Sanlam

Sanlam Corporate: Investments

Protection Strategies

Investment Report

Quarter 4 2022

Insurance | Financial Planning | Retirement | Investments | Wealth

Contents

Overview

In order to cater for divergent client preferences, the trustees of the **Sanlam Umbrella Fund** have approved the 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. These strategies provide different levels of guarantees and smoothing of investment returns for our clients.

The protection strategies consist of 3 options which members can invest in. (1) **Sanlam Secure Strategy** which invests 100% in the **Sanlam Monthly Bonus Fund,** (2) **Sanlam Stable Strategy** which invest 100% in **Sanlam Stable Bonus Portfolio,** and the (3) **Volatility Protection Strategy** which invest 75% in **Sanlam Monthly Bonus Fund** and 25% in **Satrix Enhanced Balanced tracker Fund**

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.

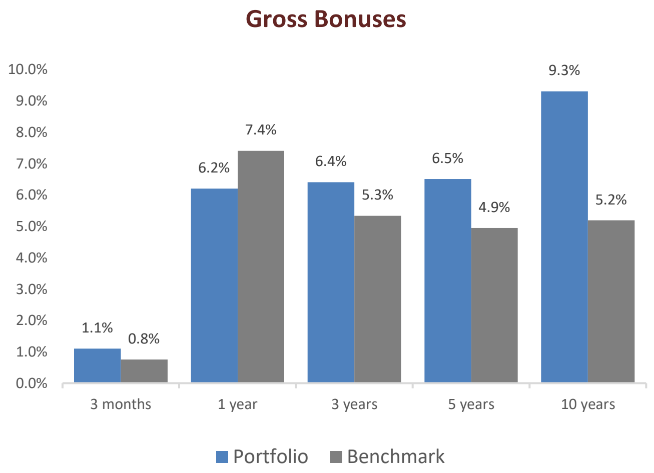
Volatility Protection Strategy

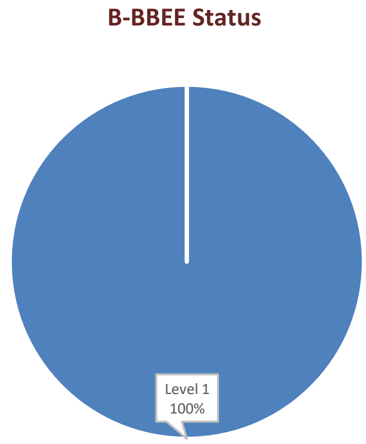
The default investment strategy is suitable for members who wish to achieve inflation-beating real returns over the medium to long term, but who are particularly concerned about protecting against significant short-term investment losses.

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 Secure Strategy
Sanlam Monthly Bonus Fund

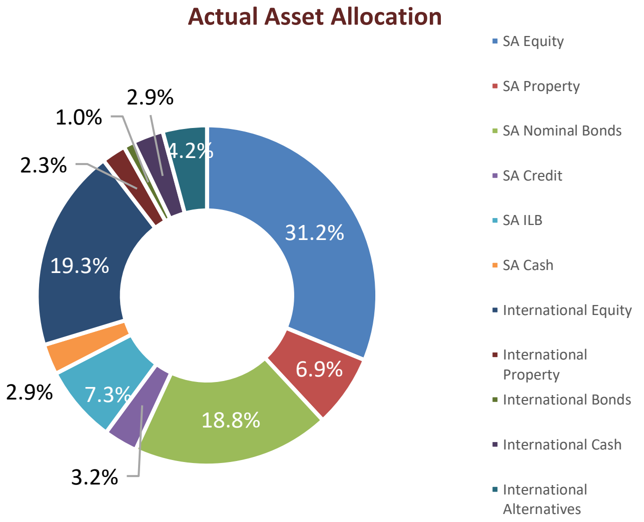


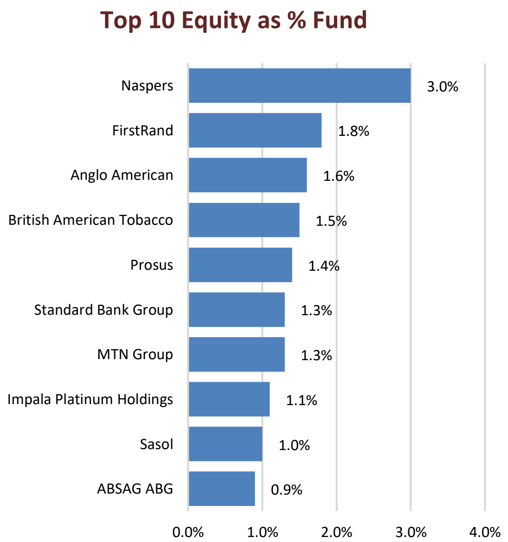


The Sanlam Monthly Bonus Fund returned 1.1% for the quarter and 6.2% for the one year ended 31 December 2022.

