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

The Fund returned 0.21% in October, bringing its 12-month total return to 13.09%, which is ahead of cash (8.26%) and its benchmark (9.12%) over the same period. We continue to believe that the Fund's current positioning offers the best probability of achieving its cash +2% objective over the medium to longer term.

Local bonds performed poorly in October. The FTSE/JSE All Bond Index (ALBI) was down 2.20%, with the long end of the curve (represented by bonds with a maturity of 12+ years) performing the worst, down 3.42%. The belly of the curve (bonds maturing in 7-12 years) closed 2.1% lower, while medium-term bonds (bonds maturing in 3-7 years) returned -1.21%. Short-term bonds (bonds maturing in 1-3 years) were down 0.06%, while cash returns were subdued at 0.66%. Inflation-linked bonds (ILBs) were also down 1.03 % for the month.

October was a bit of a mixed bag in terms of economic data, with the US, China, and euro area reporting soft economic growth for the third quarter of 2024 (Q3-24). Global inflation continued to moderate, inching closer to central banks' target ranges. Major central banks have taken a gradual approach in easing monetary policy settings.

The US economy grew by 2.8% quarter on quarter (q/q) in Q3-24 compared to growth of 3.0% q/q in Q2-24. Activity was supported by an uptick in personal consumption, strong business investment in equipment and higher government expenditure related to defence spending. Elsewhere, the economy experienced a slowdown in private inventory accumulation and a large decline in residential fixed investments. Net exports detracted.

US headline inflation slowed to 2.4% year on year (y/y) in September from 2.5% y/y in August, while core inflation ticked up to 3.3% y/y from 3.2% y/y. The main driver behind this moderation was another decline in energy costs and used vehicles prices. Shelter costs also moderated. This was offset by higher food prices and increases in services inflation which boosted core inflation.

The ECB cut its policy rate by 25 basis points (bps), moving the deposit rate to 3.25% from 3.50% at the Governing Council meeting in October. Despite the easing, the statement highlighted concerns that inflation remains high, supported by strong wage gains and sticky services inflation. Headline inflation is seen averaging at 2.5% in 2024 and only reaching the ECB's 2% target in 2026.

In China, the economy grew by 0.9% q/q in Q3-24 from 0.7% q/q in Q2-24. Growth was supported by industrial output, positive retail sales, and increases in non-property related fixed asset investment. However, the main contributor was positive net exports. The property market remains week and the broader economic outlook remains challenging. Ongoing structural issues in the housing market, entrenched deflationary pressures, and sluggish consumption have left the leadership under increasing pressure to take decisive action in efforts to boost economic growth. So far, policy support has remained cautious, focusing more on managing risks rather than pursuing aggressive growth measures.

In South Africa, Minister of Finance, Enoch Godongwana, tabled the Medium-Term Policy Budget Speech (MTPBS) in October. Thematically, the MTBPS aimed to align a dual message of ongoing sustainable consolidation targeting a debt stabilising primary surplus, while realigning expenditure priorities towards raising investment. Revenue collection estimates were moderately revised down as value-added tax, personal income tax and fuel levy collections have disappointed. The expenditure profile was revised up due to a higher wage bill, provisions for South African National Roads Agency debt repayment, and higher debt-service costs. Gross loan debt as a share of GDP is projected to stabilise at 75.5% in 2025/26, higher than the 75.3% estimate pencilled at the February Budget Review. No additional bailout funds were allocated to State-owned enterprises and Eskom's bailout package will be reduced by R2bn because of non-compliance with certain conditions. The MTPBS presented a lot of fiscal reforms, but timing and delivery (and political buy-in in some cases) remain uncertain.

The rand ended the month at R17.61/US$1, weaker than its close in the previous month but in line with its Emerging Market peer group. Offshore credit assets and certain developed market bonds continue to flag as relatively attractive. The Fund has utilised a significant part of its offshore allowance to invest in these assets. When valuations are stretched, the Fund will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollars, UK pounds, and euros). These instruments are used to adjust its exposure synthetically, allowing it to maintain its core holdings in offshore assets.

Headline inflation eased to 3.8% y/y in September from 4.4% y/y in August, while core inflation remained unchanged at 4.1% y/y. The main driver for the slowdown was another large fall in retail fuel prices. Vehicle and food prices were flat, while rental inflation picked up a little off a low base but continue with a weak trend pace. The sharp downward revisions to CPI forecasts, coupled with ongoing evidence of weak underlying growth momentum support a further 25bps cut at the November Monetary Policy Committee meeting, which will bring the year-end repo rate to 7.75%.

At the end of October, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 8.40% (three-year) and 8.96% (five-year), higher compared to the end of the previous month. Our inflation expectations suggest that the current pricing of these instruments remains attractive due to their lower modified duration and, hence, high breakeven relative to cash. In addition, NCDs have the added benefit of being liquid, thus aligning the Fund's liquidity with the needs of its investors. The Fund continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

The global monetary policy easing cycle has boosted the wind in the sails of risky assets' performance. Global and emerging market bond yields are all significantly lower than at the start of the year. However, current market pricing of interest rate expectations seems ambitious, which suggests global bond yields are well priced at current valuations. SA bonds have enjoyed renewed investor optimism following the formation of the Government of National Unity and on the heels of the global bond rally. SA inflation expectations have reduced significantly but are now fairly priced in through repo rate expectations. The country's fiscal accounts remain at risk over the longer term and current bond valuations fully discount a more optimistic outcome. ILBs still offer value relative to nominal bonds if inflation materialises higher than forecast, or if real yields follow nominal bond yields lower. Bond portfolios should be positioned neutral duration at current levels with a healthy dose of ILBs for good measure.

The local listed property sector was down 2.69% over the month, bringing its 12-month return to 51.97%. Operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. The current subdued growth outlook, combined with an increase in the cost base, due to higher administered prices and second-round effects on loadshedding, will weigh on the sector's earnings in the coming year. We believe that one must remain cautious given the high levels of uncertainty around the strength and durability of the local recovery.

We believe that allocating significant amounts of capital to the local credit market is unwise and would represent a substantial opportunity cost in the face of attractive valuations in other, more liquid asset classes. The current level of credit spreads on offer are at historically compressed.

The use of structured products, such as credit-linked notes (CLNs), has become ubiquitous within the local market. This sector has grown exponentially over the last five years and has reached a market size of over R100 billion. However, only a third of this market reprices, creating an inaccurate representation of asset volatility and pricing. CLNs mask the underlying/see-through credit risk as the issuing entity (predominantly local banks) is seen as the primary credit risk. The increased usage of CLNs has not expanded the pool of borrowers, rather it has only served to concentrate it. This is due to the ability to limit the volatility of these instruments through not marking them to market[1] based on the underlying asset price movements. This is why CLN repacks of SA government bonds have become so popular over the last five years. The combination of attractive yields and no volatility is an opportunity that not many would pass up, unless, of course, transparency of pricing is important to the underlying investor. As a result, there can be significant unseen risks within fixed-income funds. Investors need to remain prudently focused on finding assets of which the valuations are correctly aligned to fundamentals and efficient market pricing.

We remain vigilant of the risks from the dislocations between stretched valuations and the local economy's underlying fundamentals. However, we believe that the Fund's current positioning correctly reflects appropriate levels of caution, while its yield of 9.54% (gross of fees) remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected portfolio performance over the next 12 months. As is evident, we remain cautious in our management of the Fund. We continue to invest only in assets and instruments that we believe have the correct risk and term premium to limit investor downside and enhance yield.

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

[1] Valuations are not regularly adjusted to mirror their current value