market now trades more than one standard deviation below its average since 1999 (see chart 5). SA equity valuations also 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 with conservative earnings and rating assumptions from current cheap valuations, SA equities show good forward return prospects across our envisaged scenarios.

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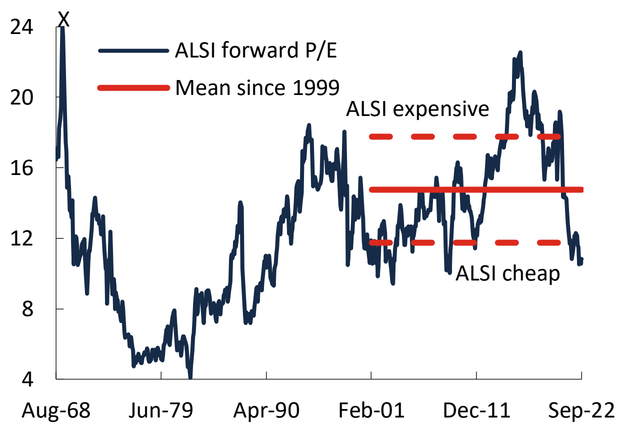
Chart 5: SA equity market forward P/E



Source: IRESS, Momentum Investments

Chart 6: SA real bond yield

Source: IRESS, Momentum Investments

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 6). We are approaching a period of low monthly inflation accruals which should become less supportive for ILBs. Break-even tightening can be expected with inflation falling in the coming year. The prospective SA real cash yield has been rising from a low level in line with policy rate increases and is now only slightly below its historical average. Cash has been the most expensive asset class versus bonds and equities since the aggressive policy rate cuts in 2020.

There has been some operational SA listed property sector improvement outside the Office sub-sector, with vacancy rates and rental reversions generally improving. But metrics are still worse than in 2019 and reversions are still predominantly negative. Higher interest costs are also a financial worry in a rising policy rate environment. At least it seems as if property values have stabilised outside the Office sector, with some companies even experiencing rising valuations. From a portfolio construction perspective, the potential for meaningful listed property return upside from undervalued levels needs to be weighed against some remaining negative fundamental factors.

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, the current spot gold price looks around 40% too high. Tactically, gold is thus not an attractive asset class now.

Overlapping crises sets back global growth

The COVID-19 pandemic and Russia's invasion of Ukraine are no longer viewed as the most serious threats facing global financial markets. Investors are now worried about high inflation remaining stickier for longer, tighter global financial conditions and the potential for the world economy to enter a deep economic slumber on the back of less accommodative fiscal and monetary policies.

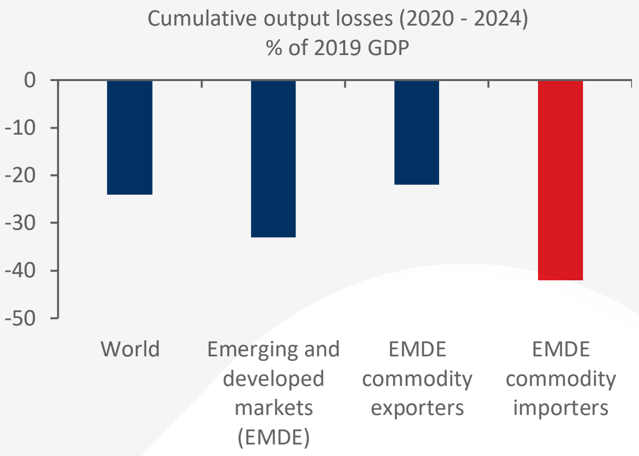
Although investors according to Bank of America Merrill Lynch's Global Fund Manager Survey see the war in Ukraine as posing a smaller tail risk to markets, with peace remaining a distant prospect, the globe may have to live with a prolonged standoff between these two countries. Despite an attempt by the West to choke off Russian oil supply, Russia's energy revenues continue to be buoyed by surging demand from Asia. With oil revenues continuing to bankroll Russian President Vladimir Putin's invasion of Ukraine, there is no apparent immediate financial pressure on Russia to wind down its military campaign.

A winter of discontent looms ahead for Europe as the Kremlin, in retaliation for being slapped with sanctions, continues to steadily cut off gas supply, critical for heating homes and generating electricity across Europe. Although gas-intensive sectors account for only 6% of European gross domestic product (GDP), turning off the gas taps threatens to throw an already fragile European economy into a deeper slump next year given the knock-on effects of a gas shortage. While the hit to economic activity will be affected by the final passthrough to consumers, any offsetting behavioural response from consumers, potential subsidies from government, the availability of LNG or other energy alternatives and the intensity of winter, recessionary conditions are likely to strike Europe next year.

The Russia-Ukraine war has likely ushered in an era of higher geopolitical instability. Tensions between China and Taiwan have recently soared since US House Speaker Nancy Pelosi visited the island in August. Recent missile launches by Mainland China in the Strait of Taiwan threatens to provoke the long-standing conflict over Taiwan's sovereignty. While the Pentagon suggests that the risk of an invasion of Taiwan by Beijing remains low in the next two years, increased efforts to intimidate Taiwan raises the risk of Beijing forcing a functional reunification of Taiwan with China. Although Taiwan's economy accounts for less than 1% of global GDP, Taiwan is responsible for producing 92% of the world's advanced semiconductors, which are an essential component of electronic devices. As such, conflict compromising trade through the Strait of Taiwan could raise volatility, add another leg to already-high inflation, dent growth and complicate monetary policy decision making even further.

Russia's invasion of Ukraine has hastened the deceleration in global growth. Commodity price volatility, additional disruptions to global trade, tighter financing conditions and softening external demand have set the world economy on a weaker growth path. According to the World Bank, cumulative global output losses between 2020 and 2024 are expected to near 25% of the level of GDP in 2019 relative to a scenario under which the globe had not been derailed from its growth path between 2010 and 2019 (see chart 7). Cumulative output losses are likely to be as large as 40% for net commodity importing nations which have faced high food and energy prices amid global supply chain disruptions.

Chart 7: Global growth set to be markedly weaker



Source: World Bank, Momentum Investments

The crocodile jaws between growth and inflation have continued to widen. While growth forecasts have been marked lower across the globe, inflation forecasts have ratcheted higher. In our view, high inflation has been a symptom of both demand and supply-led factors. High and rising inflation was a problem even before Russia invaded Ukraine. Tangled global supply chains in the wake of the COVID-19 pandemic initially drove prices higher, globally. But this was later provoked by the extraordinary demand for goods in 2021 as countries emerged from lockdowns, allowing consumers to leave their homes and buy goods with the money they saved up during weeks of economic inactivity. But, just as demand-driven inflation began to fade and as global supply chain bottlenecks started to ease, the Ukraine crisis created new strains. The Russia-Ukraine war has left the world facing extended reductions to energy supply, severe sanctions that are likely to impact food security and the inaccessibility of rare metals, that are necessary in the production of key technologies.

More stubborn and persistent inflation than initially thought possible has dominated policy discussions. Fortunately, there are tentative signs of inflation topping out. While in previous decades, wages were highly sensitive to past inflation due to the popularity of centralised bargaining and coordinated wage setting arrangements, these trends have lessened significantly and should limit the possibility of an entrenched wage-price spiral. Secondly, measures of supply chain disruptions are showing fewer capacity constraints which should lower supply-side pressures. And thirdly, excess personal savings driven up by government stimulus in the aftermath of the pandemic, have largely dried up, providing less support to demand-led inflation.

Nevertheless, inflation could prove to be stickier for longer in markets where the inflation genie has escaped the bottle. In the UK and US, inflation has become far more broad-based in nature and as such it may take longer for inflation to get back to central banks' targets even after food and fuel price pressures have lessened. Meanwhile, Europe's energy crisis is likely to continue to have an inflationary impact in the coming quarters. The Bloomberg median consensus expectation for average annual inflation in the US, Eurozone and UK remains above the central bank target of 2%, even in 2024.

