momentum investments

IN THE moment

Portfolio returns in perspective

Introduction

During March, we had two great economic shocks that negatively affected financial markets, namely the COVID-19 crisis and Moody's downgrade of SA's sovereign rating from Baa3 to Ba1 (junk). We have sent extensive communications during March, highlighting the effect on the global and local economies as well as the markets.

Below is a recap of the major economic highlights in March:

- United States (US): The surge in initial jobless claims illuminates the start of the dire effects of large parts of the US economy being shut down to curb the spread of COVID-19.
- Eurozone: Early high-frequency indicators tell a tale of a collapsing economy, as the COVID-19 crisis urges country-wide lockdowns to stop the rise in infection rates.
- United Kingdom (UK): The sterling has been the hardest-hit currency from those in the 11-largest industrialised economies since the outbreak of the disease.
- Emerging markets (EMs): A sustained tightening in external financing conditions could result in on balance of payments for a number of vulnerable EMs.
- South Africa (SA): Moody's downgraded SA's sovereign rating to Ba1 from Baa3 and maintained a negative outlook amid persistently low growth and widespread fiscal pressures.
- Financial markets: Markets dropped precipitously in reaction to the spike in unpredictability. Turmoil triggered market-wide circuit breakers for the first time since 1997.

The effect on markets and your portfolios

Please refer to the annexure for detailed commentary on various local and global markets.

We believe in portfolios that are well diversified, not only across various asset classes, but also across various investment strategies and investment managers. Unfortunately, in extreme market conditions, many asset classes fall simultaneously and historic correlations become less relevant. In the recent market turmoil, there were very few asset classes that would have provided protection in absolute terms. However, most asset classes responded differently to the crises, be it in the magnitude of negative returns or the recovery period. Only US treasuries and local cash would have protected you against the extreme sell off in the markets, but these 'safe' asset classes also tend to come with their own risks, specifically the risk of inflation eroding their real returns.

Even though our portfolios have mostly delivered negative returns, the portfolios also provided you with a degree of protection against the severe fall in local equities and property as detailed in the tables below.

Returns at 31 March 2020

Asset class/ portfolios	Index	One month	Three months	Six months	One year	Three years	Five years	Seven years
Local								
Local cash	Short-term Fixed Interest Composite Index	0,57%	1,69%	3,47%	7,21%	7,30%	7,21%	6,78%
Local bonds	JSE Assa All Bond Index	-9,75%	-8,72%	-7,14%	-2,99%	5,26%	5,17%	5,50%
Local property	FTSE/JSE SA Listed Property Index	-36,57%	-48,15%	-47,85%	-47,91%	-22,98%	-13,48%	-5,11%
Local equity	FTSE/JSE Capped Shareholder Weighted Index	-16,69%	-26,58%	-22,70%	-24,53%	-7,37%	-3,80%	2,70%
Global								
Global bonds	Citigroup WGBI	12,08%	27,88%	18,52%	29,52%	14,30%	10,91%	11,78%
Global property	FTSE EPRA/NAREIT	-11,70%	-8,65%	-13,98%	-5,24%	6,80%	6,67%	11,62%
Global equity	MSCI AC World	-1,23%	0,37%	1,10%	10,13%	12,26%	11,59%	16,03%
Currency								
Rand/US dollar		14,11%	27,46%	17,71%	23,41%	10,01%	7,91%	9,84%
Portfolios								
Stelburg Income Portfolio		-3,38%	-2,72%	-1,11%	3,09%	6,77%	7,70%	
Stelburg Bond Portfolio		-8,10%	-7,74%	-6,93%	-3,07%	4,64%	3,91%	5,17%
Stelburg Aggressive Portfolio		-13,11%	-18,10%	-15,69%	-13,48%	-2,85%	-1,64%	3,34%

Note:
Returns before the launch of the portfolios include simulated return data. Please refer to the disclaimer at the end of this document and the portfolio's factsheet.

The biggest surprise for most investors came from the weak returns and lack of capital protection from income funds in the short term. This was mainly driven by their marginally higher duration positions relative to cash and their credit and property exposures. These are, however, the same factors that historically enabled income funds to earn cash-outperforming returns and we expect these to continue enhancing cash returns going forward. A good example of this would be the spike in bond yields, which presented an opportunity for the investment managers of our income and bond funds to lock in very attractive yields, where appropriate.

