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

The fund returned 0.6% in February, bringing its total return to 8.4% 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.

February reversed some of January's strong performance, with a negative return from the South African bond market. The All Bond Index was down 0.4%, with the worst performance coming from long-dated bonds (12+ years), which fell 0.78%. This was followed by the belly of the curve (7-12 years), which was down 0.07%, while shorter-dated bonds (3-7yrs) returned a positive 0.44%. The short end (1-3yrs) fared similarly, up 0.41%, while inflation linkers fell 0.38% and cash returned 0.5% in February.

Global data remained mixed in February, but with continued evidence of a slowing in global growth momentum. The month's news was dominated by ongoing trade talks between the US and China and the UK's messy race to the Brexit deadline of March 29. In South Africa, the escalation of Eskom's load shedding and a weak budget dampened sentiment, while growth-related numbers remain weak.

In the US, Q4-18 gross domestic product (GDP) was 2.6% quarter-on-quarter (q/q) seasonally-adjusted annualised (saa), modestly ahead of the 2.3% consensus and well supported by both solid domestic consumption and business investment growth. For the year, GDP was 2.9%, from 2.2% in 2017. The US government shutdown will affect momentum and sentiment in Q1-19 and led to several data delays in February. Nonetheless, available high-frequency data have, on balance, been weaker: durable goods orders were softer, and housing starts fell sharply in February. Forward-looking data also softened, with the February Institute for Supply Management manufacturing index lower than expected at 54.2 from 56.6 in January.

Headline consumer prices were broadly in line with expectations. Headline inflation was 1.6% y/y in January from 1.9% y/y in December, core Consumer Price Index (CPI) inflation was unchanged at 2.2% y/y from 2.1%, while core personal consumption expenditure (PCE) inflation was unchanged at 1.9% y/y in December.

At the end of February, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 8.2% (three-year) and 8.7% (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 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.

China's high-frequency industrial activity, home sales, and Lunar New Year (LNY) travel and consumption data all point to a continued moderation in growth in January and February, but there are some signs that policy stimulus has picked up pace. January data showed a strong surge in credit lending, with credit growth of 10.4% y/y from 9.3% y/y in December off a high January 2018 base, and the The People's Bank of China's average loan rate fell almost 30 bps in February.

In South Africa, the tabling of the Budget for 2019/20 dominated headlines amid mounting concerns about Eskom. The Minister of Finance announced significant R23 billion per annum support for Eskom over the next three years, which will see the deficit widen to -4.7% of GDP in 2019/20 before a very modest consolidation to -4.3% by 2021/22. The wider deficit implies a higher debt trajectory, with gross debt-to-GDP now expected to rise to 58.9% over the same period. This weakened fiscal position and uncertainty about a plan to salvage Eskom has raised concerns about the outlook for South Africa's one remaining investment-grade rating from Moody's. The agency is expected to update the market on its views at the end of March.

The rand was down 5.9% over the month, ending at 14.09 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)

Growth momentum remains subdued, with activity data a mixed bag as December power outages affected mining and manufacturing production. The former contracted -4.8% y/y from -5.8% in November, while manufacturing production was up just 0.1% y/y from 1.3% y/y the month before. Retail sales contracted 1.4% y/y in December after growth of 2.9% in November. One bright spot was an improvement in credit growth in January, up 6.5% y/y from 5.1% y/y in December.

Domestic inflation slowed sharply again in January to 4.0% y/y from 4.5% in December on much lower retail fuel prices and a downtick in food inflation. Core ticked lower to 4.4% y/y. With both inflation and growth subdued, we do not expect any change to policy rates at the March Monetary Policy Committee meeting.

Local government bonds mostly reflect realistic expectations for the local economy, although have benefitted from a turn in global sentiment recently. South African bonds compare favourably to their emerging market peers, relative to their own history, and still offer a respectable cushion against further global policy normalisation. At current levels, the yields on offer in the local bond market are fairly valued relative to their underlying fundamentals and warrant a neutral to modestly positive allocation. The relative underperformance of inflation-linked bonds (ILBs) versus nominal bonds in past quarters has resulted in real yields moving to levels that have not been seen in at least the last eight years. While nominal bonds continue to compare favourably to ILB's, the balance in the front end of the curve has shifted towards ILBs.

The local listed property sector was down 4.8% in February, bringing its return for the rolling 12-month period to -5.2%. 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 1.5% in February, bringing its 12-month return to 17.8%. Preference shares offer a steady dividend yield linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 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 8.89% 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 Mauro Longano
as at 28 February 2019