Sanlam Corporate: Investments

Protection Strategies

Investment Report

Quarter 1 2023

Insurance | Financial Planning | Retirement | Investments | Wealth

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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.

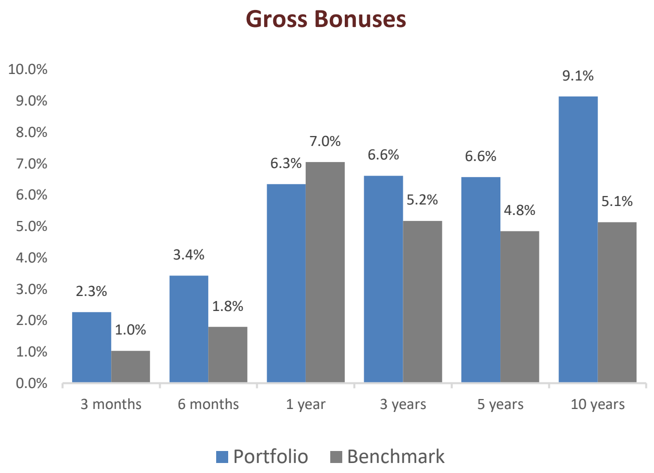
Volatility Protection Strategy

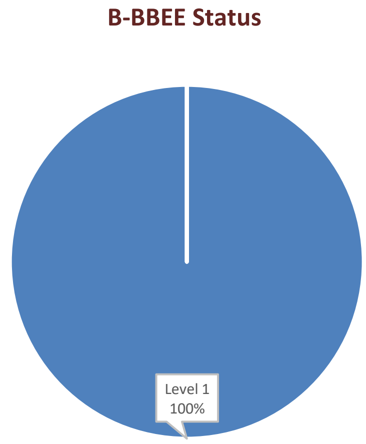
The default investment strategy is suitable for members who wish to achieve inflation-beating real returns over the medium to long term, but who are particularly concerned about protecting against significant short-term investment losses.

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

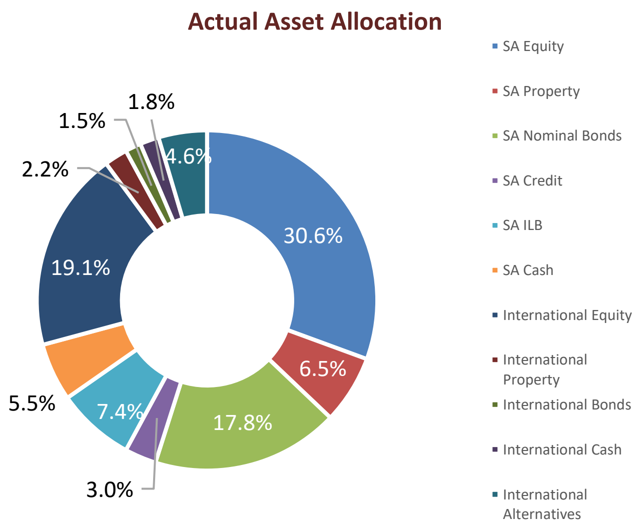


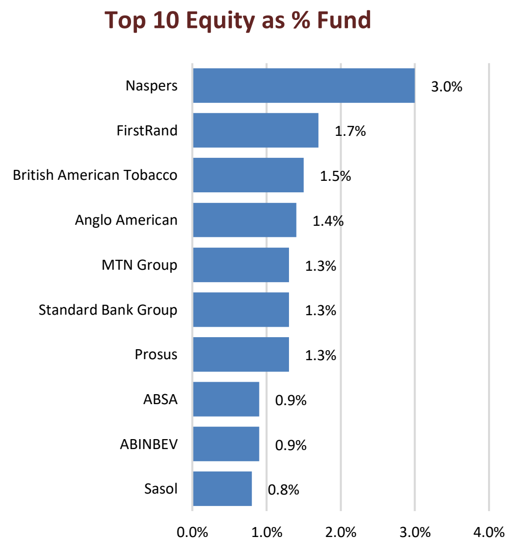


The Sanlam Monthly Bonus Fund returned 2.3% for the quarter and 6.3% for the one year ended 31 March 2023.

The returns over the last 10 years have exceeded inflation by 4.0% 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.

