Our full range of rand-denominated offshore funds is temporarily closed to new investments via the South African Unit Trust product. Read more here.

Please note that the commentary is for the US dollar retail class of the Fund. The feeder Fund is 100% invested in the underlying US dollar Fund. However, given small valuation, trading and translation differences for the two Funds, investors should expect differences in returns in the short term. Over the long term, we aim to achieve the same outcome in US dollar terms for both Funds.

The last few months of 2023 were particularly eventful for global markets, especially fixed income. While the first three-quarters of 2023 were busy: regional US bank failures, the collapse of Credit Suisse, an outlandish mania around AI technology, US debt ceiling drama, geopolitical flare-ups and a continuous battle between markets and central banks around the state of macroeconomics and policy (amongst others); this was a relative side-show compared to 2023's final instalment. Here, the combination of macro dataflow and signalled changes in approach by the US Federal Reserve Board (Fed) and European Central Bank (ECB) proved a potent mix in driving core market interest rates definitively and aggressively lower in a very condensed window.

Performance

The Fund had a very strong end to the year, with a return of 2.6% for the fourth quarter (Q4-23), well ahead of the benchmark at 1.5%. Despite being relatively cautiously positioned with respect to corporate credit exposures, this allocation provided a reasonable contribution. However, the heavy lifting came from the fund's interest rate exposure, which had been escalated in prior months to position for cyclically elevated risk-free rates. While the timing, speed and synchroneity of the turn-around in the market's expectations for policy rate cuts were surprising, the Fund had been appropriately positioned for this. For 2023 as a whole, the Fund's performance was 5.7%, 0.1% ahead of the benchmark. With the difficulty in navigating the typically challenging end-of-cycle phase as onerous as it always has been, it's reasonable to conclude that the Fund's performance over the course of 2023 was agreeable.

Asset class performances

The closing months of 2023 saw dramatic swings in Developed Market (DM) sovereign debt yields. Within core markets, the broad dynamics seen were essentially very similar: continued bear steepening to the worst levels of their respective cycles in September or October before a very swift reversal over November and December as yields fell substantially across the board. Driven by the Fed's leadership, but also common factors relating to global inflation trends, market expectations for monetary policy became wholly convinced of widespread peaks in policy rates and cutting cycles being initiated during 2024.

The Fed introduced significant communication changes during Q4-23. Most pertinently, the Federal Open Market Committee (FOMC) had previously expressed a reluctance to pursue easier monetary policy in the face of unusually resilient growth dynamics. With consumer spending remaining robust and an exceptionally tight labour market, the FOMC saw little opportunity to cut rates, even as inflation dynamics played out as more benign than anticipated. Yet Q4-23 saw this argument being dropped by key FOMC members in a universally interpreted move, signalling the end of the tightening cycle, as well as a shelving of the higher-for-longer mantra that the FOMC had maintained in prior months. The response in US interest rates was an extremely strong rally across the yield curve, although modestly more from shorter-end rates in yield terms. The net result was that US Treasury (UST) yields – especially longer-dated maturities – ended the year at very similar levels to which they started in 2023 after round-tripping to elevated levels last seen immediately before the Global Financial Crisis (GFC).

After diverging from the Fed in September by hiking another 25 basis points (bps), the ECB quickly fell into line with not too dissimilar messaging about the potential for monetary easing in Q4-23. Indeed, the refinancing rate is widely seen to have peaked at its current 4.5% and markets are pricing meaningful cuts to start in the first half of 2024 (H1:24). This was helped by a further fall in headline inflation (to a recent low of 2.4% y/y in November) and continued easing in core inflation (last at 3.4% y/y in December). The net result was a 12-month high in the 10-year Bund yield of 2.97% in early October and a low of 1.90% in late December. Within Europe, spreads to the German yield curve largely reflected moves in outright yields. After significant weakness in September and October, intra-European spreads reached their tightest levels for 2023 in the closing weeks of the year.

