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

Performance and fund positioning

The Fund returned 0.47% in January, bringing its 12-month total return to 10.62%, which is ahead of cash (8.16%) and its benchmark 9.01%) 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 had an uninspiring performance in January. The FTSE/JSE All Bond Index (ALBI) returned 0.44%, with the long end of the curve (12+ years) flat at 0.08%. The belly of the curve (bonds maturing in 7-12 years) closed 0.49% higher, while medium-term bonds (maturing in 3-7 years) returned 0.76% and short-term bonds (maturing in 1-3 years) were up 0.77%. Cash returns were also flat at 0.64%, while inflation-linked bonds (ILBs) were down 0.32% for the month.

The US economy grew 2.3% quarter on quarter (q/q) in Q4-24 from 3.2% q/q in the third quarter of 2024 (Q3-24). For the 2024 calendar year, growth came in at 2.8% from 2.9% in 2023. Consumer spending was the main driver of growth, with most of the spending allocated to vehicle purchases and travel services. Government also contributed to growth, while business investment disappointed, dragging down gross fixed capital investment for the quarter. Both exports and imports contracted, thus leaving the contribution from net trade muted.

The Federal Reserve Board (the Fed) left the Fed funds rate target range unchanged at 4.25% - 4.50% at the Federal Open Market Committee (FOMC) January meeting, as expected. The FOMC noted that the economy has continued to expand at a solid pace and unemployment has stabilised within the Fed's tolerance range. Inflation has made strides towards reaching the 2% target, but it remains higher than where the Fed would like it to be.

US headline inflation ticked up to 2.9% year on year (y/y) in December from 2.7% y/y in November, while core inflation eased to 3.2% y/y from 3.3% y/y. Increases in food prices, transportation costs and energy services inflation were the main contributors to the headline inflation acceleration. Apparel, shelter and used car prices moderated. The moderation in the pace of disinflation has been below the Fed's preferred pace, thus supporting the more cautious monetary policy easing path.

The rand ended the month at R18.67/US$1, slightly stronger 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.

China's economy grew by 1.6% q/q in Q4-24 from 1.3% q/q in Q3-24. In 2024, the economy expanded by 5% from 5.2% in 2023. Most of the growth was led by strong industrial output, retail sales, and net exports. Furthermore, growth was induced by a broad range of stimulus measures implemented in September to revive stagnant economic momentum and address persistent challenges, including rising deflation risks, persistently weak demand, and the prolonged property sector downturn.

China's headline inflation slowed to 0.1% y/y in December from 0.2% y/y in November. The moderation was due to a big drop in food prices, household utilities, and transport costs. Medical costs, apparel, and recreation prices also eased. Deflation in the Producer Price Index continued, with inflation falling 2.3% y/y in December from 2.5% y/y in November.

The South African Reserve Bank (SARB) cut the repo rate by 25bps in a split decision, taking the repo rate to 7.5%, with four members voting to cut and two for an on-hold outcome at the January Monetary Policy Committee (MPC) meeting. The after-meeting statement continued the more cautious narrative which characterised the November 2024 decision, influenced strongly by external developments. The MPC explicitly sets policy according to its assessment of the balance of risks, and it is clearly concerned about the impact of external policy changes and developments on the currency, and subsequently the outlook for prices. The split vote also suggests a shift in the risk assessment to a generally more cautious footing.

Headline inflation increased slightly to 3.0% y/y in December from 2.9% y/y in November, while core inflation slowed to 3.6% y/y from 3.7% y/y. The uptick was due to increases in food and fuel prices, while prices for housing utilities, energy, and alcoholic beverages moderated. An unexpected downside came from weak rentals data, which is captured quarterly, that showed a market slowing in monthly rental increases when compared to September's survey.

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 being 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.

After a solid 2024, the road ahead is less certain. 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 down 3% over the month, bringing its 12-month return to 20.57%. 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 9.31% (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 January 2024