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distance between
two points is also
the **smoothest**”

Smoothed Bonus Report

Fourth Quarter 2022

momentum
corporate





Looking back over the past year and quarter

Dear valued investors



Financial markets struggled last year, especially global markets that were generally in negative territory. Many of the same themes caused inflationary pressures and persisted over the year. Fortunately, over the last quarter, China lifted its zero COVID policy and global energy prices fell. Due to Europe diversifying away from Russian Energy and aided in a large part by a far milder winter, these factors contributed to the fall in global energy prices. In China, the lifting of its zero COVID policy has been positive, albeit resulting in the subsequent rise in infections. The Russia-Ukraine war still looms like a gloomy grey cloud dampening global growth.

The MSCI Developed Markets (DM) Index declined by -13.17% in 2022 (3.51% for the quarter). Over the year the equity markets in the United States, Europe, Central Asia and East Asia regions mainly led to negative returns, while the United Kingdom managed to eke out a meagre 2.10%. MSCI Emerging Markets (EM) delivered returns of -14.50% (3.87% for the quarter), due to the Russia-Ukraine conflict, geopolitical tensions and slower global growth.

The local equity market delivered low lacklustre returns but performed far stronger than global markets. The JSE All Share Index delivered 3.58% over the year (15.16% for the quarter), supported mainly by resources and financials. In South Africa's fixed income markets, the FTSE/JSE Government Inflation-linked Bond Index (ILBI) delivered 4.24% for the year (2.22% for the quarter). That was far lower than the heights it reached in 2021. The FTSE/JSE All Bond Index returned 4.26% for the year (5.68% for the quarter), now delivering returns below inflation. At the same time, the FTSE/JSE Listed Property Index (Sapy) delivered 0.49% for the year (19.31% for the quarter), with a strong recovery over the quarter.

Due to rising inflationary pressures, the inflation rate increased to 7.44% from 5.47% in the previous year. The fall in energy prices over the last quarter will help to curb inflationary pressures, especially the fall in the price of Brent crude oil to 80.83 dollars per barrel from a high in May of 120.14 dollars per barrel. Unfortunately, the price of local energy in the form of electricity will be rising by an average of 18.65% on 1 April 2023 as announced by the National Energy Regulator of South Africa. There is, however, pressure to have this reviewed.

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

Momentum Corporate smoothed bonus portfolios

Historically, a global portfolio consisting of equities and bonds on average provided investors with some diversification to protect total returns. That is when one type of asset class performed poorly, the other one performed well enough to ensure at least some positive overall returns. Over the last year, many of these diversified asset classes have not provided the diversified returns that we expected. Smoothed bonus portfolios provide a further overlay of smoothing out the market fluctuations, but the lower returns will still feed into monthly bonus rates declared.

Markets are generally expected to have a degree of volatility and we have seen a material increase in volatility over the last few years which 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, capital guarantees provide further comfort.

We recently launched the Universal Fifty Smooth Return Fund (UFSRF). 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 complements our smoothed bonus offering.

As we embark on a new year, we wish all our clients all the best for 2023. We look forward to smoothing out these stormy seas as we take your members on the journey to financial success.

Warm regards

**Steed
Duncan-Smith**

Client Relationship Manager
Momentum Corporate





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South Africa's energy crisis

Introduction



The energy crisis in South Africa continues to scourge our society and economy alike, with power outages now part of our daily lives. As unemployment peaks due to the alarming increase in job losses and the cost of living rising steadily, we find ourselves in a very dark place. Normalising an abnormal situation is what South Africans are facing. With the energy crisis directly affecting our economy and consequently inflation, which has recently hit a 13-year high of 7.8%, smoothed bonus portfolios are the way to invest to protect against untimely market downturns.

Impacts of loadshedding

Most South Africans have experienced loadshedding because of the energy crisis. It affects different dimensions of society in various ways. Below, we explore a few challenges with which most South Africans are faced:

- **Lacking internet and connectivity:** Negatively impacting productivity for those working from home;
 - **Increased traffic:** Exacerbated with traffic lights not working during periods of loadshedding, subsequently leading to further delays in people getting to work on time, which will directly affect productivity;
 - **Reduced security:** Theft, compromised digital security systems and shoplifting;
 - **Damaged equipment:** Power surges damaging equipment and costing businesses unbudgeted expenses, including the cost of insurance;
 - **Shutdown of smaller businesses:** Given the need for backup generators and solar system installation to remain operational to compete against larger businesses; and
- **Food security:** Farmers face an insurmountable challenge of trying to irrigate outside loadshedding hours. Maintaining cooling systems to keep foods fresh for longer is also an ongoing challenge. This in turn will contribute towards high prices of food products.

Notwithstanding the above, there are always indirect or opportunity costs that cannot be quantified in any way but are unavoidable given the energy crisis. These costs include hundreds of thousands of jobs that could have been created had it not been for loadshedding, South Africa's reputational risk will impact our tourism industry, lack of confidence in our government, the loss of skills and expertise due to emigration, as well as low morale which could lead to lack of efficiency and lower productivity.

These are but a small subset of an infinite number of issues caused by the energy crisis. In isolation and in accumulation with one another, the impacts have severe restrictions for us, the consumers. With COVID-19 still bearing down on society, the ongoing war between Russia and Ukraine, loadshedding in South Africa is adding to a struggling economy and poverty that already plagues our nation.

Sailesh Reddy

Product Specialist
Structured Solutions

Inflation changes and contributors

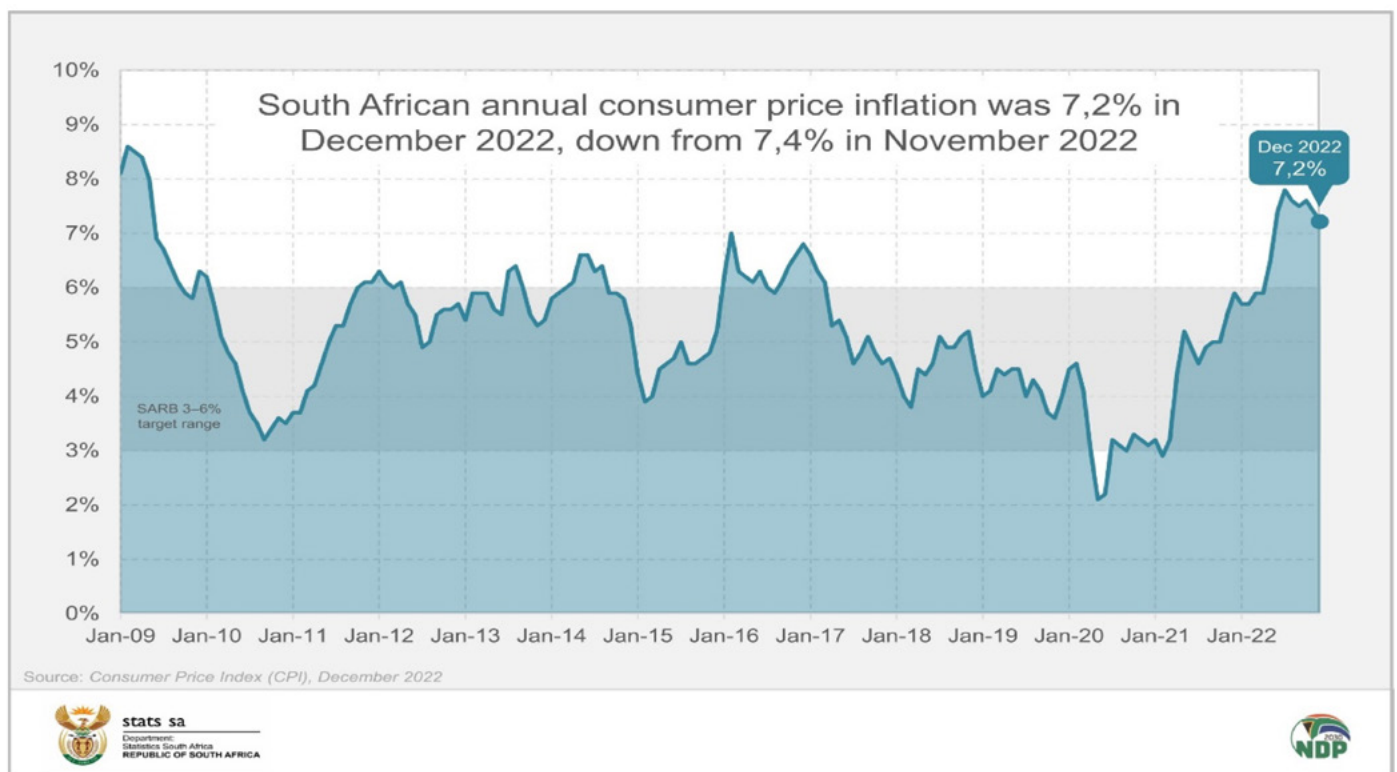
Energy regulator NERSA has granted power utility Eskom a nearly 19% price hike from 1 April 2023 – a tariff increase more than double the rate of inflation. Municipalities will add a premium to this, which will further worsen the burden. This means that South Africans would not only be paying more; they will also be getting less access to electricity. The situation has gone from bad to worse and the cost of living for most of the country's people is becoming unsustainable.

The price hikes have a significant bearing on our farming industry. For example, farmers are already spending millions of rands on acquiring generators and solar panels, in addition to further millions of rands spent on fuel to power generators and equipment. This directly contributes to the increase in inflation as the supply chain is disrupted, increasing the cost of production and impacting

manufacturing costs across various industries. The electricity price hike compounds this.

The farming sector and, consequently, the food industry is experiencing one of the most notable downfalls of loadshedding. Disruption of planting schedules, increasing the cost of production and adding a higher level to farming operations has meant that food prices have had to increase and have been one of the main contributors to inflation increases.

In December 2022, Statistics South Africa published an annual consumer price inflation of 7.2%, down from 7.8% in July 2022 – the highest inflation rate seen in 13 years! This was the fourth consecutive month where annual consumer price inflation was above the upper limit of the South African Reserve Bank's (SARB) target range of 6% per annum. These rates are the highest we have seen since May 2009 of 8% per annum. This can be seen in the graph below:



Further economic impact of loadshedding

Economists believe loadshedding is marching South Africa towards a recession. As the South African energy crisis deepens, economists believe we are facing a 45% chance of slipping into a recession this year. The probability of this happening in the coming 12 months increased from odds of 35% in November 2022 due to recently having the longest streak of consecutive daily power outages. This increase is the result of the energy crisis intensifying, which in turn threatens to curb domestic output. "The outlook for South Africa's economy in 2023 isn't impressive," said Finance Minister Enoch Godongwana. It comes as no surprise given the constraints on our energy supply.

According to Miyelani Maluleke, an economist at ABSA corporate and investment banking, inflation had peaked in South Africa and is likely to return to within the SARB's target range of between 3% and 6% in mid-2023 and end 2023 at 4.6%. The two primary drivers of the high inflation can be attributed to food and fuel increases.

Forecasts For Key South African Economic Indicators

These can be seen on the quarter-on-quarter forecasts for 2023/2024:

	4Q 2022	1Q 2023	2Q 2023	3Q 2023	4Q 2023	1Q 2024	2Q 2024
Change in gross domestic product (QoQ)	-0.5%	0.2%	0.3%	0.3%	0.3%	0.4%	0.4%
Change in headline inflation (YoY)	7.4%	6.8%	5.7%	4.8%	4.6%	4.8%	4.9%
Key interest rate (end of period)	7%	7.5%	7.5%	7.5%	7.25%	7%	6.75%

Source: Bloomberg survey

Note: Table shows median estimate of economists surveyed by Bloomberg Jan. 9-12

Bloomberg

Dr Nicola Brink, head of finance at the SARB, said loadshedding is contributing towards slow and inequitable domestic economic growth which in turn makes it an unfavourable operating environment for the financial sector. She added that loadshedding has had the dual negative impact of influencing investor sentiment towards South Africans as well as a detrimental effect on business productivity.

South Africa's gross sovereign debt over the current financial year 2022/2023 is being projected at around R4.7 trillion and the plan to take over a significant portion of Eskom's debt – R400 billion – means our sovereign credit rating remains below sub-investment level. This status is an indication of a country's ability to pay back debt. It means that the government would need to pay more in debt servicing costs and spend less on infrastructure.

Overall, alarm bells are ringing throughout the economy. With no end in sight for loadshedding, the outlook for the South African investment market is bleak. With economic uncertainty abounding, there is a real risk of protracted negative investor sentiment which can result in a material pullback in the equity and bond markets to the detriment of those investing in linked portfolios. The situation could be exacerbated by yet another sovereign credit downgrade, let alone the increasing prospect of a global recession. Due consideration should be given to providing sufficient protection for investors, especially if there is a need to access their retirement funds in the short to medium term.

The value of investing in a smoothed bonus portfolio

Smoothed bonus portfolios aim to provide inflation-beating returns over the long term while protecting against market volatility in the short term, with investment market pullback a very real possibility under current conditions. The nature in which the assets are invested for smoothed bonus portfolios is that their market value will fluctuate and may be volatile, year-on-year. Smoothed bonus portfolios aim to reduce the impact of negatively fluctuating returns year-on-year while still achieving positive returns in the long term. This is done by holding back a portion of the returns during periods of strong positive market returns. This is then used to declare positive bonuses in periods of low market returns. While smoothed bonus portfolios are not exempt from harsh market conditions, it offers a sense of protection to the client during market falls.

Investors seeking strong positive returns may shy away from smoothed bonus portfolios due to the holding back of returns during periods of strong market performance. However, the protection of client capital and regular bonus declarations during market falls create a stable returns profile for investors.

