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Momentum Investments Flexible Factor Portfolio Range

Quarterly commentary to end September 2023

Assessing investment returns in an outcome-based investment context

The Momentum Investments Flexible Factor Portfolio Range is managed in terms of our outcome-based investing philosophy, where we design the portfolios to maximise the probability of achieving the inflation-plus return target of each portfolio over the relevant period, while continuing to meet the portfolios' risk targets. To achieve this, our portfolio management approach conceptually starts at an (multi) asset class level, then progresses to the identification of specific investment strategies within each asset class (if appropriate) and finally ends up in the selection of (potentially more than one) investment mandates awarded to investment managers that will implement the desired investment strategies.

Given this outcome-based investing framework, when assessing the returns of the Momentum Investments Flexible Portfolio Range, it is important to start by looking at the returns from the portfolios against their inflation-related targets. This allows us to answer the question: did we achieve our target over the most recent relevant period? We then assess these returns relative to this target in terms of the following:

- The returns provided by the asset classes included in the portfolios
- The returns from the building blocks that provide the asset class exposure for the portfolio against their asset class (or strategic) benchmark. This in turn is explained by:
    - The returns from the investment strategies (or styles) used in the building block (if any)
    - The returns from the investment managers that were awarded the mandates used in each of the building blocks

This quarterly review thus starts with the assessment of the investment returns generated by the portfolios against their targeted investment outcomes over the most recent periods. The next section focuses on the economic environment and the returns generated by the asset classes (beta) for the most recent quarter, measured against our average real return expectations for each asset class. We review the returns from the building blocks and the underlying investment managers against their strategic investment benchmarks.

Economic overview

With inflation slowing and signs emerging that past monetary policy tightening is having an effect on the economy, the end is likely in sight for global central banks. But even if interest rates have not yet peaked, further hikes should be less consequential for financial markets given the extent of rate tightening so far. Interest rate cuts are nonetheless still seen to be some way off. Central banks are nervous about prematurely declaring a victory in taming inflation and will likely maintain a restrictive policy until inflation is sustainably bound closer to the central bank target.

As has been the case for United States (US) bonds for over a year, good economic growth news recently also became bad news for US equities due to worries that a good growth outcome implies policy rates will remain higher for longer. The narrow-based

nature of this year's US equity market advance also brings the sustainability of ongoing market upside into question. US bonds now trade at a discount to US equities, a rarity this century, making them historically cheap alternatives to equities.
Although structural bottlenecks are likely to cap South Africa's (SA) growth recovery to an expected 1% next year and 1.7% in the year after, tangible progress on priority reforms has been identified for their potential impact on economic growth and job creation point to better growth conditions ahead and could provide a healthy platform for a 2% handle on medium-term growth outcomes.

Even though we expect inflation to resume its glidepath toward the 4.5% midpoint of the target band on a more sustainable basis, SA interest rates are likely to stay on hold until the second quarter of 2024 to counter fiscal dominance risks and continued upside risks to the inflation profile.

SA equities still trade at huge valuation discounts to the rest of the world and its history. Although the SA equity market will likely also suffer during any global equity drawdowns in risk-off periods, it could perform relatively better in subsequent risk-on recoveries due to its positive valuation underpin. SA real bond yields are attractive against their history, as well as relative to those in global markets, with part of the high real yield differential due to a fiscal and country risk premium. We expect falling inflation in the coming year to be less supportive of inflation-linked bonds. The prospective SA real cash yield has been rising from a low level in line with policy rate increases and recently expected falling inflation and is currently cheap versus history. Although SA-listed property companies are experiencing improving operational performance, financial metrics have deteriorated.

Portfolio management

Portfolio performance across the portfolio range was negative as most asset classes recorded losses. However, performances for year-to-date and over one year were still in positive territory. During the quarter we continued to de-risk the portfolios by reducing both local and global equity. We used the proceeds to increase both local and global cash as yields remained at attractive levels.

Asset class returns

The returns for the asset class benchmarks for the third quarter of 2023 are reported in the first column of the table below. The next column highlights the returns for these asset classes for the previous year. These one-year returns are then converted into real returns by deducting inflation (4.8%) for the year. The final column in the table contains the returns above inflation we expect to get (on average) for these asset classes for a full market cycle.

