Prescient
INVESTMENT MANAGEMENT

MULTI-ASSET MONTHLY COMMENTARY

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1. QUICK VIEW

- Most equity markets rebound from their September slump.
- Major central banks leave key rates unchanged.
- The final SARB MPC meeting of the year takes place on the 18th of November.
- U.S. CPI surges 6.2% year-on-year, the highest in more than 30 years.
- South African finance minister Enoch Godongwana presents his first Medium-Term Budget Policy Statement.
- Global Covid-19 cases grow at a slower pace; vaccines administered in South Africa surpass 21 million doses.

2. GLOBAL MACROECONOMICS

Most global equity markets rebounded from their September slump. The MSCI World Index rallied 5.0% in October, while major U.S. indices gained between 4%-7%, partially lifted by upbeat third-quarter earnings. The S&P500 is up more than 22% in dollar terms for the year, with two months to go in 2021.

The U.S. dollar marginally weakened against a basket of its currency peers and was mixed against emerging market currencies. The Turkish Lira hit record lows versus the U.S. dollar as the Turkish central bank cut its policy rate by 200 basis points and President Erdogan ordered the expulsion of ambassadors of the U.S. and nine other western countries. The rand had a volatile month, giving up its gains of nearly 4.0% before ending the month 1.2% weaker against the greenback. We remain overweight on the ZAR, GBP, EUR and JPY relative to the USD.

On the commodity front, Brent crude oil staged its eighth monthly gain for the year and climbed to its highest level since 2014 intramonth. Surging energy prices are also fueling concerns about the potential impact on global manufacturing activity, consumer spending and inflation.

U.S. October CPI came in hotter than expected, surging 6.2% in October from a year ago, the highest since December 1990. Analysts estimates were 5.9%. Core CPI, which strips out volatile food and energy prices, gained 4.6% versus an estimate of 4.0%. The rise in CPI was led by shelter, vehicle, and energy costs. On a monthly basis, headline and core CPI rose 0.9% and 0.6%, respectively.

The Federal Open Market Committee (FOMC) left its key rates unchanged and announced that it would begin tapering the pace of its asset purchases later in November. This will see reductions of $15 billion from the current $120 billion each month. Across the Atlantic, both the European Central Bank and the Bank of England also left their monetary policy rates unchanged. The European Central Bank will continue its purchases under its pandemic emergency program at a “moderately” slower pace than seen in the second and third quarters. Locally, the final S.A. Reserve Bank’s Monetary Policy Committee (MPC) meeting of the year is scheduled to take place, with the interest rate decision to be announced on the 18th of November. Recall that the SARB’s QPM model at the September meeting signalled one rate hike in the fourth quarter of this year.

This month, recently-appointed South African finance minister, Enoch Godongwana, presented his first Medium-Term Budget Policy Statement, or MTBPS. The budget revised its revenue projection higher, primarily due to stronger commodity price dynamics and tax collections exceeding expectations in the short term. The GDP growth estimate for 2021 was revised up to 5.1% from the February budget projection of 3.3%, while growth for 2022 was revised down to 1.8% from 2.2%. The consolidated budget deficit is expected to be 7.8% of GDP in 2021/22, gradually reducing to 4.9% in 2024/25. The local bonds and currency reacted positively to the MTBPS. In terms of positioning, we are overweight S.A. bonds.

Globally, new confirmed Covid-19 cases grew at a slower pace in October. As countries around the world gently loosened restrictions, a recent spike in cases in China forced officials to tighten control measures as Beijing maintained its relentless zero-Covid approach. Locally, vaccinations opened up for all children between the ages of 12-17, taking the total number of vaccines administered in South Africa to over 21 million.

OUR SYSTEMATIC VIEW ON GLOBAL MARKETS

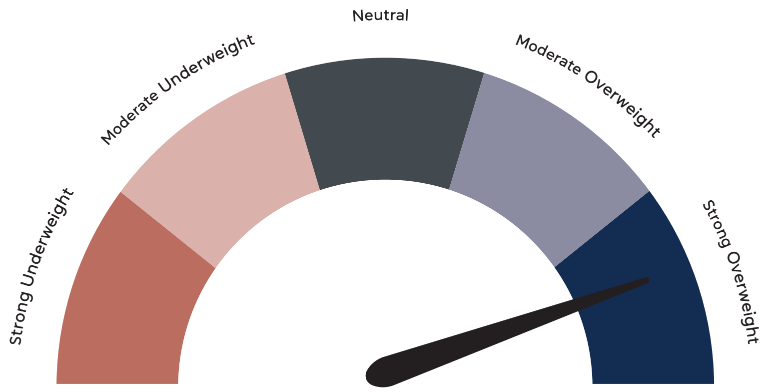
Our indicators continue to argue a bullish case for S.A. equities, nominal and inflation-linked bonds, and we remain overweight on these assets. We have downgraded European equities from strong overweight to moderate overweight, with valuations appearing relatively stretched at these levels. We have also downgraded developed market high yield credit from neutral to a moderate underweight. With inflation prints in the U.S. and other developed nations rising, real yields on developed market high yield credit are unattractive and, in some cases, well into negative territory, with credit spreads unlikely to compensate us for the required investment risk.

