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

Smoothed Bonus Report

First Quarter 2024

momentum
corporate

Reviewing the **last quarter**

Dear valued investors

As reported by the Financial Times, global equity markets experienced their most robust performance in the past five years during the first quarter of 2024. This was driven by confidence regarding a gradual economic downturn in the United States (US) and the enthusiasm surrounding artificial intelligence (AI). Furthermore, we observed a decrease in equities market volatility throughout the same quarter. The Volatility Index (VIX), which measures Wall Street's level of anxiety, remained relatively stable during the quarter, and ended March 2024 at 13 points. This is notably lower than its average of 19.6 points since 1990.

Although the global market has mostly dismissed the possibility of a US recession in recent quarters, several indicators suggest that there is still a significant and non-negligible risk of recession. Although the market narrative has transitioned from anticipating a severe economic downturn to a more gradual decline, and now to expecting no decline at all, recession indicators such as an inverted yield curve still indicate potential problems. If a recession were to occur, global equities could experience a substantial downside. Financial markets are incorporating incoming data and the central bank's statements to revise their perspectives on the economic outlook and the expected path of inflation. Consequently, markets have substantially reduced the projected number of interest rate cuts for 2024.

The local South African equity market ignored the global trend and went down 2,2% in the first quarter of 2024. The FTSE/JSE All Share Index was supported by slight gains in industrial shares, while resources and financial shares detracted from the overall index. Local and global portfolio managers remain underweight SA equities, enhancing their rerating potential should there be positive surprises on the domestic economic growth front. In SA's fixed-income markets, the 10-year government bond yield saw a widening of the Credit Default Spreads and sold off 94 basis points in the quarter. The FTSE/JSE All Bond Index declined by 1,8% in the same period. The fall in the FTSE/JSE Inflation-linked Index was smaller at 0,3% whilst the FTSE/JSE SA Listed Property Index gained 3.8% over the quarter ended 31 March 2024.

In the first quarter of 2024, the rand saw a depreciation of 2.8% against the US dollar. The inflation outlook continues to be at risk due to the depreciation, increased prices of administered goods, and rising global food and oil prices driven by geopolitical factors. However, it is anticipated that demand-pull and wage inflation will be restricted, hence restricting any second-round or lasting inflationary pressures. A decrease in South African interest rates during the latter half of the year is anticipated.

Herman van Papendorp and Sanisha Packirisamy, members of the macro research team at Momentum Investments, provide additional analysis and insights on the market and the economic landscape in their publication located on page 9.

Waseema Hassen

Technical Marketing:
Investment Deal Maker
Momentum Corporate

Momentum Corporate smoothed bonus

The first quarter of 2024 saw a robust overall market performance across our portfolios. The driving force behind these positive outcomes stemmed predominantly from a strong global equity market performance. A steady increase in global exposure in our portfolios over the previous quarters bodes well for the overall performance of our smoothed bonus range. This has helped manage funding levels and resulted in stable declared bonus rates for our smoothed bonus portfolios over the 6 months to 31 March 2024. As of 31 March 2024, all our smoothed bonus portfolios were fully funded.

Volatility is a prevalent feature in markets. While the first quarter of 2024 experienced low volatility, the upcoming year will witness several significant elections globally. This includes elections in newly established democracies or countries with effective autocratic systems. Consequently, there is a heightened risk of authoritarianism gaining ground while liberal democracy remains on the defensive. The potential economic repercussions of democratic backsliding worldwide may lead to increased market volatility. Our smoothed bonus portfolios excel in providing steady bonus rates over time, with considerably fewer swings compared to alternative investment options. The inclusion of capital guarantees in the Momentum Corporate smoothing bonus range increases the level of security for investors, providing them with a sense of assurance during periods of uncertainty.

> We look forward to navigating these volatile market conditions together and being your trusted partner in helping your members achieve financial success.

Kind regards

Waseema Hassen

Contents

How does AI impact the investment landscape by Tanzin Durr	5
Momentum Investments market commentary for the quarter ended 31 March 2024 by Sanisha Packirisamy and Herman van Papendorp	9
Smooth Edge Fund	25
Multi-Manager Smooth Growth Fund Global	26
Smooth Growth Fund Global	27
Universal Multi-Manager Smooth Growth Fund	28
Universal Smooth Growth Fund	29
Multi-Manager Smooth Growth Fund Global Bonus Series 2020	30
Universal Smart Guarantee +3 Fund	31
Multi-Manager Secure Growth Fund	32
Smoothed Bonus Portfolios: Key Features	33
Contact details	34

How does AI impact the investment landscape?

Tanzin Durr

Product Specialist
Structured Solutions

Introduction

In today's digital age, artificial intelligence (AI) has become an ever-present part of our lives, from virtual assistants like Siri and Alexa to advanced technologies in Tesla cars. Even though Tesla cars are less common in South Africa, they are widely popular around the world. AI is a subject of fascination and apprehension, with many unsure about its capabilities and potential risks.

AI is a discipline across mathematics, statistics, and information technology that seeks to mimic human cognitive skills within a computer. These skills include learning, processing, perceiving, rationality, and logic.

This article explores the evolution of AI, its benefits to the investment industry, and the risks it poses. Understanding these complexities is crucial for making informed investment decisions in an increasingly AI-driven world.

The evolution of AI

AI's journey has been remarkable. Its origins trace back to the mid-20th century with the development of simple algorithms. The technology's significant milestone occurred in 1997 when IBM's chess-playing computer defeated chess grandmaster Garry Kasparov in 1997, showcasing AI's potential. In the 2000s, the field saw the rise of big data and sophisticated computing. This era brought us breakthroughs in deep learning. A standout moment came in 2016 when Google's AlphaGo defeated a professional Go player, further highlighting AI's capabilities. Today, AI is everywhere, an example of this is personal assistants like Siri and Alexa mentioned earlier as well as generative AI systems such as ChatGPT.

It's also making big waves in industries like healthcare and finance, transforming them with predictive analytics and automated systems. According to Exploding Topics (2024), the global AI market was worth US$ 196,63 billion in January 2024 and is expected to grow to US$ 1,85 trillion by 2030. The graph by Precedence Research (2023), illustrates the growth in the AI market over time, with 2023 as base year.

Artificial Intelligence (AI) Market size, 2022 to 2032 (USD Billion)

Source: www.precedenceresearch.com

With all these developments, AI isn't just a technological phenomenon—it's also a topic of ethical and practical debate, raising questions about the future and how we navigate it.

AI in the investment industry: Opportunities, uses and benefits

AI's uses in the investment industry are vast, including the enhancement of investment strategies, the creation of better customer experiences and contributing to a more productive economy overall.

Some notable uses of AI in the investment industry include:

- its ability to improve market predictions;
- its use in risk management by predicting market downturns;
- automated trading to reduce costs and improve efficiency;
- portfolio optimisation, and the construction of investment strategies;
- it enables the creation of new asset classes;
- it can provide personalised investment advice through AI-driven chatbots and virtual assistants, improving consumers' experience.

AI promotes innovation and efficiency and can enhance productivity across various industries. Hence, it can create new investment opportunities and boost market growth.

AI drives a significant shift towards more dynamic and sophisticated investment environments, offering substantial advantages to individual investors and financial institutions. However, the use of AI also carries numerous risks.

Potential risks of AI in investments

The risks AI poses in the investment landscape are multifaceted and can affect investments both directly and indirectly. Some of these risks, as outlined by Beazley (2024), Investopedia (2022), and the National Institute of Standards and Technology (2022), include:

Personal investment decision-making

- AI may not always align with personal investment objectives or risk tolerance, potentially leading to unsuitable recommendations;
- Over-reliance on AI advisors could diminish an investor's understanding and active decision-making in investment processes;
- The effectiveness of AI recommendations depends heavily on the quality of the data, meaning that poor or biased data could lead to ineffective advice. For example, a trading algorithm might be biased against stocks from a particular region, if historical data shows less profitability.

Market dynamics and stability

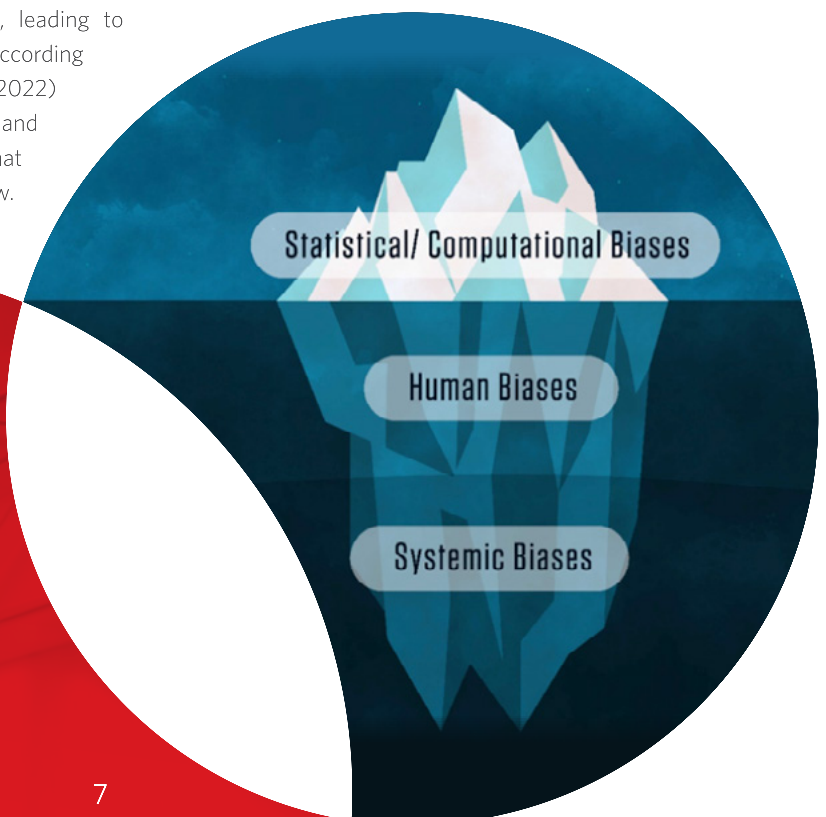
- Algorithms respond rapidly to new information. This might lead to increased market sensitivity and overreaction to news or financial reports, which could exacerbate market volatility;
- Algorithmic trading strategies may not behave well during unusual market conditions. The dynamic nature of stressed markets can challenge the foundation upon which many algorithms are built. This might lead to algorithms generating large and unexpected trades, causing significant financial losses or market crashes. For example, in 2012, Knight Capital, a US-based financial services firm, lost US$440 million in 30 minutes due to a software glitch that triggered unintended trades.

Systemic risks

- Systemic risks related to AI in financial markets stem from many firms using similar AI algorithms for trading, which can make their trading behaviours closely aligned. This homogeneity might amplify financial shocks. For example, if these AI models all share a particular flaw, it could trigger a widespread financial crisis as all these models simultaneously fail similarly.

Bias concerns

- AI systems might learn biases in their training data, leading to discriminatory practices or unfair market advantages. According to the National Institute of Standards and Technology (2022) the bias in AI goes deeper than that in the training data and machine learning processes, to broader societal factors that influence how technology is developed, as illustrated below.



Regulatory and compliance risks

- AI systems may not comply with all existing financial regulations, which could lead to legal challenges or fines;
- Regulatory landscapes regarding AI are still evolving, creating uncertainty and potential compliance risks.

Market structure and operational risks

- AI can disrupt financial markets by speeding up market trends or changing industry norms and practices. These disruptions might cause markets to become more volatile and undermine the reliability of conventional investment strategies. AI's fast processing and decision-making capabilities can amplify market movements, increasing uncertainty and risk in investment environments;
- AI could allow for the creation of more complex financial instruments, making it difficult for investors to understand risks and make informed decisions, leaving them entirely reliant on AI.

Economic and societal impact

- Automation driven by AI could lead to significant job losses, impacting consumer spending and overall economic stability.

The benefits of investing in a smoothed bonus portfolio in this context

The rapid evolution of AI, paired with the opportunities and uncertainties it brings to the investment environment, necessitates a well-informed, comprehensive, and dynamic approach to incorporating AI considerations into investment strategies.

AI's continual evolvement in the investment space is the only certainty in an otherwise uncertain world. We eagerly anticipate how this technology will not only transform our daily lives but also our investment decisions and the market as a whole.

Amidst all this uncertainty created by AI, smoothed bonus portfolios offer several advantages, particularly for investors who are more risk-averse or close to retirement. When providing capital guarantees, in addition to smoothed returns, these portfolios protect investors from short term market volatility while aiming to deliver returns that outperform inflation over the long term.

Investing in a 100% guaranteed smoothed bonus portfolio would, through its capital guaranteed nature, protect the investor from potential market crashes caused by AI. In addition to this, the smoothing principles employed in these portfolios, could combat short term market volatility, which is expected to increase due to the fast processing and decision-making capabilities of AI.

Conclusion

The evolution of AI brings about significant shifts in the investment environment, allowing for an ever-more interconnected world. At the same time, using AI has numerous benefits and risks and increases uncertainty as it evolves.

Investing in smoothed bonus portfolios provides stability amidst market uncertainty. Momentum is pro-digitalisation and open do adapting to emerging AI trends in a responsible manner.

Reference list

1. *Exploding Topics. (2024). AI Market Size Statistics (2024). Retrieved from https://explodingtopics.com/blog/ai-market-size-stats.*
2. *Precedence Research. (2023). Artificial Intelligence (AI) Market (By Offering: Hardware, Software, Services; By Technology: Machine Learning, Natural Language Processing, Context-Aware Computing, Computer Vision; By Deployment: On-premise, Cloud; By Organization Size: Large enterprises, Small & medium enterprises; By Business Function: Marketing and Sales, Security, Finance, Law, Human Resource, Other; By End-Use:) - Global Industry Analysis, Size, Share, Growth, Trends, Regional Outlook, and Forecast 2023-2032. Retrieved from https://www.precedenceresearch.com/artificial-intelligence-market.*
3. *National Institute of Standards and Technology (NIST). (2022). There's More to AI Bias than Biased Data: NIST Report Highlights. Retrieved from https://nist.gov/news-events/news/2022/03/theres-more-ai-bias-biased-data-nist-report-highlights#:~:text=As%20a%20step%20toward%20improving,beyond%20the%20machine%20learning%20processes.*
4. *Beazley. (2024). The opportunities and risks of AI in the investment industry. Retrieved from https://www.beazley.com/en-US/articles/the-opportunities-risks-of-ai-in-the-investment-industry/*

Investopedia. (2022). Four big risks of algorithmic high-frequency trading. Retrieved from https://www.investopedia.com/articles/markets/012716/four-big-risks-algorithmic-highfrequency-trading.asp

Momentum Investments market commentary for the quarter ended **March 2024**

by Sanisha Packirisamy and
Herman van Papendorp

Highlights

Markets

- For South African (SA) investors, our preference remains tilted towards domestic asset classes over their global counterparts in the upcoming year due to more appealing valuations and the potential for rand appreciation.
- History shows that the behaviour of global equities after the last United States (US) rate hike in the cycle, as well as after the first rate cut, depended on whether both these interest rate milestones were associated with US recessions or not. It thus matters a lot for the outlook for global equities whether there will be a recession in the US.
- While the global equity market has in recent quarters largely discarded the US recession probability, some indicators point to a lingering and non-negligible risk of recession. There could be a significant downside for equities should recession ensue.
- US bonds are presently trading at a discount to US equities, a situation seldom witnessed in the 21st century. Furthermore, based on the ratio between the current US bond yield and the through-the-cycle US equity earnings yield, equities are currently priced more than one-and-a-half standard deviations expensive relative to US bonds.
- The valuation metrics of the SA equity market have reset to consistently lower levels since the pandemic. SA equities remain very underowned by local and global portfolio managers, enhancing their rerating potential should there be positive surprises on the domestic economic growth front or if a global risk-on environment takes hold.
- We believe that SA's elevated nominal bond yields already incorporate substantial fiscal and country risk premiums. Break-even widening and above-average monthly accruals in 2024 in line with an expected rising inflation trend should fundamentally support inflation-linked bonds (ILBs) this year. We foresee a necessity for investors to extend the duration of their SA fixed-income holdings during 2024 to mitigate the escalating reinvestment risk associated with shorter-duration fixed-income assets like cash as we near the start of the domestic rate cutting cycle.
- Strong recent returns from the listed property sector show that at least some of the apparent fundamental improvements have already been discounted, which should constrain future returns.
- Geopolitical factors, along with central bank gold purchases, are expected to continue as primary positive catalysts for the US dollar gold price in the near term.