UK gilts came through persuasively in Q4-23, but especially in shorter-dated bonds. Indeed, the swing in short-rate expectations was among the largest among the G10. Strong headline disinflation helped provide the extra impetus. After closing Q3-23 at 6.7% y/y (EU harmonised), UK CPI fell to 3.9% y/y. Core CPI proved much stickier – as had been the case earlier in the year and relative to other core DMs – but the decline became more entrenched in Q4-23, with the last print of the year at 5.1% y/y.

Elsewhere in DMs, sovereign debt markets were the echoes of that seen in the US and eurozone. Japan was somewhat of an outlier among core bond markets. Although Japanese Government bond yields ended lower on the quarter and some long-end steepening was seen, overall moves here were much more muted in magnitude – although when adjusted for outright levels, Japan was arguably just part of the herd. Higher beta markets (Canada and New Zealand) lived up to their reputations, while the especially maligned Euro area markets of Q3-23 (including Greece, Italy, and Portugal) were the other markets that caught up more assertively from more beaten-up levels.

As was the case in driving the bulk of yield moves throughout 2023, real yields were again primarily responsible for the overall shift in interest rates in DMs. In the US, the bull steepening logged by Treasury Inflation-Protected Securities (TIPs) was the central force. After hovering around cyclical highs of 2.5% for several weeks, the 10-year US TIP real yield then made a beeline lower to end the year around 1.7%. The shape of the US real yield curve is increasingly more normal, although it still does incorporate the priced-in imminent cutting cycle. Absolute levels of 1.5% to 1.75% for long-dated real yields are fairly defensible on a forward, through-the-cycle basis.

With a strong underpin provided by lower core rates across the board, it is unsurprising that Emerging Market (EM) local currency sovereign bonds notched up a strong quarter, especially after a challenging Q3-23 all-round. Contributions came from currency and bond performances, and all countries within the peer group participated in the rising tide. Even challenging, idiosyncratic stories weren't significant enough to produce outright drawdowns, except for Egypt and Turkey, which suffered mainly because of currency weakness. The net result for local currency EM debt markets for 2023 was a very respectable return of 12.7% in unhedged USD terms, helped by currency and capital gains.

For external (USD) EM sovereign bonds, 2023 produced an overall return of 11.1% in USD. After mediocre quarters over the year to date, Q4-23 bucked the trend and produced the largest three-month gain since the Covid-19 bounce in Q2-20 (prior highs were in the wake of the GFC). Wildly divergent returns, depending on country, but most of the out-sized gainers were from the highly stressed and/or defaulted country pool, depicting a fairly low quality of return performance from the asset class.

US Investment Grade (IG) corporate credit had a magnificent last quarter of 2023. Total returns for the overall market were 7.9% - responsible for the vast bulk of the year's outcome of 8.4%. This was almost exclusively down to the strong underpin provided by base rates, as excess returns (i.e., returns from just the credit component) only managed 1.75% - a pretty good outcome, but not remarkable on a multi-year basis. The less impressive contribution from the credit component shouldn't be too unsurprising. Starting spreads at the end of Q3-23 were already judged as being on the tight side (c. 125bps for the aggregate market) – yet some additional compression was achieved in Q4-23, with the year's tightest levels notched up in the closing days of the year (c. 105bps).

For US High Yield (HY) corporate credits, the fourth quarter was also a strong finish to the year. For the aggregate market, total returns were 7.1% in Q4-23 (+13.5% for 2023), with decent excess returns of 3.2% in Q4-23, helping the overall outcome nicely. Spreads very much reflected the return profile of risk assets more broadly in the year's closing months, with a very weak October followed by two especially large, positive months in November and December. While sector and fundamental corporate news flow certainly didn't stand in the way of the rampantly rising market, the key driver remained expectations around monetary conditions and how these influenced base rates.