Central banks have embraced large interest rate rises to douse the flames of inflation. According to the Financial Times, central banks are engaged in the biggest number of large interest rate moves at any time since the turn of the century, including the GFC. Yet, monetary policy remains accommodative in some countries. The Bank for International Settlements shows that real policy rates are still negative for a range of advanced and emerging economies and are far lower than any point in the last three decades. As such, we believe more interest rate hikes are coming in the near term.

While, for now, central banks' attention is squarely focused on inflation, which remains significantly above target, a year from now, the focus of central banks may shift from inflation to growth. As more favourable base effects kick in for food and energy inflation and as the transmission mechanism of higher interest rates begins to weigh on demand and weaken inflation, central banks, such as the Fed, may shift their focus to the growth outlook and may be pushed to ease interest rates even if inflation has not yet reached target. We believe that healthy household and corporate balance sheets, manageable risks in the financial sector and a more credible Fed will cushion the blow to GDP and as such, we think the risks to a deep, protracted recession in the US are limited.

Arguably, recession risks are higher for the Eurozone. Akin to the sovereign debt crisis that played out in the Eurozone between 2009 and 2012, lenders in European financial markets are questioning the fiscal sustainability of select member states and have started demanding higher risk premia. Public finances are in a worse state today than at the peak of the previous sovereign debt crisis. The COVID-19 pandemic left lasting fiscal scars but Russia's invasion of Ukraine has added to the Eurozone's fiscal woes. Decisions regarding sanctions, defense, refugee reception and alternatives to Russian energy could prove expensive. In particular, the burden on bank balance sheets will be greater in countries that face more demanding reforms.

Keeping inflation at bay will require a tightening in monetary policy which will raise borrowing costs. And together with declining growth, this could negatively affect sovereign debt sustainability in member countries, such as Italy and other southern European debt nations. As such, the European Central Bank walks a fine line between supporting bond markets and gradually withdrawing monetary accommodation to fight inflation.

With the interest rate differential likely to decline between the US and the Eurozone in 2023 and 2024, we could see capital flows reversing out of safe-haven US assets into perceived riskier markets and this could prompt US dollar weakness.

The International Monetary Fund warns that higher-than-expected inflation adds to the cost-of-living crisis. The resurgence in inflation has reinforced inequality within countries and across regions and threatens to inflame social tensions. Analysts have warned that a more robust policy response from major central banks would be bad news for EMs in the short run. As funding costs rise, so does the risk of a debt crisis. But at the same time, delaying tighter policy would lead to more draconian actions down the line resulting in a larger economic cost.

Parts of Asia have defied the global surge in inflation despite suffering the same jump in commodity prices. Governments' management of the pandemic prevented dramatic swings in consumption from services to goods and back again. Less severe swings in demand meant less pressure for supply to respond. Moreover, Asia is still the manufacturing hub of the world, which means they suffered less disruption to supply. Japan has bucked the global wave of monetary tightening in a show of resolve to support a pedestrian economic recovery in spite of rapid falls in the yen. Similarly, without immediate inflation to worry about, the People's Bank of China can nurse the nascent economic recovery as tight lockdown restrictions begin to ease. An expected growth recovery in China from around 3% this year to around 5% next year should provide an additional support factor for net commodity exporting currencies, including the rand, alongside potential US dollar weakness.

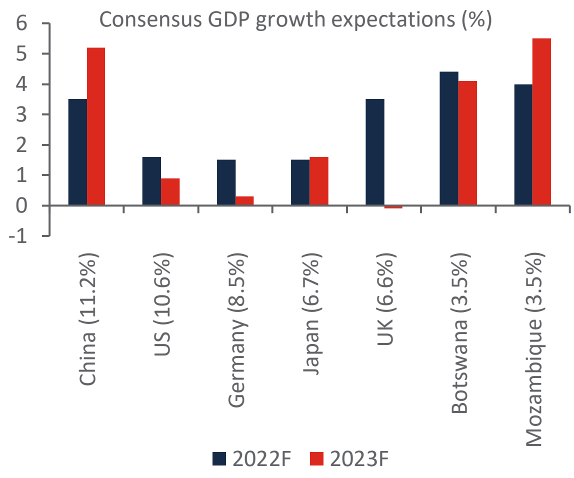
Bringing it back home, the SARB is expected to continue frontloading interest rate hikes. Although inflationary pressures are mostly visible at a headline level at this stage, the SARB worries that inflation persistence is setting in. Our own headline inflation forecasts of below 7% this year but closer to 5% for next year and a more moderate expected outcome on core inflation suggest that the interest rate view expressed by the FRA market is overly aggressive (240 basis points over the next twelve months relative to our own assumption of a further 50 basis points) and would jeopardise already pedestrian growth.

Growth in SA is set to slow to around 2% this year and decelerate further to around 1.5% next year after rebounding strongly in 2021. The post-pandemic recovery has not been broad-based and many industries outside of services are still lagging. Moreover, employment gains have been more muted relative to the improvement in economic activity since the pandemic.

Akin to 2021, household spending is likely to be the primary driver of economic activity this year. However, declining asset prices, depressed sentiment, high inflation and further interest rate hikes could drive weakness in household consumption next year. Morgan Stanley notes that projects in the energy, water, mining and logistic sectors are likely to underpin growth in fixed investment next year. Nevertheless, fixed investment is unlikely to provide major support to growth this year given that nearly 80% of manufacturers in SA believe that an uncertain political climate is hindering investment prospects. Unreliable power supply will further dampen a more broad-based recovery in fixed investment, in our view. In addition, many of SA's major export partners outside of China are likely to experience softer demand next year (see chart 8).

Although the February national budget edged us in the right direction, there is still much work to be done to restore SA's fiscal position and place the country on a sustainable debt path. In our view, higher growth is necessary to achieve this. Without higher structural growth, large unmet needs in social spending, defunct municipalities and unstable state-owned enterprises will weigh heavily on longer-term fiscal outcomes. Worryingly, endemic corruption has further eroded service delivery and socio-economic development.

Chart 8: Weaker growth expected in SA's trading partners



Source: Bloomberg, Momentum Investments
(% in brackets indicate contribution to SA exports)

The global Financial Action Task Force (FATF) has noted structural deficiencies in SA's ability investigate and prosecute financial crimes given the extent of deterioration in SA's criminal justice system following the previous administration's subversion of democracy leaving the tax authority, intelligence agencies and crime-fighting and law enforcement agencies incapacitated. Aside from technical factors, the decision to greylist SA depends on the FATF's judgement of government's political willingness to achieve sufficient progress in addressing the concerns highlighted. Regardless of the outcome of the FATF's decision to greylist SA, we believe this warning should serve as a wake-up call for SA policymakers, regulators and law enforcement agencies to convince the country's international counterparts it is worth their effort to maintain relationships in the interim as SA continues to build a more robust legal and compliance framework to remain competitive on the global stage.

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

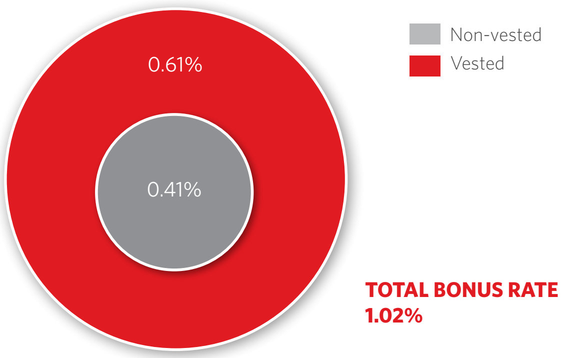
Fund Snap Shot

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%	R412.60m	0.93% [1]	5.50% [1]

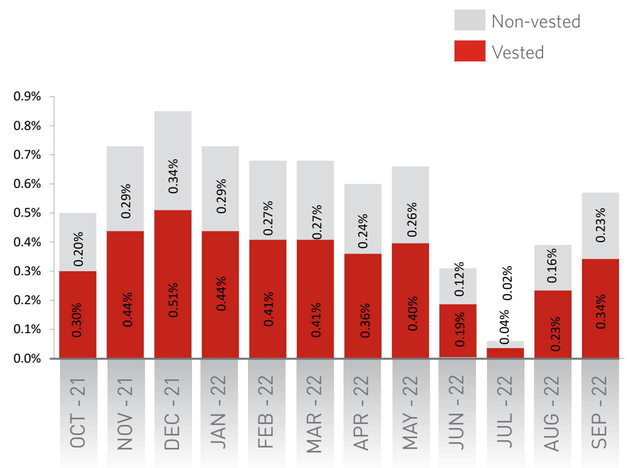
[1]Based on back-tested bonus rates and returns