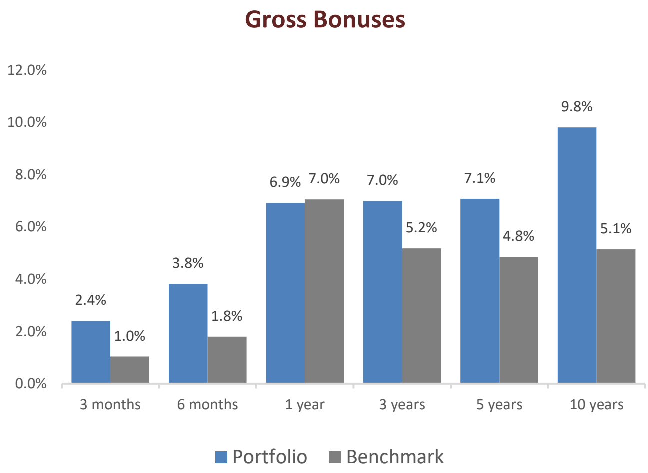
*Inflation is lagged by one month

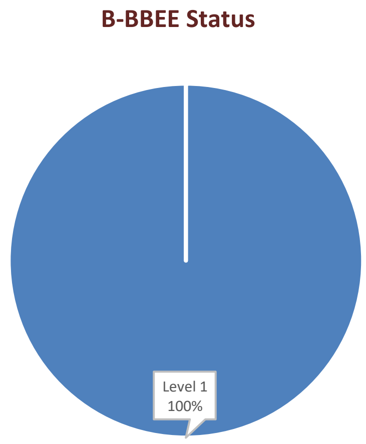




Looking at the current composition of the portfolio, the overweight positions are SA ILBs, International Cash, SA Equity. The portfolio had a neutral position in SA Property. The underweight positions in the portfolio are SA Cash, SA Nominal Bonds, SA Credit, International Bonds, International Alternatives,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

Sanlam Stable Strategy
Sanlam Stable Bonus Portfolio

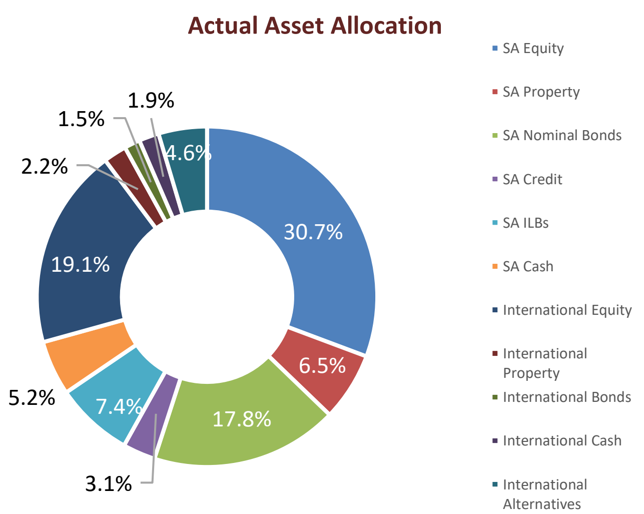


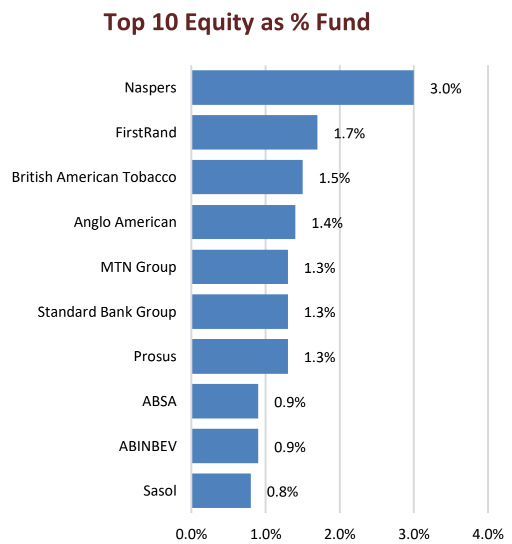


The Sanlam Stable Bonus Portfolio returned 2.4% for the quarter and 6.9% for the one year ended 31 March 2023.

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 4.7% p.a. over the last 10 years, with very stable and predictable returns over the period.

