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

The fund returned 0.39% in January, bringing its total return for the 12-month period to 8.77%. This is well ahead of the returns delivered by both cash (7.11%) and its benchmark (7.84%) over the same one-year period.
The All Bond Index rallied strongly in January, reflecting not only supportive global market sentiment, but also relief and optimism about the change in ruling ANC leadership in the wake of the December ANC elective conference. The rally was relatively broad-based, with longer-dated bonds of 12+ years performing best (2.1%), followed by the belly of the curve (7 to 12 years), which rose 1.5%. Short-dated bonds (1 to 3 years) were up 1.04%, and bonds maturing over 3 to 7 years rose 1.27%. Inflation-linkers, however, fell -1.38%, while cash returned 0.58%.

Economic resilience in developed economies, US tax reform and the government shutdown, ongoing low inflation and central bank uncertainty all featured in generally positive market news in January.

In the US, President Trump managed to pass wide-ranging tax reform in late December, and throughout January the equity markets rallied in response. It is impossible to make accurate estimates of the economic impact of the reform package, but the short-term impact on both investment and spending is deemed to be positive. Activity indicators remain generally upbeat, although Q4-17 GDP numbers disappointed the consensus. GDP growth was 2.6% q/q saa in Q4-17 (consensus 3.0%), from 3.2% in Q3-17. While this was disappointing, the details were not as soft – most concentrated in inventories and net trade, while final sales growth actually accelerated. Final demand was up 3.2% q/q saa in Q4-17, well ahead of the 2.2% q/q saa pace of the previous quarter. Elsewhere forward-looking ISM data remain strong at 59.1 in January. The January payrolls data were also ahead of expectations with payrolls running 200k m/m and the unemployment rate unchanged at 4.1%.

With respect to inflation, the January employment report showed strong gains in average hourly earnings which rose 0.3% on the month. Quarterly data however show core PCE at 1.9% with new numbers due this week. As expected the January FOMC, Chair Janet Yellen's last, left the Fed funds rate unchanged, but signalled with more confidence that inflation should continue to accelerate this year. Markets are pricing three 25bps hikes in the funds rate in calendar 2018, starting with 25bps in March.

Economic news from Europe has also been strong, with euro area flash GDP for Q4-17 up 0.6% q/q from 0.7% q/q in Q3-17. Not all of the member states have reported, and there is some chance of upward revisions when data from Germany and Italy are published in mid-February. High frequency data suggests activity momentum remains robust into 2018 – the January euro area economic sentiment indicator (from the European Commission) posted the second highest reading since the end of 2000, supported by buoyant sentiment in all sectors. The election calendar this year holds some risk with the Italian elections scheduled for 4 March, but significantly fewer election risks than 2017.

In South Africa, the much stronger currency should ensure inflation remains low through most of 2018, with December's CPI print showing inflation of 4.7% y/y expected to moderate in January and February. Lower food inflation, a 5.2% Eskom tariff adjustment and a stronger currency suggest consumer inflation will average 4.5-5% in 2018. The SARB left the repo rate on hold at 6.75% at the January MPC meeting, citing uncertainty related to the upcoming Budget and Moody's ratings review as their primary causes for caution. With inflation close to the mid-point of the target range, we think there is room for the MPC to cut rates by 25bps at the March meeting. At the end of January, shorter-dated negotiable certificates of deposit (NCDs) traded at 8.215% (three-year) and 8.825% (five-year) respectively, slightly higher than Decembers' close. 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 100bps in the three-year area and 130bps 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.

Within emerging markets, the rise in global trade and commodity prices have provided a welcome boost to activity and profitability. Recent data show some moderation in China's growth momentum and weakness in the property market is partly offset by external trade and relatively resilient consumption. Property indicators show moderation in price growth across cities, which are now contracting in month-on-month terms. Associated construction activity has also slowed, and very robust export growth is now converging on more moderate global growth rates. Taken together, moderating property-related activity and somewhat slower export growth suggest GDP will slow to a range of 6.4% in 2018 from 6.8% in 2017.

The rand continued its advance in January, to end the month at 11.85, 4.5% stronger than its close in December. Early indications of a change in how the ruling party is run have reinforced some of this sentiment, and the new ANC president's interventions at Eskom have sent a strong signal of a new commitment to eradicating corruption and stabilising SOCs. Growth forecasts, on average, have been revised up from about 1% to about 1.5% in most cases, with depressed consumption and investment expectations easing at the margin. Forward-looking data show improving sentiment in the January PMI, and an actual seasonally adjusted reading of 49.9 from 44.9 in December. These factors have driven the outperformance of the rand within its emerging markets peer group. The fund benefited from holding put options on the dollar against the rand, which had the effect of synthetically reducing the funds' offshore exposure as the rand rallied against the dollar. The fund maintains a 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)

The fund has continuously used any spike in yields as an opportunity to add selective exposure to the longer area of the bond curve (12y+) at levels of around 10.25% to 10.50%, given its attractive return prospects relative to cash over the longer term. The SA economy could be at a key turning point if the newly elected ruling party leadership is able to push through much needed growth reforms, stabilise ailing parastatals and restore confidence in the SA economy. SA's growth could receive a short-term boost from inventory renewal as corporate SA starts to spend again after a yearlong hiatus. Inflation will remain well behaved with chances of further downside surprises adding 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 are only at fair value, and with exclusion from the Citi WGBI still a possibility, we choose to be neutral on SA government bonds, looking instead for more attractive levels to extend duration further.

The SA listed-property sector lost 9.9% in January, bringing its return for rolling 12 month period to 3.85%. 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. On the surface, it appears quite stretched. However, if one excludes the offshore exposure, the property sector's yield rises to approximately 8.9%, 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 down 0.66% in December, bringing its 12-month return to -4.4%. 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 8.89% 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 31 January 2018