Sanlam

Sanlam Corporate: Investments

Sanlam Unity Umbrella Fund

Investment Report

Quarter 2 2024

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Overview
of the default investment strategy

The Trustees of the Fund have a formal investment strategy in place whereby the Fund aims to provide stable long term returns in excess of inflation that suits the majority of the members' long-term investment needs.

The Fund currently invests 100% in Sanlam Stable Bonus Fund in order to achieve its objectives.

- Protects investors against short-term volatility while providing partial guarantees on benefit payments
- Smoothes investment return
- Bonuses consist of a vesting and non-vesting portion, and are declared monthly in advance. Bonuses cannot be negative.

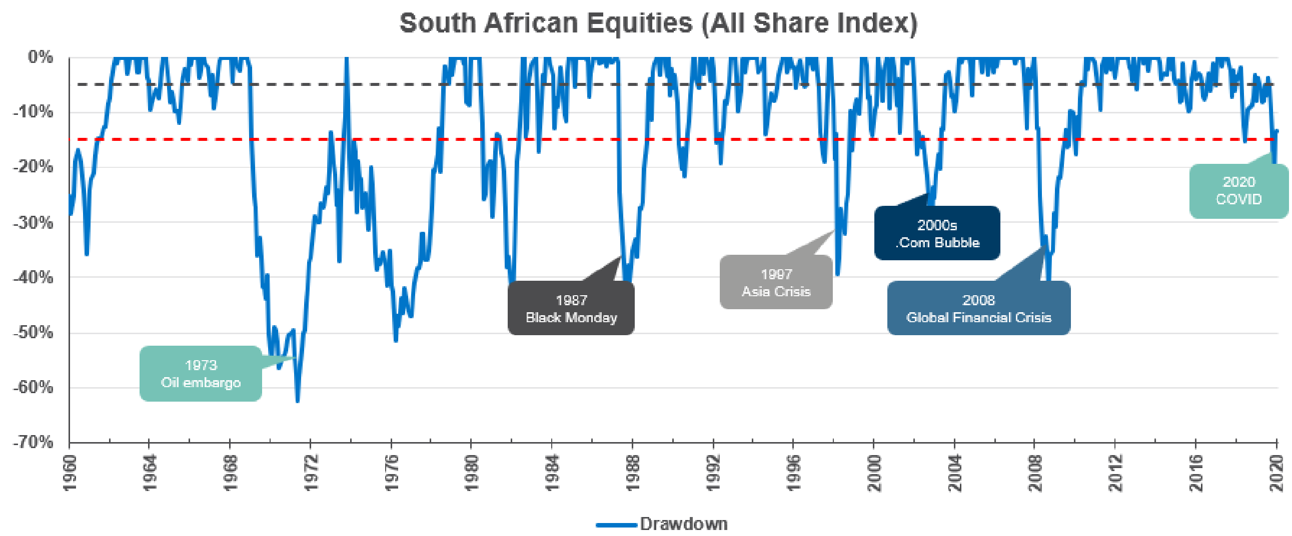
This is achieved by smoothing the returns over time, and guaranteeing (for resignation, retirement, death, retrenchment and disability events) the net contributions invested together with the vested bonuses.

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.

Why Sanlam Stable Bonus Portfolio?

Investment Markets are subject to **drawdowns** (negative returns). Smoothing of investment returns can reduce the drawdowns but **may not be enough to eliminate** them (some investors who do not like seeing their fund value going down may still worry). Adding a guarantee can fully **eliminate the drawdowns** and hence give investors the piece of mind.



