momentum
corporate

Smooth Bonus Report

Fourth Quarter 2020

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

Looking back over the past quarter

Dear valued investors

With the bad start in global equity markets in the first quarter of 2020, one feared for the worst. In March 2020, equity markets tumbled globally, as a result of the COVID19 crisis. However, what we experienced after this was one of the greatest recoveries the world has ever seen in terms of magnitude and speed. The FTSE/JSE All-Share Index was up 23,18% to the end of June 2020 and other global equity markets posted similar returns. In the third quarter, local and global equity markets were positive and, in the fourth quarter to December 2020, the FTSE/JSE All-Share Index was up 7,00% for the year and 9,75% for the quarter, with the MSCI All Country World Index posting 16,25% (in US dollar terms) for the year.

In the fourth quarter of 2020 and leading into the first quarter of 2021, many countries had entered another hard lockdown, due to a second wave of COVID-19 infections. With the rise in infections and the related lockdowns, this is likely to slow down economic activity in the first half of 2021. The development and rollout of COVID-19 vaccines world-wide is likely have a positive effect on growth in the second half of 2021, although there is still some uncertainty abound. South Africa has been slow to procure vaccines, lagging most countries and that together with other structural challenges may hamper growth.

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

Through these challenging times, our smooth bonus portfolios have continued their trend of not removing any non-vested bonuses, and our clients benefit from 100% of their fund value on benefit payments such as death, disability, resignation and retirement.

The recovery in the equity markets from April to December 2020 contributed to the strengthening of the funding levels of our portfolios, with many now fully funded or close to it. As funding levels improve, we trust that asset classes will return to their normal dynamics of delivering in line with their long-term return expectations. With the rollout of COVID-19 vaccines in 2021 around the world, we hope South Africa and the world will recover economically and that 2021 will be a prosperous one.

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 2020, 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 constructed to deliver smoothed returns (targeting inflation plus 4% a year) at a total cost of about 1% per year.

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

Warm regards

Steed Duncan-Smith

Client Relationship Manager
Momentum Corporate

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The resurgence of cryptocurrencies

by Jacques Fourie

Introduction

During the eventful year that was 2020, investor sentiment moved towards alternative investment strategies, as economic and market uncertainty was rife. Cryptocurrencies emerged as a favourite alternate asset class among investors.

What is a cryptocurrency?

Cryptocurrency[1] is a virtual currency protected by cryptography, to make sure it will be very difficult to counterfeit the currencies, hence the name ‘cryptocurrency’. The first cryptocurrency, namely Bitcoin, was released in early 2009. To date, there has been an emergence of numerous cryptocurrencies. Other than Bitcoin, the most common are Ethereum and Ripple XRP.

Blockchain[2] technology enables the existence of cryptocurrencies, allowing Bitcoin and other cryptocurrencies to operate without the need for a central authority. Blockchain is a digital ledger, which tracks all transactions across various computers and limits the ability to change records called blocks. The records can only be altered by changing all the subsequent blocks linked to the block you want to alter.

Cryptocurrencies are issued at a fixed rate and need computing power to generate new cryptocurrencies. Crypto miners provide the necessary computing power. Miners verify that all new transactions are correct, collect transactions and order them into a new block, add the block to the blockchain as well as introduce the new block into the cryptocurrency network. Miners also provide security to the cryptocurrency network by making it harder to alter blocks and the more miners, the safer the network becomes[3].

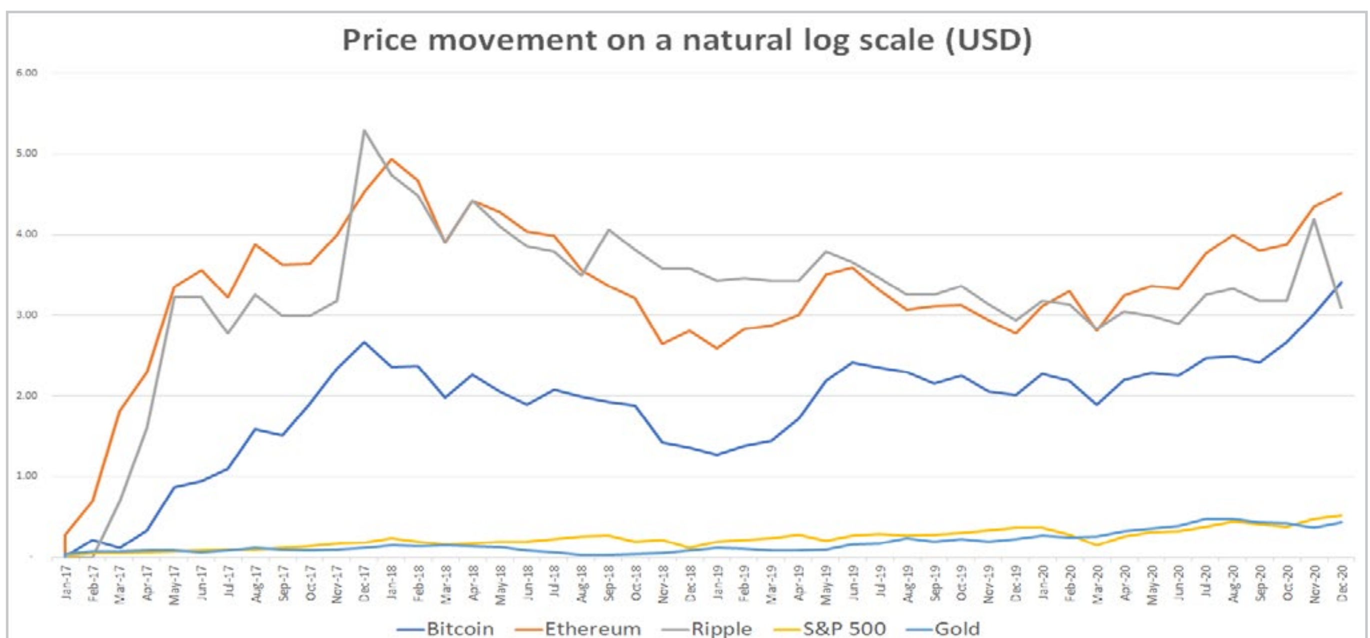
Cryptocurrency bubbles – is the next crash around the corner?

A bubble is a period where there is a rapid increase in the market value of assets followed by a sudden drop in value. This sudden drop can be referred to as a ‘bubble burst’.

Cryptocurrencies experienced a bubble in 2017, when the value went up significantly (Bitcoin and Ethereum went up by 1338% and 9148% respectively for the year ended 31 December 2017) and crashed in 2018 (‘bubble burst”). If an investor invested $100 000 in Bitcoin or Ethereum on 31 December 2017, it would have been worth around $27 000 or $18 000 respectively by 31 December 2018.

In light of relatively positive investor sentiment in the alternative asset class in 2020, Bitcoin and Ethereum increaed by 303% and 471% respectively for the year ended 31 December 2020. This might be an indication that cryptocurrencies are in a bubble once more. If history repeats itself, then cryptocurrency prices may come down drastically during 2021, but only time will tell.

Below is the comparison of the returns from cryptocurrencies to conventional asset classes (on a natural log scale).



Sources: bitcoinprice.com and investing.com

By looking at the relative volatility displayed and by comparing conventional asset classes with Bitcoin, Ethereum and Ripple, it's easy to see that the conventional asset classes (such as equity, as benchmarked by the S&P500) are stable in comparison to cryptocurrencies. Our smooth bonus portfolios are invested in conventional asset classes and may be invested in alternative asset classes, such as private equity and infrastructure (but not cryptocurrencies).

As can be seen from the above, there are advantages and disadvantages when investing in cryptocurrencies. Below is a list of the advantages and disadvantages:

Advantages of cryptocurrencies

- **Affordable transaction costs:** Cryptocurrencies have lower transaction costs, as there are no third-party payments.
- **Instant payments:** Payments using cryptocurrencies can be instantaneous, whereas alternative payment methods could take days, for example electronic transfers. International payments using cryptocurrencies can be more efficient and affordable than traditional payment methods.
- **Accessibility:** There are many applications available where cryptocurrencies can be bought with little to no effort, for example Luno.
- Fractions can be bought instead of whole units, which increases the pool of potential investors. Therefore, lower-income individuals also invest.

Disadvantages of cryptocurrencies

- **Fraud:** Payments are not easily tracked, which can encourage illegal activities. Hackers can hack into wallets and transfer cryptocurrencies, and there is no way to reverse transactions after they have occurred. Investment platforms may emerge that are not reputable, which could lead to a significant risk of losing money. Mirror Trading International trading platform is an example of this, with investors struggling to withdraw their investments and the company placed under investigation by the Financial Sector Conduct Authority (August 2020) and Federal Bureau of Investigation (January 2021) for illegal activities.
- **Volatility:** Cryptocurrencies can be very volatile with large increases and decreases being a frequent occurrence.

All in all, while cryptocurrencies may appear to be very attractive investment opportunities, the discerning investors should make sure they are well-informed about the risks and rewards associated with investing in them.

Our smooth bonus portfolios protect investors against high volatility, even during market crashes. While smooth bonus portfolios and cryptocurrencies would be affected by these events, investors in smooth bonus portfolios are cushioned against experiencing the full effect of the guarantees offered by smooth bonus portfolios. Investors, who choose to invest in cryptocurrencies, may end up losing a lot of money, and especially investors, who want to invest their retirement savings, would be better served if they considered options such as smooth bonus portfolios that offer much less volatility. There is also certainty provided to investors upon retirement, where benefit payments are guaranteed to be paid at full fund value.

Smooth bonus portfolios may not offer the significant short-term returns, as those seen by cryptocurrencies, but will provide sustainable long-term returns with low volatility to meet investors' long-term goals.

Sources:

1. investopedia.com/terms/c/cryptocurrency.asp

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Jacques Fourie

Product Specialist
Structured Solutions

Momentum Investments market commentary for the quarter ended December 2020

by Sanisha Packirisamy and Herman van Papendorp

Highlights

Markets

- Global financial markets whipsawed in 2020 in reaction to a devastating COVID-19 pandemic and the subsequent decisions taken by governments and policymakers to protect citizens and keep economies afloat.
- Outside of Europe, global equity markets experienced strong returns in 2020. Easier monetary policy and additional fiscal support drove robust returns in equity markets in the United States (US), while European shares lost ground.
- The South African (SA) equity market trailed global equity markets in 2020. Resource shares were the standout performers for 2020, while financial shares fared poorly.
- In our view, whether or not the COVID-19 virus can be tempered successfully in 2021 will largely determine risk appetite in global financial markets. Improved global growth, still ultra-easy policy settings and a positive vaccine outcome should provide general support for more risky assets like global equities. Safe-haven asset classes, like global bonds, are nevertheless likely to face headwinds in a cyclical recovery phase, with bonds facing the additional challenge of somewhat higher inflation.
- It looks like the stars are finally aligning for the SA equity market, with a strong expected profit recovery in 2021 providing fundamental support on top of an envisaged conducive global risk-on environment, while a more favourable valuation underpin after years of poor performance should enhance potential return upside.
- SA real bond yields remain compelling, in sharp contrast to zero real cash yields. In the inflation-linked bond (ILB) space, the expected rise in SA inflation, as 2021 progresses, should provide a positive fundamental underpin.
- Listed property share prices have been decimated, with valuations at rock-bottom levels relative to history. It is likely that the weaker fundamental environment has already been discounted by share prices in the sector.

