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Momentum Passive Lifestage Portfolio Range

Quarterly commentary to end June 2024

Assessing investment returns in an outcome-based investment context

The portfolio range has a lifestage model, which allows a member of a retirement fund to switch from a more aggressive investment portfolio with longer terms to retirement to more conservative and, ultimately, defensive portfolios as a member approaches retirement. The lifestage model uses a combination of asset classes, managed by multiple investment managers with different investment strategies to achieve its objectives. The lifestage philosophy uses the 'term to retirement' as a proxy for the risk a member can adopt. This means, for example, the asset classes in which members of a retirement fund would invest 10 years from retirement will have a different emphasis from those closer to retirement. It stands to reason that when a member of a retirement fund has a long-term investment horizon, the member should be invested in growth asset classes, which would include a significant allocation to higher-yielding asset classes and strategies also characterised by a higher level of risk (such as local equities and property as well as global equities). Although these asset classes are volatile, they provide returns above inflation over the long term. However, as a member moves to a medium-term investment horizon, the exposure to volatile asset classes should be gradually reduced to protect members in a retirement fund from being exposed to unnecessary volatility.

Momentum's purpose is to enhance the lifetime financial wellness of people, their communities, and their businesses, building a reputation for innovation and trustworthiness. In this way, we aim to become the preferred lifetime financial wellness partners to our clients. In keeping with the financial wellness framework, we have developed an investment philosophy that maximises the probability of you achieving your unique investment goals. We call this investment approach Momentum Investments' outcome-based investing. In response to the ever-evolving investment landscape, we manage our portfolios in such a way that they set their sights beyond mere benchmarks and instead focus on the things that matter the most to you – ensuring we maximise the probability of you achieving your investment goals. This portfolio range is managed using the outcome-based investment philosophy.

When assessing the returns of the Momentum Passive Lifestage Portfolio Range, it is important to start by looking at the returns from the portfolios against their inflation-related targets. This allows Momentum Investments to answer the question: Did the portfolio achieve its desired outcome over the most recent relevant time period? The returns are then further assessed 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 portfolios against their asset class (or strategic) benchmarks.

This quarterly review thus starts with a review of the investment returns generated by the portfolios against their targeted investment outcomes over the most recent periods. This is followed by an assessment of the economic environment and the returns generated by the asset classes (beta) in the most recent quarter against those Momentum Investments expects them to achieve on average. The returns from the building blocks used in the portfolios against their strategic investment benchmarks for this period are then reviewed.

Economic overview

Barring a sharp rise in geopolitical tensions, the global economy appears increasingly likely to avoid a hard landing. Despite more muted expectations for policy easing relative to the start of the year, global economic activity is still expected to continue expanding, albeit at a slower pace and below historical averages. The durability of the recovery, we believe, does not depend on significant policy easing but will be supported by still-robust wage growth, declining inflation and ongoing tightness in labour markets.

Although slowing United States (US) growth into 2025 could underpin both global bonds and equities due to the associated more positive rate cut expectations, it will be less supportive for equities should profit fears emerge. Historically, global equities have performed robustly when the US rate-cutting cycle was not accompanied by a recession, whereas they tend to decline somewhat during recessions. Expensive US valuations are the main return risk for global equities going forward. US bonds are presently trading at a discount to US equities, a situation seldom witnessed in the 21st century.

South Africa (SA) has now entered a phase where collective decision-making is crucial for effective governance. As such, the stability of the incoming government will hinge on the political maturity of the represented parties in parliament. We anticipate that business and consumer confidence will rise in hopes of continued structural reforms, leading to a better economic path. There is potential for growth to exceed our base case of 1% this year and 1.7% next year as accountability and governance improve and policy and reform continuity prevail. Further rand strength could result from developed market central banks lowering interest rates in response to disinflation, though significant appreciation will depend on empirical growth evidence. As tail risks to the currency recede, upside threats to our inflation view of 5.3% this year and 4.5% next year are likely to wane. Should growth outperform expectations, there could be room for more significant rate cuts than the 100 basis points we currently forecast over the next year.

The valuation metrics of the SA equity market have reset to consistently lower levels since the pandemic. SA equities remain very under owned 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. SA bond yields are attractive against their history in real terms, as well as relative to global yields, with part of the high real yield differential due to a high fiscal risk premium.