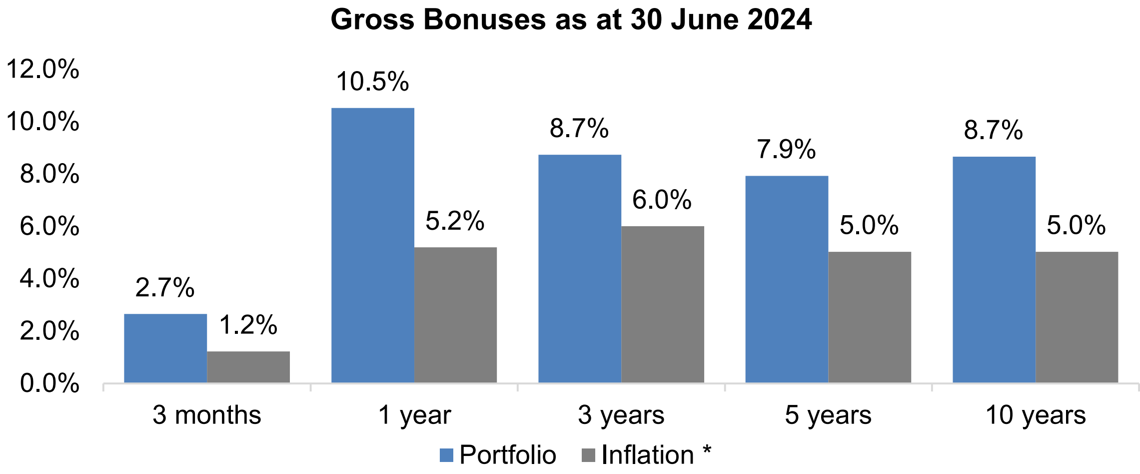
What are Smoothed Bonus Portfolios?

In smoothed bonus portfolios, investment returns are smoothed by way of regular bonus declarations. This results in stable and dependable investment returns, lessening the roller-coaster ride that investors in market-linked portfolios might experience – consider the global financial crisis during 2008 as an example. These bonus declarations are based on the returns achieved on the portfolio's underlying investments. However, some returns are set aside during periods of strong market growth to be used to boost returns during periods of weaker performance.

Guarantees

- The book value is the value that is guaranteed to be paid out for benefit payments (death, disability, resignation, retrenchment and retirement) regardless of market conditions. The book value is the net contributions accumulated at the bonus rates.
- There is no limit on the amount of benefit payments at book value.
- All guarantees are backed by the financial strength of Sanlam Life.
  - Solvency cover of 170% on 31 December 2023 and a Standard & Poor (S&P) credit rating of zaAAA.
  - The resilience of the Sanlam share price during the sub-prime crisis shows the market's confidence in Sanlam and its management

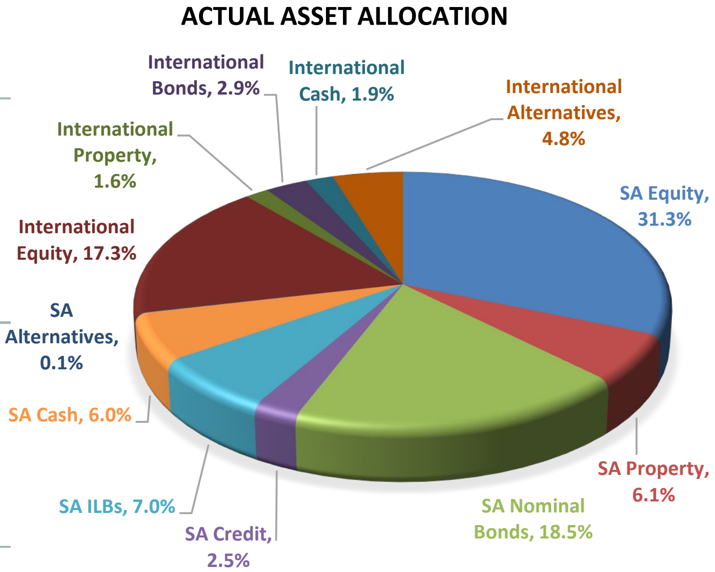
Default Investment Strategy
Sanlam Stable Bonus Portfolio

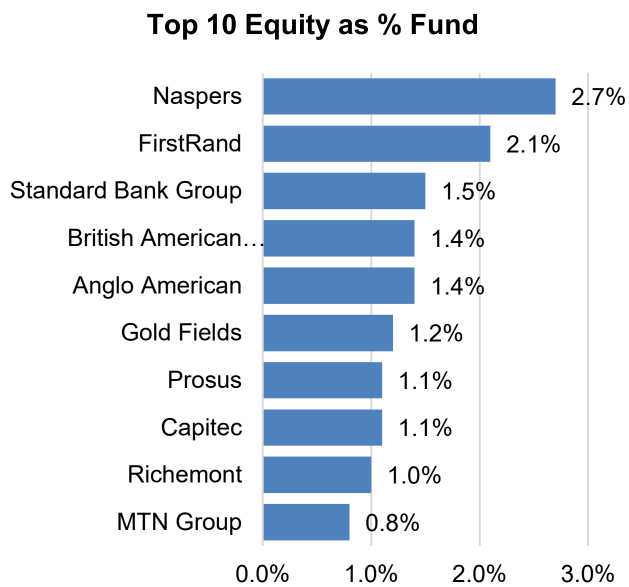


The Sanlam Stable Bonus Portfolio returned 2.7% for the quarter ended 30 June 2024 and a return of 10.5% for the year. Over the long term, the portfolio posted strong inflation beating returns.

