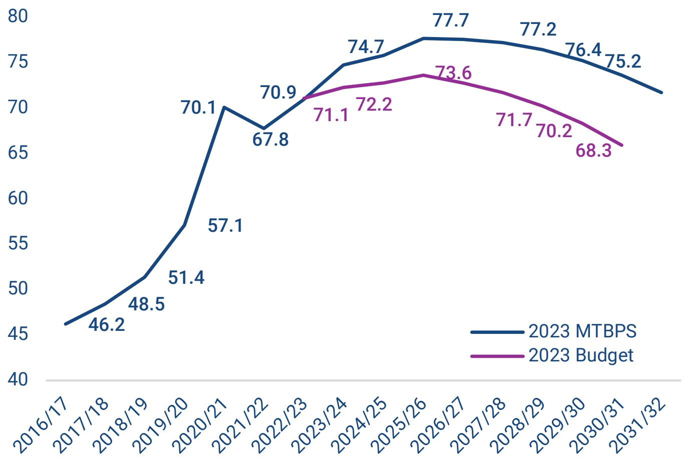
SA debt burden on the rise

South Africa Debt-to-GDP 2016/17 - 2031/32



Source: 10X Investments National Treasury

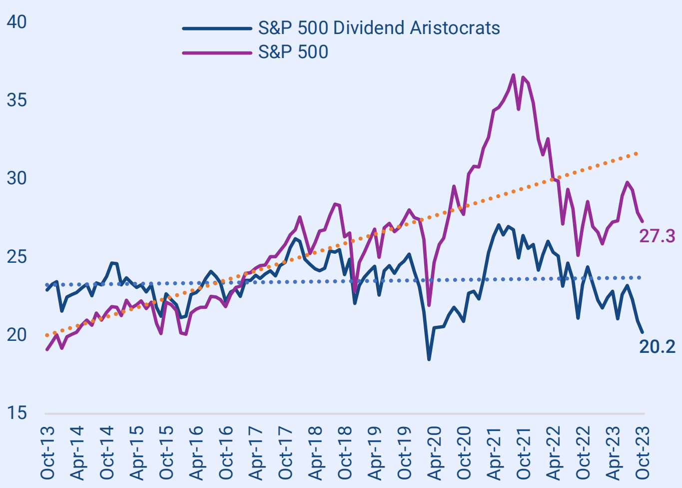
Unfortunately, the release of the Medium-Term Budget Policy Statement on the 1st of November, provided us with a rather bleak outlook for SA's long-term debt trajectory. Lower tax revenues (primarily due to lower commodity prices) coupled with higher debt service costs and wage settlements increased the budget deficit for FY 23/24 to 4.7% from 3.9% earlier in the year.

Even with rosy GDP growth numbers being factored in by National Treasury, the level of debt to GDP is now expected to plateau at just under 78% in 2026. We're now spending 20c on interest costs out of every R1 raised from tax revenue.

Like many other countries, including the US, these debt dynamics are just not sustainable.

Not all US equity is expensive

CAPE Ratio October 2013 - October 2023



Source: 10X Investments Bloomberg

Big tech has had another stellar year outperforming the broader market by 50% in 2023. The Magnificent 7 (the big tech players from Apple to Nvidia) now make up close to 30% of the S&P 500. A company like Apple is almost **twice** the size of the German stock market.

While there are concerns of bubble-like valuations across the tech sector the same is not necessarily true for the broader market. To illustrate this, the chart on the left tracks a cyclically adjusted price earnings (CAPE) ratio of an index of quality, consistent dividend paying companies from MacDonalds to Dulux, that is far closer to fair value compared to the broader more highly concentrated US Index. Interestingly the Dividend Aristocrats earnings growth has kept pace with the broad market over the last decade.

S&P 500 & 10Y Yield Combo to achieve a 4.25% ERP*

10Y T-Note Yield	S&P 500 Level
4.0%	2855
3.5%	3040
3.0%	3250
2.5%	3490
2.0%	3770
1.5%	4100
1.0%	4490

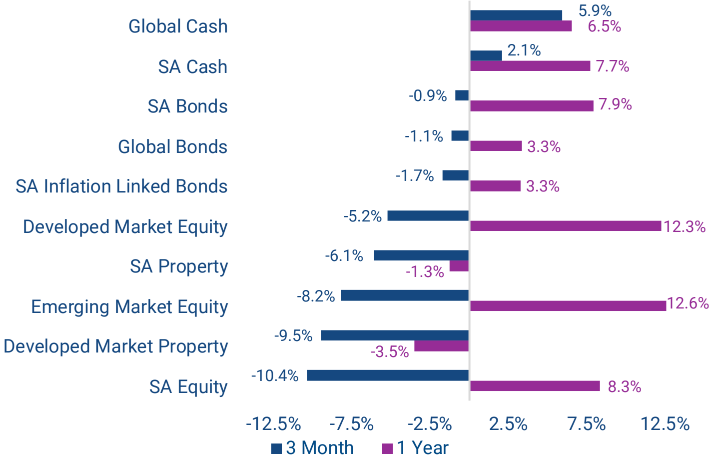
*ERP defined as S&P 500 12m fwd EY – 10Y Yield

Source: 10X Investments, Rosenberg Research

The broader US equity market is not only expensive on an absolute basis but now the most expensive it's been relative to bonds since the early 2000s. A metric that we track closely is the Equity Risk Premium (ERP) which compares the earnings yield of equities to bonds (S&P 500 v 10-year UST). The average multi year level sits at around 4.25% compared to the current level of 0.75%.