Economics

- The strength of the global economic upturn will be reliant on the success of vaccination campaigns and greater global co-operation to guarantee efficient distribution of vaccines worldwide. However, the road to recovery remains uneven and uncertain, particularly in light of renewed lockdown restrictions and new COVID-19 strains.
- More diversified economies that are less exposed to contact-intensive activity will likely fare better in the coming quarters. Meanwhile, more concentrated economies that are reliant on services, oil or small business activity are likely to require further support and will take longer to recover.
- Continued fiscal support and an ultra-accommodative monetary policy stance are crucial in keeping the economy afloat and will lessen lasting economic damage from the crisis. A premature withdrawal of stimulus could pull the rug out from under the nascent recovery if the private sector cannot pick up the economic growth baton.
- Meanwhile in SA, muted confidence, a likely rise in bankruptcies, a strained fiscus and ongoing electricity shortages will contain the anticipated recovery in 2021, more so given the recent tightening in lockdown restrictions. After contracting at an expected 8.1% in 2020, SA growth is likely to increase to a below-consensus 2% in 2021, before slowing to 1.6% in 2022.
- Efforts to arrest the increase in government's debt burden through achieving higher growth will likely be constrained and could lead to further negative rating actions later in 2021, in our view.
- While near term inflation pressures are likely tilted to the downside, we see inflation rising in the medium term from an expected average of 3.2% in 2020 to 3.9% in 2021 and 4.7% in 2022.
- We are projecting a shift higher in interest rates in the second half of 2021 given the SA Reserve Bank's (Sarb) warning against the constraints of fiscal dominance and the dangers of running negative real interest rates for a protracted period.

Virus uncertainty and policy responses drove wild swings in asset classes in 2020

Global financial markets whipsawed in 2020 in reaction to a devastating COVID-19 pandemic and the subsequent decisions taken by governments and policymakers to protect citizens and keep economies afloat. Higher levels of uncertainty were reflected in the initial spike in the CBOE Volatility Index (Vix) in March 2020 before unprecedented fiscal and monetary stimulus calmed markets during the year.

Outside of Europe, global equity markets experienced strong returns in 2020. The MSCI All Country World Index ended the year 16.3% higher, after rising 26.6% in 2019. A more accommodative monetary policy stance adopted by the major developed market (DM) central banks fuelled DM equity markets in 2020. Returns in the MSCI DM Index powered ahead at 15.9%. Easier monetary policy and additional fiscal support drove robust returns in US equity markets. The US equity market was the star performer in the DM composite, with the S&P 500 Index rushing ahead by 18.4% in 2020, following gains of 31.5% in 2019. The Nikkei 225 Index followed hotly on its heels, gaining 18.3% in 2020, while the Eurostoxx 50 Index lost ground after a stellar 29.3% rise in 2019 and fell by 2.6% in 2020.

DM government bond yields rallied further in 2020. The US 10-year government bond yield declined by more than 100 basis points to 0.9% by the end of 2020, while the German 10-year government bond yield rallied a further 38 basis points to negative 0.6%.

The MSCI Emerging Market (EM) Index continued its winning streak and surged 18.3% in 2020, after gaining 18.4% in 2019, despite weaker commodity prices during the year as a whole. The Bloomberg Commodity Price Index dipped 3.1% in 2020, previously up 7.7% in 2019.

Although risk appetite towards EMs deteriorated in 2020, overall, the JPMorgan EM Bond Index (Embi) spread improved 75 points in the final quarter of 2020. The biggest deterioration in sovereign credit quality for the year was observed in Russia, where the credit default swap (CDS) spread blew up 55% in 2020. The most substantial improvements were seen in Argentina (down 66%) and Bulgaria (16% lower). Mexico (46%), Turkey (43%) and Brazil (43%) experienced the largest improvements in their respective CDS spreads during the last quarter of 2020. Although the JPMorgan EM Currency Index depreciated by 5.7% for the year as a whole, the composite appreciated by 6.2% in the final quarter of the year on favourable election results in the US and positive news flow regarding viable

COVID-19 vaccines. The steepest quarterly depreciation against the US dollar was in the Argentine peso (10.1%), while the most significant currency appreciations were in the SA rand (14.8%) and Colombian peso (12.5%).

The local equity market trailed global equity markets in 2020. The FTSE/JSE All-Share Index gained 7% in 2020 after increasing 12% in 2019. Resource shares were the standout winners in 2020, while financial shares fared poorly.

The FTSE/JSE Resources Index shot 21.2% higher in 2020, posting its fifth consecutive annual increase in returns. Gold and platinum prices were up 25.1% and 10.9% for the year following increases of 18.3% and 21.5% in 2019, respectively. Gold had its strongest year since 2010 given raised uncertainty around the trajectory of the COVID-19 pandemic and consequent economic outcomes.

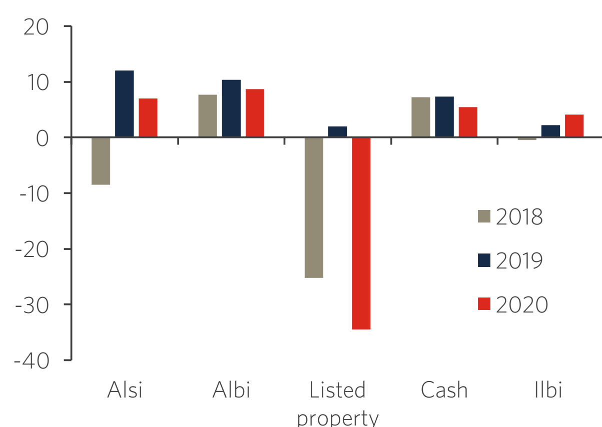
Financial shares had a dismal year, with the FTSE/JSE Financials Index down 19.7% for 2020 after inching 0.6% higher in 2019. Decent returns of 12% were recorded in the FTSE/JSE Industrials Index for 2020, following an 8.9% uptick in 2019. Although the FTSE/JSE Mid-cap and Small-cap indices were down 14.4% and 0.3%, respectively, for the year, they staged impressive gains of 13% and 20.5%, respectively, in the final quarter of 2020.

The SA 10-year government bond yield rallied by a mere three basis points in 2020 after a more extensive 26-point rally the year before. The FTSE/JSE All Bond Index (Albi) managed an 8.7% increase for 2020, following a 10.3% lift in 2019, while the JSE Assa Government Inflation-linked Bond Index (Ilbi) edged up only 4.1% higher in 2020 following a 2.3% uptick in 2019. Meanwhile, the FTSE/JSE SA Listed Property Index floundered 34.5% in 2020 after rising by only 1.9% in 2019 (see chart 1).

A weaker US dollar left the rand firmer in the fourth quarter of 2020. Nevertheless, the rand was still 4.7% weaker against the US dollar for 2020 after appreciating by 2.5% in 2019. The rand was 12.6% weaker against the euro at the end of 2020 after appreciating by 4.9% in 2019, while the rand extended losses against the pound in 2020 by a further 7.6% following 1.3% the year before. SA's five-year CDS spread widened by 26% during 2020 reflecting a worsening in SA trend growth and a deterioration in government finances, which led to further sovereign rating downgrades late in 2020.

According to Deutsche Bank, the cryptocurrency, Bitcoin, staged an impressive performance in 2020. Bitcoin strengthened by 305.1% against the US dollar in 2020 as investors sought a potential hedge against the risk of higher inflation.

Chart 1: Annual local asset class returns (%)



Source: Iress, Momentum Investments

Virus or vaccine victorious?

In our view, whether or not the COVID-19 virus can be tempered successfully in 2021 will largely determine the risk appetite in global financial markets. In turn, this will determine whether riskier asset classes or safe-haven asset classes will prevail in 2021. Although the balance of probabilities favours a positive vaccine outcome and hence a conducive environment for more risky asset classes, we acknowledge that there could be sporadic downside risks for these asset classes in case of disappointment on the vaccine implementation front.

An improved global growth picture, together with still ultra-easy policy settings and a positive vaccine outcome, should provide general support for more risky assets like global equities. Global equities should also benefit from a split US Congress given a lower likelihood for increased regulation and taxes and less volatility in markets. Safe-haven asset classes like global bonds are nevertheless likely to face headwinds in a cyclical recovery phase, with bonds facing the additional challenge of somewhat higher inflation.

Against the backdrop of many global risks and uncertainties, central banks are likely to remain strongly committed to keeping interest rates at very low levels even as inflation starts drifting upwards, particularly with the shift to average inflation targeting. Even though global cash exposure in a very low interest rate environment should be limited, some rand weakness could boost rand returns.

Although the SA economy will remain trapped in a low-growth quagmire until structural policy reforms are successfully implemented, the fortunate reality for investors in the SA equity market is that the local economy is only a secondary driver for the overall local stock market. It looks like the stars are finally aligning for the SA equity market, with a strong expected profit recovery in 2021 providing fundamental support on top of an envisaged conducive global risk-on environment, while a more favourable valuation underpin after years of poor performance should enhance potential return upside.

SA real bond yields remain compelling, in sharp contrast to zero real cash yields. Within the EM world, SA real vanilla bond yields remain one of the highest, more than compensating prospective investors for the high local fiscal risk premium required. Current SA real bond yields and yield spreads are indeed multiple-sigma attractive events against their respective historical averages.

Due to a combination of aggressive Sarb interest rate cuts in 2020 in response to COVID-19, as well as expectations for higher local inflation in the next year, prospective SA real cash yields have fallen close to zero, which is more than one standard deviation below its historical average. This makes the real return available to investors from local cash unappealing, in contrast to the high real yields available from SA ILBs and vanilla bonds.

In the ILB space, the expected rise in SA inflation as 2021 progresses should provide a positive fundamental underpin for the asset class going forward. More specifically, the meaningful positive monthly inflation accruals expected to be banked by ILB investors from the second quarter of 2021 should be particularly favourable for the asset class in the coming months.

The SA commercial property sector experienced a rapid further weakening in its fundamentals in 2020 due to the destructive impact of Covid-19 induced lockdowns on the economy and its tenant base. However, share prices of the listed companies have been decimated, with valuations at rock-bottom levels relative to history. As such, it can be postulated that the weaker fundamental environment has already been discounted by share prices in the sector.

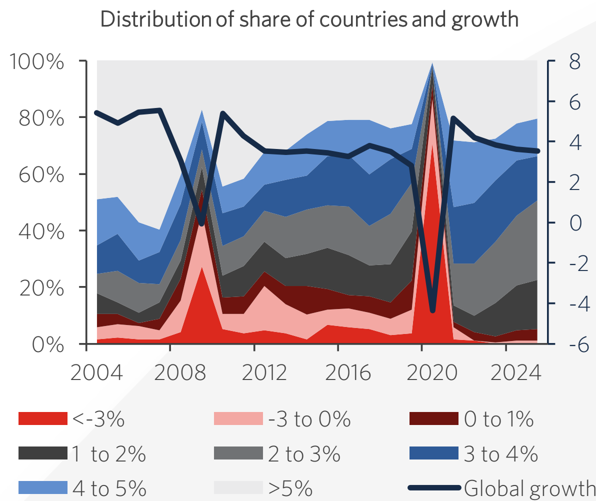
Promising vaccines unlock hope for an economic recovery

Pharmaceutical breakthroughs have fed optimism for a faster global economic recovery. Nonetheless, we still view the road to recovery as uneven and uncertain (see chart 2), particularly in light of renewed lockdown restrictions in response to a resurgence in infections and new COVID-19 strains. In our view, countries that are larger, more flexible, less exposed to contact-intensive activity and that have a more diversified underlying contribution to economic activity will likely fare better in the coming quarters. Meanwhile, smaller, more concentrated economies that are reliant on services (such as hospitality and tourism), oil or a more entrenched small business culture are likely to require further support and will take longer to recover.