Asset class	Q3 2023 Returns	Nominal returns for the previous 12 months	Real returns for previous 12 months*	Expected real return (p.a.)
Local equity (Capped SWIX)	-3.8%	11.9%	7.1%	5.8%
Local bonds (ALBI)	-0.3%	7.2%	2.4%	3.3%
Local listed property (SAPY)	-1.0%	12.9%	8.1%	7.0%
Local ILBs (ILBI)	0.7%	3.0%	-1.8%	2.8%
Local cash (SteFI)	2.1%	7.5%	2.7%	1.3%
Global equity (MSCI ACWI)	-3.6%	27.3%	22.4%	6.5%
Global bonds (WGBI)	-4.3%	1.0%	-3.8%	-0.3%
Global property	-5.8%	7.7%	2.9%	4.0%
US dollar/rand**	-0.3%	4.8%		
SA CPI*	1.4%	4.8%		

*CPI is lagged by one month.
**A positive/negative value here reflects the effects of a depreciation/appreciation of the rand against the US dollar on global asset class returns in rand terms. As the rand gets weaker/stronger, the returns of global investments get better/worse from a local investor's perspective.

Building block return assessment

As explained above, our outcome-based investment philosophy starts at the asset class level and then goes down to an investment strategy (if appropriate) and investment mandate level within each asset class. We thus construct building blocks that reflect our selected investment strategies and managers that were awarded the mandates to implement these to either improve on the returns of the asset class or manage its risk profile.

Local multiple balanced building block

The multiple balanced building block delivered a return of -2.0% for the quarter that ended 30 September 2023 as all assets, except SA cash and ILBs, experienced a negative quarter with SA equity experiencing a bigger drawdown.

Abax delivered a return of -0.2% for the quarter and did a commendable job amidst the market volatility. ABSA and Capitec contributed to performance as domestic banks continued to recover. Dipula again showed its resilience publishing decent results in a tough operating environment. Continued pressure on government bond yields, especially the long end continued to impact the fund negatively. Looking ahead Abax maintains a defensive positioning but has redeployed their formerly high cash allocation into low-risk term assets with diversification attributes. They have substantially increased the allocation to local short and medium-term inflation-linked bonds on attractive outright valuations and inflation protection. On the local bond side, the portfolio has increased its turnover by successfully taking advantage of relative value opportunities, shifting their holdings between different similar-characteristic bonds as they fluctuate between cheap and expensive.

Coronation delivered a return of -1.9% for the quarter, outperforming its benchmark return of -2.3%. Importantly, the Fund continues to outperform its benchmark over longer, more meaningful periods with an approximate 2.5% alpha per annum over the past 5 years. Amongst the domestic asset classes, the Fund favours SA equities that offer attractive return prospects and diversification away from a tough domestic economy (through a combination of non-SA exposure and strong domestic franchises). Fund holdings include global stocks listed on the JSE and selected resources and domestic stocks.

The Fund has a sizeable holding in the banks with their low ratings and attractive high single-digit dividend yields and the managers continue to believe that banks with their low ratings and ability to grow their revenues in the mid-to-high single-digits offer an attractive medium-term investment. Within resources, the underweight position in PGMs has benefited the portfolio.

The core industrial holdings include many of the global stocks listed in SA like Richemont, Aspen, Bidcorp, British American Tobacco and Anheuser-Busch InBev. The portfolio has limited property exposure, preferring to use its risk budget in equities.

Foord outperformed the benchmark as well with a return of -1.8% for the quarter. The Bond exposure contributed given Foord's conservative positioning on the front end of the yield curve. South African equity investments detracted as the local index tracked global bourses lower led by industrial giants Richemont and Naspers/Prosus and resources shares which drifted down on generally lower commodity prices. Although the allocation to listed property remains low, investments in the sector contributed positively to fund returns with recoveries in both Equites and Stor-Age adding value. The physical gold investment detracted given the dollar price for bullion drifted lower, however, the NewGold ETF serves a crucial portfolio diversification purpose as both a hedge against inflation and as an alternative store of value to fiat currency. Cash was a top contributor to absolute returns given returns for most other asset classes were in negative territory.

Ninety One Asset Management delivered a return of -3.5% for the quarter. From an asset selection point of view, key contributions for the quarter included exposure to local financials such as Absa, Sanlam and Standard Bank which had a strong run, providing some relief in a sea of red. Domestic defensive companies such as Shoprite provided some support over the quarter and additional gains came from real estate holdings with shares such as Redefine gaining almost 8% over the period. Exposure to equities detracted from absolute returns. Equity selection however has been the primary detractor from performance over the period. Exposure to global cyclical counters such as Richemont detracted from returns. In addition, holdings in Resources like Impala Platinum, Gold Fields and South32 also closed the quarter lower on softer commodity prices. In line with global technology counters, Naspers and Prosus declined. SA Inc. counters such as MTN also detracted.

Local absolute strategies building block

The Absolute Strategy building block delivered a return of -1% for the quarter.

M&G delivered a return of -2.1% for the quarter as all assets except for SA cash and ILBs experienced a negative quarter with SA equity experiencing a bigger drawdown. Looking at the fund's asset allocation, South African inflation-linked bonds added the

most value to absolute performance for the quarter, while SA cash also added value. SA listed property was flat. South African nominal bonds detracted from performance, with SA equities being the largest detractor.

