CORONATION
TRUST IS EARNED™

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

Performance and fund positioning

The Fund returned 3.10% for the quarter to end September 2024, which is ahead of the STeFI Composite benchmark of 2.07%. Since inception last year, the Fund has returned 8.44%, which is ahead of the benchmark return of 7.07%.

The recent quarter continued to see positive sentiment filter through into domestic asset classes, which benefited the Fund via its holdings in nominal government bonds and longer-dated fixed rate NCDs. Economic data was also encouraging, with the August headline and core CPI measures beating expectations at 4.4% year-on-year (y/y) and 4.1% y/y, respectively. The main reasons for the slowdown in these measures were lower fuel prices, coupled with a moderation in both goods and services inflation.

Following on from the above, the SARB MPC started its cutting cycle with a 25 basis points (bps) cut, taking the repo rate to 8.0% and consequently providing additional support for duration assets (assets that are sensitive to interest rate changes). The decision was reached 'by consensus' and followed a more aggressive 50bps cut by the US Federal Reserve the night before. The decision acknowledged an improved inflation outlook, moderating inflation expectations (although still too high), and was accompanied by a meaningful near-term downward revision to inflation forecasts. Growth is further expected to improve, supported by consumer spending, network industry improvements and improved sentiment.

The subdued inflation outlook, together with a more positive view on growth, points to a sustained easing cycle from here. Our call remains for a further 25bps of easing in November 2024, with another 75bps in 2025, taking the repo rate down to 7%.

Quarterly returns for the fixed income asset classes in which the Fund can invest were all compelling relative to cash. The FTSE/JSE All Bond Index (ALBI) posted a return of 10.54%. Once again, bonds with a duration of 12+ years posted the strongest performance, returning 14.17%. However, all the ALBI constituents performed well ahead of cash and the Fund was able to take advantage of this through its unhedged holdings of R2030 and R213 nominal government bonds, which posted returns of 7.39% and 8.69%, respectively. The Fund also used this opportunity to lock in gains, and modestly reduced nominal bond duration. Going forward, we still believe that the sub-one-year area of the curve offers the best risk/reward opportunity for a cash cognisant mandate.

National Treasury also introduced two new nominal bonds (R2033 and R2038) to take advantage of maturity gaps on the funding curve. As issuance increases, these may well be candidates for a position within the Fund.

Unlike the previous quarter, which offered opportunities in the money market space, this last quarter proved to be uneventful. Increased certainty on the path forward for short-term rates led to NCDs and Treasury Bills (T-bills) trading significantly lower. As an example, one-year NCDs retraced from 8.9% to 8.2%, with 12-month T-bills retracing by a similar magnitude. As highlighted in our previous commentary, we anticipated that the absorption of GEFECRA proceeds (Gold and Foreign Exchange Contingency Reserve Account) totaling around R80bn into the banking system would create downward pressure on bank credit spreads. This certainly proved to be the case, with one-year NCD credit spreads reducing from 62.5bps to 55.5bps. In the absence of any real credit issuance in the debt markets, NCD spreads are likely to remain low.

The above provides a good introduction to our views on credit, which we continue to see as expensive despite the strong performance of alternative asset classes. Corporate credit has continued to be well bid, and consequently, spreads continue to compress. Our exposure to corporate credit reduced marginally over the period due to short-dated maturities not being fully replaced.

Appetite for credit has been further supported by the fact that the government bond spreads above comparable maturity interest rate swaps have compressed significantly. As a result, investing into hedged nominal government bonds as an alternative to credit has become less attractive. Using the R2030 government bond as an example, its spread above the five-year interest rate swap retraced from 170bps to 138bps during the quarter. The Fund did hold some hedged government exposure but sold when the spread dipped below our performance target.

The Fund's position in inflation linkers increased by around 5% and remains significant. This was funded largely out of short-dated nominal government bonds, predominantly the R186. The SA Government Inflation-Linked Bond Index lagged its nominal counterpart significantly, although still posted a cash-beating return of 4.75%. However, as is always the case with the inflation-linked bonds (ILBs), the returns can differ dramatically between individual instruments.

By far the most significant holding in the Fund remained the I2025, which unfortunately returned below cash at 1.61%, and was particularly impacted by the strong downward revisions in the short-term inflation profile. Our increased linker position mostly came about by adding I2029 and I2033 bonds, which returned above cash at 2.74% and 4.35%, respectively. While our muted inflation profile over the next year does make the one-year total return profile of linkers unattractive relative to nominal bonds, there are reasons why these instruments still warrant a position in a cash-cognisant mandate:

1. Real rates in the instruments we hold remain high relative to history, and returns are still expected to beat cash. In this respect, returns are also more compelling than the rates on offer from money market instruments such as NCDs and T-bills. As examples, the one-year total returns for I2029 and I2033 are expected to be 8.6% and 9.4%, respectively, which is well above our expectation for an average cash rate of 7.5%. Our I2025 holdings act as a cash proxy in the absence of more attractive instruments, with only four months until maturity.

2. ILBs have also traditionally provided greater protection than their nominal counterparts in the event of an inflation shock, which can be particularly damaging for a portfolio that carries duration risk and has a cash-cognisant benchmark. In effect, we do not position our portfolios for a single outcome.

Outlook

Given recent strong asset returns, we remain vigilant on valuation and will continue to only invest in instruments that we believe offer appropriate returns for the underlying level of risk. The global backdrop is also likely to become more volatile in the coming months, with elections in major economies and possible flare-ups in geopolitical tensions. However, 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 30 September 2024