	Strong Underweight	Moderate Underweight	Neutral	Moderate Overweight	Strong Overweight
Equities					
South Africa					Overweight
United States			Neutral		
European Union				Overweight	
Emerging Markets			Neutral		
DM Small Caps				Overweight	
EM Small Caps			Neutral		
Bonds					
South Africa					Overweight
United States			Neutral		
European Union	Underweight				
EM (USD)		Underweight			
EM (Local)		Underweight			
Credit					
South Africa				Overweight	
DM Investment Grade		Underweight			
DM High Yield		Underweight			
EM (USD)	Underweight				
Real Assets					
SA Property			Neutral		
SA Preference Shares			Neutral		
SA ILBs					Overweight
DM Property			Neutral		
FX					
Euro					Overweight
British Pound				Overweight	
Japanese Yen					Overweight
SA Rand					Overweight

UNPACKING OUR VIEW ON S.A. EQUITIES

WHERE WE CURRENTLY STAND

South African equities continue to exhibit value opportunities, particularly earnings relative to global equities and a generally positive outlook across our other three pillars that move markets (economics, financial conditions and sentiment).



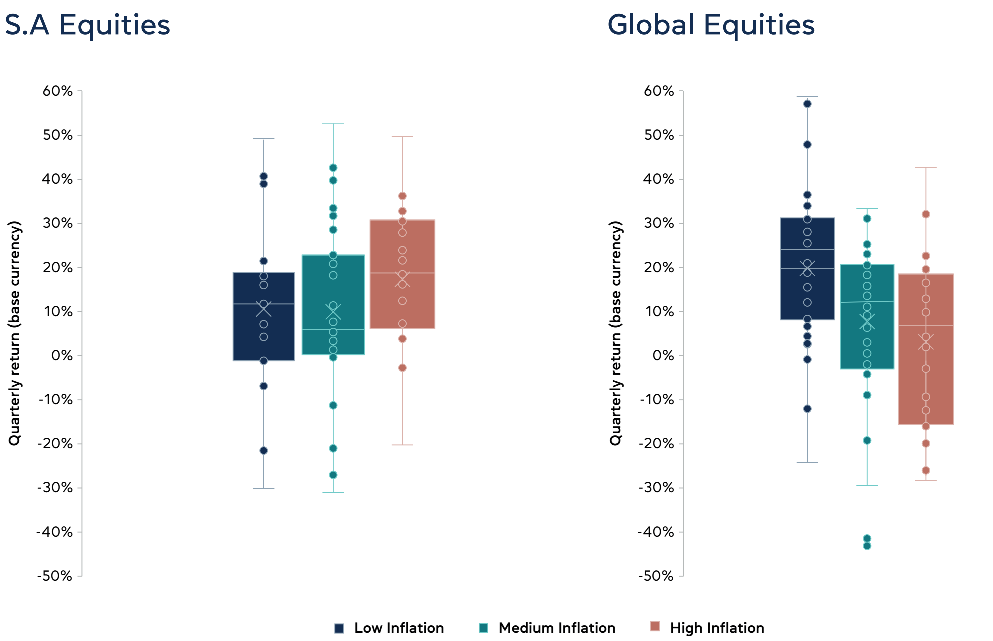
Two main changes to the global environment have developed over the past month. The first is the U.S. Fed coming out with a firm timeline for tapering off quantitative easing. The second is a CPI print that came in well above market expectations and fed the fire for structural rather than temporary inflation. We'll cover this in a bit more detail later on, but there are two key points – high inflation in the U.S. is generally good for S.A. equities, which act as a form of inflation hedge, and periods of heightened inflation after a crisis (especially with unprecedented stimulus) can be followed by low inflation due to a higher base effect in prices and the faucet of free money being turned off. We are left with an equity market on the home front that shows pockets of value within a generally risk-on global environment. It is certainly an attractive opportunity for an offshore investor looking for growth exposure to hedge inflation risk.

Valuations	Economics	Financial Conditions	Sentiment
Price to Earnings	Prescient Economic Indicator	Monetary Policy	Business Sentiment
Price to Book	Economic Surprise Index	Credit Spreads	Consumer Sentiment
Price to Sales	Profit Margin	Funding Pressure	Investor Sentiment
Relative Earnings Yield	Yield Curve	Cross-Currency Basis	Public Sentiment
	Labour Market		

LOOKING AHEAD: RISKS TO OUR VIEWS

HIGH INFLATION – A RISK/REWARD TRADE-OFF

The latest inflation print in the U.S. at 6.2% comes in ahead of expectations and cements the status of U.S. inflation being abnormally high versus the Fed's 2% target. How long this will last remains debatable, but the core contributors remain the same – energy (due to increased oil prices) and new and used car sales (due to supply chain bottlenecks). But what could it mean for South African asset classes when there is a high inflationary regime in the U.S., and what is all the fuss about? Our analysis shows that higher U.S. inflation is, if anything, a good thing for South African growth assets, with investors searching for inflation-beating assets in other currencies. As always, the reward must be worth the risk, but with yields so low offshore, there is much on offer in S.A. for offshore investors looking for an inflationary hedge who are willing to dip their toes in foreign waters.



