Sanlam

Sanlam Corporate: Investments

Trustee Approved Default Investment Strategies Report

Quarter 3 2022

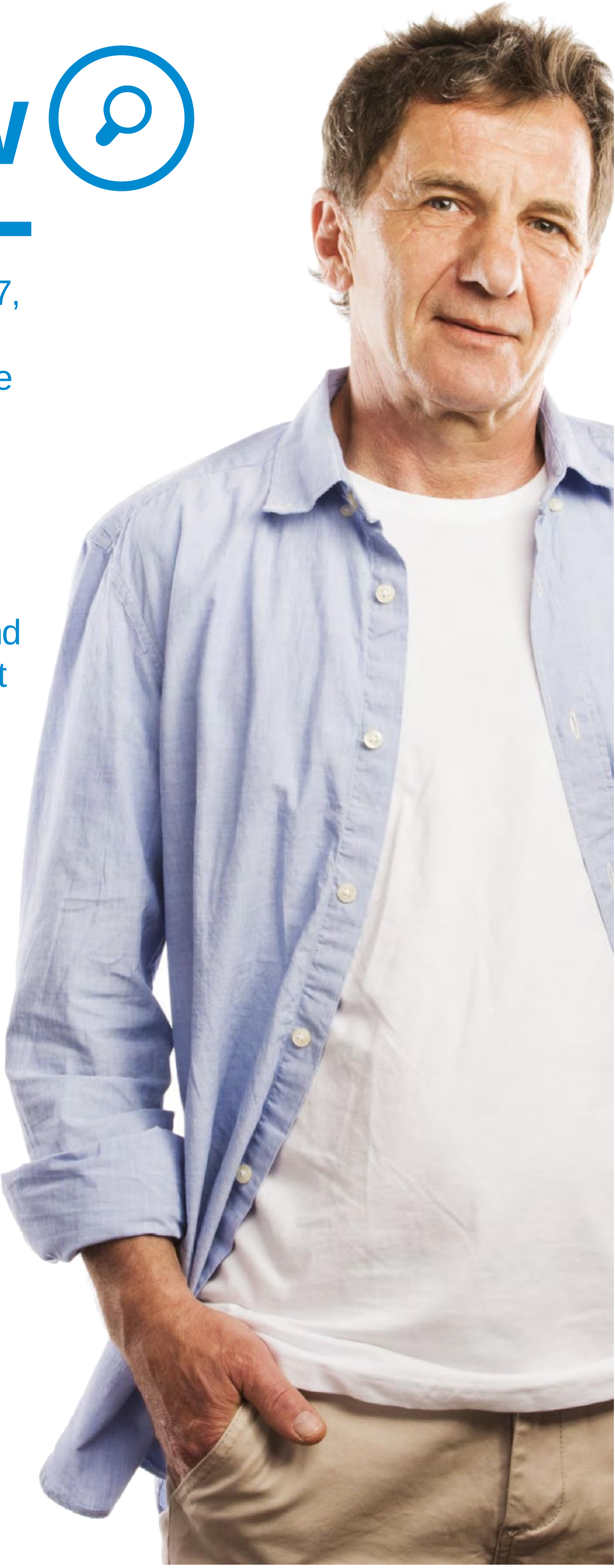
Insurance | Financial Planning | Retirement | Investments | Wealth

Contents

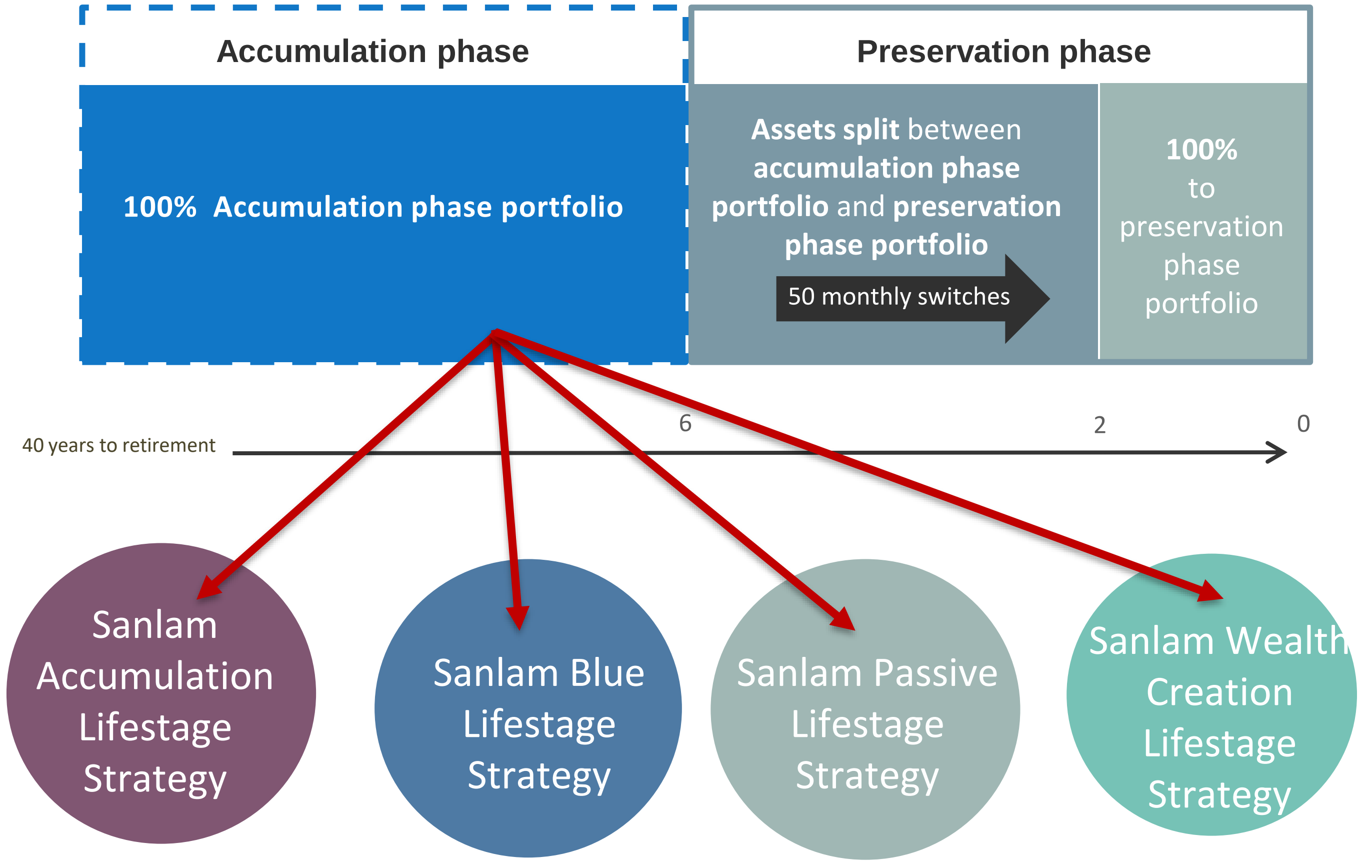
Overview

In line with Default Regulation 37, the trustees have approved the **Sanlam Lifestage model** as the Fund's **default** investment strategy. However, in order to cater for divergent client preferences, the trustees have also approved three **alternative default lifestage strategies**, and three **protection strategies** that can be chosen as a default investment strategy at participating employer level depending on the required investment objectives and product option.

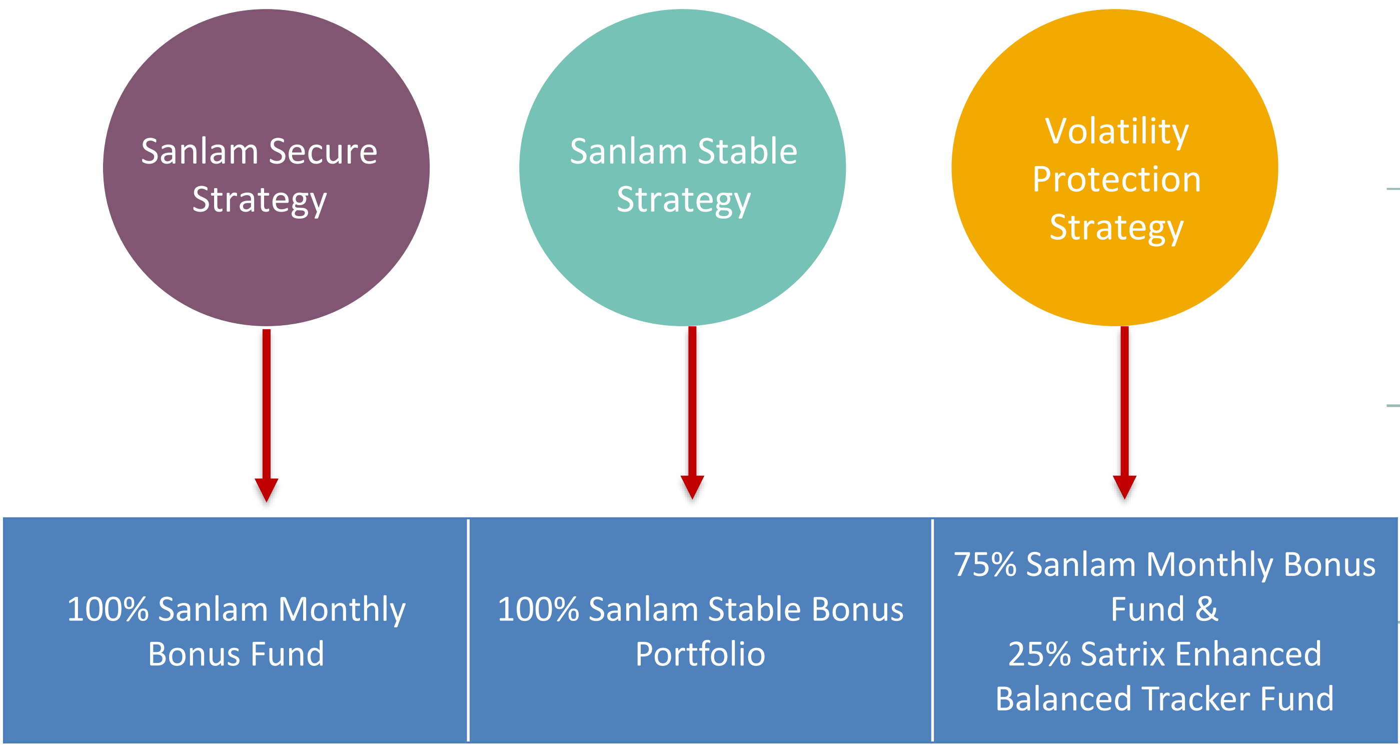
A **lifestage strategy** aims to meet each member's savings requirement by working towards a target date, which would be the Normal Retirement Age or the Planned Retirement Age (if different).



