

PORTFOLIO MANAGER COMMENTARY

The fund returned 1.4% for the quarter and has achieved a total return of 5.6% for the last 12 months, closing the quarter with an effective annual yield of 6.13%.

In comparison 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.

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 to express 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 fair return in what has been a very low yielding environment since late 2010 when the repo rate was adjusted downwards to 5.5%, and has remained unchanged since. Whereas 12-month NCDs have risen to 6.28% they are not fully factoring in the strong possibility that interest rates may well be more than 0.5% higher in a year's time, thus making it a safer bet to remain invested in either short dated (one or two months) or floating rate investments.

The fund has been a gatherer of short dated corporate bonds (Nedbank, Investec, Netcare), which have entered the money market universe as their term has shortened to less than one year to maturity. These offer far better value than one-year NCDs at the moment.

The three-month commercial paper market has grown substantially over the past year, with new names such as Resilient, Redefine, Vodacom, Scania and Macquarie entering the market. We caution against investing in commercial paper at prevailing credit spreads which are paper thin – a sentiment which carries through to areas of the corporate bond market as well. While we welcome these newcomers to the capital market, we believe the money market is lending to them at very cheap levels and that corporate credit spreads are unsustainable and not fully reflective of the risks inherent in some of these companies.

In a challengingly low interest rate environment, we believe the fund has delivered a fair yield, having eeked out the best value available in the money market. This is evident from the top quartile ranking in its sector over the long term.

Portfolio manager

Tania Miglietta