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

Performance

Global markets continued their strong march upwards in Q3 of 2024. The MSCI ACWI returned 7% for the quarter, lifting the year-to-date (ytd) return to 19%. The returns are broad based across markets and have been supported by generally resilient economic growth and employment data. Continued easing in inflation supported the start of cuts in policy rates across many markets, including the US where a larger-than-expected cut of 50bps was announced. The positive outlook also reflected in global bond markets with a 7% return from the Bloomberg Barclays Global Aggregate Bond Index for the quarter (4% ytd).

Emerging markets joined the party, rising 9% in Q3 and 17% ytd. China was a strong contributor to these returns as a raft of stimulus measures were finally announced in September, resulting in a 24% return for the MSCI China Index in that month alone.

Geopolitical tensions remain high and appear to be escalating in the Middle East, raising the potential of a broader regional conflict. The oil price has bounced off its September lows and the gold price ended the quarter close to an all-time high above $2 600/oz, perhaps reflecting these risks despite the relatively benign economic environment that appears to be unfolding.

Domestic markets performed strongly as positive sentiment attributed to the new government continued into Q3, supported by a 25bps rate cut from the SARB in September. The JSE Capped SWIX returned 10% for the quarter, taking the ytd return to 16%. The bond market rallied strongly as yields declined, taking the ALBI return to 11% for the quarter and 17% for the ytd. This optimism is also reflected in the currency as the rand closed the quarter at 17.27 to the USD, a strengthening of 6% since the beginning of the year – almost all of which happened in Q3.

The Fund's returns have been supported by the strong markets, delivering 4.7% for the quarter and 15.3% over the last 12 months, substantially ahead of the CPI +3% target. Similarly, the Fund has outperformed its target over all meaningful long-term periods with the exception of 10 years, where it is slightly behind target but still comfortably ahead of inflation. Since inception, Fund performance remains ahead of target.

Portfolio actions and fund positioning

The Fund retains a substantial exposure to global assets at 40% of fund on a gross basis at the end of September, largely unchanged from June. While this has contributed strongly to returns over the longer term, the strength in domestic assets and the currency in Q3 meant that the global portion of the portfolio provided little assistance in the quarter, with the bulk of the uplift coming from the Fund's holding in SA bonds and equities.

We remain of the view that a relatively full allocation to global assets is appropriate. While headline indices have performed strongly and market breadth has improved, we continue to find attractive stock picking opportunities in global markets across both regions and sectors. It is often challenging to pinpoint when or what will cause the value on offer to be accurately priced by markets. The recent rally in Chinese stocks is a case in point; the market was impatiently waiting for stimulus measures to be announced by the government to address the country's economic slowdown, but there was no way of knowing whether or when any such measures would be forthcoming. When they finally were, the reaction was swift and strong, benefiting stocks held in the portfolio that we consider having high quality, strongly growing earning streams but the prices of which had been excessively discounted largely due to macro uncertainties. The opportunity remains for a similar realisation of value in many other non-Chinese stocks in the portfolio but the timing of this is impossible to know. Mindful of the robust performance of the headline indices and the objective of protecting capital, we retain put protection over 20% of the global equity allocation. The global fixed income allocation consists of short-dated US T-bills as well as corporate credits offering attractive yields.

One can certainly sketch a positive scenario to support the price moves in South African assets. Nearly 100 days in, the GNU is performing well and there appears to be genuine intent on all sides to ensure its longevity and to work together constructively despite some of the teething problems already experienced. The private sector has seconded skills into government to assist with delivery. The country has had no loadshedding for almost 200 days (at the time of writing) and real plans to deal with other infrastructure challenges are taking shape. The strong rand and lower oil price are helping to deliver lower inflation and we have begun a rate-cutting cycle. The two-pot system could provide a short-term sugar-rush to consumers, boosting confidence somewhat and potentially supporting higher credit extension.

We have been cautious in sizing our exposure to South African assets in the past, and despite these positive developments remain so. There are some quick fixes to be had (speeding up the processing of skilled work visas for example), but many of the challenges that we have flagged in the past persist. Decades of underinvestment in infrastructure (rail, ports and water) will take years to correct. Failing municipalities will impede attempts at improvements in service delivery. The longer-term fiscal outlook remains challenged as constrained government revenue and continued high expenditure demands for the public sector wage bill, social grants and debt servicing costs mean that a rising debt-to-GDP ratio remains likely, even factoring in potentially higher GDP growth.

As a result, our exposure to domestic-facing equities remains concentrated in high quality businesses that we would expect to outperform in a challenged economic environment, and duration in bond holdings is carefully managed. We are, however, cognisant of the risk of a more positive outcome – a high road scenario in which tangible evidence of real execution by government translates into better operating conditions for domestic businesses, as well as the buying of financial assets by foreign investors who have largely sat on the sidelines until now. Within the domestic equity allocation, we continue to carry meaningful exposure to the banks where valuations remain reasonable but should respond in a geared fashion to such a scenario. Within the domestic fixed income allocation, we continue to hold an investment in ILBs which offer attractive real yields and protection against higher-than-expected inflation in a low road scenario, but also to fixed rate bonds (both government and corporates) which despite their strong run still screen attractively in a global context should the high road scenario eventuate. We have also elected to increase the currency lock in the Fund to reduce sensitivity to any further potential rand strength, reducing gross offshore asset exposure from 40% to an effective 33% offshore currency exposure.

Outlook

We have finally entered the easing phase of the rate cycle in the US, and this tends to determine the trajectory in other markets around the world. The global economic outlook is generally positive despite a number of geopolitical risks and markets have responded strongly. However, we still see many attractive opportunities in mispriced global equities and credits.

The sentiment emanating from South Africa is positive and this has been reflected in strong moves in both domestic asset prices and the currency. We are in the early phase of the GNU and still need to see this mood translate into meaningful on-the-ground action. If this comes about, there is scope for improved earnings growth from domestic-facing businesses and possibly a further rerating of equities and bonds. For these reasons, we remain cautious but highly alert to the risks to the upside.

As always, we endeavour to build portfolios that deliver returns that exceed inflation hurdles and minimise drawdowns in a variety of scenarios, such as the ones we are presented with currently, rather than positioning for a single potential outcome.

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