

PORTFOLIO MANAGER COMMENTARY

Bond yields have been in a general downward trend since mid-January, a trend that was maintained in March and gained momentum following the South African Reserve Bank's (SARB) decision to cut the repo rate by 50 basis points (to 6.5%) at the MPC meeting on 25 March. The SARB's move, which had not been fully discounted in the markets, was enabled by a combination of lower-than-expected inflation, and generally still soft economic data as well as continued rand strength which bode well for further disinflation. At this stage, we believe that most of the expected good news is factored in, and our base case would be for rates to remain on hold for the remainder of this year.

Inflation re-entered the 3% - 6% target range in February at 5.7% (data released in March), which was sooner than many had expected. We think that underlying trends in consumer inflation look positive, while a broad number of categories continue to show beneficial influences from the currency. Indeed, most of the rand-sensitive categories are either within or below the inflation target range. The main factors holding inflation up continue to be administered prices, and even these appear to be less of a problem than had initially been expected (e.g. the Eskom price increase being approved at a lower level than requested). We think CPI could fall to around the mid-point of the target range during the course of this year. Movements in the rand will continue to be crucial, and a reversal of rand strength remains a key risk.

Although growth has undoubtedly bottomed and is moving noticeably higher, this so far seems to be led principally by manufacturing (linked to exports and the global recovery) and domestic car sales (coming off an exceptionally battered base).

A latent risk for both SA and emerging market bond yields in general arises from the US bond market, where yields have recently moved higher on a combination of stronger growth data and large supply, even despite expectations of interest rate rises being pushed out as core inflation surprises on the downside. As quantitative easing programmes start being wound down, we expect that supply issues will continue to dominate US and other developed bond markets – and at some stage, though now it is looking more likely to be in 2011, major central banks will have to start reversing emergency low levels of interest rates as well. It is thus difficult to see an outcome where global bond yields do not continue rising into 2011, and this will almost certainly have an impact on SA yields as well.

The fund is focused on providing a good yield for investors and does not take the same capital risk positions as a bond fund would. It returned 2.60% for the quarter and 9.09% for the last 12 months, largely due to fixed and floating rate corporate bonds and floating rate bank investments which provide a good interest rate buffer when domestic interest rates eventually start to rise. A detractor has been the holding in inflation-linked bonds which have not performed well in recent months as inflation has surprised to the downside. The total return from the 2013/2014 maturity inflation-linked bonds held in the portfolio should accelerate when inflation starts to rise.

The fund's current yield to maturity of 8% gross of fees is greater than that of a traditional money market fund, due to a yield pick-up achieved from the longer date maturities in this fund.

Portfolio manager

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