The returns over the last 10 years have exceeded inflation by 4.1% p.a. over the period. However, with sharply rising inflation and poor equity returns over the last year, one can see how the real after inflation return has decreased over the short-term. Sanlam can never remove or reduce any of the monthly bonuses once declared.

*Inflation is lagged by one month

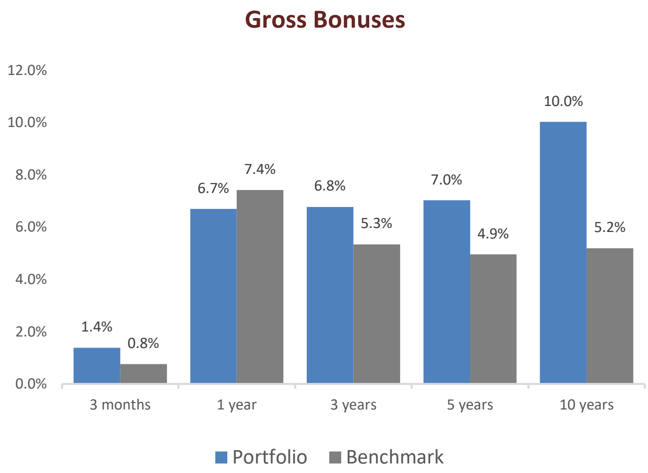


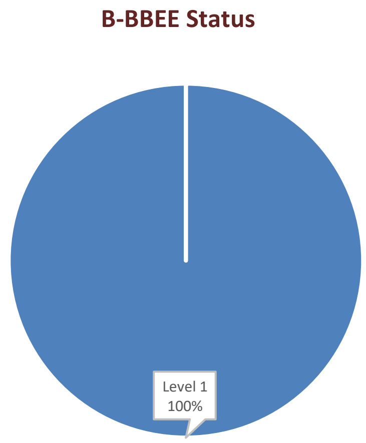


Looking at the current composition of the portfolio, the overweight positions are SA ILBs, International Cash, SA Equity, SA Property and SA Nominal Bonds. The underweight positions in the portfolio are SA Cash, SA Credit, International Bonds, International Alternatives, International Equity and International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