Conclusion

In light of continual power outages adversely affecting the economy, one should look to protect one's investments, given the material investment market uncertainty as well as the steady rise in the cost of living. Through a full capital guarantee and non-negative bonuses, smoothed bonus portfolios can be a way to achieve this.



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

by Sanisha Packirisamy and
Herman van Papendorp

Highlights

Markets

- While global equity markets could be under pressure during the larger part of 2023 as they deal with the potential for recessions and the final phases of rate tightening, there could be some relief for equities towards the latter part of the year as markets start looking beyond the downward growth cycle and begin discounting an eventual Fed pivot to lower interest rates.
- Fundamentally, the anticipated combination of falling inflation and slowing economic growth (with a meaningful risk of recession) should be supportive of the United States (US) bond market in 2023. This could re-establish the hedging benefits of having government bonds in a global diversified portfolio, particularly during potential equity drawdown periods amid a cyclical slowdown or recession. The significant runup in bond yields in 2022 has once again made fixed income a viable income-providing alternative to equities and made US government bonds look cheap versus US equities.
- Although global property fundamentals remain solid and the asset class looks cheap against equities, its expensiveness against fixed-income assets erodes its relative attractiveness.
- South African (SA) equities have an attractive valuation underpin, both within the global universe and against its history. This should stand it in good stead during potential global equity drawdowns, but particularly during subsequent recoveries when global risk appetite rises. Even more so, as SA is the fifth most underowned market within global emerging market (GEM) equity funds.
- SA real bond yields are attractive against their history, as well as relative to those in global markets, with part of the high real yield differential due to a fiscal and country risk premium. We expect falling inflation in the coming year to become less supportive of 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.
- Although SA listed property operational metrics are improving, they remain worse than in the pre-COVID era. The potential for meaningful listed property return upside from undervalued levels needs to be weighed against some remaining negative fundamental factors.

Economics

- The globe is facing higher levels of geo-economic fragmentation, reduced liquidity, a lower growth pattern in China, increased global conflict and higher inequality.
- Although an over-tightening in monetary policy raises the risk of negative growth outcomes sooner, the risk of under-tightening is seen to pose a bigger threat. Unhinged inflation expectations could force central banks to tighten policy even more, over a longer period, resulting in a more damaging hit to growth and jobs.
- A further easing in supply-chain disruptions, favourable base effects in food and fuel and demand destruction are expected to drive inflation lower in 2023. A return to central bank targets could nonetheless take time given stickier services and wage inflation.
- In our view, central banks need to have clear sight of a sustained deceleration in underlying inflation and a reversal in tight labour market conditions for interest rate cuts to be considered. Market-implied policy rates point to a peak in the US federal (Fed) funds rate in the first half of next year. Market participants are pricing in a cut before the end of 2023, after an expected pause.
- A faster relaxation in COVID-19 regulations in China, a warmer winter in Europe that prevents energy rationing or stronger real wage growth for the US consumer can lift our base case view on global growth.
- Stickier inflation leading to additional interest rate tightening (relative to the baseline), a colder European winter that enforces more energy rationing, a bumpier path to unwinding China's zero-COVID strategy, renewed Chinese property sector woes or an accelerated decoupling between the US and China could leave global growth at a mere 0.5% in 2023.
- Lower growth in SA's main trading partners will reduce demand for SA's exports, while slow reform in energy and logistics as well as mounting consumer headwinds will cap growth in domestic demand. Question marks over SA's political outlook cast a dark shadow over investment and growth prospects.
- The SA Reserve Bank (SARB) is likely to hike further in the first quarter of 2023 to arrest the spread of broad-based inflation pressures.
- A potential greylisting and a consequent exiting of a greylisted status will depend on perceived action to address the Financial Action Task Force's (FATF) concerns.

A turbulent year for investors

Fund managers were left with little place to hide in financial markets given losses experienced in equity markets and a torrid year for bonds, which faced a surge in inflation and an aggressive response from central banks. Commodities (soft commodities, in particular) were among the best performing asset classes given supply chain blockages exacerbated by the Russian-Ukrainian conflict. Meanwhile, after soaring to record highs during the pandemic, Bitcoin sank to the bottom of the performance table last year as the collapse of the cryptocurrency exchange FTX shook the entire crypto world. A number of crypto exchanges and lenders filed for bankruptcy or paused customer withdrawals in 2022.

Despite geopolitical turbulence and elevated uncertainty, Wall Street's fear gauge (the CBOE Volatility Index or VIX) topped out at 36 points in early March 2022 and retreated to below 22 points by the end of the year. In contrast, the Merrill Lynch Option Volatility Estimate (MOVE), which captures a yield curve-weighted index of the normalised implied volatility on one-month Treasury options, peaked at 160 points in October, before retracing to 113 points by the end of last year, which was still 34 points higher than the start of 2022.

The Russian invasion of Ukraine exacerbated supply-chain disruptions and sent the prices of soft commodities soaring in 2022. The Bloomberg Commodity Price Index, which also includes hard commodities, increased by 16.1% in 2022, following a 27.1% rise in 2021. The dollar price of gold ended the year largely unchanged (a return of negative 0.3%) at US\$1824/oz with sharp rises in the US dollar and Treasury yields limiting gains during the year, while the dollar price of platinum and crude oil rose by 10.9% and 10.5%, respectively, to end the year at US\$1079/oz and US\$86/bbl.

Global equities finished last year 18.4% weaker (see chart 1), erasing gains of a similar magnitude the year before. This was the weakest result since 2008 (when global equities tanked 42.2%) and the third worst year since 1987. Developed and EM equities performed equally as poorly over the year. The MSCI Developed Market (DM) Index fell 18.1% in 2022, after gaining an impressive 21.8% in 2021. Meanwhile, the MSCI EM Index extended its losses by a further 20% after dipping by 2.5% in 2021.

Within the DM composite, US equities were hit the hardest. The S&P 500 Index fell 18.1% (relative to a 37% drop in 2008) and lost US\$8.22 trillion after a banner year for equities in 2021. The Fed's resolve to quell high inflation led to one of the most aggressive interest rate tightening cycles in decades, dampening the outcome for equities. Growth and technology shares were particularly battered given sticky inflation, steep interest rate hikes and downbeat sentiment, while defensive sectors outperformed amid growing recessionary fears.

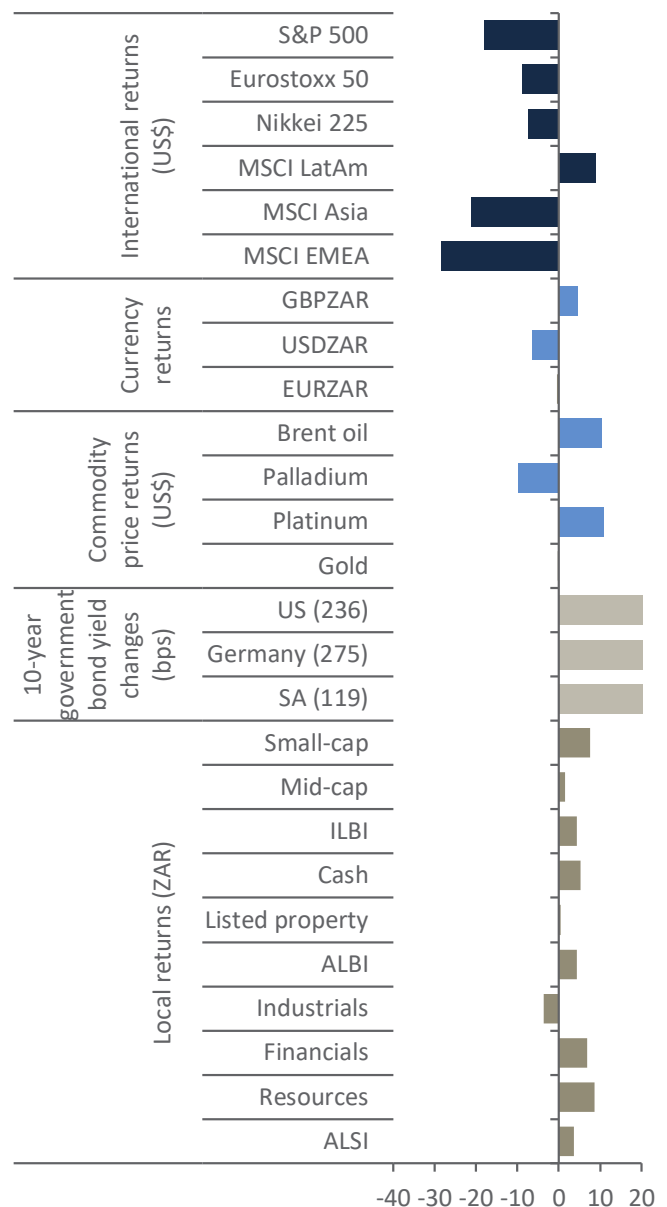
Returns on the Eurostoxx 50 Index have been in negative territory six times since 2007. The index lost 8.8% in 2022, after surging 24% the year before. Returns were notably more negative in 2008, 2011 and 2018. Across in Japan, the Nikkei 225 Index dipped for the fifth time since 2007. The index shed 7.3% in 2022, following a 6.7% uptick in 2021.

Weakness in the MSCI EM Index was predominantly driven by a sharp fall in equities in the Europe, Middle East and Africa (EMEA) and Asian regions, while equity markets in Latin America managed a healthy gain of 8.9%, making up for an 8.1% dip in 2021. The MSCI EMEA Index fell sharply by 28.3% after rising 18% in 2021. The MSCI Asia Index reported losses for a second consecutive year and plunged 21.1% in 2022.

Even though bonds usually act as a shock absorber in portfolios when equities plunge, the global bond market suffered a significant meltdown last year. More-aggressive-than-expected interest rate hikes and decades-high inflation pressured most bond asset classes, with 2022 registering as the worst year for the Barclay's Global Aggregate Bond Index, since its inception. The yield on the US 10-year government bond rose by an additional 236 points in 2022, following an increase of nearly 60 points in 2021, while the German 10-year government bond yield increased by nearly 275 basis points last year and 314 basis points since the end of 2020.

The local equity market outperformed its global counterparts and gained 3.6% in 2022, following a robust increase of 29.2% the year before. Energy, tobacco, banks, metals/mining and food producers were the top performers last year, while pharmaceuticals, construction and telecommunications brought up the rear in the local equity market. Gains were driven by the FTSE/JSE Resources Index which closed the year 8.6% in the black. The FTSE/JSE Financials Index jumped 6.9% in the same period, while returns on the FTSE/JSE Industrials Index disappointed at negative 3.7%.

Chart 1: Annual asset class returns (%)



Source: Iress, Momentum Investments

10-year government bond yield changes indicated in brackets (truncated in chart)

The FTSE/JSE Mid-cap index ended the year 1.6% firmer while small-cap equities powered ahead at 7.6%.

In SA's fixed income markets, the 10-year government bond yield sold off 119 basis points. The JSE Assa All Bond Index returned 4.3% for the year, while the JSE Assa Government ILB Index gained by a similar margin. The FTSE/JSE SA Listed Property Index eked out a 0.5% return for 2022 after recovering by 36.9% a year earlier.

EM currencies generally weakened against a firmer dollar in 2022, despite the latter losing steam towards the end of the year on investor expectations for a lower peak in US interest rates amid concerns over an impending recession. The Russian rouble outperformed by nearly

81%, followed by a 34% recovery in the Argentine peso in 2022. Meanwhile, the South Korean won and Hungarian forint posted the weakest returns of the EM peers at around negative 11% against the US dollar in 2022. The rand depreciated by 6.4% against the US dollar and 0.5% against the euro but strengthened by 4.7% against the British pound. A struggling UK economy and a continuation of the energy crisis have continued to weigh on the pound.

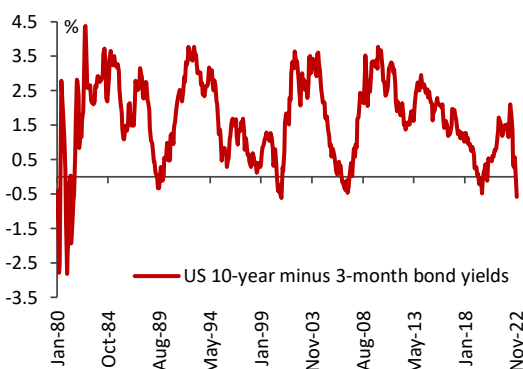
Despite reaching 380 points in July 2022, SA's five-year CDS spread widened only marginally by 23 points for the full year and ended 2022 at 244 points.

Interplay between inflation, rates and growth to determine global asset class returns in 2023

In the absence of further energy or supply chain shocks, it currently seems likely that global inflation should fall in 2023, led by the US. Not only will a very high 2022 base assist the year/year comparisons in 2023 (particularly for headline inflation), but disinflationary trends should be further supported by an already evident improvement in supply bottlenecks, the erosion of corporate pricing power by high inventory levels and a slowdown in cyclical demand.

While a slowdown in global economic activity in 2023 seems almost inevitable in reaction to previous policy tightening and the erosion of real spending power, the magnitude of the growth slowdown remains uncertain. A mild slowdown (or so-called soft landing) is certainly still possible, but more indicators are pointing to the increased probability of a global recession this year. Among these, inverted yield curves, as a reflection of tight monetary policies, have increasingly become the norm in many DMs. In the US, the recent inversion of the three-month/10-year part of the yield curve has historically been an infallible predictor of a US recession within the subsequent 12 months (see chart 2).