After a sharp contraction in growth in 2020, the global economy is nevertheless likely to gain momentum overall in 2021 as medical advances lead to a gradual relaxation in restrictions on mobility, allowing for a significant bounce in activity in many economies. The strength of the economic upturn will, however, be reliant on the success of vaccination campaigns and greater global co-operation to guarantee efficient distribution of vaccines worldwide.

After an expected growth slump in the final quarter of 2020 and the first quarter of 2021, the European and North American economies are likely to emerge strong from the colder weather as warmer weather sets in and lockdown measures ease as large shares of the population are vaccinated, which will allow for greater mobility and higher levels of economic activity. Several Asian economies, including China which entered the pandemic first, have benefited from advanced tracing and tracking systems and have been more successful in curbing the initial increase in infection rates. China is the only major economy worldwide that is expected to grow in 2020 and stage a more impressive recovery in 2021.

Chart 2: A more widely distributed expectation of global growth than what followed the 2008 crisis



Source: International Monetary Fund (IMF) Financial Stability Report, Momentum Investments Global growth read of the right-hand axis

Unprecedented fiscal and monetary policy stimulus helped avoid a more catastrophic growth outcome resulting from stringent lockdown measures. However, the crisis has had a disproportionate effect on society, with small businesses and informal sectors bearing the brunt of the economic pain. While those covered by social safety nets were largely protected from more adverse economic consequences of the pandemic, a slower improvement in low-skilled employment will drive an asymmetric disruption in this area of the labour market.

In our view, with global interest rates at all-time lows, continued fiscal support and an ultra-accommodative monetary policy stance are crucial in keeping the economy afloat and will lessen lasting economic damage from the crisis. A premature withdrawal of stimulus could pull the rug out from under the nascent recovery if the private sector cannot pick up the economic growth baton. This remains the key downside risk to a more robust economic outcome in 2021, in our view.

Even though world debt levels are on track to surpass World War 2 levels, fiscal instruments with a high effect on economic activity can lead to stronger, self-sustaining growth in the private sector. The IMF warns that aside from jeopardising economic gains made so far, exercising austerity too soon could trigger adverse changes to financial conditions and could lead to stickier levels of unemployment, which would raise inequality and spur political unrest. Similarly, any disappointment on the distribution or efficacy of vaccines could wound confidence, and further waves of infections could prompt tighter containment measures, once again stifling the budding economic recovery.

Although one would expect higher levels of fiscal spending, swollen central bank balance sheets and a shift to average inflation targeting in the US to result in much higher rates of inflation, supply-side disruptions have been countered by a collapse in demand. Impaired balance sheets, job losses and wage cuts are likely to repress demand in the near term, while technological advances, ageing populations and reduced labour bargaining power are likely to keep a lid on inflation in the medium term. This should allow DMs to keep interest rates accommodative for the foreseeable future. With interest rates at rock bottom in advanced economies, central banks are expected to further expand balance sheets in 2021 to continue supporting the economy.

Instead of invoking a significant acceleration in the prices of goods and services, central bank policy decisions have driven up asset price inflation, which has worsened trends in inequality. With less equitable growth outcomes emerging in the post-pandemic era, global policy uncertainty will likely remain elevated.

Although policy uncertainty indices for the globe and the US refuse to settle below pre-pandemic levels, the recent outcome of the November 2020 US presidential election promises better relations between the US and the rest of the world. Hopes for more predictable multilateral and diplomatic dividends have emerged given the incoming administration's increased appetite for international co-operation. Even though Republicans lost the presidential battle, they are poised to retain control of the Senate. President-elect Joe Biden has an ambitious agenda, but a split Congress is likely to present an obstacle to bold changes in legislation even though a substantial fiscal stimulus package was signed off late in 2020. BBVA Research shows that a divided government has, historically, not had enough space to make significant changes to policy, whereas a unified government has had a mandate to implement

far-reaching legislative actions which can result in significantly more favourable economic outcomes.

A fraught fiscus and solemn sentiment lower the ceiling on SA's recovery

SA's swift lockdown awarded the country with time to optimise the healthcare system's preparedness to cope with the outbreak during the first wave of infections. However, the protracted nature of SA's hard lockdown measures were criticised as being economically unfeasible, given the unintended health and economic consequences of these interventions.

In the COVID-19 pandemic, instead of slashing jobs, some firms opted to cut pay or reduce working hours. More than a quarter of respondents surveyed by Statistics SA in May 2020 reported a decrease in their income. In businesses where these cuts were applied more permanently, it may take time for incomes to get back to pre-pandemic levels. Moreover, employment intentions as surveyed by the Bureau of Economic Research (BER) remain close to all-time lows, suggesting lingering negative effects on prospects for job creation.

Households are further displaying an element of caution with a renewed uptick in growth in household deposits. According to the Sarb, this may reflect households' expectations that unemployment benefits and cash flow relief from debt repayment holidays are only

a transitory income windfall. With lower-skilled informal jobs likely to take even longer to recover, there will be pressure on government to continue supporting these households beyond the extended date of the COVID-19 relief funds. This will be challenging to achieve under already-strained fiscal conditions.

The BER's Business Confidence Index, which measures to what degree formal businesses are satisfied with prevailing conditions, bounced off a low of five index points in the second quarter of 2020 to 40 index points in the fourth quarter as lockdown restrictions continued to ease, but the sustainability of this bounce remains highly uncertain. Formal business liquidations have been slow to rise, but data captured in the World Bank's Doing Business project points to a two-year delay in the time taken to resolve insolvency in SA, compared to one year in the US. Moreover, a number of informal business closures may not be captured in this data.

With the private sector accounting for more than 70% of total gross fixed capital formation, reigniting confidence remains critical in generating faster growth in investment. Sluggish progress in implementing reforms and uncertainty in key areas of economic and regulatory policy have scuppered growth in private sector fixed investment in the past five years.

SA may well have to contend with policy uncertainty for a while longer given a resurgence in COVID-19 infections and a busy political calendar ahead. The by-elections held on 11 November 2020 served as a barometer of change in the political mood in SA following the after-effects of the pandemic. Although voter turnout remained low, the by-elections still serve as a preview of the municipal elections, which are expected to be held in the third quarter of 2021. Despite public criticism hurled at the African National Congress (ANC) government for its handling of the COVID-19 crisis, the ANC stood out as the most stable political party emerging from the by-elections. It maintained 64 seats, lost three seats and gained five seats. High-profile resignations in the official opposition party hurt by-election outcomes for the Democratic Alliance (DA). The DA maintained 14 seats, gained two and lost nine, of which four of the latter were lost to small parties.

A number of postponed conferences will also take place in 2021, including the ANC Women's League Conference, the ANC Youth League Conference and the ANC National General Council, in which there will be further signs of President Cyril Ramaphosa's ability to consolidate his political authority in the 2022 ANC Elective Conference ahead of the 2024 National and Provincial elections.

One of the ways in which government aims to re-energise growth in SA is through bolstering its infrastructure efforts. Nonetheless, the Head of the Office of Investment and Infrastructure in the Presidency has admitted that the national investment target is unaffordable for the fiscus alone and this level of spending is reliant on private sector participation. To quell the debate around prescribed assets, the ANC subcommittee on economic transformation has proposed encouraging private pension funds to fund profitable infrastructure projects through a more collaborative approach rather than being forced to invest in specific state-owned enterprises, where government maladministration and deficient operational capacity remain concerning.

Government's Economic Reconstruction and Recovery Plan is a display of social compacting efforts and is centred on infrastructure and employment programmes to kickstart SA's stuttering economic engine and ultimately increase the country's relative attractiveness for inward investment. Even though low-hanging fruit such as the auctioning of broadband spectrum, negotiating supplementary power purchase agreements, implementing gazetted infrastructure projects and reforming visa regulations should provide some growth underpin for the economy, harder-hitting reforms, such as overhauling operational and financial inefficiencies at SA's major parastatals, strengthening state capacity, improving educational outcomes or addressing rigidities in the labour market are unlikely to unfold in the near term. As such, the ceiling remains low on SA's expected growth recovery in the medium term and we suspect that trend growth for the next five years has likely fallen to 1.7%.

Muted confidence, a likely rise in bankruptcies, a strained fiscus and ongoing electricity supply constraints will likely contain the anticipated recovery in growth in 2021, more so given the recent tightening in lockdown restrictions in response to a new and more transmissible COVID-19 strain. After contracting at an expected 8.1% in 2020, growth in the SA economy is likely to increase to a below-consensus 2% in 2021, before slowing to 1.6% in 2022.

The SA government responded to the pandemic with the largest relief effort in the country's history, even though EMs in general have had to tackle this crisis with fewer fiscal resources and higher borrowing costs. Once the risk of sliding back into recession dissipates, numerous EMs are likely to change tactic to achieve a faster and more sustainable pace of fiscal consolidation by broadening their respective tax bases. In SA's case, however, there is limited room to implement tax-raising measures to narrow a burgeoning budget deficit. SA's tax burden (ratio of tax to gross domestic product (GDP)) is among the highest in an EM context. Onerous tax measures applied in the past decade have left SA ranking as the country experiencing the largest change in its tax burden between 2009 and 2018.

While Moody's anticipates the weighted global average fiscal deficit ratio to recover from 11% in 2020 to about 5.5% in 2022, SA's fiscal deficit is likely to be around 9% of GDP. This means that SA will experience the biggest jump in its debt ratio relative to its EM counterparts in the next three years.

In the October medium-term budget, government outlined its intentions to shift spending away from the civil servant wage bill and allocate more resources to capital assets. In real terms this would imply an overall decrease in the government wage bill. Protecting incomes for lower paid workers and being more frugal at the high end may be more palatable for the labour unions. Nevertheless, drawn out negotiations on civil servant wages for the next three years remain a risk and government could miss the

31 March 2021 deadline for agreement on the wage deal. Although the appetite for strike activity may have lessened in a scarce jobs environment, public sector labour market disruptions cannot be ruled out completely.

In our view, the conciliatory and consensus-building approach taken by the president to implement structural reforms suggests a more incremental pace of progress on achieving the country's reform targets. These efforts will contribute to a higher growth trajectory over time rather than reflect immediately in the form of significantly higher near-term growth rates. Consequently, efforts to arrest the increase in government's debt burden will likely be constrained and could lead to further negative rating actions later in 2021, in our view.

Growing fiscal deficits and rising public debt place constraints on further easing of monetary policy. In a November 2020 speech, the Sarb explored two avenues in which fiscal policy affects monetary policy. In the first instance, an unfavourable fiscal position creates uncertainty for investors, which has the potential to increase volatility in the exchange rate. Secondly, a deterioration in fiscal metrics raises sustainability concerns and lifts the premium investors require on SA bonds.

The Sarb has been clear that monetary policy faces limitations in trying to boost potential growth. Instead, interest rate cuts aim to help consumers and firms with debt, to better manage their cash flows. In our view, the level of interest rates is not a major constraint to growth. Average lending rates to households and corporates are low relative to history. Moreover, fewer than 20% of local manufacturers have cited short-term interest rates as a constraint to investment, which is the lowest rating since 1988.

As such, we are of the view that additional easing is less likely from here, unless SA suffers another growth setback induced by a further and prolonged tightening in lockdown restrictions or if there is another sharp dip in inflation. While near term inflation pressures are likely tilted to the downside (see table 1), we see inflation rising in the medium term from an expected average of 3.2% in 2020 to 3.9% in 2021 and 4.7% in 2022.

