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

The fund returned 0.43% in February, bringing its total return for the 12-month period to 8.67%. This is well ahead of the returns delivered by both cash (7.09%) and its benchmark (7.82%) over the same one-year period.

The All Bond Index had another strong month following its rally in January, reflecting not only supportive global market sentiment, but also renewed optimism about domestic political change, with the appointment of Cyril Ramaphosa as president of the country on 15 February 2018. The aggregate index rose 3.9% during the month. The rally was also relatively broad-based, with longer-dated bonds (12+ years) performing best (5.02%), followed by the belly of the curve (7 to 12 years), which rose 2.9%. Short-dated bonds (1 to 3 years) were up 1.13%, and bonds maturing 3 to 7 years rose 1.55%. Inflation-linkers rose 1.12%, while cash returned 0.52%.

While the generally positive economic news continued into February, central bank rhetoric in developed economies generated some volatility, and US president Donald Trump's tariff announcement in early March added considerable uncertainty.

In the US, incoming activity data have been mixed in the wake of the announced tax changes and fiscal adjustment. February ISM data rose 1.7 points to 60.8, from 59.1, personal spending showed nominal growth of 0.2% and durable goods sales contracted -3.7% m/m. Taken together, GDP is tracking about 1.7% q/q, broadly on track for 3.45% annualised. With respect to inflation, the January data again surprised markets to the upside. Core CPI rose 0.35% m/m, with surprises over a relatively broad base and 2.1% y/y. However, core PCE inflation was stable at 0.3% m/m and 1.5% y/y. The January employment report showed strong gains in average hourly earnings, which rose 0.3% on the month ahead of consensus. The market is now pricing three hikes of 25 basis points (bps) each this year, from two hikes prior to the February Federal Open Market Committee meeting. Consensus forecasts are closer to four hikes in 2018.

Economic news from Europe remained relatively strong. Euro area PMIs were a little weaker in February at 57.5, nonetheless GDP is tracking ahead of the fourth quarter of last year's 0.6% q/q. Euro area inflation remains well within target, despite the elevated rate of output growth and low unemployment. February inflation data were in line with expectations, HICP inflation eased to 1.2% y/y from 1.3% y/y (off a low base), and core inflation was unchanged at 1.0% y/y. Forward looking data suggest inflation has troughed, and headline CPI is expected to return to 1.5% - 1.6% y/y from March. Upside risk, for now, is balanced by the appreciation in the euro.

In the UK, Brexit negotiations remain at the centre of domestic politics. The draft EU exit treaty was unveiled by the European Commission at the end of February, highlighting the sticky negotiating points which still require legal clarity. The Northern Irish Border is still the biggest sticking point, and with no clear resolution in sight, the March 22-23 EU summit deadline seems likely to be missed. If sufficient clarity is achieved by June, then a final deal seems likely only in October, with considerable risk that this deadline comes under pressure too. Data show that growth momentum continues to slow. Manufacturing PMIs fell again in February to 55.2 (55.3), continuing the weaker trend off last November's peak. Consumer confidence gave back some of the January rebound, falling back to a level of -10. The housing market remains under pressure, with Nationwide house prices falling 0.3% m/m in February.

In South Africa, despite the 1% VAT hike, which will add up to 0.6ppts to headline inflation, the stronger currency should ensure inflation remains within the target range through 2018, with January's CPI print showing inflation of 4.4% y/y and further moderation expected in February, and an even lower print possible with another cut to fuel prices in March. Given the somewhat tighter fiscal policy signalled in the Budget, coupled with the change in political leadership and Cabinet reshuffle (and despite the VAT hike), we think Moody's might just keep south Africa at investment grade at its March review, leaving room for the MPC to cut rates by 25 bps at the March meeting. At the end of February, shorter-dated negotiable certificates of deposit (NCDs) traded at 8.11% (three-year) and 8.64% (five-year) respectively, slightly lower than January's closes. NCD spreads relative to cash remain at quite tight levels due to a compression in credit spreads. NCDs continue to hold appeal due to the inherent protection offered by their yields and relative to our expectations for the repo rate. However, the hunt for yield in the local market has started to push bank credit spreads into expensive territory (less than 100 bps in the three-year area and 130 bps in the five-year area). The fund continues to hold decent exposure to these instruments (both floating and fixed), but we will remain cautious and selective when increasing exposure. NCDs have the added benefit of being liquid, thus aligning the liquidity of the fund with the needs of its investors.

