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

The fund returned 1.0% in April, bringing its total return to 7.9% for the 12-month period. This is ahead of the returns delivered by cash (6.9%) and its benchmark (7.6%) over the same one-year period.

The performance of local bonds moderated after a strong March. The All Bond Total Return Index was up 0.7%, with the best performance coming from the belly of the curve (7-12 years), which returned 0.97%. In contrast, the long end (12+ years) underperformed, returning only 0.62% as the yield curve steepened. After a poor start to the year, inflation linkers returned a strong 3.34% for March as real yields rallied. Cash returned 0.6% for the month.

While global data showed some improvement in April, with activity data picking up at the margin, the growth outlook remains constrained and fragile. This was reaffirmed by the International Monetary Fund, which in its latest World Economic Outlook, revised its global growth projection down to 3.3% for 2019 from 3.5%. In conjunction with inflation pressures remaining subdued, most major central banks continued to deliver a dovish message helping support risk assets. Beyond ongoing US-China trade negotiations, the month's headlines were dominated by the news of Brexit being granted a further six-month extension, while a resurgence of fault lines in Turkey and Argentina also garnered attention. In South Africa, moribund activity data have taken second place to the market's increased focus on upcoming national elections and how various scenarios may play out.

In the US, the major release for the month was first-quarter GDP data, which printed at an impressive 3.2% quarter-on-quarter (q/q). While this represented an upside surprise relative to market expectations, the quality of growth was not as encouraging as first appears, with the volatile categories of net trade and inventories together contributing 1.7% to growth. Looking beyond this, soft household and business spending was evident in a smaller 1.4% increase in domestic final sales. Recent high-frequency data remains mixed. While retail sales numbers were stronger across the board, at 1.2% month-on-month (m/m), and business and consumer sentiment showed an uptick, industrial production was again tepid at -0.1% m/m. The unemployment rate was steady at 3.8% but average hourly earnings were slightly softer than expected at 0.1% m/m.

US headline CPI for March increased to 1.9% year-on-year (y/y) from 1.5% y/y for February, driven by an increase in energy prices. Core CPI, however, was a touch lower at 2.0% y/y. The lack of inflationary impulse in the economy was further confirmed by core PCE inflation printing at a meager 1.6% y/y. In this context, the Federal Reserve (Fed) maintained a dovish tilt in its latest Federal Open Market Committee statement, with no hike still envisaged in 2019.

At the end of April, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 8.28% (three-year) and 8.76% (five-year); basically unchanged over the month. The spreads of floating-rate NCDs have dulled in appeal over the last few quarters due to a compression in credit spreads. There has been a reduced need for funding from banks in South Africa, given the low-growth environment. Fixed-rate NCDs continue to hold appeal due to the inherent protection offered by their yields and relative to our expectations for a stable repo rate. However, credit spreads remain in expensive territory (less than 100 basis points [bps] in the three-year area and 110 bps in the five-year area). The fund continues to hold decent exposure to these instruments (less floating than 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.

In South Africa, growth prospects remain weak after continued soft high frequency data, exacerbated by unexpected country-wide electricity outages. Mining and manufacturing production contracted in annual terms over the past two months and retail sales continue to be weak. It is most likely that the economy contracted in the first quarter of the year and this poses a risk to the South African Reserve Bank's (SARB) forecasted 1.3% annual growth expected for 2019.

The rand was up 1.4% over the quarter, ending at 14.30 to the dollar. Sentiment towards South Africa continues to swing with emerging market sentiment. 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).

Headline inflation printed 4.5% in March vs 4.1% in February. The increase was due to high fuel prices, increased public transport costs and various excise cost increases following the release of the National Budget. Continued exchange rate weakness, higher than expected global oil prices, and a surprise in food inflation are upside risks that could change the inflation forecast numbers.

The SARB left rates unchanged at the March Monetary Policy Committe meeting and emphasised both a low 2021 CPI forecast at 4.7% (4.8% in February), as well as a reassuring moderation in long-term inflation expectations, as measured by the Bureau for Economic Research (BER) to 5.1% - the lowest since the survey started. The shift in global growth slowdown is less of a concern after the US and eurozone GDP surprises, especially as the Fed and European Central Bank have come out with dovish statements after their last meetings and may keep rates on hold for the rest of the year. This supports a more accommodative stance for South Africa's monetary policy.

Chronic load shedding and poor local sentiment will continue to weigh on South Africa's growth outcomes. Inflation should remain under control allowing policy rates in South Africa to at worse, remain stable. Global monetary policy has once again turned more supportive for risk sentiment, which should help buoy emerging market valuations over the shorter term. At current levels, local government bonds trade cheap to fair value estimates. However, given the longer-term risks posed to the economy from a further state-owned enterprise deterioration, allocations should be kept at a neutral level. While nominal bonds continue to compare favourably to inflation-linked bonds (ILBs), the balance in the front end of the curve has shifted towards ILBs.

The local listed property sector was up 2% over the month, bringing its return for the rolling 12-month period to -11.8%. Listed property has been the largest drag on the fund, primarily due to generalised equity weakness and idiosyncratic domestic issues relating to the possible closure of Edcon, its impact on the broader property sector and lower real GDP growth. However, from an income perspective, distribution growth and expectations around future distribution growth remain sound. Despite the underperformance, from a valuation perspective, the sector is still very attractive. The changes in the property sector over the last decade (including the increased ability to hedge borrowings and large offshore exposures) should make listed property more resilient going forward. If one excludes the offshore exposure, the property sector's yield rises to approximately 10.7%, 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. 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 2.5% over the month, bringing its 12-month return to 20.7%. Preference shares offer a steady dividend yield linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 9% 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. 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 risks 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 local economy. However, we believe that the fund's current positioning correctly reflects appropriate levels of caution. The fund's yield of 8.72% 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 Mauro Longano
as at 30 April 2019