CORONATION JIBAR PLUS FUND

Quarterly Portfolio Manager Commentary

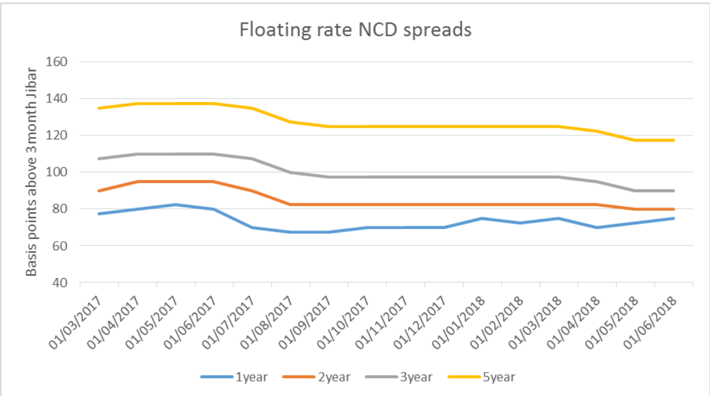
Please note that the commentary is for the retail class of the fund.

The fund delivered strong returns over the last quarter. Over the three-year period, the performance of the fund is ahead of its benchmark, delivering a return of 7.9% versus the STEFI index return of 6.9%.

The South African Reserve Bank (SARB's) Monetary Policy Committee (MPC) kept interest rates unchanged during the quarter, which was largely attributable to the muted inflation profile over the forecast period. Higher oil prices and a weaker exchange rate are still being offset by lower food inflation and the tailwinds of currency appreciation earlier in the year. Our current forecast reflects that CPI will average 4.8% in 2018 and 5.1% in 2019, which suggests that the SARB still has room for easing rates further. What must also be considered is that the growth environment remains weak with first-quarter GDP declining by 2.2% quarter-on-quarter seasonally adjusted and annualised, which was below market expectations. While growth is not a direct part of the SARB mandate, it is a consideration in setting monetary policy. In addition, the deterioration in global risk appetite and its adverse impact on emerging markets is also likely to be a significant hurdle. We continue to expect an interest rate cut at the next MPC meeting in July, but markets remain hawkish with one full 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 remained broadly stable over the last quarter at 6.9%. All the floating rate instruments in the fund reset to the prevailing 3-month Jibar rate every three months post their initial investment date. Over the last quarter, most of the floating rate instruments have now reset to this rate, with the fund yield now fully expressing the impact of the interest rate cut earlier in the year. As it is still our view that the repo rate will be cut by a further 25 basis points, one can expect a commensurate impact on the fund yield going forward.

The last quarter has seen spreads on negotiable certificates of deposit (NCDs) decrease marginally. In the absence of significant primary credit issuance and 12-month Treasury bills yielding 7.75%, it still makes sense to place excess liquidity with banks where one can purchase a 1-year NCD at around the 8% level. The contraction in NCD credit spreads 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.



Source: Bloomberg

The last quarter has seen an increase in South African government bond yields following general risk aversion in emerging markets. What typically transpires from these types of sell-offs is increased buying of bonds by domestic funds, which sell shorter-dated credit holdings to provide the necessary liquidity. Recently, we have seen increased offers in secondary market credit and the fund has taken advantage of these opportunities to increase its holding in credit instruments by 3.13% since the last quarter. As part of this process, we have been purchasing short-dated, fixed rate instruments at yields above 8%, which is attractive relative to the fund benchmark while not breaching its mandated duration restriction. Given the fund's ability to invest in instruments of up to five years in maturity, there have also been opportunities to invest in slightly longer-dated fixed and floating rate instruments at attractive credit spreads and all-in yields. As is the case with all purchases of credit instruments, they need to meet our stringent fair-value criteria and are subject to approval from our credit committee.

Credit issuance in the primary market remains very subdued, which is partly a function of the low growth environment. The recent weakness in GDP growth was to some degree attributable to lower capital expenditure and this remains particularly concerning for credit markets from an overall supply perspective. For the five months ending May 2018, issuance from banks was down 43.8% with corporate issuance being down 9.5%. Issuance from State Owned Enterprises has shown some improvement off a very low base in 2017.

Our current GDP growth expectations are 1.8% in 2018 and 2.2% for 2019. Together with our expectations for one further rate cut, this should be positive for credit issuance heading into the second half of the year. Nonetheless, we remain cautious and continue to only invest in instruments that are attractively priced relative to their underlying risk profile. Capital preservation and liquidity remain our key focus areas.

Portfolio managers
Nishan Maharaj, Mauro Longano and Sinovuyo Ndaleni
as at 30 June 2018