Chart 2: US recessionary indicators are lining up



Source: Iress, Momentum Investments

Cyclical slowdowns or recessions have not been good for growth assets like equities historically. MRB Research shows that recessionary periods since 1970 have been particularly harsh for global equities, with drawdowns during recessions roughly three times larger and lasting around four times longer than those in non-recessionary slowdowns (see table 1). Part of the explanation for the exaggerated poor equity performance during recessions is the outright contraction in corporate profits normally associated with recessionary periods.

Table 1: Peak-to-trough declines during historical global equity corrections

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

Source: MRB

Should a recession come to fruition in 2023, current US consensus earnings numbers that still anticipate mid-single-digit growth rates for the year will have to be cut well into negative growth territory. Furthermore, research from Bank of America reveals that US equity volatility normally rises during recession years and that the US equity market never bottoms before a recession starts (see table 2). These factors point to the possibility of more downside for US equities in the run up to a potential recession in 2023, unless a recession can be avoided.

Table 2: US equities never bottom before a recession starts

Peak date	Trough date	Days before (-) / after (+) start of recession		Days before (-) / after (+) end of recession	
		S&P 500 peak	S&P 500 trough	S&P 500 peak	S&P 500 trough
5 Jan 1953	14 Sep 1953	-207	45	-207	-259
2 Aug 1956	22 Oct 1957	-394	52	-394	-190
3 Aug 1959	25 Oct 1960	-271	178	-271	-126
29 Nov 1968	26 May 1970	-397	146	-397	-188
11 Jan 1973	3 Oct 1974	-323	307	-323	-179
13 Feb 1980	27 Mar 1980	13	56	13	-126
28 Nov 1980	12 Aug 1982	-245	377	-245	-110
16 Jul 1990	11 Oct 1990	-15	72	-15	-171
24 Mar 2000	9 Oct 2002	-372	557	-372	313
9 Oct 2007	9 Mar 2009	-83	434	-83	-113
27 Dec 2019	23 Mar 2020	-64	23	-64	-38
	Median	-214	204	-214	-108
	Average	-245	146	-245	-126

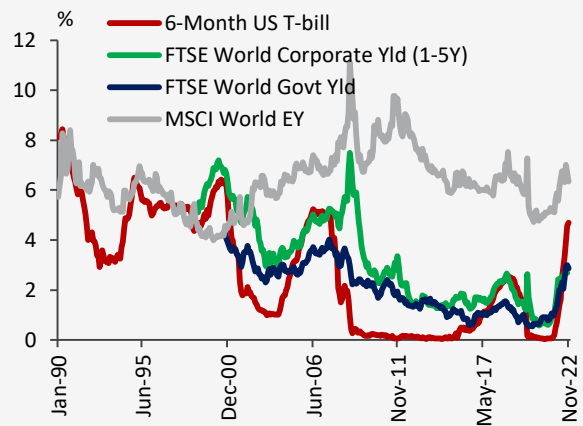
Source: Bank of America

While global equity markets could be under pressure during the bulk of this year as they deal with the final phases of rate tightening and the potential for economic recessions, there could be some relief for equities towards the latter part of the year as markets start looking beyond the downward growth cycle and begin discounting an eventual Fed pivot to lower interest rates. This could support equity valuations enough to negate the negative impact of ongoing downward earnings revisions at the time, igniting an equity market recovery by then.

Fundamentally, the anticipated combination of falling inflation and slowing economic growth (with a meaningful risk of recession) should be supportive of the US bond market this year. Research by Morgan Stanley shows that during downturn phases of the US business cycle, US bonds provide better-than-average returns, whereas US equities provide significantly worse-than-average returns. As inflation subsides, this could re-establish the hedging benefits of having government bonds in a global diversified portfolio in 2023, particularly against the backdrop of drawdown risk for equities during downturn/recession periods.

For a long time since the global financial crisis (GFC), fixed-income yields remained so low that investors seeking income for their portfolios had no option but to favour equities, where they could at least get more meaningful income from dividends. This became known as the TINA era, that is there is no alternative (to equities). However, with fixed-income yields shooting up in 2022 to narrow the gap with equity yields (see chart 3), TINA has now evolved to TANYA (there are nominal yield alternatives) and TARA (there are real alternatives).

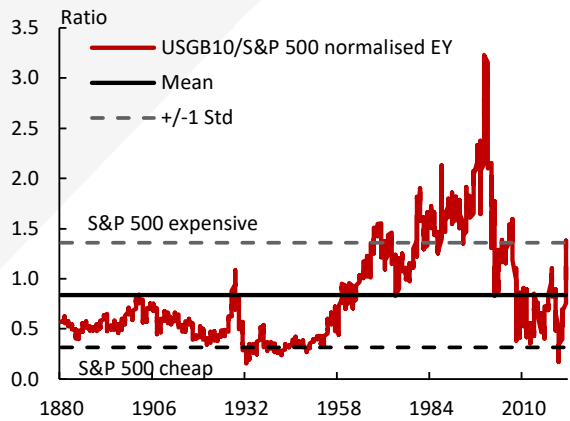
Chart 3: Fixed-income yields have narrowed the gap with equity yields



Source: Morgan Stanley

The significant runup in bond yields last year has also now made US government bonds look cheap versus US equities. On a normalised earnings yield gap basis (using earnings over the past decade), US equities are currently around one standard deviation expensive versus bonds on long-term averages (see chart 4). At the current through-the-cycle earnings yield, US 10-year bond yields would have to fall to around 2.4% to erase the equity valuation premium. Conversely, at current bond yields, US equities would have to fall by around 35% to close the valuation gap.

Chart 4: Relative US equity/bond valuations



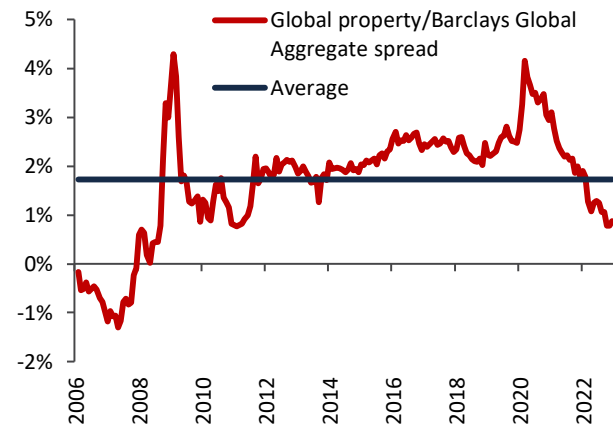
Source: Iress, Momentum Investments

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 global financial crisis (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.

Global property currently looks cheap against global equities, with an above-average yield spread. However, the global property yield is currently expensive versus fixed-income assets (nominal and real US yields, as well as global investment-grade bonds), with yield spreads below their historical averages (see chart 5), hence eroding the relative attractiveness of the asset class.

For SA investors, our expectation for some rand appreciation as global risk appetite improves later in 2023, would erode the local currency returns from global assets. Together with the more attractive valuations available from SA assets that provide a high margin of safety, we prefer SA asset classes over global assets in 2023.

Chart 5: Global property expensive versus global investment grade bonds

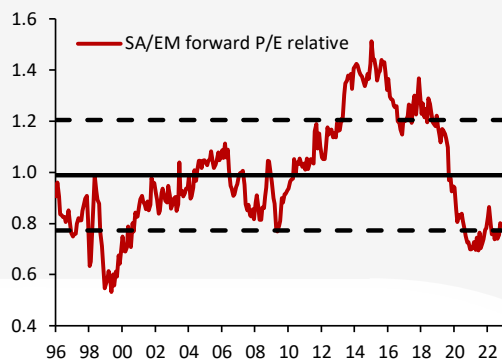


Source: Bloomberg, Momentum Investments

Underowned and undervalued SA equity market has rerating potential

SA equities have an attractive valuation underpin, both within the global universe and against its history. This should stand it in good stead during potential global equity drawdowns, but particularly during subsequent recoveries when global risk appetite rises. SA equity valuations remain cheap against EM (and even more so against DM), with SA a superior dividend payer within EM and at a large forward P/E discount to EM (see chart 6). Research by SBG Securities highlights that apart from insurance, real estate, banks and capital goods, all MSCI SA sectors are trading at a discount to MSCI EM currently.

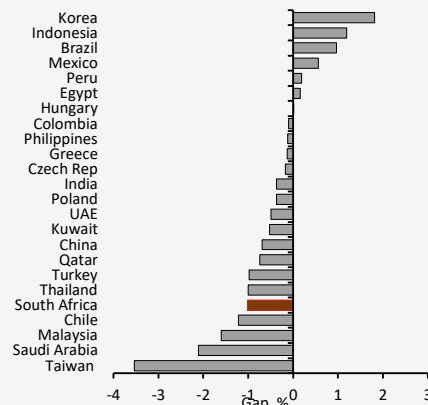
Chart 6: SA forward P/E relative to EM



Source: SBG Securities

Russia's exclusion from EM indices and investor worries about China's investability within EM due to regulatory overreach should benefit the other constituents of EM equity benchmarks. This should be particularly true for SA, which is the fifth most underowned market within GEM equity funds (see chart 7) and as such should have meaningful rerating potential from current cheap valuations when global risk appetite improves.

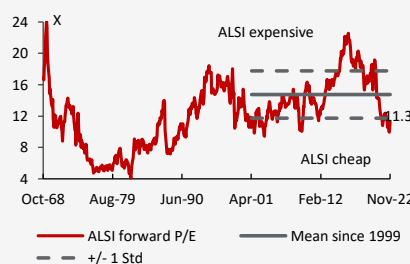
Chart 7: GEM funds' % allocations to EM countries versus benchmark



Source: SBG Securities

Even assuming a conservative 6% earnings growth in the next year, the SA equity market is now more than one standard deviation cheap on a forward P/E basis against the average since 1999 (see chart 8). In our view, a lot of bad news is currently priced into SA equities, enhancing the future return potential from current levels.

Chart 8: ALSI forward P/E



Source: Iress, Momentum Investments

SA bond yields are attractive in real terms

With global inflation still at very high levels, the real government bond yields available in the developed world remain in significantly negative territory.

Although there are inflation outliers like Turkey within EM, in general, inflation rates in the emerging world have lagged those in DM. As such, EM real bond yields based on current inflation rates remain positive in most EM countries, with SA's real yields among the highest (see table 3).

Table 3: Real ex-post 10-year government bond yields

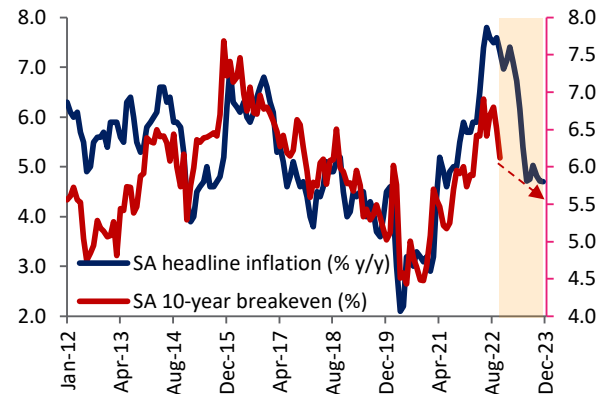
DM	
Japan	-3.5%
US	-4.2%
UK	-8.0%
Europe	-8.2%
EM	
Brazil	6.4%
South Africa	3.9%
Mexico	0.6%
Russia	-2.5%
Turkey	-75.0%

Source: Iress, Momentum Investments

Not only are SA real bond yields currently attractive versus DM and EM yields, but SA's real yield premiums against DM are also high against historical averages. Furthermore, SA's prospective real yield is also more than one-half of a standard deviation higher than its historical average. We argue that SA's high real bond yields already discount high fiscal and country risk premiums.

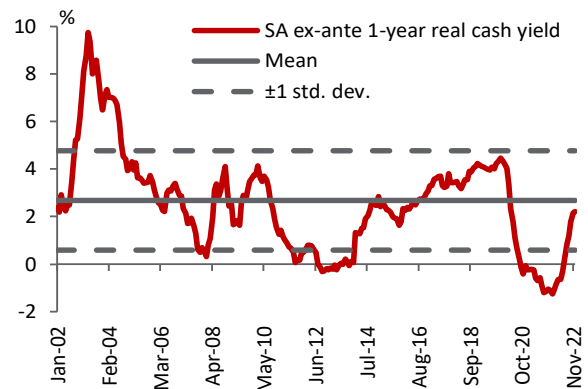
In the ILB space, we expect some breakeven tightening in line with falling inflation in the coming year (see chart 9). As such, monthly inflation accruals are likely to remain low until the second quarter of this year, which should become less supportive for ILBs. The prospective SA real cash yield has been rising from a low level in line with policy rate increases and is now only slightly below its historical average (see chart 10).

Chart 9: Breakeven tightening expected in line with falling inflation in the coming year



Source: IRESS, Momentum Investments

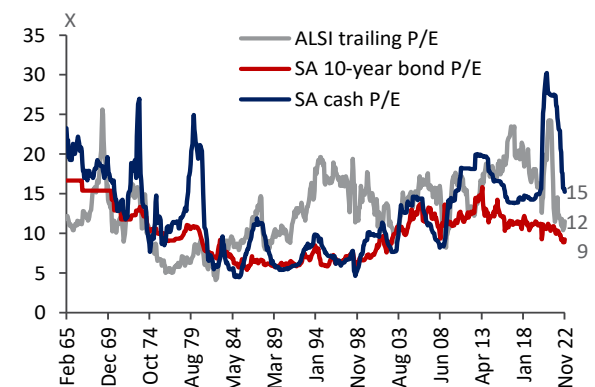
Chart 10: Prospective SA real cash yield



Source: Iress, Momentum Investments

Relative to SA equities and cash, SA nominal bonds have consistently been the cheapest asset class since 2013 (see chart 11). Aggressive COVID-related SARB interest rate cuts have made cash the most expensive asset class since 2020, while sharp profit upgrades in 2021 have pushed SA equity valuations sharply down.