The rand rally lost momentum in February as it ended the month at 11.89, 0.5% stronger than its close in January, but still ahead of its emerging markets peer group. February was a tense month of negotiations taking place behind closed doors in South Africa: Former President Jacob Zuma resigned on 14 February, with Cyril Ramaphosa sworn in on Thursday, 15 February 2018. Just four working days later former finance minister Malusi Gigaba delivered the 2018/9 Budget, which detailed a 1% VAT hike to 15%, effective in April. Total revenue increases of R36 billion were announced for the coming fiscal year. On Monday, 26 February, President Ramaphosa reshuffled his Cabinet, replacing amongst others, Malusi Gigaba, with former finance minister Nhlanhla Nene. At current levels, the rand seems to price a great deal of the good news in and we would expect a halt in the rally that we have seen over the last two months. The fund maintains its healthy exposure to offshore assets, and when valuations are stretched, it will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollar, UK pound and euro). These instruments are used to adjust the fund's exposure synthetically, allowing it to maintain its core holdings in offshore assets. (It has the added benefit of enhancing the fund's yield when bringing offshore exposure back to rand.)

Recent political changes in SA have the potential to positively influence policy implementation, and place the local economy on a path to rehabilitation. Parastatals need to be stabilised, growth initiatives need to be pursued in earnest, and confidence needs to be restored in SA's institutions in order to put SA on a more sustainable path towards higher growth. In the short term, growth could receive a boost from consumer spending and inventory renewal as corporate SA starts to spend again after a multi-year hiatus. Inflation will remain well behaved with chances of further downside surprises added to the case for a lower repo rate. SA government bonds should benefit from this renewed optimism and contained inflation. However, at current levels, they price in a great deal of good news and are at best fair to slightly expensive, keeping us more neutral in our allocation to SA government bonds, looking instead for more attractive levels to enter overweight positions.

The SA listed-property sector lost 10.5% in February, bringing its return for rolling 12-month period to -8%. Despite the recent fall, we remain confident that the sector offers selective value. The changes in the property sector over the last decade (including the increased ability to hedge borrowings and large offshore exposures) have rendered the yield gap between the property index and the current 10-year government bond a poor measure of value. If one excludes the offshore exposure, the property sector's yield rises to approximately 9.6%, which compares very favourably to the benchmark bond. The fund maintains holdings in counters that offer strong distribution and income growth, with upside to their net asset value valuations. In the event of a moderation in listed property valuations (which may be triggered by further risk asset or bond market weakness), we will look to increase the fund's exposure to this sector at more attractive levels.

The preference share index was up 0.54% in February, bringing its 12-month return to -2.8%. Preference shares offer a steady dividend yield, linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 8.5% and 11% (subject to a 20% dividends tax, depending on the investor entity). The change in capital structure requirements mandated by Basel III will discourage banks from issuing preference shares. This will limit availability (and boost possible buybacks). In addition, most of the bank-related preference shares trade at a discount, which enhances their attractiveness for holders from a total return perspective and increases the likelihood of bank buybacks. Despite attractive valuations, this asset class will continue to dissipate given the lack of new issuance and because it stands at risk of being classified as eligible loss-absorbing capital (only senior to equity). The fund maintains select exposure to certain high-quality corporate preference shares, but will not actively look to increase its holdings.

We remain vigilant of risks emanating from the dislocations between stretched valuations and the underlying fundamentals of the SA economy. However, we believe that the fund's current positioning correctly reflects appropriate levels of caution. The fund's yield of 8.91% remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected fund performance over the next 12 months.

As is evident, we remain cautious in our management of the fund. We continue to invest only in assets and instruments that we believe have the correct risk and term premium, to limit investor downside and enhance yield.

Portfolio managers
Nishan Maharaj and Mark le Roux
as at 28 February 2018