Real interest rates based on one-year ahead inflation expectations are negative. Although running negative real interest rates could put pressure on the local currency to depreciate, the level of pass-through has remained muted in an environment where retailers are trying to protect growth in sales volumes. Furthermore, the currency strengthened late in 2020 on vaccine optimism, a weaker US dollar and a general alleviation in volatility in financial markets. A more favourable terms-of-trade and positive momentum on global vaccine hopes should support the rand in the interim. Nevertheless, we continue to see a depreciating bias in the local currency in the medium term given SA's deteriorating macro-fundamentals on a relative EM comparison.

We are projecting a shift higher in interest rates in the second half of 2021 given the Sarb's warning against the dangers of running negative real interest rates for a protracted period.

Table 1: SA inflation pressures

Inflation component	Short term	Medium term
Food	↑	→
Energy	↑	↑
Wage growth	↓	↑
Rental prices	↓	↑
Imported prices	↓	↑
Administered prices	↑	↑
Output gap	↓	↓
Credit growth	→	→
Inflation expectations	↓	→

Source: Momentum Investments

Sanisha Packirisamy

Economist

Momentum Investments

Herman van Papendorp

Head: Macro Research and Asset Allocation

Momentum Investments

Partially Vesting Smooth Bonus Range

Universal Multi-Manager Smooth Growth Fund

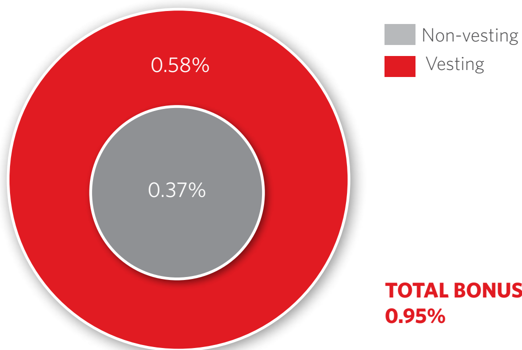
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	100% - 105%	0.75% [1]	2.65% [1]

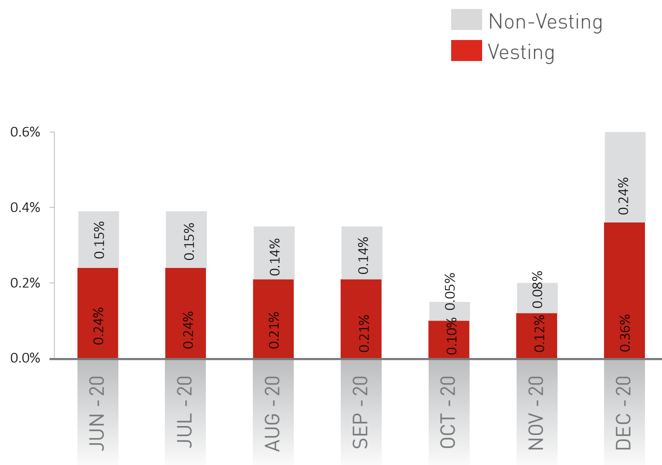
[1]Based on back-tested bonuses and returns

Performance

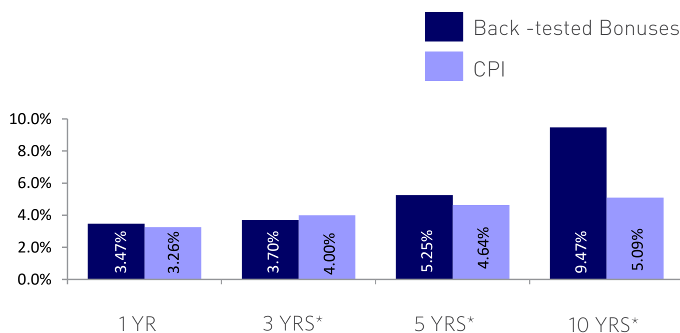
The total bonus* for the past quarter on the Universal Multi-Manager Smooth Growth Fund is shown below.



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



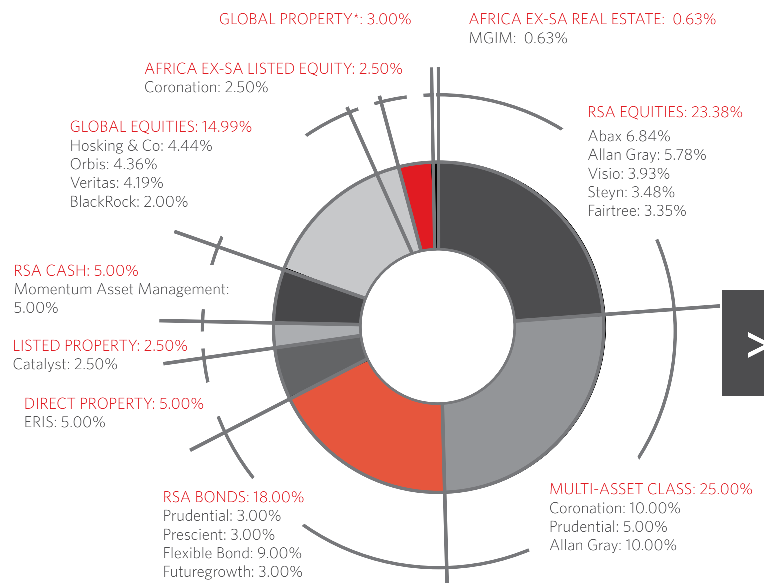
CPI figures are lagged by two months

* Annualised

Asset Allocation

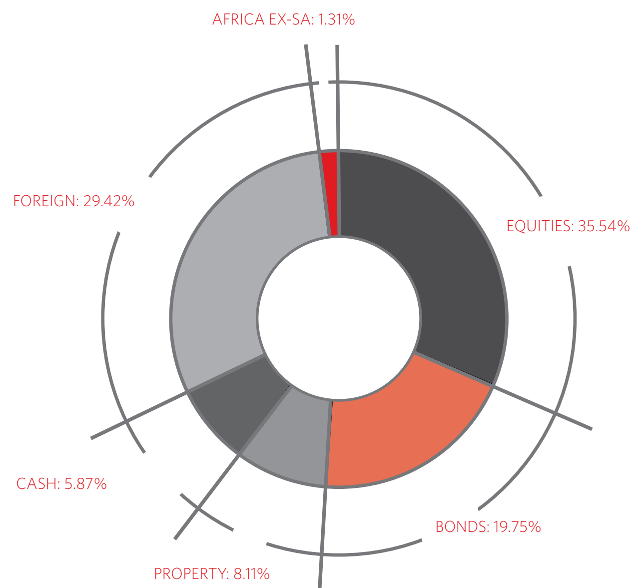
On 1 December 2020, changes were made to the strategic asset allocations.

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 below.



**Asset class has not been awarded any mandates*

The effective asset allocation of the portfolio is shown alongside.



Universal Smooth Growth Fund

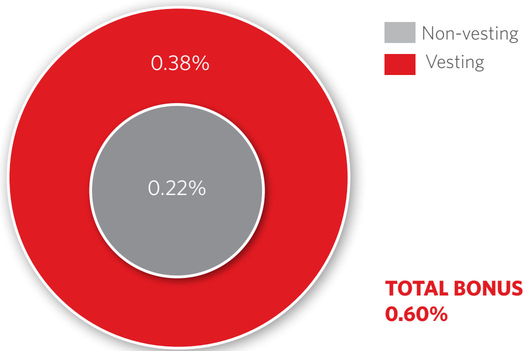
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	100% - 105%	0.69% [1]	1.26% [1]

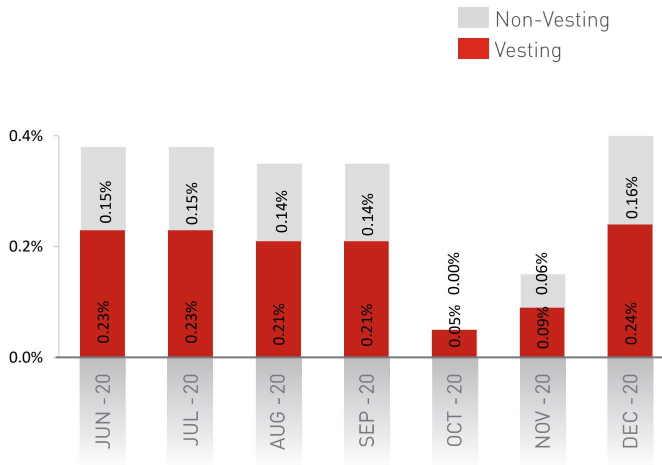
[1]Based on back-tested bonuses and returns

Performance

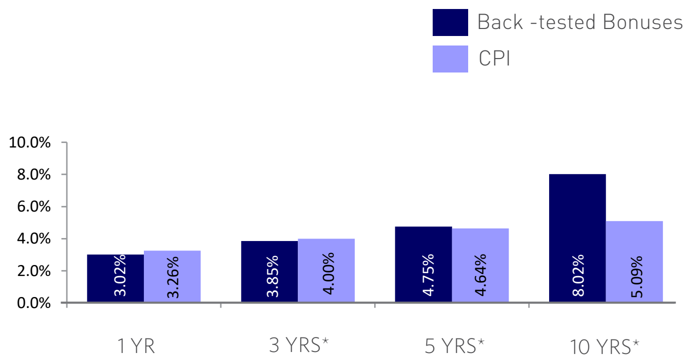
The total bonus* for the past quarter on the Momentum Universal Smooth Growth Fund is shown below.



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

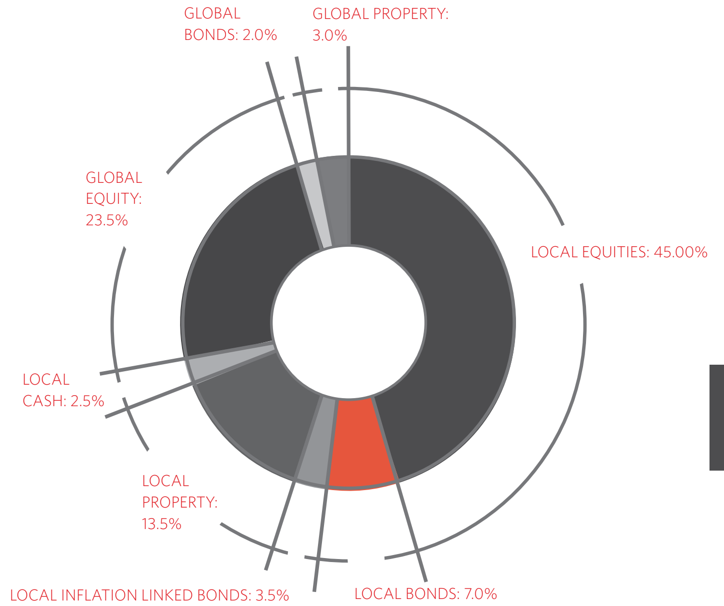


CPI figures are lagged by two months

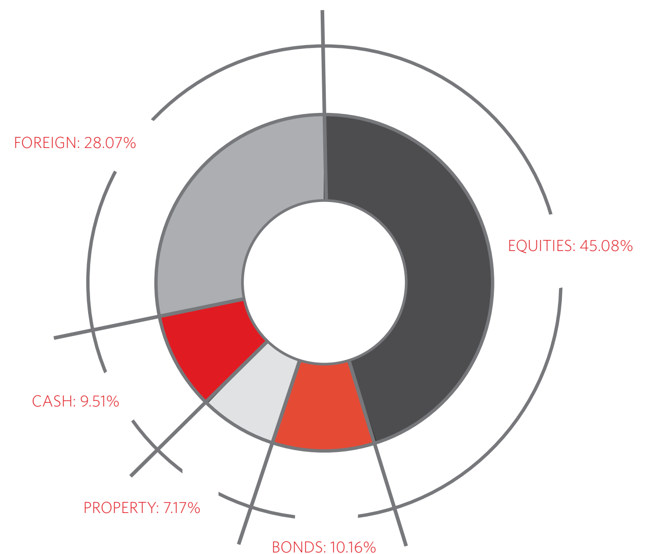
* Annualised

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

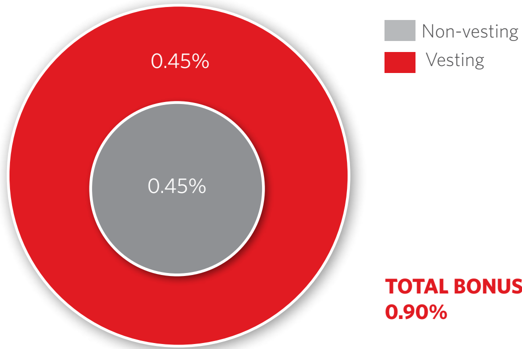
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	100% - 105%	0.86% [1]	3.62% [1]

