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

At the halfway point of this year, we have already had to contend with a few surprise election outcomes and proceedings. India's Prime Minister Narendra Modi was widely expected to have a clean sweep but had to form a coalition to secure a third term; while in France, President Emmanuel Macron called a snap national election in response to the gains by far-right parties in the EU parliamentary elections, who then suffered a surprise defeat against a left-wing alliance. At home, our own elections resulted in the ruling national party, the ANC, losing its majority position by an unexpectedly wide margin. Despite this result, initial fears of violence in KwaZulu-Natal or an alliance with the populist EFF or MK party have not materialised. Instead, we have seen a calm acceptance of the loss of its majority by the ANC and, encouragingly, a pull towards forming a centrist grouping with the DA. Notwithstanding the fraught negotiations leading up to the formation of the cabinet, the outcome announced by the President is broadly sensible. This is a positive result for the country and will hopefully lead to much-needed reforms being implemented. Our domestic asset prices have responded accordingly with a strong rally in SA government bonds, local property stocks, SA Inc. businesses and a strengthening of the rand versus the US dollar.

Performance and positioning

Given our full exposure to offshore assets, we have had relatively lighter exposure to local assets. Our income-and-growth funds will, therefore, have underperformed many peers over the quarter to end-June during this relief rally. Nevertheless, the quarter's performance remains credible, with a positive return of 1.3%, and the Fund is still comfortably ahead of its inflation target over one year, with a return of 9.5%, and delivering decent real returns over longer time horizons.

Looking forward, while the formation of the Government of National Unity (GNU) will be a significant improvement to the one-party rule of the ANC, it will not be easy to manage the day-to-day working of a government consisting of many different viewpoints and ideologies. The low growth rut in which we find ourselves is the result of many years of neglect of infrastructure spending and poor management of vital SOEs such as Eskom and Transnet. Without adequate power, water, rail, and functioning ports, the economy will struggle to reach its full potential. Turning these very important cogs of the economy into efficient working enterprises will take time and monumental effort.

The government has also run up a huge debt burden that has had the effect of pushing local government bond yields very high, making debt servicing costly and borrowing for new investments very expensive. It will take several years of running much tighter budgets to improve the government's fiscal position. This comes at a time when big spending on neglected infrastructure is necessary.

These structural issues are not insurmountable, but the implementation of reform policies, together with timely execution, will be critical to overcoming them. We expect that the political coordination of the GNU will not be smooth and will require compromises to be made for the country's benefit. Hence, while the election outcome has been viewed constructively, the difficult work still lies ahead. Our income-and-growth portfolios have not made any significant changes to their positioning in response to the elections, as our key views are still largely in place. These are:

1. SA assets look cheap, but we remain selective. Our focus will continue to be on the longer-term outlook for these assets rather than positioning ourselves for short-term opportunities.

   - As discussed above, a positive election outcome does not automatically and immediately result in a significant improvement in our country's growth profile. We have a reasonable allocation to SA government and inflation-linked bonds, mostly in the belly of the curve, where we think the real risk-adjusted returns are the most attractive.
   - Our exposure to SA government bonds is supplemented by allocations to SA corporate credit, where the yields to maturity are healthy.
   - The income-generating portion of our portfolio's domestic allocation is complemented by SA growth assets (mainly equities). Our domestic equity allocation comprises global businesses that are listed on the JSE, very specific commodity shares and robust domestic businesses that have reasonable growth prospects and that can supplement their growth with good dividend yields. The recent trading updates by the banks are instructive. While the banks all trade at multiples, which are at a discount to their long-term history, FirstRand and Nedbank (both held in the portfolio) delivered better-than-expected earnings, while Absa (not held) came in with sub-par results. This confirms that, ultimately, the underlying fundamentals continue to matter more than broad-brush investing in 'cheap' domestic assets.

2. Global assets have rallied, but global growth prospects remain resilient, and we continue to find broad selection opportunities. These assets provide us with the necessary diversification. Easing interest rates in response to slowing inflationary pressures should be supportive of global asset pricing.

   - Global equities may look stretched at the index level, particularly in the US, but stock picking and regional investment opportunities abound. In contrast to a very stagnant SA economy, global growth has been more resilient, and we are seeing significant secular changes in some industries. The allocation to companies operating in the global technology, payment processing, rail transport, and gaming and entertainment space provides us exposure to these different drivers at reasonable valuations.
   - Global corporate credit and holdings in US treasuries continue to generate a positive real yield and provide diversification in this portfolio's income category.

Outlook

In conclusion, the economic outlook for SA has improved and the new government has an opportunity to raise business and consumer confidence levels off an extremely low base *if* they follow sound long-term policies and appoint competent individuals in areas where it is needed. While we are hopeful for this scenario, we remain cautious in assuming quick success. Outside of SA, we think macro risks are easing, but major political and geopolitical risks remain and could create disorder. Our focus continues to be on building our portfolios from the bottom up to deliver robust inflation-beating returns in a diverse range of scenarios.

Portfolio managers
Pallavi Ambekar, Charles de Kock and Neill Young
as at 30 June 2024