Economics

- Incoming data and central bank rhetoric are being taken on board by financial markets as they adjust their views of the economic outlook and the trajectory for inflation. As such, markets have significantly pulled back the number of expected interest rate cuts for 2024.
- While the narrative in markets has shifted from a 'hard landing' to a 'soft landing' to a 'no landing' expectation on growth, recession indicators, such as an inverted yield curve, continue to flag warning signals.
- Given the effects of disrupted trade flows, supply chain shortages, increased uncertainty and higher risk premia that arise out of geopolitical tensions, a higher level of political instability in the global economy could result in higher inflation, lower growth and significant welfare losses. As such, a more explicit link between economic policies and foreign or national security policies is likely to form going forward.
- A record number of elections globally, including those in fledging democracies or effective autocracies, raises the risks of authoritarianism making gains while liberal democracy continues to play defence. Democratic backsliding in the world could have high economic costs.
- In SA, polls for the 29 May 2024 general elections currently flag a significant risk for the incumbent ruling party. While progress towards democratic pluralism is a step towards a more diverse political landscape, coalitions have not had a stellar record at a local level in SA.
- Opposition parties will fiercely vie for the nation's urban regions, suggesting that the ruling party is likely to retain the predominantly rural provinces. Gauteng and KwaZulu-Natal are nevertheless likely to face the most contestation and have a higher likelihood of resulting in a coalition government at a provincial level.
- We expect pedestrian growth of 1% this year, up from 0.7% last year, to be supported by fixed investment in energy and a marginal recovery in household spending.
- Upside risks to the inflation outlook continue to stem from a weaker exchange rate, administered prices and geopolitically-driven higher global food and oil prices. Meanwhile, demand-pull and wage inflation are expected to remain contained, limiting second-round or persistent inflationary pressures.
- We expect the first move to lower SA interest rates in the second half of the year. In line with the SA Reserve Bank's (SARB) Quarterly Projection Model now only forecasting 50 basis points worth of easing by the end of the year, risks are titled to a shallower interest rate cutting cycle.

Market backpedals on expectations of interest rate cuts

Global bond and equity markets concluded the initial quarter of 2024 on a positive note, with investors preparing for additional volatile swings after experiencing months of alternating between optimism and pessimism regarding potential interest rate cuts by major central banks. Strong economic indicators provided encouraging signs, bolstering the likelihood of a gentle economic slowdown. A favourable shift in the overall economic environment was also evident in the adjustment of market expectations for interest rate reductions, which notably decreased, aligning more closely now with central banks' guidance. Nevertheless, the market's solid performance continued undeterred, even as the threat of higher-for-longer interest rates re-emerged.

According to the Financial Times, global equity markets achieved their strongest first-quarter performance in half a decade in 2024, propelled by optimism for a smooth economic slowdown in the US and excitement surrounding artificial intelligence. Accompanying strong equity market returns was an environment of low equity market volatility during the quarter. Wall Street's fear gauge (the CBOE Volatility Index or VIX) tracked broadly sideways in the quarter and ended March 2024 at 13 points, significantly below its longer-term average of 19.6 since 1990.

The Merrill Lynch Option Volatility Estimate (MOVE) Index, which captures a yield curve-weighted index of the normalised implied volatility on one-month Treasury options, followed the narrative of low volatility and retraced 18.2% in the quarter, ending March at 86 points — the lowest level since June 2022 and falling below its long-term average of 94.4 points recorded since 1987.

The rate cutting cycle is gathering momentum in response to falling inflation and stable growth outcomes. According to Cbrates, global central banks implemented 12 interest rate hikes in the first quarter of the year relative to 36 cuts. Emerging markets (EM) which hiked interest rates earlier and to a greater extent, have experienced a faster drop-off in inflation, allowing their respective central banks to cut interest rates sooner given their tighter real (inflation-adjusted) interest rate environment.

The US Federal Reserve (Fed) and the Bank of England (BoE) last hiked interest rates in July 2023. The European Central Bank (ECB) pressed pause a little later, after its last increase in September 2023. Since then, inflation has fallen further but economic data has remained reasonably resilient. Despite lower inflation, many of the major central banks cautioned against aggressive market expectations for interest rate cuts earlier in the year, placing the 'higher-for-longer' debate on interest rate policy back on the table. Financial markets have taken heed of central bank rhetoric and scaled back expectations on the expected number of interest rate cuts this year and have similarly pushed out the expected timing of the cuts.

Bitcoin was once again one of the best performing asset classes in the quarter, shooting 67% higher in the first quarter of the year, partly driven by the January 2024 launch of the US spot bitcoin exchange-traded funds (ETFs). According to BitMEX Research, spot bitcoin ETFs attracted net inflows of US$12.1 billion by the end of the first quarter. Markets anticipate increased price appreciation later in the year due to the upcoming halving event and the advancement of various layer-two Bitcoin networks, which are secondary networks to address scalability issues and enhance its functionality.

With overall growth expectations stabilising in China, the Bloomberg Commodity Price Index (the four largest weights in this index include gold at 15%, WTI Crude oil at 8%, natural gas at 8% and Brent Crude oil at 7%) lifted by 2.2% in the first quarter. Slower manufacturing growth in the world's largest economies and persistent trouble in China's real estate sector capped demand for base metals. Base metals exhibited a mixed performance over the quarter, with copper and nickel prices up between 3% and 5%, while zinc prices dipped over 6% and iron and steel prices fell between 16% and 20%. Aluminium prices traded broadly sideways during the corresponding period.

Within agricultural commodities, sugar, coffee and cotton saw the sharpest increases over the quarter, ranging between 8% and 10%. The price of cocoa and coffee beans has been driven higher as the combination of severe temperatures and drought conditions in major bean-producing nations has resulted in reduced harvests. West Africa, which contributes to around 80% of the world's cocoa, has been affected by dry weather conditions, sending cocoa prices to historical highs of nearly US$10 000 per metric tonne. Weather woes added to supply issues that were already at play, given the chronic underinvestment in cocoa farms. Meanwhile, coffee bean supplies in Vietnam, one of the main global suppliers, are under pressure, with the 2023-24 crop expected to drop 20%. Unfavourable weather conditions threaten to reduce the 2024-25 harvest in the Brazilian region, which could keep coffee prices elevated in the coming months.

Gold remained an outperformer among precious metals, rising 8.1% in the first quarter of the year. Geopolitical unrest continued to underpin support for gold, while central bank purchases added to gold demand. The World Gold Council reported that central banks bought 64 tonnes of gold for January and February this year, which was 43% lower than the same period in 2023, but a fourfold increase in 2022, suggesting that the broad trend of gold buying remains intact. In contrast, platinum and palladium prices moved lower by 7% and 8% over the same period.

Crude oil prices rose on the back of continued attacks by Houthi rebels in the Red Sea, while natural gas prices continued to fall due to an unusually warm winter and healthy US output. The international price of Brent crude oil jumped 13.6% in the quarter. A continued commitment from the Organisation of the Petroleum Exporting Countries plus (OPEC+), which represents around 40% of world oil production, and resilient global demand are also keeping prices higher.

Global stock markets performed well in the first quarter of the year, buoyed by economic resilience. The 8.2% rise in the MSCI All Country World Index was predominantly supported by a firm performance in developed market (DM) equities. The MSCI DM Index advanced 8.9% during the first quarter with Japanese equities registering the biggest increase. The Japanese Nikkei 225 Index experienced a phenomenal rise of 21.5% in the quarter as foreign investors continued to buy Japanese stocks, taking advantage of the cheap yen and corporate governance reforms that have supported an increase in shareholder returns.

Semiconductor stocks, in particular, ran hard. The yen continued to slide despite the Bank of Japan (BoJ) hiking interest rates for the first time in 17 years. Cautious sentiment by the BoJ tempered further interest rate hike expectations and sent the yen weaker.

Gains in the Eurostoxx 50 Index followed at 12.9% for the quarter, partly driven by expectations that the ECB may have to lower interest rates before the Fed given a weaker growth backdrop. Investors' expectations of earlier rate cuts for the region were buoyed after Switzerland kicked off the easing cycle among the larger DM economies in March 2024. More attractive valuations compared to US stocks have further driven increased investment in European shares.

Gains in the S&P 500 Index were solid at 10.6% for the first quarter of the year, the biggest first-quarter gain since 2019, but US equities still trailed the performance of the European and Japanese bourses. The uptick in the S&P 500 Index continued to be driven by information technology and communication services stocks (despite underperformance by Apple and Tesla, two of the dubbed 'Magnificent 7' stocks), but a broader rally was also evident in energy, financials, healthcare and industrial shares. J.P. Morgan Wealth Management calculated that the Magnificent 7 stocks contributed 41% of the S&P 500 Index's returns in the first quarter of the year, down from 60% in 2023. DailyFX reported that over 80% of the index traded above their respective 200-day simple average in the first quarter creating further evidence of a broader market upswing. In addition, Bank of America Merrill Lynch pointed out that there were record flows into US equity funds in March 2024, which supported the rise in the S&P 500 Index.

Gains in EM stocks were milder compared to their DM counterparts, in line with shallow gains in commodity prices, ongoing concerns over China's property sector and a further rise in US treasury yields. The MSCI EM Index inched 2.4% higher in the first quarter of the year, dragged lower by shares in Latin America. The MSCI Latin America Index slid 4% over the same timeframe on lacklustre iron ore prices. The MSCI EMEA (Europe, the Middle East and Africa) Index closed the quarter 1% higher while the MSCI Asia Index gained 3.4% over the same period.

Stubborn inflation data and an uptick in manufacturing activity in the US tempered rate cut expectations for 2024, leaving the yield on the US 10-year government bond higher. Yields in the US jumped 32 basis points in the first quarter of 2024 to 4.2%. The German 10-year government bond yield followed suit and sold off 27 basis points to end the quarter at 2.3%. The Fed's dot plot — a chart that records each Fed official's projection for the central bank's key short-term interest rate — signalled 75 basis points of cuts in 2024 and a further 75 basis points in 2025 (down from a previous 100 basis points). Fixed income markets have adjusted their previously aggressive easing expectations to match that of the Fed, taking heed of cautious central bank rhetoric. Market-implied policy rates for the Eurozone and United Kingdom (UK) further point to a scaling back in rate cut expectations for the year.

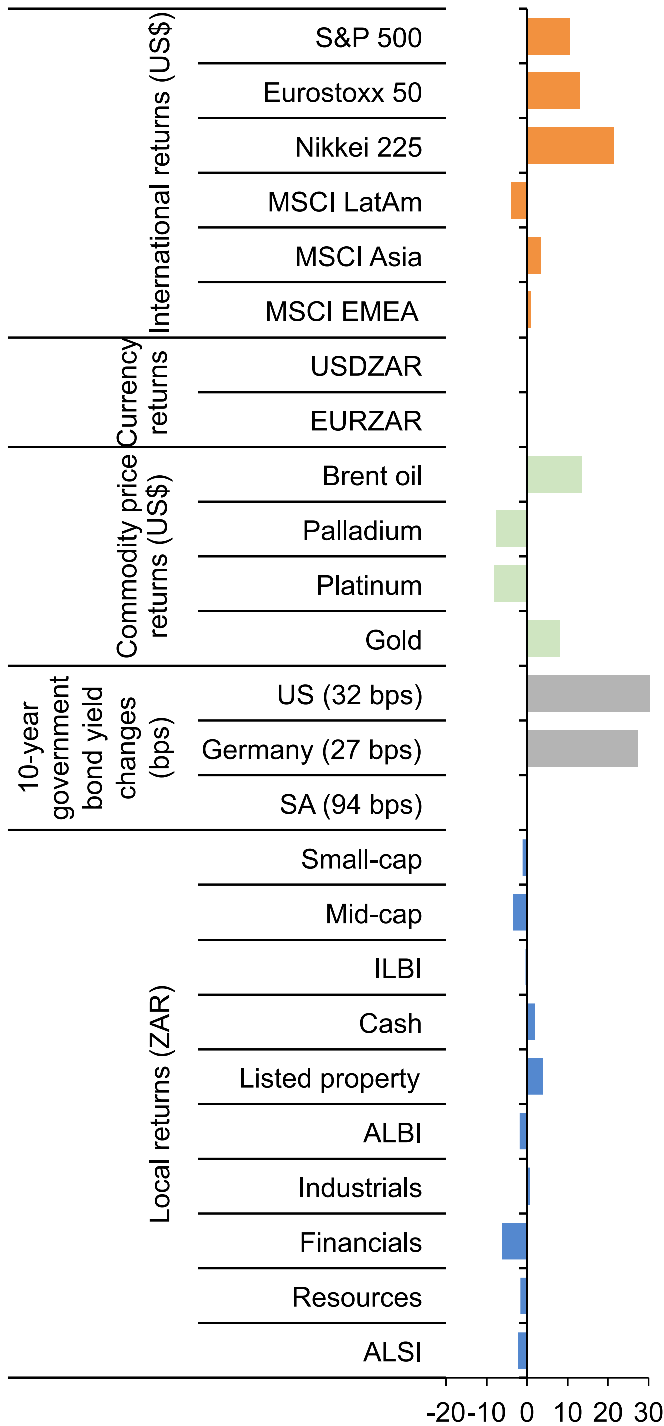
Mirroring subdued risk aversion in markets, the J.P. Morgan EM Bond Index (EMBI) spread narrowed by more than 15 points in the first quarter of 2024. Argentina experienced the sharpest narrowing in the credit default swap (CDS) spread of 35 points as investors priced in the potential for better economic conditions ahead following President Javier Mileis' bold actions to reform the economy. On the other hand, spreads widened the most in South Korea (41 points), SA (28 points) and China (20 points) over the same period.

The local equity market ignored the global trend and went down 2.2% in the first quarter of the year (see chart 1). The FTSE/JSE All Share Index (ALSI) was supported by slight gains in industrial shares, while resource and financial shares detracted from the overall index. The FTSE/JSE Industrials Index crept up 0.6% in the quarter, while the FTSE/JSE Industrials Index tumbled 6.1% and the FTSE/JSE Resources Index lost 1.6%.

The FTSE/JSE Mid-cap index ended the quarter 3.5% lower. Small-cap shares fared slightly better, falling by a lesser 1.1% in the quarter.

In SA's fixed income markets, the 10-year government bond yield echoed the sentiment expressed in the widening of the CDS spread and sold off 94 basis points in the quarter.

Chart 1: Asset class returns for Q1 2024 (%)



Source: Iress, Momentum Investments

The JSE Assa All Bond Index declined by 1.8% in the first quarter. The fall in the FTSE/JSE Inflation-linked Index (CILI) was smaller at 0.3%. The FTSE/JSE SA Listed Property Index saw gains of 3.8% over the same period.

