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

The Fund returned 0.6% in August, bringing its total return to 4.2% for the 12-month period.

Local bonds once again delivered an unexciting but positive performance in August. The All Bond Index returned 0. 9%, mainly lifted by the belly of the curve (3-7 years), which returned 1.20%. Short-dated bonds (1-3 years) returned 0.6 %, and bonds with a maturity of 7-12 years returned 0.6 %. The long-end of the curve (12+ years) had a solid performance, returning 0.96%, while inflation-linked bonds (ILBs) had a good month and returned 3.9 %. Cash returns remained steady at 0.3 %.

The most recent second-quarter GDP growth numbers show the devastating impact of the lockdown on developed economies, with very weak prints published for the US, EU and especially the UK. Fiscal and monetary support is expected to continue as governments and central banks expand support programmes to provide relief to corporates and households. Inflation pressures should remain muted for now (despite some recent upside surprises to the data) and monetary policy interventions are expected to remain in place for a considerable period.

US headline inflation increased to 1.0% year-on-year (y/y) in July from 0.6% y/y in June. An increase in food prices and rebound in vehicle prices contributed to the inflation uptick, which was higher than the consensus expectation. Core inflation increased to 1.6% y/y in July vs June's 1.2% y/y number. Federal Reserve Chair Powell used the annual Jackson Hole symposium to announce changes to the Fed's monetary policy framework, which will move to targeting an 'average' inflation at 2%. Federal Reserve policy makers continue to see little threat to inflation and expect to hold interest rates near zero for the foreseeable future.

The rand was stronger, as it gained 0.8% against the US dollar, ending July at US$1/R16.60. The easing of lockdown measures globally and initial indications that the expected contraction would not be as severe as initially thought, served to buoy risk sentiment and emerging market currencies. However, the local fundamental backdrop remains quite poor. The Fund maintains its healthy exposure to offshore assets and, when valuations are stretched, will hedge/unhedge portions of its exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollars, UK pounds and euros). These instruments are used to adjust the Fund's exposure synthetically, allowing it to maintain its core holdings in offshore assets.

US headline inflation increased to 1.0% year-on-year (y/y) in July from 0.6% y/y in June. An increase in food prices and rebound in vehicle prices contributed to the inflation uptick, which was higher than the consensus expectation. Core inflation increased to 1.6% y/y in July vs June's 1.2% y/y number. Federal Reserve (Fed) Chair Powell used the annual Jackson Hole symposium to announce changes to the Fed's monetary policy framework, which will move to targeting an 'average' inflation at 2%. Fed policymakers continue to see little threat to inflation and expect to hold interest rates near zero for the foreseeable future.

In Europe, headline inflation printed at 0.4% y/y in July, slightly up from 0.3% y/y in June. The main contributors to the uptick in inflation were an increase energy, food and alcohol prices. Core inflation increased to 1.2% y/y in July from June's 0.8% y/y. The European Central Bank (ECB) will meet in mid-September and the market is expecting the bank to keep rates unchanged and maintain the asset purchase programme.

In emerging markets, China's headline inflation rose to 2.7% y/y in July from 2.5% y/y in June, with food prices contributing to the higher aggregate. The Caixin China General Manufacturing PMI rose to 53.1 points in August from 52.8 points in the July. The latest reading pointed to an improvement in the health of the sector, adding to signs of an economic recovery after the pandemic hit the economy earlier this year. Elsewhere in emerging markets, the impact of Covid-19 on growth is still evolving. A range of central banks have announced lower interest rates and active (or intentions to implement) interventions in government bond markets through quantitative easing programmes.

In South Africa, headline inflation for July printed at 3.2% y/y versus June's 2.2% y/y. The upward pressure in inflation was mostly attributable to a rise in retail fuel prices, coupled with rising 'miscellaneous' goods and services prices (mostly related to funeral expenses) and higher electricity and water tariffs. Core inflation increased to 3.2% in July versus 3.0% in June. Prices are expected to rise in coming months as fuel prices normalise and as economic activity starts picking up. However, inflation should remain well below the South African Reserve Bank's 4.5% midpoint in coming months, leaving room for further monetary policy easing.

South Africa's second-quarter GDP contracted 51% q/q, bringing GDP in annual terms to -17.1% y/y, reflecting a collapse in economic activity during the hard lockdown. Agriculture was marginally positive, benefiting from good rains, strong field crops and good exports, however mining and manufacturing collapsed 73-75% y/y, pulling the overall number down significantly. The return of load shedding risks capping the recovery as the economy emerges from lockdown.

The fallout from the Covid-19 pandemic will linger for some time. In South Africa, the impact will be felt most in a much dimmer growth outlook, which will have a severe impact on government finances. The effects of the very hard lockdown and poor policy choices will weigh heavily on the economy going forward. As the economy was not well positioned going into the crisis, strong reforms are needed to return the country to a structurally better growth path, although lower interest rates will lend support to the economy through this difficult phase. South African Government Bonds (SAGBs) do embed a decent risk premium, although this premium has reduced slightly post the recovery in the second quarter of 2020. South Africa is on the brink of a debt trap and, although promises have been made to restore the country to a more sustainable debt trajectory, the implementation risks remain elevated. The valuation of SAGBs does provide some offset to this, implying that local bonds do warrant at least a neutral allocation in portfolios.

At the end of August, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 4.90% (three-year) and 6.08% (five-year), slightly lower than the previous month. Shorter-dated NCDs have pulled lower due to the significant interest rate cuts, recovery in bond yields and tightening of credit spreads. Short-dated fixed-rate NCDs continue to hold appeal due to the inherent protection offered by their yields and relative to our expectations for a lower repo rate. In addition, NCDs have the added benefit of being liquid, thus aligning the liquidity of the Fund with the needs of its investors. The Fund continues to hold decent exposure to these instruments (less floating than fixed), but we will remain cautious and selective when increasing exposure.

The local listed property sector was down 8.6% over August, bringing its return to -44. 3% over the rolling 12-month period. Listed property has been the largest drag on the Fund's performance. This has resulted in a general rise in balance-sheet risk across the sector. The current crisis will reduce rental income, put pressure on asset values, increase the cost of borrowing for lower-quality businesses, and test inexperienced management teams. It is entirely possible that most of the companies will require additional capital and that dividends are suspended to preserve capital. One must be cautious not to take these at face value and understand how the key issues mentioned above affect that yield. We believe there are a few select large-cap counters that satisfy our stringent conditionality.

The FTSE/JSE Preference Share Index was down 1.4% over August, bringing its return to -14.7% over the 12-month period. Preference shares offer a steady dividend yield linked to the prime rate and, depending on the risk profile of the issuer, currently yield between 8% and 10% (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 the 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 6.4% (Gross of fees) 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 31 August 2020