Performance

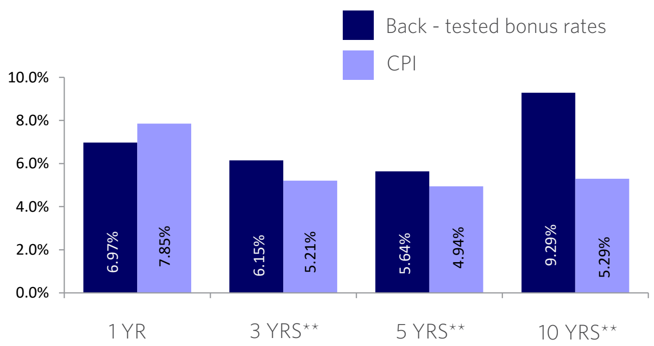
The total bonus rate* for the past quarter on the Universal Multi-Manager Smooth Growth Fund is shown below.



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



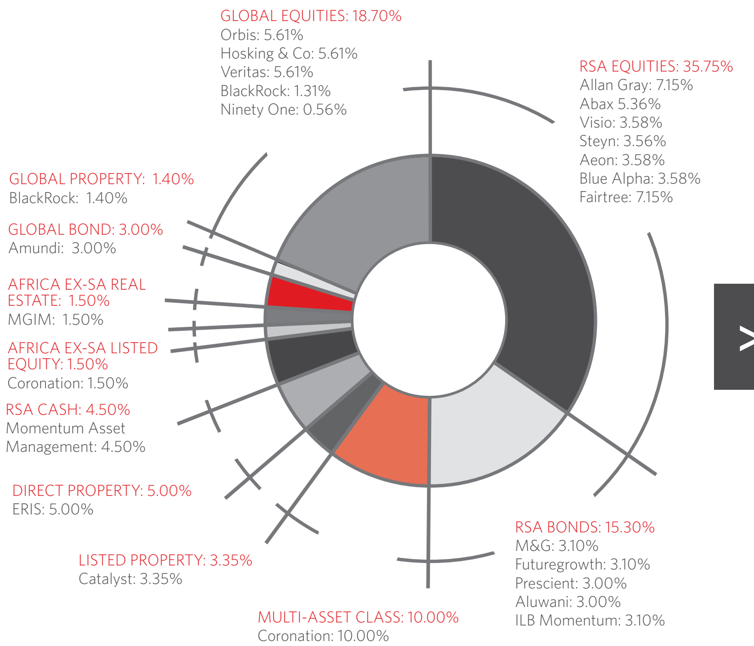
CPI figures are lagged by two months

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

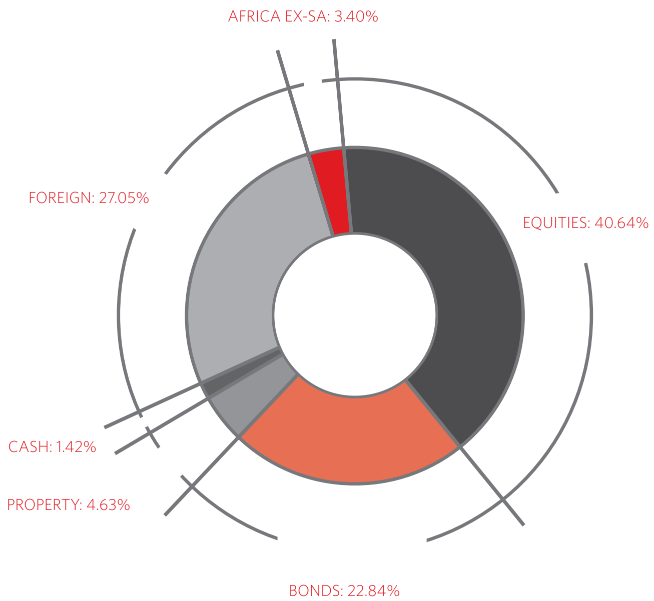
** Annualised

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

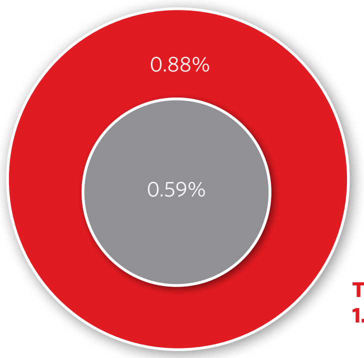
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	92.5% - 97.5%	R335.7m	1.10% [1]	4.35% [1]

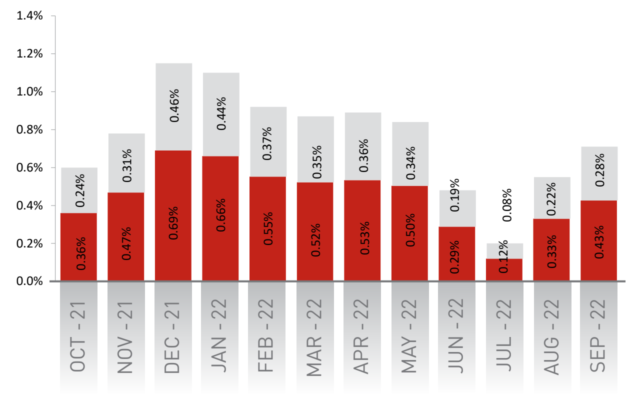
[1]Based on back-tested bonus rates and returns

Performance

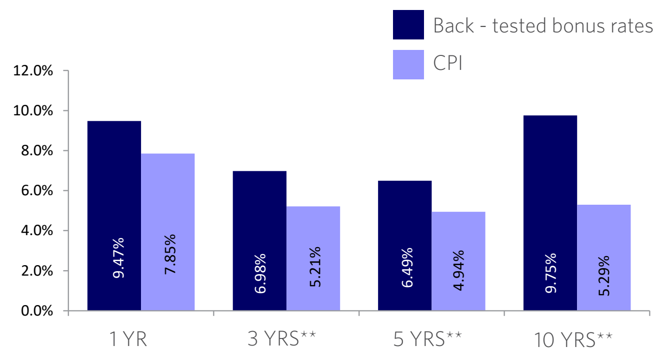
The total bonus rate* for the past quarter on the Universal Smooth Growth Fund is shown below.



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



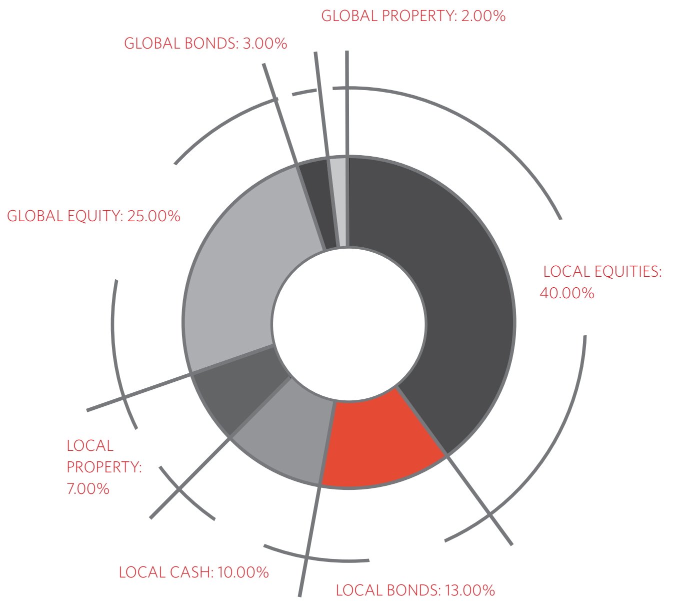
The chart below shows the long term bonus* performance of the Universal Smooth Growth Fund against CPI



