Momentum Passive Lifestage Portfolio Range
quarterly commentary to end June 2019

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 ‘term to retirement’ as a proxy for the risk a member is able to 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 with 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.

**Momentum Passive Lifestage Portfolio Range returns**

The portfolios in this range have inception dates of April 2015. Factor 3 has managed to outperform its strategic benchmark over 3 years, returning 5.5% vs a benchmark return of 5.2%. Factor 4 was in line with the strategic benchmark over four years (5.9%). Factors 5 and 6 do not yet have five and six year history. All the portfolios’ returns however have lagged their respective inflation targets as a result of the low returns from growth asset classes at this time.

**Economic overview**

The geopolitical backdrop remained unsettling for global investors in the second quarter of the year as trade talks between the world’s two largest economies, the United States (US) and China, continued to ebb and flow. Renewed growth risks and tepid inflation have caused most developed market central banks to walk away from their mantra of policy normalisation. However, global central bank balance sheets are close to historic highs and interest rates in a number of economies remain close to record lows, which limits the scope and magnitude of monetary policy measures to resuscitate growth. Moreover, high levels of public debt will constrain support from fiscal stimulus. By front-loading its interest rate response to subdued inflation and rising growth risks, the US Federal Reserve is likely to sustain the current economic expansion and prevent a sharp dip in growth. Other major central banks have joined the dovish chorus and could ease monetary policy further in the coming quarters.

Global bonds have traditionally tended to outperform equities in a weaker growth environment, but the long lead time between yield curve inversion and the peak in the equity market suggests ongoing support for global equities in the short term.

With the pace of reform likely to be gradual in the near term only, the outlook for growth in South Africa is expected to remain sluggish at around 0.5% in 2019 and will likely struggle to achieve a rate higher than 1.5% in 2020. In Momentum Investments’ view, there is a significant risk that Moody’s will change its outlook on the country’s sovereign rating from stable to negative in 2019. This will be to flag the inability of government to stabilise debt and achieve speedier fiscal consolidation in an environment of low growth and hampered by political constraints. Should interest rates drop in the near term in response to subdued inflation, we anticipate the cutting cycle to be shallow, given the structural nature of South Africa’s low-growth quandary.

South African shares are trading considerably below their highs after disappointing in the last five years. However, historical data underpins prospective South African equity returns from the current low five-year trailing return level. The country flaunts the highest real yield among its global investment grade peers, highlighting the relative attractiveness of local fixed income. Listed property has been trading cheaply against South African
government bonds for the last ten years. Good returns are expected, from the low base in 2018, even taking into account real distribution growth of negative 2%.

**Asset class returns**

The returns for the asset class benchmarks for the second quarter of 2019 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 (4.48%) for the year. The final column in the table contains the returns above inflation Momentum Investments expects to get (on average) for these asset classes for a full market cycle.

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Q2 2019 returns</th>
<th>Nominal returns for the 12 months</th>
<th>Real returns for 12 months*</th>
<th>Expected real return (p.a.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local equity (Capped Swix)</td>
<td>2.90%</td>
<td>1.11%</td>
<td>-3.37%</td>
<td>5.80%</td>
</tr>
<tr>
<td>Local bonds (Albi)</td>
<td>3.70%</td>
<td>11.50%</td>
<td>7.02%</td>
<td>3.30%</td>
</tr>
<tr>
<td>Local property (Sapy)</td>
<td>4.52%</td>
<td>0.79%</td>
<td>-3.69%</td>
<td>7.00%</td>
</tr>
<tr>
<td>Local ILBs (Igov)</td>
<td>2.80%</td>
<td>4.06%</td>
<td>-0.42%</td>
<td>2.80%</td>
</tr>
<tr>
<td>Local cash (SteFI)</td>
<td>1.84%</td>
<td>7.33%</td>
<td>2.85%</td>
<td>1.30%</td>
</tr>
<tr>
<td>Global equity (MSCI World)</td>
<td>1.74%</td>
<td>9.31%</td>
<td>4.83%</td>
<td>6.50%</td>
</tr>
<tr>
<td>Global bonds (WGBI)</td>
<td>0.84%</td>
<td>8.93%</td>
<td>4.45%</td>
<td>-0.30%</td>
</tr>
<tr>
<td>US dollar/rand**</td>
<td>-2.24%</td>
<td>2.89%</td>
<td></td>
<td>4.48%</td>
</tr>
<tr>
<td>SA CPI</td>
<td></td>
<td></td>
<td></td>
<td>4.48%</td>
</tr>
</tbody>
</table>

* 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.

The table above highlights the challenges growth asset classes have experienced in the last year. The best-performing asset class for the period was local bonds, while local property was the worst-performing asset class.