Chart 11: SA asset class valuations

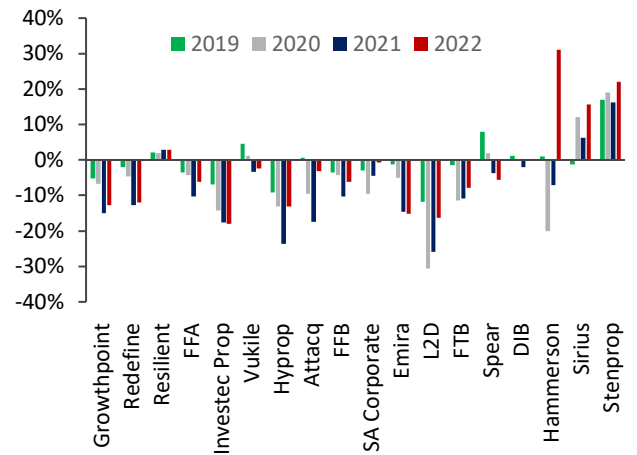


Source: Iress, Momentum Investments

Listed property operational metrics improving, but still worse than pre-COVID

Earnings recovery in the SA listed property sector is supported by continued operational improvement outside the office sub-sector, with vacancy rates, rental growth and rental reversions generally improving. But metrics are still worse than pre-COVID and reversions are still predominantly negative (see chart 12), which keep net operating income growth anaemic. 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.

Chart 12: Rental reversions improving, but still predominantly negative



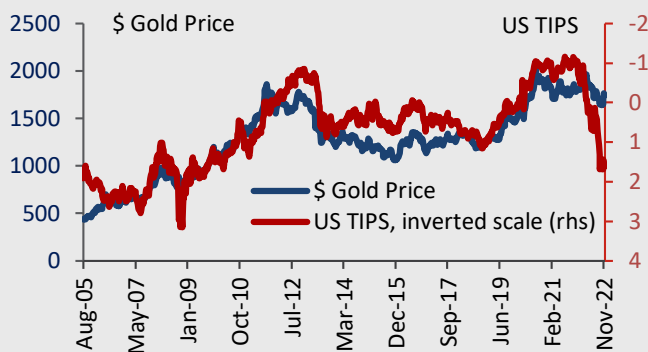
Source: Company reports, Momentum Investments

Gold price currently too high based on US real rates

With the fundamental driver for the gold price being the opportunity cost of holding a non-interest-bearing asset, it is unsurprising that US real interest rates have been the dominant determinant for the US dollar gold price in the last two decades (see chart 13). A bigger surprise is that movements in the US dollar do not provide additional explanatory power for the behaviour of the dollar gold price.

Based on the current level of US real interest rates, the predicted value of the dollar gold price is almost 50% below the current actual spot level. Tactically, gold is thus not an attractive asset class right now. However, we maintain that there is always a strategic rationale for gold as a portfolio risk diversifier due to its safe-haven characteristics during risk-off global bouts, as well as its limited correlation with other asset classes in a portfolio.

Chart 13: US real rates and the gold price



Source: Iress, Momentum Investments

A world with more fragility

Despite the new Omicron variant of COVID-19 knocking at the door to the entrance of 2022, people around the world were largely expecting better global growth and lower volatility in financial markets. Many have, unfortunately, been negatively surprised at the way last year unfolded. The world economy has faced a spate of ill-fated events, starting with Russia's war of aggression in Ukraine, a crippling energy crisis, higher inflation, tighter global financial conditions and strict lockdown measures in China.

As conflict continues in Ukraine, Russia has refocused its war efforts to target civilian infrastructure. Although the Kremlin is beginning to feel pressure to show results in Ukraine after facing setbacks on the battlefield, financial markets deem the use of nuclear weapons as low. Nevertheless, in our view, this risk could rise should Russia face defeat in Ukraine.

Aside from the war in Ukraine, the global incidence of unrest has risen. But this could get worse before it gets better. In September last year, Verisk Maplecroft highlighted that from the 132 countries analysed, 62 were expected to see the risk of social unrest increasing in the following two quarters. This is unsurprising given the effect of sharply higher food and fuel costs on inequality, particularly across EMs where consumers typically spend a larger share of their wallet on such items.

The World Bank warns that we have shifted from an era of relative predictability to a world with more fragility. Previously, international co-operation was premised on a rules-based framework, resulting in lower inflation, lower interest rates and lower volatility. Greater uncertainty, higher volatility, geopolitical strife and more frequent climate-related disasters are nevertheless gripping the global economy and darkening the outlook for growth.

Wellington Management argues that under this new regime, central banks will, at times, struggle to find an appropriate balance between taming inflation and supporting growth. Consequently, we are likely to experience more frequent moves from one economic phase to another.

More regular economic and political shocks are likely to throw economies off course more easily unless a greater level of resilience is instilled at a macroeconomic level. While random and exogenous events can overshadow the impact of fundamental factors, a focus on long-term structural trends can help to reduce reliance on timing shorter-term cycles and shorter-term economic and market forecasts, which are likely to span a wider range going forward.

The impact of the war in Ukraine, persistent inflation, soaring cost of living pressures, an acute energy crisis in Europe and an unexpected slowdown in China have impaired growth. With policy homogeneity having increased across the globe this year, investors are concerned that a simultaneous tightening

in monetary policy will compound growth woes. Although we have experienced the fastest pace of interest rate hikes in decades, the World Bank shows that interest rates, particularly in inflation-adjusted (real) terms remain negative in aggregate and are significantly lower at this point relative to prior global recessions in post-war history.

With rising price pressures posing the most immediate threat to real disposable incomes, central banks have narrowed their focus on restoring price stability, even as fears mount over slowing global growth. While the International Monetary Fund (IMF) acknowledges the potential risks associated with an over-tightening in monetary policy, to the extent that policymakers are forced to reverse hikes sooner than anticipated in a perceived policy error, it warns that the risk of under-tightening is a larger concern. Allowing inflation to run hotter for longer could derail inflation expectations and embed persistent price pressures. Central bank credibility would not only be negatively affected, but a deeper cost-of-living crisis would force central banks to tighten by more, at a later date, compounding negative growth and employment outcomes.

Prospects for growth this year have dimmed considerably. At the start of 2022, the consensus expected DMs to grow at 2.4% this year. However, this projection has faded to 0.5%. Similarly, a year ago, financial markets were looking forward to growth of 4.8% in EMs for this year. But these forecasts have since slipped to below 4%. This is in spite of a better expected outcome for China in 2023, particularly in light of recent measures to lift stringent lockdown regulations.

Although these revisions appear large, the World Bank notes that market revisions to growth in the year preceding a recession were worse during the GFC and the COVID-19 pandemic. In the case of the former episode, expected global growth experienced a downgrade of around 5.5% in the year running up to the recession. Meanwhile, downward revisions to expected global growth in the year preceding the pandemic amounted to more than 7%. In this context, the adjustment to growth forecasts this time around does not appear as severe. As such, we see the risk of a global downturn as being higher than an outright global recession. A contraction in real gross domestic product (GDP) per capita during a typical recession impacts standards of living and has significant socio-economic repercussions, making the distinction between a downturn and a recession important.

The risk of a global recession cannot, however, be definitively ruled out at this stage. With the IMF predicting that growth in more than a third of economies worldwide will contract either in 2022 or 2023 (up from 5% at the start of 2022), the World Bank warns that only a small shock is required to knock the global economy into a deeper slump.

Indicators such as global growth, manufacturing new export orders, the global purchasing managers' index and global equity prices have followed the same path as prior global recessions. Consumer sentiment has however fallen more sharply relative to past cycles on the back of a collapse in growth in real disposable income of negative 3.5% for the global economy, due to rising living costs.

Depressed sentiment has raised recessionary risks. At the end of 2021, the Bloomberg consensus forecasted the recession risk for the US economy in the next year at 15%. However, this probability rocketed to 65% a year later. Similarly, the consensus pitched the probability of a recession in the United Kingdom (UK) and Germany at around 20% at the end of 2021, but these forecasts have since jumped to 90%.

The outcome for the US economy plays an important role in determining the recession probability for the global economy. The World Bank notes that on an unconditional basis, the probability of a global downturn or recession is between 10% and 15%. However, if the US economy slips into recession, the risks of a global recession or downturn are higher at around 70% and 85%, respectively.

In our view, solid fundamentals could prevent a deep and protracted recession in the US economy despite our forecast of a marginally negative growth rate for this year of negative 0.1%. Firstly, household wealth (still close to 780% of disposable income) and savings remain supportive of household spending. Secondly, unemployment rates remain close to multi-decade lows with the US labour force participation rate close to 80% if the age group older than 54 years is excluded. Thirdly, banks' capital buffers are higher than in the period leading up to the GFC, leaving the US economy with a higher level of financial stability this time around. Fourthly, central banks have acquired a higher level of credibility since the 1970s when the world hit a stagflationary bump in the road.

And finally, even though the US housing market is showing signs of distress, the dip experienced so far has not been as severe as that during the GFC.

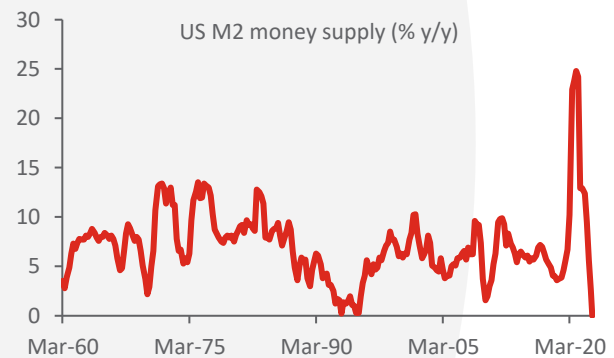
Economic troubles are, nevertheless, bubbling in Europe, leaving growth prospects for this year weaker than in the US. The rise in cost of living due to energy last year (as a share of average household consumption) went as high as 12% for Italy and 10% for the UK. As such, we expect tighter financial conditions and a high cost of living to leave growth at negative 0.6% for the Eurozone and negative 1% for the UK this year.

While inflation dominated news headlines last year, convincing signs of supply-side inflation receding could result in disinflation driving the narrative this year. The New York Fed President John Williams remarked that the outer layer of the inflation onion has shown signs of relief. Supply-chain bottlenecks have been easing consistently. Supplier delivery times have shortened drastically, while the New York Fed Global Supply Chain Pressure Index has tumbled.

While Williams notes that core goods inflation, which makes up the middle layer of the onion, remains high, there are signs of this reversing. Moreover, continued dollar strength has reined in inflation on imported goods.

Williams warns that the innermost layer of the onion, underlying inflation, is where the most attention needs to be paid. Stickiness in inflation in this area of the consumer basket can result in a slower pull back to the Fed's inflation target of 2%.

Chart 14: Collapse in growth of M2 money supply



Source: Bloomberg, Momentum Investments

Data up to November 2022

That said, forward-looking signs are painting an encouraging picture. Growth in M2 money supply has dropped from over 25% 18 months ago to 0% (see chart 14). Given its typical 18-month lag with inflation, price pressures should ease significantly in the coming quarters. Indicators such as the Zillow Observed Rent Index point to a softening in rental inflation, while fewer small businesses are planning to raise selling prices. Overstocked retailers in the US will also find it difficult to pass on higher costs in an environment of slowing excess demand.

While the Bloomberg consensus suggests that we have passed the peak in inflation, globally, inflation is likely to remain above target this year. The median consensus shifted its expectation for headline inflation in DMs for this year from 2.1% at the end of 2021 to 5.4% at the end of 2022. Similarly, the market's projection for headline inflation in EMs rose from 3.6% to 5.8% in the same period.

Geopolitical conflict, which has sucker-punched the global economy, has driven investors into safe-haven investments, including the US dollar. This exacerbated inflationary pressures for many economies. Research by the European Central Bank further attributes a firmer US dollar to better relative macroeconomic outcomes in the US and a higher interest rate differential with the Eurozone. While these factors can continue to drive dollar strength in the interim, we expect narrower interest rate differentials from the second half of this year to drive dollar weakness. As interest rates decline in the US economy, investors are likely to transfer money out of the US and into other countries that offer a higher interest rate. These capital flow adjustments are likely to lead to a weakening in the US dollar against the currencies of higher-yielding countries.

Market-implied policy rates expect the US Fed to wrap up its interest rate hiking cycle in the first half of this year, peaking at 5%. The first cut has been pencilled in before the end of this year, following a pause after the last hike.

The dollar is expected to follow a depreciating path over the medium to longer term, but the rate of depreciation is likely to slow beyond this year. US government budget and current account deficit projections look unfavourable relative to the Eurozone in the medium to longer term, while a rich valuation on a purchasing power parity calculation further suggests some retracement in the dollar.

Central banks' focus up until now has been to tame inflation even as recession risks loom. While reaching a peak in global inflation is a necessary condition and may be enough for central banks to reach a peak in hawkishness, it is not seen as sufficient for an actual pivot towards an easing in monetary policy. In particular, we believe that central banks need to see a clear deceleration in underlying inflation or a reversal in tight labour markets.

Fixed income markets in the United Kingdom punished the former administration, led by Liz Truss, at the end of the third quarter of 2022, when she delivered budget proposals that markets expected would only spur inflation and necessitate even more tightening in monetary policy.