Sanlam Stable Strategy

Sanlam Stable Bonus Portfolio

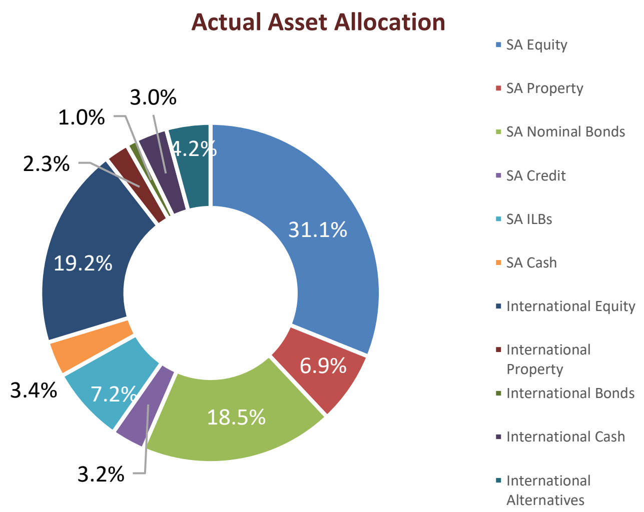


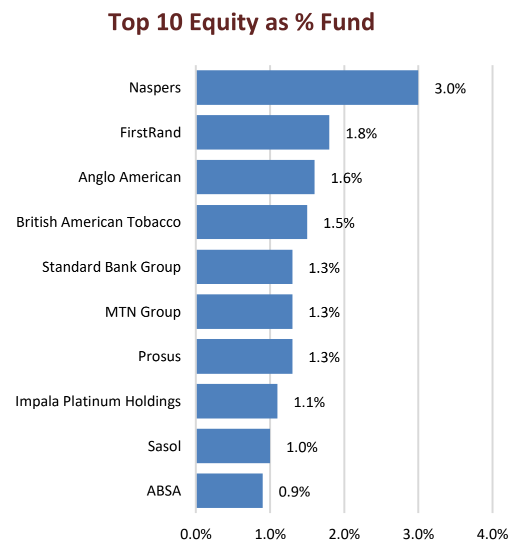


The Sanlam Stable Bonus Portfolio returned 1.4% for the quarter and 6.7% for the one year ended 31 December 2022.

Sanlam Stable Strategy provides monthly bonuses, roughly half of which is vesting and half non-vesting. In an extreme market downturn Sanlam may remove some of the accumulated non-vested bonuses, although we have not done so since launching the underlying portfolio in 1986. This strategy provided a real return of 4.8% p.a. over the last 10 years, with very stable and predictable returns over the period. Once again, we can see the impact of rising inflation over the short-term.

*Inflation is lagged by one month

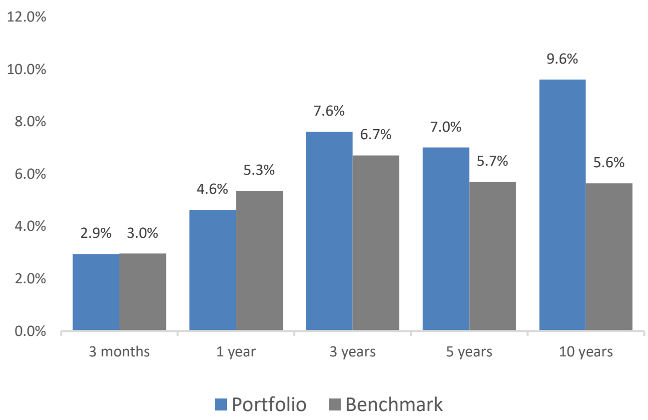




Looking at the current composition of the portfolio, the overweight positions are SA ILBs, International Cash, SA Equity, SA Property and SA Nominal Bonds. The underweight positions in the portfolio are SA Cash, SA Credit, SA Nominal Bond, International Bonds, International Equity, International Alternatives,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

Volatility Protection Strategy
Sanlam Capital Protection Portfolio

Gross Bonuses



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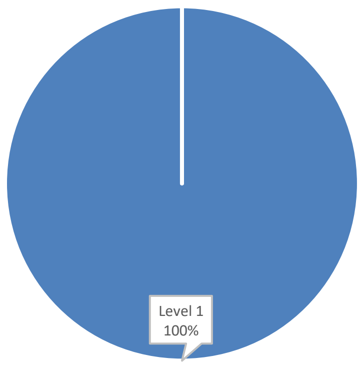
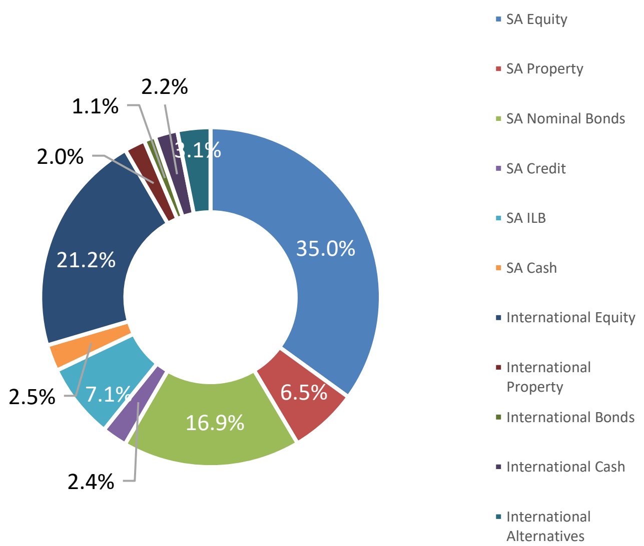


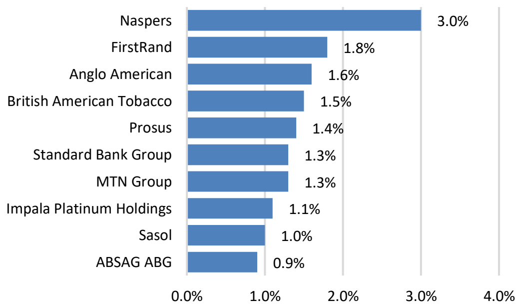
The Volatility Protection Strategy returned 2.9% for the quarter and 4.6% for the one year ended 31 December 2022.