Portfolio management

Portfolio performance was positive for the quarter and was driven largely by the recovery in domestic asset classes post the May election. There were no material changes to the portfolio positioning, we did however increase global exposure towards the end of the quarter at Rand levels between R18 and R18.25 to the US Dollar.

Asset class returns

The returns for the asset class benchmarks for the second 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 (5.2%) 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	Q2 2024 returns	Nominal returns for the previous 12 months	Real returns for previous 12 months*	Expected real return (p.a.)
Local equity (Capped SWIX)	8.2%	10.0%	4.9%	5.8%
Local bonds (ALBI)	7.5%	13.7%	8.5%	3.3%
Local listed property (SAPY)	5.5%	26.3%	21.1%	7.0%
Local ILBs (ILBI)	2.4%	9.0%	3.8%	2.8%
Local cash (SteFI)	2.1%	8.5%	3.4%	1.3%
Global equity (MSCI ACWI)	-0.9%	15.9%	10.7%	6.5%
Global bonds (WGBI)	-1.6%	-0.6%	-5.8%	-0.3%
Global property	-5.8%	2.1%	-3.1%	4.0%
US dollar/rand**	-3.8%	-3.4%		
SA CPI*	**1.2%**	**5.2%**		

*CPI is lagged by 1 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 investing philosophy starts at the asset class level and then goes down to an investment strategy (if appropriate) and investment mandate choice 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 equity building block

The second quarter (Q2) of 2024 saw a moderation in the bullish investor sentiment towards global equities during the previous two quarters, as stubbornly persistent inflation in the US prevented the US Federal Reserve from starting to lower interest rates, despite an expectedly high number of companies reporting strong fundamentals in their results across a variety of sectors. Election uncertainties also weighed on market sentiment in France and the UK, but positive results in South Africa and India encouraged equity rallies.

In South Africa, asset prices rallied, and the rand gained ground on the back of what investors considered to be a successful outcome for the May national elections, in which there was almost no violence, the new Government of National Unity (GNU) was formed timeously, and President Cyril Ramaphosa was sworn in for his second term. Both the FTSE/JSE All Share Index and Capped SWIX Index delivered 8.2% in rand terms, boosted by a notable 17.8% return from Financials, 5.7% from Listed Property, 5.2% from Industrials, and 3.5% from Resources, due to general gains in commodity prices.

The building block delivered a return of 8.2% for the quarter, in line with the benchmark.

Local property building block

The SA Listed Property Index (SAPY) and the All-Property Index (ALPI) recorded total returns of 5.50% and 5.71% respectively for the quarter ended June 2024.

Over the past few years, returns in South African listed property have been volatile, heavily influenced by the macroeconomic environment, with property fundamentals playing a less significant role. The sector's recovery, which began in the last quarter of 2023, has continued due to slowing inflation, more stable energy generation, a favourable election outcome, and positive cabinet selections, along with a re-rating of local bonds. The SA Listed Property Index (SAPY) and the All-Property Index (ALPI)

delivered year-to-date returns of 9.6% and 9.4% respectively as of 30 June 2024, outperforming the other asset classes including equities (5.7%), bonds (5.6%), and cash (4.2%) over the same period.

The building block delivered a return of 5.7% for the quarter, in line with the benchmark.

Local bond building blocks

Q2 of the new year saw fixed income asset classes shoot the lights out. Total returns were significantly positive as yields moved sharply lower. Leading the way were nominal bonds, with yields rallying 80 bps and the ALBI returning 7.49%. Listed property (5.50%) and ILBs (2.43%) followed suit, and the ZAR gained 3.96% against the U.S. dollar. Cash (STeFI) delivered its customary 2.06%, which is a decent return, but it was made to look pedestrian relative to the other asset classes. All the sectors delivered strong absolute performances for the quarter. The 1-3-years sector was the weakest-performing sector with a return of 3.35%, The 3-7-years sector had a return of 5.64%, the 7-12-years sector delivered a return of 8.04%, whilst the 12+ years sector was the strongest performer with a stellar return of 9.91%.

The building block delivered a return of 7.5% for the quarter, in line with the benchmark.

