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

The Fund returned 0.3% in January, bringing its total return to 4.1% for the 12-month period. This return is behind cash, at 4.5% and the Fund's benchmark.

Local bond performance in January was unremarkable. The All Bond Index delivered a total return of 0.76%, with the long-term bonds (12+ years) returning 0.99%. The 7-12-year area of the curve also delivered a modest return of 0.96%, while medium-term bonds (3-7 years) returned 0.50%. Short-term bonds delivered a meagre 0.17%, while inflation-linked bonds (ILBs) were the top performers, up by 2.04%. Cash returns held steady at 0.26%.

Global economies have started posting GDP growth numbers for the fourth quarter of 2020 (Q4-20). The results show a slow recovery after a strong third quarter, and the outlook for 2021 remains uncertain, given renewed lockdowns and the surging second pandemic wave. The International Monetary Fund (IMF) expects the world economy to report a contraction of 3.5% for 2020 and is projecting a global economic expansion of 5.5% in 2021 and 4.2% in 2022. These growth numbers are based on expectations of a vaccine-powered strengthening of activity in the latter part of the year and added global policy support in many countries.

In the US, the Federal Open Market Committee left the target range for the federal funds rate unchanged at 0.00%-0.25% at its January meeting. The Committee also left the pace and size of asset purchases unchanged. The US Federal Reserve acknowledged that the pace of recovery had slowed down. It stated that current rates would remain appropriate until the labour market returns to full employment and inflation has risen back to its internal target, which moderately exceeds 2%. In December, headline inflation increased to 1.4% year-on-year (y/y) from a 1.2% y/y print in November. The biggest contributor to the inflation uptick was an increase in energy prices. Core inflation remained unchanged at 1.6% y/y.

In emerging markets, China's economy grew by 6.5% saa q/q in Q4-20 following an expansion of 4.9% saa q/q in Q3-20. The recovery was driven by increases in industrial production, retail sales and the manufacturing sector. During 2020, the economy expanded by 2.3%, making China likely to be the only country to avoid a contraction related to Covid-19 shocks. Headline inflation rose by 0.2% y/y in December after a contraction of 0.5% y/y in November. An increase in prices of food, healthcare services and education contributed to the inflation uptick. During 2020, inflation rose to 2.5%. Core inflation decreased to 0.4% y/y in December versus 0.5% y/y in November.

Elsewhere, the impact of Covid-19 on growth is still evolving, with many countries still battling rising infection rates and relatively stringent lockdown restrictions. The rollout of the vaccine in 2021 will be slow but is expected to contribute to recovery in economic activity in the latter part of the year. Central banks will continue to be accommodative and able to intervene when necessary.

The rand was weaker, as it lost 3% against the US dollar over January, ending at US$1/R15.16. 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 EM currencies. However, the local fundamental backdrop remains quite poor. The Fund maintains its healthy exposure to offshore assets. When valuations are stretched, it 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. In addition, the Fund currently has option structures in place to protect its holding if the rand moves materially below US$1/R16 on a sustained basis.

At the end of August, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 5.0% (three-year) and 5.98% (five-year), higher than the previous month. Shorter-dated NCDs have been 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 our expectations of a lower repo rate. In addition, NCDs have the added benefit of being liquid, thus aligning the Fund's liquidity with the needs of its investors. The Fund continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

In South Africa, growth momentum slowed in Q4-20 and will probably remain soft in the first quarter of 2021, but prospects for a relatively strong recovery as global tailwinds and the domestic vaccine rollout gain traction are quite good. The South African Reserve Bank (SARB) left the repo rate unchanged at 3.5% at its Monetary Policy meeting in January, with the statement reiterating that the current monetary stance is accommodative, with the real policy rate at 0.2%. Furthermore, risks to inflation and growth are assessed to be "balanced". The hurdle to further easing remains uncertain currency risk associated with a weak fiscal position.

Headline inflation slowed moderately to 3.1% y/y in December from 3.2% y/y in November, bringing the annual average to just 3.3%. A moderation drove the slowdown in food prices and a decline in housing and utilities inflation. Core inflation was unchanged at 3.3% y/y. Even with inflation expected to accelerate to an average of 3.8% in 2021, this still represents very benign inflation pressure in the economy, with both headline and core readings well below the mid-point of the SARB's target range. Underlying economic conditions are easing but remain challenging, given SA's poor starting point. Inflation will remain under control, but a stronger shift needs to be made towards higher growth without pushing the country further into a debt trap. Progress has been made by reallocating expenditure away from a bloated wage bill and towards pro-growth elements; however, further unpalatable austerity might be required if reforms are not accelerated. Despite their rally at the end of 2020, SA government bonds (SAGBs) still encapsulate a significant risk premium that provides a decent offset to the underlying fundamental backdrop. With their elevated real yields and inherent inflation protection, shorter-dated ILBs also provide an attractive allocation opportunity for bond portfolios.

The local listed property sector was down 3.2% in January, bringing its 12-month return to -34.6%. Listed property has been the largest drag on the Fund's performance. The current crisis will reduce rental income, put pressure on asset values, increase borrowing costs 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 factors 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 up 1% in January, bringing its 12 return to -9.7%. 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 of its associated 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 local economy's underlying fundamentals. However, we believe that the Fund's current positioning correctly reflects appropriate levels of caution. The Fund's yield of 5.8% 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 January 2021