CORONATION
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Please note that the commentary is for the retail class of the Fund

The Fund returned 0.6% in July, bringing its total return to 7.1% for the 12-month period. This return is ahead of cash (3.5%) and that of its benchmark (3.9%).
Local bonds delivered an uninspiring performance in July. The All Bond Index returned 0.8%, supported by the long-end (7-12 years), which delivered 1.1%. The very back end of the curve (+12 years) delivered a meagre 0.6% and medium-term bonds (3-7 years) delivered 1.1%. The short end (1-3 years) delivered 0.9% and cash returned 0.3%. Inflation-linked bonds (ILBs) returned an unexciting 0.5%.

July saw several economies reporting GDP estimates for the second quarter of 2021 (Q2-21), most of which continue to show a strong recovery in output. However, there has also been a material increase in the number of countries showing another rise in coronavirus variant infection rates. Renewed restrictions in some countries are likely to dampen growth momentum in the third quarter of the year. July also saw inflation surprises continue in a broadening number of countries, raising the risk that some aspects of the price pressure may be less transitory than currently expected. So far, both developed market central banks and markets are still expecting these pressures to ease.

The US economy grew by 6.5% quarter on quarter (q/q) seasonally adjusted annualised (saa) in Q2-21 versus 8.5% q/q saa growth in Q1-21. Consumer spending was the main contributor to growth as easing restrictions enabled more normal consumption patterns. Non-residential fixed investments also contributed to the recovery, while inventories, non-residential capital expenditure and net trade continue to weigh. The increased spread of the new variants of the coronavirus, supply-chain disruptions and worker shortages are a persistent downside risk to growth and may weigh in the second half of the year.

The Federal Reserve Board (the Fed) left policy rates unchanged at 0.00% to 0.25% and maintained the size of the asset purchasing programme, as expected by the market. However, the post-meeting communication highlighted that the Fed sees the economy making progress towards reaching its maximum employment and price stability goals. This raises the risk of a tapering in asset purchases in coming months. The Fed chair further commented that the committee has done an initial assessment of how asset purchases can be adjusted in terms of timing, pace and composition. Headline inflation accelerated to 5.4% year on year (y/y) in June from 5% y/y in May. The biggest contributors remain increases in prices of used vehicles, fuel and transportation. Core inflation increased to 4.5% y/y in June from 3.8% y/y in May.

In emerging markets, China's economy grew by 1.3% q/q saa in Q2-21 versus a revised growth of 0.4% q/q saa in Q1-21. Growth was supported by both strong consumer spending and industrial production, but tighter credit conditions and emerging corporate policy uncertainty threaten to slow growth going forward. Headline inflation slowed to 1.1% y/y in June from 1.3%y/y in May. The downside surprise was due to lower food prices and muted price changes in transport, communication, housing and fuel costs. Core inflation was unchanged at 0.9% y/y. China's central bank eased commercial bank reserve requirements in July in tentative support for slower growth momentum.

The rand was weaker over July, but its performance over the last year is slightly ahead of high-yielding emerging market assets. Going forward, the cyclical tailwinds from strong commodity prices should continue to underpin the rand's valuation. 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.

The South African Reserve Bank (SARB) left the repo rate unchanged at 3.5% at its July meeting. The Bank's quarterly projection model now points to a single hike in the fourth quarter of 2021, from two at the previous meeting. Central Bank Governor Lesetja Kganyago reiterated that the Monetary Policy Committee would remain accommodative, despite the anticipated rate hikes. Inflation risks are seen to be to the upside, stemming mostly from rising fuel prices, administered cost increases and hikes in electricity tariffs. Growth forecasts were kept unchanged at 4.2%, with the SARB expecting the social unrest damage to be offset by better-than-expected economic recovery to date. The SARB still assesses risks to the growth outlook as balanced but acknowledges the downside risks coming from the social unrest, disruption of the vaccination programme, a longer-than-expected lockdown to contain the third wave, power supply constraints, and policy uncertainties.

Headline inflation moderated to 4.9% y/y in June from 5.2% y/y in May. Transport, housing, food and non-alcoholic beverages remain the biggest drivers of inflation. While inflation risks remain balanced, food and fuel supply constraints (in part related to the recent unrest) could put pressure on some goods prices. Core inflation increased a tick to 3.2% y/y in June from 3.1% y/y in May.

At the end of July, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 5.83% (three-year) and 6.85% (five-year), significantly lower than the close at the end of the previous month. This was in large part driven by expectations for local interest rates that receded following the SARB's decision to stay on hold. SA's more moderate inflation expectations suggest that current pricing of these instruments remains attractive due to their lower modified duration and, hence, high breakeven relative to cash. 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.

The prospects for the local economy have improved as reform progress has gathered momentum and global developments have provided tailwinds to the local recovery. Inflation is moving higher, but should remain under control despite uneasiness around global inflation. The recovery in growth should gain more traction and spill into next year, which will provide more breathing room for the fiscus. SA government bonds (SAGBs), despite their recovery in Q1-21, still embed a significant risk premium relative to cash. The steepness of the yield curve makes the 12-year to 15-year area attractive, even if the local rate hiking cycle starts sooner than expected. We continue to favour positions to SAGBs focused in the 12-year to 15-year area of the curve and allocations to ILBs with a maturity of less than eight years.

The local listed property sector was down 0.4% over July, bringing its 12-month return to 25.6%, and has been the largest drag on the Fund's performance. The balance sheet concerns coming out of the Covid-19 crisis have subsided somewhat as companies have managed to introduce dividend payout ratios (with some withholding dividends entirely) and sell assets. Going forward, operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. We believe that one must remain cautious, given the high levels of uncertainty around the strength and durability of the local recovery. However, certain counters are showing value, given their unique capital structures and earnings potential. These counters remain a core holding within the Fund.

The FTSE/JSE Preference Share Index was down 0.5% over the month, bringing its 12-month return to 16.6%. 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, which 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 its associated risks are 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 5.6% 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 July 2021