LIFESTAGE STRATEGY



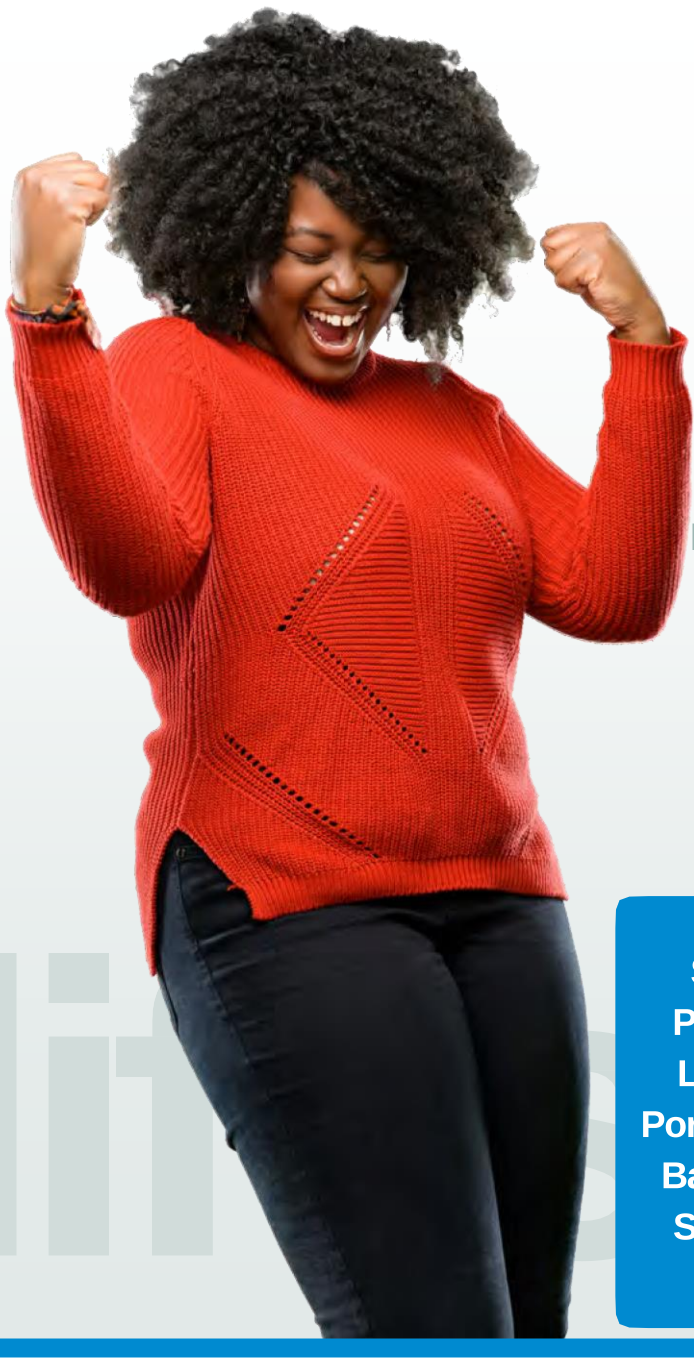
PROTECTION STRATEGY



In the Lifestage approach, a member's savings are initially invested in a portfolio that emphasizes long-term capital growth with some tolerance for short-term market volatility.

As retirement approaches, this target date strategy invests in an investment portfolio matching the member's post-retirement needs or plans, but in the years prior to this greater emphasis is placed on achieving capital growth.

Lifestage Strategy



6 YEARS FROM RETIREMENT AGE

Accumulation phase

All members with **more than 6 years** from Retirement Age

GROWTH

The Accumulation Phase Portfolio aims to provide market-related capital growth to members who need to grow their retirement savings and have more than six years from retirement.

Sanlam Accumulation Portfolio or **Sanlam Blue Lifestage Accumulation Portfolio** or **Satrix Enhanced Balanced Tracker Fund** or **Sanlam Wealth Creation Portfolio**

While each lifestage strategy utilises a different accumulation phase portfolio, all of the Trustee-approved lifestage strategies utilises the Sanlam Capital Protection Portfolio in the preservation phase.

The phasing from the accumulation phase portfolio to the preservation phase portfolio is calculated and implemented monthly based on members' actual age, with no cost to the member. The first phasing switch disinvests 1/50th of exposure in the accumulation phase portfolio and re-invests the proceeds in the preservation phase portfolio. The second monthly phasing switches a further portion of the exposure in the accumulation phase portfolio and invests the proceeds in the preservation phase portfolio.

The third monthly phasing switches a similar portion of the exposure in accumulation phase portfolio and invests the proceeds in the preservation phase portfolio. The monthly phasing switches are repeated until, after 50 switches, the exposure to the accumulation phase portfolio is zero and the member is fully invested in the preservation phase portfolio 22 months prior to retirement.

The Fund's communication strategy makes provision for the distribution of communication to members 7 years, 6.5 years and 1 year before retirement date.

22 MONTHS FROM RETIREMENT AGE

RETIREMENT AGE

Systematic automated monthly transition

All members with less than **6 years but more than 22 months** from Retirement Age

50 MONTHLY

Transition from the accumulation phase to the preservation phase takes place by means of **50 monthly switches**

- Sanlam Accumulation Portfolio
- Sanlam Blue Lifestage Accumulation Portfolio
- Satrix Enhanced Balanced Tracker Fund
- Sanlam Wealth Creation Portfolio

Preservation phase

All members with **22 months and less remaining** from Retirement Age

PROTECTION

A preservation phase portfolio protects a member against the specific risks inherent in the purchase of an annuity

- Sanlam Capital Protection Portfolio

This portfolio was selected as the preservation strategy given its objective to protect the invested capital by guaranteeing the net contributions invested.

Accumulation phase

Portfolios offered in Lifestage strategies

Sanlam Accumulation *Lifestage*

The Sanlam Accumulation Portfolio aims to provide market-related growth to members who are more than six years from retirement and who need to grow their retirement savings. The portfolio allocates its assets across equity, bond, property, cash, hedge fund and international portfolios. In the case of each domestic portfolio a core/satellite investment strategy is employed. The core is a low-cost index-tracking strategy, around which the satellite managers aim for active returns through the outperformance of their respective benchmarks. The portfolio has an aggressive risk profile.

Sanlam Blue *Lifestage*

The Sanlam Blue Lifestage Accumulation Portfolio aims to invest 50% in SIM Balanced Fund and 50% in SPW Balanced Fund. Both portfolios invest in a wide spectrum of investments in equity, bonds, money and property markets in order to maximise total returns over the long term. By investing in a portfolio which diversifies across all the major asset classes, investors “outsource” the difficult decision of how much and when to invest in the different asset categories to the fund manager. The portfolio is suitable for investors requiring capital growth via a moderate-aggressive risk balanced portfolio.

Accumulation phase

Portfolios continue

Sanlam Passive *Lifestage*

The portfolio's objective is to provide high long-term investment growth. It invests primarily in equities, property, fixed-interest investments, cash and foreign assets. Each of the underlying asset classes, except cash, is managed on a passive basis - in other words, by tracking an underlying index. Tactical asset allocation is also employed to enhance the performance of the fund relative to the performance of its benchmark. The underlying portfolio is the Satrix Enhanced Balanced Tracker Fund. The portfolio has a moderate to aggressive risk profile.

Sanlam Wealth Creation

Lifestage

The portfolio’s objective is to deliver superior real returns over the long term. This balanced portfolio is managed in a multi-manager basis and includes international exposure.

Each manager has been selected on the basis of rigorous quantitative and qualitative analysis. The underlying managers of the portfolio have been selected, mandated, monitored and reviewed by a Joint Investment Committee.

Lifestage Preservation Portfolio

Sanlam Capital Protection Portfolio

This portfolio was selected as the preservation strategy given its objective to protect the invested capital by guaranteeing the net contributions invested.

The portfolio invests in the Sanlam Stable Bonus Portfolio. The Stable Bonus Portfolio provides investors with exposure to the financial markets, which provides investors with exposure to equity markets, but also protects them against adverse market movements. This is achieved by smoothing the returns over time and guaranteeing the net contributions invested together with the vested bonuses in case of resignation, retirement, death, retrenchment or disability..

Non-vested bonuses are also declared over and above the vested bonuses. These can be removed in very extreme circumstances though this has never yet occurred since the portfolio's commencement in 1986.

The underlying portfolio has a diversified exposure to domestic equity, bonds, property and alternative investments as well as international assets. The portfolio has a conservative risk profile.

Protection Strategies Portfolios

Sanlam Secure Strategy

The trustees have approved an alternative default investment strategy suitable for members who wish to achieve inflation-beating real returns over the medium to long term, but who are particularly concerned against significant short-terms investment losses.

The strategy will most likely result in lower returns than the Lifestage Strategies over the long term as a consequence or the implicit cost the underlying guarantees and lower effective equity exposure. Nonetheless, the trustees recognise that such a strategy is suitable for many members – particularly those members who are not financially sophisticated and who might not appreciate that a high equity exposure inevitably implies some risk of capital loss over the short-term.

The strategy could be considered by investors preferring a cautious approach to money management; investors who require capital security and investors who regard financial security as highly important. The strategy currently invests all contributions in the Sanlam Monthly Bonus Fund which declares fully vesting bonuses with full guarantees.

Sanlam Stable Strategy

The trustees have approved an alternative default investment strategy, suitable for members who wish to have exposure to the financial markets, while protecting themselves against adverse movements in the markets.

This is achieved by smoothing the returns over time, and guaranteeing (for resignation, retirement, death, retrenchment and disability events) the net contributions invested together with the vested bonuses.

Non-vested bonuses are also declared on top of that. These can be removed in very extreme circumstances though this has never yet occurred since the portfolio's commencement in 1986.

The strategy could be considered by investors preferring a cautious, arm's-length approach to money management; investors wishing to avoid any chance of losing money; investors who require capital security and investors who regard financial security as highly important. The strategy currently invests all contributions in the Sanlam Stable Bonus Portfolio.

