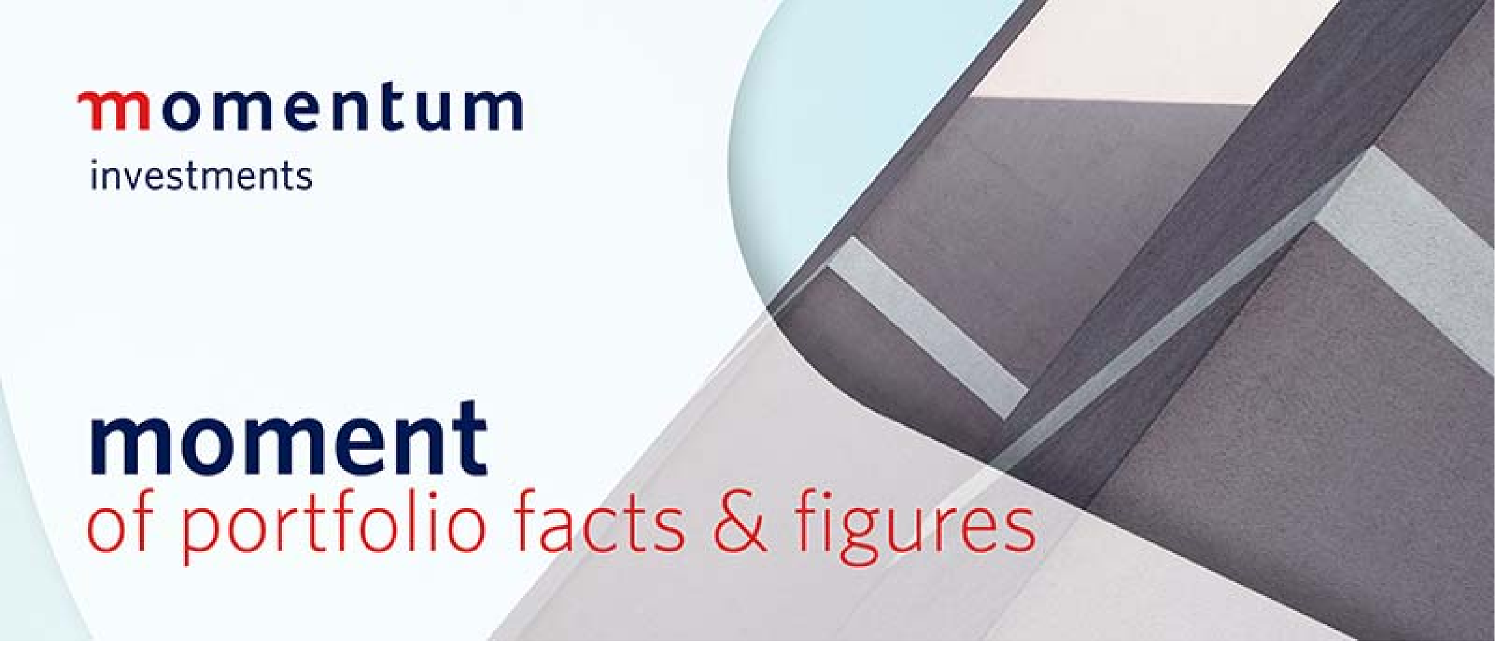

Momentum Passive Lifestage Portfolio Range

quarterly commentary to end September 2020

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 Factor Portfolio Range returns

The respective inflation objectives of the portfolios have been difficult to attain, given the low return from growth asset classes for the last five years. However, the factors outperformed their strategic benchmarks for most periods.

Economic overview

High-frequency data releases and sentiment indicators indicate that a strong bounce back in global economic activity in the third quarter of the year may fizzle out prematurely. The recovery has shown signs of being unbalanced. Businesses have become less pessimistic about the outlook for the economy and corporate earnings, whereas consumer behaviour appears to continue to reflect the uncertainty of COVID-19.

Ongoing stimulus is likely necessary to support financial markets and underpin confidence for sustained economic growth. With the blurring of fiscal and monetary policy, it is not clear what will force governments to rein in spending. This raises an additional concern of central banks becoming more vulnerable to political interference. Moreover, inflation expectations are also at risk of becoming unanchored down the line.

Even as further restrictions are lifted on the local economy, electricity shortages, policy uncertainty, lingering unemployment, an anticipated rise in bankruptcies, a slow pace of reform and soaring government debt will continue to restrain spending and investment, thereby limiting South Africa's (SA) recovery to a below-consensus 2.0% in 2021, in our view, from a contraction of around 8.0% in 2020.