The 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 real returns of 3.7% 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 ILBs. International Cash, SA Equity, SA Nominal Bonds and International Bonds. The portfolio is neutral in International Alternatives. The underweight positions in the portfolio are International Equity, SA Alternatives, SA Credit, SA Cash, International Property and SA Property.SA Property, SA Inflation-Linked Bonds, Foreign Equity and Foreign Property.

Performance summary

30 June 2024 Default Investment Strategy	3 Months	6 months	1 year	3 years	5 years	10 years
Sanlam Stable Bonus Portfolio	2.7%	5.3%	10.5%	8.7%	7.9%	8.7%
CPI*	1.2%	2.3%	5.2%	6.0%	5.0%	5.0%

**CPI figures are lagged by one month*

Macroeconomic commentary

Highlights

Global

- US Fed's revised dot-plot points to one rate cut this year and four rate cuts in 2025
- ECB cuts rates for first time in five years even as core inflation revised higher
- European Parliamentary elections show gains for right-wing political parties
- BOJ to reduce bond purchases in move to unwind monetary stimulus

Local

- Bloated GNU formed after ANC fails to gain majority in SA elections
- SA bonds rally as political risk premium declines
- SA raises tariffs on Shein and Temu imports
- SA Q1 GDP contracts by 0.1% quarter/quarter but expands by 0.5% year/year
- Rate cut optimism returns to South Africa's FRA market

Global economics

Global Equities

Equity markets benefited from the risk-on soft-landing narrative in the second quarter, as disinflation trends continued and global growth stayed in expansionary territory, albeit at a slower pace. US headline and core inflation came in lower than expected at 3.3% and 3.4%, leading to fed funds futures pricing in one rate cut this year. The MSCI ACWI gained 2.9% in US dollars (-0.9% in Rands) over the last quarter, driven by US tech stocks, while Eurozone markets declined due to gains by right-wing political parties in European Parliamentary elections and France's snap election decision.

It is feared that a right-leaning European Parliament may prioritize issues like migration over other issues such as the "green-deal" or digital transitions. The shift to the right could also complicate parliamentary approval for accession treaties, enhanced financial assistance for enlargement-related reforms, and the emphasis on the rule of law. Far-right parties generally oppose further EU enlargement, viewing it as costly in terms of national sovereignty, economic efforts, and potential "undesired" migration flows. Adding fuel to the fire was Emmanuel Macron's decision - to immediately dissolve the French parliament and call a snap election in July. The Euro Stoxx 50 Index was 4.1% lower for the quarter. In contrast, emerging markets outperformed their developed market counterparts to rally 4.6% in US dollars (0.8% in rands), buoyed by a 7.3% (in USD) surge in the Hang Seng Index as Chinese state-owned asset managers embarked on a state-sanctioned ETF buying spree.

Global Bonds

Despite disinflation and dovish central banks, nominal bonds returned negatively as yield curves shifted higher, with the Bloomberg Capital Aggregate Bond Index yield rising to 3.9% and returning -1.1% in US dollars and -4.6% in rands. Corporate bonds also fell, with yields on the Bloomberg Capital Global Corporate Bond Index increasing to 5.04% and returning -0.2% in US dollars and -3.7% in rands. Emerging market bonds gained 0.7% in US dollars (-2.9% in rands) due to higher yields and reduced spreads, while inflation-linked bonds fell as real yields rose to 1.59%, with the Bloomberg Capital Global Government Inflation-Linked Bond Index returning -0.8% in US dollars and -4.4% in rands. The Bank of Japan's balance sheet reduction and European election shifts influenced these outcomes, while breakeven inflation rates declined, signaling stable inflation expectations and suggesting potential future US Fed rate cuts.