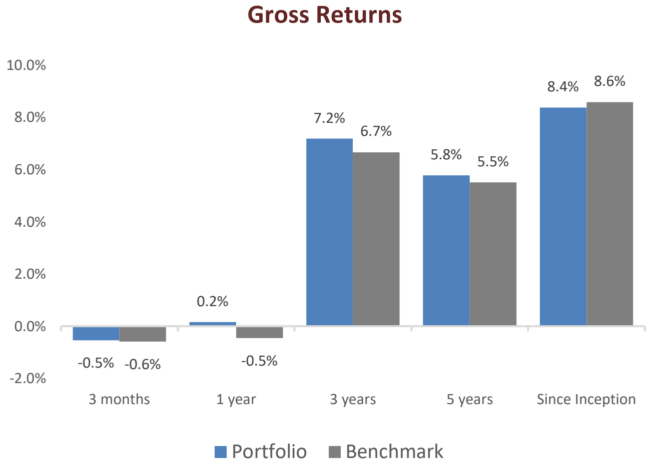
Volatility Protection Strategy

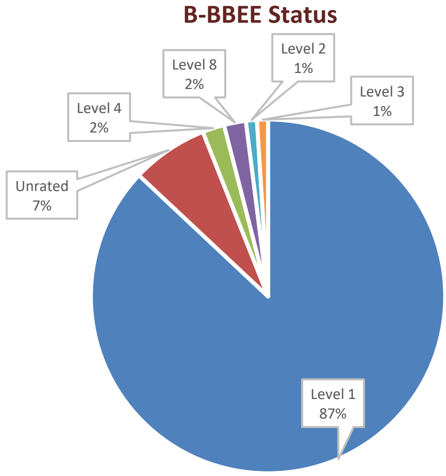
The default investment strategy is suitable for members who wish to achieve inflation-beating real returns over the medium to long term, but who are particularly concerned about protecting against significant short-term investment losses.

The strategy will most likely result in lower returns than the four Lifestage strategies over the long term as a consequence of the implicit cost of the underlying guarantees and lower effective equity exposure. Nonetheless, the trustees recognise that such a strategy is suitable for many members – particularly those members who are not financially sophisticated and who might not appreciate that a high equity exposure inevitably implies some risk of capital loss over the short-term.

The trustees review the investment strategy of the Volatility Protection Strategy continually and will make periodic changes to the underlying investments in line with the objectives of the strategy. The Volatility Protection Strategy aims to invest 75% in the Sanlam Monthly Bonus Fund and 25% in the Satrix Enhanced Balanced Tracker Fund.

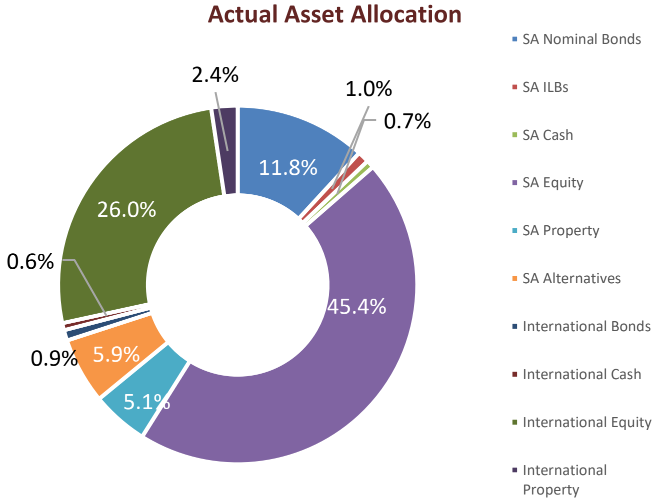
Sanlam Accumulation Lifestage
Sanlam Accumulation Portfolio

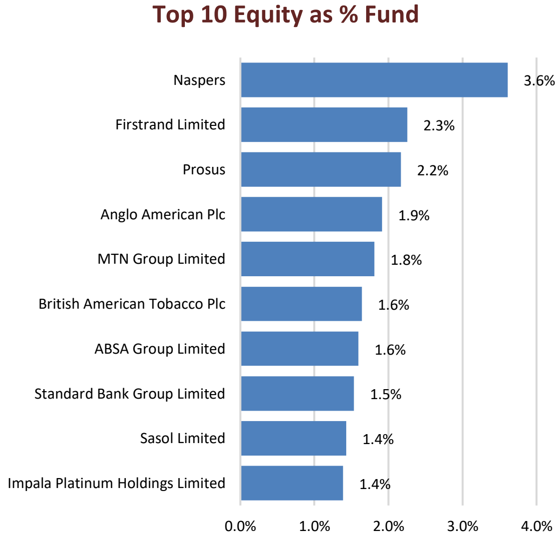




The Sanlam Accumulation Portfolio returned -0.5% for the quarter and 0.2% for the one year ended 30 September 2022.

Within manager selection, SA Equity, SA Property, SA Bonds, SA Hedge Funds, Offshore Africa Equity and Foreign Bonds added value. SA ILBs, SA Cash, SA Absolute Return was neutral while other assets namely Foreign Equity, Offshore EM Equity, Foreign Property and Foreign Cash detracted from performance from a manager selection perspective. On the asset allocation side, allocation to SA Property, SA Bonds, SA Hedge Funds, Offshore Africa Equity and Foreign Property contributed positively to performance while SA Equity, SA Cash, Foreign Equity, Offshore EM Equity, Foreign Bonds and Foreign Cash detracted from it. The remaining assets were neutral.

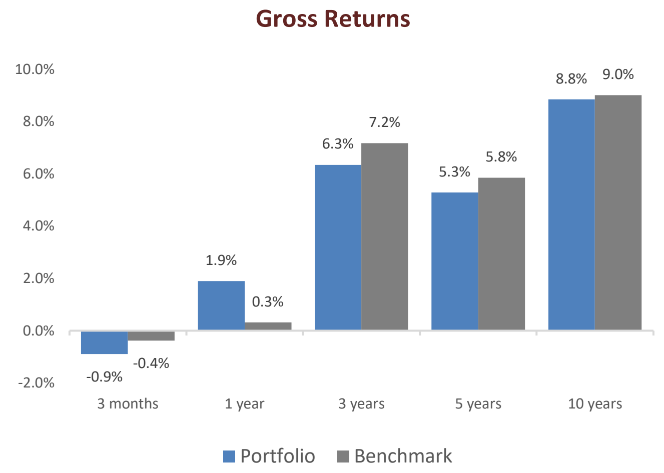


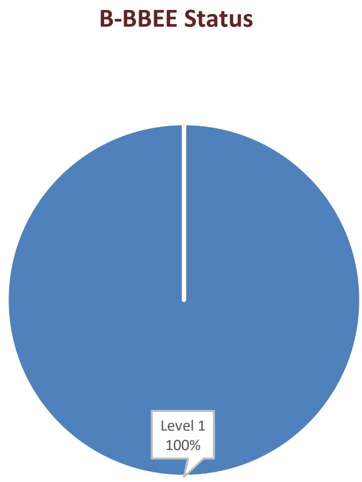


Looking at the current composition of the portfolio, the overweight positions are SA Equity, SA Bonds, SA Hedge Funds, Offshore Africa Equity and Offshore EM Equity. The underweight positions in the portfolio are SA Property, SA ILBs, SA Cash, Foreign Equity, Foreign Property and Foreign Bonds.

Sanlam Blue Lifestage

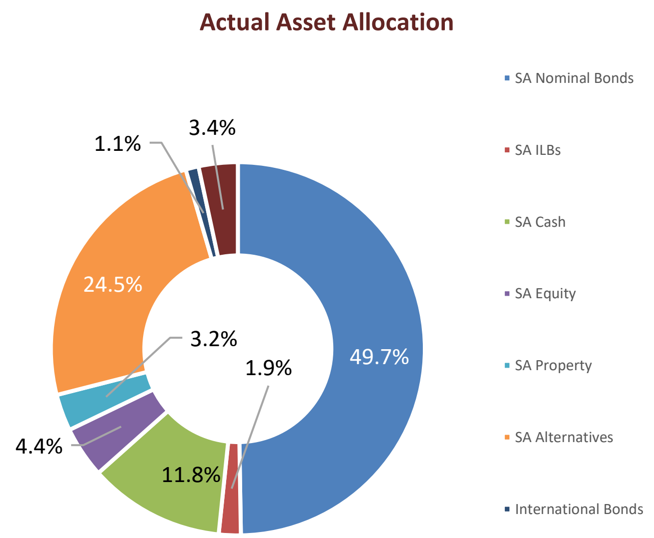
Sanlam Blue Lifestage Accumulation Portfolio

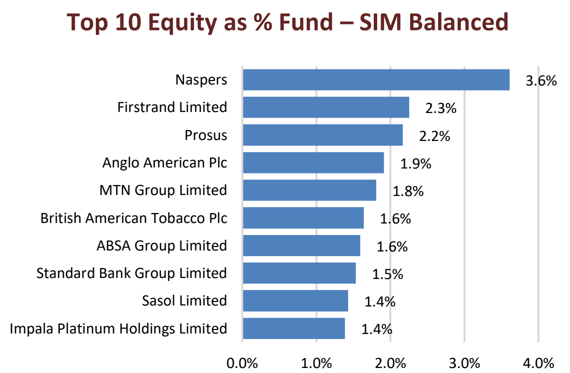


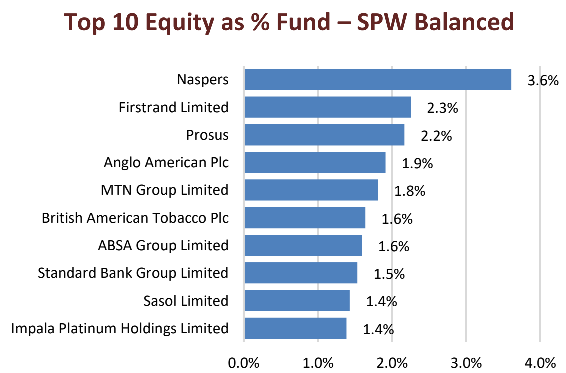


The Sanlam Blue Accumulation Portfolio returned -0.9% for the quarter and 1.9% for the one year ended 30 September 2022.

SIM Balanced Fund (48.8%) utilizes Alexander Forbes Global Large Manager Watch Median as its benchmark, for the quarter ended 30 September 2022, the portfolio returned a negative return of 1.3% compared to -0.9% by the benchmark. Looking at the one-year return, the SIM Balanced portfolio return -0.40% vs a benchmark which returned 0.10%. On the other hand, SPW Balanced Fund uses the Gross ASISA South African MA High Equity as its benchmark, the portfolio returned -0.5% vs. 0.1% benchmark return over the quarter ended 30 September 2022. Over the one-year period, the SPW Balanced Fund delivered positive return of 4.2% which outperformed its benchmark (1.0%).