The Volatility Protection Strategy has given a similar return to the Sanlam Secure Strategy over the last 10 years, but with a bit more volatility. This is due to the strategy since 2017 having a 25% exposure to the Satrix Enhanced Balanced Tracker fund, which is an aggressive passive portfolio. This passive component can add extra returns when markets are strong but, can lead to the strategy having occasional negative returns. It is important to note that the Volatility Protection Strategy does not provide a capital guarantee but provides returns which are far less volatile that a normal balanced fund.

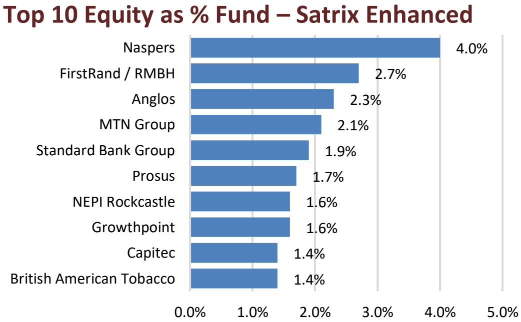
Actual Asset Allocation



Top 10 Equity as % Fund – Monthly Bonus



Top 10 Equity as % Fund – Satrix Enhanced



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

Performance summary

31 December 2022	3 Months	6 months	1 year	3 years	5 years	SI
Sanlam Secure Strategy						
Sanlam Monthly Bonus Fund	1.1%	2.4%	6.2%	6.4%	6.5%	10.5%
CPI*	1.0%	2.9%	7.2%	5.4%	4.9%	-
Sanlam Stable Strategy						
Sanlam Stable Bonus Portfolio	1.4%	2.7%	6.7%	6.8%	7.0%	11.6%
CPI*	1.0%	2.9%	7.2%	5.4%	4.9%	-
Volatility Protection Strategy						
Volatility Protection Strategy	2.9%	3.8%	4.6%	7.6%	7.0%	11.0%
Benchmark	3.0%	4.2%	5.3%	6.7%	5.7%	5.6%

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

Macroeconomic commentary

Highlights

Global

- World Bank revises 2023 global growth lower to 1.7% on synchronized slowdown
- US labour market strength may keep rates higher for longer, but productivity is key
- Fed raises rates a cumulative 125 basis points with the terminal rate also higher at 5% to 5.25%.
- ECB raises rates 50 basis points and signals March start to quantitative tightening
- BOJ expands 10-year bond yield target range to +/-50 basis points from +/-25 basis points
- Earnings downgrades on recession risks a headwind for equities in 2023

Local

- Cyril Ramaphosa secures a second term as ANC President and NEC elects new faces, purging the old.
- SARB slashed its 2023 growth forecast for SA to 0.3% from 1.1% at the time of the previous (November 2022) meeting.

Global economics

Global Equities

Risk assets rallied in the fourth quarter of the year, buoyed by expectations of a near-term peak in the interest rate cycle and a pivot on rates during 2023. However, persistent hawkish comments from the US Fed that rates would remain higher for longer with no pivot in 2023, saw equites sell off in December following two months of stellar gains. The MSCI World Index declined by 4.3% in US dollars (-4.2% in rands) in December, bringing the quarterly gain to 9.8%. For the year, the index was down some 18.1% in US dollars as a market derating technology and growth stocks, fueled by rising real bond yields, weighed on prices. Given solid gains on the Hang Seng Index (13.4%) following China's abrupt re-opening, emerging market equities also rallied 9.8% over the quarter. For the year, emerging market equities declined by 19.9% in US dollars as investors priced in the likelihood of a global recession.

The question now is whether equities will post a second consecutive year of negative returns in 2023. The good news for investors is that since 1928, the S&P500 Index has only delivered consecutive years of negative returns eight times. Put differently, the index has delivered a positive annual return following a down year, 67% of the time.