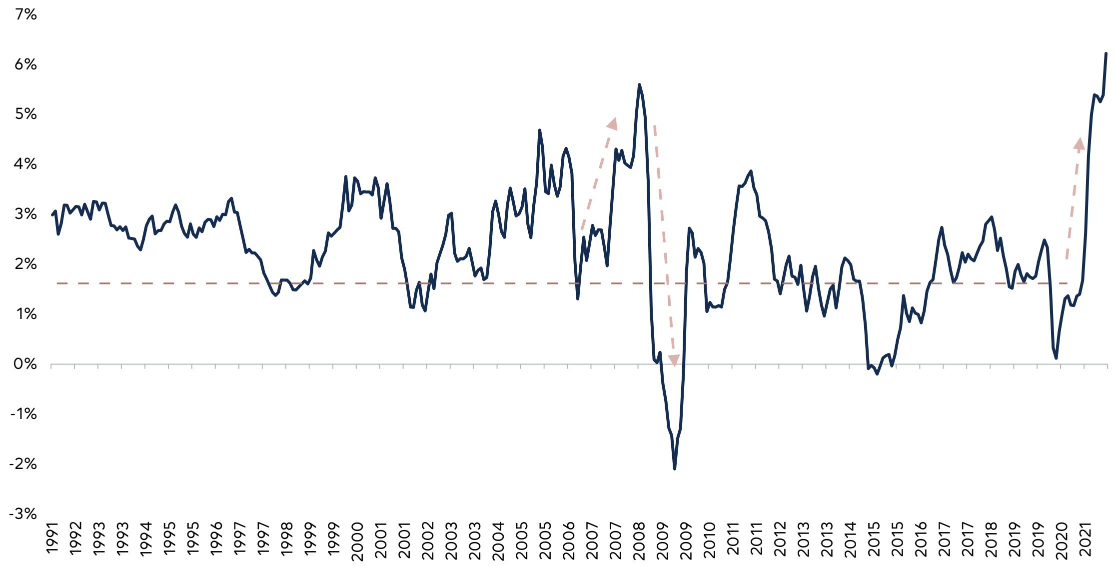
Sources: Prescient Investment Management, US Fed, Bloomberg (as at 31 October 2021)

INFLATION BECOMES DEFLATION – THE CONTRARIAN VIEW

It's always easy to sell a good headline, but it is much more important to take a step back and think through the next steps in the inflationary playbook logically. The effects of quantitative easing are generally inflationary, with money flooding the market, reducing its value and prices/wages rising. This is all subject to the so-called monetary impulse – a combination of money supply and the velocity of money (essentially how effective monetary stimulus is) leading to growth. The velocity of money has been declining for some time, so the writing has been on the wall for the winding down of the stimulus program due to its waning effectiveness.

The last regime of aggressive monetary stimulus, both through rate cuts and a Fed bond-buying program, was during and post the Global Financial Crisis in 2008. It continued in the form of multiple versions of Q.E., but the immediate effects of a crisis with strong stimulus and heightened inflation were reversed as the effectiveness of stimulus wore off and resulted in an undershoot on inflation in the years immediately after that. As always, this time is different, but we can't write off the scenario entirely given the roadmap for reduced Q.E., a hot equity market and a growth outlook on edge for the major developed markets.

US CPI YOY over the last 30 years



Sources: Prescient Investment Management, US Fed, Bloomberg (as at 31 October 2021)

BRINGING IT ALL TOGETHER

We have a lot to be thankful for as the year comes to a close, with multi-asset funds attracting inflows after having had a stellar year and rebounding back towards their long-term inflation-beating return targets. Significant opportunities across asset classes provide the impetus for an ongoing rally while at the same time offering a diversity of reasons for outperformance. Multi-asset offerings are seeing strong inflows as we head towards the end of the calendar year, with investors using the rebalancing opportunity to question previous norms and invest in funds with low fee profiles that do what they say on the tin. Prescient's multi-asset offerings aim to service client demand by combining what we see as the best of active and passive into a low fee offering run systematically and staying ahead of the curve.

South African assets remain attractive relative to their offshore counterparts, while the risk-on appetite remains intact for global investors. We say with confidence that if any of the above were to change, we would pick it up overnight, and our portfolios would be repositioned the very next day to align to the new normal.

As always, we remain guided by insight and informed by science – trusting the data we process to give us a logical, refined view across global asset classes and providing clients with peace of mind that our funds stay true to form and do exactly what they say on the tin.