The US dollar rose as firmer-than-expected growth data and stubborn inflation prints suggested that the Fed could reduce the number of rate cuts in 2024. As such, the J.P. Morgan EM currency index depreciated by 1.2% during the quarter. The Chilean peso (10.3%), the Turkish lira (8.7%) and the Thai baht (6.4%) suffered the steepest rates of depreciation, while the Mexican peso strengthened by 2.1% in the quarter. According to Bloomberg and Deutsche Bank, the Mexican peso is trading at its strongest real effective valuation since 2005, largely due to Mexico's record-high interest rates. The Bank of Mexico lowered interest rates to 11% for the first time in March 2024 after seven consecutive decisions to keep rates steady.

The rand weakened 2.8% against the US dollar in the first quarter of 2023. Losses against the euro were more muted at 0.9%, pointing to dollar strength as a significant driver of a weaker rand over the quarter.

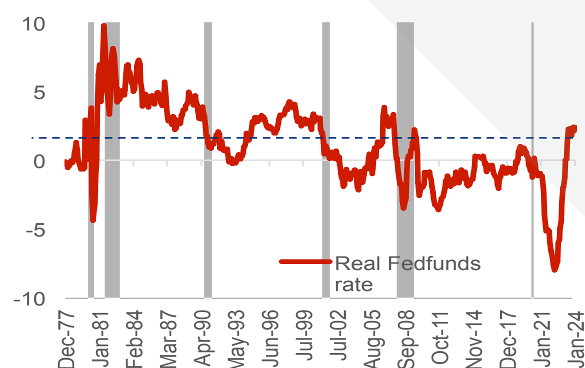
US bonds are preferred to US equities on margin-of-safety grounds

According to Deutsche Bank, the highest-ever proportion of the world's population will be experiencing some form of elections in their countries or regions during 2024, with almost half of the world's people heading to the polls this year. For global financial markets, this could imply a higher-than-usual potential for election-induced volatility risk in 2024.

An important fundamental theme for world markets in 2024 will be the expected reversal in the global interest rate cycle from a rising phase in place since March 2022 to a declining trend from later this year. History shows that the behaviour of global equities after the last US rate hike in the cycle, as well as after the first Fed rate cut, very much depended on whether both these interest rate milestones were associated with US recessions or not. Assuming that the last Fed rate increase in the current cycle was indeed in July 2023, the strong performance of developed equity markets since then has mimicked the no-recession historical experience, as shown by a recent Barclays study. With global equity markets seemingly not discounting much recession risk after the last rate hike this time round, there could be a significant downside for equities should a recession ensue. Similarly, research from Deutsche Bank concludes that historically, there has been a huge divergence in the returns from US equities after the first rate cut in the cycle, depending on the occurrence of a recession or not.

It thus matters a lot for the outlook for global equities whether there will be a recession in the US. While the global equity market has in recent quarters largely discarded the probability of recession, some indicators point to a lingering and non-negligible risk of recession. The long and variable lags of monetary policy, together with the fact that real US policy rates have only been positive since May 2023 after a prolonged period of being predominantly in negative territory (see chart 2), could suggest that the full impact of the current rising interest rate cycle is yet to be felt in the US economy. In addition, the consumption support provided up to now by the build-up of excess savings during the pandemic is likely to dwindle going forward as the excess savings pool becomes depleted. We also note that the US leading economic indicator momentum has never before been as negative as it is currently without a recession following.

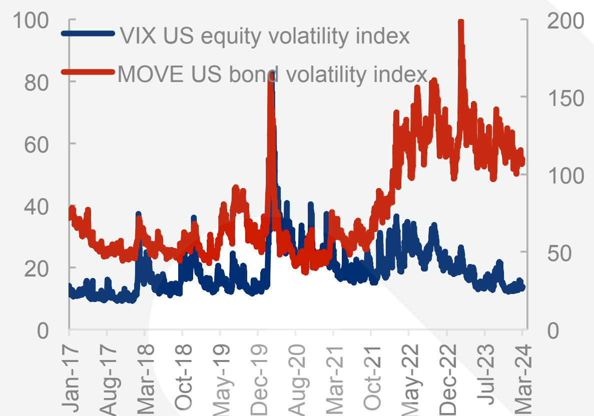
Chart 2: The Fed real policy rate has only been positive since May last year



Source: Iress, Momentum Investments

There has been a discernible discrepancy in the volatility trends of the US equity and bond markets since the initiation of the Fed's monetary policy tightening cycle in early 2022. Despite bond volatility stabilising at elevated levels since then, equity volatility has decreased to its lowest levels since the onset of the pandemic (see chart 3).

Chart 3: US equity market seems complacent about risks

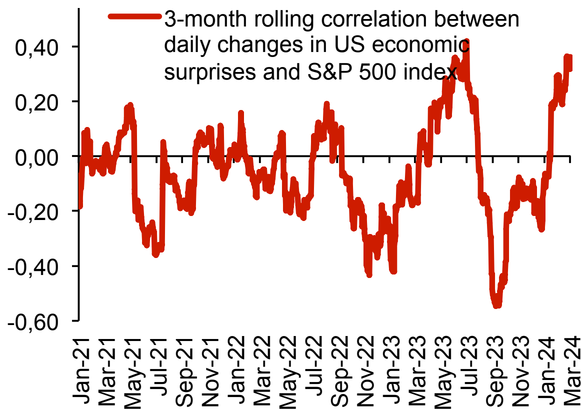


Source: Bloomberg, Momentum Investments

This could suggest a state of complacency within the equity market, where uncertainties about geopolitical tensions, US economic growth, inflationary pressures and policy rate adjustments are not adequately factored into equity volatility metrics. Research conducted by UBS indicates that historically, periods characterised by low volatility in the US equity market that already discounts a favourable scenario, has led to constrained subsequent returns from US equities.

In recent months, there has also been a disconnect between the reactions of the US bond and equity markets to changing perceptions about the likely start and magnitude of the US rate cutting cycle. As expectations for the first rate cut were pushed out to a later date and the anticipated number of rate cuts in 2024 was halved, bond yields rose, but equities nevertheless continued to head higher. This is probably a reflection that US equities have become less rate sensitive and more growth (and earnings) sensitive. Indeed, there is now a positive correlation between economic surprises and the US equity market (see chart 4), with improving economic surprises leading to higher equities and vice versa.

Chart 4: Improving economic surprises now positive for the US equity market

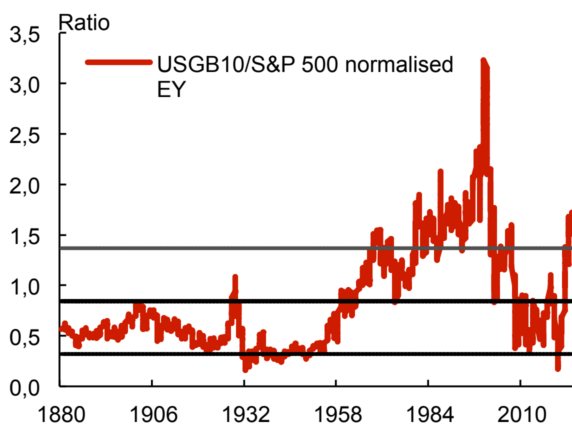


Source: Bloomberg, Momentum Investments

In contrast, improving US economic growth surprises have consistently been bad news for US bonds since the onset of the rising US interest rate cycle in the early part of 2022, with a steady positive correlation between US economic surprises and US bond yields ever since. This is also confirmed by real bond yields (and by implication policy rate expectations) being the main driving force(s) for global nominal bond yields throughout 2022-24, in contrast to rising inflation expectations pushing yields higher in 2020-21.

The combination of rising policy rates and strong growth momentum has propelled US bond yields significantly higher in recent years. As a result, US bonds are presently trading at a discount to US equities, a situation seldom witnessed in the 21st century. An examination of the ratio between the current US bond yield and the through-the-cycle US equity earnings yield demonstrates that equities are currently priced more than one-and-a-half standard deviations expensive relative to US bonds (see chart 5). This is a departure from the extended trend observed since the global financial crisis (GFC) when US equities consistently traded at a comparatively lower valuation compared to bonds.

Chart 5: Relative US equity/bond valuations

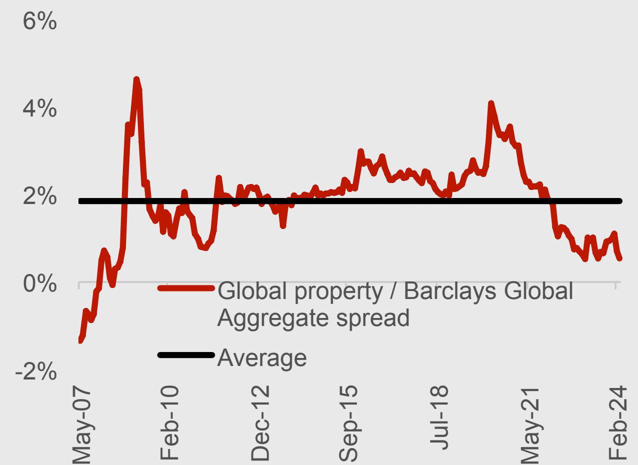


Source: Iress, Momentum Investments

Rental growth in the US real estate investment trust (REIT) sector has normalised to lower levels after a strong showing in the initial aftermath of the COVID period. Meanwhile, occupancy rates continue to decline in the office sector and are reverting down to pre-pandemic levels in the other sectors. Although global property currently looks cheap against global equities, with yield spreads above historical averages after many years of poor relative performance, it still seems expensively valued versus fixed-income asset classes like nominal and real US Treasuries and global investment grade bonds, with respective yield spreads below normal (see chart 6).

For SA investors, our preference remains tilted towards domestic asset classes over their global counterparts in the upcoming year. SA assets exhibit more appealing valuations compared to global alternatives and already reflect significantly negative scenarios. Any uptick in global risk appetite throughout 2024, possibly ignited by potential future declines in DM policy rates, or better-than-expected local outcomes, might alleviate the valuation discount of SA assets. Furthermore, the potential appreciation of the rand linked to either of these developments could diminish the returns from global assets denominated in local currency.

Chart 6: Global property expensive versus global investment grade bonds

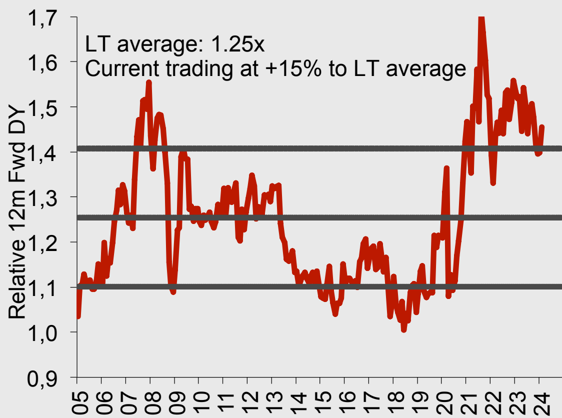


Source: Bloomberg, Momentum Investments

Large SA equity valuation discounts remain

The valuation metrics of the SA equity market have reset to consistently lower levels since the COVID-19 pandemic. Although a 25% long-term average dividend yield premium of SA equities to EM has been in place over time, the current 46% premium is significantly higher (see chart 7). In a similar vein, SA's current 24% forward P/E discount to EM is meaningfully more than the 2% long-term discount. Also, UBS shows that although SA's current return on equity (RoE) relative to EM is slightly above its historical average (and at almost a 20% premium to EM), SA's relative P/B that investors pay for this premium profitability is at all-time lows (and at a 10% discount to EM).

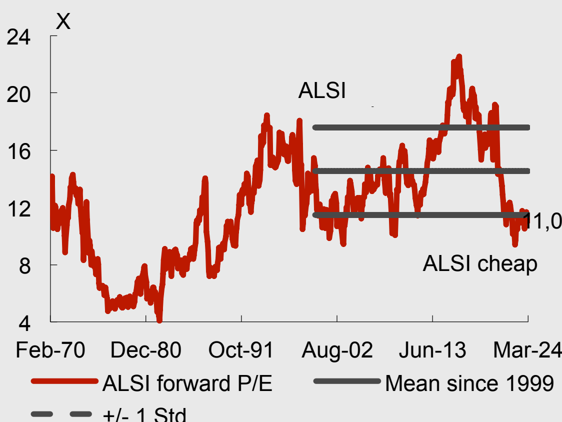
Chart 7: SA forward dividend yield relative to EM



Source: SBG Securities

Furthermore, the SA equity market forward P/E is now trading at more than one standard deviation below its average since 1999, even assuming a conservative below-consensus 9% profit growth in the next year (see chart 8). The SA equity market has consistently traded around the one standard deviation cheap level in its history since mid-2021. SA equities thus don't only look very cheap against the global universe as stated earlier, but also against their history.

Chart 8: ALSI forward P/E

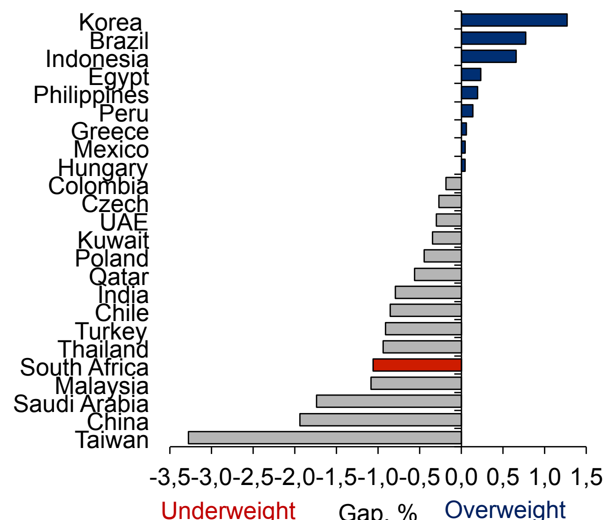


Source: Iress, Momentum Investments

Many reasons can be put forward to explain the significant risk premium attached to the SA equity market in recent years. The overarching of these is the view that the dwindling growth performance trend seen from the SA economy in recent years, facilitated by the inconsistency of electricity supply and the degradation of the transport network, will continue unabated into the future. While only around 30% of the operational performance of the SA equity market is dependent on the internal economy, there is nevertheless a large sentiment discount attached to all SA-listed companies due to a poor economic growth expectation. For the valuation discount to narrow, a better-than-expected outcome than the anticipated dire scenario has to be forthcoming. Some rerating could also follow if a global risk-on environment takes hold.

SA equities remain very underowned by local and global portfolio managers, which implies that there is no overhang in the asset class, enhancing its rerating potential should there be positive surprises on the domestic economic growth front. SBG Securities notes that domestic multi-asset fund managers' 38.8% SA equity weighting in the fourth quarter of 2023 is close to historical lows. SA is also the fifth most underowned market within global EM (GEM) equity funds (see chart 9) and should have meaningful rerating potential from current cheap valuations whenever global risk appetite improves.

Chart 9: Underweight SA exposure in EM equity fund



Source: SBG Securities

How significantly the SA equity market punches below its weight globally is highlighted by Deutsche Bank research which shows that although the SA equity market produces roughly the same amount of profit as Amazon, the market capitalisation of Amazon is around six times that of the whole SA equity market.