Global Bonds

Global bonds yielded positive returns in the fourth quarter of 2022 even as yields increased marginally following the Fed's cumulative 125 basis points of rate hikes, a 50-basis point rate hike from the European Central Bank (ECB) and the Bank of Japan's (BOJ's) unexpected announcement of a doubling of the cap on Japan's 10-year bond yield. The ECB also announced the start of quantitative tightening in March this year, with the APP portfolio declining at a monthly rate of Euro 15 billion until the end of the second quarter. The ECB President, Christine Lagarde, stated that the central bank expected a short-lived and shallow recession this year with staff -

projections for real GDP growth downgraded to 0.5%. However, the inflation projections were revised up to 6.3% (from 5.5%) for 2023 and to 3.4% (from 2.3%) for 2024. Lagarde stressed that the central bank viewed growth risks as skewed to the downside while inflation risks were skewed to the upside. For this reason, the ECB was likely to continue raising rates in 50-basis point increments, with a terminal rate of some 3% expected. The ECB also made it very clear that they would not be pivoting any time soon.

The BOJ, for its part, surprised the market with a change to its policy of yield curve control, widening the 10-year cap to 0.5% from 0.25% previously. Investors perceived the move as a potential first step towards rate hikes this year, prompting Japanese Government Bond (JGB) yields to rise and the Yen to strengthen. The increase in yields forced the BOJ to make substantial unscheduled bond purchases as speculators tested the central bank’s resolve to protect the new cap. Although price pressures are comparatively muted in Japan, they reached a four-decade high of 3.7% on surging imported energy costs (exacerbated by yen weakness) and a BOJ statement highlighting a recent rise in inflation expectations.

The policy rate hikes lifted yields across the nominal and inflation-linked bond curves, triggering a de-rating in equity markets. A better-than-expected inflation print in the both the US and the EU saw real bond yields rise as investors betted on a lower-than-expected inflation outcome for the year. A sharp drop in energy costs has fueled the more positive sentiment with natural gas prices falling some 39% over the quarter, aided by a warmer European winter. The yield on the Bloomberg Capital Global Aggregate Bond Index increased marginally from 3.7% to 3.73%, whereas global government inflation-linked bond yields increased to 1.05% from 0.81% the previous quarter. Since US breakeven inflation rates across the one-to-ten-year portion of the curve are all well anchored at below 2.5%, this suggests the market expects inflation to drop-off sharply this year. The Bloomberg Capital Global Aggregate Bond Index yielded some 4.6% in US dollars (-1% in rands), while the Bloomberg Capital Global Inflation Linked Bond Index yielded 4.1% in US dollars (-1.5% in rands). Emerging market bonds, in turn, outperformed their nominal sovereign counterparts yielding 6.6% in US dollars given their higher absolute yields and a compression in spreads.

Global Listed Property

Despite the small rise in bond yields and the policy rate hikes by the Fed and the ECB, the EPRA/NAREIT Developed Markets Property Index gained 7.1% in US dollars (1.4% in rands) over the quarter, ahead of the 4.6% yielded by global bonds. Since global listed property stocks had derated sharply over the year to end-September, the sector rerated in the fourth quarter on expectations of a near term peak in the interest rate cycle and a rate pivot later this year. The sector re-rated with the price-to-book ratio increasing from 1.16X to 1.23X, well below the 1.45X historical mean. Warnings from Fed speakers that the terminal rate of interest would be higher than what the market expects and would remain higher for longer did however result in property stocks giving back some of their gains in December.

Given expectations of further rate hikes through the first quarter of 2023, coupled with still high energy costs (which are falling), declining real incomes and expected corporate lay-offs, slowing turnover growth and subdued rental escalations are expected to be a headwind for the sector.