*Inflation is lagged by one month

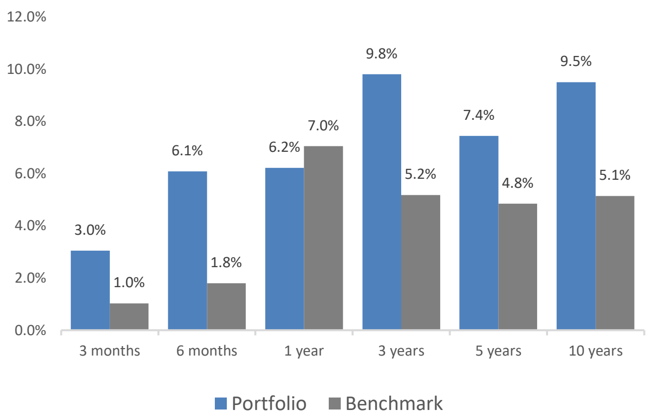




Looking at the current composition of the portfolio, the overweight positions are SA Alternatives, International Equity, SA ILBs and International Cash. The portfolio is neutral in SA Nominal Bonds and underweight in all the otherr asset classes.

Volatility Protection Strategy

Gross Bonuses



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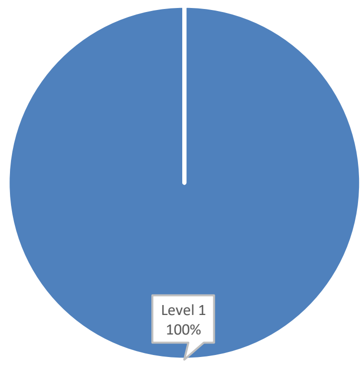
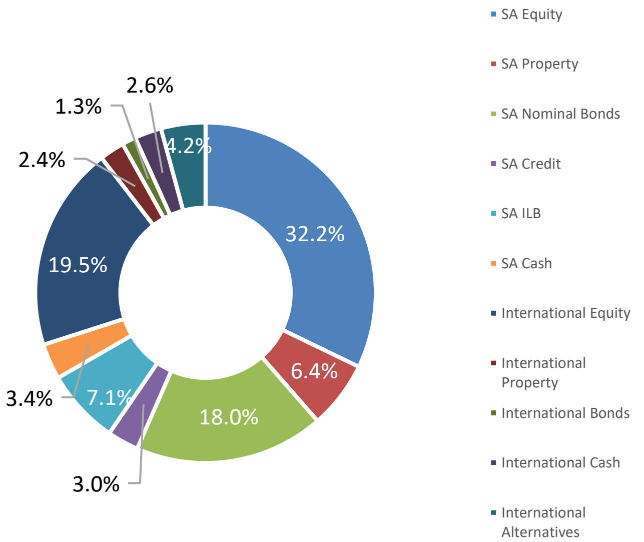


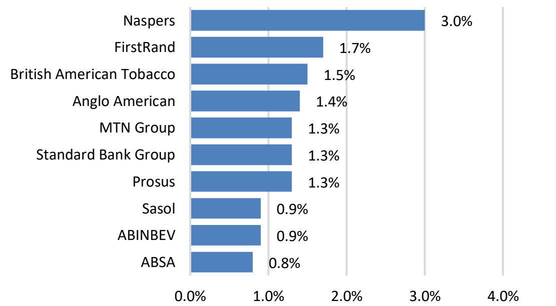
The Volatility Protection Strategy returned 3.0% for the quarter and 6.2% for the one year ended 31 March 2023.

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.

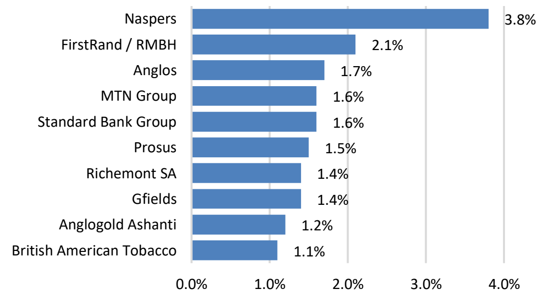
Actual Asset Allocation



Top 10 Equity as % Fund – Monthly Bonus



Top 10 Equity as % Fund – Satrix Enhanced



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.

Performance summary

31 March 2023	3 Months	6 months	1 year	3 years	5 years	SI
Sanlam Secure Strategy						
Sanlam Monthly Bonus Fund	2.3%	3.4%	6.3%	6.6%	6.6%	10.3%
CPI*	1.0%	1.8%	7.0%	5.2%	4.8%	-
Sanlam Stable Strategy						
Sanlam Stable Bonus Portfolio	2.4%	3.8%	6.9%	7.0%	7.1%	13.5%
CPI*	1.0%	1.8%	7.0%	5.2%	4.8%	-
Volatility Protection Strategy						
Volatility Protection Strategy	3.0%	6.1%	6.2%	9.8%	7.4%	11.1%
Benchmark	1.0%	1.8%	7.0%	5.2%	4.8%	-

**CPI figures are calculated to end of February 2023*
Benchmark used for Volatility Protection Strategy is 75% of Inflation and 25% of the Composite Benchmark for Satrix Enhanced Balanced Tracker Fund.