Fiscal policy must work in concert with monetary policy, otherwise, the IMF warns, the fight to douse inflation will only be prolonged. The World Bank points out that the fraction of countries tightening fiscal policies this year is expected to reach its highest level since the early 1990s. As such, this could amplify the negative effects of tighter monetary policy on growth.

While previously, DM governments could enact fiscal stimulus without worrying too much about higher inflation, we have now shifted to an era with more explicit policy trade-offs. Nonetheless, we believe that in a slower growth environment, with higher levels of social unrest, governments around the world will be tempted to lean on fiscal policies to alleviate growth troubles. Moreover, electoral cycles are expected to increasingly influence fiscal decisions in a more politically polarised world.

In the US, analysts warn that reaching the debt ceiling could land up being used as a political tool as it was in 2011, resulting in a sovereign downgrade by Standard and Poor Global Ratings. Vox warns that the outcome of the likely standoff could potentially end in a further weakening in parts of government that have already been underfunded for a decade, including education, transport and water resources and international affairs.

EMs have experienced the fastest rise in debt in the past decade than they have in the past 50 years. Moreover, higher global borrowing costs have intensified financial stress for vulnerable countries with a large share of foreign-denominated debt.

A backdrop of weaker global growth is likely to increase EM vulnerability. A sharp slowdown in the US or Eurozone or softer-than-expected growth in China could trigger acute financial stress

in emerging and developing countries. While we believe that larger middle-income countries are economically and fiscally fit to weather this storm, poorer and more-economically exposed nations will likely find it difficult to avoid fiscal and debt distress. As such, more dominoes could fall in this narrower composite.

Within the EM composite, prospects are brightening for China. A gradual loosening of zero-COVID policies, an investment in climate transition and a frontloading of infrastructure projects are likely to fuel a recovery in China this year. While we acknowledge that property market woes may spill negatively into economic growth, leaving the expected growth figure for this year short of Beijing's 5.5% target, a faster and smoother relaxation in stringent lockdown regulations in China could result in a rebound in downtrodden consumer confidence. As such, a revival in household spending and tourism could deliver an upside risk to the outlook for the global economy this year.

Another area which may surprise positively is Europe. Analysts suggest that Russia picked the worst year for gas blackmail. Not only has Europe experienced a record-warm season so far, but the region has had unprecedented late gas injections. Moreover, liquified natural gas supplies hit a record high and disappointing demand in China has lowered global demand for energy. With Europe's gas storage level reaching the highest level in over a decade, supplies may just be sufficient to meet demand, lowering the need for caps on energy demand and leading to a potentially better outcome on European growth.

The US economy could likewise deliver a positive growth surprise this year. If real disposable incomes recover more strongly than anticipated, owing to higher nominal wages, lower inflation and strong jobs growth, a more buoyant US growth wave could lift all economic ships next year.

Nonetheless, one can also easily think of ways in which the global economic situation could get worse. A higher magnitude and longer duration in interest rate tightening could push the US economy into a more painful slump, dragging growth in all economies lower.

In addition, a colder-than-expected winter in Europe could raise the urgency of Europe's energy crisis, enforcing caps on usage and lowering demand.

Moreover, a bumpier transition to lower COVID-19 restrictions in China could set a gloomier scene for growth and consequently commodity prices, worsening the outlook for EMs that are highly reliant on trade.

China also faces the risk of rising geoeconomic fragmentation. The US' latest across-the-board sanctions on Chinese companies in the semiconductor industry represent the country's latest efforts to contain Beijing's technology and military advances and indicate a further decoupling between the world's largest countries. This is likely to accelerate the decline in globalisation already underway, brought on by onshoring and nearshoring to reduce reliance on global supply chains.

Global slowdown and local economic and political challenges darken SA's outlook

Against this backdrop of dimmer global growth, a slow grind lower in elevated inflation and geopolitically, a more fragmented world, growth in SA is set to moderate from an expected 2.5% in 2022 to 1.1% this year. Recent negative political developments raising uncertainty over the leadership of the country pose significant downside risks to this view.

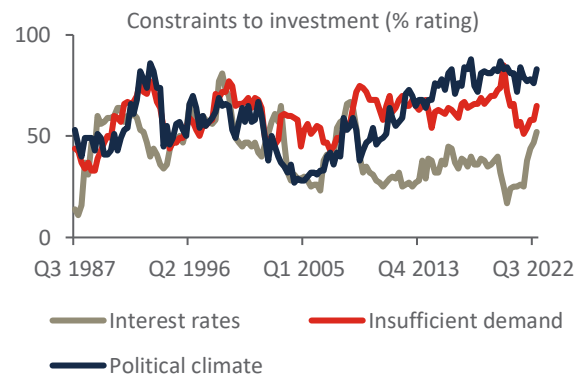
Lower growth in some of SA's main trading partners will reduce demand for our exports, leaving private demand and investment as the main contributors to growth. Structural challenges and mounting headwinds will continue to dampen local demand, nonetheless. The pace of increase in nominal wages and social grants has failed to keep up with the latest surge in inflation, while employment prospects are weakening given continued downgrades to this year's expected growth outcome. Meanwhile, businesses remain constrained by softer expected demand, a staggered pace of economic reforms and policy uncertainty.

Uncertainty over President Cyril Ramaphosa's continued leadership in SA, following his alleged failure to properly report a robbery at his game farm, has raised the risk of a slower pace of reforms and lowers government's ability to provide more predictable and stable policy outcomes. In a more negative scenario, in which a successor within the ruling party does not continue to champion the reforms Ramaphosa has already set in motion, we could see an unwinding of progress in key areas, such as the fight against corruption and the reinstatement of SA's institutional credibility.

In our view, output remains further at risk from persistent disruptions at malfunctioning state-owned enterprises. Electricity outages have ramped up in intensity, with a third of offline generating capacity arising from unplanned outages. Crippling strikes, theft and vandalism have, in addition, undermined Transnet's contribution to economic growth given the entity's importance in transporting freight to local markets and ports. BusinessTech reports that, in 2021, SA's rail network carried the lowest volume in a decade. Not only does this cause further damage to SA's road infrastructure, but it also pushes up operational costs for businesses.

Although embedded generation projects are gaining traction and should underpin growth this year, the recovery in fixed investment is unlikely to be broad-based due to ongoing challenges suppressing business sentiment. According to the Bureau for Economic Research (BER), 83% of manufacturers still cite the general political climate as an obstacle to investment in SA. This is expected to climb further on the back of recent unfavourable local political developments. Around 65% rate insufficient demand as a constraint and a rising share (from 17% in the third quarter of 2020 to 52% in the fourth quarter of 2022) agree that short-term interest rates are hindering investment prospects (see chart 15).

Chart 15: Constraints to investment in SA



Source: BER, Momentum Investments

Data up to Q4 2022

Relative to many of SA's peers, the overshoot in the inflation target has been relatively modest. The high base effect created in food and fuel inflation should deliver a welcome reprieve this year. At an underlying level, wage inflation shows little signs of developing into a wage-price spiral. The rise in services inflation has also been tame, partly owing to above-average vacancies in the rental market, which has resulted in downward pressure on rental escalations.

Although inflation in rand-sensitive core goods has surprised to the upside, the rand could strengthen by the end of this year on an improved global risk backdrop and a more conducive environment for capital flows into EMs. Inflation pressures, at a headline level, are expected to unwind from an expected 6.9% in 2022 to 5.8% this year. Though underlying measures of local inflation are likely to react with a lag, given a delay in pass-through effects, we anticipate core inflation to remain well within target in the medium term.

Conforming with warnings heralded by the IMF and World Bank, the SARB cautioned against the risk of under-tightening and clarified that policy rates may expand beyond the neutral level if upside risks to the inflation trajectory are viewed as material.

We anticipate a further 50 basis points in the current series of interest rate hikes, leaving the repo at 7.50%. But we acknowledge the risk of additional tightening should inflation prove stickier than projected. If persistent local political uncertainty bids the rand weaker on a more sustainable basis, the outlook for inflation expectations could come under threat, leading to a tighter stance on monetary policy.

While decisive intervention by Treasury lowers the probability of a greylisting event, shortcomings in the hollowed out criminal justice system keep the probability as more likely than not. While investors are well versed on the structural challenges the country

faces, limiting the impact of a greylisting event on SA asset classes, perceived inaction by SA to address the FATF's concerns or a reversal in anti-corruption reform efforts to date would result in a larger negative effect on economic and capital markets.

If SA displays a concerted effort to address the FATF's recommendations within an 18- to 24-month period, as was the case with Mauritius and Botswana, it could convince the country's counterparts to maintain relationships in the interim. Intellidex notes under this scenario, GDP losses would be less than 1% and any associated capital outflows would be small in magnitude and relatively short-lived. Intellidex paints a more bearish risk scenario, in which SA remains on the greylist for as long as five years. Without any convincing action by SA's policymakers, regulators and law enforcement agencies to address the FATF's concerns, SA could lose up to 3% of GDP in this worst-case scenario.

Although the rating agencies left SA's sovereign rating unchanged at the latest review, in line with expectations, we maintain our concerns over downward pressure on ratings in the medium to longer term on weak growth potential, an uncertain political outlook, rising socio-economic risks and increasing social demands on the budget.

The IMF has warned that fiscal policy should remain aligned with monetary policy in the next while to ensure that authorities can quell inflationary pressures. While fiscal authorities, locally, have promised to rebuild fiscal buffers and maintain a prudent approach to expenditure, the near-term improvement in SA's fiscal position has largely been thanks to a commodity price boon. In our view, this fiscal bonanza has merely masked underlying fiscal imbalances that the country has failed to resolve for over a decade, due to

bad governance and anaemic growth. Real economic stagnation forecasted in the medium term is suggestive of continued fiscal weakness ahead.

Despite some buffer built into the unallocated and contingency reserves, the fiscal consolidation path that Treasury has proposed, to stabilise debt in the near term, remains questionable given the exclusion of major risks in the baseline and an implausible spending trajectory. In our view, debt levels are already high, resulting in a large interest bill, crowding out more useful forms of government expenditure. Rising social demands and support for parastatals and financially bankrupt municipalities will only add to the challenge of stabilising debt at the proposed 71.4% of GDP in SA.

The prospect of SA's sovereign rating returning to investment grade remains some way off in our view. This will rely on implementing growth-enhancing reforms to activate economic opportunities for poor households. In addition, deregulating the economy is viewed as a prerequisite for local businesses to grow, absorb labour and support sustainable revenue streams.

Moreover, curtailing growth in the wage bill and finding a long-term financial solution for state-owned enterprises, which creates economic value, can stabilise government finances in the long run. Conviction in government's willingness and ability to implement unambiguous policies quickly and efficiently can further jumpstart the economy and raise market confidence.

In this light, the outcome of the leadership of SA and the appetite to further the country's structural reform agenda remain critical to growth, investment and socio-economic outcomes.



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Partially Vesting Smoothed Bonus Range

Universal Multi-Manager Smooth Growth Fund



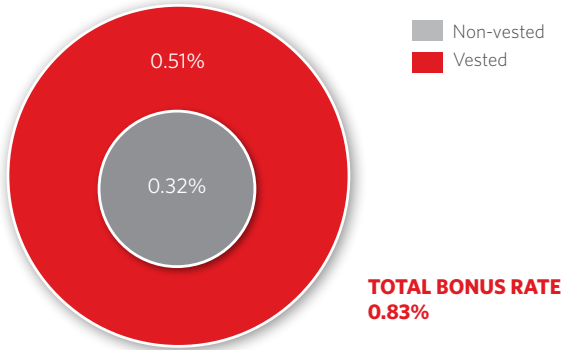
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	97.5% - 102.5%	R453.3m	0.98%	6.89%

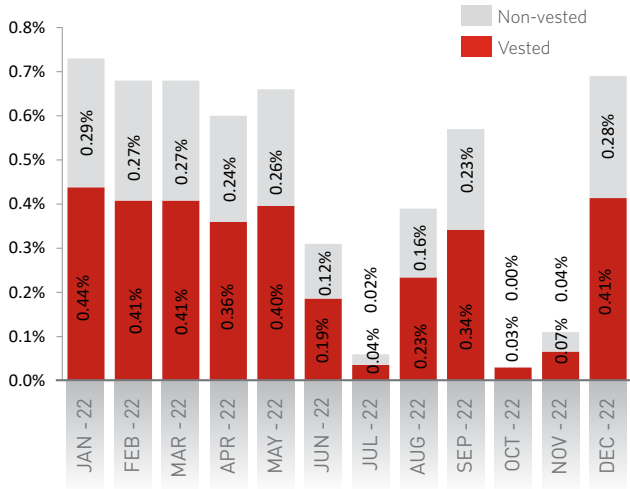
¹Based on back-tested bonus rates and returns

Performance

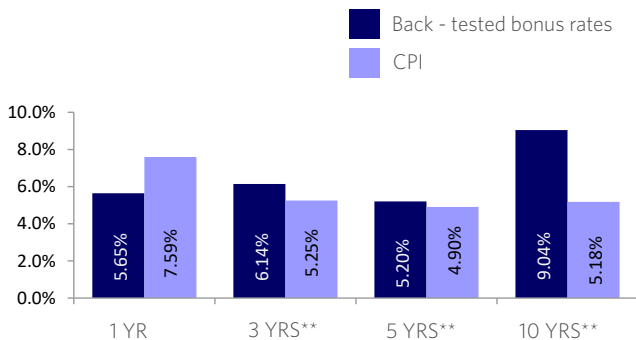
The total bonus rate* for the past quarter on the **Universal Multi-Manager Smooth Growth Fund** is shown below.