Substantial country and fiscal risk premiums incorporated into SA bond yields

Rising nominal bond yields and falling inflation have pushed real DM bond yields towards positive territory, from very negative levels previously. Nevertheless, based on current bond yields and inflation, it is only US real bond yields that are currently positive in the DM region (see table 1). This contrasts with the significantly positive real bond yields available in the EM world. Among the investable EM countries, Brazil and SA offer the highest real bond yields based on current nominal yields and the most recent inflation print.

SA's real bond yields not only present an attractive proposition compared to both DM and EM yields in absolute terms but also incorporate significant premiums against DM historical averages. For instance, the premium is nearly one standard deviation above the average compared to the US since the implementation of SA's inflation targeting regime.

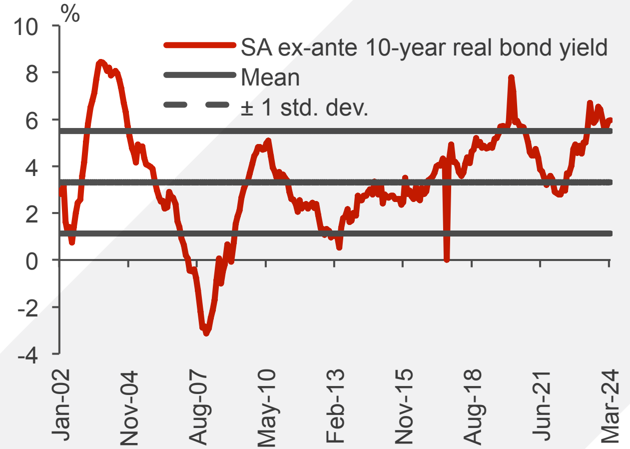
Table 1: Real ex-post 10-year government bond yields

DM	
US	1.0%
UK	0.0%
Europe	-0.2%
Japan	-1.4%
EM	
Russia	6.5%
Brazil	6.4%
South Africa	6.2%
Mexico	4.8%
Türkiye	-42.2%

Source: Iress, Momentum Investments

Furthermore, SA's projected real bond yield is more than one standard deviation higher than its historical average post the adoption of inflation targeting (see chart 10). We believe that SA's elevated nominal and real bond yields already incorporate substantial fiscal and country risk premiums. Relative to SA equities and cash, SA nominal bonds have consistently been the cheapest asset class since 2013.

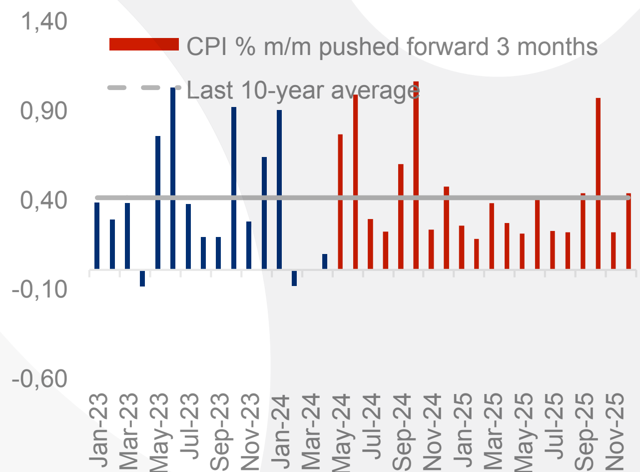
Chart 10: SA ex-ante real bond yield



Source: Iress, Momentum Investments

Break-even widening and above-average monthly accruals in 2024 in line with a rising expected inflation trend should fundamentally support ILBs this year. But sharp break-even tightening and lower-than-average accruals in 2025, as inflation falls, are likely to be less favourable for ILBS next year (see chart 11).

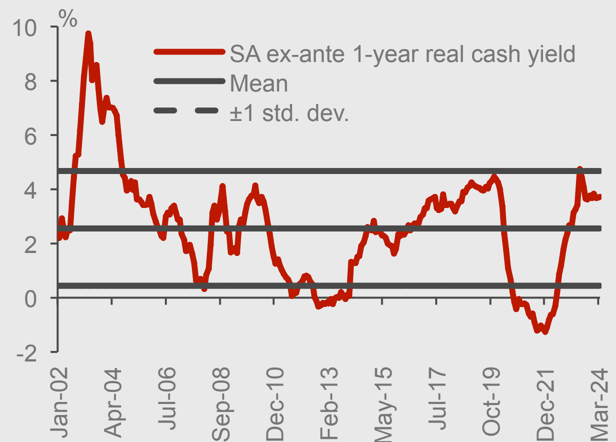
Chart 11: Fundamental support for ILBs in 2024



Source: Iress, Momentum Investments

The prospective SA real cash yield has been rising from a low level in line with policy rate increases and has stabilised around one half of a standard deviation above its historical average (see chart 12). Much like the scenario with US cash, we foresee a necessity for investors to extend the duration of their SA fixed-income holdings during 2024 to mitigate the escalating reinvestment risk associated with shorter-duration fixed-income assets like cash as we near the start of the domestic rate cutting cycle.

Chart 12: Prospective SA real cash yield



Source: Iress, Momentum Investments

Strong recent returns constrain future listed property performance

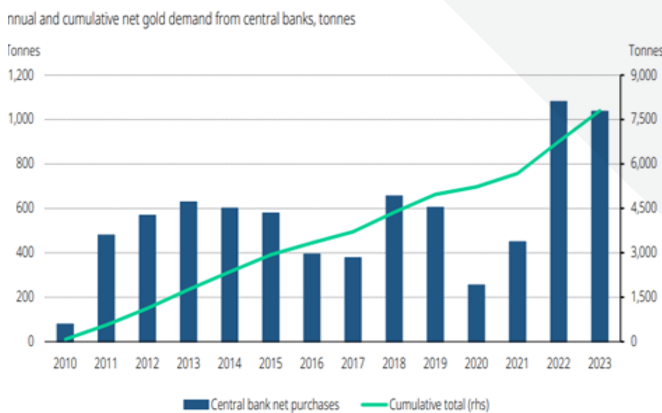
There has been a recovery in SA listed property operating income due to improved fundamentals. Office vacancy rates improved by 1.5% during 2023, from 16.7% in Q4'22 to 15.2% in Q4'23, while the slight acceleration expected in local GDP growth in 2024-25 should provide incremental demand support for Office space. Retail fundamentals have improved, with falling vacancies and better rental growth experienced in the sector. Industrial fundamentals are also improving, as apparent from low vacancies, decent escalations and less negative reversions, while rising Industrial net operating income is supporting an uptick in Industrial property sector values.

However, strong recent returns from the listed property sector show that at least some of the apparent fundamental improvements have already been discounted, which should constrain future returns.

Geopolitics and related central bank gold buying the dominant drivers for the gold price

Since the Russia/Ukraine war and the resultant financial sanctions imposed on Russia by the West, US real yields have no longer been the fundamental driver for the US dollar gold price. Instead, the highest gold buying from global central banks in 55 years in 2022 and the second-highest buying in 2023 (see chart 13), probably for geopolitical and diversification reasons, propelled the gold price to all-time highs in nominal terms. The central bank buying in 2023 was dominated by China, Poland and Singapore. Gold enables central banks to diversify their reserves away from assets like U.S. Treasuries and the dollar and, unlike currencies and bonds, it does not rely on any issuer or government.

Chart 13: Central bank gold buying highest ever in 2022-23

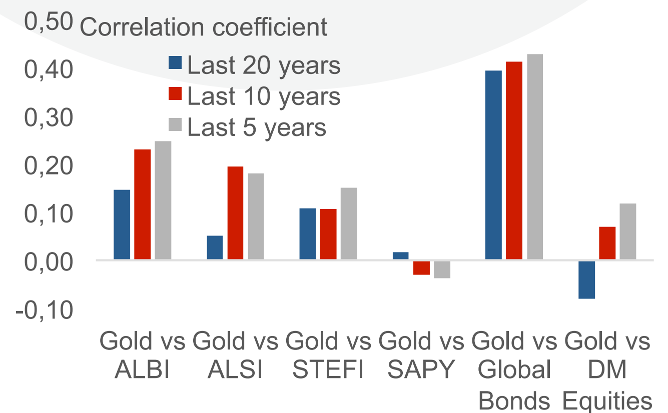


Source: World Gold Council

Given the anticipated persistence of geopolitical tensions in the foreseeable future amid the ongoing trend of deglobalization and the emergence of a multipolar world order, particularly between the Western powers and China, gold is poised to sustain its strategic appeal within central bank and investment portfolios due to its perceived role as a hedge against political volatility and uncertainty, making it a preferred asset for risk mitigation purposes. In a recent World Gold Council survey, central banks highlighted gold's value in crisis times, its diversification attributes and store-of-value credentials as their main justifications for holding gold reserves. The People's Bank of China, in particular, has significant scope for increasing its gold exposure, with only 4% of its reserves currently consisting of gold. This contrasts with other EMs like Russia and Turkey, where gold accounts for around 25% of total central bank reserves, and DMs like the US and Germany with around two-thirds of reserves in gold.

Gold also has a strategic rationale as a portfolio risk diversifier, because it is expected to hold its value through turbulent times and has limited correlation with other asset classes (see chart 14). Furthermore, research from SBG Securities shows that for a SA investor, the rand gold price has been a consistently strong relative asset class performer historically, as perennial rand weakness has provided huge support over many years.

Chart 14: Gold has a limited correlation with other asset classes



Source: Iress, Bloomberg, Momentum Investments

Landing the monetary policy plane smoothly

Investors are faced with the challenge of navigating an uncertain terrain dotted with structural challenges, all while interest rates are hovering near 17-year highs. Although the world is primed for a transition to interest rate cuts as central banks shift gears from reducing inflation to keeping it under control, all while trying to support growth, central bankers have warned that tighter monetary policy may be warranted for longer until inflationary pressures are definitively behind us.

In general, inflation has shown a notable improvement since reaching its highest levels in over 40 years. Energy costs have eased significantly since surging on the back of Russia's invasion of Ukraine. Supply chains have recovered sufficiently, leading to a reduction in prices across various categories of goods. Moreover, China's declining export prices have translated into lower import prices elsewhere, further aiding global disinflation. World inflation halved in October 2023 from its peak of 8% in September 2022 and has since retraced further to below 3.5%.

Varying processes in the fight against inflation created a divergent interest rate and growth outlook for economies, with the current policy trade-offs for a number of EMs appearing more favourable than for developed economies which reacted with tighter monetary policy only later in the cycle. According to the World Bank's Global Economic Prospects report in January 2024, there were more EMs that were cutting interest rates than not, while there were still more DMs that were hiking relative to cutting. Headline price pressures have unwound faster in EMs, peaking at 7.9% in September 2022 but falling below their longer-term average of 4.6% in October 2023 to 3.7% at the start of the year. In DM economies, however, headline inflation has yet to reach its longer-term average of 2.1%, with DM central banks reacting to inflationary pressures later than some EMs, which managed to hike earlier in the cycle.

There is a degree of heterogeneity among the EM composite too. Inflation reached higher peaks in countries in Latin America, with central banks responding earlier and more aggressively, allowing them to alter course quicker as inflation responded more rapidly to a higher interest rate environment. With inflation in Asia never quite reaching the heights of its emerging peers, there was less need for very sharp adjustments in interest rates.

In contrast, too low inflation in China led the People's Bank of China to cut the one-year loan prime rate (a benchmark rate for most households and corporates) from 3.85% at the end of 2021 to 3.45% at the end of the first quarter of 2024 and the five-year loan prime rate from 4.65% to 3.95% over the same period. Financial markets are pricing in further interest rate easing measures in China, including two additional cuts to the reserve requirement ratio in the second half of this year. These, together with continued targeted measures in the property sector, should continue to support growth, preventing economic growth from cratering. However, it is unlikely to be enough to provide significant upside to economic growth forecasts for China. Additional growth support has nevertheless been evident in the green technology and advanced manufacturing sectors, which are growing fast off a low base. Rapid growth in these sectors provides a partial offset to depressed consumer spending (a function of weak asset prices and high levels of youth unemployment) and a still-troubled housing market which continues to detract from overall economic activity, albeit at a slower pace.

Similarly, deflation pressures kept interest rate policy in negative territory in Japan since 2016. Nonetheless, the BoJ has bucked the global trend of stable to lower interest rates by raising interest rates for the first time in 17 years in March 2024 and abandoning yield curve control – a policy that entailed buying Japanese government bonds to control interest rates. After chasing inflation for two decades, it may have finally arrived. Some of Japan's largest corporates agreed to raise salaries by 5.3% in March, representing the most significant wage hike in more than three decades. The BoJ has noted the virtuous cycle between wages and prices and notes the results of the spring wage negotiations as a positive step towards the central bank achieving its inflation target of 2%.

In the context of diminishing inflation and an unexpectedly robust economic performance, market participants initially diverged from the forecasts of central bankers, leading them to anticipate early interest rate cuts. However, central bank officials stepped in to counter excessive optimism, emphasising that the battle to return inflation to target levels remained ongoing. In its latest quarterly report, the Bank for International Settlements noted that central banks are nearing success in their efforts to regain control over the global inflation surge but warned that services inflation remained sticky.

Christopher Waller, a member of the Fed Board of Governors, summed up the risks of premature easing in a speech in late March by saying, "Fortunately, the strength of the US economy and resilience of the labour market mean the risk of waiting a little longer to ease policy is small and significantly lower than acting too soon and possibly squandering our progress on inflation". He went on to explain that the recent upside surprises in inflation data in the US did not necessarily derail the expected continued downtrend in inflation by noting that "It is appropriate to point out that a month or two of data does not necessarily indicate a trend, and there are good reasons to think that progress on inflation will be uneven but likely to continue down toward 2%."

Incoming data is likely being taken on board by financial markets in adjusting their views of the economic outlook and the trajectory for inflation. As such, markets have significantly pulled back the number of expected rate cuts for 2024. Moreover, central bank guidance has successfully aided a shift in market expectations back towards alignment with their projections, reducing the disparity between market and central bank outlooks.

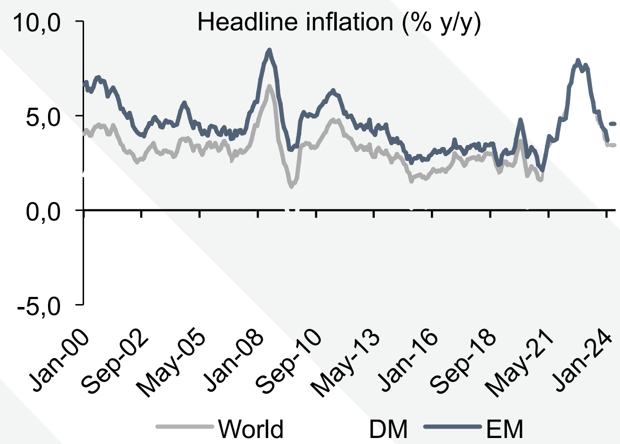
While financial markets were discounting close to seven interest rate cuts for the US for this year, the Fed futures have shifted markedly since then, suggesting that market participants have pared back expectations to only three cuts this year and have pushed out the expected start date to easing from the first to the third quarter of 2024. Similarly overnight indexed swap (OIS) markets point to financial markets lowering their expectations for interest rate cuts in the UK and Eurozone from six to between two and three over the same period.

Cutting interest rates by too much too soon risks a sustained rebound in inflation. Although the speed of disinflation surprised markets positively in 2023, there are a number of factors that caution against extrapolating this trend. Although core goods inflation fell sharply, partly owing to post-pandemic activity corrections and China's contracting export prices, these forces driving inflation lower could start reversing. Moreover, the threat of further global supply chain disruptions looms even though container ships are rerouting cargo through the Cape of Good Hope at an additional transportation fee and a time delay of roughly between seven and 10 days. Ernst and Young calculates that a prolonged conflict in the Red Sea, with shipping costs staying elevated, could add 0.7 percentage points to global inflation this year. The disruptions in the Red Sea have worsened preexisting difficulties in global shipping, with the Panama Canal, another crucial route for international trade, facing significant challenges due to a severe drought that is limiting its transit capacity.