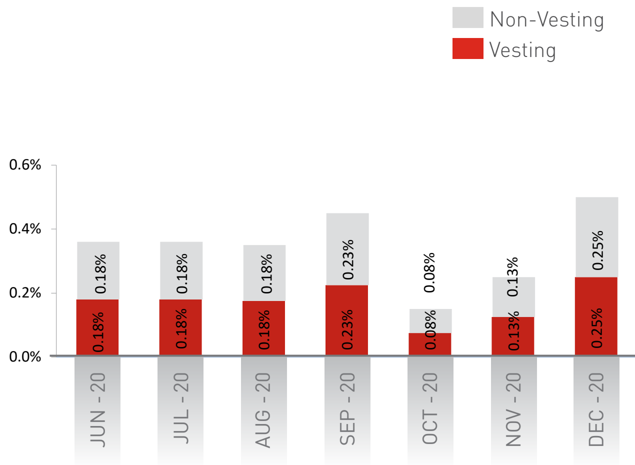
[1]Based on back-tested bonuses and returns

Performance

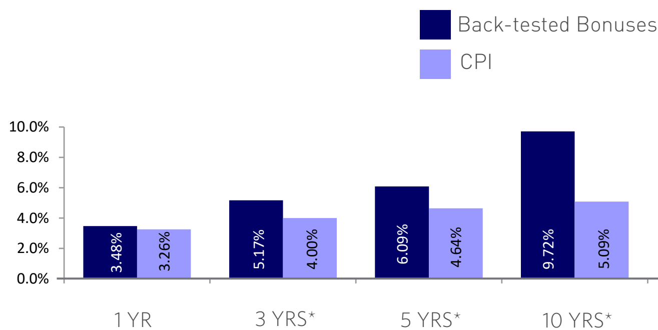
The total bonus* for the past quarter on the Momentum Universal Smooth-Edge Fund is shown below.



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

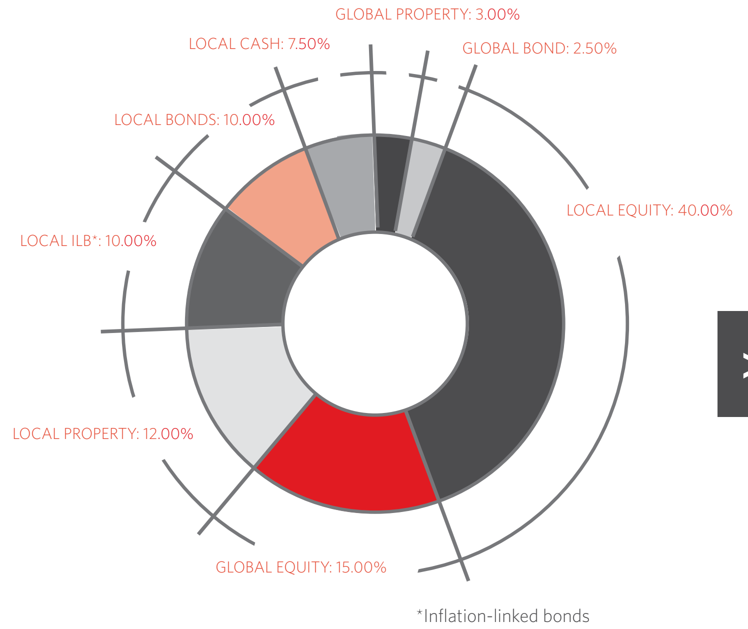


CPI figures are lagged by two months

** Annualised

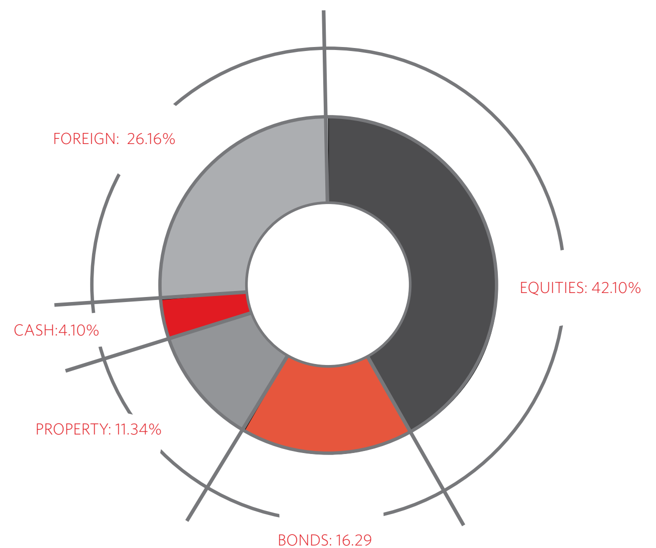
Asset Allocation

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.



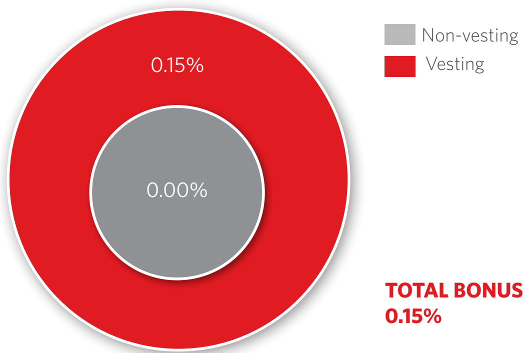
Partially Vesting Smooth Bonus Range
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

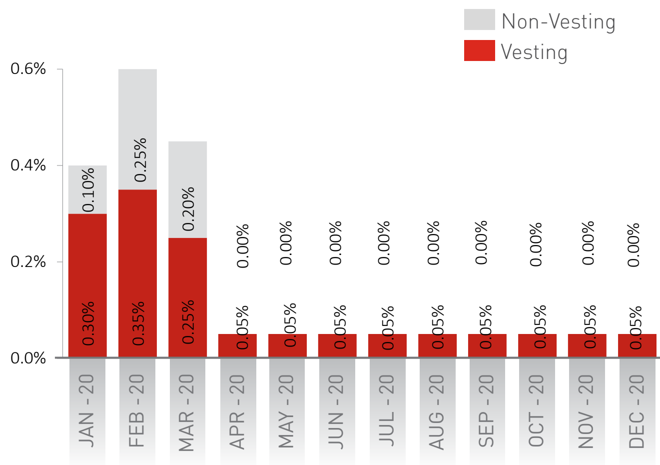
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	95% - 100%	R10.6bn	0.72%	2.12%

Performance

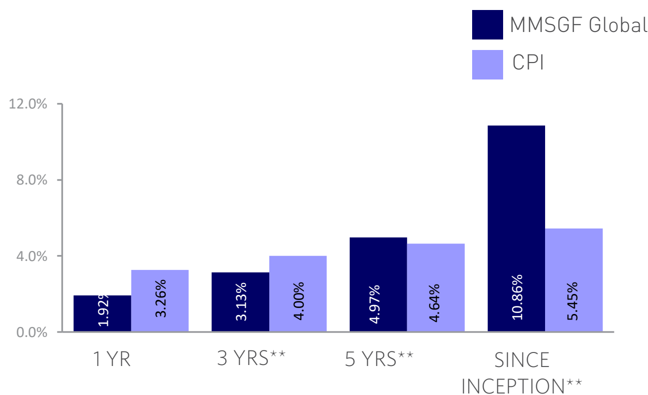
The total bonus* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



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



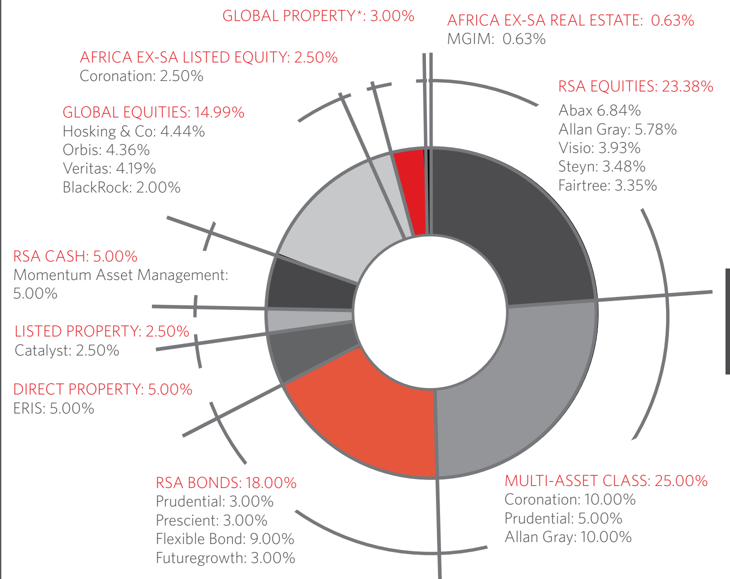
CPI figures are lagged by two months

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

Asset Allocation

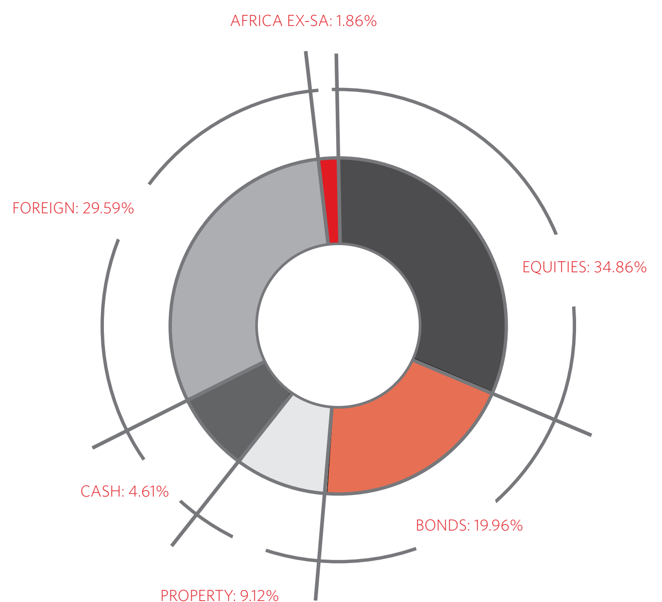
On 1 December 2020, changes were made to the strategic asset allocations.

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 below.



**Asset class has not been awarded any mandates*

The effective asset allocation of the portfolio is shown alongside.