Global Listed Property

The rise in bond yields and the deferral of interest rate cuts weighed on the global listed property sector in the second quarter of the year, even as the sector re-rated on a price-to-book basis. The FTSE EPRA Nareit Developed Markets Property Index declined by 2.2% in US dollars and -5.7% in rands. The price-to-book ratio increased from 1.23X to 1.34X, still below the 1.46X mean. Since REITs currently trade at a 12% discount to net asset value and offer an attractive dividend yield of about 4.5%, there is still value to be found in listed property. Top-line rental growth continues to beat consensus estimates while better-than-expected tenant demand and muted supply across most sectors also support property. However, the deferral of interest rate cuts to late in the year could still limit companies' ability to refinance expiring loans at lower rates, raising default risks and placing forward earnings under pressure.

Local economics

Local Equities

South African equities surged in the second quarter, with the FTSE/JSE All Share Index rising 8.2% in rands and 12.2% in US dollars, driven by a favorable election outcome and improved interest rate expectations. The ANC's failure to secure a majority, gaining only 40.2% of the vote, led to the formation of a Government of National Unity (GNU) that includes the ANC, DA, IFP, PA, FF+, PAC, and Good, but excludes the EFF and MKP. The new Cabinet comprises 32 ministers and 43 deputy ministers, with the ANC holding 20 cabinet posts, the DA six, and the IFP two, while the PA, FF+, Good, and PAC each secured one position. This political shift boosted investor sentiment as economic policy moved towards a more market-friendly stance, with interest rate expectations now anticipating three rate cuts over the coming year, influenced by the US Fed's revised dot-plot and better-than-expected local inflation data.

SA Inc. shares performed strongly, with financials up 17.8% (Capitec +27.3%, Coronation +25.5%, FirstRand +24.6%), driven by a reduced risk of nationalization. Industrials gained 14.6% (Barloworld +40.6%, Raubex Group +32.7%, Wilson Bayly Holmes Ovcon +19.8%), while healthcare stocks increased 7.9% (Life Healthcare +17.8%, Adcock Ingram +9.3%, Netcare +7.1%). Technology stocks rose 6.8% (Altron +22.3%, Karooooo Ltd +14.9%, Prosus +8.8%), and consumer discretionary stocks were up 6.0% (Foschini +28.1%, Truworths +22.2%, Mr Price Group +18.5%). Consumer staples gained 3.2% (PicknPay +37.6%, Spar +33.9%, Astral Foods +15.5%), and basic materials increased 3.2% (Tharisa PLC +44.3%, African Rainbow Minerals +43.2%, Afrimat +25.2%), while telecommunications lagged with a -4.6% drop (Telkom -18.3%, Blue Label Telecoms -16.7%, Multichoice -6.2%). Despite a lower-than-expected Q1 GDP, the outlook improved with positive signs in mining, manufacturing, and retail, supported by a higher leading economic indicator and a generally positive growth outlook.

Local Bonds

South African bonds rallied sharply in the second quarter as the political risk premium priced into the market declined following the positive election outcome. The formation of a GNU saw bond yields decline as the EFF and MKP were excluded from the Cabinet. Expectations of more market-friendly policies and the re-appointment of Enoch Godongwana as the Minister of Finance – ensuring fiscal consolidation – buoyed sentiment, with the yield on the All-Bond Index falling from 12.05% to 11.31%, a massive 74 basis point decline. Due to the sharply lower bond yields, the All-Bond Index yielded an impressive 7.5% in rands and 11.5% in US dollars. The long end of the curve (12+ years) was the best-performing sub-sector as duration was rewarded following the decline in yields. Inflation-linked bonds yielded a more subdued 2.4% in rands as yields moved from 5.01% to 5.07%.

While headline and core inflation missed estimates earlier in the quarter, towards the back-end inflation was trending lower, in line with expectations. Headline inflation eased to 5.2%, while core inflation came in at 4.6%, just shy of the SARB's 4.5% target. Since interest rate expectations also improved over the quarter, the stage is set for the SARB to start its rate cutting cycle, although there does seem to be some push-back from the Governor. He has warned that inflation expectations are still elevated, and that the SARB must deliver on its inflation target sooner rather than later, to re-anchor expectations. Although FRAs are pricing in three rate cuts over the coming twelve months, up from one rate cut expected at the end of March, these expectations can still be upended if the SARB revises the inflation target range lower, from the current 3-6% range, to a new 2-4% range. The implication of the revised inflation target would be higher-for-longer interest rates and a shallower rate cutting cycle.

