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

The Fund returned 0.68% in May, bringing its total return to 6.83% for the 12-month period. This return is ahead of cash (3.63%) and that of its benchmark (3.99%).

Local bonds had a great May. The All Bond Index returned 3.73%, supported by the back end of the curve (12+ years), which delivered 5.80%. Bonds maturing in 7-12 years' time returned 3.47% and medium-term bonds (3-7 years) returned 0.87%. The short-term (1-3 years) part of the curve delivered -0.08% and cash returned 0.30%. Inflation-linked bonds (ILBs) ended the month at 3.36%.

May saw a sharp rise in measured inflation – especially in developed economies – as the weak 2020 base started to unwind. Despite higher inflation prints and mounting concerns about the durability of higher prices, central banks maintained monetary policy settings and guidance. Economic activity continued to improve across the globe as restrictions are being lifted and vaccine rollout programmes gain momentum.

In the US, headline inflation accelerated to 3.6% year on year (y/y) in April verses (vs) 2.6% y/y in March. This is the highest reading since September 2008 and was largely driven by a combination of factors, including the weak base, some demand pressures for previously restricted goods, rising fuel prices, and supply constraints. Prices for energy, vehicles, apparel and housing all accelerated, while food and medical services prices remained flat. Core inflation rose to 3.0% y/y from 1.6% y/y in April. Guidance from the Federal Reserve Board suggests changing inflation risk is being closely monitored but is not yet alarming.

In emerging markets, China's headline inflation increased to 0.9% y/y in April from 0.4% y/y in March. The uptick in inflation was driven by an increase in prices for non-food goods, transport and communication, and household goods and services. Food prices dropped for the third month, with the price of pork declining by 21.4%. Core inflation increased to 0.7% y/y in April from 0.3% in March. Inflation pressure is seen to be on the upside, mainly due to base effects and rising commodity prices, although these tend to have a limited pass-through from producer price inflation to consumer price inflation. The vaccine programme rollout in China has increased significantly, with authorities aiming to have 80% of the population vaccinated before year end. After a very strong fourth quarter in 2020 which continued into the first quarter of 2021, activity data has moderated in sequential terms, but the economy should still post very strong real growth this year.

The rand was stronger over the month of April, in line with the recovery in high yielding emerging market assets and boosted by the rally in commodity prices, ending at US\$1/R13.73. In South Africa, specifically, positive developments on the growth and political front supported currency outperformance over the month. 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) Monetary Policy Committee (MPC) unanimously voted to leave the repo rate unchanged at 3.5% at the last meeting. The MPC revised 2021 growth upwards to 4.2% from a previous forecast of 3.8%. The upward revision was prompted by higher commodity prices and improved trade data, as well as better prospects for the global growth recovery. While growth outlook risks are 'balanced', the MPC sees inflation risks on the upside. Broader reforms, including a stabilising debt trajectory and increase in electricity supply were again cited in the statement as potential changes that could enhance monetary policy transmission and improve growth.

Headline inflation accelerated to 4.4% y/y in April from 3.2% y/y in March. The main drivers of the inflation uptick were increases in the prices of fuel, food, transport, housing, recreation and restaurants. As a result of rising non-food and fuel prices, core inflation also increased to 3.0% y/y in April from 2.5% y/y in March. Overall inflation pressure remains moderate and the outlook for 2021 is for inflation to remain within the SARB's target range.

At the end of May, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 5.81% (three-year) and 6.43% (five-year), slightly higher than the close at the end of the previous month. This was in large part driven by expectations for higher inflation, reduced stimulus, and quicker rate normalisation rates across global emerging and developed markets. However, South Africa'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.

South Africa remains in a delicate balancing act. In the short term, inflation should be contained as growth picks up, supporting a cyclically-better economic outcome. However, the fiscal accounts are problematic, given the high levels of debt. While this improvement has provided some breathing room, there needs to be an acceleration in growth-enhancing reforms, more emphasis on reviving private-sector confidence to encourage investment, and no deviation from current expenditure plans. The recent move higher in developed market bond yields has sparked concerns of a replay of the 2013 taper tantrum, however, local bond valuations are much more generous now, with a much-reduced external funding requirement. We view South African government bonds (SAGBs) as an attractive investment opportunity and would still advocate an overweight position relative to benchmark for a bond fund. In addition, we would also allocate to 4-year ILBs and steer clear of corporate credit spreads at current levels.

The local listed property sector was down 3.2% over May, bringing its 12-month return to 37.7%. Listed property has been the largest drag on the Fund's performance. The balance sheet concerns coming out of the 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 0.61% over the month, bringing its 12-month return to 23.2%. 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 May 2021