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Momentum Investments Flexible Factor Portfolio Range

Quarterly commentary to end March 2024

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

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. Given the effects of disrupted trade flows, supply chain shortages, increased uncertainty and higher risk premia arising from geopolitical tensions, a higher level of political instability in the global economy could result in higher inflation, lower growth and significant welfare losses in the longer term.

For South African (SA) investors, our preference remains tilted towards domestic asset classes over global counterparts in the upcoming year due to more appealing valuations and the potential for rand appreciation. While global equity markets have largely discarded the probability of a recession in the United States (US), some indicators point to a lingering and non-negligible risk. There could be a significant downside for equities should recession ensue. Moreover, equities are currently priced more than one-and-a-half standard deviations expensive relative to US bonds.

A record number of elections are taking place globally this year. In SA, polls for the May general elections currently flag a significant risk for the incumbent ruling party. 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. Aligned with the SA Reserve Bank's (SARB) Quarterly Projection Model which, now forecasts only 50 basis points worth of easing by the end of the year, risks are titled to a shallower interest rate cutting cycle.

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 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.

Portfolio management

Portfolio performance was positive for the quarter and was driven largely by the global exposure. The overweight position to global equity and corresponding underweight to local equity contributed to returns. During the quarter we increased the global exposure (at levels between R18.50 and R18.60) which was funded predominantly from reducing local equity and local bonds after the recovery in the fourth quarter. The cash allocation in the portfolios is at the highest levels since mid-2020 and reflects the cautious views of the investment team.

Asset class returns

The returns for the asset class benchmarks for the first quarter of 2024 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 (5.6%) 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	Q1 2024 Returns	Nominal returns for the previous 12 months	Real returns for previous 12 months*	Expected real return (p.a.)
Local equity (Capped SWIX)	-2.3%	2.9%	-2.7%	5.8%
Local bonds (ALBI)	-1.8%	4.2%	-1.4%	3.3%
Local listed property (SAPY)	3.8%	20.5%	14.9%	7.0%
Local ILBs (ILBI)	-0.5%	5.6%	0.0%	2.8%
Local cash (SteFI)	2.1%	8.4%	2.8%	1.3%
Global equity (MSCI ACWI)	12.1%	32.4%	26.8%	6.5%
Global bonds (WGBI)	-2.4%	-0.8%	-6.4%	-0.3%
Global property	2.5%	16.0%	10.5%	4.0%
US dollar/rand**	3.5%	6.9%		
SA CPI*	**1.1%**	**5.6%**		

*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 building block delivered a return of -1.0% for the quarter ending March. Performances were impacted by the negative returns of both equity and bonds.

Abax produced a net return of -2.1% over the quarter, however, performance over the longer term is pleasing relative to our peers and the market. The holding in British American Tobacco was the top contributor to performance as they announced the resumption of share buy-backs. BAT continues to trade at a dividend yield, in pounds, of over 10% with a rump P/E ratio of less than 5 times. Other rand hedge, including Anglo-American and Richemont, also contributed. Sasol was again under pressure as weak chemical prices impacted the earnings outlook for Sasol. This is not a high-quality company, but the current valuation reflects a lot of negativity. ABSA was also under pressure as a slightly soft earnings release was punished by the market. Similarly to BAT, ABSA is now trading at a P/E ratio of less than 6x and a divi yield of greater than 10%.

Looking ahead Abax still believes local bonds are attractively valued. The 10-year government bond yield now exceeds 12%. With inflation expectations anchored around 5.5% and global rates having peaked, this offers an attractive real return of 6.5%, which is more than our aimed inflation +5% target. Elections remain a potential catalyst for a rerating which could further add to returns.

The South African equity market continues to be attractively priced, both on a relative and absolute basis. They have recently increased the exposure to the banking sector, which is well capitalised, well provided and providing an attractive dividend yield at an undemanding valuation.

Ninety-One delivered a return of -2.3% for the period. Contributors to performance included SA-listed property which decoupled from SA bonds, delivering a positive contribution to returns. Naspers, Prosus and Richemont performed well in a negative local equity market backdrop as China sentiment improved, while BidCorp performed well after solid results. The holding in Goldfields also had a strong quarter.

Rand weakness supported returns of some of the Rand-hedge, domestic-listed holdings. Detractors from returns were SA bonds which had a disappointing start to the year with sharp declines, especially in March, 'SA Inc.' stocks which fell out of favour and Diversified miners.