Nevertheless, the Drewry World Container Index had already fallen more than 25% from its peak in January 2024 by the end of March, suggesting that the current situation is unlikely to be as damaging to global supply chains as the pandemic-induced disruptions were when port disruptions and lower freight capacity exacerbated the situation.

Core services, on the other hand, continue to pose a headwind for the expected pace of disinflation this year. According to an International Monetary Fund (IMF) blog post in January 2024, more than half of inflation in the US was being driven by labour market tightness towards the end of last year. While this was not as large a factor behind elevated inflation in the Eurozone, the second-round effects of the passthrough of energy prices into other areas of the inflation basket were keeping inflationary pressures high in the Eurozone. That said, softening activity in labour demand indicators in the Group of Seven (G7) economies, relative to their average levels experienced since 2013, and a reversal in wage growth, albeit still significantly higher than longer-term averages, should drive down wage growth closer to central bank targets in the coming quarters.

Chart 15: Disinflation underway globally



Source: Capital Economics, Momentum Investments

Dashes indicate the long-term average for each series

Further slowing the pace of disinflation has been generally better-than-expected growth. The anticipated landing of the global economy has so far not materialised. The descent in inflation, unlike in a typical economic cycle, has not been accompanied by a painful recession in the past quarters. The strength of economic growth nonetheless varies from region to region following the extent to which policymakers initially reacted to the pandemic and supply chain disruptions caused by the Russia-Ukraine and Israel-Palestine wars and more recently the conflict in the Red Sea. While the US displayed remarkable strength, growing at an estimated 2.5% last year, which was considerably higher than the Fed's 0.5% projection at the end of 2022, growth in other advanced economies such as the UK and Germany was notably slower. This was in part due to the gap in stimulus size and the amount of excess savings that drove household spending higher in the US economy, relative to many households in Europe which are still holding a significant pile of cash that they have not yet deployed into the economy.

IMF Managing Director, Kristalina Georgieva noted at a media roundtable in February that "At this time of the cycle, there is risk of premature loosening, but there is also risk of keeping interest rates higher for longer. They now need to land the plane smoothly". As the Eurozone and UK struggle to digest high interest rates, pressure has been mounting for the ECB and the BoE to ease monetary policy to address deteriorating economic momentum. While economic stagnation in the UK argues for looser monetary policy, core inflation has been stickier in the UK than elsewhere, suggesting a trickier trade-off for the BoE which may warrant a more patient approach to cutting interest rates.

Contrastingly, growth has blown past expectations in the US, with unemployment levels remaining low and consumer spending still strong. Firm hiring levels, excess pandemic savings and above-average wage increases have supported consumer spending while fixed-rate mortgages have reduced the economy's sensitivity to a rising interest rate environment.

Nevertheless, it will be difficult for the US economy to maintain the same pace of growth this year as experienced in 2023 as pandemic savings run low, credit card delinquencies rise, fixed investment intentions scale back, new orders of machinery and raw materials slow down and fiscal spending comes under pressure. While the narrative in markets has shifted from a 'hard landing' to a 'soft landing' to a 'no landing' expectation on growth, recession indicators continue to flag warning signals. The inverted yield curve has suggested a recession is more likely than not for the past two years. An inverted yield curve has traditionally been a strong predictor of recessions within a 12-month timeframe, but it has not been accurate during this economic cycle. According to research from the New York Fed, the likelihood of a US recession occurring before February 2025 was estimated at 58% in March, marking one of the highest forward-looking recession probabilities on record for this model since the 1980s.

The global economy's resilience has been significant in the context of surging inflation, the sharpest interest rate tightening cycle in 40 years and the wars in two regions critical to the world's food and energy supply. The latter has emphasised the significant role that geopolitical developments play in shaping global economic performance. The COVID-19 pandemic and the conflict in Ukraine underscored nations' worldwide interdependencies and the difficulties in attaining resilience with lean and globally connected supply chains, particularly when production was heavily centralised in a few markets. Governments have subsequently reacted by broadening their dependence on industrial strategies and aim to restrategise supply chains to bring them closer to home. In some sectors, geopolitical rivalries have already become intertwined with these industrial strategies.

Given the effects of disrupted trade flows, supply chain shortages, increased uncertainty and higher risk premia that arise out of geopolitical tensions, a higher level of political instability in the global economy could result in higher inflation, lower growth and significant welfare losses. As such, a more explicit link between economic policies and foreign or national security policies is likely to form going forward.

Houthi rebels' attacks on cargo ships in the Red Sea were the latest threat to a wider Middle East conflict. However, the centre of danger has remained contained without drawing in the US and Iran. Shipping companies have avoided the area and global oil prices have not been majorly affected by the crisis. Although the United Nations Security Council passed a resolution demanding an immediate ceasefire in Gaza, Israel has shown few signs of complying with the resolution. The Economist notes that "with no truce and no climactic battle, the alternative is stalemate", limiting the effect on the globe but worsening the outcomes for the region, with the impact of reduced tourism, lower gas exports and pressured revenues from the Suez Canal already hurting growth and fiscal outcomes in the Middle East.

As the Russia-Ukraine war enters its third year, Ukraine is struggling against Russia's material military advantage, buttressed by ammunition and missiles from Iran and North Korea. Americans are increasingly split on the war, leading to an ebbing of material support for Ukraine. Moreover, European assistance faces budgetary challenges and is unlikely to make up for the gap left by the Americans. Nevertheless, CNBC notes that there are hopes that a US military assistance package totalling US$60 billion could receive approval soon, while Europe reached an agreement in March for a Ukraine assistance fund worth US$5.48 billion. Nevertheless, Ukraine's fate still hangs in the balance, hinging on the outcome of the US elections for future military assistance.

The US elections are one of many taking place this year, with nearly half of the world's population heading to the polls. While some of the nations voting this year are established democracies, like the US, others are either fledging democracies or effective autocracies, with few real options for voters to choose from, raising the risks of authoritarianism making gains while liberal democracy continues to play defence. Democratic backsliding in the world could have high economic costs. In a paper published by the American Economic Association in December 2023, "Populist Leaders and the Economy", the authors found that after 15 years of populist governance (the study covered 51 populist presidents and prime ministers from 1900 to 2020), gross domestic product per capita is 10% lower compared to a plausible non-populist counterfactual.

The presidential race in the US this year looks to be reminiscent of 2020, where Democrat Joe Biden will be running against Republican Donald Trump.

Under a potential second term for Trump, US protectionist policies could gain traction, triggering trade wars with some of America's key trading partners, raising inflation and reducing growth. Although the trade relationship between America and China could sour under a second Trump term, The Economist notes that China could benefit from Trump's tempestuous relationships with America's allies in Europe and Asia, allowing China to nurture these partnerships. Moreover, Trump's apparent stance on Taiwan could benefit China. In addition, Trump's promised tax cuts could also lead to a wider fiscal deficit and a bigger debt pile for Americans. With fewer Americans wanting the US to play a major role in international affairs, the US's leadership on climate change will likely falter while Trump's economic nationalism and foreign policy restraint will pose a challenge for Europe.

Cooperative government principles may face its first real test in May 2024 in SA

Election polls for the 29 May 2024 general elections currently flag a significant risk for the incumbent ruling party, the African National Congress (ANC) to fall below 50% of the vote for the first time in SA since 1994. This is hardly surprising in the context of a deterioration in service delivery, crippling logistics and energy constraints and perceived insufficient progress in the fight against corruption. This brings about the possibility of a multi-party government for the first time in SA, which could be a significant political inflection point for the country and the broader region.

While progress towards democratic pluralism is a step towards a more diverse political landscape, coalitions have not had a stellar record at a local level in SA. Since 2016, many of the country's most important urban metros have been governed by ineffective coalitions. The opposition is nevertheless maturing in SA with a proliferation of more than 350 new parties registering for the general elections with the Independent Electoral Commission. Many of these parties are headed by former political influencers who have defected from the larger political parties and aim to woo voters from the more established political parties and capture some of the disillusioned voter base.

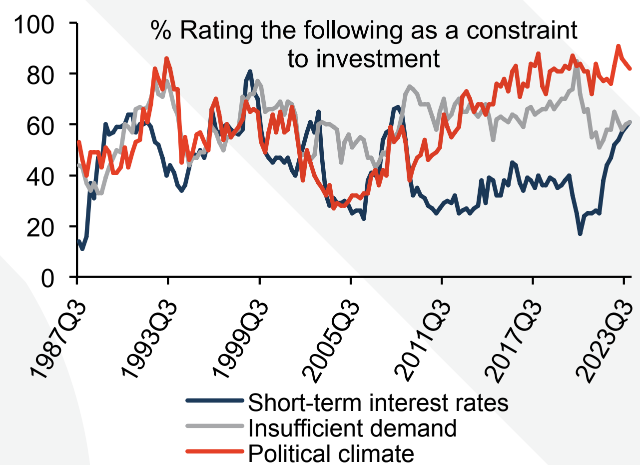
An increased number of political parties contesting the election could signify a vibrant democracy. However, it could also reflect voter discontent with the established political system. With significant infrastructure and funding constraints facing these smaller parties, it is unlikely that many of them will be able to contest the elections on the day.

Similarly, even though 27.8 million voters are eligible to cast their votes in the 2024 elections, many are unlikely to turn out on the day. In 2019, there were nine million registered voters who did not turn up to cast their ballot despite having registered. Studies from the Institute for Security Studies note that young voters, in particular, are discouraged to cast their ballot because of unemployment, corruption, poor infrastructure and inadequate education services. The shift away from emotional allegiance to political parties is also noticeable in the split vote phenomenon. For instance, the ANC garnered a higher number of votes across all provinces in the national ballot compared to the provincial ballots, indicating strategic voting. Opposition parties will fiercely vie for the nation's urban regions, suggesting that the ANC is likely to retain the predominantly rural provinces. Gauteng and KwaZulu-Natal are nevertheless likely to face the most contestation and have a higher likelihood of resulting in a coalition government at a provincial level.

Political parties' effectiveness will hinge on their capacity to bridge racial and socioeconomic gaps that historically shaped political party backing and their success in rallying support from the so-called 'born frees', the youth born after 1994 who lack allegiance to the ANC. As such, the voter turnout based on geographical (urban versus rural) and age (particularly the younger age cohorts) will be an important determinant of the election outcome.

An uncertain political climate has consistently been rated as a top constraint facing new investment by manufacturers in the Bureau for Economic Research's (BER) quarterly manufacturing survey. Failures in SA's network industries have additionally held back the addition of new productive capacity. While loadshedding is likely to have less of an impact on growth going forward, logistical inefficiencies are likely to replace insufficient energy supply as the Achilles heel of growth.

Chart 16: Political uncertainty is a constraint to growth



Source: BER, Momentum Investments

We expect pedestrian growth of 1% this year, up from 0.7% last year, to be supported by fixed investment in energy and a marginal recovery in household spending. The SARB anticipates that the growth detraction from insufficient energy supply will reduce from 1.5 percentage points in 2023 to 0.6 percentage points this year as private sector investment in renewables ramps up. Meanwhile, consumers should fare slightly better this year as real wages recover in line with a further reprieve in inflation and some alleviation of consumer debt burdens, particularly for middle- and upper-income earners as interest rates ease.

The economy can no longer rely on significant government stimulus to bolster growth prospects given pressured revenues in light of softer commodity prices and slow growth. Nevertheless, demands on the fiscus are likely to grow given the country's escalating socioeconomic pressures.

Ongoing logistical woes, weaker global commodity prices and lingering political and fiscal concerns have weighed on the rand. The local unit should nonetheless retrace somewhat from oversold levels in the coming quarters in the run up to possible interest rate cuts in the US. This could trigger an improvement in global risk appetite, benefiting EM assets including the rand.

Nevertheless, upside risks to the inflation outlook continue to stem from a weaker exchange rate, administered prices and geopolitically-driven higher global food and oil prices. Meanwhile, demand-pull and wage inflation are expected to remain contained, limiting second-round or persistent inflationary pressures. As such, the retreat in headline inflation is likely to be sustained in the coming quarters.

Although the SARB is likely to pivot course this year and lower interest rates, monetary policy should remain restrictive in inflation-adjusted terms in the coming months in view of upside price pressures. Moreover, the SARB is likely to take note of the inflationary effects of fiscal stimulus which restrict the SARB from lowering rates by too much too soon. Although many countries in Latin America have already cut interest rates, many of these countries had hiked interest rates sooner than SA did and to a greater extent. As a result, real policy rates remain higher in these jurisdictions, advocating for earlier and more aggressive easing than in countries such as SA.

In light of recent global and local developments, including the skewed upside risks to inflation, we expect the first move to lower interest rates in the second half of the year. In line with the Quarterly Projection Model now only forecasting 50 basis points worth of easing by the end of the year, risks are titled to a shallower interest rate cutting cycle.

Sanisha
Packirisamy

Economist
Momentum Investments

Herman
van Papendorp

Head: Macro Research and Asset Allocation
Momentum Investments

Partially Vesting Smoothed Bonus Range

Smooth-Edge Fund

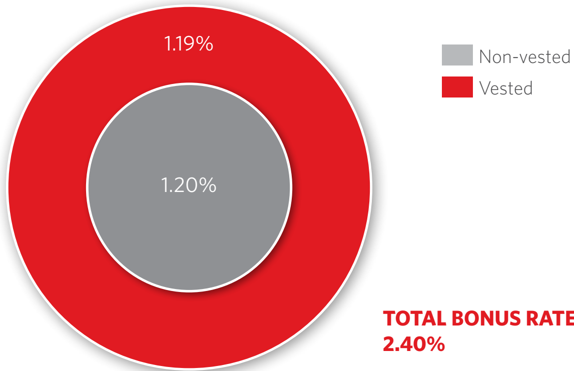
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Feb 2019	100% - 105%	R1.9bn	0.69%	8.77%

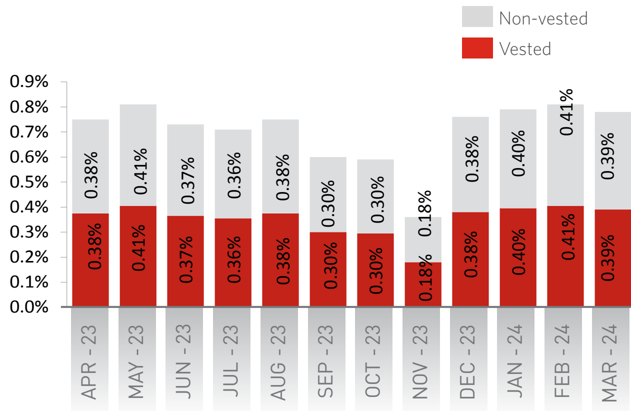
[1]Based on back-tested bonus rates and returns

Performance

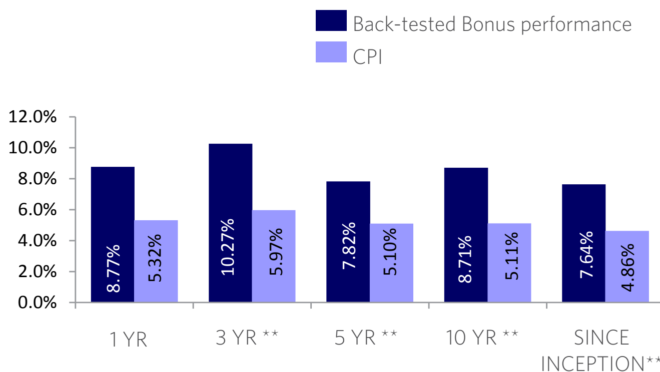
The total bonus rate for the past quarter on the Momentum Smooth-Edge Fund is shown below.