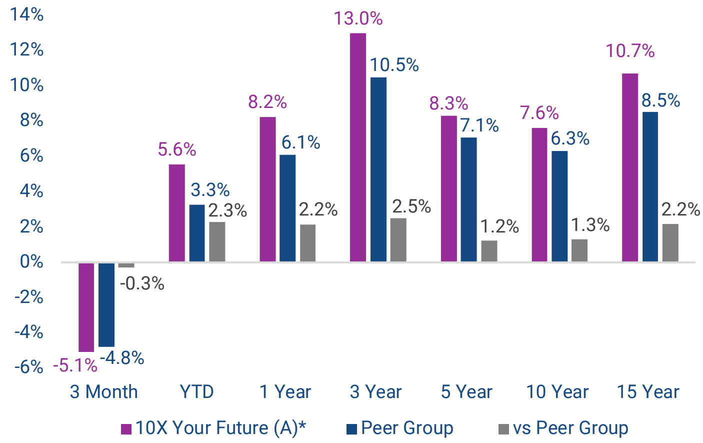
A base case scenario in the next economic downturn is 10-year UST yields closer to 2.5-3% and a US equity market 25% below current levels.

Asset class returns to 31 October 2023
Cash is king



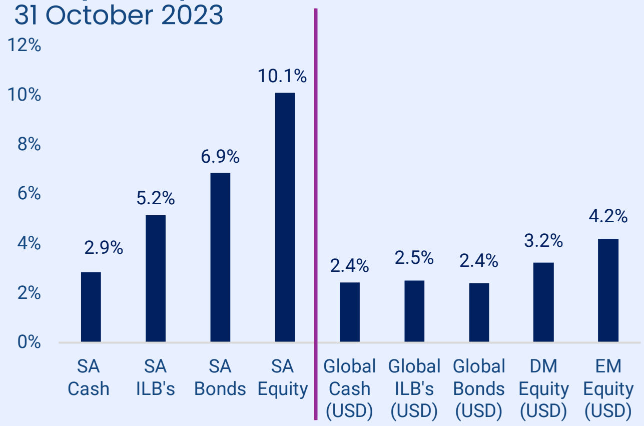
Source: 10X Investments Bloomberg

Portfolio returns to 31 October 2023
Consistent performance



Source: 10X Investments Morningstar; CPI lagged by 1 month; * returns prior to March 2019 are those of 10X Umbrella Pension Fund adjusted for Class A fee

5-10 year expected asset class return
31 October 2023



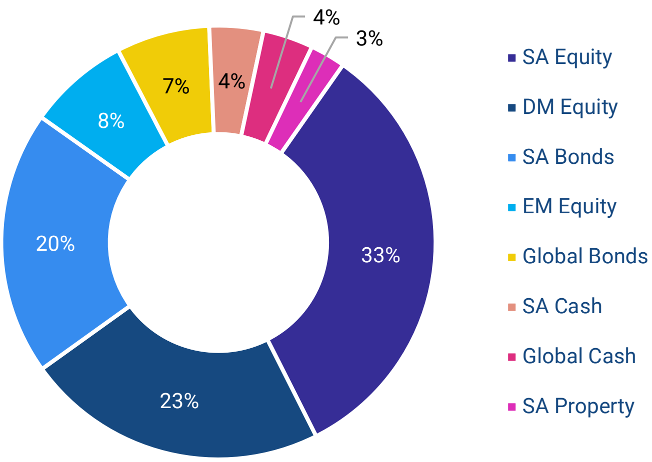
Source: 10X Investments, Bloomberg

Real (after-inflation) return expectations

High real yields in SA bonds are driving attractive valuations across SA asset classes, underpinning strong forward looking return expectations. The premium of SA equities over SA bonds remains materially below the longer-term average.

The steepening of global bond curves now mean that this asset class is relatively more attractive than global cash, whilst global equity return expectations remain depressed.

10X Your Future Fund Asset Allocation
31 October 2023



Source: 10X Investment

Asset Allocation

With a 66% allocation to growth assets, the fund remains defensively positioned. This is primarily due to the low long-term real return expectations on offer in global equity markets relative to bonds. In addition, our risk framework indicates a high proportion of downside scenarios for risk assets.

The fund has benefited from a higher allocation to global cash over the last 3 months. However, the steepening of the US yield curve since the end of June has increased the expected return from global bonds relative to global cash. This has presented an opportunity to increase the allocation to both global government bonds and TIPs funded from global cash.

Anton Eser
Chief Investment Officer

Chris Eddy
Head of Multi Asset Funds

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