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

The fund generated a return of 1.9% for the quarter to end-June 2019 (Q2-19) and 7.8% over a rolling 12-month period, which is ahead of the three-month STeFI benchmark return of 6.9%.

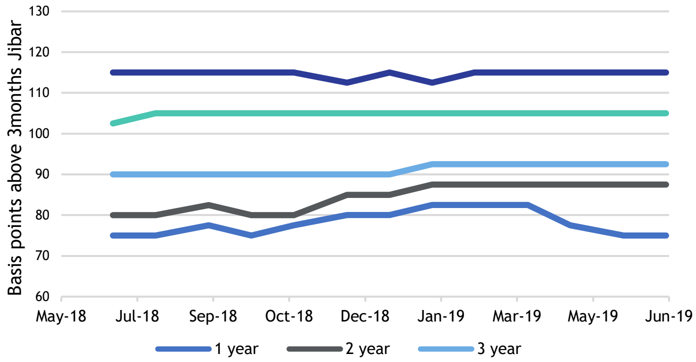
The period was marked by a disappointing contraction in GDP of 3.2% quarter-on-quarter, seasonally adjusted and annualised. This was considerably worse than expected, with the extent of the weakness relatively broad-based. While power outages during the first quarter of 2019 would have contributed to this outcome, the data is testament to very constrained domestic demand. According to our internal forecasts, the economy is now likely to grow by 0.7% in 2019.

Headline inflation in May printed at 4.5% year-on-year, which was at the midpoint of the South African Reserve Bank's (SARB's) target range. This continues to be affected by muted inflation in food, discretionary services and goods. Our current expectation is for CPI to average 4.4% in 2019 and 5% in 2020. Longer term, the risk of higher food prices and administered price increases should be moderated by the weaker demand environment. The outlook for fuel prices also looks to be more benign, given the impact of weaker global growth on the oil price, together with recent rand strength.

The SARB's Monetary Policy Committee (MPC) left the repo rate unchanged at 6.75% at their last meeting in May. The vote was split 3:2, with two members voting for a 25 basis points (bps) cut and three members voting to hold rates steady. This split does highlight the narrative that there is room for monetary policy to provide some support to the weak economy, particularly given the muted inflation outlook. However, the MPC reiterated that the challenges facing the economy are primarily structural in nature and cannot be resolved by monetary policy alone. The interest rate market is currently pricing two 25bps interest rate cuts over the next year, which is in line with our own internal interest rate expectations. Should this outcome materialise, one can expect the absolute yield on the fund to decrease, given that the majority of the investments are held in floating-rate instruments.

Spreads on negotiable certificates of deposit (NCDs), as reflected above the three-month Jibar reference rate, have remained stable. The exception has been one-year instruments, which saw spreads decreasing from 85bps to 75bps. The contraction in NCD spreads will continue to be positive for the fund, although the benefit is only received when an NCD is sold back to the issuing bank. As such, while there is no immediate yield uplift, 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 well positioned to handle adverse market moves.

FLOATING-RATE NCD SPREADS ABOVE JIBAR



Source: Bloomberg

The period saw robust issuance from banks, state-owned enterprises and corporates. Support for primary market auctions remained strong, despite the tight spreads on offer. Based on our internal fair value models, credit spreads on new issues generally reflect as being expensive and hence we remain cautious. We continue to only invest in instruments that are attractively priced relative to their underlying risk profile, with capital preservation and liquidity remaining key focus areas for the fund.

Portfolio managers
Nishan Maharaj, Mauro Longano and Sinovuyo Ndaleni
as at 30 June 2019