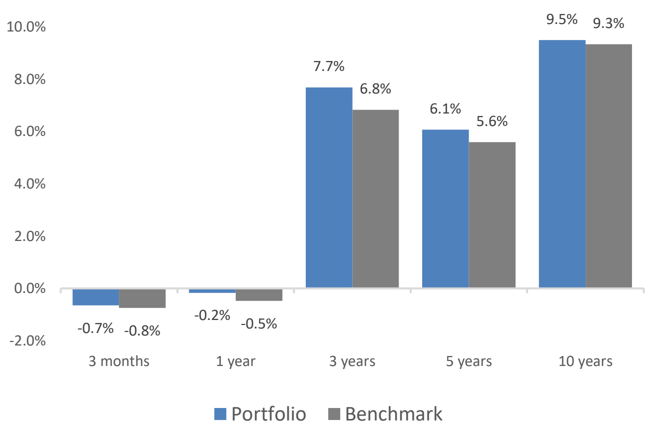


The assets allocation for Sanlam Blue Lifestage Accumulation Portfolio were calculated using the actual splits between SIM Balanced Fund and SPW Balanced Fund of 48.8% and 51.2% respectively as of 30 September 2022.

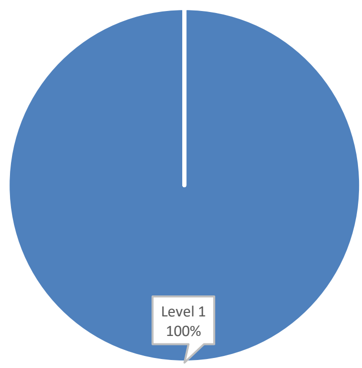
Sanlam Passive Lifestage

Satrix Enhanced Balanced Tracker Fund

Gross Returns



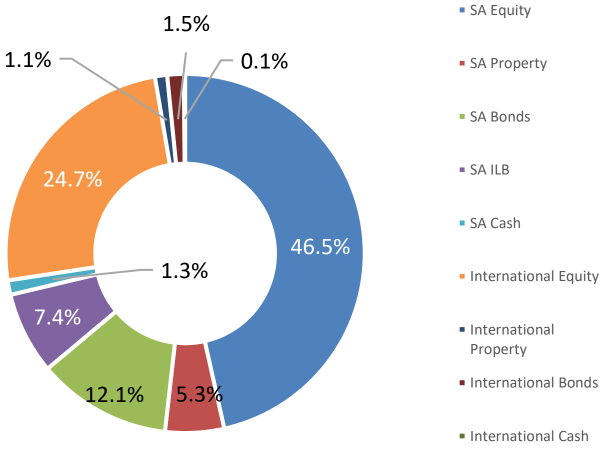
B-BBEE Status



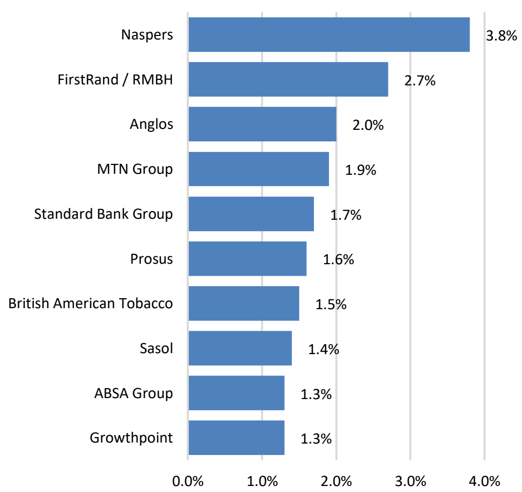
The Satrix Enhanced Balanced Tracker Fund returned -0.7% for the quarter and -0.2% for the one year ended 30 September 2022.

For the quarter ended 30 September 2022, Satrix Enhanced Balanced Tracker Fund outperformed its benchmark by 0.1%. Looking at stock selection, within international assets the contribution to excess performance was 0.2% while local fixed assets detracted by 1.2%. Local cash and local equity stock selection contributed 0.03% and 0.01% respectively while other assets classes remained neutral. As a result, the total contribution by stock selection to the total excess performance amounted to 0.01%. Assets allocation contributed 0.09%, the main contributors were local cash (1.0%) and local equity (0.6%) while the main detracted were from structured products (-1.3%) and Local fixed assets (-0.2%).

Actual Asset Allocation



Top 10 Equity as % Fund

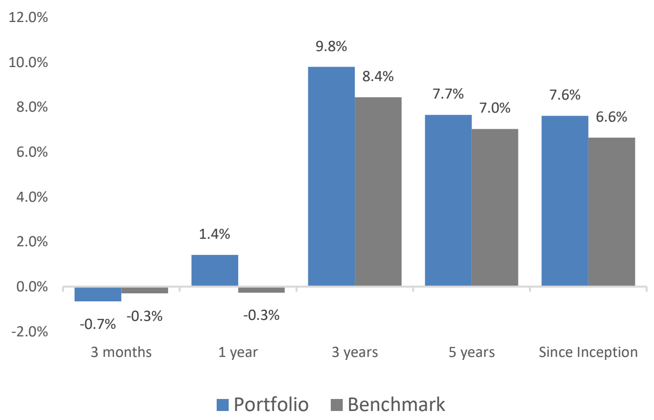


Looking at the current composition of the portfolio, the overweight positions are SA Equity, SA Nominal Bonds, SA ILBs, International Equity and International Cash. The underweight positions in the portfolio are SA Property, SA Cash, International Property and International Bonds.

Sanlam Wealth Creation Lifestage

Sanlam Wealth Creation Portfolio

Gross Returns



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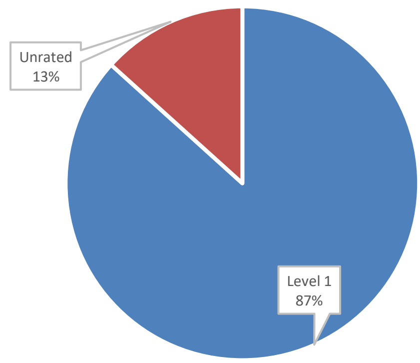
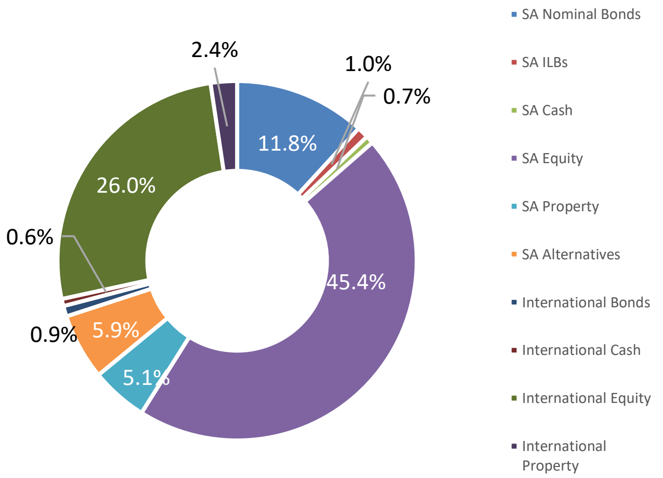


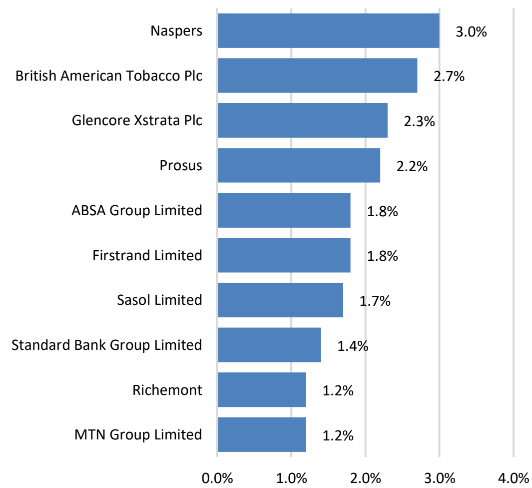
The Sanlam Wealth Creation Portfolio returned -0.7% for the quarter and 1.4% for the one year ended 30 September 2022. The portfolio underperformed its benchmark over the last quarter but continues to deliver stunning returns ahead of 7.0% p.a. over the longer periods and well ahead of its benchmark.

*Returns prior to 1 August 2022 are reflective of the Sanlam Wealth Creation portfolio structured on the AlexForbes life license

Actual Asset Allocation

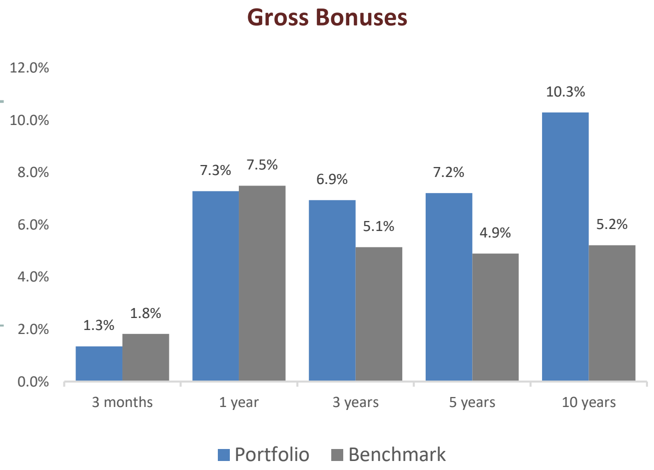


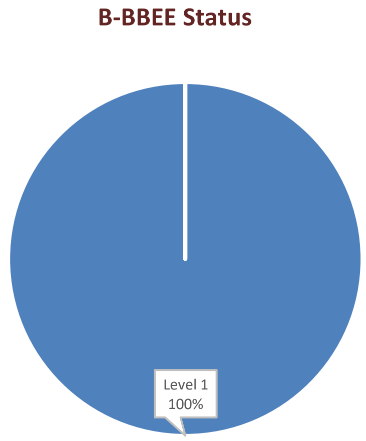
Top 10 Equity as % Fund



Sanlam Wealth Creation Portfolio is a Domestic Balanced Portfolio with a specialist offshore approach. This is a multi-asset, multi managed portfolio and have exposure to all the major asset classes, including offshore. The portfolio benchmark comprises of 52% Alexander Forbes SA Large Manager Watch (Median), 13% Capped FTSE/JSE Shareholder Weighted Total Return Index (Capped SWIX), 7% BEASSA ALBI Total Return Index, 25% MSCI World All Country Index and 3% JP Morgan Global Government Bond.