Electricity tariffs pose the main upside risk to inflation in the near term. We anticipate an average headline inflation rate of just above 3% for 2020, rising mildly to just below 4% in 2021. Interest rates are expected to remain unchanged until the second half of 2021 when the SA Reserve Bank begins to unwind negative real interest rates to avoid endangering the savings industry and broader financial stability.

Portfolio management

The portfolios recorded positive returns for the quarter on the back of strong global and local equity returns, and benefitted from being overweight local and global equity as well as underweight local property. Being underweight inflation-link bonds detracted from returns.

We continue to manage the portfolios with caution, given that we expect market volatility during final quarter of 2020 and, therefore, still have protection strategies on local equity. Towards the end of the quarter, we also reduced the global property and global equity exposures and trimmed the local equity positions across the portfolios. We have also been incrementally increasing the cash exposures, as a risk-mitigation mechanism, given significant global political and key local economic events in the final quarter.

We continue to monitor these exposures and developments daily, with a view to provide the optimal risk-adjusted outcome to you as well as the assurance that your investments are being actively managed in a prudent and responsible manner.

Asset class returns

The returns for the asset class benchmarks for the third quarter of 2020 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 (3.11%) 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 2020 returns	Nominal returns for the previous 12 months	Real returns for previous 12 months*	Expected real return (p.a.)
Local equity (Capped Swix)	1.01%	-5.02%	-8.12%	5.75%
Local bonds (Albi)	1.45%	3.58%	0.49%	3.25%
Local property (Sapy)	-14.14%	-46.07%	-49.17%	7.00%
Local ILBs (Ilbi)	1.21%	-1.92%	-5.02%	2.75%
Local cash (Stefi)	1.16%	6.20%	3.11%	1.25%
Global equity (MSCI ACWI)	4.53%	22.88%	19.78%	6.50%
Global bonds (WGBI)	-1.32%	17.47%	14.37%	-0.25%
Global property	-8.50%	-5.38%	-8.47%	4.00%
US dollar/rand**	-3.44%	10.70%		
SA CPI*	**2.01%**	**3.11%**		

*CPI is to end August 2020

**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

Local equity building block

The FTSE/JSE All Share (Alsi), Shareholder Weighted (Swix) and the Capped Shareholder Weighted (Capped Swix) Indices remained relatively flat at 0.67%, negative 0.33% and 1.0% respectively during the quarter. FTSE/JSE Financials increased 2.2% for the quarter, while FTSE/JSE Resources and Industrials were down 4.5% and 1.9% respectively. The rand strengthened by 3.6% to R16.75/$ during the quarter. Iron Ore increased by 20.3% to $118/t and Brent Crude oil increased by 1.29%, ending on $42/bbl. Copper increased 11.1% to $6668/t. Gold increased by 5.9% to $1886/oz, Platinum at $893/oz was up 7.7% along with Palladium which increased by 18.9% to $2311/oz. The VIX Index (Volatility or 'Fear' Index) decreased by 13.4% to 26.4 during the quarter, but remained elevated due to geo-political uncertainty and fears of a second wave of COVID-19.

The local equity building block produced a marginally lower return than its benchmark, the FTSE/JSE Capped Shareholder-weighted Top 40 Index, with a return of 1.28% for the quarter. For past the year, the building block returned negative 3.57%.

Local property building block

The third quarter of the year was abuzz with activity, as it coincides with the period during which some of the real estate investment trusts (Reits) report their June financial results. This reporting period provided valuable insights into the operating conditions tenants faced during various levels of the lockdown, and how Reits navigated the environment. As expected, the key takeaway from the results was that the outbreak of COVID-19 had a significant effect on tenant operations. Owing to the lockdowns, many tenants could not operate at the same level of capacity they did before the outbreak of the pandemic. These trading conditions have negatively affected tenant cash flows and their ability to service operating commitments such as rental expenses. To alleviate the cash flow pressures faced by tenants during the period, Reits provided some rental relief to tenants which came in the form of rental discounts or deferrals. Most of the relief packages were directed towards retail tenants (including SMME retail operators, gyms and sit-down restaurants) as their businesses were directly affected by lockdowns.

Office and industrial sector tenants received minimal rental relief, as many continued to trade throughout the lockdown, albeit at interrupted levels. A marked improvement in operating activity was noted in the third quarter relative to where operating activity was in the second quarter of the year. This improvement follows the relaxation of lockdown regulations, as the country moved from alert level 3 regulations from beginning June, to alert level 2 regulations in August and, recently, alert level 1 regulations, which took effect from 21 September 2020. Rental collection metrics are also off the lows from the second quarter, and the picture today is very pleasing across all sectors, although rental collections are not at the 95% to 100% range we are accustomed to.

