

PORTFOLIO MANAGER COMMENTARY

The Coronation Strategic Income Fund returned 1.3% for month of March and 3.55% for the quarter.

Bond yields have been in a general downward trend since mid-January, a trend that was maintained in March and which gained in momentum following the SARB's 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 at the moment; there seems to be an absence of any significant demand-side pressure, while a broad number of categories continue to show beneficial influences from the currency. 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).

The generally positive domestic news was underpinned by a move lower in emerging market spreads over March as well. However, another 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.

We thus remain in a position of largely balanced risks, where shorter-term domestic outcomes have been positive for bonds (and may be so for some months yet), but where there are concerns about the longer term.

The property stock weighting has been maintained in line with our view that property would continue to perform well, and indeed it has during the quarter.

Preference shares also had a good run this quarter returning 7.75%. The fund holds a wide spread of bank and corporate preference shares which contributed positively to the fund's return.

Inflation-linked bonds (ILBs) were a little disappointing this quarter. Given that inflation is falling the full benefit of these is not being felt at the moment but ILBs provide long-term inflation protection which we seek as inflation is cyclical and will rise again over the longer term.

The fund returned 3.55% for the quarter and 10.96% for the year whilst money market fund yields averaged 7 – 8%.

Portfolio managers

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