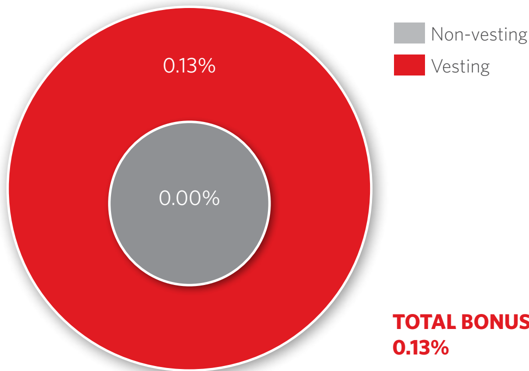
Partially Vesting Smooth Bonus Range
Smooth Growth Fund Global

Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	95% - 100%	R1.8bn	0.77%	1.76%

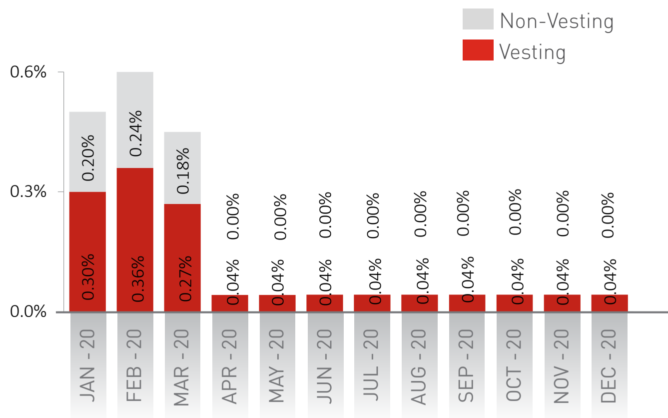
Performance

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

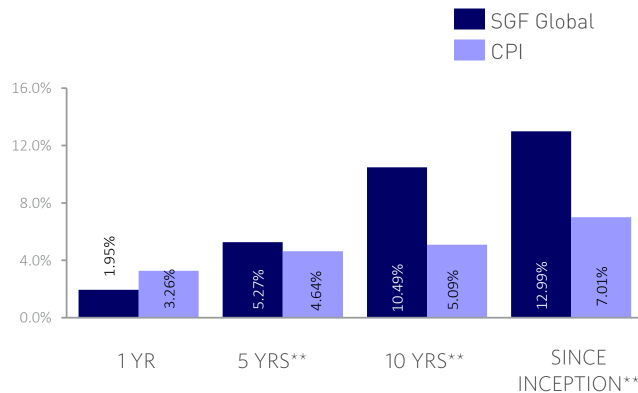


TOTAL BONUS 0.13%

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



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



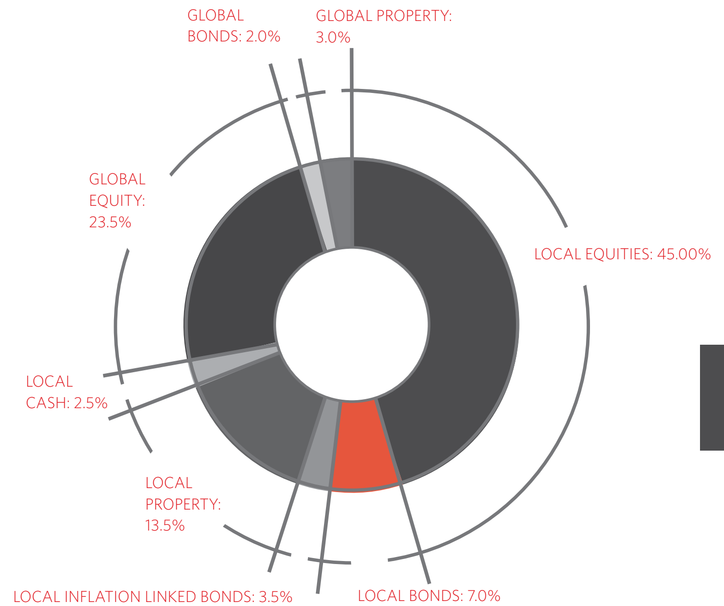
CPI figures are lagged by two months

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

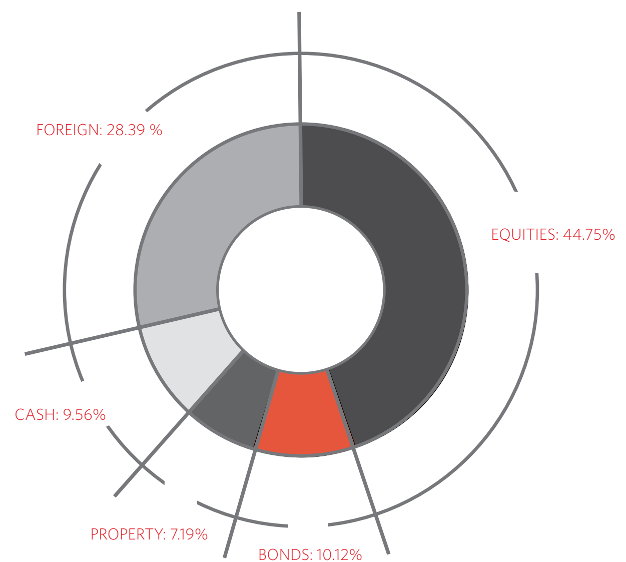
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



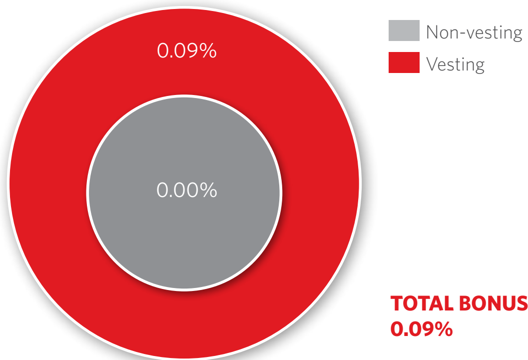
Partially Vesting Smooth Bonus Range
Multi-Manager Smooth Growth Fund Global Bonus Series 2020 *(previously MMSGF Local)*

Fund Snap Shot

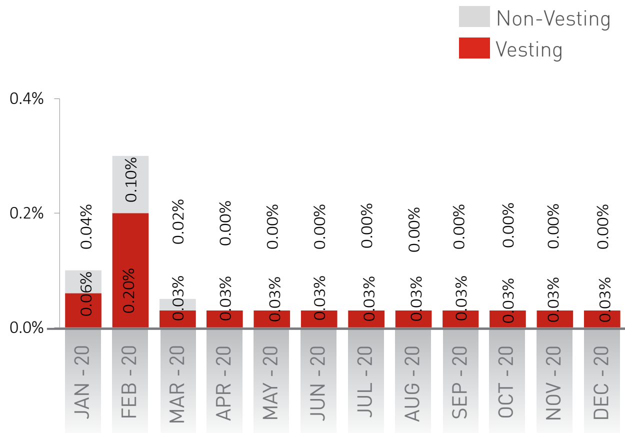
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	87.5% - 92.5%	R143m	0.84%	-1.69%

Performance

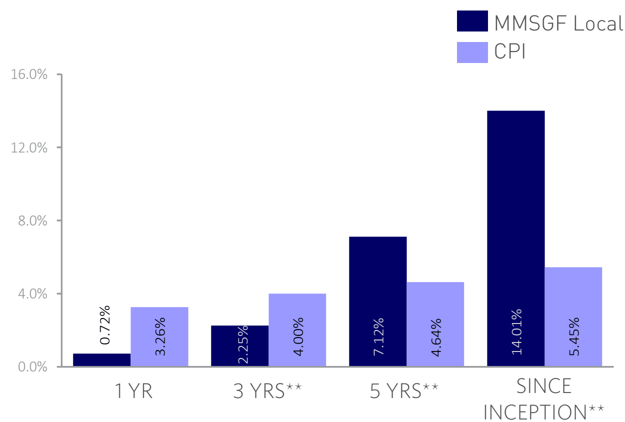
The total bonus* for the past quarter on the MMSGF Global Bonus Series 2020 is shown below.



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



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



CPI figures are lagged by two months

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

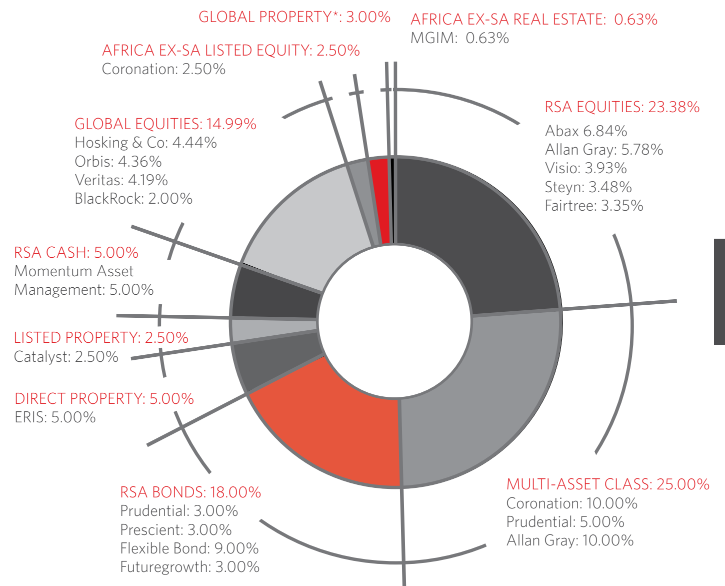
** Annualised

Asset Allocation

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

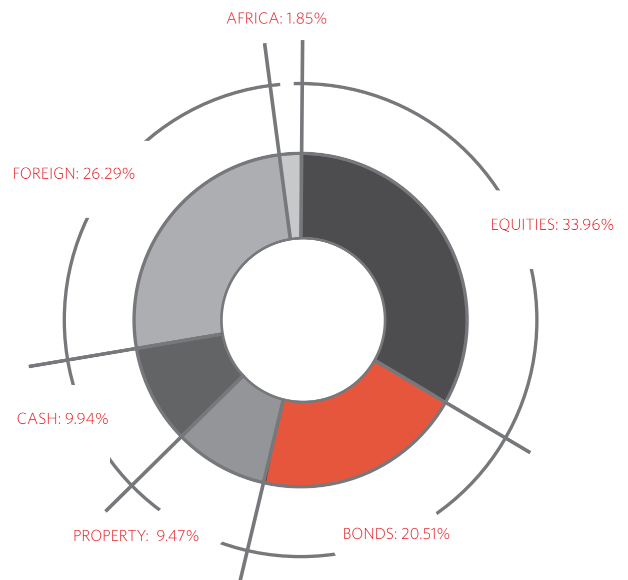
The Africa ex-SA Real Estate allocation is expected to increase gradually over the next 5 years to a total of 2.5% in line with drawdown notices from Momentum Global Investment Management (MGIM).

The strategic asset allocation of the portfolio is shown alongside.