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

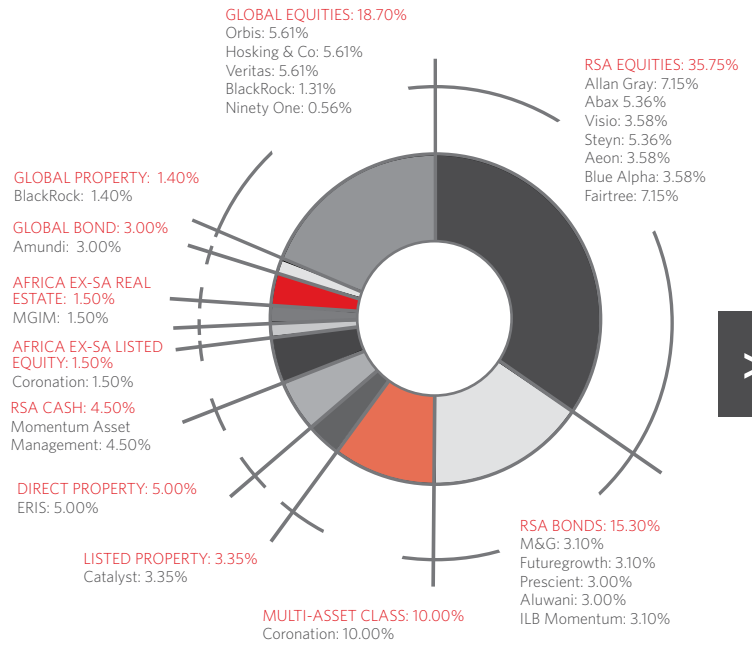


CPI figures are lagged by two months

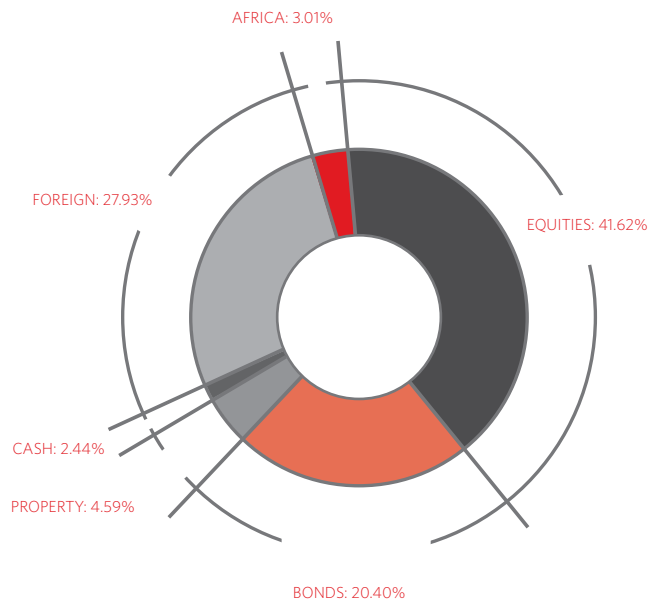
* Bonus rates are net of underlying asset charges but are gross of the policy fee
 ** Annualised

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



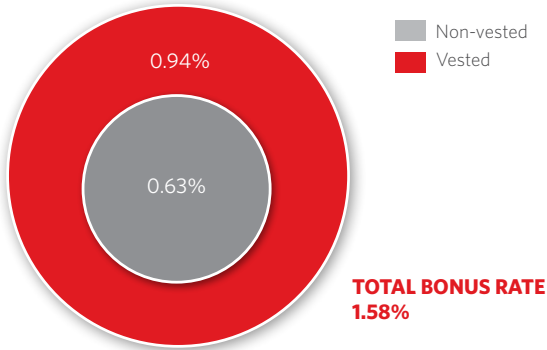
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	97.5% - 102.5%	R346.8m	1.10% ¹	5.73% ¹

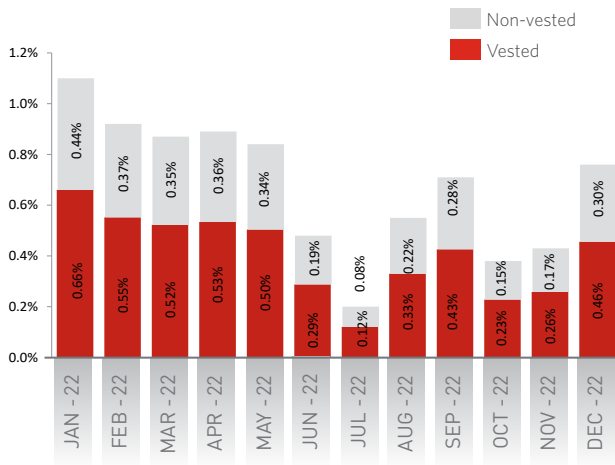
¹Based on back-tested bonus rates and returns

Performance

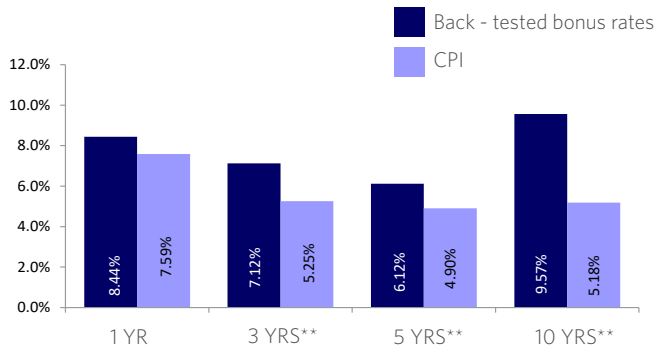
The total bonus rate* for the past quarter on the **Universal Smooth Growth Fund** is shown below.



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



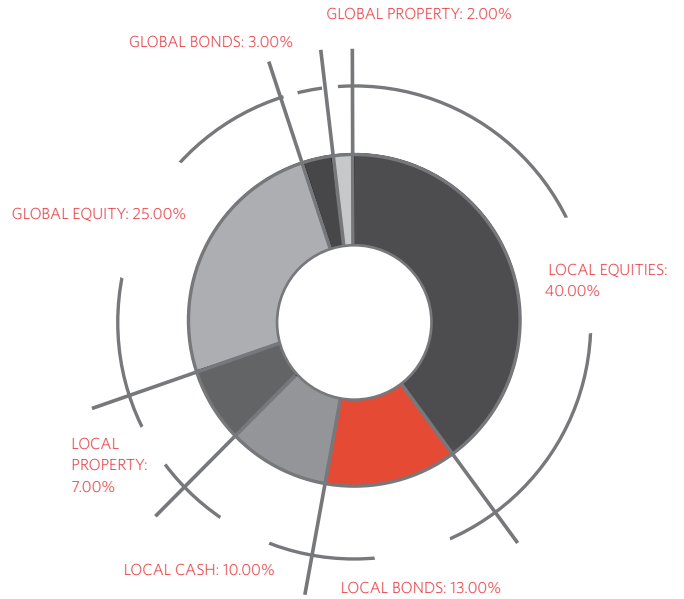
The chart below shows the long term bonus* performance of the **Universal Smooth Growth Fund** against CPI



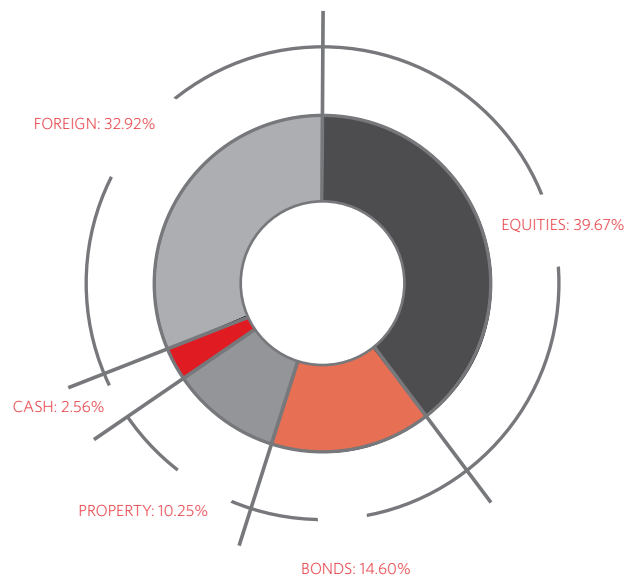
CPI figures are lagged by two months

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

Multi-Manager Smooth Growth Fund Global

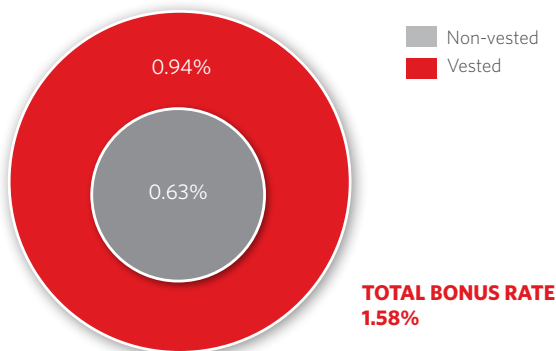


Fund Snap Shot

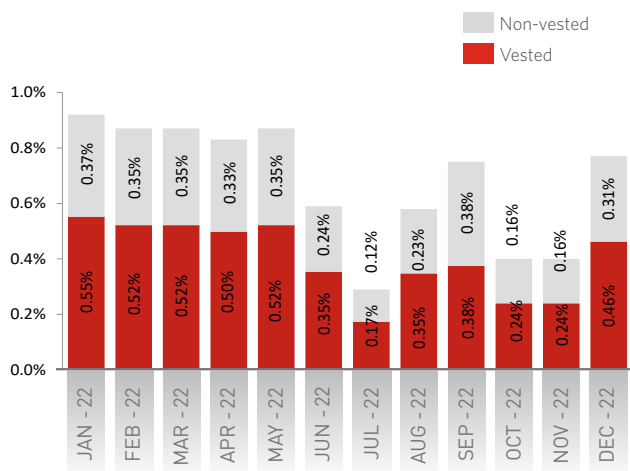
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	100% - 105%	R7.7bn	1.11%	6.28%

Performance

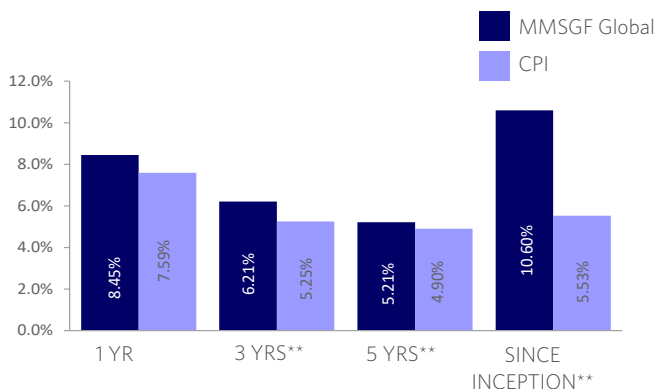
The total bonus rate* for the past quarter on the **Multi-Manager Smooth Growth Fund Global** is shown below.