Despite being a defensive asset class historically, local bonds also provided little protection during this period. Their negative returns can be attributed to the massive global risk-off trade, leading to a flight of capital from emerging markets and SA's downgrade to junk status, with the negative returns being exacerbated by the weakening of the rand. However, not all was lost, as the weakening rand also cushioned the portfolios against the sell off in global equities.

The portfolios were further protected against the spectacular fall in local equities and property, owing to their prudent allocation to these asset classes. Within the local equity allocation, the portfolios also got robust relative protection from the recently introduced exposure to a dedicated quality strategy.

Based on our initial engagements with the underlying investment managers, we are confident that most of them have also protected their funds through their prudent portfolio construction and management processes. Some of the investment managers were less successful in protecting the portfolios, but these were typically the investment managers that provided us with good outperformance during periods when growth asset classes were providing good inflation-outperforming returns.

The severe sell off in the markets has also created a significant buying opportunity for some of our investment managers and some are already positioned to take maximum advantage of the eventual recovery in the market.

We are also continually monitoring your portfolios' positions to make sure that market drift does not cause unintended risks in the portfolios. We have identified that the portfolios are overweight global equities and local bonds as well as underweight local property and local equities (to a lesser extent). In our view, the biggest relative risk in the portfolios is being overweight global asset classes, which would detract from returns if the rand strengthens. We are, however, comfortable to maintain these overweight positions, given that local bonds are also overweight, and would likely benefit should the rand strengthen.

We will do a full analysis of the portfolios' returns at your upcoming quarterly investment meeting. We will also discuss how we are going to position the portfolios to take maximum advantage of a potential recovery, while remaining acutely aware of the potential risks. .

In conclusion

We understand that, during these testing times, one may feel overwhelmed and helpless, and not just financially. For some of us it is not natural not to do anything during situations like these and our mantra of 'stay invested' may be of little comfort, but we assure you that it is the best course of action. As investment professionals, we have seen these distressed markets many times in the past and like humanity, markets will always recover.

Bennie Crous
Portfolio Manager
Momentum Investment Consulting

Annexure

Global markets

Global financial markets plunged in the first half of the month, as the vicious economic and health shocks intensified, sending shares further into correction territory. The responding bazooka of central bank and government spending plans nevertheless slowed the drop in global equity markets late in the month.

The CBOE Volatility Index (Vix), or fear gauge, climbed nearly 40 points in the first quarter of the year to 53 points, but touched an intra-quarter high of 83 points. Investor angst led to the MSCI All Country World Index crashing 22% in the first two and a half weeks of the month. Strong policymaker efforts to curb the spread of COVID-19 led a reversal in equity markets at the end of the month, but global equities still finished March 2020 13.5% in the red. For the year to date, the MSCI All Country World Index weathered a 21.4% fall, led weaker by an almost equally weak return from developed and emerging equity markets.

The MSCI Developed Markets (DM) Index extended its slide in March 2020 and ended the month 13.2% weaker. Losses were greatest in the Eurostoxx 50 Index at 16.2%, followed by a 12.4% dip in the S&P500 Index and a 9.7% drop in the Nikkei 225 Index.

The MSCI DM Index lost more than a fifth of its value YTD, as the COVID-19 pandemic roiled financial markets. US, European and Japanese bourses contributed to the extensive losses in the first quarter of the year. The Eurostoxx 50 Index haemorrhaged 25.3% in the first quarter of the year, followed by a 19.6% crash in the S&P 500 Index and a 19.2% plunge in the Nikkei 225 Index.

The S&P 500 Index skidded down 19% at its worst point in the month, but staged a decent rally thereafter on aggressive buying from central banks and an announcement by the US government that it would be rolling out stimulus measures of about 10% of gross domestic product.

The Eurostoxx 50 Index had fallen more than 28% at its worst point in the month. Italian Prime Minister, Giuseppe Conte, put the entire country under lockdown on 10 March 2020, while Spain and France followed, by ordering residents to stay in their homes. Policymakers have still not found a way forward on a co-ordinated fiscal response. France, Italy and Spain have called for pooled Euro-area resources, while Germany remains opposed.

The Nikkei 225 Index suffered a 21% blow at its worst point in the month, but rebounded on the US Fed's announcement of an open-ended asset purchase programme and a US$2.2 trillion COVID-19 stimulus bill, which was struck between the White House and Senate in Washington. Japanese buyers' optimism was also lifted on an expected increase in equity purchases by the Bank of Japan and public pension funds.

DM government bond yields plummeted further in the first quarter of 2020, as investors retreated to safety. The US 10-year government bond yield rallied 125 basis points to an all-time low of 0.6%, while the German 10-year government bond yield sank nearly 30 basis points deeper into negative territory to negative 0.5%.