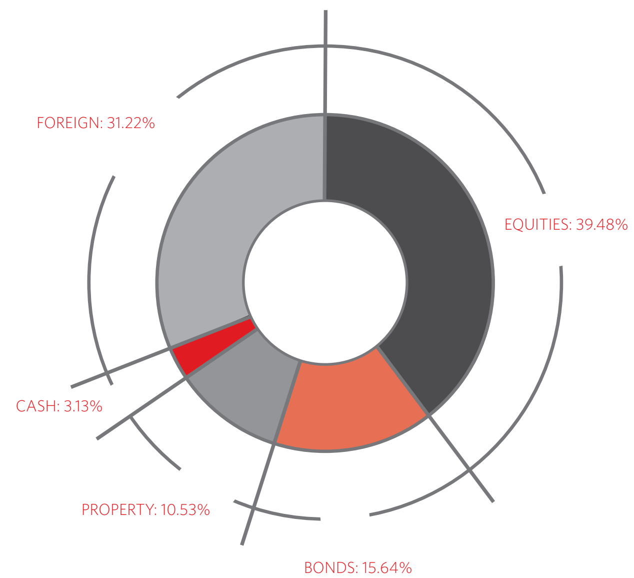
CPI figures are lagged by two months

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

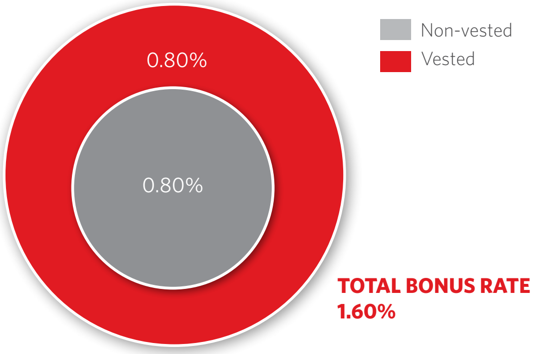
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	95% - 100%	R134.4m	1.27% [1]	5.96% [1]

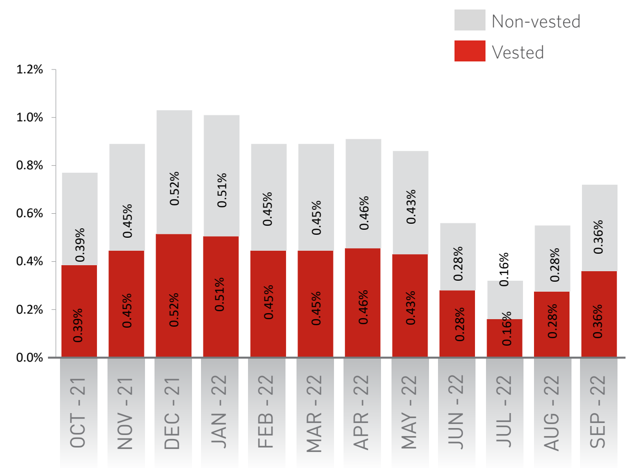
[1]Based on back-tested bonus rates and returns

Performance

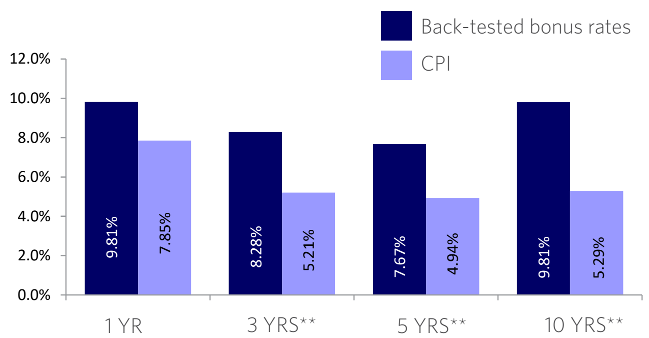
The total bonus rate* for the past quarter on the Universal Smooth-Edge Fund is shown below.



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



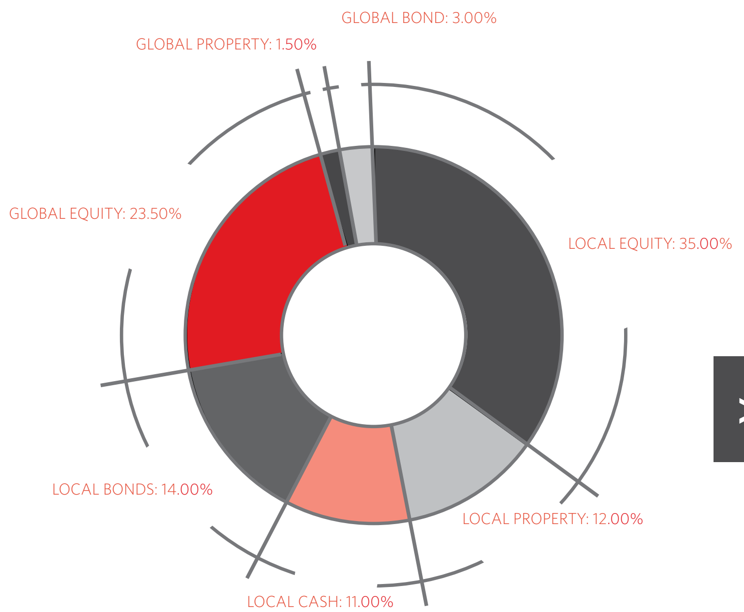
The chart below shows the long term bonus* performance of the Universal Smooth-Edge Fund against CPI



CPI figures are lagged by two months

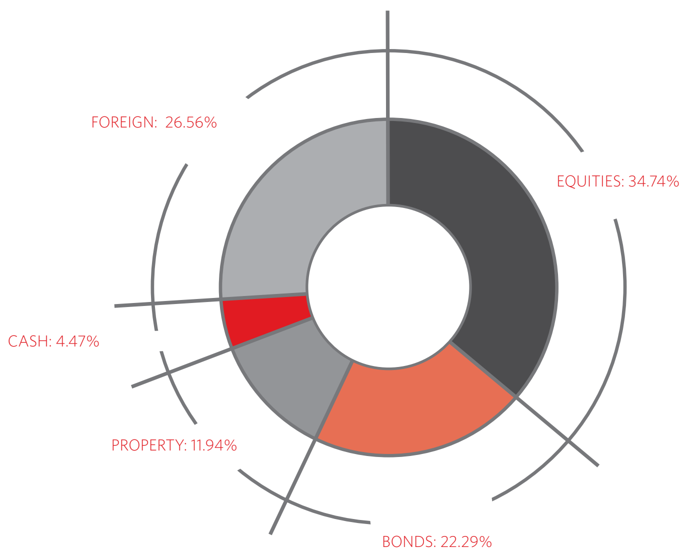
Asset Allocation

The strategic asset allocation of the portfolio is shown below.



*Inflation-linked bonds

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

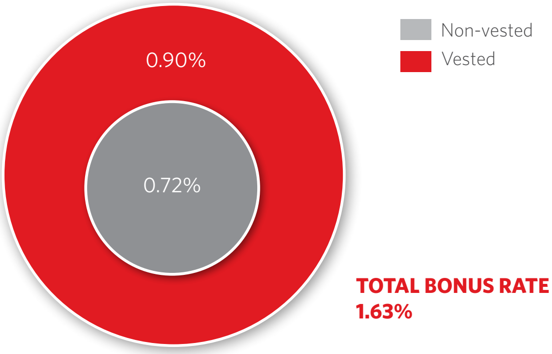
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

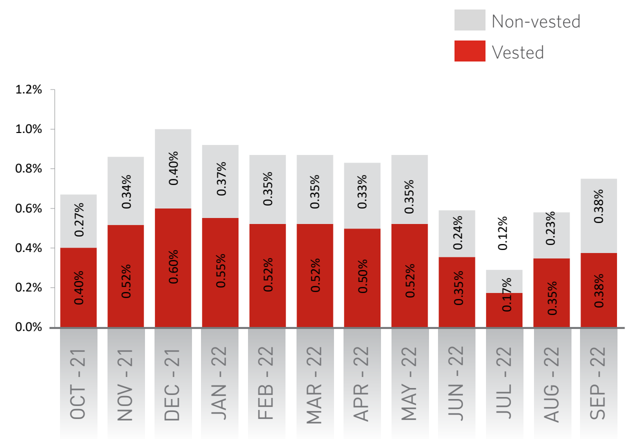
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	95% - 100%	R7.7bn	1.13%	4.94%

