Please note that the commentary is for the retail class of the Fund.

The Fund returned 1.70% over the last quarter, which was behind the STeFI composite benchmark of 2.01%. Since inception, the Fund has returned 9.47% p.a. which is ahead of the benchmark return of 8.48% p.a.

The last quarter saw volatility return to domestic asset classes, with the SA 10-year bond yield widening by approximately 60 basis points (bps) before recovering some losses toward quarter-end. This volatility was driven by a combination of factors, including US rate uncertainty surrounding the Presidential elections, hawkish SARB MPC commentary despite cutting rates, and the Medium-Term Budget Policy Statement. In addition, local macroeconomic data presented a mixed picture across various sectors. The economy experienced a contraction in the third quarter of 2024, with annual growth at just 0.3% year on year (y/y). This weakness was primarily driven by a significant decline in the agricultural sector, but it was clear that domestic demand continues to be very constrained.

On the inflation front, there was a notable improvement. November CPI came in lower than expected at 2.9% y/y, with core inflation moderating to 3.7% y/y. Food inflation has significantly decelerated, contributing to the overall benign inflation environment. In response to these developments, the SARB implemented a 25bps cut in the repo rate, bringing it to 7.75%.

While the economic data supports further monetary easing, the SARB remains cautious in its approach, emphasising that additional easing is likely to be influenced by local price developments (particularly administered prices, food, and wages) and global factors which will likely also impact the currency.

The October Medium-Term Budget Policy Statement presented mixed results. While it showed strong alignment with the Government of National Unity's objectives, especially in infrastructure spending and efficiency measures, several crucial challenges remained unsolved. Key concerns include uncertainties around the wage bill, municipal finances, and debt, as well as funding for state-owned enterprises. These issues, along with potential growth challenges and funding conditions, raise questions about reaching the projected debt peak. The outlook was further dampened by an upward revision of the budget deficit, together with a lower-than-targeted primary surplus.

The quarterly returns of fixed income asset classes available to the Fund fell short of expectations, with both nominal and inflation-linked bonds (ILBs) underperforming cash. The FTSE/JSE All Bond Index (ALBI) returned 0.43%, with the one- to three-year and three- to seven-year buckets showing the strongest performance at 1.45% and 1.30% respectively. Though the Fund's positions are concentrated in these buckets through its holdings in R2030s and R213s, returns still lagged cash. However, given the attractiveness of government bonds relative to cash over the medium term, the opportunity was taken to increase nominal duration by approximately 0.25 years, with holdings continuing to be concentrated on the aforementioned bonds along with the R186. Looking ahead, we maintain that the sub-10-year portion of the curve presents the optimal risk/reward opportunity for a cash-cognisant mandate.

ILBs, as measured by the Barclays/ABSA Govt Inflation-Linked Bonds Index, performed marginally better than their nominal counterparts, returning 0.76% for the quarter, though still underperforming cash. The Fund's holdings were concentrated in the I2029, which delivered a lower return of 0.44%. While the subdued inflation outlook for the coming months may constrain ILB returns, real rates remain compelling, with four-year ILBs trading at 4.7%. Combined with our expected inflation profile for the next year, returns are expected to exceed 10%, which remains attractive relative to cash and their nominal bond counterparts. In addition, ILBs also act as an important diversifier, particularly in volatile environments. The Fund currently maintains approximately 25% allocation to short-dated ILBs which was increased during the period. However, our I2025 holdings of approximately 4% of Fund will mature at the end of January 2025, after which we will reinvest the proceeds into appropriate investment opportunities.

Money market opportunities were limited, with NCD yields remaining range-bound despite broader volatility and a reflection of the tight credit market conditions. However, Treasury Bills offered better opportunities, allowing us to invest in six- and nine-month instruments yielding above 8.2%. These investments are particularly attractive given our expectation that the repo rate will settle at 7.25% over the next year.

Credit market opportunities remain very limited as spreads continue to compress. While we found some small opportunities in the secondary market, our overall credit allocation is likely to decrease gradually. We did identify promising opportunities in inflation-linked corporate credit, particularly from financial institutions, which contributed to our increased allocation to inflation-linked instruments mentioned above.

Outlook

We remain cautious about the year ahead, given continued political instability in developed markets, increasingly hawkish narratives from central banks, and flare-ups in geopolitical tensions. Volatility is likely to be a key theme, which may result in short periods of underperformance. However, we remain focused on valuation and will continue to invest only in instruments that we believe offer appropriate returns for their underlying level of risk. On the local front, we see inflation well under control and averaging 4.3% for 2025, despite the SARB's rhetoric. Key risks, however, will include the government's ongoing commitment to fiscal reform while maintaining its focus on stimulating growth.

Given the current Fund yield of 9.30%, together with its modest duration positioning, we believe it remains on track to deliver its target of cash + 1.5% over the medium term.

Portfolio managers
Nishan Maharaj and Mauro Longano
as at 31 December 2024