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



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

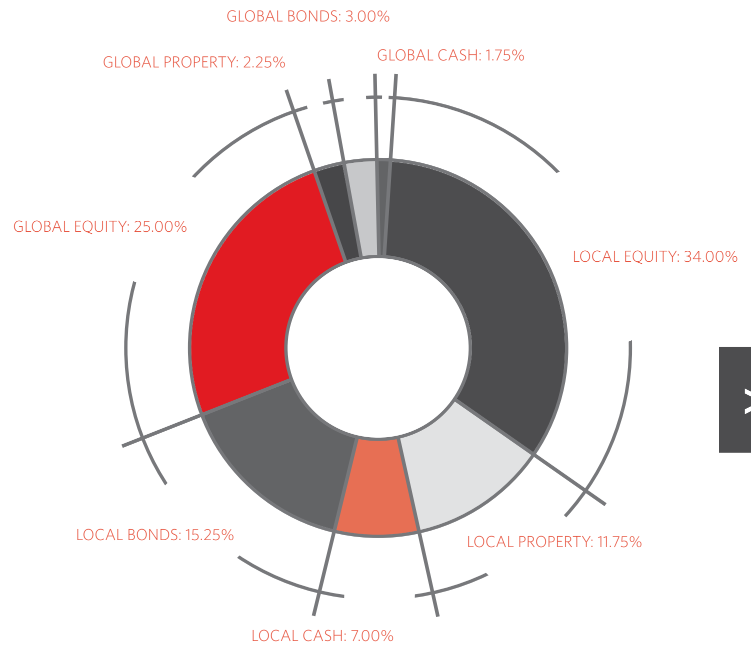


CPI figures are lagged by two months

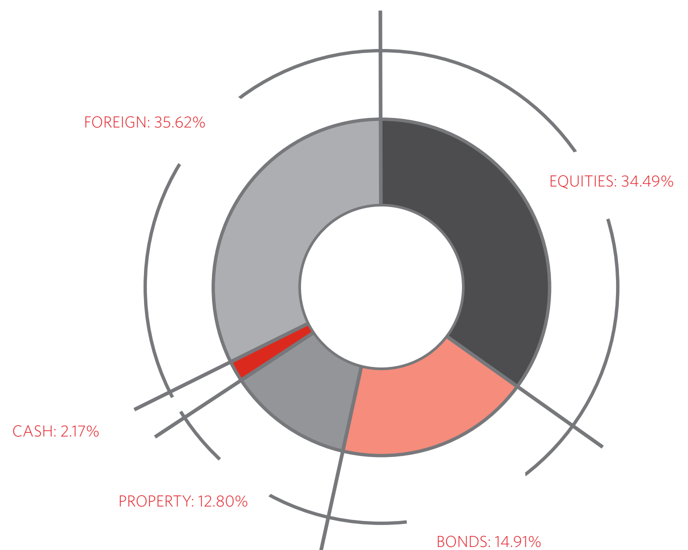
* The bonus rates and back-tested bonus rates are gross of the investment management fee
** Annualised

Asset Allocation

The strategic asset allocation is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smoothed Bonus Range

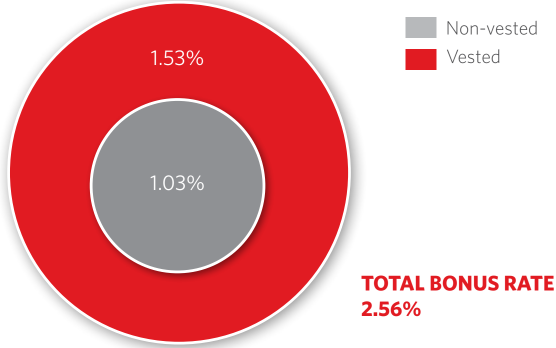
Multi-Manager Smooth Growth Fund Global

Fund Snap Shot

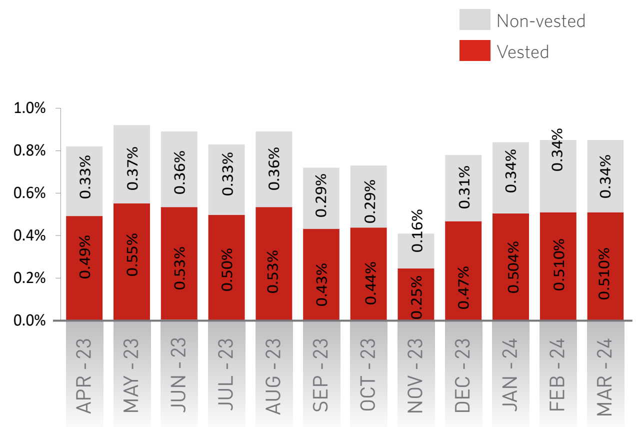
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	100% - 105%	R6.5bn	0.61%	8.85%

Performance

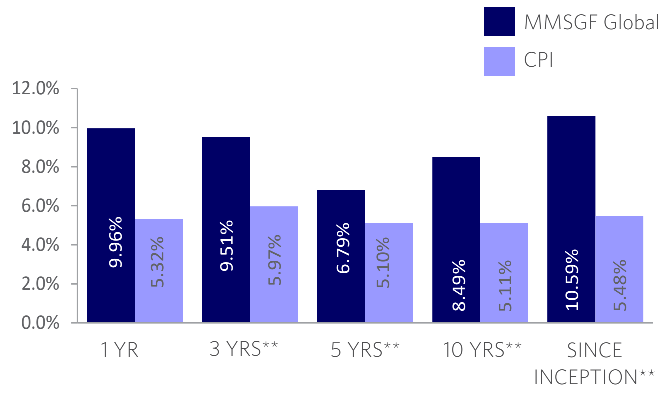
The total bonus rate* for the past quarter on the Multi-Manager Smooth Growth Fund Global is shown below.



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



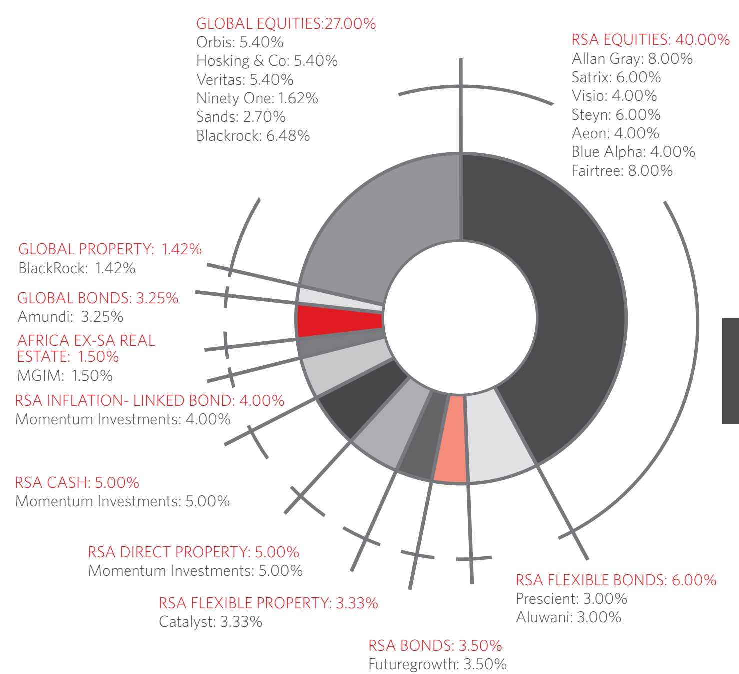
CPI figures are lagged by two months

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

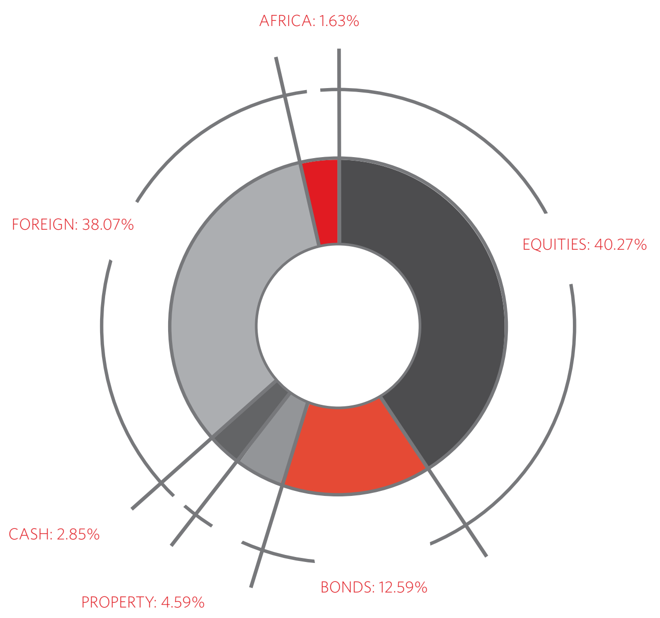
** Annualised

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.



<

>

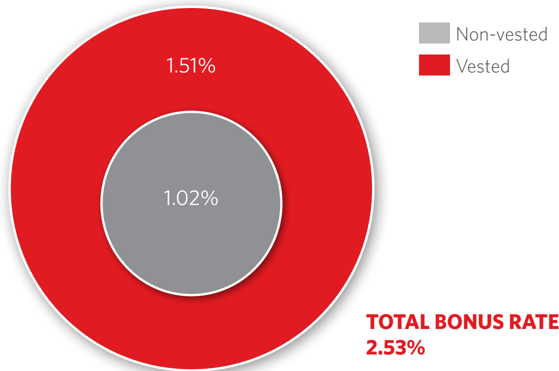
Partially Vesting Smoothed Bonus Range
Smooth Growth Fund Global

Fund Snap Shot

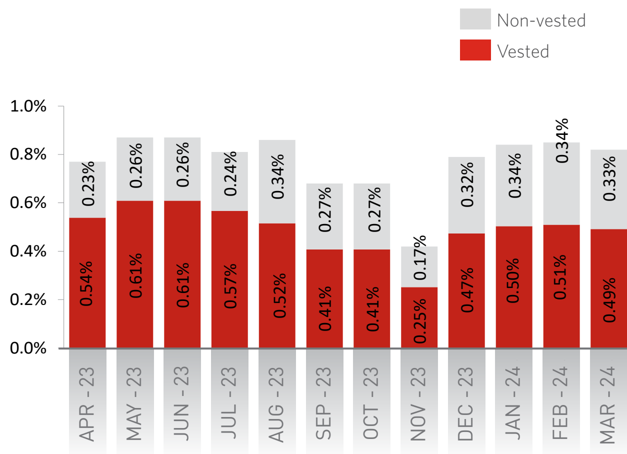
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 1989	100% - 105%	R1.7bn	0.67%	8.70%

Performance

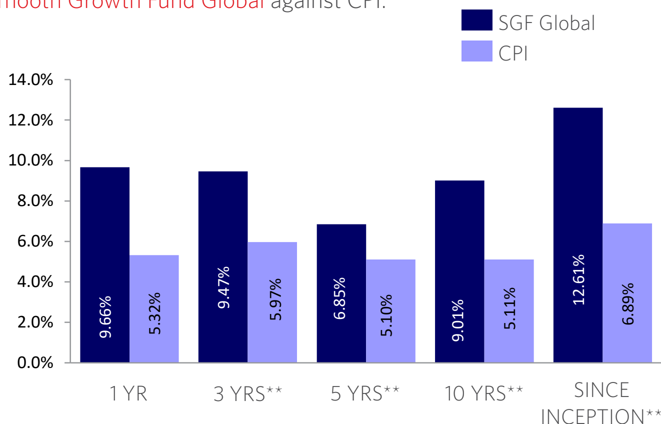
The total bonus rate* for the past quarter on the Smooth Growth Fund Global is shown below.



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



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



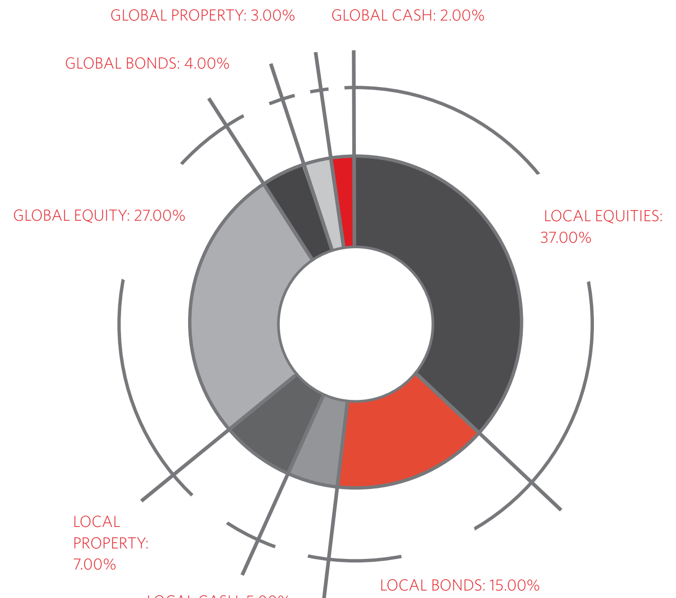
CPI figures are lagged by two months

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

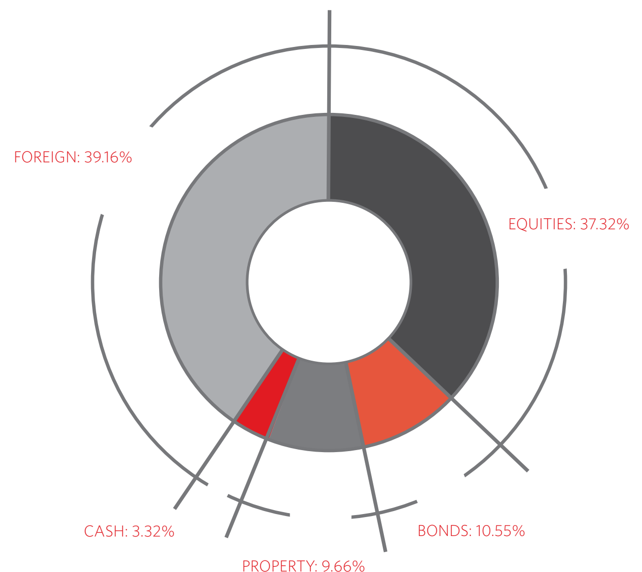
** Annualised

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smoothed Bonus Range

Universal Multi-Manager Smooth Growth Fund

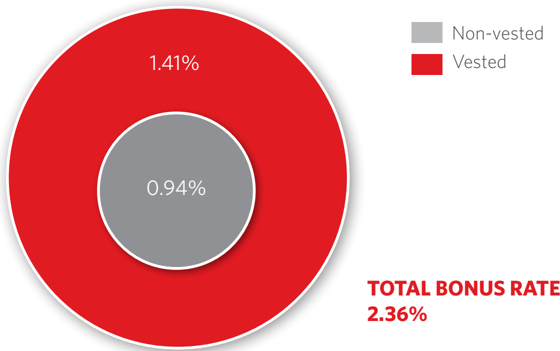
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	100% - 105%	R388.8m	0.79%	8.46%

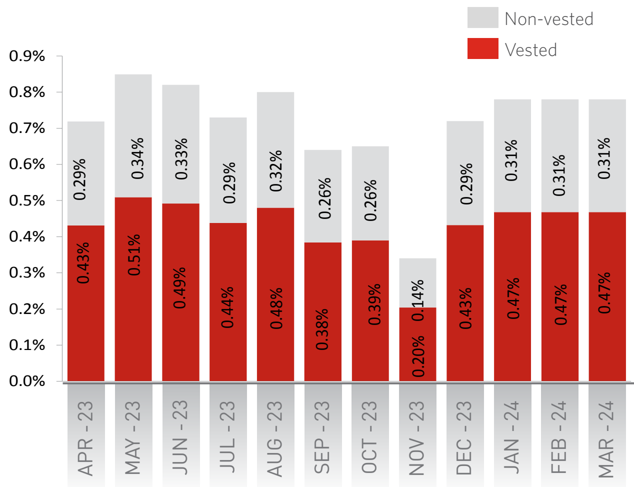
[1]Based on back-tested bonus rates and returns

Performance

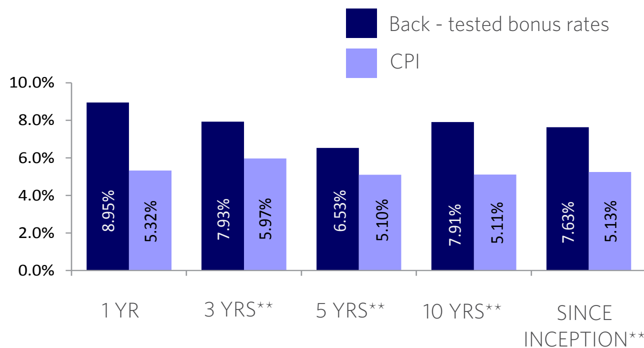
The total bonus rate* for the past quarter on the Universal Multi-Manager Smooth Growth Fund is shown below.