The IG and HY markets in Europe weren't as over-the-top impressive in Q4-23 relative to their US counterparts despite posting exceptional quarterly outcomes to close off the year. Indeed, this superior performance in the closing weeks of the year ensured that the US was moderately better performing in absolute (local currency) terms for the entire year across the credit quality spectrum. Indeed, from a corporate fundamental standing, this relative outcome appropriately reflects aggregate developments between the two markets over the year, even as this was only reflected as such in the closing moments. Spreads in Europe remain more elevated than in the US – a situation that has prevailed very noticeably since mid-year in HY and progressively so throughout the year in IG.

Finally, after a disappointing Q3-23, the FTSE EPRA NAREIT Global Index (TR) bounced aggressively in Q4-23, undoing the hardship and disappointment of all the preceding months. Indeed, even leading into the closing days of November, the aggregate index was still essentially flat for the YTD, having ended October at c. -10% YTD before putting on the entire year's positive gains in a few weeks. In a mirror image of the course of Q3-23, the common underlying factor lay with the synchronised re-pricing of interest rate risks across all the key composite markets. With the potential for higher, or at the very least, sustained high rates perceived to be the most probable outcome in September, it wasn't surprising that this sector – being especially sensitive to this influence – had been broadly maligned. But with the sharp turn-around with perceived risks here, the turn-around in fortunes was equally bold and substantial.

Fund activity

Concerning Fund activity over the quarter, as is mostly the case, the bulk of transactions related to the recycling of existing exposures that had drifted into modestly expensive territory and were replaced by new issues perceived to be relatively cheaply priced. This tends to occur within the higher-rated credit buckets involving short-dated issues (usually one to three years). There is also the natural recycling of maturing issues, given that the Fund tends to have a meaningful and continuous liquidity ladder spanning from one quarter to the next.

Aside from the Fund's continuous turnover relating to value-driven recycling across the high-quality, short-dated buckets, activity during the past quarter was fairly contained. With US short-dated rates becoming even more elevated into the first part of Q4-23, there was plentiful opportunity to achieve the Fund's objectives within the short end of the US yield curve without accumulating additional forms of risk. Indeed, as spreads continued to compress from already fairly cyclically stretched levels, the Fund took the opportunity to pare back spread exposure here through individual instruments that had become less appealing from a long-term valuation perspective. In addition, the Fund had previously accumulated a reasonable spread of interest rate duration exposures, situated at various tenors along the US yield curve – these were selectively and carefully trimmed into the wave of strength that cascaded over Q4-23. The aggregate response was a down-scaling of aggregate credit and interest rate exposure over the last quarter.

In terms of idiosyncratic risk that the Fund found attractive during the quarter, opportunities certainly did arise. They were taken advantage of, but these proved much slimmer on the ground than in prior months as spread markets became zealously marked up in a frenzy of re-pricing. Specific names of interest included short-dated call USD AT1 Banorte (one of Mexico's four largest universal banking groups) – a credit we have long invested in and are especially impressed by within the LatAm banking sphere. A new name within the financials space: Citizens Financial Group (large, regional banking group concentrated in the NE US); this is a well-run entity with some of the best capital metrics (and generation!) within its peer group and is far removed from the issues that struck US regional banks earlier in the year. A new name within the mid-stream space, Western Midstream, is a sector that has found itself in an unexpectedly advantageous position given energy use developments in the US over 2023. This entity has solid credit metrics, a strong liquidity profile, and demonstrated behaviour supportive of its debt investors. This is a low-risk, diversified, volume-based entity which builds out its business through fee-based contracts and a welcome addition to the stable.

In the Fund's property exposure, this was augmented during the early part of the quarter with additions to existing names: Charter Hall Long Wale, GrowthPoint Australia, Klépierre, Segro, Hammerson, and Land Securities. Some rotation took place out of British Land and Instone. This proved a timely net addition given the aggressive rally experienced in the immediately following weeks.

Portfolio managers
Nishan Maharaj and Seamus Vasey
as at 31 December 2023