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

The fund returned 1.5% in May, bringing its total return to 4. 6% for the 12-month period. Local bonds delivered great performance during May, rebounding from a low base in April. The All Bond Index returned 7.1%, with the long-term bonds (seven to 12 years) delivering the best return at 9.4%, while short-dated bonds returned 1.1%, and bonds with a maturity of three to seven years returned 4.4%. The long end of the curve (12+ years) was up 8.32%, inflation-linked bonds (ILBs) had an average month returning 1.1%, and cash earnings were slightly lower at 0.45%, reflecting the recent rate cuts.

The effects of Covid-19 are still playing out in the global economy, as the second quarter of 2020 (Q2-20) has seen countries slowly easing restrictions and economic activity picking up moderately. With data indicating growth under extreme pressure, central banks continue to expand quantitative easing to provide relief to households and corporates. Oil prices recovered slightly in May, but inflation pressure remains low.

The market expects the Federal Reserve Board (the Fed) to shift to a medium- term inflation target policy coupled with an open-ended quantitative easing programme at its meeting in June. At the last meeting, Fed Chair Colin Powell noted that negative interest rates are not yet a consideration for the US and that asset purchases would continue 'as needed'. He also highlighted the limitations of monetary policy in a crisis such as this and called for further fiscal support. US headline inflation fell to 0.3.% year on year (y/y) in April from 1.5% y/y in March. The decline was due to lower energy, fuel, apparel, services, transport and recreation prices. Producer price inflation (PPI) contracted -1.2% y/y in April from 0.7% y/y in May. With unemployment rates rising across the US, inflation pressures are expected to remain low.

In emerging markets, China's economic activity picked up on the back of eased lockdown restrictions. Headline inflation decreased to 3.3% y/y in April versus 4.3% y/y in March. The National People's Congress of China did not commit to a growth target for the year but announced additional fiscal support in excess of market expectations. Total fiscal support is now estimated at 4.8% of GDP, concentrated in tax and fee reductions, and an additional 2% of GDP emergency funding for Covid-19 economic recovery, mainly for infrastructure. 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) interventions in government bond markets through quantitative easing programmes. Broadly, emerging market inflation should moderate in the coming months due to lower oil prices, although significantly weaker currencies pose some threat to inflation in the longer term.

The rand was stronger, as it gained 5.6% against the US dollar, ending May at US$1/R17.55. The easing of lockdown measures globally and initial indications that the expected contraction would not be as severe as initially thought, serve to buoy risk sentiment and EM 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.

The South African Reserve Bank (SARB) cut the repo rate by 50 basis points (bps) to 3.75% at its May monetary policy meeting. The vote was split with three members voting for a 50bps cut and two members preferring 25bps. This could signal a moderation in the increment of rate cuts going forward. We expect the SARB to cut the repo rate again in July, with a greater probability of 25bps. The May SARB forecast GDP contraction of 7% in 2020 and a gradual recovery in 2021 and 2022, with GDP growth of 3.8% and 2.9%, respectively.

Furthermore, the SARB is expecting inflation to average 3.4% in 2020, to rebound to 4.4% in 2021 and 2022, somewhat higher than our forecasts. Overall the SARB policy stance remains conservative, and recent comments from the Governor suggest any market interventions will be implemented to avoid dislocation rather than actively aiming to reduce long-term interest rates. Business activity, having collapsed sharply during the hard lockdown in April, showed some signs of recovery in May. The ABSA Purchasing Managers Index ticked up, and the Business Activity Index, which is broadly analogous to output, recovered markedly to 43.2 points in May after falling to a record low of 5.1 points in April. Vehicle sales were less negative in May after a collapse in April. Overall, however, there is little hard data to go by.

At the end of February, shorter dated fixed-rate negotiable certificates of deposit (NCDs) traded at 5.56% (three-year) and 6.60% (five-year), much lower than the previous month. Shorter dated NCDs have pulled lower due to the significant interest rate cuts, while the five-year levels have pulled wider, due to the recovery in bond yields. 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 overall impact of this crisis on growth and government finances is likely to be severe, and the effects of lockdown and poor policy choices will weigh heavily on the economy going forward. As South Africa's 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 the economy through this difficult phase. South African Government Bonds do embed a decent risk premium relative to cash and their emerging market peers, albeit, this premium has compressed with the recent rally in bond yields. The risk that South Africa will fall into a debt trap remains high, but valuation does provide some offset to this, implying that local bonds do warrant at least a neutral allocation in portfolios.

The local listed-property sector was down 0.5% over May, bringing its return for the rolling 12-month period to -45.4%. 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 2% over May, bringing its 12-month return to -13.9%. 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 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 6.80% (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
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