Performance

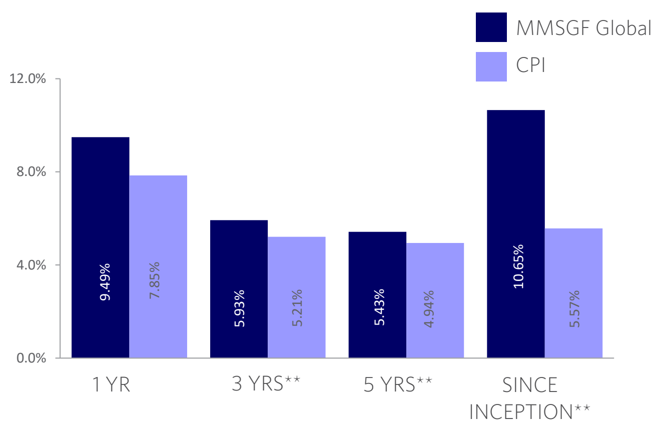
The total bonus rate* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



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



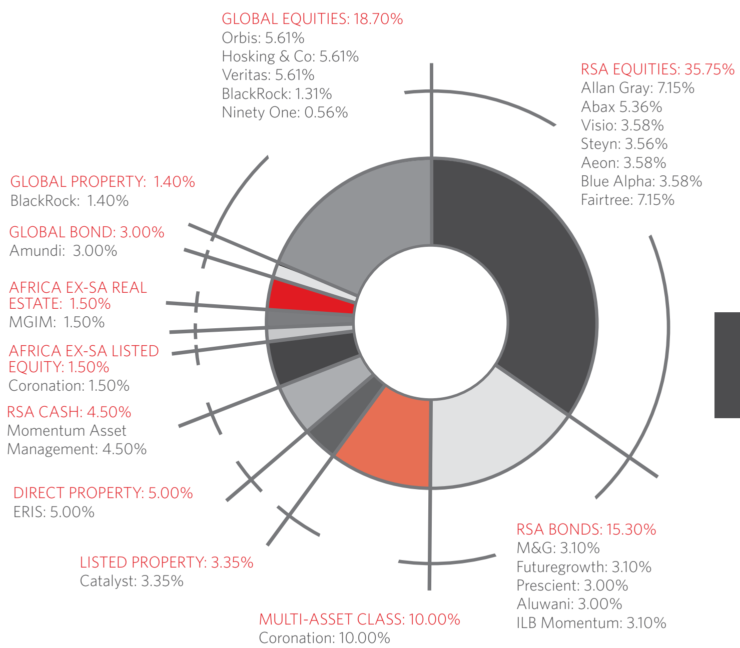
CPI figures are lagged by two months

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

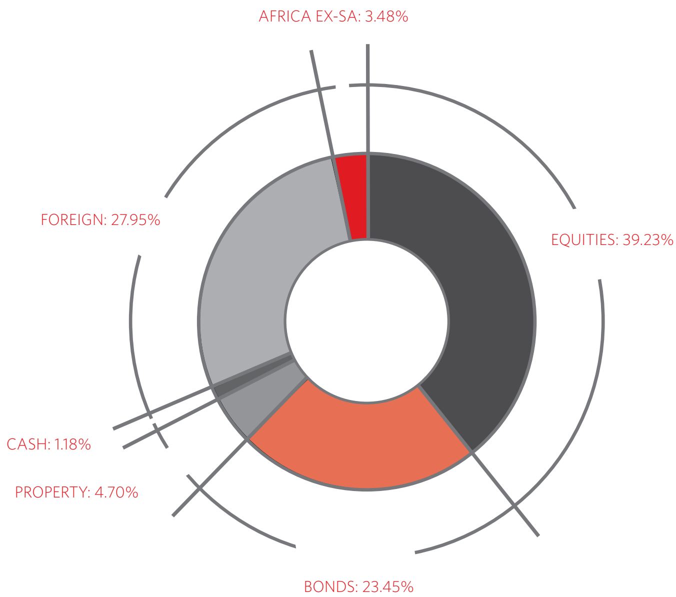
** Annualised

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

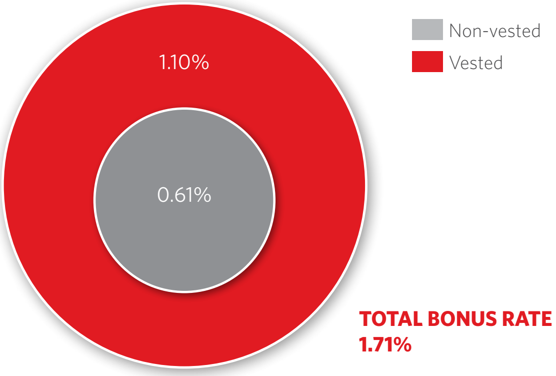
Smooth Growth Fund Global

Fund Snap Shot

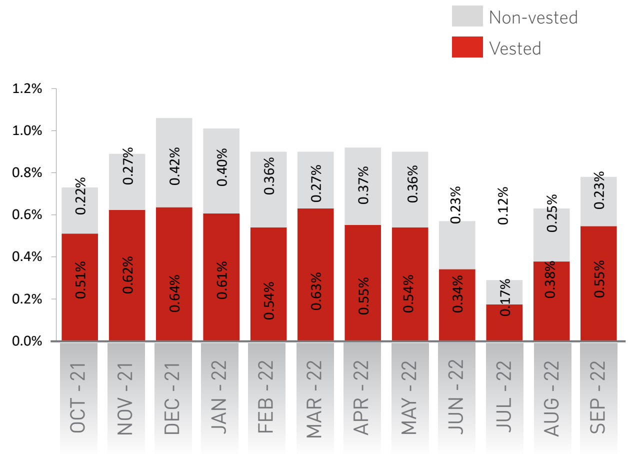
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	95% - 100%	R1.7bn	1.18%	3.80%

Performance

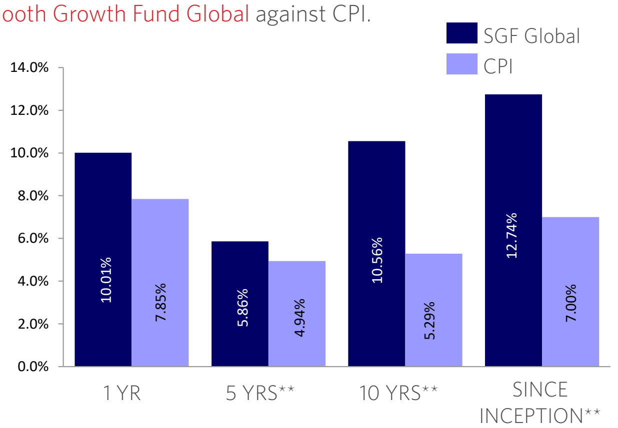
The total bonus rate* for the past quarter on the Smooth Growth Fund Global is shown below.



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.