**Asset class has not been awarded any mandates*

The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smooth Bonus Range

Smooth-Edge Fund

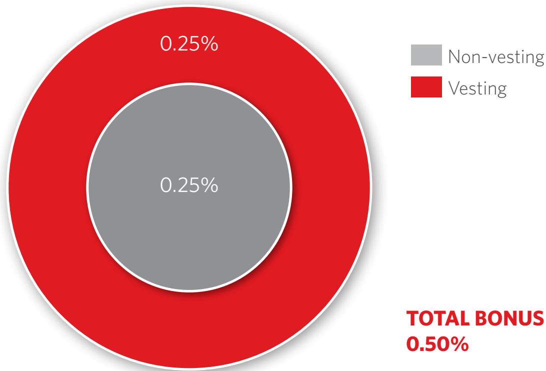
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	100% - 105%	R100m	0.84% [1]	3.62% [1]

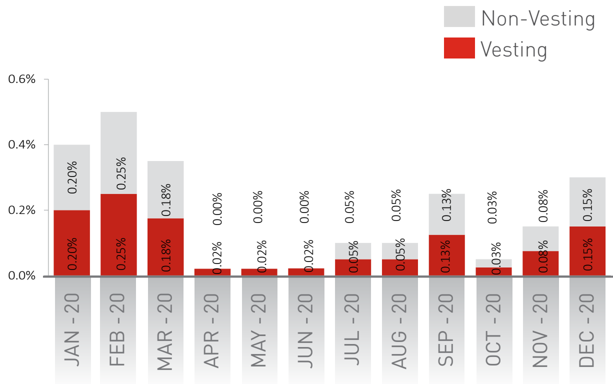
[1]Based on back-tested bonuses and returns

Performance

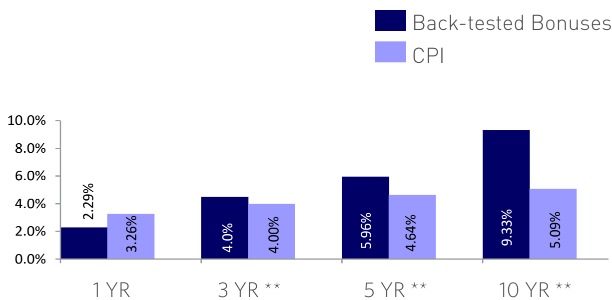
The total bonus for the past quarter on the Momentum Smooth-Edge Fund is shown below.



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



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



CPI figures are lagged by two months

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

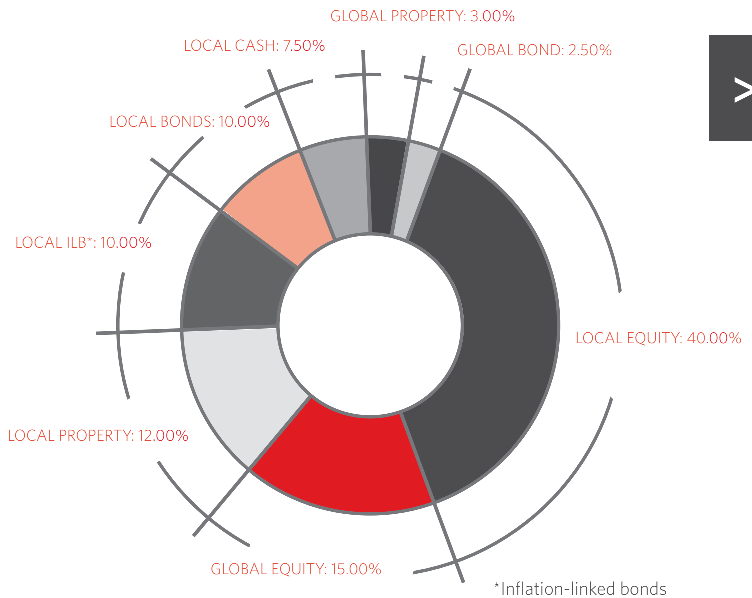
** Annualised

Asset Allocation

The 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.

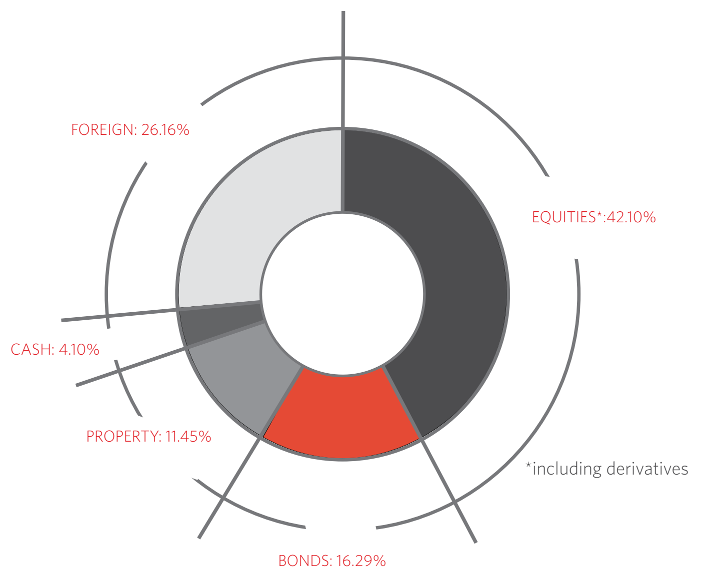
Not only does this solution offer members inflation-beating investment return prospects and protection from market volatility, but the significantly lower capital charge means more money goes directly to the members' retirement savings to bolster their retirement outcomes.

The strategic asset allocation is shown alongside.



*Inflation-linked bonds

The effective asset allocation of the portfolio is shown alongside.



*including derivatives

Fully Vesting Smooth Bonus Range

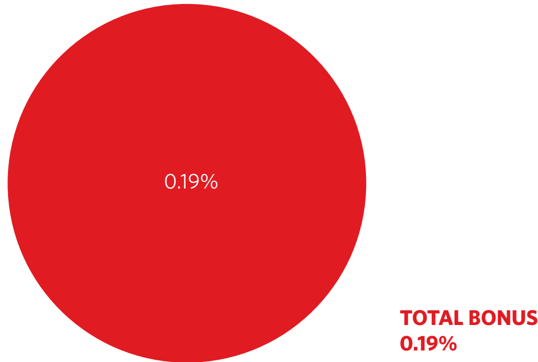
Smart Guarantee + 3 Fund

Fund Snap Shot

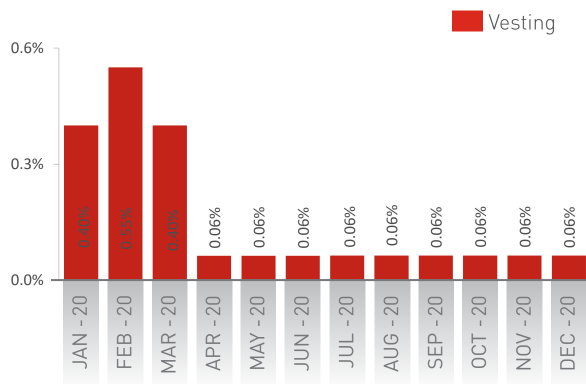
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	92.5% - 97.5%	R425m	0.91%	0.44%

Performance

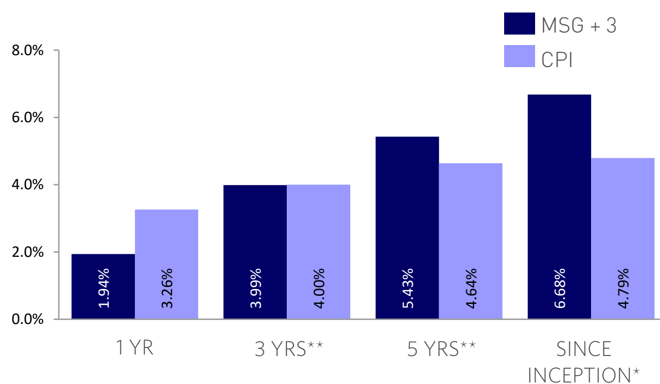
The total bonus* for the past quarter on the Smart Guarantee + 3 Fund is shown below.



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

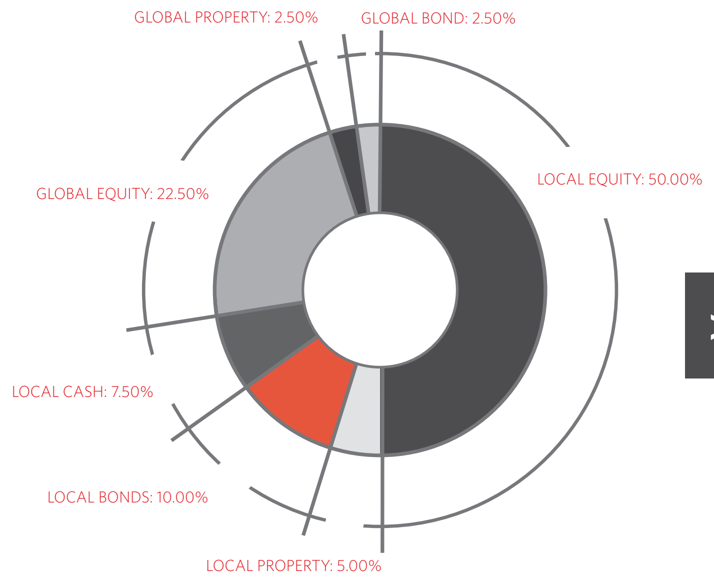
* Bonuses are net of underlying asset charges but are gross of the investment management fee

** Annualised

Asset Allocation

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

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



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

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

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

MSG +3: Bonuses to be declared

Given that the monthly bonuses are based on the weighted average of the previous 36 months' returns of the bonus generating portfolio, it is possible to calculate the future bonuses that will be declared under various future investment return assumptions. Assuming zero returns over the following 34 months (there is a 2 month lag), around **3.30%** of bonuses will still be declared.

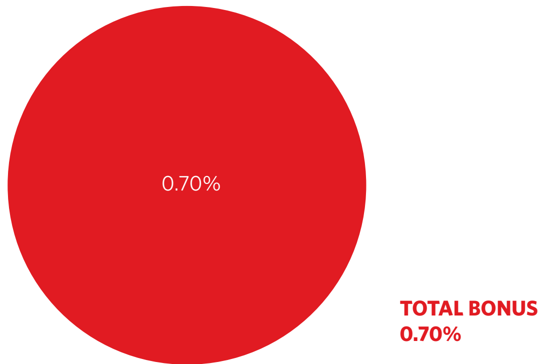
Fully Vesting Smooth Bonus Range
Smart Guarantee Bonus Series 2020

Fund Snap Shot

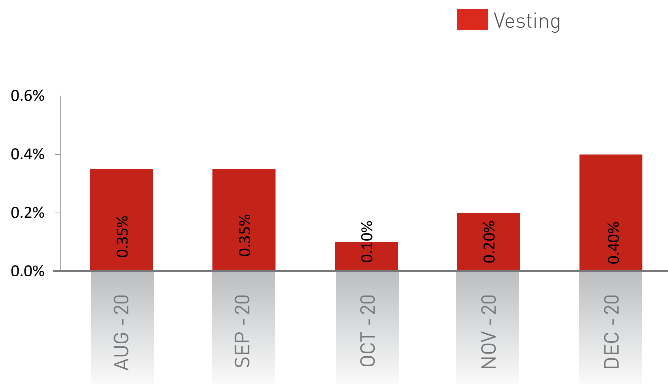
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
August 2020	100% - 105%	R50.4m	-	1.21%

Performance

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

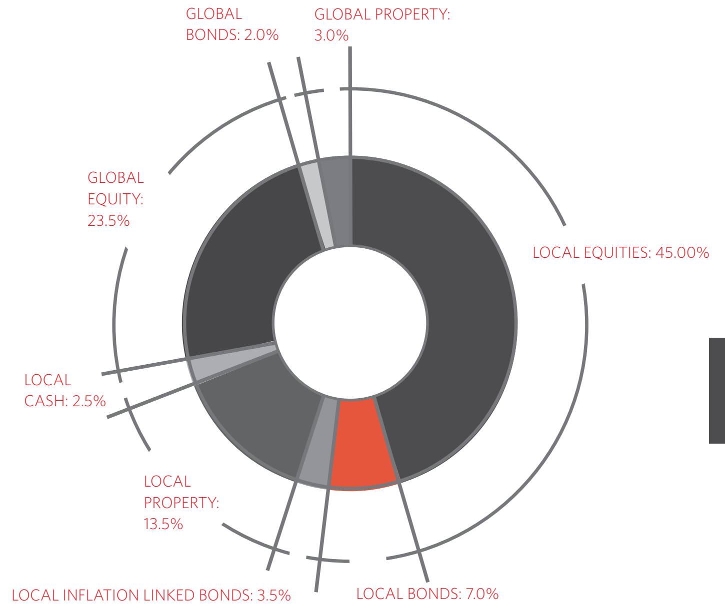


The chart below shows the actual monthly bonuses* for the past 12 months.