Local economics

Local Equities

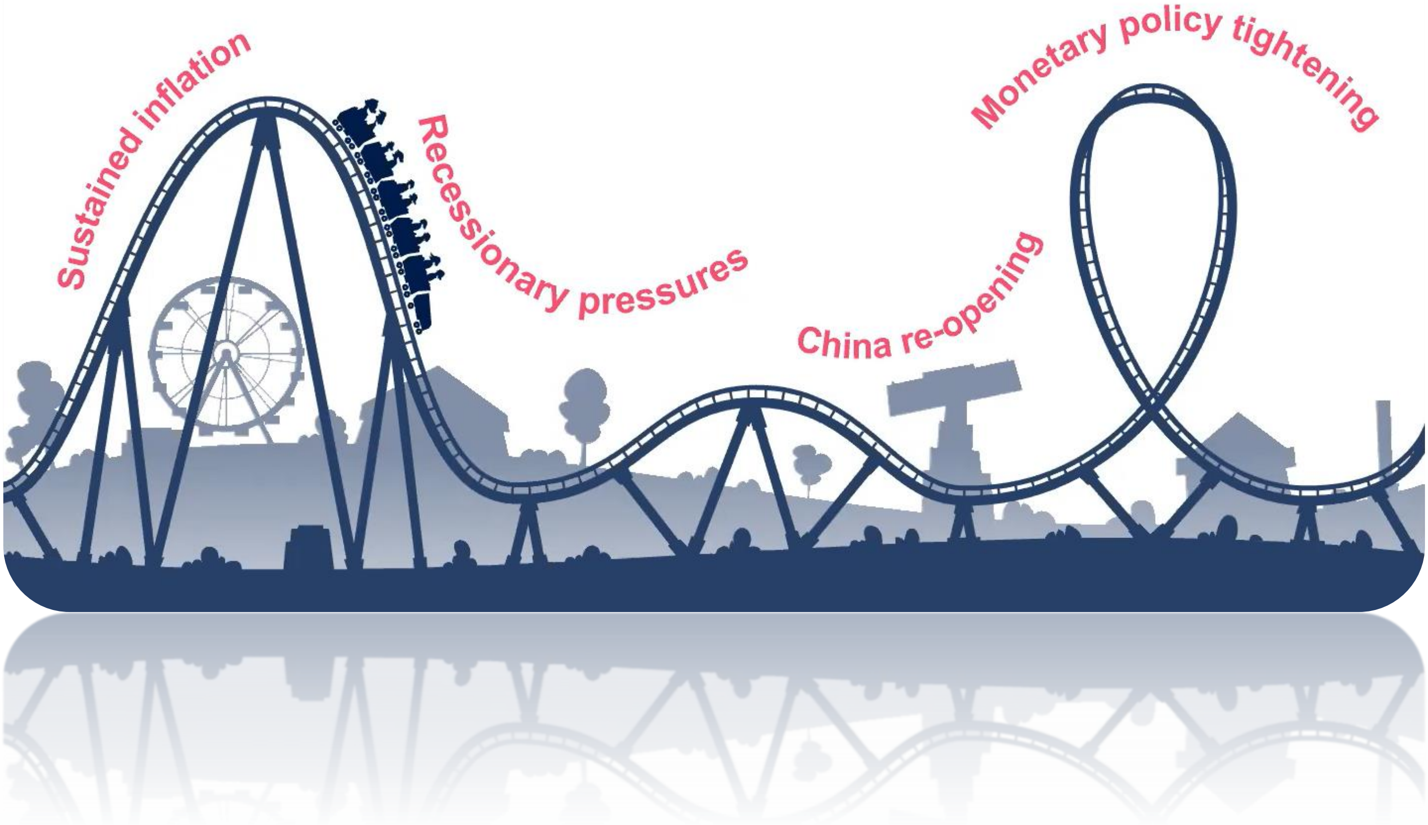
South African equities outperformed their developed and emerging market counterparts in the fourth quarter of the year, rallying 15.2% in rands, buoyed by cyclical and rand-hedge stocks. In US dollar terms, the All-Share Index rallied 21.6%, well ahead of the 9.8% yielded by developed and emerging market equities. Due to China's re-opening, industrial metals prices rebounded 17.2% in US dollars, led by gains in nickel (36.5%) and iron-ore (14.4%). Consequently, industrial metals and mining stocks on the JSE rallied 20.4% in rands, while precious metals and mining counters rallied 19.8%, aided by a 24.1% rise in the platinum price and an 8.4% gain in the gold price. The China re-opening trade and a loosening of regulatory restrictions on technology companies boosted technology stocks (24.3%), led by Naspers (25.2%) and Prosus (24.2%). The re-opening trade was also positive for consumer discretionary stocks (23.1%) – notably Richemont – that gained 30.4% over the quarter. The laggards included healthcare (2.4%), telecommunications (3.2%), industrials (5.6%) and consumer goods (6.7%).