Preservation phase portfolio
Sanlam Capital Protection Portfolio

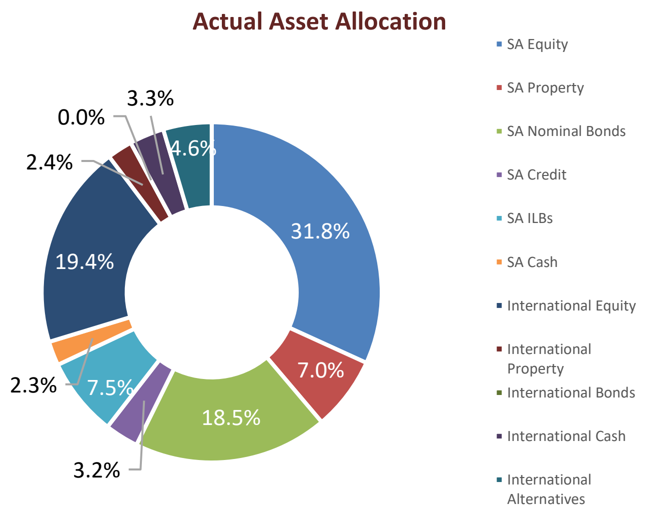


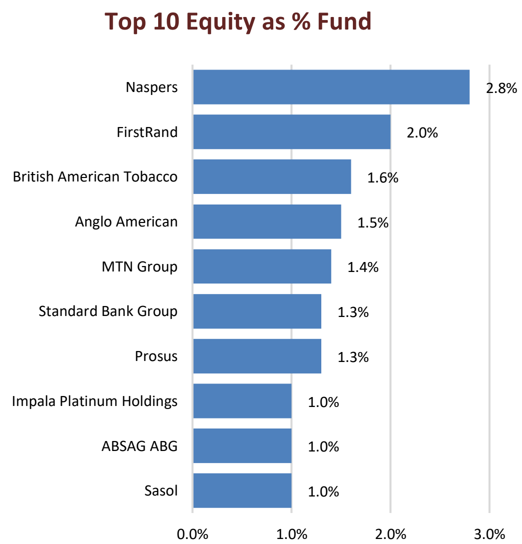


The Sanlam Capital Protection Portfolio returned 1.3% for the quarter and 7.3% for the one year ended 30 September 2022.

For the quarter ended 30 September 2022, the underlying portfolio for the Sanlam Capital Protection Portfolio outperformed its benchmark by 0.1% over the quarter. Assets allocation detracted from access performance by 0.18% while stock selection contributed 0.33% toward excess performance.

*Inflation is lagged by one month

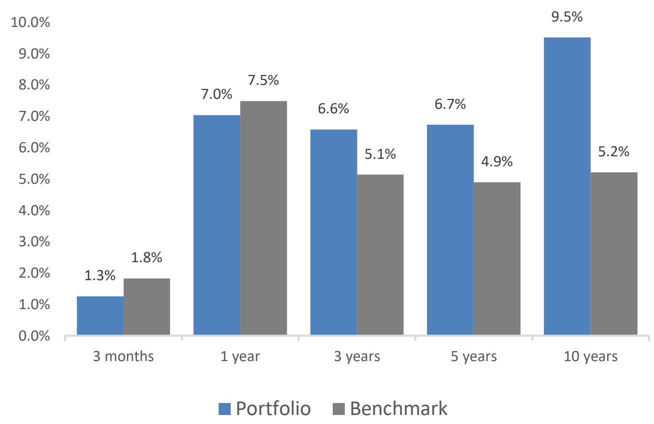




Looking at the current composition of the portfolio, the overweight positions are SA ILBs, International Property, International Alternatives, International Equity, International Cash and SA Property. The underweight positions in the portfolio are SA Cash, International Bonds, SA Credit, SA Nominal Bonds and SA Equity.

Sanlam Secure Strategy
Sanlam Monthly Bonus Fund

Gross Bonuses



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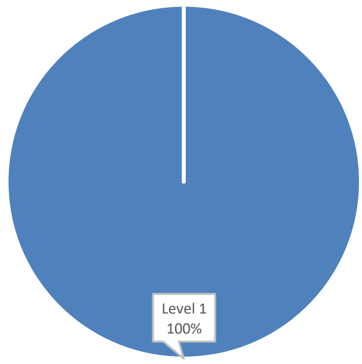
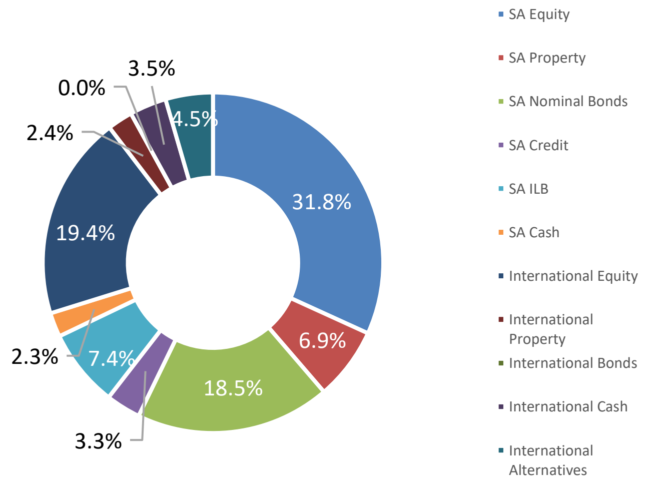


The Sanlam Monthly Bonus Fund returned 1.3% for the quarter and 7.0% for the one year ended 30 September 2022.

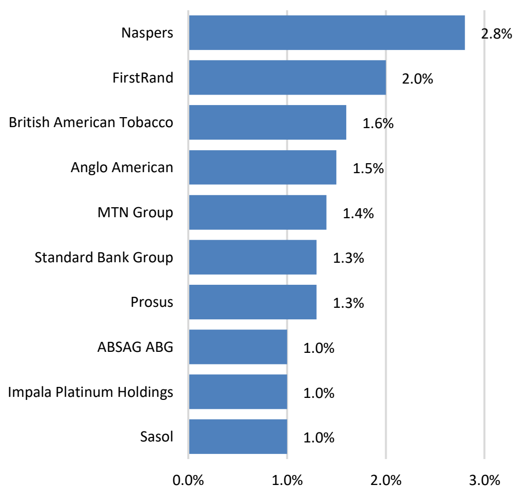
For the quarter ended 30 September 2022, the underlying portfolio for Sanlam Monthly Bonus Fund outperformed it benchmark by 0.1%. Assets allocation detracted from access performance by 0.19% while stock selection contributed 0.33% toward excess performance.

*Inflation is lagged by one month

Actual Asset Allocation



Top 10 Equity as % Fund

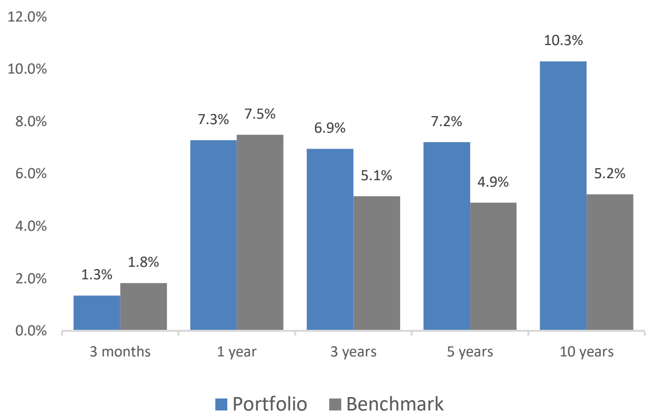


Looking at the current composition of the portfolio, the overweight positions are SA ILBs, International Property, International Alternatives, International Equity, International Cash and SA Property. The underweight positions in the portfolio are SA Cash, International Bonds, SA Credit, SA Nominal Bonds and SA Equity.

Sanlam Stable Strategy

Sanlam Stable Bonus Portfolio

Gross Bonuses



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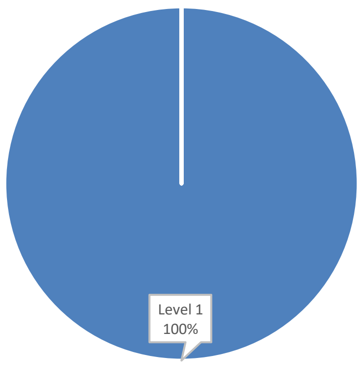
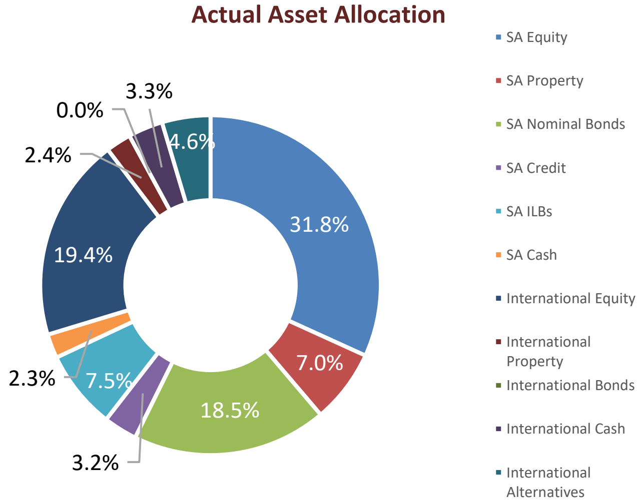


The Sanlam Stable Bonus Portfolio returned 1.3% for the quarter and 7.3% for the one year ended 30 September 2022.

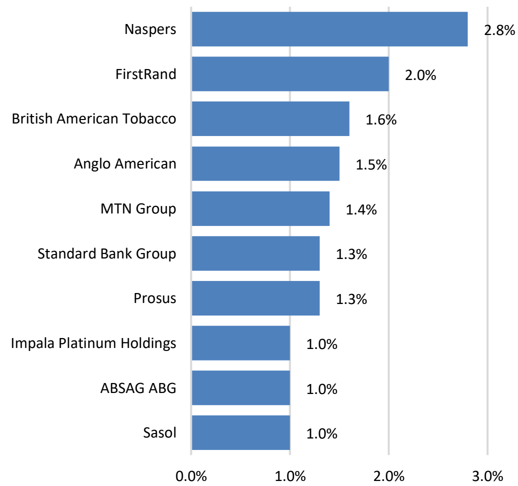
For the quarter ended 30 September 2022, the underlying portfolio for the Sanlam Stable Bonus Portfolio outperformed its benchmark by 0.1% over the quarter. Assets allocation detracted from access performance by 0.18% while stock selection contributed 0.33% toward excess performance.