Foord fared slightly better than Abax and Ninety-One and delivered a return of -0.20% for the quarter. Cash continued to contribute meaningfully to absolute returns, particularly when compared to local equities which fell during the quarter. An allocation to physical gold contributed given a rally in the dollar price for bullion, boosted even further by a weaker rand resulting in a 9% increase in gold bullion in March to hit new all-time highs on geopolitical tension and Chinese central bank buying. SA bonds detracted slightly from returns given increasing bond yields as South African bonds tracked global bond yields higher after a slew of adverse US inflation surprises caused investors to pare expectations for interest rate cuts. South African equity investments detracted from returns as the JSE drifted lower, weighed down by financial counters and resource shares. Sentiment towards South African equities remains low on the back of slow growth and the uncertainty surrounding the May national elections. The allocation to select listed property contributed positively to fund returns with holdings in Fortress, Shaftesbury Capital and NEPI Rockcastle adding value. During the quarter Foord increased the allocation to inflation-linked bonds and the Gold ETF.

Coronation was the best performing manager in the blend with a return of 0.4%. The Fund was able to supplement low market returns in this period with strong alpha over the quarter and year, respectively. The Strategy continues to favour SA equities within the domestic asset classes, given the high offshore exposure of many JSE-listed companies and attractive return prospects. Holdings include global stocks listed on the JSE and selected resources and domestic stocks. The fund's core holdings in the industrial sector include many of the global stocks listed in SA: Naspers, Richemont, Aspen, Bidcorp, British American Tobacco, and Anheuser-Busch InBev and Coronation continue to reassess the domestic holdings and cull those that are not well-positioned to withstand the challenging domestic environment. The Fund has also benefitted from the underweight position in resource counters, specifically platinum which has underperformed the broader market.

Local absolute strategies building block

The building block had a difficult quarter in what was a tough quarter for most South African asset classes. It delivered a return of -0.67% for the quarter, slightly lagging the benchmark return of -0.41%.

M&G under-performed its real return investment objective over the quarter, delivering -1.7%. Looking at the fund's asset allocation, SA cash holdings added by far the most value to absolute performance for the quarter, followed by SA-listed property which also made a positive contribution. SA equity exposure was the largest detractor from performance, followed by SA nominal bonds.

Within SA equities, the rally in Naspers and Prosus shares added good value to the fund, as did the rebound in Multichoice over the quarter. Other notable contributors included globally exposed holdings Richemont and BAT, and gold counters AngloGold Ashanti and Gold Fields. The largest detractors from performance were MTN (over concerns around its Nigerian operations), banking shares Standard Bank, First Rand and Absa, mining counters Harmony and Exxaro as well as Sasol.

Sentio underperformed the internal benchmark slightly during the quarter, delivering -0.9%. In Fixed Income the fund initially had an overweight duration position but moved tactically over the quarter, resulting in slight underperformance relative to the strategic benchmark. The overweight duration stance continues to be held as the manager views valuations to still attractive with SA inflation still within the target band.

The top 10 contributors included positions in AngloGold Ashanti, Naspers, Goldfields, Richemont, Prosus, Multichoice, Bidcorp, BTI and RH Bopelo. Their position in property contributed to the returns and was led by NEPI Rockcastle. Top 10 Detractors included positions in Firstrand, Standard Bank, Remgro, MTN, Sasol, BHP Group, Shoprite Discovery, Woolworths, and Discovery.

Laurium delivered a negative return of -1.2% for the quarter. These negative returns were attributable to the local equity and fixed-income allocations. Additionally, the property allocation in the fund had a marginal positive contribution, with STOR-AGE being the preferred pick in the sector.

The real return component had a good quarter, achieving 0.5% for the quarter. Prescient delivered a return of 0.4%, with income and money market being the strongest contributors to performance. Local equity exposure was the main detractor for the quarter. Sanlam investments achieved a return of 0.6% for the quarter. This component is defensively positioned and is focused primarily on capital protection.

Local cash building block

Monetary policy remained on hold during Q1 of the new year, as both the January and March meetings saw the monetary authorities vote unanimously to keep the repo rate unchanged. The repo rate has now remained at 8.25% (prime at 11.75%) since May 2023, as the authorities monitor and assess the impact of their current policy stance on growth and inflation. The traded money market reflected the benign policy environment, with rates virtually unchanged and volatility low over the quarter. The 3-month Jibar rate moved 5bps lower to 8.35%, while the 12-month rate was unmoved at 9.12%. Based on these Jibar rate levels the total return for the STeFi Composite Index was 2.06% for the quarter.

For the quarter, the building block delivered a return of 2.3% compared to 2.1% for the SteFI benchmark.