Local Listed Property

South African listed property rallied in the second quarter of the year as bond yields plummeted, with the SAPY yielding a pleasing 5.5% in rands and 9.4% in US dollars. Even though dividends per share declined by 1.2% quarter/quarter, the property-to-bond yield ratio derated slightly from 0.53X to 0.55X, still well below the 0.85X mean. This suggests that lower bond yields were the primary driver of returns over the quarter. However, with real nominal bond yields trading below their fair value, there is limited scope for a further compression in bond yields, at least over the near term. Property stocks are also expected to derate relative to bonds going forward, given that the property-to-bond yield ratio is now at a historical inflection point. Although pressure from higher interest rates affects earnings growth, positive operating metrics, such as improved office vacancy rates and retail rental reversions, suggest there is potential for earnings acceleration once interest rates begin to decline.

Summary

The risk-on trade dominated markets in the second quarter of the year, as ongoing disinflation triggered interest rate cuts in Canada, the EU, Sweden and Switzerland. While the US Federal Reserve (US Fed) left rates unchanged, its revised dot-plot signalled that the next move in rates would be a cut, but that the timing of the cuts would be data dependent. Global and developed market Composite PMIs were generally higher over the quarter, but developing economies showed a small slowdown in economic activity. Softer readings were seen in Brazil, Russia, South Africa and the UK, while Japan moved into outright contractionary territory. With growth expected to slow over the coming year, consensus earnings estimates were revised marginally lower, in line with the "soft-landing" outlook for the global economy.

Despite the downward revisions, earnings growth in the second forecast year was revised higher, suggesting that any economic slowdown is likely to be short-lived. Emerging markets outperformed their developed market counterparts, buoyed by a surge in the Hang Seng Index, as state-owed asset managers bought up Chinese ETFs to place a floor under the market. In contrast, EU parliamentary elections and France's decision to call a snap election weighed on Eurozone equity markets. Nominal and inflation-linked global bonds yielded negative returns as yield curves shifted higher on the deferral of interest rate cuts following the US Fed's revised dot-plot.

On the domestic front, the favourable election outcome and the formation of a government of national unity boosted investor sentiment, with bonds rallying sharply and SA Inc. shares surging over the quarter. In general, South African asset classes outperformed their global counterparts, thanks to rand appreciation. Bonds also benefitted from a sharp decline in the country's political risk premium after the elections, while domestic equities rallied on a more favourable interest rate outlook and expectations of more market-friendly policies by the new government. Fears that banks and mines could be nationalised abated as the EFF and MKP were excluded from the new Cabinet. Interest rate expectations also shifted meaningfully lower with the FRAs pricing in three rate cuts over the coming year rather than the single cut priced in a month earlier.

Market performance summary (in ZAR) to 30 June 2024

		3 months	6 months	1 year	3 years	5 years	10 years
Local	Equities (All Share Index)	8.2%	5.8%	9.1%	11.0%	10.6%	8.2%
	Equities (Capped SWIX)	8.2%	5.7%	10.0%	10.1%	8.7%	6.5%
	Property	5.5%	9.6%	26.3%	11.7%	0.9%	3.2%
	Nominal Bonds	7.5%	5.6%	13.7%	7.6%	7.8%	8.2%
	Inflation Linked Bonds	2.4%	1.9%	9.0%	6.9%	6.3%	5.0%
	Cash	2.1%	4.2%	8.5%	6.5%	6.1%	6.6%
International	Equities (MSCI ACWI)	-0.8%	11.1%	15.4%	14.4%	16.6%	14.5%
	Equities (MSCI EM)	0.8%	4.3%	5.8%	2.2%	8.0%	8.6%
	Bonds	-4.6%	-3.3%	-2.4%	2.6%	3.2%	5.1%
	Property	-5.6%	-4.0%	0.8%	3.1%	4.4%	8.0%
	Rand vs US Dollar	-3.6%	-0.2%	-3.3%	8.5%	5.3%	5.6%
Equity Sector	Financials	15.9%	8.9%	24.4%	17.4%	6.9%	7.0%
	Resources	3.6%	1.9%	0.4%	4.6%	10.8%	5.7%
	Industrials	5.2%	5.9%	5.1%	9.7%	10.4%	7.8%
Size	Small Cap	10.7%	9.6%	20.2%	16.8%	15.2%	8.3%
	Medium Cap	9.5%	5.7%	17.3%	9.4%	7.6%	6.6%
	Large Cap	7.9%	5.5%	7.2%	11.1%	10.9%	8.2%

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