Macroeconomic commentary

Highlights

Global

- FDIC deposit guarantees restore confidence in US banking system after Silicon Valley Bank and US Signature Bank failures
- Bank contagion claims Credit Suisse but UBS steps in to buy the bank
- ECB hikes rates 50 basis points despite banking sector contagion and the US Fed raises rates 25 basis points to 4.75% to 5% range
- PBOC cuts the required reserve ratio by 25 basis points

Local

- SARB raises rates 50 basis points to 7.75% on rising inflation expectations
- Unions agree to 7.5% public sector wage offer in two-year deal
- S&P downgrades SA's sovereign rating to BB- stable from positive
- SA's close Russian ties risk expulsion from AGOA

Global economics

Global Equities

The first quarter of 2023 saw heightened market volatility due to uncertainty over the terminal interest rate, with the China re-opening theme driving returns. US banking failures triggered a selloff in banking stocks, but the market recovered following the Federal Deposit Insurance Corporation's decision to guarantee all deposits. Escalating geopolitical tensions, including Russia's war in Ukraine and the forging of closer ties between Russia, China, Iran and North Korea, created a further divide between the West and the East. With the market pricing out the expected earnings per share, Global Equities as measured by the MSCI World ACWI performed the best (11.9%) of all broad asset classes below. Central bank hiked rates even as inflation came in better than expected. With core inflation remaining high the ECB is expected to raise rates a further 75 basis points this year, while the US Fed is expected to pause following a further 25 basis point hike in May, leading to an expectation of a higher-for-longer interest rate scenario, which could become a headwind for risk assets.

Economic growth is slowing, leading to a contraction in corporate earnings, but markets have already priced this in, with earnings expected to recover next year

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Global Bonds

Global bond yields were lower in Q1 due to the repricing of the US Fed's terminal rate of interest following the US mini-banking crisis. Inflation-linked bonds rallied as real yields declined, and despite rising default risks, high yield credit spreads were lower. Emerging market bonds lagged their developed market counterparts. While a May rate hike is expected from the US Fed, yield curves are likely to push higher over the near term with a bear market curve flattening signaling a slowdown in economic growth. A material risk to the bond market outlook is the potential for the new Governor of the Bank of Japan to unwind the Yield Curve Control (YCC) program, which could lead to a reversal in capital flows out of US treasuries into JGBs, resulting in a sharp rise in US treasury yields and spillover effects on equities, with growth stocks most at risk.

Global Listed Property

Lower bond yields in Q1 helped global listed property achieve a positive return, but the sector remains volatile and faces challenges from banks tightening credit standards. The sector has derated over the month, but the price-to-book ratio remains largely unchanged and below historical averages. There is a risk of stranded assets arising from the transition to a green economy, since ‘greenifying’ old buildings could cost around 20% of net asset value, write-downs on old buildings could become a headwind for investors.

Local economics

Local Equities

The JSE All Share Index underperformed developed and emerging market equities in Q1 2023, and the mini-banking crisis in March was a headwind for the domestic equity market, dragging banking stocks lower. However, banks and financials managed to post a small positive return. The consumer discretionary sector led by Richemont and Sun International was the biggest winner. Healthcare received a boost from Aspen, and the rally in technology stocks followed China’s reopening that saw Naspers and Prosus post solid returns. The resources sector and platinum counters saw a sell-off. The South African Reserve Bank set up the Corporation for Deposit Insurance on 24 March 2023. Although GFCF has increased to 14.5% of GDP from a low of 12.9% in Q2 2021, it still falls short of the 30% needed to boost GDP growth to 5% per annum. The 125% tax break for renewable energy could be supportive of fixed investment expenditure this year. However, headwinds to the investment drive include bottlenecks at ports, higher stages of load-shedding, and South Africa's close ties to Russia.

Local Bonds

South African bonds had a lacklustre first quarter compared to global counterparts due to the currency depreciation against the USD, but the yield on the All-Bond Index decreased, resulting in a 3.4% return in rands and a -0.9% return in USD. Inflation-linked bonds lagged due to a small increase in real yields, and foreigners were net sellers while domestic investors took up the slack. The SARB revised its headline inflation estimates upward and warned of further currency weakness linked to load-shedding and higher financing needs, dampening sentiment in the bond market. The export commodity price index is forecast to decline by 20% this year, widening the current account deficit, and growth was revised marginally lower. The recent wage agreement with public sector unions creates a hole in the budget, and concerns remain about Treasury's revenue projections and budget deficits over the coming years.