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



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



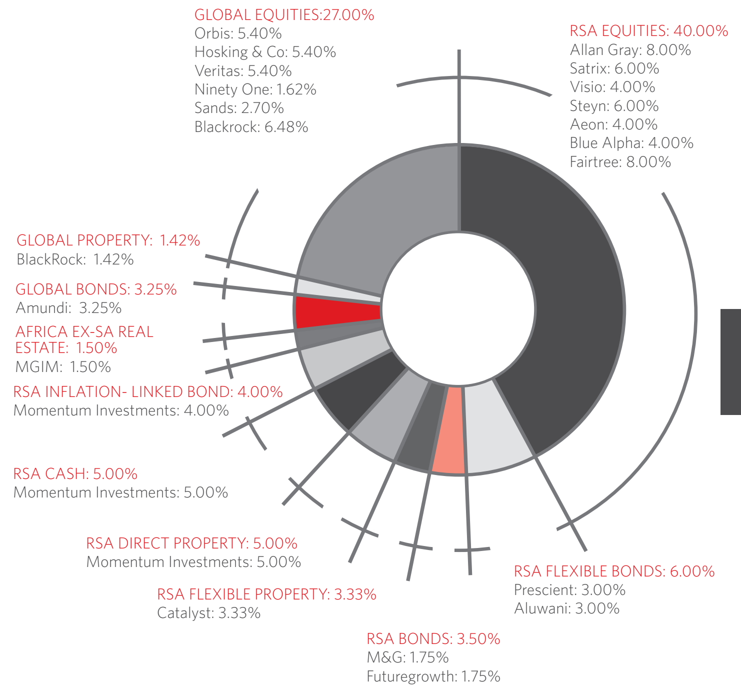
CPI figures are lagged by two months

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

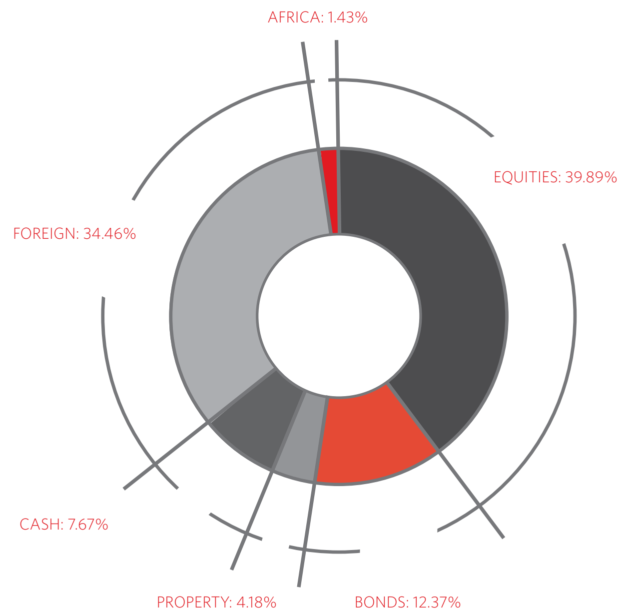
** Annualised

Asset Allocation

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



The effective asset allocation of the portfolio is shown alongside.



Partially Vesting Smoothed Bonus Range
Universal Smooth Growth Fund

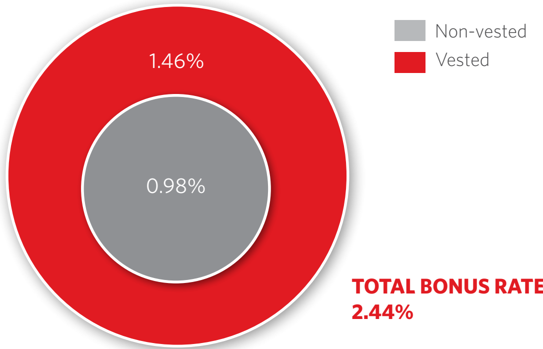
Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jun 2020	100% - 105%	R424.7m	0.70%	8.48%

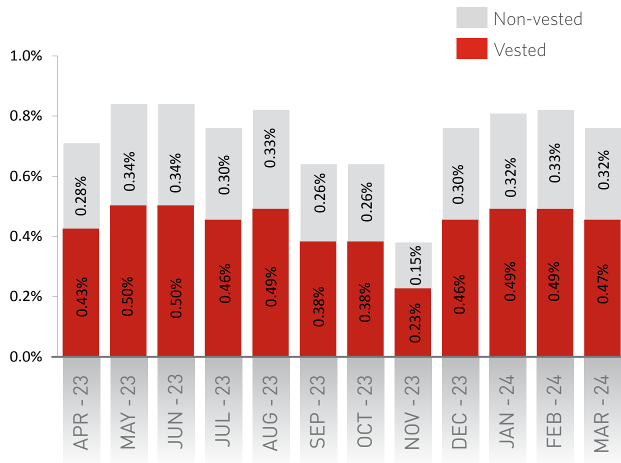
[1]Based on back-tested bonus rates and returns

Performance

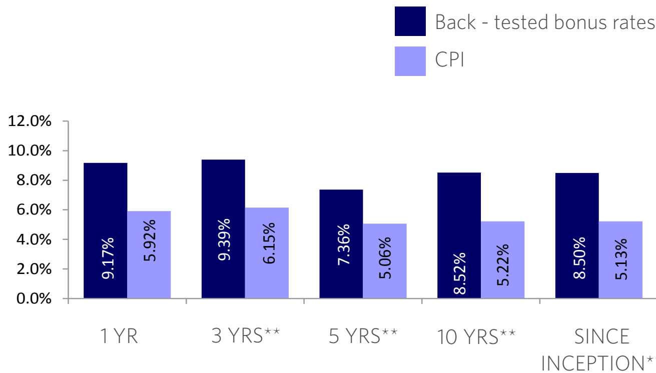
The total bonus rate* for the past quarter on the Universal Smooth Growth Fund is shown below.



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



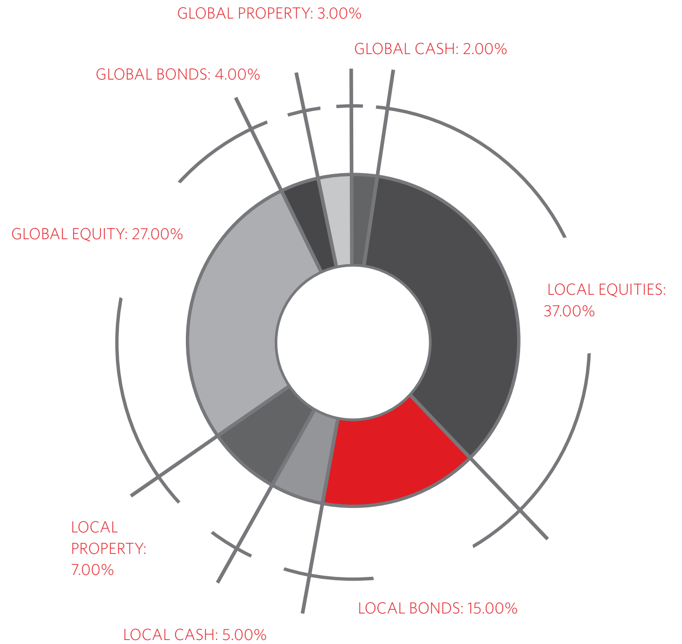
The chart below shows the long term bonus* performance of the Universal Smooth Growth Fund against CPI



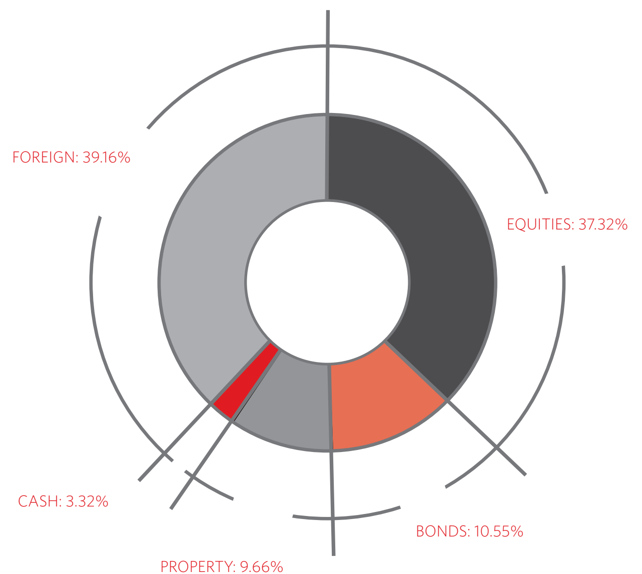
CPI figures are lagged by two months

Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.



The effective asset allocation of the portfolio is shown alongside.



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

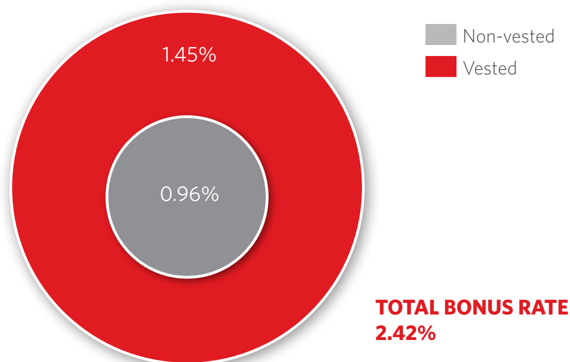
Partially Vesting Smoothed Bonus Range Multi-Manager Smooth Growth Fund Global Bonus Series 2020 *(previously MMSGF Local)*

Fund Snap Shot

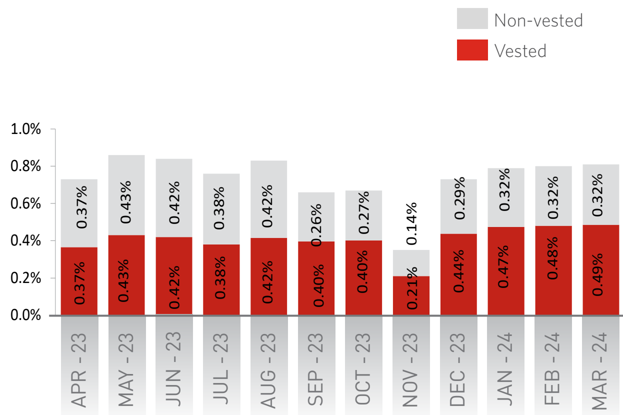
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Jan 2004	100% - 105%	R100.1m	1.04%	8.70%

Performance

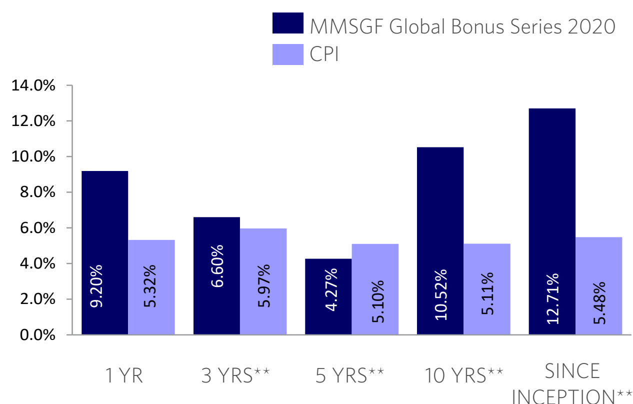
The total bonus rate* for the past quarter on the MMSGF Global Bonus Series 2020 is shown below.



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



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



CPI figures are lagged by two months

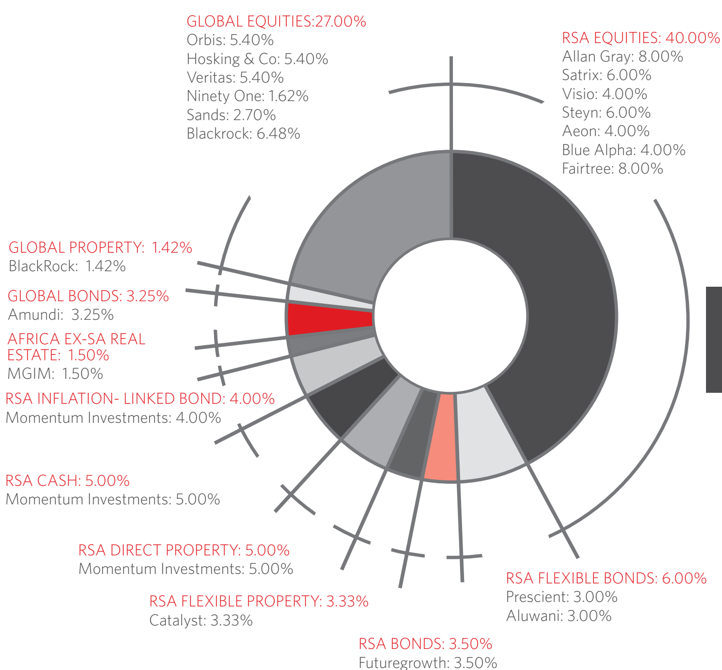
* Bonus rates are net of underlying asset charges but are gross of the policy fee

** Annualised

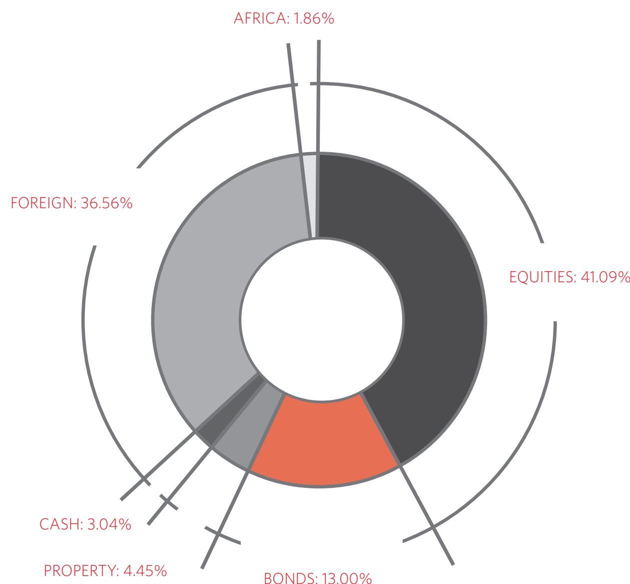
Asset Allocation

The strategic asset allocation of the portfolio is shown alongside.