Notwithstanding these improved conditions, the SA listed property sector index (Sapy) ended the quarter near similar levels to those seen at the height of the lockdowns in March and April. During the quarter ended September 2020, the Sapy declined by 14.1%.

The building block returned negative 14.5%, which was marginally below the benchmark return.

Local bond and inflation-linked bond building blocks

There was much less volatility in the third quarter of 2020 for local fixed income asset classes, after what happened the previous quarter. However, uncertainty remains elevated and this is reflected in the returns for the period. Nominal bonds led the way with the Albi delivering 1.45%, marginally outperforming cash as measured by the Stefi (1.16%). ILBs, as measured by the Igov, continued to lag, delivering 1.00% and listed property (Sapy) yet again delivered negatives returns of 14.14%.

For the quarter, the SA bond building block yielded 1.4%, in line with the Igov benchmark. For the year, it yielded a return of 3.17%, compared to the benchmark 3.3%.

The ILB building block yielded 1% for the quarter and negative 2.43% for the past year, in line with the benchmark.

Local cash building block

There was further easing in the repo rate, but only a 0.25% cut at the July meeting, which was followed by a pause at the September meeting. The repo rate was anchored at historical lows of 3.50%. The Jibar rate is at 3.35%. The forward rate agreements curve indicates that the market does not expect any further interest rate moves from current levels in 2020. Credit spreads have started to compress strongly during the latter part of the quarter and the exposure to non-government issuers has been decreased somewhat.

For the quarter, the building block delivered a return of 1.5% compared to 1.2% for the Stefi benchmark.

And for the year, the building block delivered a return of 7.5% against the Stefi benchmark of 6.2%. The building block consistently met its objective of capital preservation, by maintaining positive returns on a one-year rolling basis.

Global equity building block

Despite a sharp setback during September, risky asset classes made further gains in the third quarter, building on the recovery, which began in late March. Wall Street, particularly tech stocks and other clear beneficiaries of the pandemic, again led the way, with the S&P500 returning 8.8%. Chinese markets also performed strongly, with the CSI 300Index up 10% and, this, with a weak dollar, helped push emerging markets to a return of 9.6%, outpacing the MSCI Developed Market Index, up 7.9%.
European markets were weighed down by increasing concerns about a damaging second wave of COVID-19 and rising anxiety about the Brexit discussions ahead of key deadlines in October.; Europe ex UK returned only 1.4% in euro terms, while the UK market fell 4.3% in pound terms. The underperformance of the UK, which was also held back by the dominance in the index of energy and financials, sectors which were severely damaged by the effect of the pandemic, were stark: so far this year the market is down 21% compared with a rise in the US of 5%.

Driving markets were two key factors. First was the continuing economic recovery from the pandemic-induced collapse in the early months of the year. This was sharper than many predicted and in turn resulted in corporate profits generally coming in ahead of expectations, although clearly not across all sectors. Second was the extraordinary support provided by the major central banks, which continued to purchase assets on a substantial scale, while keeping interest rates close to or below zero, and provide guidance, which points to a long period ahead of ultra-loose policy.

Against this backdrop, the building block underperformed its MSCI AC World Index benchmark for the past quarter, returning 5.1% relative to 4.9% for the benchmark

Global fixed income building block

The global bond building block returned negative 1.8% for the quarter, which was below the benchmark return of negative 1.5%.

Despite the continued COVID-19 uncertainty and expectations that the virus's economic effect will be longer lasting than initially envisioned, markets remained beholden to central banks and government stimulus packages. The US Federal Reserve now foresees ultra-low policy rates remaining in place until 2023, which has anchored US Treasury yields to date (US ten year at 0.65%), dampened volatility and encouraged investors to seek out higher yields within corporate credit (US credit outperformed government bonds by 1,7% in the third quarter and high yield outperformed by 4.5%) or other riskier asset classes.

Global property building block

The global property building block returned negative 3.4% for the quarter, which was below the benchmark return of negative 1.8%. Rand strength and tighter restriction measures, specifically in the UK and Europe, were the major reasons for the negative returns.

Conclusion

It's only natural to be concerned when investment markets experience the volatility that 2020 has. The key during uncertain and volatile times like these is to remain invested and not to succumb to emotional reactions and to look beyond short-term fears. The portfolio managers are continually assessing how best to manage your well-diversified portfolios during this period.