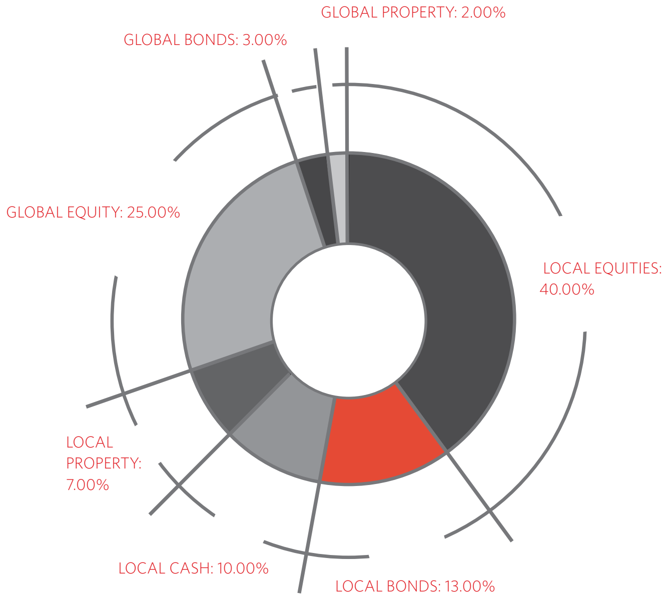
CPI figures are lagged by two months

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

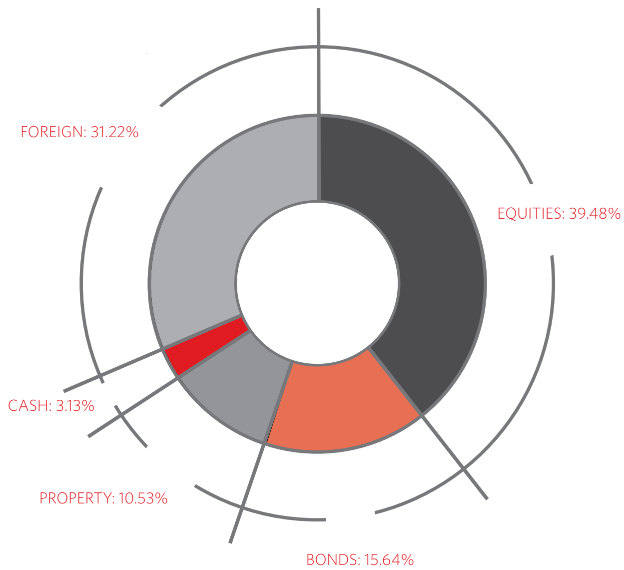
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



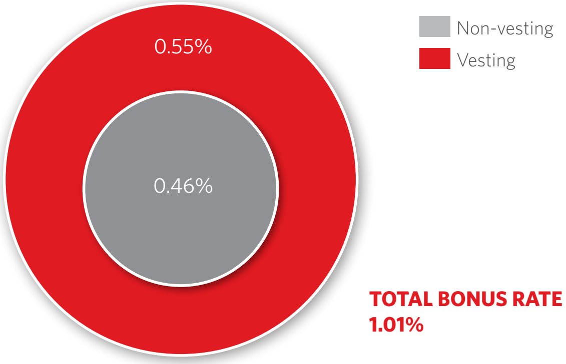
Partially Vesting Smoothed Bonus Range Multi-Manager Smooth Growth Fund Global Bonus Series 2020 *(previously MMSGF Local)*

Fund Snap Shot

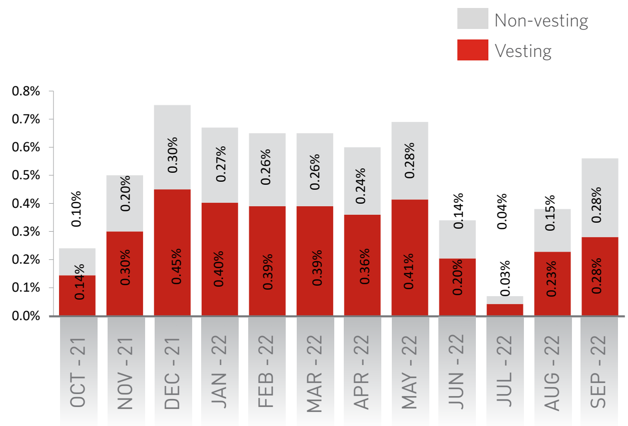
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	92.5% - 97.5%	R133.00m	0.87%	2.98%

Performance

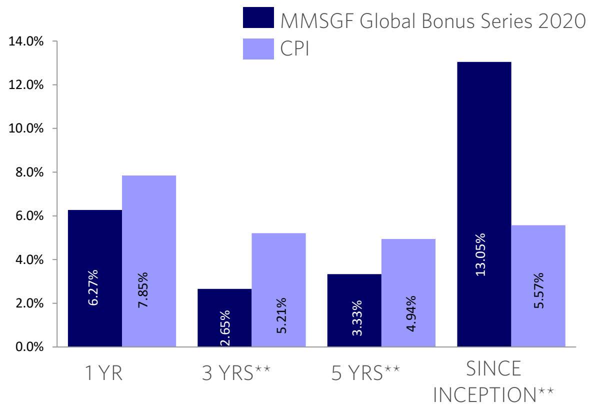
The total bonus rate* for the past quarter on the MMSGF Global Bonus Series 2020 is shown below.



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



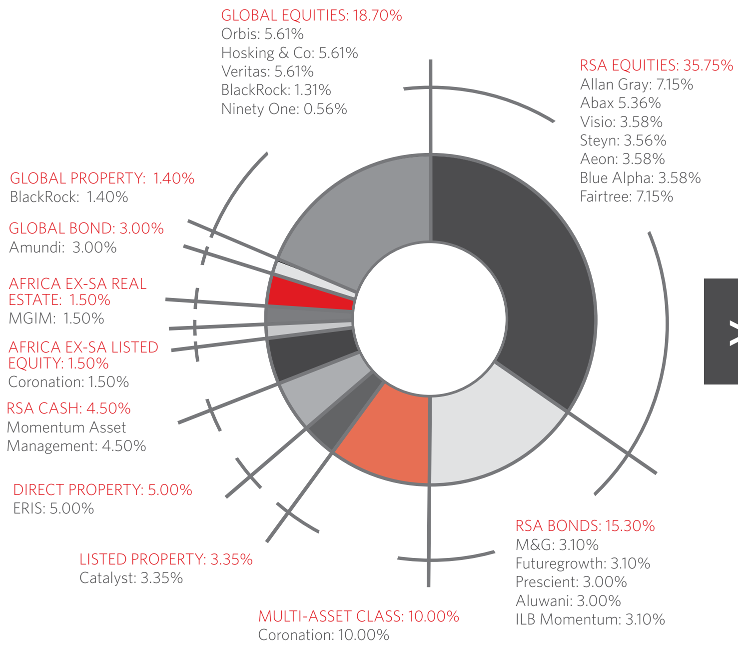
CPI figures are lagged by two months

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

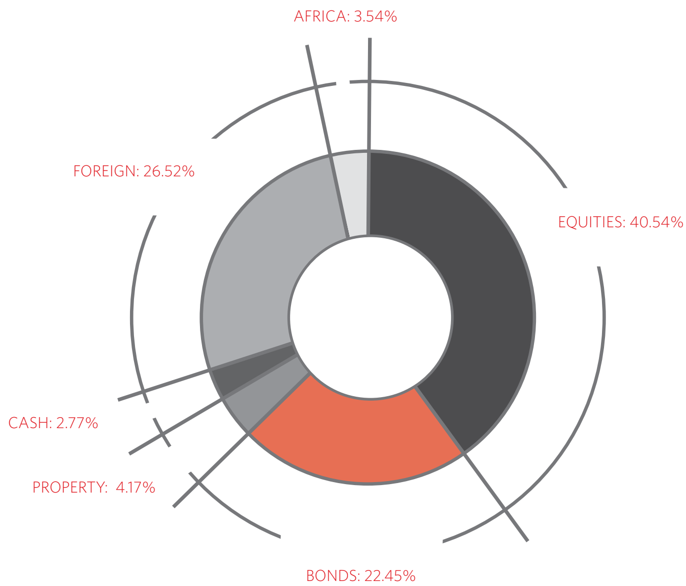
Asset Allocation

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

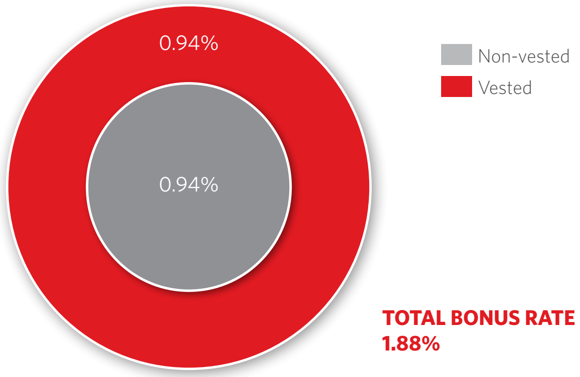
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	95% - 100%	R464.10m	1.33% [1]	5.64% [1]