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



The effective asset allocation of the portfolio is shown alongside.



Fully Vesting Smoothed Bonus Range

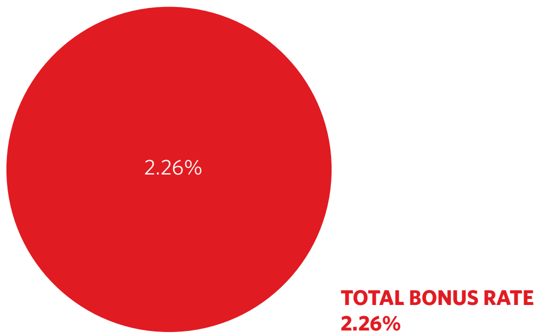
Universal Smart Guarantee+3 Fund

Fund Snap Shot

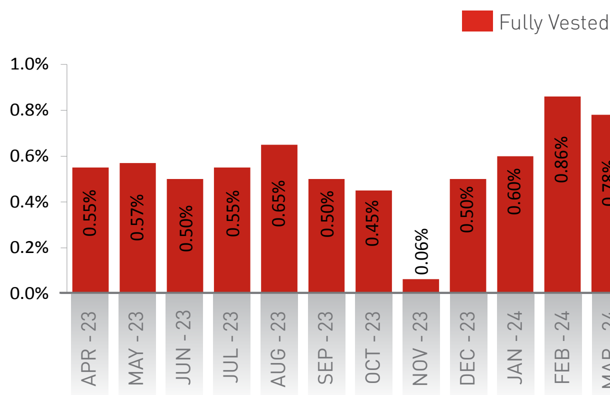
INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN OF BONUS GENERATING PORTFOLIO
Oct 2013	97.5% - 102.5%	R575.4m	1.00%	8.65%

Performance

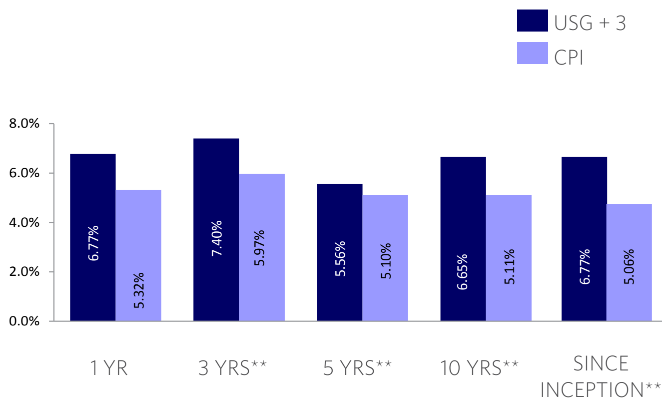
The total bonus rate* for the past quarter on the Universal Smart Guarantee +3 Fund is shown below.



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.



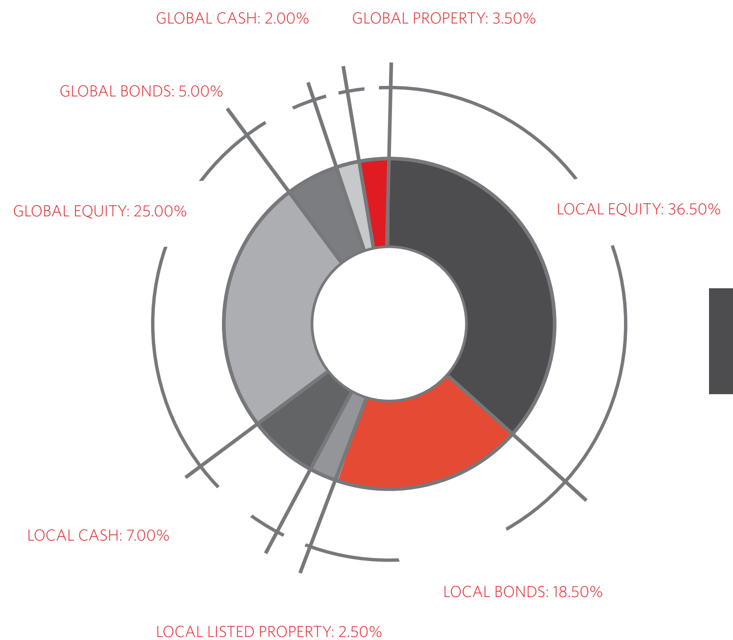
CPI figures are lagged by two months

* 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 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 **10.42%** of bonuses will still be declared.

Fully Vesting Smoothed Bonus Range

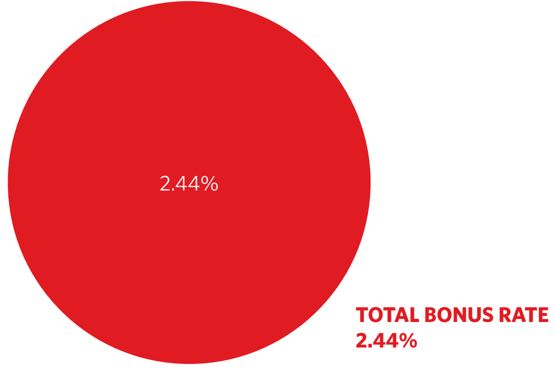
Multi-Manager Secure Growth Fund

Fund Snap Shot

INCEPTION DATE	FUNDING LEVEL RANGE	FUND SIZE	ANNUALISED 3-YEAR VOLATILITY OF BONUS RATES	ANNUALISED 3-YEAR UNDERLYING ASSET RETURN
Nov 2007	105% - 110%	R73.9m	0.50%	7.74%

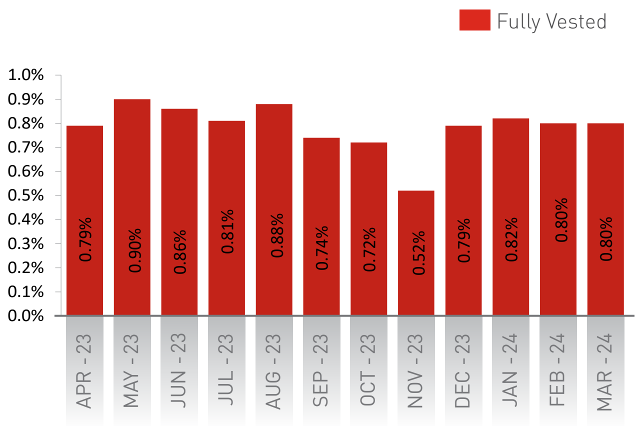
Performance

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

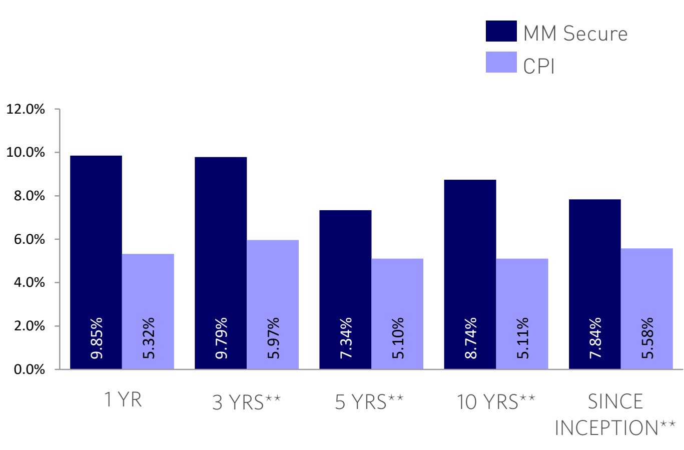


TOTAL BONUS RATE 2.44%

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



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



CPI figures are lagged by two months

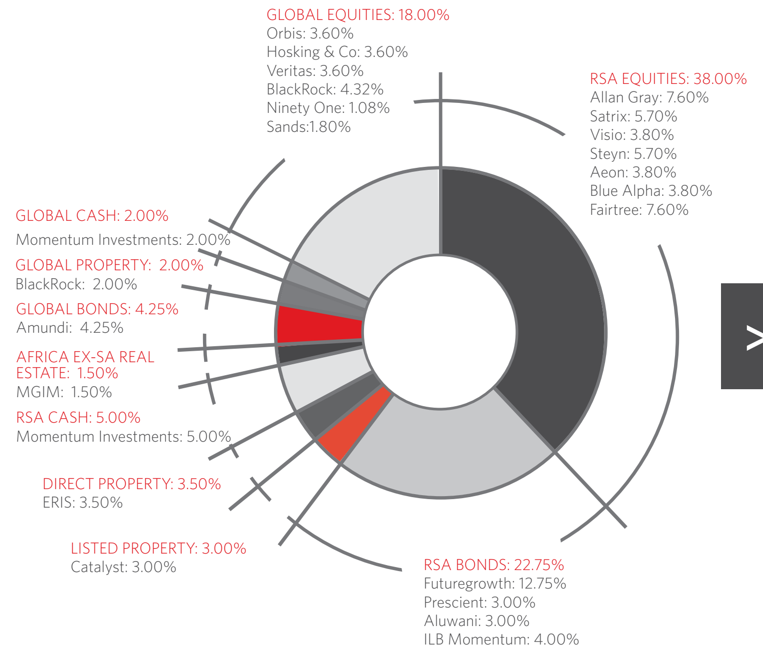
* Bonus rates are net of underlying asset charges but are gross of the policy fee

** Annualised

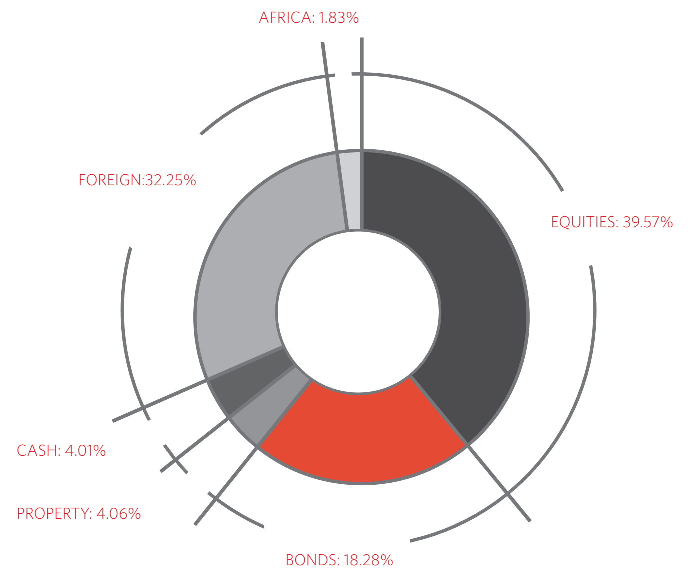
Asset Allocation

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

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



The effective asset allocation of the portfolio is shown alongside.



Smoothed Bonus Portfolios Key Features

<table>
<tr><th></th><th></th><th>Fund Return Objective</th><th>Manager</th><th>Mandate Type</th><th>Guarantee on Policy Benefits[1]</th><th>Market Value Adjustment on Voluntary Exits[2]</th><th>Capital Charge</th><th>Policy Fee or Investment Management Fee*</th><th>Inception Date</th></tr>
<tr><td rowspan="6">Partially Vesting</td><td>Multi-Manager Smooth Growth Fund Global</td><td rowspan="3">CPI + 4% pa, net of the policy fee and underlying asset charges over the long term</td><td rowspan="3">Multi-Manager</td><td rowspan="3">Moderate Balanced</td><td rowspan="3">100% of net capital invested and vested bonus declared (net of the Policy fee)</td><td rowspan="3">Yes</td><td rowspan="3">0.90% pa</td><td rowspan="3">0.35% of the first R50m, 0.25% of the excess above R50m[3]</td><td>January 2004</td></tr>
<tr><td>Universal Multi-Manager Smooth Growth Fund</td><td>June 2020</td></tr>
<tr><td>Multi-Manager Smooth Growth Fund Global Bonus Series 2020</td><td>January 2004</td></tr>
<tr><td>Smooth Growth Fund Global</td><td rowspan="2">CPI + 4% pa, net of the investment management fee and underlying asset charges over the long term</td><td rowspan="2">Momentum Investments</td><td rowspan="2">Moderate Balanced</td><td rowspan="2">100% of net capital invested and vested bonus declared (net of the investment management fee)</td><td rowspan="2">Yes</td><td rowspan="2">0.90% pa</td><td rowspan="2">0.45% of the first R10m, 0.35% of the next R40m, 0.25% of the excess above R50m[3]*</td><td>January 1989</td></tr>
<tr><td>Universal Smooth Growth Fund</td><td>June 2020</td></tr>
<tr><td>Smooth-Edge Fund</td><td>CPI + 4% pa, net of the investment management fee and underlying asset charges over the long term</td><td>Momentum Investments</td><td>Moderate Balanced</td><td>100% of net capital invested and vested bonus declared (net of the investment management fee)</td><td>Yes</td><td>0.60% pa</td><td>0.25% pa[3]*</td><td>February 2019</td></tr>
<tr><td rowspan="2">Fully Vesting</td><td>Multi-Manager Secure Growth Fund</td><td>CPI + 2% pa, net of the policy fee and underlying asset charges over the long term</td><td>Multi-Manager</td><td>Moderate Conservative Balanced</td><td>100% of net capital invested and total bonus declared (net of the Policy fee)</td><td>Yes</td><td>1.40% pa</td><td>0.35% of the first R50m, 0.25% of the excess above R50m[3]</td><td>November 2007</td></tr>
<tr><td>Universal Smart Guarantee+3 Fund</td><td>CPI + 3% pa, net of the investment management fee and underlying asset charges over the long term</td><td>Insurer Liability Driven Investment</td><td>Insurer Liability Driven Investment</td><td>100% of net capital invested and total bonus declared (net of the Investment management fee)</td><td>Yes</td><td>0.50% pa</td><td>0.75% pa[3]*</td><td>October 2013</td></tr>
</table>

*Policy fee includes the cost of investment administration.

*Investment management fee includes policy fee and certain fees related to the management of the assets (not included in underlying asset charges).

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. Underlying asset charges include capital charge and net priced asset fees and performance fees (where applicable).

Email: emailus@momentum.co.za

Website: www.momentum.co.za

Disclaimer: Copyright reserved © Momentum Metropolitan 2024 – Momentum Corporate is a part of Momentum Metropolitan Life Limited (registration number 1904/002186/06), a wholly owned subsidiary of Momentum Metropolitan Holdings Limited. Momentum Corporate is the underwriter and benefit administrator of the FundsAtWork Umbrella Pension and Provident Funds. The document is for illustrative purposes only and does not constitute tax, legal, accounting, or financial advice. You rely on the contents at your sole discretion. We recommend that you consult with a financial adviser before making any changes to your group employee benefits. Momentum Metropolitan Holdings Limited, its subsidiaries, including Momentum Metropolitan Life Limited, will not be liable for any loss, damage (whether direct or consequential) or expenses of any nature which may be incurred because of, or which may be caused, directly or indirectly, to the use or reliance on this publication. Terms and conditions apply.

Momentum Metropolitan Life Limited is a licensed life insurer, authorised financial services (FSP6406) and registered credit provider (NCRCP173), and rated B-BBEE Level 1.