*Inflation is lagged by one month

Actual Asset Allocation

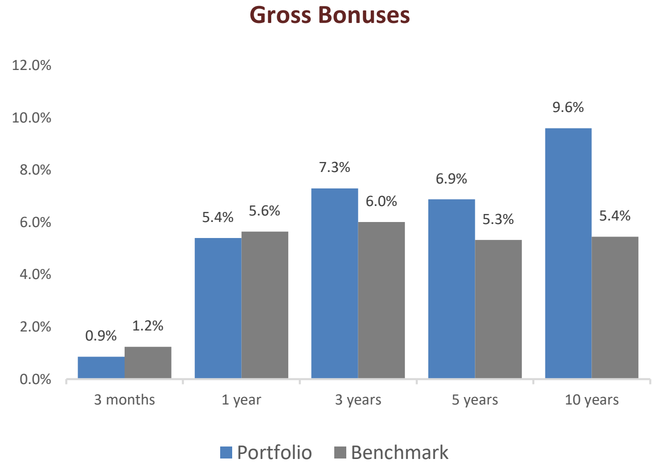


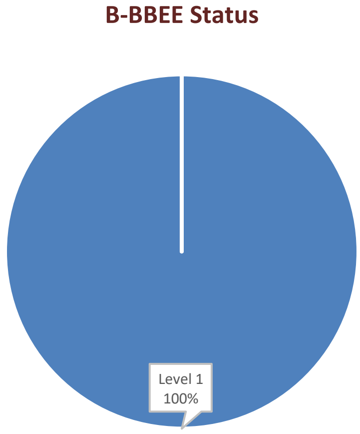
Top 10 Equity as % Fund



Looking at the current composition of the portfolio, the overweight positions are SA ILBs, International Property, International Alternatives, International Equity, International Cash and SA Property. The underweight positions in the portfolio are SA Cash, International Bonds, SA Credit, SA Nominal Bonds and SA Equity.

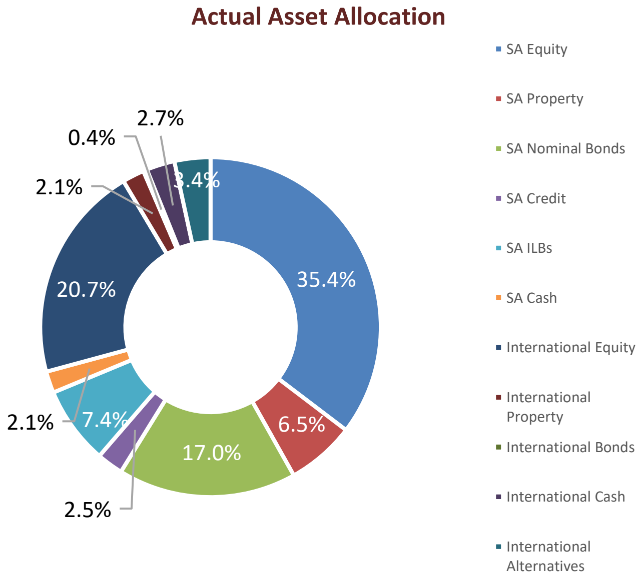
Volatility Protection Strategy
Sanlam Capital Protection Portfolio

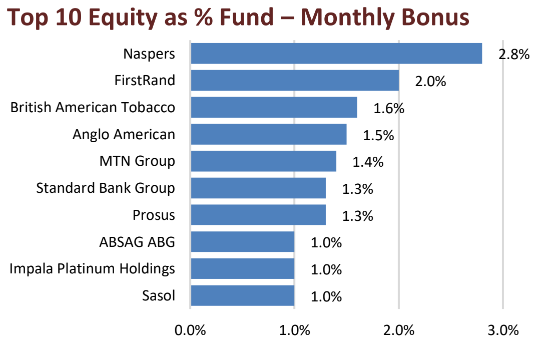


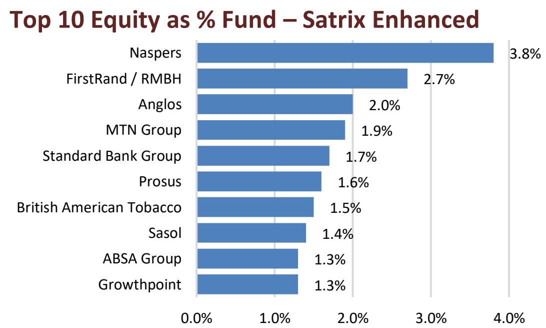


The Volatility Protection Strategy returned 0.9% for the quarter and 5.4% for the one year ended 30 September 2022.

For the quarter ended 30 September 2022, the underlying portfolio for the Sanlam Capital Protection Portfolio outperformed its benchmark by 0.1% over the quarter. Assets allocation detracted from access performance by 0.18% while stock selection contributed 0.33% toward excess performance. For the quarter ended 30 September 2022, Satrix Enhanced Balanced Tracker Fund outperformed its benchmark by 0.1%. Looking at stock selection, within international assets the contribution to excess performance was 0.2% while local fixed assets detracted by 1.2%. Local cash and local equity stock selection contributed 0.03% and 0.01% respectively while other assets classes remained neutral. As a result, the total contribution by stock selection to the total excess performance amounted to 0.01%. Assets allocation contributed 0.09%, the main contributors were local cash (1.0%) and local equity (0.6%) while the main detracted were from structured products (-1.3%) and Local fixed assets (-0.2%).







Looking at the current composition of the portfolio, the overweight positions are SA ILBs, International Property, International Alternatives, International Equity, International Cash and SA Property. The underweight positions in the portfolio are SA Cash, International Bonds, SA Credit and SA Equity. The strategy is currently neutral on , SA Nominal Bonds.

Performance summary

30 September 2022	3 months	6 months	1 year	3 years	5 years	SI
Accumulation Phase						
Sanlam Lifestage						
Sanlam Accumulation Portfolio	-0.5%	-7.6%	0.2%	7.2%	5.8%	8.4%
Benchmark	-0.6%	-7.9%	-0.5%	6.7%	5.5%	8.6%
Sanlam Blue Lifestage						
Sanlam Blue Accumulation Portfolio	-0.9%	-4.7%	1.9%	6.3%	5.3%	10.8%
Benchmark	-0.4%	-5.6%	0.3%	7.2%	5.8%	10.8%
Sanlam Passive Lifestage						
Satrix Enhanced Balanced Tracker Fund	-0.7%	-7.9%	-0.2%	7.7%	6.1%	9.5%
Benchmark	-0.8%	-7.9%	-0.5%	6.8%	5.6%	9.6%
Sanlam Wealth Creation						
Sanlam Wealth Creation Portfolio*	-0.7%	-6.0%	1.4%	9.8%	7.7%	7.6%
Benchmark	-0.3%	-6.4%	-0.3%	8.4%	7.0%	6.6%
Preservation Phase						
Capital Protection Portfolio**	1.3%	3.0%	7.3%	6.9%	7.2%	11.7%
CPI***	1.8%	4.2%	7.5%	5.1%	4.9%	5.5%

**Returns prior to 1 August 2022 are reflective of the Sanlam Wealth Creation portfolio structured on the AlexForbes life license*
*** The Capital Protection Portfolio does not have an explicit benchmark.*
****CPI figures are calculated to end of August 2022*

Performance summary

30 September 2022	3 Months	6 months	1 year	3 years	5 years	SI
Sanlam Secure Strategy						
Sanlam Monthly Bonus Fund	1.3%	2.8%	7.0%	6.6%	6.7%	10.4%
CPI*	1.8%	4.2%	7.5%	5.1%	4.9%	5.5%
Sanlam Stable Strategy						
Sanlam Stable Bonus Portfolio	1.3%	3.0%	7.3%	6.9%	7.2%	11.7%
CPI*	1.8%	4.2%	7.5%	5.1%	4.9%	5.5%
Volatility Protection Strategy						
Volatility Protection Strategy	0.9%	0.1%	5.4%	7.3%	6.9%	11.0%
Benchmark	1.2%	1.2%	5.6%	6.0%	5.3%	5.6%

**CPI figures are calculated to end of August 2022*

Macroeconomic commentary

Highlights

Global

- Risk assets sell-off on rising bond yields; higher terminal interest rate Fed
- International Monetary Fund (IMF) revises global growth lower
- September Federal Open Market Committee (FOMC) minutes dent any hopes of near-term rate pivot
- UK's unfunded tax cuts drive currency and bond market sell-off

Local

- Medium-term Budget Policy Statement (MTBPS) to record lower fiscal deficit for 2022/23 fiscal year but greylisting remains a headwind
- SA Reserve Bank (SARB) raises rates 75 basis points in 3:2 vote

Global economics

Global Equities

The sell-off in global equities continued in the third quarter of the year as central banks retained their hawkish stance on interest rates, even in the face of a pending global recession. The MSCI World Index fell by 6.2% in US dollars (2.9% in rands), whereas emerging markets fell an even bigger 11.4% (in US dollars) amid expectations that further jumbo rate hikes by the US Fed would have a disproportionate effect on the growth outlook for these economies as central bankers attempt to shore up their currencies to reduce imported inflationary pressures and the risk of debt defaults. Fed fund futures pushed higher, signaling a higher terminal rate of interest than the previous quarter. At quarter-end, nine-month fed fund futures were 104 basis points higher at 4.45%, only to rise further in October following the release of the US September inflation print. Given the higher-than-expected inflation reading, coupled with indications that inflation was becoming more broad-based as reflected in core inflation, the nine-month fed fund futures rate increased by a further 31 basis points to 4.94%, suggesting the terminal fed funds rate could be closer to 5%. Given the University of Michigan's o-year forward inflation gauge at 4.7%, the fed funds rate is expected to be positive-real in a year's time, lending some support to the projected terminal rate of interest. With bond yields rising across both the nominal and inflation-linked curves, equities derated in line with the higher real yield. US 10-year Tip yields increased to 1.69%, up meaningfully from 0.65% the previous quarter. While 10-year real yields are trading above their long-term mean, an over-shoot is expected until the terminal rate of interest is achieved, and economic growth slows substantially.