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



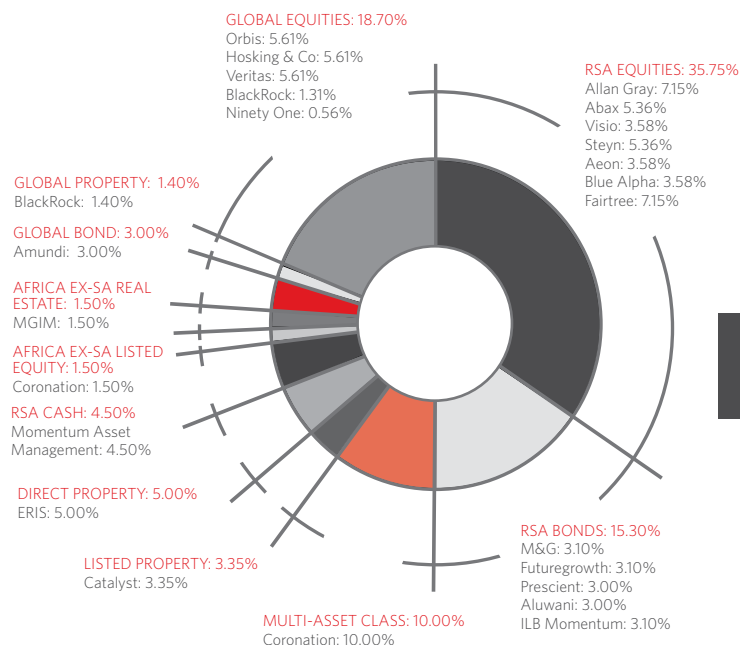
CPI figures are lagged by two months

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

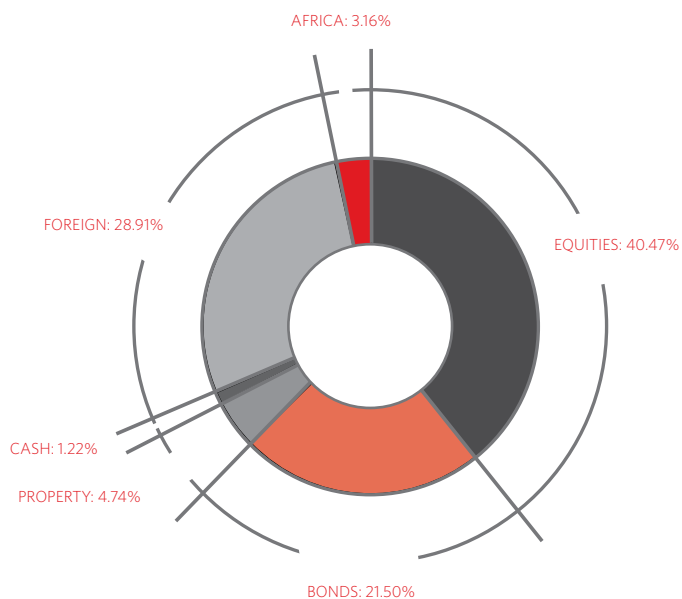
** Annualised

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

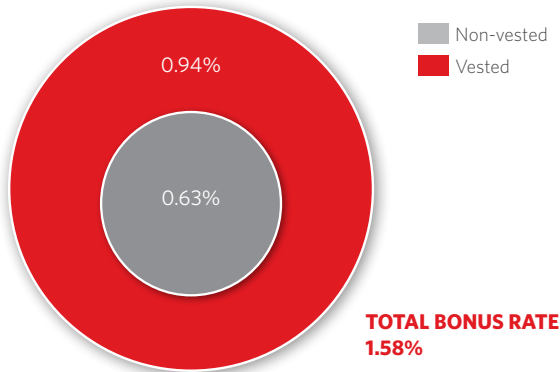


Fund Snap Shot

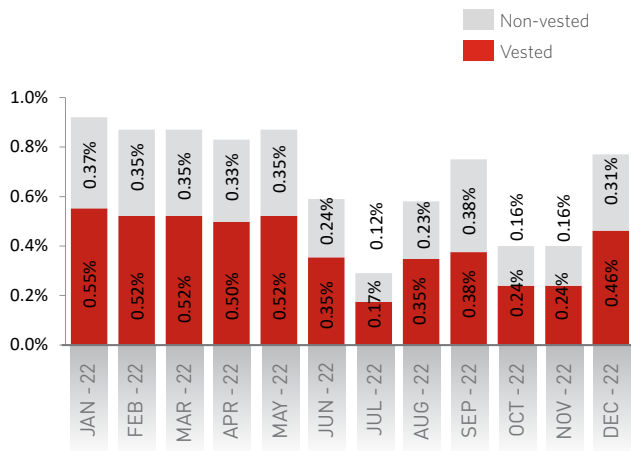
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	100% - 105%	R1.6bn	1.19%	5.17%

Performance

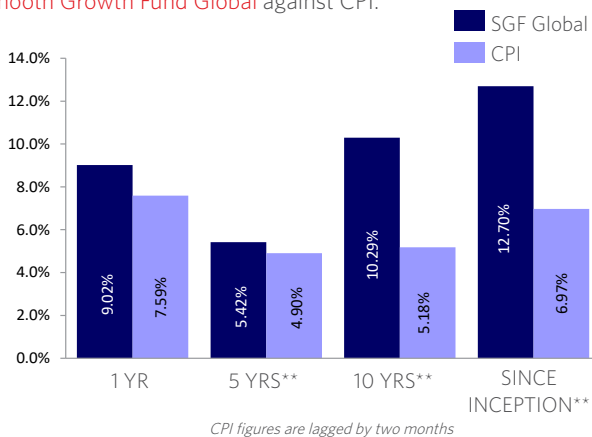
The total bonus rate* for the past quarter on the Smooth Growth Fund Global is shown below.



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

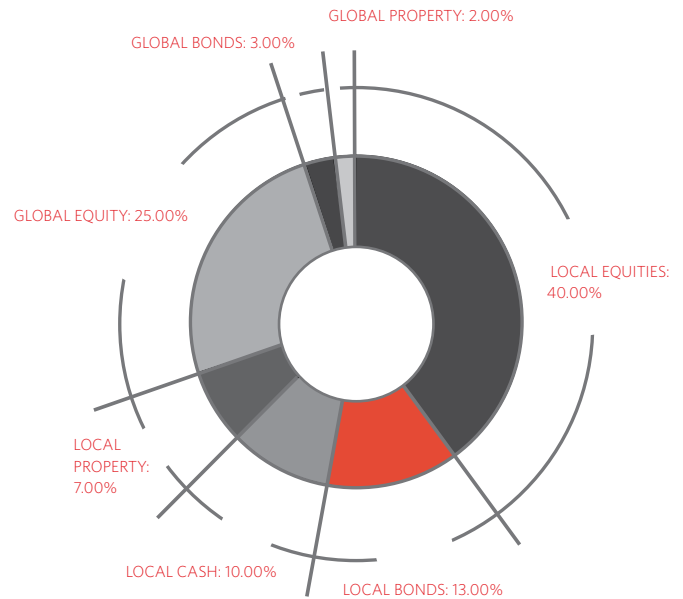


The chart below shows the long term bonus* performance of the Smooth Growth Fund Global against CPI.

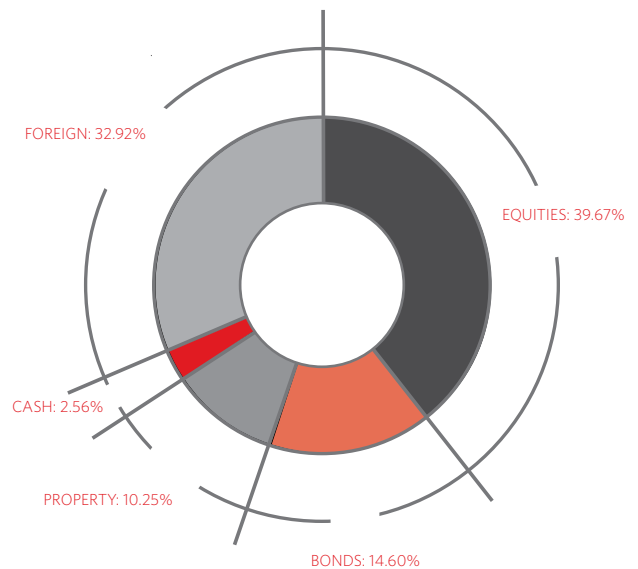


Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



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

** Annualised

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

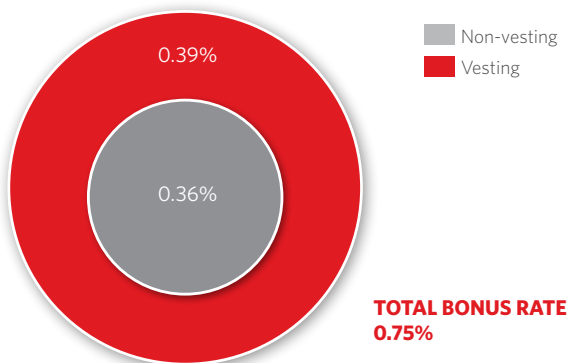


Fund Snap Shot

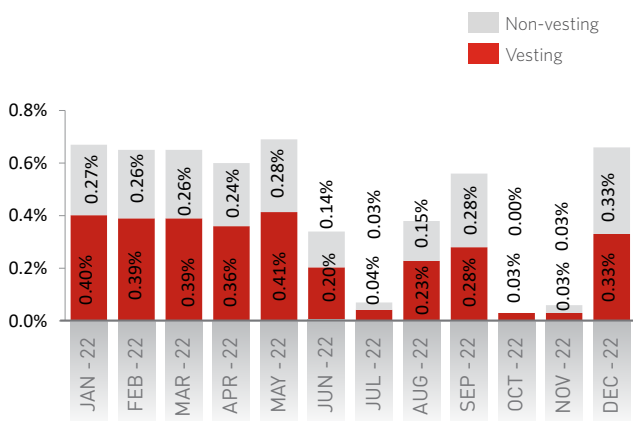
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	97.5% - 102.5%	R142m	0.90%	3.88%

Performance

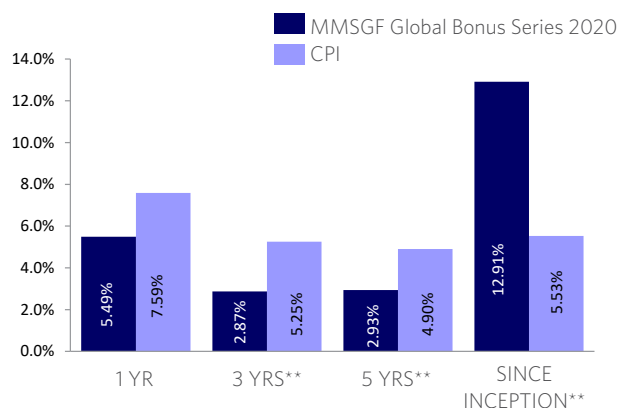
The total bonus rate* for the past quarter on the **MMSGF Global Bonus Series 2020** is shown below.



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



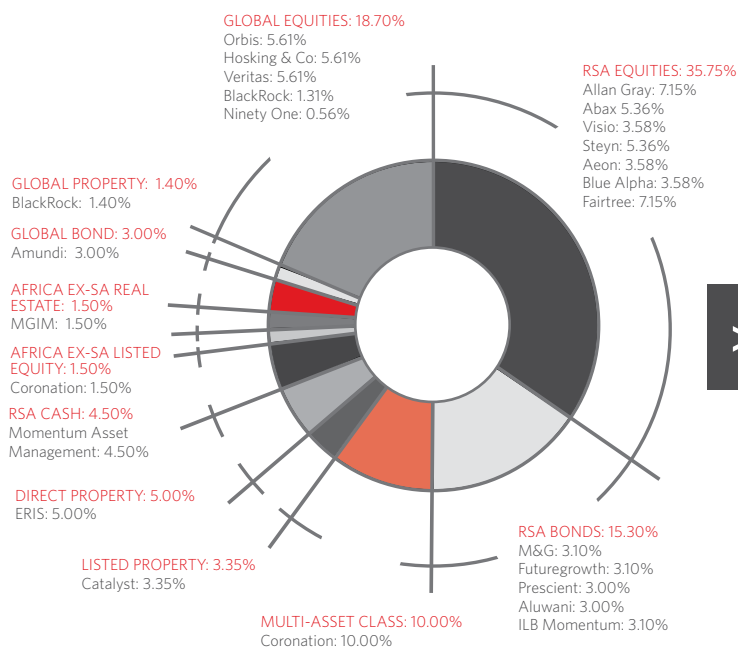
The chart below shows the long term bonus rates* performance of the **MMSGF Global Bonus Series 2020** against CPI



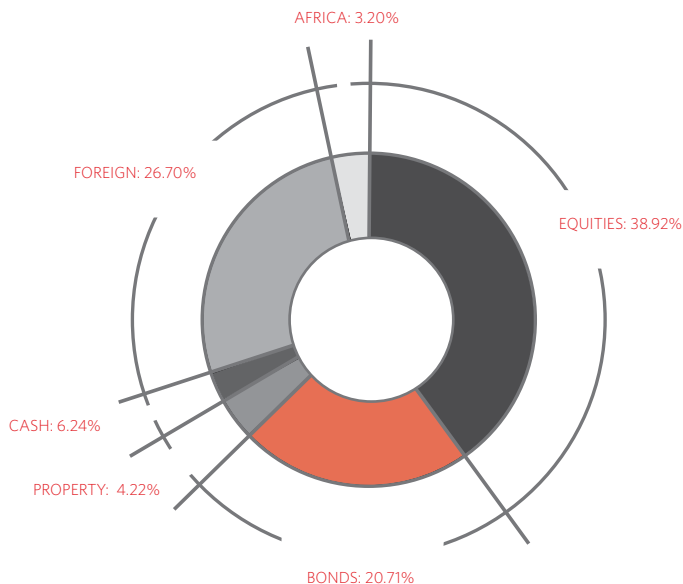
Asset Allocation

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.



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

Partially Vesting Smoothed Bonus Range

Smooth-Edge Fund



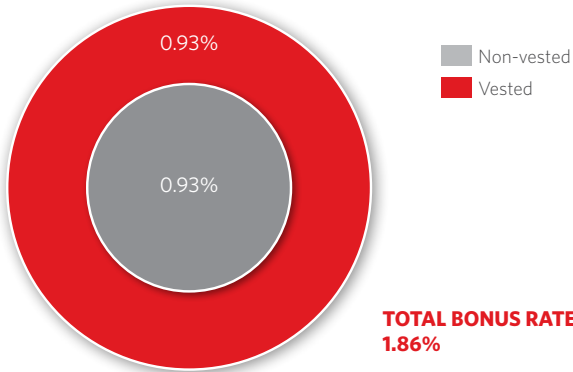
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	100% - 105%	R1037.7m	1.32% ¹	7.31% ¹

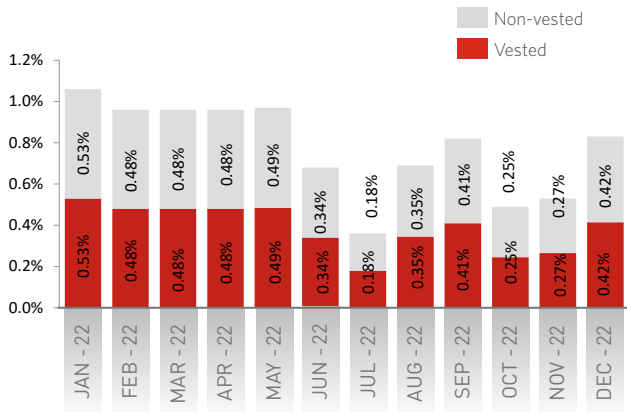
¹Based on back-tested bonus rates and returns

Performance

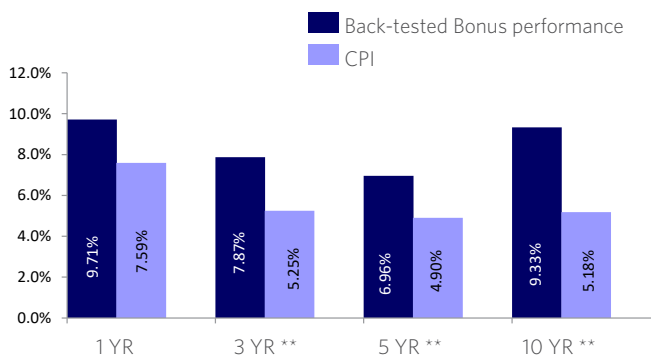
The total bonus rate for the past quarter on the **Momentum Smooth-Edge Fund** is shown below.