Local Listed Property

The SA listed property sector was the worst performing of the broad sectors in the first quarter, notwithstanding lower bond yields. While contagion from the two US bank failures was no doubt a contributing factor in March, the sector was expensive relative to bonds and was due for a correction. Higher stages of load-shedding and the impact on the performance of super-regional malls also weighed on sentiment, while subdued economic growth and rising interest rates were expected to constrain rental escalations and resets in the year ahead.

The FTSE/JSE SA Listed Property (SAPY) Index yielded -5.1% in rands and -8.9% in USDs as the sector derated relative to bonds. The property-to-bond yield ratio increased from 0.73X to 0.8X, still expensive relative to the 0.9X mean. While distributions grew by 2.1% quarter-on-quarter, this was insufficient to offset the negative return. The biggest gainers over the quarter included Attacq (16.3%), Hammerson Plc (15.4%) and Fortress A (10.5%), whereas the losers included SA Corporate Real Estate (-14.7%), Redefine (-14.0%) and Liberty Two Degrees (-13.6%).

Summary

Equities and bonds both rallied in the first quarter of the year notwithstanding uncertainty about the extent of central bank monetary tightening following some months of inflation beats and misses. The market also shrugged off rising geopolitical tensions and concerns around the earnings outlook given a slowing global economy. The China re-opening theme was supportive of equities, whereas the US mini-banking crisis supported bonds on an expected softening in inflationary pressures from a tightening in credit conditions and slower loan growth. Due to the Federal Deposit Insurance Corporation ‘s decision to guarantee all deposits, equity markets recovered from the rout in banking stocks to end the quarter in positive territory, with the MSCI World Index the best performing of the broad asset classes. Although emerging markets lagged their developed market counterparts, China’s re-opening, the People’s Bank of China (PBOC)’s 25 basis point cut to the required reserve ratio and Alibaba’s planned restructuring all supported the risk-on trade. Positive Purchasing Manager Index data also helped to underpin equities, although data released in April showed a deeper contraction in manufacturing across the US, UK, and EU. In general, South African asset classes underperformed their global peers, courtesy of rand depreciation.

Market performance summary (in ZAR) to 31 March 2023

		3 months	6 months	1 year	3 years	5 years	10 years
Local	Equities (All Share Index)	5.2%	21.1%	4.9%	24.2%	10.4%	10.2%
	Equities (Capped SWIX)	2.4%	15.0%	0.2%	23.0%	6.5%	8.4%
	Property	-5.1%	13.3%	-3.4%	18.2%	-4.1%	1.3%
	Nominal Bonds	3.4%	9.3%	5.8%	11.6%	6.9%	7.3%
	Inflation Linked Bonds	0.9%	3.1%	4.9%	10.7%	4.5%	4.8%
	Cash	1.7%	3.4%	6.0%	4.8%	5.8%	6.2%
Global	Equities (MSCI ACWI)	11.9%	16.3%	12.4%	15.1%	15.9%	15.4%
	Bonds	7.4%	6.3%	11.6%	-3.6%	7.0%	6.9%
	Property	4.7%	5.5%	-4.3%	6.4%	9.4%	9.7%
	Rand vs US Dollar	4.3%	-1.3%	21.4%	-0.2%	8.4%	6.8%
Equity Sector	Financials	5.2%	12.6%	-8.6%	22.5%	1.2%	6.8%
	Resources	2.4%	10.7%	-13.0%	30.5%	20.7%	8.5%
	Industrials	-5.1%	31.4%	25.9%	19.2%	8.6%	10.5%
Size	Small Cap	3.4%	5.3%	4.2%	36.6%	7.4%	9.0%
	Medium Cap	0.9%	7.0%	-5.9%	19.9%	3.8%	6.7%
	Large Cap	1.7%	24.4%	6.8%	24.6%	11.5%	10.6%

call us

Marie du Plessis
Sanlam Corporate Investments
+27 (21) 950 7548
Marie.duPlessis@sanlam.co.za

Matimu Ngobeni
Sanlam Corporate Investments
+21 (21) 950 2085
Matimu.Ngobeni@sanlam.co.za

Sanlam
Live with confidence

2 Strand Road, Bellville, Cape Town | PO Box 1, Sanlamhof 7532, South Africa

T +27 (0)21 947 9111
F +27 (0)21 947 8066

www.sanlam.co.za