While economic growth surprised to the upside in the third quarter, rising by 1.6% quarter-on-quarter seasonally adjusted and 4.1% year-on-year, the growth outlook over the coming years is expected to be benign, due to electricity supply constraints, a pending global recession, lower commodity prices and the high cost of capital. The SARB slashed its 2023 growth forecast for SA to 0.3% from 1.1% at the time of the previous (November 2022) meeting. Its 2024 and 2025 forecasts were also lowered notably, to 0.7% (from 1.4%) and 1.0% (from 1.5%), respectively.

The load-shedding intensity index was at 1 692.5 GWh, with load-shedding rising to an all-time high of 1054 hours in the third quarter of the year, some 47.7% of the time (an average of 14.8 calendar days per month). The South African Reserve Bank (SARB) revised its growth estimates for 2023 lower to 1.1% (from 1.4% previously), while growth for 2024 was also revised lower to 1.4% (from 1.7% previously). The World Bank's latest estimates are very similar at 1.4% and 1.8% respectively. Despite the weak growth outlook, markets got some cheer following the release of the Absa and Standard Bank purchasing manager indices. The Absa PMI rose from 52.6 index points to 53.1 index points, while the Standard Bank PMI dropped slightly to 50.2 index points from 50.6 index points, still is expansionary territory. In terms of the ABSA activity indices, new orders, employment and expected business conditions showed large gains, while the new orders to inventories ratio rebounded sharply, pointing to expanding manufacturing activity over the next two quarters.

Local Listed Property

South African listed property stocks benefitted from the rally in domestic bonds helping to offset a 13.5% decline in dividends per share over the quarter. The SAPY yielded a staggering 19.3% in rands and 26% in US dollars as the sector also rerated relative to bonds. The property-to-bond yield ratio eased from 0.75X to 0.73X, still expensive relative to the 0.9X mean. The biggest gainers over the quarter included Hammerson Plc (36.5%), Growthpoint (29.8%), Nepi Rockcastle Plc (27.2%) and Redefine (24.7%), while the laggards included Emira (0%), Liberty Two Degrees (1.1%), Industrials Reit (1.2%) and Capco (3.5%).



What can we expect to continue to be topical going into 2023?

What can we expect to continue to be topical going into 2023?

It is incredibly difficult to make any prediction about anything, especially investment markets, however, there are significant risks which were topical in 2022 that we believe will continue into 2023. For example, the interplay between inflation, interest rates and economic growth is likely to impact global and local asset class returns in 2023. In this instance, we are likely to witness either a global recession driven by the hawkish monetary policy displayed by global central banks, or on the flip side a bull market driven by a sharper than expected decline in global inflation. The latter position can be attributed by China reopening its economy more rapidly. These risks, while having divergent and potentially large impacts on financial markets, are well appreciated and less likely to surprise. On the other hand, a global earnings recession shock in our view is the event that could surprise the most.

Market performance summary (in ZAR) to 31 December 2022

	31 December 2022	3 months	1 year	3 years	5 years	10 years
Local	Equities (All Share Index)	15.2%	3.6%	12.7%	8.0%	9.9%
	Equities (Capped SWIX)	12.2%	4.4%	10.1%	4.9%	8.3%
	Property	19.3%	0.5%	-3.4%	-7.2%	2.8%
	Nominal Bonds	5.7%	4.3%	7.1%	7.8%	7.1%
	Inflation Linked Bonds	2.2%	4.2%	7.8%	5.1%	5.0%
	Cash	1.6%	5.2%	4.8%	5.8%	6.1%
Global	Equities	3.9%	-12.7%	12.0%	13.1%	16.7%
	Bonds	-1.0%	-10.7%	2.0%	4.8%	6.7%
	Property	0.8%	-19.2%	1.5%	6.3%	10.7%
	Rand vs US Dollar	-5.3%	6.6%	6.8%	6.6%	7.2%
Sector	Financials	12.9%	6.9%	3.7%	0.5%	7.4%
	Resources	16.1%	8.6%	20.3%	20.9%	8.3%
	Industrials	15.7%	-3.7%	10.9%	4.1%	9.8%
Size	Small Cap	4.4%	7.6%	19.5%	6.9%	9.8%
	Medium Cap	8.0%	1.6%	3.9%	3.2%	7.1%
	Large Cap	17.1%	4.2%	13.7%	8.7%	10.2%

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