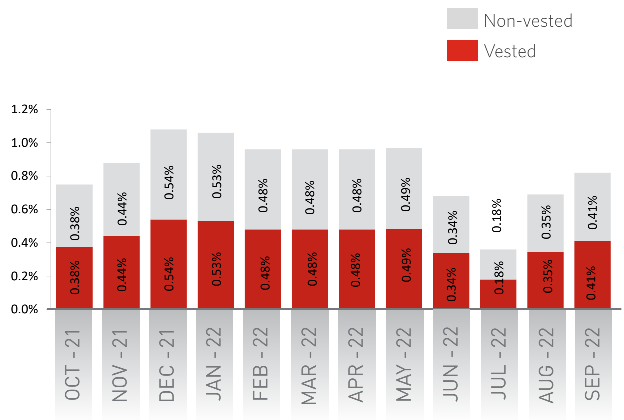
[1]Based on back-tested bonus rates and returns

Performance

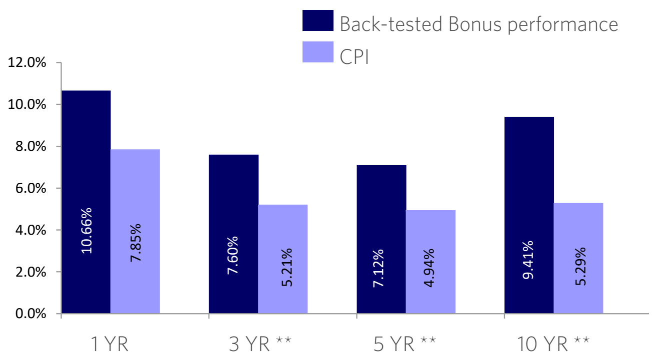
The total bonus rate for the past quarter on the Momentum Smooth-Edge Fund is shown below.



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



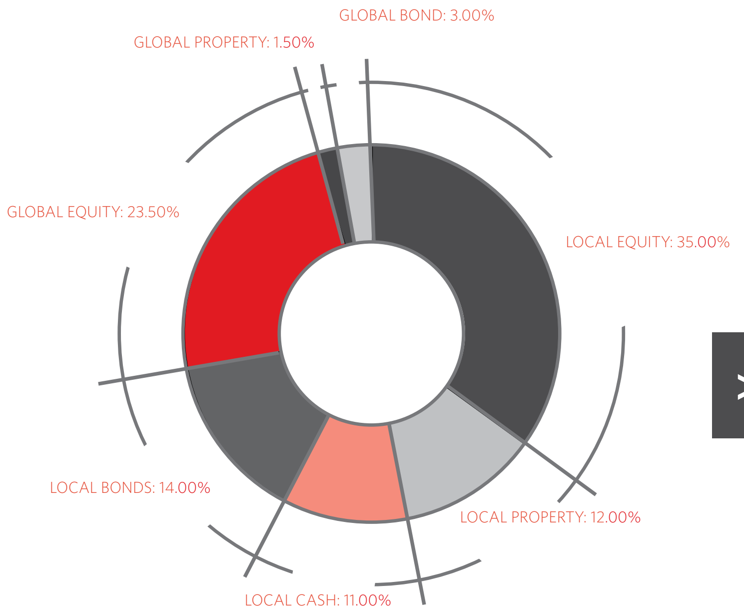
CPI figures are lagged by two months

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

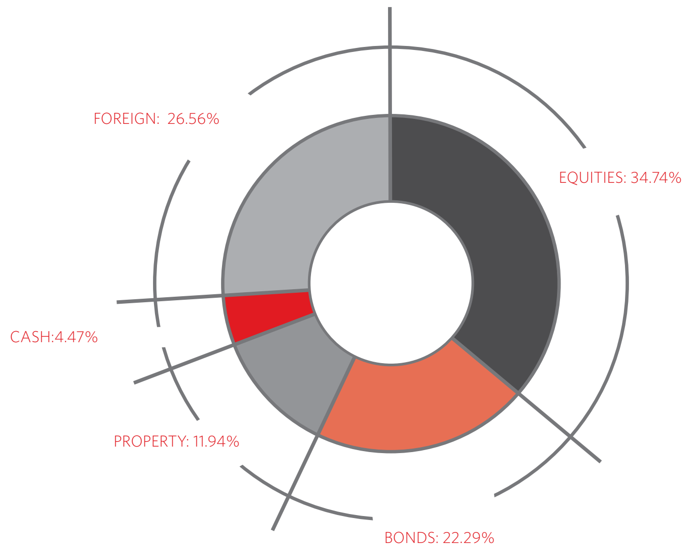
** Annualised

Asset Allocation

The strategic asset allocation is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



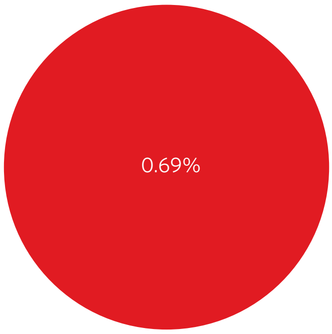
Fully Vesting Smoothed Bonus Range
Universal Smart Guarantee+3 Fund

Fund Snap Shot

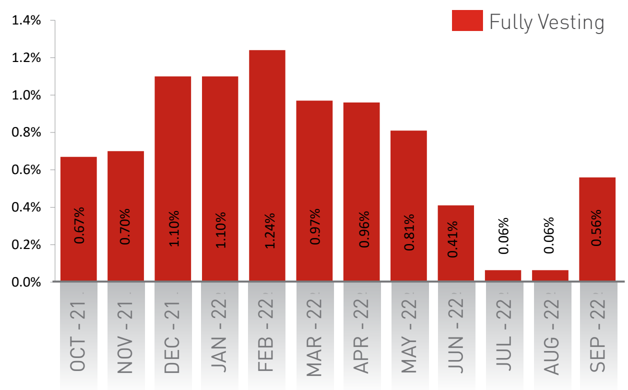
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	90% - 95%	R572.3m	1.23%	4.68%

Performance

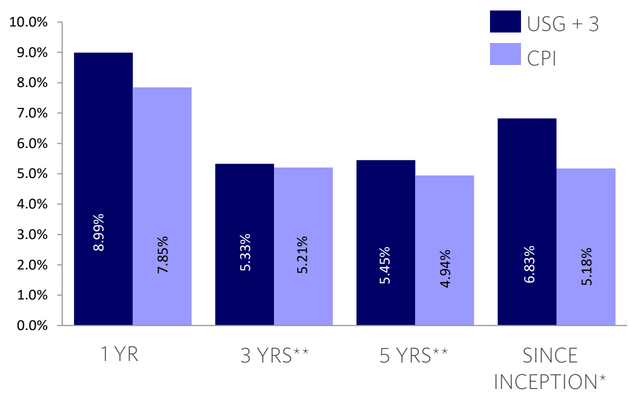
The total bonus rate* for the past quarter on the Universal Smart Guarantee +3 Fund is shown below.



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.

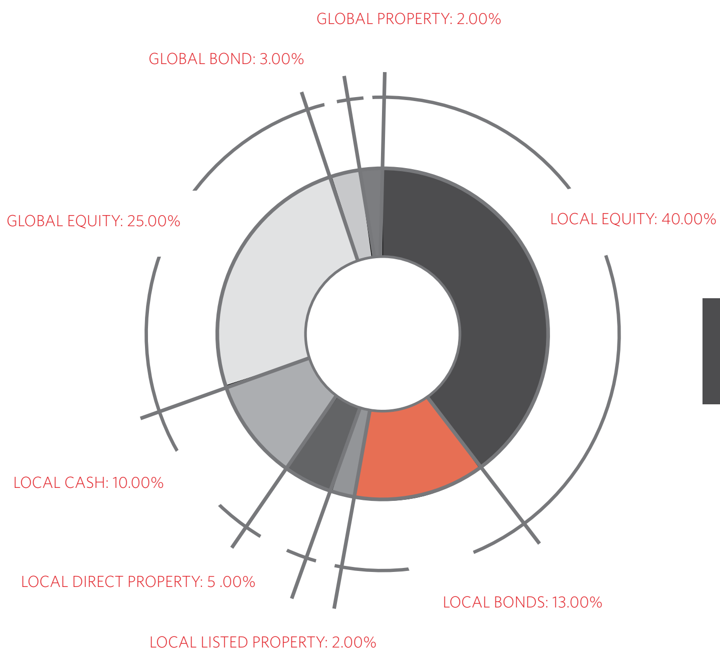


CPI figures are lagged by two months

* 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 **4.68%** will still be declared.

