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

Performance and fund positioning

The Fund returned 0.63% in February, bringing its 12-month total return to 11.05%, which is ahead of cash (8.09%) and its benchmark 8.93%) over the same period. We 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 were flat in February. The FTSE/JSE All Bond Index (ALBI) returned 0.07%, with the long end of the curve (bonds with maturities of 12+ years) down 0.12%. The belly of the curve (7-12 years to maturity) closed 0.03% lower, while medium-term bonds (3-7 years to maturity) posted 0.28% and short-term bonds (1-3 years to maturity) returned 0.50%. Cash returns came in at 0.57%, while inflation-linked bonds (ILBs) were up 1.00%.

Geopolitical tensions dominated financial markets' news flow in February and continue to raise uncertainty and create potential headwinds for inflation and economic activity in 2025. Inflation readings in general surprised to the upside, with slower-than-expected price moderations.

US headline inflation ticked up to 3% year on year (y/y) in January from 2.9% y/y in December, while core inflation was up 3.3% y/y from 3.2% y/y. The rise was due to a sharp increase in used car and truck prices, compounded by rising energy costs. Prices of food, shelter, and healthcare were steady. The moderation in the pace of disinflation has been below the Federal Reserve Board's preferred pace, supporting a more hesitant monetary policy easing path. The markets are pricing in a policy rate hold at the March meeting.

China's headline inflation rose to 0.5% y/y in January from 0.1% y/y in December. The uptick was mostly due to once-off holiday spending following the 2025 Lunar New Year celebrations. Food prices and services inflation contributed the most. However, deflation in the Producer Price Index continued, with inflation falling 2.3 % y/y in January, same as in December – raising the risk of further disinflation in consumer prices in the coming months.

The rand ended the month at R18.69/US$1, slightly 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 offshore 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.

South Africa (SA)'s economy grew just 0.6% q/q in Q4-24 from a revised contraction of 0.1% in Q3-24 (previously -0.3%). This brought overall growth in 2024 to 0.6% from 0.7% in 2023. From the production side, recovery was concentrated in a rebound in agricultural output, and growth in financial and business services, and trade. This was offset by weakness in mining, manufacturing, utilities, and transport. From the expenditure side, consumer spending and exports both recovered, but this was offset by ongoing weakness in gross fixed capital formation and an increase in imports. Annual data broadly reflected these trends, with a nascent consumer recovery undermined by weak capital expenditure and the inability of trade to provide a fillip.

SA headline inflation accelerated to 3.2% y/y in January from 3.0% y/y in December, while core inflation slowed to 3.5% y/y from 3.6% y/y. The uptick was due to price increases in household contents and equipment, healthcare services, and a seasonal rise in hotel prices. Elsewhere, soft price increases were observed for food and non-alcoholic beverages, while apparel prices remained unchanged. The inflation outlook has improved at the margin, with the reweighting of the basket and a recent easing in retail fuel prices.

At the end of December, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 8.32% (three-year) and 8.84% (five-year), with both maturities unchanged 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.

Inflation has remained well behaved and is expected to stay close to the midpoint of the current target band, however, the SARB's reluctance to ease rates might prove a headwind to bond yields and the economy going forward. In addition, local growth has remained lacklustre, and the growth required to shed the burden of our current debt load remains much higher than baseline forecasts. The risk premium on SA bonds has been much reduced and is commensurate, if not too idealistic, with SA's economic future. In addition, global risks remain high as the incoming US president's policy direction might stoke inflation and push global bond yields even higher still. We continue to maintain a neutral position on local bond yields considering their reduced risk premium, with very little exposure to local credit and a moderate allocation to ILBs given their attractive valuation and offsetting risk attributes.

The local listed property sector was up 0.07% over the month, bringing its 12-month return to 17.83%. Operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. The current increase in the cost base, due to higher administered prices and second-round effects on deteriorating infrastructure in much of the country, 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.

Local credit spreads are at historically tight levels due to low levels of issuance and large swaths of capital looking for a home with reduced volatility. 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 by not marking them to market based on the underlying asset price movements. 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. Except for a few opportunities, we view the local credit market as unattractive relative to other asset classes.

Outlook

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 9.35% (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 28 February 2025