The risk of recession was highlighted in the IMF's October World Economic Outlook report that showed global growth slowing to 3.2% this year (from 6% in 2021) and to 2.7% in 2023. This is the weakest growth profile since 2001 except for the global financial crisis and the acute phase of Covid-19. The IMF warned that there was a 25% probability that global growth could fall to below 2%, a level that would be consistent with a global recession. It also estimated that a third of the global economy would contract this year or next. Within the major economies, US economic growth is expected to slow from some 1.6% this year to 1% next year, whereas EU growth is expected to slow from 3.1% to a mere 0.5%. Within the Eurozone, Germany and Italy are expected to record growth next year of -0.3% and -0.2% respectively, down from 1.5% and 3.2% this year. Growth in China is estimated at 3.2% this year – the lowest reading in four decades – before increasing to 4.4% in 2023.

Market-based indicators are also signaling recession with the US 10/2-year spread at -45bps, consistent with a recession. Although the 10-year/3-month spread is still positive, this is expected to invert post the Fed's 75 basis point increase expected in November. PMI indices are also contracting in the EU, US, UK and China, further pointing to a likely recession. But it is the Eurozone that is most at risk. With Europe's winter fast approaching, the imposition of energy demand destruction measures such as power cuts and consumption taxes will negatively impact output growth in the region, deepening the risk of recession. While energy subsidies will help lower headline and core inflation, the ECB is still expected to press ahead with jumbo rate hikes to curb aggregate demand, further adding to recession risks in the region. At this stage, however, a global recession is likely to be shallow rather than the deep recessions seen in 2008 and again in 2020.

Up to now, recession risks have been reflected in market prices as a result of multiple compressions from rising Tip yields, rather than a change in earnings expectations. Historically, consensus earnings estimate for the MSCI World Index have led market prices by around six months, but this time around, market prices have led earnings, highlighting how the macro-economic outlook is driving pricing action in markets. Due to the drawdowns in equity markets over most of the year, valuations have improved markedly with the forward price-to-earnings ratio trading at 14.3X earnings, below the 16X mean. For emerging markets, the forward price-to-earnings ratio of 10.6X is also below the mean of 15.5X, while in South Africa, the market is trading on a forward price-to-earnings ratio of 8.6X, well below the 13.1X average. Despite attractive valuations and double digit 12-month return expectations, downward revisions to consensus earnings estimates will be a headwind for equities over the near term, whereas over the longer term, expectations of a peak in the interest rate cycle will be a catalyst for an equity and bond market rally. Our base case view is that a Fed pivot is likely in the second half of 2023, supporting an overweight equity position on a six to twelve-month view. It should also be noted that following a 25%+ drawdown, the S&P500 has returned some 27% on average the following year, suggesting caution in aggressively underweighting equities at this point in time. Rather, investors should consider closing their underweight positions as the third quarter reporting earnings season is likely to surprise to the upside.

Global Bonds

The recalibration of the terminal fed funds rate, following the release of hawkish September FOMC minutes, triggered an upward shift in both nominal and inflation-linked bond yields over the quarter. The yield on the Bloomberg Global Aggregate Bond Index increased from 2.9% to 3.7%, dragging returns down by 6.9% in US dollars.

In rands, however, returns were positive (2.1%) over the quarter given rand depreciation of some 8.9%. Emerging market bonds fared slightly better, declining by 4.1% in US dollars as spreads held steady at around 405 basis points, even as the emerging market currency basket depreciated by some 6.2% against the US dollar. Due to rising default risks, global corporate bonds yielded -6.5% in US dollars as yields increased from 4.3% to 5.4%. While the Federal Open Market Committee (FOMC) minutes were the catalyst for the sell-off, the UK's unfunded tax reduction plan was a further headwind, triggering a sharp sell-off in the GBP and the UK gilt market. The UK 10-year bond yield increased from 2.2% to 4.09%, forcing a policy U-turn on economic policy by the Truss government. But it was inflation-linked bonds that bore the brunt of the rise in real bond yields given the high modified duration of the index. The yield on the Bloomberg Global Government Inflation-linked Bond Index increased from -0.06% to 0.81%, dragging returns down by a staggering 10% in US dollars and 1.2% in rands. The yield on the US 10-year Tip was also higher increasing from 0.65% to 1.68%, the primary cause of the equity market derating that took place over the month.

US break-even inflation was also lower with both the 5-year and 10-year rate declining sharply as the market digested expectations of more aggressive Fed rate hikes and a higher terminal fed funds rate. The five-year rate declined from 2.61% to 2.1% suggesting the Fed's inflation-fighting credentials remain intact. While bond yields are expected to rise further as the Fed continues to raise rates and withdraws liquidity from the market at a pace of $95billion per month (quantitative tightening), the current inversion in the yield curve will likely deepen. This bear market curve flattening – reflecting rising recession risks – is supportive of an overweight bonds' duration position on a six-to-twelve-month view. Over the near term, however, a neutral position is recommended in short duration bonds and enhanced cash, with an overweight position suggested on a six-to-12-month view. Given the current trade-off between inflation and recession, a barbell strategy is deemed the most appropriate bond market strategy for the year ahead.

Global Listed Property

The global listed property market bore the brunt of sharply higher bond yields in the third quarter, declining by a staggering 11.4% in US dollars and 2.8% in rands. The EPRA/NAREIT Developed Markets Property Index derated sharply with the price-to-book ratio declining from 1.3X to 1.13X, well below the 1.44X mean. With the front-loading of rate hikes expected to persist, at least until the end of the year, coupled with surging energy costs, declining real incomes and expected corporate layoffs, turnover growth and rental escalations are expected to be a headwind for the sector, lending support for an underweight near-term position. On a 6 to 12-month view, however, the sector is upweighted to neutral on relatively attractive valuations, an expected peak in the interest rate cycle and an easing in inflationary pressures.

Local economics

Local Equities

South African equities could not escape the freefall in markets in the third quarter of the year, with the All-Share Index declining by 1.9% in rands and 10.6% in US dollars, ahead of emerging market returns. Despite an 8.9% depreciation in the rand/US dollar exchange rate, resource counters yielded a -0.9% return, as most commodity prices fell – barring coal and palladium – on heightened recessionary risks. Palladium and coal $-prices were 17.3% and 13.2% higher, whereas cobalt (-26.3%), iron-ore (-18.9%), aluminium (-9.1%), gold (-8.0%) and copper (-7.3%) were all lower. With the composite industrial metals $-price index down some 16.9% for the quarter, the JSE's industrial metals index was 3.6% lower, while the precious metals index was 3.7% lower. The best performing of the heavyweight counters included African Rainbow Minerals (24.2%), Glencore PLC (14.3%) and BHP Group (8.1%), whereas the losers included Kumba Iron Ore (-21.3%), Sasol (-19.5%) and Sappi (-18.3%). Due to higher bonds yields, growth stocks fell some 3.1% – led by a 5.8% decline in technology stocks – whereas quality stocks declined by a more subdued 0.9%, reflecting investor demand for more defensive counters such as healthcare (1.0%) and consumer staples (0.6%). Consumer discretionary stocks were 2.4% higher, courtesy of a 2.4% return from Richemont. Financials also came under selling pressure, down some 4.2% as Capitec shares fell 24% in September after results pointing to an earnings slowdown and investor concerns around the quality of its unsecured R70bn loan book.

Following the 0.7% q/qsa contraction in second quarter GDP, the IMF revised SA's 2022 growth rate lower to 2.1%, down from the 2.3% July estimate, whereas growth for 2023 was also revised lower to 1.1%, down from 1.4% previously. The downward revision reflects the impact on food and oil prices from the ongoing conflict in Ukraine combined with fears of recession in the EU, UK and the US, and subdued growth in China. In addition to global factors, both the Absa and the S&P Global purchasing manager indices have fallen below the 50-point mark, indicating a contraction in overall business activity over the coming one to two quarters. Similarly, sharp declines in the BER Business Confidence Index and the BER Consumer Confidence Index also point to subdued growth going forward. The Business Confidence Index declined from 46 to 42 points, while the Consumer Confidence Index declined from -13 to -25 points, levels that are consistent with a recession. With load-shedding likely to persist over the coming quarters, if not years, power outages will remain a persistent constraint on overall growth. It is worth noting that load-shedding took place over 25 consecutive days in September, with many of these days at higher stages of blackouts.

The recent strike action at Transnet's rail and port operations will be a further headwind, if prolonged, the impact of which could be similar to the April KZN flooding those damaged parts of the country's rail and port infrastructure, dragging growth lower in the agriculture, mining and manufacturing sectors.

Despite the more subdued economic growth outlook, consensus earnings estimates point to positive earnings growth of some 4.5% over the coming year – before declining by some 1.0% in the second forecast year – primarily due to a 20% decline in resources earnings.

Following the market sell-off in the third quarter, valuations improved further with the forward price-to-earnings ratio declining from 8.8X to 8.6X, well below the 13.1X mean. Similarly, the forward price-to-earnings ratio for the MSCI SA Index decreased from 8.6X to 8.2X, largely due to the MSCI's higher weighting to resource shares. Relative to emerging markets and the MSCI World, the All-Share Index is trading at a discount of 23% and 43% respectively. Despite the attractive relative valuation of the domestic equity market, the amendment to Regulation 28 of the Pension Fund Act permitting funds to invest up to 45% of their assets offshore will be a headwind for equities, as funds diversify their portfolio holdings geographically. With commodity prices expected to soften further as global growth slows, the country's terms of trade will deteriorate with the rand likely to remain under pressure, at least over the next six months. However, with the US dollar expected to weaken as the US interest rate cycle peaks, rand appreciation will underpin SA Inc shares as imported inflation declines and interest rates ease. Given the inverse relationship between the ALSI and the rand/US dollar exchange rate, equities are upweighted to overweight from neutral on a six-to-twelve-month view.

Local Bond

South African bonds could not escape the rout in global markets as contagion spread across the globe, pushing up the yield on the All-Bond Index to 11.4% from 11.1% the previous quarter. Even a more subdued inflation print, at 7.6%, and expectations that inflation may have peaked in July, failed to stem the outflows. Consequently, the ALBI gained a pedestrian 0.6% in rands but declined by 8.3% in US dollars, underperforming the emerging market composite benchmark. The decline in headline CPI was mainly due to the lower fuel price which outweighed a surge in food inflation to 11.5% in August. Core inflation came in lower than expected at 4.4%, as several categories showed price increase moderation. Most notable was vehicle inflation that slowed to 5.8% from 6.3% in July. Although the decline in headline inflation is expected to continue, core inflation is likely to move higher as rental inflation and medical insurance normalize. But market expectations are that inflation will drop back into the SA Reserve Bank (SARB)'s target range in the second quarter of 2023, in line with their own estimates.