Asset Allocation

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



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

For bonus declarations, 90% of the underlying assets returns of the bonus generating portfolio are smoothed over a three-year period as per the smoothing formula. The insurer liability driven investment strategy includes a dynamic protection overlay to secure the guarantee.

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

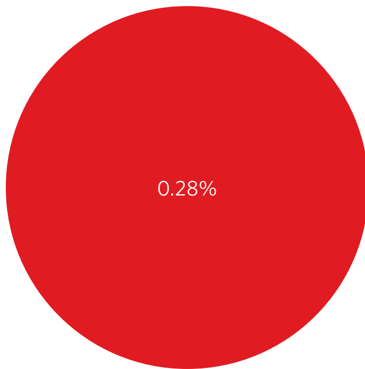
Fully Vesting Smooth Bonus Range
Multi-Manager Secure Growth Fund

Fund Snap Shot

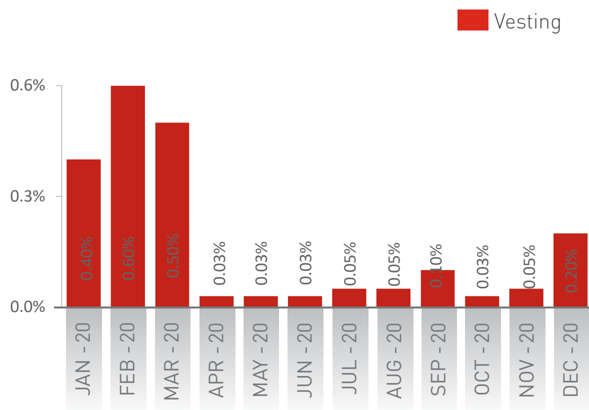
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUSES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	102.5% - 107.5%	R91m	0.76%	2.19%

Performance

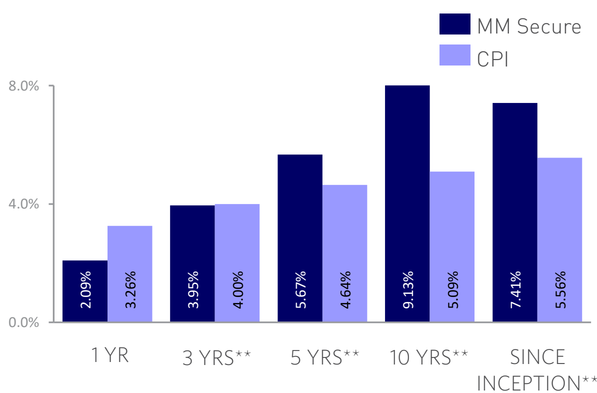
The total bonus* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



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



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



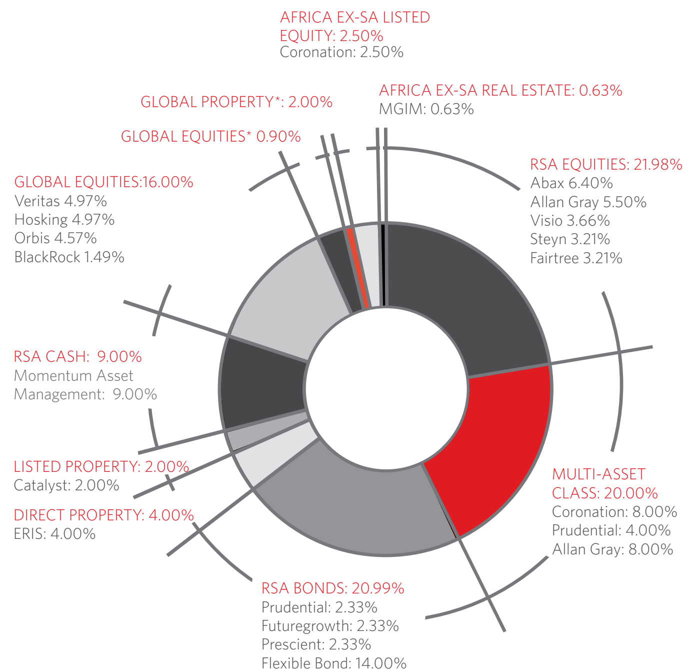
CPI figures are lagged by two months

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

Asset Allocation

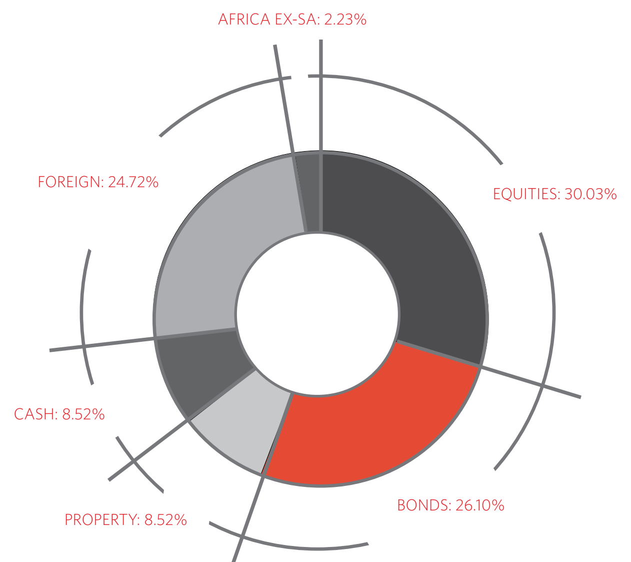
On 1 December 2020, changes were made to the strategic asset allocations.

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



**Asset class has not been awarded any mandates*

The effective asset allocation of the portfolio is shown alongside.



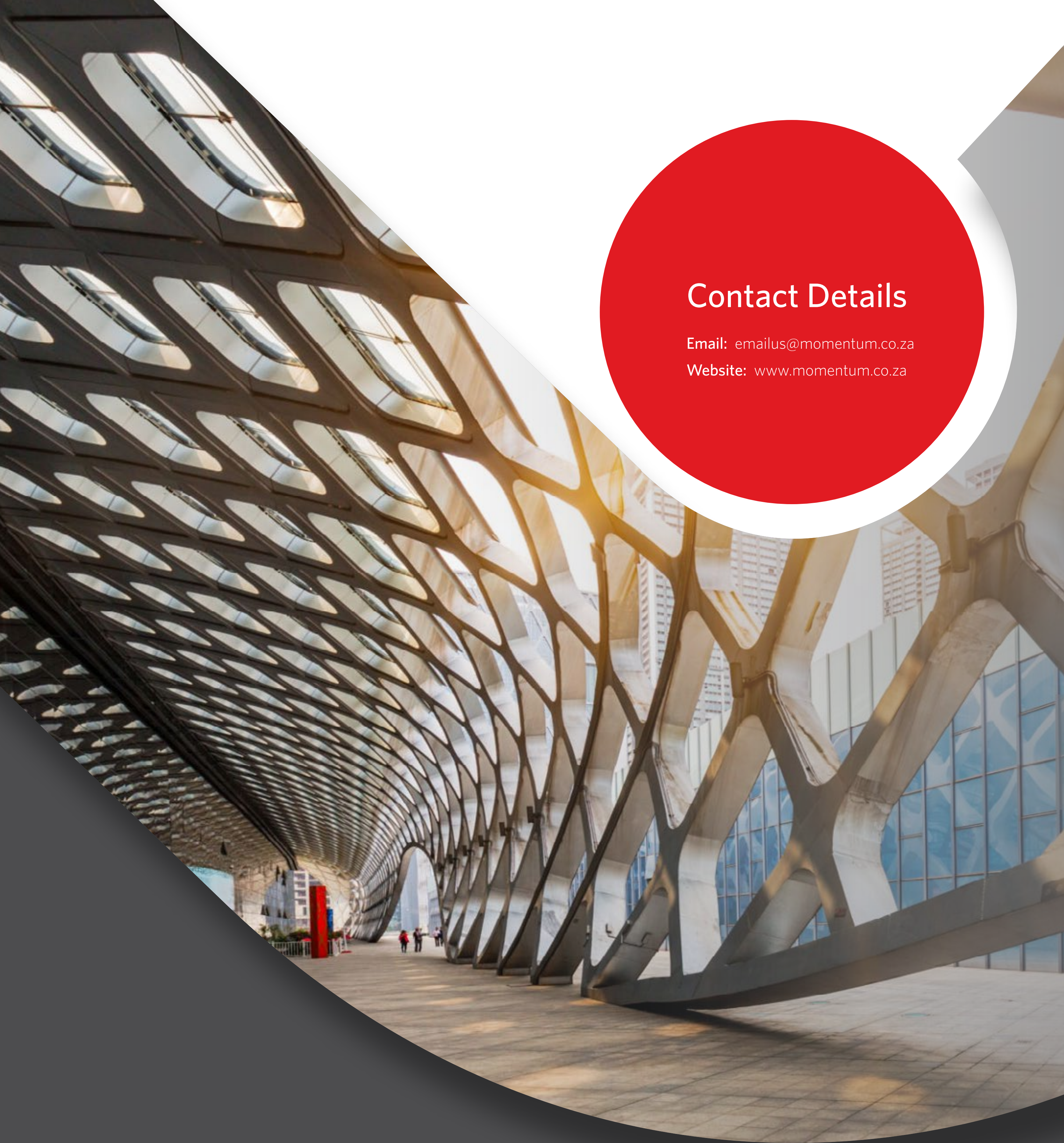
Smooth Bonus Portfolios Key Features

Vesting	Fund	Fund Return Objective	Manager	Mandate Type	Guarantee on Benefit Payments[1]	Market Value Adjustment on Voluntary Exits[2]	Capital Charge	Policy Fee or Investment Management Fee*	Inception Date
Partially Vesting	Multi-Manager Smooth Growth Fund Global	CPI + 4% pa, net of the policy fee and 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 Global Bonus Series 2020	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 Secure Growth Fund	CPI + 2% pa, net of the policy fee and underlying asset charges over a 5 year time horizon	Multi-Manager	Moderate Conservative Balanced	100% of net capital invested and total bonus declared (net of the Policy fee)	Yes	1.40% pa	0.35% of the first R50m, 0.25% of the excess above R50m[3]	November 2007
	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	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
	Smart Guarantee Bonus Series 2020	CPI + 3% pa, net of the investment management fee and underlying asset charges over a 6 year time horizon	Insurer Liability Driven Investment	Insurer Liability Driven Investment	100% of net capital invested and total bonus declared (net of the Investment management fee	Yes	0.50% pa	0.75% pa[3]*	August 2020

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

KEY:

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



Contact Details

Email: emailus@momentum.co.za

Website: www.momentum.co.za

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