Within SA equities, the holdings in Sasol, Exxaro, Glencore and Sappi added value to the fund's performance during the quarter, as did the collective overweight exposure to SA banks like Standard Bank, Absa, and Investec. China-exposed shares like Naspers/Prosus and Richemont, were the largest detractors to performance, while gold and platinum shares also detracted. MTN was another detractor for the quarter, despite the resilient results reported in August, the share price declined by 18% over the period.

Listed Property and cash exposures were reduced marginally during the quarter in favour of equity and inflation-linked bonds. Sentio delivered a return of -1.7% for the period as risk assets and particularly commodity shares underperformed in that environment. However, the fund managed to protect some capital, against a volatile macro backdrop. Detractors included positions in Impala, Angloplats, Goldfields and BHP as well as Naspers, MTN, Prosus and Firstrand. Positive contributions came from good general positioning in financials like ABSA, Standard Bank, Investec, Momentum and Sanlam, as well as positions in Shoprite. Sasol and Sappi. In Fixed Income, the fund had an overweight duration position during July and August but decided to go neutral duration during September on the 'higher for longer' interest rate narrative and is now underweight long-dated nominal bonds. The fund's underweight in ILBs, however, was a positive contribution. Overall, the fund started to de-risk towards the end of the quarter as new incoming macro and market data flashed warning signs ahead.

Laurium delivered a return of -1.7% for the quarter ending September 2023. The fund continues to hold a decent allocation to local equity and bonds (both around 40%). The local equity component of the funds has narrowly beaten the broad South African equity market as the fund benefitted from positions in Sasol, ABSA, Momentum and Mondi. The funds' position in Naspers/Prosus was a detractor over the quarter, as was its exposure to Telkom, Nedbank, AngloGold Ashanti, and the platinum sector. The fund continues to hold a large position in Prosus. The funds' rand hedge exposure is further complemented by positions in British American Tobacco, Anheuser Busch InBev, Mondi, and resources companies. The fund's exposure to the domestic SA economy is primarily through South African government bonds and the banking sector, with the preferred picks being ABSA, Nedbank, and FirstRand.

The Real Return component delivered a return of 1.1% for the period.

Sanlam delivered a return of 1.1% for the period with high allocation in money market instruments contributing to those returns. The fund continues to perform in line with expectations, focusing on portfolio optimisation to deliver the desired target return while minimising the risk of capital loss. They remain conservatively positioned but are finding opportunities for growth in both domestic and global markets. The high allocation to interest-bearing assets is contributing to performance given the very attractive rates on offer.

Prescient also delivered a return of 0.6% for the period. Over the quarter, ILBs, Income and SA Renewables were the major contributors to performance. Local equities were the major detractors to performance.

Local cash building block

The third quarter of 2023 saw monetary policy on hold, as there was no change to the repo rate at both the July and September MPC meetings. The repo rate has now remained unchanged at 8.25% (prime at 11.75%) since May 2023, as the committee assess the impact of their current policy stance on growth and inflation. The traded money market has been interesting. Although there was no move in the official repo rate, the view that the MPC is done tightening this cycle seems to be taking hold, and the 3-month Jibar rate moved 17bps lower to 8.33%, while the 12-month rate moved 32bps lower to 9.27%. Based on these Jibar rate levels the total return for the STeFi Composite Index continues to move higher and was 2.07% for the quarter.

Issuance continues to taper off, with Q4 being a seasonally less active period for credit markets, although there is still a good mix amongst banks, corporates, and securitisations. Local sustainable/green issuance also increased as issuers' commitments towards ESG gains momentum. Bank Tier 2 and AT1 spreads have compressed to record lows, despite the write-off globally of Credit Suisse's AT1 paper earlier this year.

For the quarter, the building block delivered a return of 2.46% compared to 2.05% for the SteFI benchmark.

For the year, the building block delivered a return of 9.1% against the SteFI benchmark of 7.5%. It consistently met its objective of capital preservation by maintaining positive returns on a one-year rolling basis. Both investment managers had a high exposure to floating-rate notes, which provided a fair degree of liquidity, while also providing above-benchmark yields.

Hedge fund solutions building block

The hedge funds were able to produce returns ahead of their respective benchmarks for the quarter and remain ahead on a 12-month basis. The Momentum Moderate hedge fund, a multi-strategy fund targeting a cash-plus return, produced 2.7% for the quarter compared to the 2.05% returned by the STEFI Index. Returns were mostly driven by the funds' fixed income arbitrage exposure where the managers were able to use relative value positioning without taking duration risk.