For the year, the building block delivered a return of 9.6% against the SteFI benchmark of 8.4%. 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 strength of the US economy continues to surprise investors, with developed market equities posting strong returns for the quarter despite the expectation for interest rates to remain higher for longer. Amid weak economic growth and increased pre-election uncertainty ahead of the May national elections, local asset returns suffered throughout the quarter. Domestically oriented equities and bonds were particularly hard hit. The SARB MPC unanimously decided to keep rates unchanged over the quarter at 8.25%, in line with market expectations. The SA yield curve remains steep and the situation with long bonds rising 100bps in February and March reflects investor concerns about the current fiscal situation. The All-Bond Index delivered a return of -1.80% over the quarter. Notwithstanding the commodities rally in March which provided some support to markets, equities still recorded a negative quarter.

The Momentum Portable Alpha solution delivered a return of -3.46% net vs the Capped SWIX index of -2.30%. The Momentum Aggressive has marginally underperformed, producing a net return of -0.38% vs the 50/50 cash equity benchmark which produced -0.04%. The Momentum Moderate fund of hedge delivered a return of 0.98% net of fees over the quarter, with both the equity long short and fixed income strategies doing well to protect capital in a volatile environment.

Risk levels across both the equity and fixed income books remain at moderate levels as fund managers maintain a defensive stance ahead of elections and the heightened geopolitical risk.

Special opportunities building block

The Special Opportunities Fund returned 5.0% for the first quarter of 2024. The Momentum Africa Real Estate Fund has received an indicative offer for the two Ghanaian assets and is actively pursuing an exit. Both properties are currently generating positive cash flow. The Kenyan development has had a further setback after a lorry carrying custom wardrobes overturned and damage was caused to some of the wardrobes. Due to these being bespoke for the units, this will have to be reimported and will come at an additional cost still to be determined.

The local property fund has had a good first quarter to the year with the fund seeing positive revaluations across a number of the assets. The team is currently renegotiating the debt facility on one of the assets and is now optimistic about finalising the realisation of one of the larger portfolio assets ahead of schedule.

The Corporate Debt Strategy remains the largest allocation in the fund and continues to contribute positively to the overall portfolio. No new direct opportunities were executed over the quarter.

Global equity building block

Global bond and equity markets concluded the first 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.

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.

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.

Rand weakness during the quarter contributed to the returns of the building block. During the quarter we introduced a new strategy namely the Robeco Sustainable Global Equity fund into the Building Block.

Against this backdrop, the Global Equity building block posted a return of 12.2% for the quarter ending 31 March 2024.

Global property building block

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 GPR 250 Index ended the first quarter marginally (0.5%) higher with America (-1.0%) and Europe (-2.1%) negatively impacting whilst the other three regions, Africa (3.5%), Asia (6.2%) and Oceania (8.4%) ended the quarter higher. The best performing sectors globally in USD for the year were Data Centres (47.51%), Student Housing (33.31%), and Single-Family Housing (32.03%). The worst performing sectors were Lab Space (-9.51%), Strip Retail (1.07%) and Gaming Net Lease (1.08%).

Rand weakness during the quarter contributed to the returns of the building block. Against this backdrop, the Global Property building block posted a return of 0.2% for the quarter ending 31 March 2024.

Global fixed-income building block

In the UK, after strong data in the early part of the quarter led to Gilts initially underperforming other markets, Q4 GDP print came in weak, at -0.3% and inflation data was also on the dovish side for January and February, with the latest Headline CPI at 3.4% YoY, 0.6% lower than the previous print and 0.1% lower than expectations, while Core CPI printed at 4.5%, still elevated, but following the exact same trend vs previous print and expectations. This, combined with softer labour market data, resulted in increased confidence in the path towards lower inflation over the coming months, and allowed Gilts yields to fall in the last month of the quarter. Overall, Gilt yields were still higher over the quarter with the 2-year 19 basis points higher at 4.17%, the 10-year 40 bps higher at 3.93% and the 30-year 28 basis points higher at 4.42%.

In Japan, the long-awaited end to the negative interest rate policy finally happened in March, as the Bank of Japan hiked rates for the first time since 2007. The JGB curves sold off, with the 2 years up 14 basis points to 0.19%, its highest quarterly close since 2011, the 10-year up 11 basis points to 0.73% and the 30-year up 19 basis points to 1.82%.

Rand weakness during the quarter contributed to the returns of the building block. Against this backdrop, the Global Bond building block posted a return of 0.6% for the quarter ending 31 March 2024.

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.