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

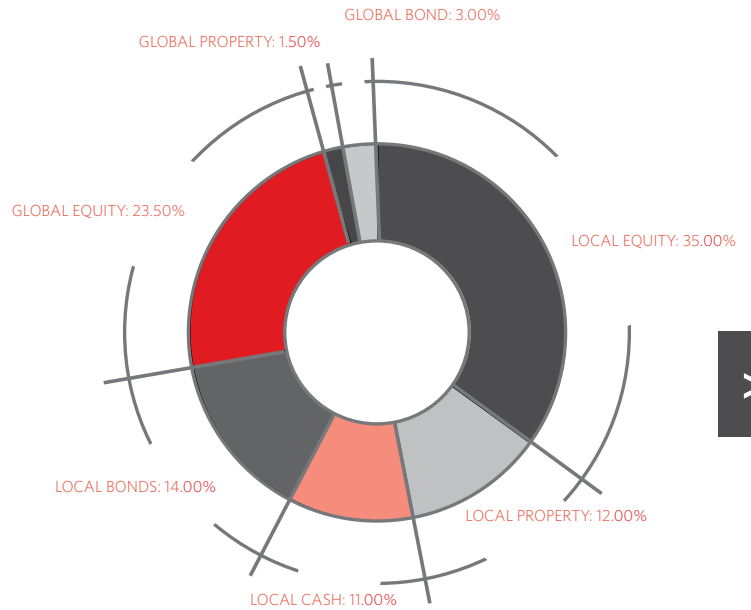


CPI figures are lagged by two months

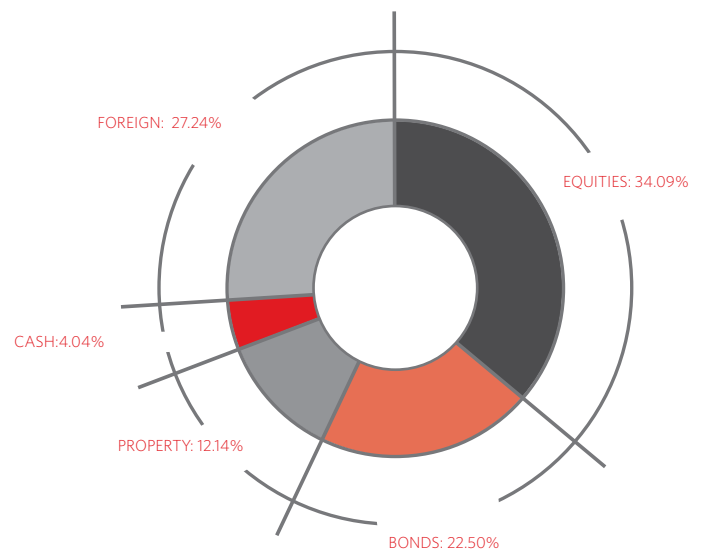
* The bonus rates and back-tested bonus rates are gross of the investment management fee
 ** Annualised

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

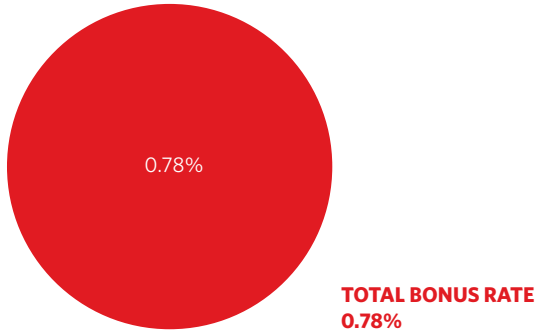


Fund Snapshot

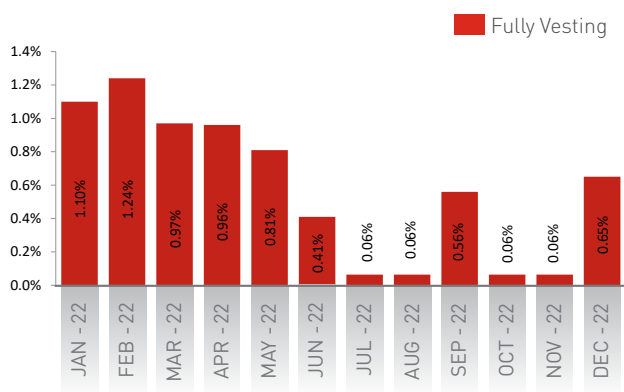
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	95% - 100%	R572.3m	1.27%	5.80%

Performance

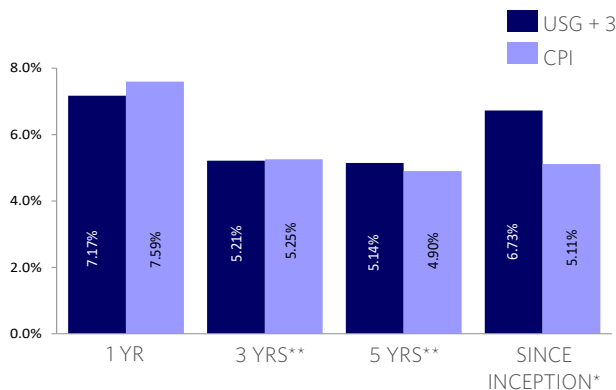
The total bonus rate* for the past quarter on the **Universal Smart Guarantee +3 Fund** is shown below.



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.

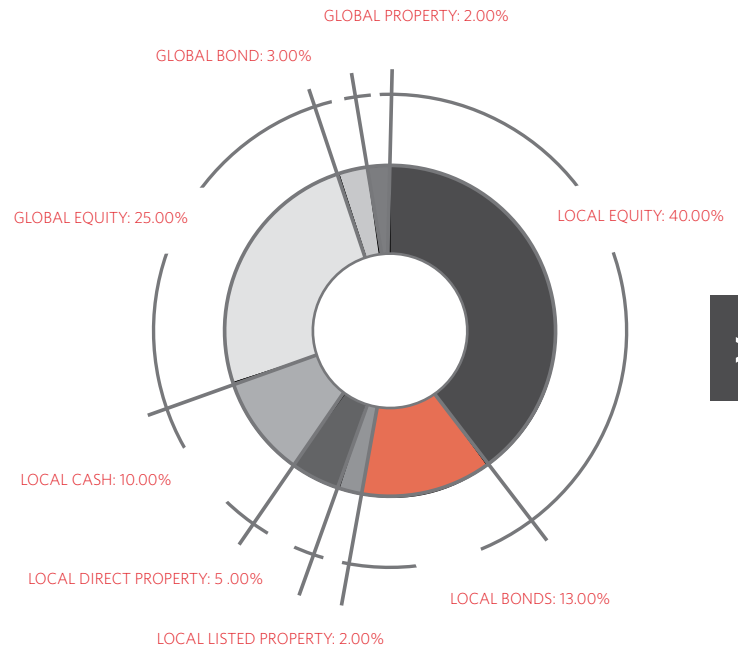


CPI figures are lagged by two months

* 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 **8.20%** will still be declared.

Fully Vesting Smoothed Bonus Range

Multi-Manager Secure Growth Fund

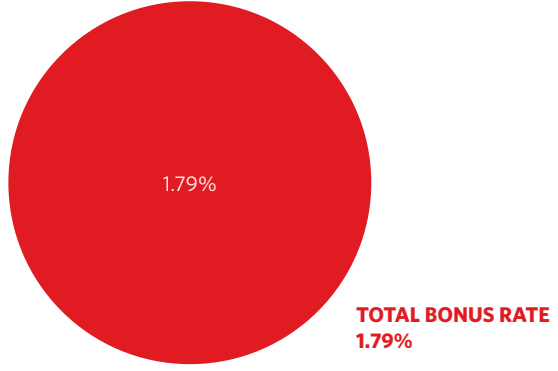


Fund Snapshot

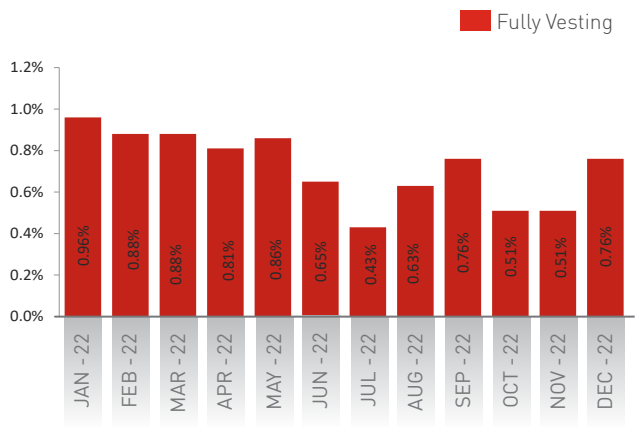
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	102.5% - 107.5%	R77.5m	1.11%	6.19%

Performance

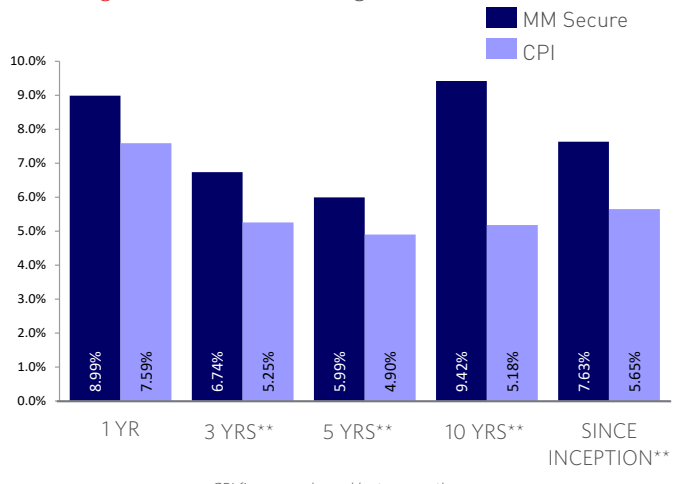
The total bonus rate* for the past quarter on the Multi-Manager Secure Growth Fund is shown below.



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



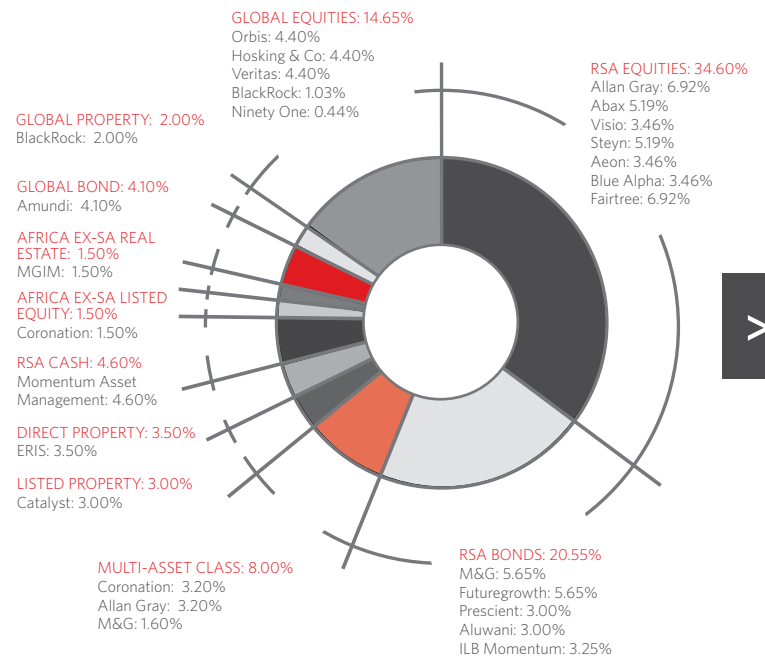
The chart below shows the long term bonus* performance of the Multi-Manager Secure Growth Fund against CPI



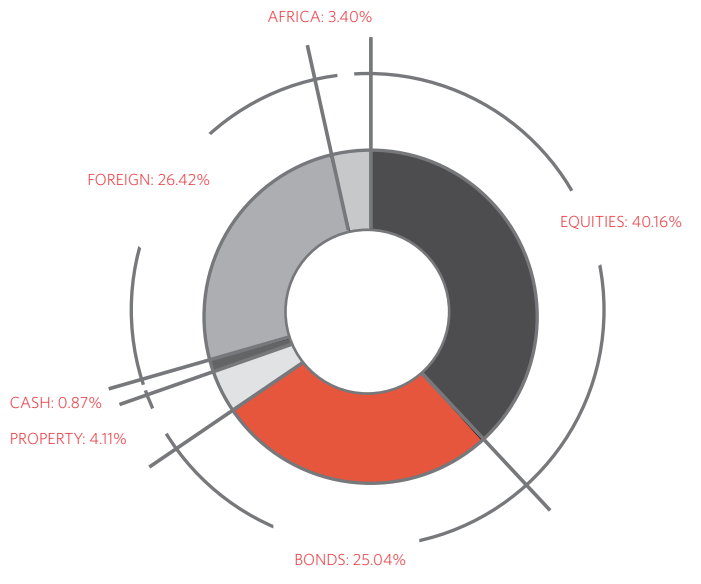
Asset Allocation

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.



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



Smoothed Bonus Portfolios Key Features

		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
	Fully Vesting	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 **
June 2020									
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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