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Momentum Passive Lifestage Portfolio Range

Quarterly commentary to end March 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

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 on the next page. 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 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 first quarter of 2024 brought a continuation of the relatively bullish investor sentiment towards global equities seen in the last months of 2023, as prospects for growth in the US were buoyed by positive company earnings reports and supportive economic data that increased the likelihood of a "soft landing" for the economy. On the other hand, global bonds were weaker as inflation proved higher than expected and major central banks kept interest rates on hold, prompting pundits to move out their rate cut expectations to the second half of the year.

The Japanese and US equity markets were the stand-out performers, while the UK disappointed. and China continued to experience losses, although the magnitude of these fell as the quarter progressed, helped by small gains in March. Emerging markets were broadly in the red, with the exception for India, and South African equities remained in the doldrums on the back of slow growth and the approaching May national elections.

Locally, the All-Share Index and the Capped SWIX Index underperformed. The local market was dragged down by a 7.6% loss in Financials, while Industrials delivered a return of 0.6%, Resources 0.8% and Listed Property 3.5%, the latter continuing its rally from the previous quarters.

On the back of this, the building block delivered a return of -2.4% 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 3.85% and 3.47% respectively for the quarter ended 31 March 2024. In March, South African listed property saw a slight pullback in its year-to-date gains. However, it remained the top-performing asset class for the first quarter, continuing the strong rebound from the final quarter of 2023, driven by market expectations of global rate cuts and an improving risk appetite. On a 12-month basis, the All-Property Index delivered returns of 20.33%, outperforming cash (8.32%), bonds (4.09%) and equities (2.87%).

During the quarter, several property funds, including Nepi Rockcastle, Growthpoint, Hammerson, Shaftesbury Capital, Mas, Fortress, Hammerson, Attacq, SAC, Hyprop, Lighthouse, and Resilient, released their results. Results have largely been in line with guidance and market expectations, and consistent with the operational outlook presented previously. Interest rates remain the key driver of low to negative performance while fundamentals continue to improve.

The building block recorded a return of 3.3% for the quarter and 19.7% for the last year.

Local bond building blocks

The first quarter of the year 2024 saw fixed income asset classes struggle after the hugely positive end to 2023. Total returns were under pressure as nominal and inflation-linked yields moved higher. Both nominal bonds, ILBs and the ZAR delivered negative returns, with the ALBI at -1.80%, the IGOV at -0.47% and the ZAR losing 3.2% against the USD. Cash (STeFI) delivered 2.06%, while the only asset class to deliver positive returns was listed property (3.85%).

Currently, credit exposure consists mainly of exposure to the large banks and these spreads have remained stable over the quarter, but at fairly compressed levels relative to history. The non-bank credit market has seen a decline in activity and a continued grind lower in spreads on offer. With spreads tight and the macro backdrop challenging, there has not been too much opportunity for yield enhancement from credit. 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 1-3-years sector was the strongest-performing sector for the quarter at a return of 0.81%, All the other sectors detracted from performance on an absolute basis. The 3-7-years sector had a return of negative 1.42%, the 7-12-years sector delivered a negative of -2.38%, whilst the 12+ years sector was the weakest performer with a negative return of -2.73%.

The building block recorded a return of -1.9% for the quarter, in line with the benchmark.

Inflation-linked bond building blocks

The total return from inflation-linked bonds (ILBs) is divided into two components – the monthly accrual and the mark-to-market of the capital value due to the move in the real yields. The first component of return is the monthly accrual earned from the yield on the bonds and the inflation uplift. This component of the total return was rather low over the quarter, (high yields but very low inflation accruals), delivering 1.99%, with 0.81% from inflation uplift and approximately 1.18% from yield accrual. The second component of the return is determined by the move in the real yields of the bonds which rose 27 bps on average across the curve. This generated capital losses of 2.46%. These components combined explain the index (IGOV) total return of -0.47%.

For the quarter, the building block delivered a return of -0.5% against the benchmark IGOV at 6.1%.

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 2.1% for the quarter.

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

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.

Against this backdrop, the Global Equity building block delivered a return of 11.2% over the quarter and 34% over the last twelve-month period, in line with the benchmark.

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.