The Momentum Aggressive hedge fund which employs an equity long-short strategy returned 1.08% for the quarter versus -0.94% returned by the 50/50 cash/equity benchmark. This fund benefitted from selective long positions and the use of single counter and Index shorts to generate returns and manage the overall directional exposure of the fund.

The Momentum Portable Alpha fund lost -2.85% for the quarter due to the structural beta exposure in the fund. The multi-strategy alpha component generated positive returns through the market neutral and fixed income arbitrage exposures in the challenging beta environment. This enabled the fund to limit the drawdown compared to the -3.8% returned by the JSE Capped SWIX Index.

Special opportunities building block

The Special Opportunities Fund delivered a return of 3.4% in Q3 2023. The portfolio has generated annualised net returns of inflation plus 4.0% since inception, net of all fees.

The Corporate Recovery strategy has reached the end of life with one remaining asset unrealized. This asset has been distributed in-specie to investors. The GP remains available to assist with concluding an exit as and when the opportunity arises. The exit will likely be a sale back to the holding company, or an IPO in time. The local property fund is approaching the end of its investment term and actively seeking exits on some of its assets, with the team being close to closing the sale of one of the larger retail properties. The Africa property fund recently concluded the sale of one of the Mauritian assets. This sale was concluded at a discount in a difficult operating environment. The team are engaging potential buyers on the Ghana properties.

The Corporate Debt Strategy remains the largest in the fund both by allocation and return. These managers have a good pipeline of opportunities in the current environment. No new direct opportunities were executed over the quarter.

Global equity building block

Eighteen months into one of the steepest monetary tightening cycles in history, financial markets have in the third quarter of 2023 begun to adjust to the Fed narrative of tighter for longer. Bond yields had already moved substantially higher as interest rates were pushed up relentlessly. Few assets could hold up in this environment, with most equity markets down, the only notable strength was in the oil market, up 27% in the quarter, supported by OPEC+ production cuts and resilience in economies.

In the third quarter of 2023, global stock markets experienced a significant downturn after a strong start to the year. The MSCI World Index, representing developed markets, fell 2.1% in the quarter, with a substantial 4.3% drop in September. Similarly, the MSCI Emerging Markets Index declined 3.4% for the quarter, with a 4.2% drop in September. Concerns about the Chinese property sector further affected sentiment in emerging markets, despite stimulus measures aimed at stabilizing the housing market.

Against this backdrop, the Global Equity building block has delivered a return of -2.6% over the quarter, in line with its MSCI AC World benchmark. Over the twelve months, the portfolio has delivered a return of 24.9%.

Global property building block

Globally, the FTSE EPRA/NAREIT Developed Rental Net Total Return Index, recorded a net total USD return of -7.61% for September. The best-performing listed real estate market was Japan which recorded a total USD return of -3.56% for the month. Europe (ex UK) recorded the lowest total USD return of -8.98%. Year to date, the index has returned -5.32% in USD, and the best-performing market has been the US (-2.28%), whilst Hong Kong (-26.76%) has been the worst-performing market.

The decline in global listed real estate in September 2023 brought the total return performance for the third quarter to -4.1% and to -2.1% year-to-date. Europe (6.0%) and Asia (1.4%) stood out in the third quarter, while there were losses for Africa (-2.9%), Oceania (-5.6%) and Americas (-7.1%). At a national level, Germany (27.4%), Mexico (18.8%) and Austria (15.0%) recorded double-digit wins in the July to September period, while China (-13.3%) and Hong Kong (-11.9%) were on the negative side of the spectrum.

Year to date, the best-performing sectors globally in USD were Data Centres (16.4%), Single Family Housing (9.6%), and Student Housing (2.8%). The worst-performing sectors were Lab Space (-29%), Net Lease (-18%), and Strip Retail (-16.8%).

The building block delivered a return of -5.9% for the quarter, which was in line with the benchmark return.

Global fixed income building block

Global stock markets experienced a significant downturn after a strong start to the year. Simultaneously, there was a global bond market sell-off, leading to higher treasury yields. The US 10-year yield surged 19.1% in the quarter and 11.3% in September, reaching 4.57%. The US 2s/10s yield curve continued to steepen at one of the fastest paces over the past decade, bringing the US 10y rate to a 16-year high of close to 5%. We also witnessed 30-year bonds hitting 5% for the first time since GFC, and after a decade of ever cheaper/lower cost of capital/rates, leading to the greatest bond bear market of all time with a peak-to-trough loss in 30-year US Treasury of -50%.

The building block delivered a return of -3.7% for the quarter, outperforming the benchmark return of -4.4%.

Conclusion

We are comfortable with the positioning of the portfolios within the current environment and believe they are well-poised to navigate this environment. The portfolios have a slight tilt to defensive strategies but have adequate exposure to growth asset classes should markets continue to rally.