EM equity markets tumbled 23.6% in the first quarter of 2020, in line with a 23.3% drop in the Bloomberg Commodity Price Index. The MSCI Latin America Index nosedived 45.6% YTD, followed by a 33.9% crash in the MSCI Europe, Middle East and the Africa (EMEA) Index and an 18.1% fall in the MSCI Asia Index.

The MSCI Latin America Index lost a third of its value in March 2020, as investors lost confidence in Brazil's ability to improve its economic outlook. The MSCI EMEA Index suffered a 21.1% knock in the same period, following a scaling up of measures in SA and Russia (the two-largest constituents of the MSCI EMEA Index) to fight the COVID-19 pandemic. The monthly loss in the MSCI Asia Index trailed at 11.7%, after China eased the lockdown in Hubei, signalling increased control over the outbreak.

Risk appetite worsened towards EMs in March 2020, with the JP Morgan EM Bond Index (Embi) spread ending March 2020 more than 223 points higher. This leaves the Embi spread 297 points higher YTD. Argentina (increase of 300%), Indonesia (257%) and Russia's (256%) credit default swap (CDS) spreads blew out the most since the end of 2019, while the deterioration in spreads was the

most muted for Bulgaria (2%), Hungary (12%) and Poland (13%).

The JPMorgan EM Currency Index shed 13.0% against the US dollar YTD, depreciating by 8.4% in March 2020. All major EM currencies printed in the red against the US dollar YTD. The steepest depreciations against the US dollar were in the Brazilian real (22.6%), SA rand (21.5%) and the Russian rouble (21.0%). During March 2020, the Mexican peso lost 17.0% against the US dollar, the Russian rouble depreciated by 14.7% and the Brazilian real slid 14.1%.

Local markets

The local equity market rout continued in March 2020, as panic set in. The FTSE/JSE All-Share Index sank 24.1% YTD, dragged lower by a 39.5% collapse in the FTSE/JSE Financials Index and a 25.3% lurch down in FTSE/JSE Resource Index.

Gold prices lifted 4.0% since the end of 2019, but platinum prices tanked 26.2% in the same period. Meanwhile, the international price of crude oil dove 65.7% in March 2020 to the lowest level since March 2002, on a collapse in demand driven by widespread lockdowns in European and the US as well as a price war launched by Saudi Arabia. According to the Financial Times, traders believe the global surplus could reach 25 million barrels a day by next month, which could overwhelm storage capacity.

The FTSE/JSE All-Share Index shrank 12.1% in March 2020, driven weaker by financial shares, which grinded 29.4% lower in the month. Bank shares performed poorly in the month, losing more than a third of their value.
The FTSE/JSE Resources Index ended March 2020 12.4% lower, while losses in the FTSE/JSE Industrials Index were limited to 3.1%, as a weaker currency buffered the fall by aiding dual-listed shares in the index. Retail shares were nevertheless hit hard in the month, falling by nearly 35% at its weakest point, when the SA government announced a 21-day lockdown on 23 March 2020.

The FTSE/JSE Mid-cap Index fared marginally worse than the FTSE/JSE Small-cap Index in March 2020, with the former stumbling 23.7% in the month (down 35.6% for the quarter), while losses in the latter amounted to 21.7% (32.6% weaker for the quarter).
The SA 10-year government bond yield sold off 186 basis points since the end of 2019. The bulk of the sell off was generated in March 2020, when yields spiked more than 180 basis points. The JSE Assa All Bond Index fell 9.7% in the month, while the JSE Assa Government Inflation-linked Bond Index traded 17.2% weaker for the same period.

Meanwhile, the FTSE/JSE SA Listed Property Index slumped by a further 36.6% in March 2020, nearly halving in value since the end of 2019. A shock to risk appetite caused by the virus and a late-month downgrade of SA's sovereign rating by Moody's into junk territory caused the rand to spike to historic levels. The rand weakened by 12.3% against the US dollar, 12.4% against the euro and 9.4% against the pound in March 2020. In line with the rise in CDS spreads across numerous EMs, SA's five-year CDS spread widened by 95% (240 points) to 419 points in March 2020, partly owing to Moody's downgrade. SA's five-year CDS spread shifted 257 points above levels seen at the end of 2019.

Despite Brazil rated as a poorer credit quality (BB- by S&P and Fitch as well asBa2 by Moody's), its CDS is trading much lower at 272 points.

Disclosures

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