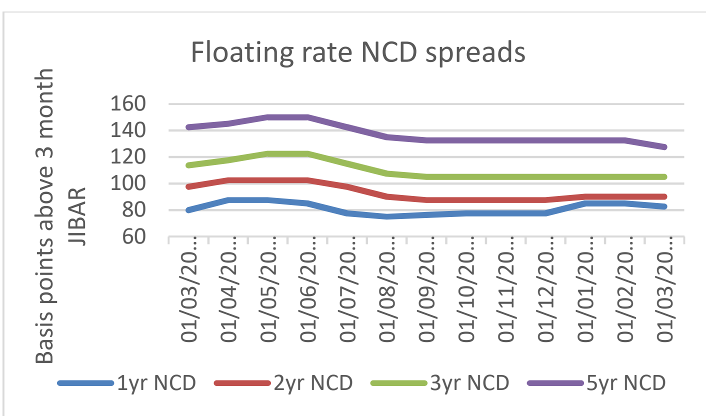
Please note that the commentary is for the retail class of the fund.

The fund generated a return (net of management fees) of 2.0% for the quarter and 8.3% over a rolling 12-month period, which is ahead of the 3-month STeFI benchmark return of 7.1%.

In March, the South African Reserve Bank's Monetary Policy Committee cut the repurchase rate by 25 basis points (bps), in line with our own expectations. While the improvement in the inflation outlook and 'constrained' growth facilitated this decision, it is important to note that it was not unanimous, with four members voting for a cut, and three members voting for no change. Our current CPI forecasts reflect an average of 4.8% for 2018 and 5.1% in 2019, with food disinflation still being a key driver of the muted outlook. On this basis, our expectation is for a further 25 bps cut at the next MPC meeting in May. It is worth mentioning, however, that the market is a little less sanguine, with only a 60% chance of an additional interest rate cut being priced over the next 12 months (as expressed through forward-rate agreements).

The cut in the repo rate has, as expected, lowered the yield of the 3-month JIBAR index off which most of the floating rate instruments in the fund are priced (the index moved from 7.1% to 6.9%). It is important to remember that the 3-month Jibar rate for floating rate instruments resets every three months after the initial investment date. As such, the yield impact on the fund will not be felt immediately, and should gradually reduce over the next quarter (assuming no change in credit spreads).

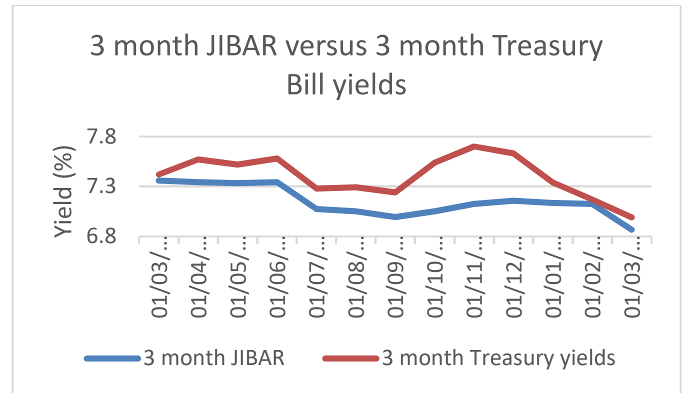
More generally, we have seen a slight contraction in NCD (Negotiable Certificates of Deposit) credit spreads over the past quarter. This has been a function of several factors, including the falling interest rate environment; subdued longer term issuance contrasted by a reasonably healthy demand for credit; and the two key risk events for the quarter (Budget Speech and the Moody's rating announcement) having passed with no notable surprises. Enough seems to have been done in the Budget speech to maintain fiscal credibility and a downgrade was avoided with the additional pleasant surprise of the sovereign outlook being changed to 'Stable' from 'Negative'. The contraction in credit spreads is 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.



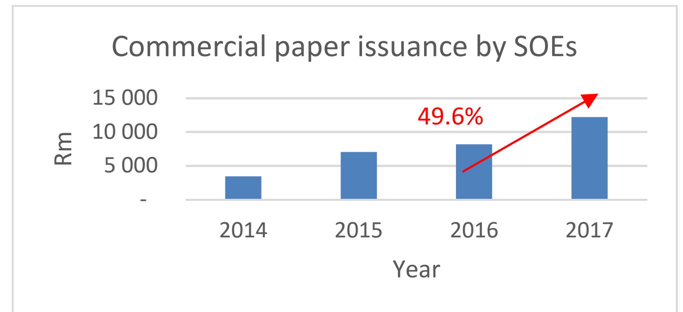
The fund continues to benefit from its holdings in 12-month fixed rate instruments which experienced a further downward shift in yield on the back of the repo rate cut. Since the beginning of the year, we have seen 1-year fixed rate yields move from 7.9% to 7.7%, which is still above the yield of the fund's benchmark. This fund does not take substantial interest rate views and the duration is limited to 90 days (currently 58 days). As such, these holdings are only maintained to the extent that they do not breach the fund's interest rate risk mandate. They also come with added liquidity benefits, in that they can be exited at very little cost.

We have previously remarked on the dislocation between 3-month JIBAR and the repo rate (currently 6.9% vs 6.5%). This is peculiar given that 3-month JIBAR is forward looking in nature and as such, we would expect it to trade at a lower yield than the repo rate in an interest rate cutting environment (as has happened during similar periods in the past). While the full picture is still not clear, we have noticed certain market dynamics which may be creating pressure on short term funding rates.

- The yields on 3-month Treasury bills have been trading above the level of the index for some time, creating a natural alternative for short-term investment.



- The dynamics of the foreign exchange market may also have played a role. Three month US dollar deposits, invested at 3-month LIBOR, are able to provide South African rand investors with and equivalent yield of 3-month JIBAR + 25bps (after currency effects are taken into consideration). This premium to interbank funding is attractive.
- While likely not a significant contributor, we have also seen some increase in commercial paper issuance, specifically from State-Owned Enterprises (SOEs). This is short-term funding, typically one to 12 months, which is issued into the market by various entities. In 2017, we saw commercial paper issuance from SOEs rise around 49%.



As previously mentioned, the fund benefits from this dislocation which ultimately translates to a higher absolute yield for the floating rate instruments which it holds. We will continue to monitor this going forward.

The fund uses corporate credit to enhance returns where we believe the spread adequately compensates us for the underlying risk of the entity. The fund did increase its exposure to corporate credit slightly during the period and this now sits at 21.6%. This was predominantly done by purchasing the corporate bonds of Growthpoint, Hyprop and Standard Bank. The pricing of all these issues met our stringent fair-value criteria.

We still remain cautious for the rest of 2018, and will continue to only invest in instruments which are attractively priced relative to their underlying risk profile. As always, capital preservation and liquidity remain our key focus areas.

Portfolio managers
Nishan Maharaj, Mauro Longano and Sinovuyo Ndaleni
as at 31 March 2018