

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

The fund generated a return (net of management fees) of 2.1% for the quarter and 8.2% over a rolling 12-month period, which is ahead of the 3-month STeFI benchmark return of 6.9%.

The SARB Monetary Policy Committee (MPC) raised the repo rate by 25 basis points (bps) to 6.75%, despite downward revisions to both inflation and growth forecasts. The decision largely reflected the governor's consistent view about the need to anchor inflation expectations towards 4.5%, the midpoint of the target range. The vote was not, however, unanimous and shows that there are still a range of views represented on the committee.

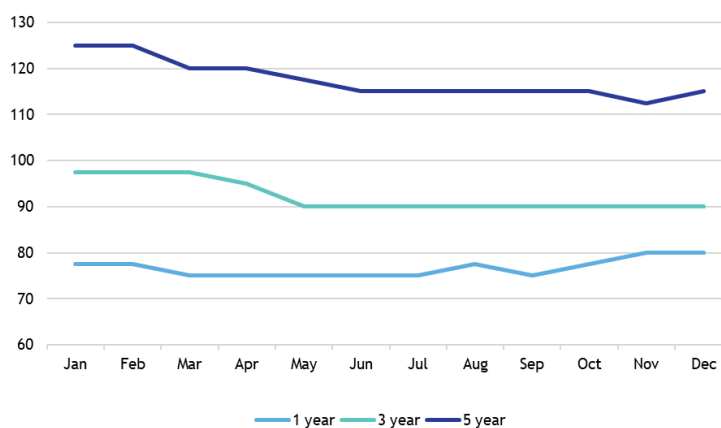
CPI surprised to the upside, printing at 5.2% year-on-year (y/y) in November 2018. This print, however, does not change our benign inflation outlook given that the large retail fuel price cut in December was not surveyed. We currently expect inflation to peak at 5.6% in 2019, largely due to base effects, slightly higher food inflation and the effect of a weaker currency. This is still within the South African Reserve Bank's inflation target band and in addition, the general growth environment for the country remains weak, with the most recent GDP growth number at 1.1% y/y. Our current view is for another two 25 bps interest rate hikes over the course of 2019 to take the repo rate to 7.25% by year end. The market remains indifferent, with around a 50% chance of a single interest rate hike being priced over the next 12 months.

The 3-month JIBAR index, off which most of the floating rate instruments in the fund are priced, has increased to 7.2%, given the hike in the repo rate. This compares to an average rate of 7.0% for the prior period. All the floating rate instruments in the fund reset to the prevailing 3-month Jibar rate every three months post their initial investment date. As such, the increase in the Jibar rate should provide some uplift to the fund yield over the next quarter. Given our expectation for two further interest rate hikes over the next year, this bodes well for the fund's yield in 2019.

The last quarter has seen spreads on NCDs (Negotiable Certificates of Deposit) remain largely constant, breaking the trend of continued compression seen for most of 2018. The notable exception to this has been one-year NCD spreads, which continue to widen. A one-year fixed rate NCD is now being offered at 8.3%, which is attractive, given the return profile of the fund, provided that the duration restriction of the mandate is not breached.

The contraction in NCD credit spreads witnessed over the last year continues to be positive for the fund, although the benefit is only received when an NCD is sold back to the issuing bank. As such, there is no immediate yield uplift, but the benefit should materialise over time, as the fund routinely creates liquidity by trading in these instruments. Going forward, we continue to see the risks to NCD spreads as being broadly balanced, with the fund being well placed to handle adverse market moves.

FLOATING RATE NCD SPREADS ABOVE JIBAR



A market we are carefully watching remains that of South African Treasury Bills. It was stated in the Medium Term Budget Policy Statement (MTPBS) that these instruments will play a greater role in government's funding requirements going forward. This increased supply will likely have an impact on Treasury Bill yields in future and, to a certain extent, we have already seen this starting to unfold. The yield on a 12 month Treasury Bill (8.4%) is now higher than that of a 12 month fixed rate bank NCD (8.3%). The Treasury Bill, in theory, comes with no credit risk but this must be considered relative to its more limited trading liquidity. Nonetheless, this yield is attractive for the fund and we will continue to explore this opportunity.

Credit issuance in the primary market remains limited, which is partly a function of the low-growth environment. The weakness in GDP growth remains particularly concerning for credit markets from an overall supply perspective. For the ten months ending October 2018, issuance from banks was down 44.7%, with corporate issuance down 16.7%. This weakness has been broad based as evidenced by weak asset growth numbers from the banking sector and subdued credit extension.

Our current GDP growth expectations are for 1.8% in 2019. This is, however, largely predicated on an improvement in consumption expenditure rather than increased fixed capital formation. This does not bode well for issuance levels. We remain cautious and continue to only invest in instruments which are attractively priced relative to their underlying risk profile. Capital preservation and liquidity remain our key focus areas.

Portfolio managers
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 as at 31 December 2018