

PORTFOLIO MANAGER COMMENTARY

The fund returned 1.65% for the quarter and has achieved a pleasing total return of 6.82% for the last 12 months, outperforming the 3-month STeFI by 1.33% (after fees).

Cash, which is yielding around 5.5%, has significantly underperformed other yielding assets during the quarter and over the last year. Note that the real return on cash has barely been positive over the past 12 months, and on a forward-looking basis out to one year, current cash rates are expected to show negative real returns. In spite of real returns falling on money market instruments, this fund has achieved a positive real return after fees.

Inflation-linked bonds (ILBs) rallied further during the month, particularly in the shorter-dated R189 where its real yield moved deeper into negative territory. It closed the quarter at -0.5% on a combination of higher inflation and potential buy-backs of the bond ahead of its maturity in March 2013. The fund has had exposure to this asset class in the form of the ABSA 31/03/2013 maturity ILB, which tracks the R189 and offers a real yield of +0.5%. The instrument has been a very good performer.

Locally, a focus was the annual budget speech in February. This surprised markets on the positive side, with the Minister reigning in the deficit projections. It has since been announced that the expected deficit for the fiscal year just ended (2011/12) is 4.5%, slightly better than expected at the time of the budget. Funding requirements still remain high, and there is some scepticism over the extent to which public sector wage increases can be contained – this being an important contribution to the expected lower deficit numbers. Soon after the budget and despite the improved numbers, Standard & Poor's joined Moody's and Fitch in attaching a negative outlook to its credit rating on South Africa. These agencies cited structural problems and the potential for politics to put pressure on the budget sometime in the future.

On the monetary policy side, although there is clearly no desire to raise interest rates anytime soon, the SARB has started expressing its concern about more broad-based inflation. We continue to see inflation remaining above target through the first half of next year. The rand could be a game-changer, but continued passthrough from oil and food price hikes as well as the increasing likelihood of further second-round effects from petrol prices keeps us cautious. We continue to believe that with inflation above target and growth at around 3%, a negative real repo rate is too accommodative and we expect interest rates to start being normalised later this year.

The fund has achieved a good outperformance of regular money market investments by being fully invested in long dated floating rate investments (FRNs), which earn a substantial spread over JIBAR for their full term. The fund is exposed to both bank and corporate FRNs thereby maximising the fund's diversification while improving the yield. FRNs pay a quarterly interest rate that resets every three months as underlying interest rates move, thus hedging out duration and keeping interest rate risk to no more than 90 days.

The fund offers a substantial yield premium over regular money market funds, by increasing the allowable term of the instruments, but without adding to the interest rate risk of the client's funds. We view this as an excellent alternative to money market funds that are subject to very low prevailing interest rates at the moment.

Portfolio managers

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