Local cash building block

Monetary policy remained on hold during Q2 of the new year, as the only MPC meeting (May) saw the 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 stable and volatility low over the quarter. The 3-month Jibar rate was unchanged at 8.35%, while the 12-month rate declined 17 bp to 8.95%. Based on these Jibar rate levels the total return for the STeFi Composite Index was 2.06% for the quarter.

The credit market has been stable over the quarter which has contributed positively to portfolio yield enhancement, but there is not a lot of opportunity by way of new issuance or spread compression at the moment. Both investment managers have thus rather increased interest rate risk by moving longer out on the money market curve as the better option for generating outperformance over the coming quarters. The four large banks are currently preferred over corporates.

For the quarter, the building block delivered a return of 2.4% compared to 2.06% for the SteFI benchmark.

Global equity building block

The second quarter (Q2) of 2024 saw a moderation in the bullish investor sentiment towards global equities during the previous two quarters, as stubbornly persistent inflation in the US prevented the US Federal Reserve from starting to lower interest rates, despite an expectedly high number of companies reporting strong fundamentals in their results across a variety of sectors. Election uncertainties also weighed on market sentiment in France and the UK, but positive results in India encouraged equity rallies. Other central banks like the European Central Bank did enact cuts, however, helping both developed and emerging market equities record moderately positive returns. Meanwhile, global bonds were weaker as US investors moved out their rate-cut expectations significantly. The majority now forecast either 25 basis points or 50 basis points of reductions starting in September at the earliest.

Global equity (as measured by the MSCI ACWI) recorded a total return of 2.9% in Q2 compared to 8.2% in Q1, while developed market equities produced 2.6% and emerging market equities produced 5.0%. Emerging markets led equity returns with strong performances from Turkey, South Africa, India and China. India recorded a surprise election result that helped reinforce democracy, and China saw a rebound amid improving sentiment and economic data.

Developed Market Equities were again led by Wall Street, reaching multiple new highs. The broad equity indices masked an extraordinary dominance of the mega-cap tech stocks, where the AI boom continues to leave behind those who fail to embrace

it. Markets outside the US were mixed, with Japan consolidating after a surge in Q1, Europe flat, held back by weak growth prospects and political worries in France, while the UK continued its recovery.

The building block delivered a return of -0.8% for the quarter.

Global property building block

Global REIT Indices (GPR 250) increased by 1.0% in June 2024 but remain negative year-to-date. The GPR 250 Index reported a 1.3% loss in the second quarter and is down 0.9% for the first half of the year. In Q2 2024, Africa (5.8%) and the Americas (0.5%) delivered positive returns, while Europe (-0.5%), Asia (-6.8%), and Oceania (-11.3%) declined. The sector (1.0%) underperformed relative to broader equities (2.4%).

The Global Property building block delivered a return of -6.3% for the quarter.

Global fixed-income building block

In the US, positive investor sentiment toward equities cooled slightly as the US Federal Reserve (Fed) continued to keep interest rates on hold for the quarter amid stubbornly high services inflation. At its 12 June meeting, it raised its inflation forecast slightly and the “dot plot” guidance indicated its members’ interest rate expectations now comprised only one 25bp rate cut this year, although several members did foresee two 25bp cuts. This important adjustment indicated rates would end 2024 at 5.1% compared to 4.6% in their March guidance.

In the UK, the Bank of England (BoE) again kept its main interest rate unchanged at 5.25% at its May and June meetings, even as May CPI fell to 2.0% year-over-year from 2.3% in April. The chances for a cut in interest rates improved, with the market pricing in a 25bp rate cut in August and more expected.

In the Euro area, the European Central Bank (ECB) lowered its benchmark interest rate by 25bps at its June meeting to 3.75%, as had been expected. May CPI came in at 2.6% year-over-year, just above the 2.5% consensus and still higher than the ECB’s target of 2.0%. However, inflation is projected to soften further despite stubborn services inflation.

Bonds were generally flat over the quarter with credit spreads remaining at historically low levels. Returns were however masked by a significantly wide trading range, a reflection of the considerable uncertainty about the timing and extent of rate cuts. Against this backdrop, the Global Bond building block achieved a return of -4.6% for the quarter with Rand strength explaining most of this return.

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.