**Building block return assessment**

**Local equity building block**

During the second quarter of 2019, the FTSE/JSE All Share Index (Alsi) posted a total return of 3.9% compared to the 8% for the first three months of 2019. The TSE/JSE Financials was the best performer, returning 5.4%, followed by the FTSE/JSE Industrials with a total return of 4%. Among the other important indices the FTSE/JSE Shareholder Weighted Index (Swix) (2.86%) performed in line with the FTSE/JSE Capped Shareholder Weighted All Share Index (Capped Swix) (2.90%).

The local equity building block performed in line with its benchmark, the FTSE/JSE Capped Shareholder-weighted Top 40 Index, producing a return of 3.2% for the quarter. For the year, the building block returned negative 0.5% and the benchmark negative 0.6%.
Local property building block
The SA listed property sector, benchmarked by the Sapy, delivered a total return of 4.52% in the second quarter of the year, with returns largely driven by income growth of 3.2% and capital returns of 1.3%. The sector outperformed cash, nominal bonds and the local equities, which were up 1.8%, 3.7% and 3.9% respectively.

The property building block returned 4.3% over the quarter and 0.5% over the last 12 months, marginally behind the benchmark return of 4.5 and 0.8% respectively.

Local bond and inflation-linked bond building blocks
In Momentum Investments’ view, there is a significant risk that Moody’s will change its outlook on the country’s sovereign rating from stable to negative in 2019. This will be to flag the inability of government to stabilise debt and achieve speedier fiscal consolidation in an environment of low growth and hampered by political constraints. Should interest rates drop in the near term in response to subdued inflation, the company anticipates the cutting cycle to be shallow, given the structural nature of South Africa’s low-growth quandary.

Inflation-linked bonds bounced back this quarter, despite a continued benign inflation environment. Returns were boosted by a decline in real yields which were lower by an average 15 basis points across the curve. Much of the move lower was in short-dated maturities as this area of the curve responded to the change in sentiment globally, as growth fears have increased and economic data softened.

The local bond and inflation-linked bond building blocks produced 3.5% and 2.7% respectively, relative to the Govi and Igov benchmarks, which returned 3.7% and 2.8% for the quarter. For the year, the bond building block returned 10.3% compared to a benchmark return of 11.3% and inflation-linked bond s returned 4%, which was in line with the benchmark.

Local cash building block
For the quarter ending 31 March 2019, the portfolio delivered a return of 2.1% compared to 1.8% for the benchmark. Credit spreads have run ahead of themselves, with compression being driven by lack of supply as opposed to fundamentals. The underlying investment manager was very selective on which credit exposure to include in the portfolio.

The credit spreads earned assisted in the portfolio’s generation of returns.

For the year ending 31 March 2019, the portfolio delivered a return of 8.8% against the SteFI benchmark of 7.4%. The portfolio consistently met its objective of capital preservation by maintaining positive returns on a one-year rolling basis. The underlying investment manager had a high exposure to floating-rate notes, which provided a high degree of liquidity, while also providing excellent yields.

Global equity building block
Global equities posted positive returns over the quarter, despite a sell-off in May due to concerns over the US-China trade war. Equity markets were supported by the increasingly accommodative stance of major central
banks and hopes of easing trade tensions in June. For the quarter, developed market equities advanced 4.0% in US dollar terms, taking the year to date return to 17.0%.

The US equity market led the way, returning 7.0%, and reached new all-time highs. The announcement by President Trump early in June that tariffs on Mexican imports had been avoided and the decision to resume trade talks with China provided a more favourable backdrop for markets. European equities advanced 4.3% in euro terms, despite the sharp fall in May. An about turn by the European Central Bank, in favour of keeping policy looser for even longer, was another key driver for the market rebound in June. In the UK, equities provided a positive return, returning 3.3% in sterling terms. Domestic politics continued to dominate and drive investor uncertainty, as the Conservative Party leadership race began. Japanese equities lagged the other major equity markets, falling 2.4% over the quarter, primarily as a result of weakness in May. The yen strengthened against other major currencies, driven by the perceived safe-haven status at times of market risk.

The global equity building block was in line with its MSCI AC World benchmark. The building block returned 1.6% for the quarter compared to the benchmark return of 1.5%

Global property building block
The global property building block was introduced to the portfolio range during the course of the fourth quarter of 2018. The building block is managed passively by Blackrock and is aimed at achieving capital growth by tracking closely the return of the FTSE EPRA/NAREIT Developed Index. The building block is invested in equity securities of companies that form part of the benchmark index. The building block returned negative 2.18% for the quarter, which was below the benchmark return of negative 1.23%.

Conclusion
Momentum Investments still strongly believes in the appropriateness of the investment strategies of the portfolios within the Momentum Passive Lifestage Portfolio Range. While the market environment has been tough, the company’s outcome-based investing approach is limiting the underperformance against their targeted investment outcomes during this difficult time by diversifying across multiple asset classes and investment strategies.