The SARB left its 2022 inflation estimate unchanged at 6.5%, but revised inflation lower over the coming years. The 2023 estimate was lowered to 5.3% from 5.7% – primarily due to lower food, fuel and core inflation forecasts – whereas inflation for 2024 was revised down to 4.6% from 4.7% previously. Core inflation was left unchanged at 4.3% for this year but was revised lower in 2023 to 5.4% from 5.6%, while the estimate for 2024 was also marginally lower at 4.8%, down from 4.9% at the previous Monetary Policy Committee (MPC) meeting.

Inflation-linked bonds were also caught in the contagion net, as yields on the CILI Inflation-linked Bond Index increased from 3.8% to 4.3%, dragging returns down by 1.0% in rands and 9.7% in US dollars.

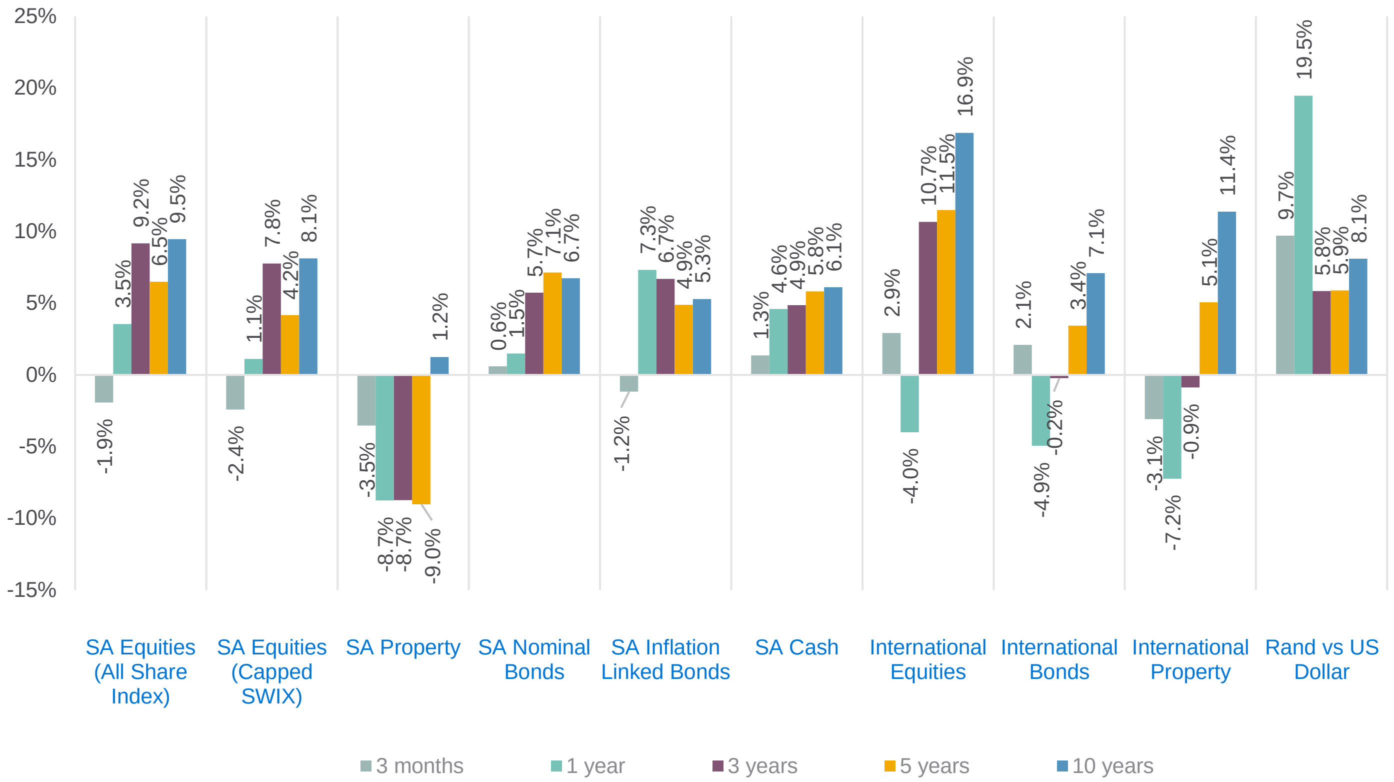
All eyes will, however, be on the Medium-term Budget Policy Statement in October for signs of capitulation by the Minister of Finance to political demands for the introduction of a basic income grant and additional funding for the NHI. With revenue receipts running well ahead of budget, the temptation may be to spend the windfall rather than to provision for future years when revenue is likely to fall short of budget as economic growth slows. For the first five months of the 2022/23 fiscal year, revenue is up some 10.2% year/year, well ahead of the 1.7% budgeted for. While VAT receipts are trending below budget (11.9% vs 12.5%), personal income tax and corporate tax revenues are up by 8.4% and 14.7% respectively, ahead of the 6.1% and -15.8% budgeted for in February. Similarly, with expenditure increasing by 3.3% over the comparable period, slightly behind the budgeted increase of 4.7%, the Minister could table a smaller-than-expected fiscal deficit for the year. Despite the improved fiscal outlook, South Africa's possible greylisting by the Financial Action Task Force in February next year could be a headwind for the bond market. While a greylisting would be tantamount to a ratings downgrade, leading to capital and currency outflows and higher transactional, administrative, and funding costs for banks, bond yields could push higher as the sovereign risk premium rises. Despite this risk, the overweight to nominal bonds is retained given the current high yields on offer.

Local Listed Property

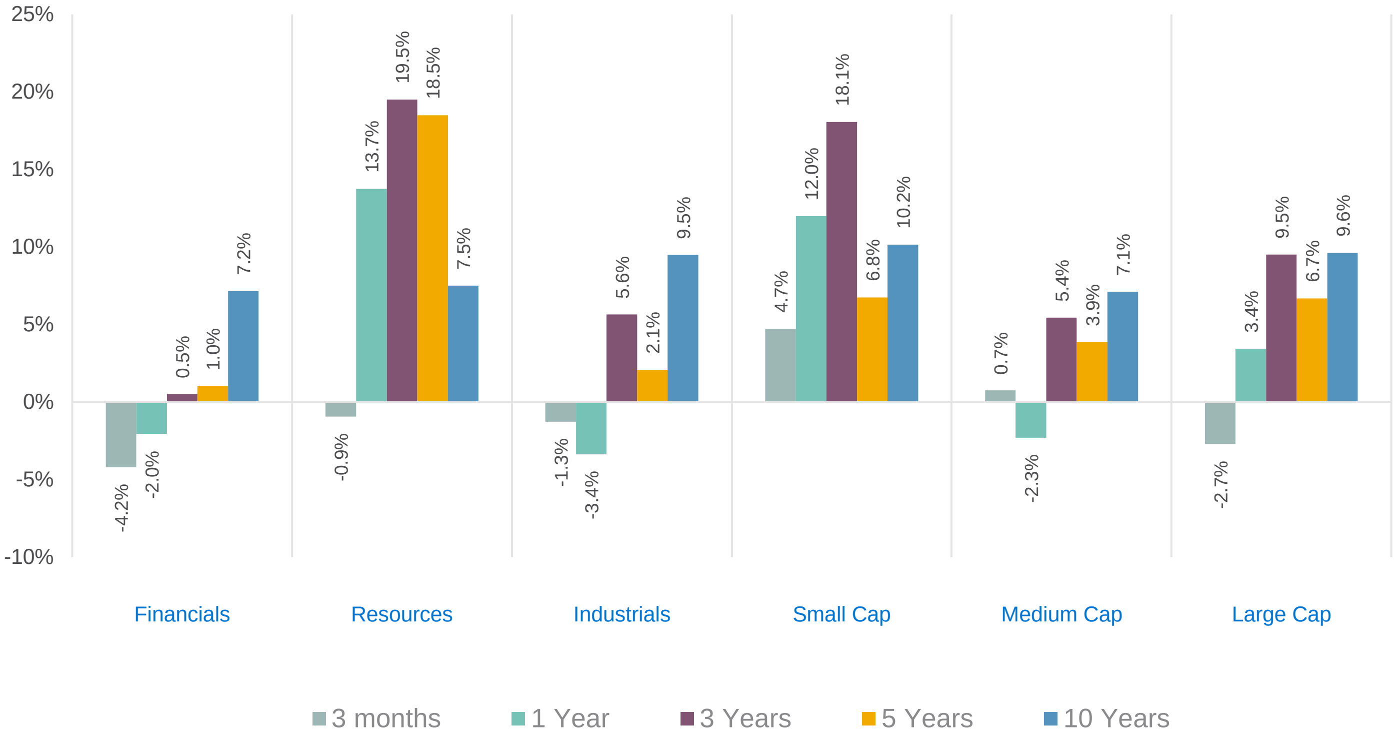
The rise in bond yields and the sharp sell-off in global listed property weighed heavily on the domestic listed property sector in the third quarter, with the SAPY declining by 3.5% in rands and 12.1% in US dollars. The sector derated relative to the 10-year bond yield, with the property-to-bond yield ratio rising to 0.94X from 0.88X, slightly ahead of the 0.9X long term mean. Dividends per share were 4.3% higher over the quarter, helping to partially offset some of the sector derating. Although the sector is now valued, an overshoot is expected given the trajectory of interest rate increases expected between now and the end of next year.

With discretionary spending likely to come under pressure from rising interest rates, high food and fuel costs and private sector wages not keeping up with inflation, consumers are expected to cut back on discretionary spending, limiting turnover growth in the year ahead. Consequently, the underweight to listed property is retained with listed equity exposure the preferred asset class in which to take on risk given the greater sector diversification on offer. The biggest losers over the quarter included Capco (-23.7%), Fortress A (-16.3%), Industrials REIT Ltd (-12.3%) and Lighthouse Capital (-11.0%), while the gainers included Liberty Two Degrees (31.0%), Attacq (22.3%), Emira (21.7%) and Fortress B (15.2%).

Market performance summary (in ZAR) to 30 September 2022



Equity Sector Performance summary (in ZAR) to 30 September 2022



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