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

The first three months of the year saw a broad rebound in almost every asset class after a very difficult final quarter in 2018. The S&P 500 posted its strongest first quarter since 1998, gaining 13.7% year to date. Meanwhile, 10-year US Treasuries gained 2.9%, German Bund yields fell below zero and credit spreads saw broad tightening. The repricing in global bond markets was largely driven by a change in expectation for further interest rate hikes in the US to potential rate cuts over the next twelve months. The positive performance also fed through into the South African asset classes. During the quarter, the FTSE/JSE Shareholder Weighted All Share Index (SWIX) returned 3.9%, bonds returned 3.8% and domestic property continued to lag, at 1.3%. Against this backdrop, the fund had a decent quarter, delivering a return of 5.1%.

The generally strong asset class performances reflect higher investor risk appetite, but do not necessarily come with more positivity on the longer-term growth outlook. Growth in both developed and emerging markets is still expected to slow and many key issues remain unresolved. The US and China have yet to come to a trade agreement that is satisfactory to both parties. The Brexit process continues to drag on, with no clear plan. Large emerging markets, such as Brazil and Turkey, have come out of crisis mode but still seem to hit pockets of turbulence.

In line with this, South Africa's growth outlook continues to be muted. Rising commodity prices and increased political stability should have led to a more positive picture. However, Eskom's financial and operational issues have quashed any optimistic momentum. While increased government support has temporarily settled Eskom's financial issues, solving their operational issues will present more of a challenge. We expect load shedding will be more frequent going forward, and that it will have a negative impact on the current productivity and profitability of South African corporates. Businesses will also delay or scrap new investments, and this will negatively impact future growth.

Despite this more cautious outlook, the fund still has a 76% position in domestic assets. Within this, the largest local allocation is to fixed-income assets (44% of fund), with a weighted average yield of 9.4%. This yield handily meets the fund's mandate of delivering returns of CPI +3%. The risk of a downgrade to our sovereign rating has been delayed, with Moody's deciding not to change their credit outlook at the end of March. While bonds have reacted positively, we think this is a stay of execution rather than an absolute pardon. The risk of a downgrade may still re-emerge in the coming months, but for now the real yields on our portfolio of fixed-income assets remain attractive, given a benign inflation outlook.

We have kept our South African equity exposure fairly constant at 20% of the portfolio, with a high weighting to rand-hedge shares. Some of our large equity positions, such as British American Tobacco and MTN posted robust recoveries after delivering good financial results. Resource counters in particular have had a big re-rating, and we took the opportunity of share price strength to sell out of our Anglo American Platinum position. We have also taken up select small exposures to domestically-focused defensive businesses. While we are cautious about our South African growth outlook, our investment discipline is to focus on valuations. If an attractive opportunity presents itself at the right price, we will act accordingly.

South African property shares have continued to deliver a lacklustre performance. Landlords have now finalised an agreement to support Edcon, either via rental reduction or with a recapitalisation. These actions will result in muted distribution growth going forward. While yields are looking reasonable, we have chosen to largely maintain our exposure to domestic property at 6%.

At the start of the year our international exposure was relatively low at 17%. We bought currency futures to take advantage of attractive exchange rates and exposure now sits at 23%. Our offshore exposure is still mainly allocated to global equities, and all of the underlying international investments have delivered good alpha in the last quarter, further assisted by the rand weakness.

In summary, the fund has had an encouraging start to the year. Over the last 12 months, it has now managed to beat inflation and its benchmark. Longer-term performance also meets these criteria. While the ongoing global uncertainties create much volatility and can result in a range of positive or adverse growth outcomes, our unwavering focus is to build a diversified portfolio that can absorb unanticipated shocks. In this manner, we want to deliver on the fund's dual mandate of beating inflation by 3% over time and protecting capital over all rolling 12-month periods.

Portfolio managers
Charles de Kock and Pallavi Ambekar
as at 31 March 2019