Fully Vesting Smoothed Bonus Range

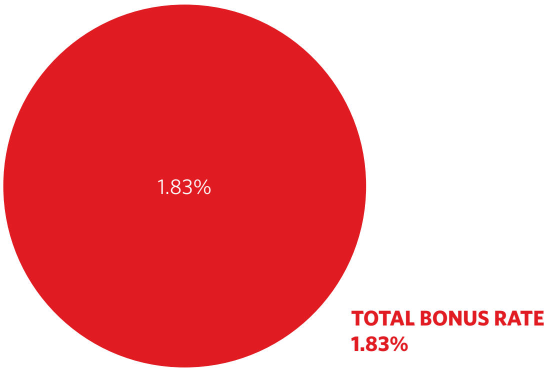
Multi-Manager Secure Growth Fund

Fund Snap Shot

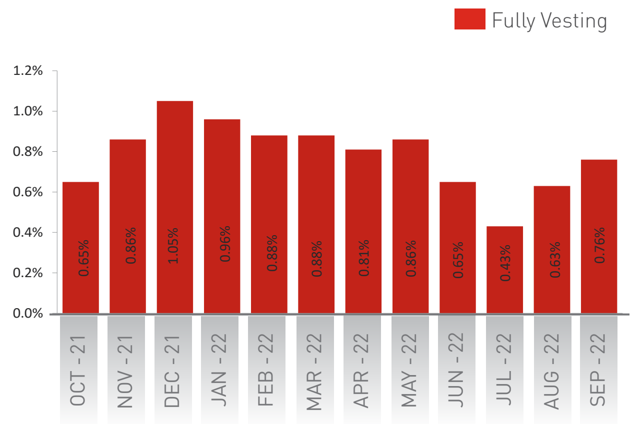
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	100% - 105%	R76.3m	1.12%	4.77%

Performance

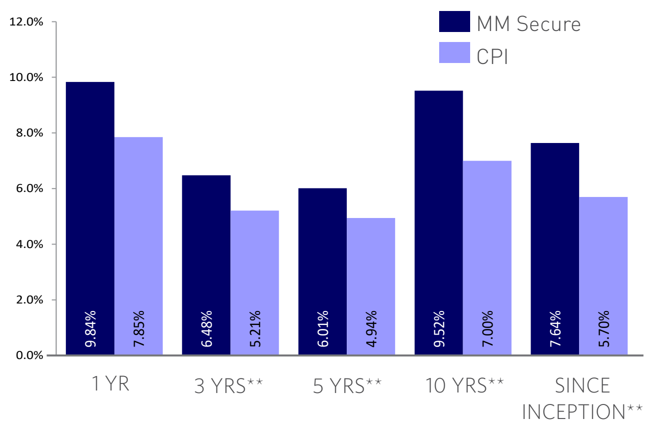
The total bonus rate* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



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



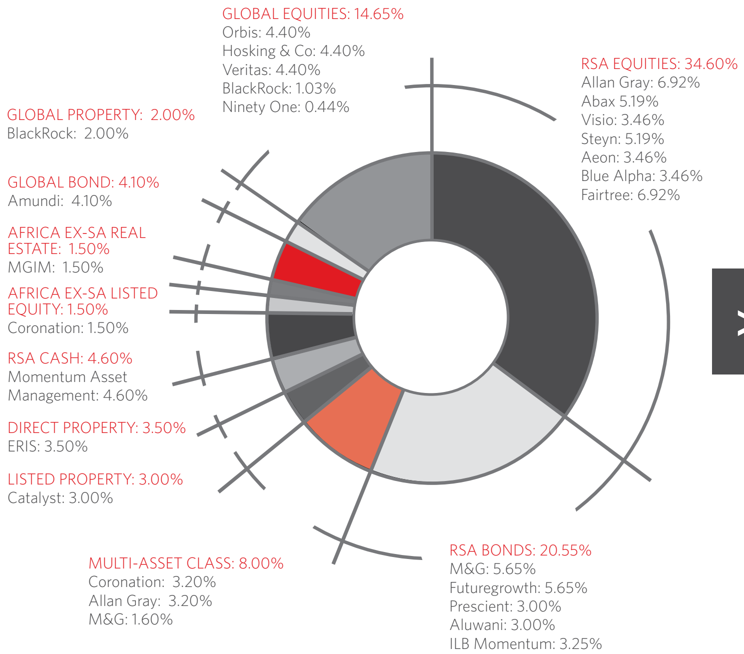
CPI figures are lagged by two months

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

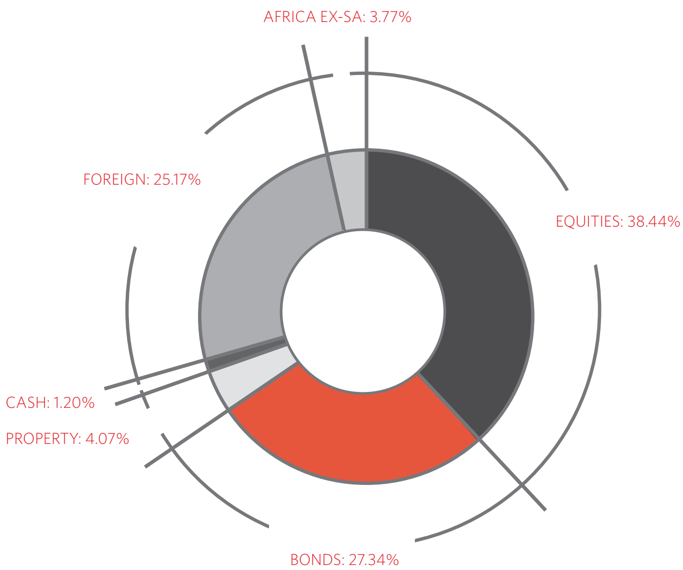
Asset Allocation

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

	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 declared (net of the Policy fee)	Yes	0.90% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	January 2004
	Universal Multi-Manager Smooth Growth Fund								June 2020
	Multi-Manager Smooth Growth Fund Global Bonus Series 2020								January 2004
	Smooth Growth Fund Global	CPI + 4% pa, net of the investment management fee and underlying asset charges over the long term	Momentum Investments	Moderate Balanced	100% of capital invested and vested bonus declared (net of the investment management fee)	Yes	0.90% pa	0.45% of the first R10m, 0.35% of the next R40m, 0.25% of the excess above R50m[3]*	January 1989
	Universal Smooth Growth Fund								June 2020
	Smooth-Edge Fund	CPI + 4% pa, net of the investment management fee and underlying asset charges over the long term	Momentum Investments	Moderate Balanced	100% of net capital invested and vested bonus declared (net of the Investment management fee)	Yes	0.60% pa	0.25% pa[3]*	February 2019
	Universal Smooth-Edge Fund								June 2020
Fully Vesting	Multi-Manager Secure Growth Fund	CPI + 2% pa, net of the policy fee and underlying asset charges over the long term	Multi-Manager	Moderate Conservative Balanced	100% of net capital invested and total bonus declared (net of the Policy fee)	Yes	1.40% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	November 2007
	Universal Smart Guarantee+3 Fund	CPI + 3% pa, net of the investment management fee and underlying asset charges over the long term	Insurer Liability Driven Investment	Insurer Liability Driven Investment	100% of net capital invested and total bonus declared (net of the Investment management fee)	Yes	0.50% pa	0.75% pa[3]*	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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