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

Performance

The Fund returned 0.68% in March, bringing its 12-month total return to 6.92%, which is ahead of cash (5.63%) and its benchmark (6.21%) over the same period. We continue to believe that current positioning offers the best probability of achieving the Fund's cash + 2% objective over the medium to longer term.

Fund positioning

The relative calm and optimism of the new year quickly evaporated during the first quarter of 2023 (Q1-23). Global inflation data proved to be stickier than anticipated in its descent, pushing expectations of monetary policy normalisation higher. The US went from pricing a peak in the federal funds rate of 4.9% at the end of January to between 5.5% and 5.75% by end-February. This reversed during the month of March, as bank failures in the US and Europe stirred up memories of the 2008/2009 Global Financial Crisis. The tightening in lending standards by the banking sector, specifically second tier banks, which are large lenders in the US economy, is expected to act as a handbrake on demand, putting downward pressure on growth. Global bonds have proven to be the only safe place to hide during this period as yields on US and EU bonds compressed by almost 50 basis points (bps) during the quarter.

South African (SA) bonds lagged their developed and emerging market peers. The rand was down 4.3% over the quarter, making it one of the worst performing emerging market currencies. SA bonds also underperformed, with their spread over US bonds widening by 20bps despite many other emerging markets seeing spreads tightening. The FTSE/JSE All Bond Index (ALBI) returned 3.39% over the quarter, which was ahead of cash (1.70%), however, this outperformance was smaller for the 12 months to end March (ALBI +5.83% vs cash +5.63%). Most of the ALBI's positive return was driven by a change in the shape of the yield curve, with 7- to 12-year maturities outperforming maturities of more than 12 years, as the latter steepened significantly over the last quarter. Inflation-linked bonds (ILBs) have continued to lag the performance of the ALBI and cash over the last quarter (+0.94%) and year (+4.92%). This has been predominantly due to a move higher in real yields in sympathy with nominal bonds and reduced inflation accrual as inflation has been heading lower.

March was dominated by central bank meetings, with the majority hiking policy rates in response to elevated inflation readings. All central banks reiterated that future rate hikes will be driven by economic data and the recent financial markets turmoil won't shift their goal of moving inflation down to target levels.

In the US, the Federal Reserve Board (Fed) raised policy rates by 25bps, moving the target rate range to 4.75% - 5% at the March Federal Open Market Committee (FOMC) meeting. The Fed restated that it will closely monitor economic activity, labour conditions, and economic as well as financial developments in assessing the implications for monetary policy going forward. The Fed also noted that the recent developments in the banking sector are likely to result in tighter credit conditions for households and businesses and weigh on economic activity, hiring and inflation. Nonetheless, further tightening is still considered necessary to bring inflation closer to the 2% target.

US headline inflation moderated to 6.0% year on year (y/y) in February from 6.4% y/y in January, while core inflation marginally decreased to 5.5% y/y in February from 5.6% y/y in January. Food prices grew at a slower pace, while used vehicle prices decreased. There was also a sharp decline in energy prices and slower increase in house prices. Services inflation remains high, and the Fed remains focused on higher wages. Inflation is proving to be more resilient than expected, which may not only see further rate hikes, but also the Fed holding policy settings tighter for longer.

In emerging markets, the People's Bank of China (PBOC) cut its reserve requirement ratio for large financial institutions by 25bps to 10.75% and left policy rates unchanged at the March meeting. The decision to lower the reserve requirement ratio will free up cash for lending and support a recovery that is facing headwinds from a global downturn and housing rout. The market is expecting more support from the PBOC to help revive the economy post the dropping of the zero-Covid policy.

The rand ended the month at R17.79/US$1. The turmoil in the global banking sector saw a significant repricing in US monetary policy expectations, which supported a softer US dollar and emerging market currencies. Developed market bond yields have moved significantly lower, putting them slightly below our expectations of fair value. Credit assets have seen a substantial drop in valuations, making them look very attractive. The Fund has utilised a significant part of its offshore allowance to invest in these types of assets. When valuations are stretched, the Fund 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) raised the repo rate by 50bps, moving the policy rate to 7.75% at the March Monetary Policy Committee meeting. The decision hinged primarily on a deterioration in the outlook for inflation, which was more evident in how the MPC articulated risks to the baseline than actual revisions to forecasts. The elevated risk assessment was also attributed to stickier global inflation, the risk of a broader increase in prices associated with loadshedding, rising electricity and administered prices, a deterioration in inflation expectations, and rising pressure on wages. Furthermore, an anticipated significant widening in the current account deficit in response to weaker global growth, deteriorating terms of trade, and an increase in investment has raised MPC concerns about further currency weakness. Looking ahead, we see the SARB remaining vigilant to inflation risk, with another 25bps hike possible in May or July.

At the end of March, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 8.85% (three-year) and 9.37% (five-year), lower than the close at the end of February. Our inflation expectations suggest that the 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.

ILBs are securities designed to help protect investors from inflation. They are indexed to inflation so that the principal and, hence, the interest payments rise and fall with the rate of inflation. Our current inflation forecasts suggest inflation for 2023 will average 6.2% and 5.8% in 2024. These are much stickier than our previous forecasts and with the move higher in real yields over the last 12 months (50bps), ILBs now offer an interesting investment opportunity – both versus their nominal counterparts and for the inherent protection they offer. Using inflation expectations of 5.5% - 6.5% over the next year, ILBs with a maturity of 10 years (and less) offer an attractive yield pick-up (0.3% - 2%) relative to their nominal counterparts and, as such, should be considered to make up a larger part of the bond portfolios, either in addition to current nominal holdings or as a substitute for them.

The environment for global fixed income remains unsettled. Thoughts of higher inflation have now been dosed by concerns that recent bank failures lead to a larger global growth slide and deep recession. Despite the rally in global fixed income, SA has lagged its emerging market peers significantly given our own idiosyncratic problems with regards to undependable electricity supply and slow pace of reforms. Fiscal risks have escalated amid the façade of consolidation. However, the valuation of SA government bonds has adjusted relative to its peer group and still encompasses a significant risk premium. ILBs are now offering significant value given elevated inflation risks and should be incorporated into portfolios as substitutes for, or in addition to, shorter-dated nominal bond holdings.

We believe that the corporate credit spreads currently on offer are not attractive, and do not reflect their inherent risks. As such, we have been allocating away from credit and allowing our investment in credit to become less material in our portfolios for quite some time. The local credit market has been influenced by a shortage in supply and an increase in liquidity. Issuance this year has been net negative, and according to ASISA data, savings continue to accumulate. A supply/demand imbalance of this magnitude continues to distort fundamental credit pricing. However, with the recent repricing in global rates and global credit markets, we believe these offer an attractive opportunity for investors.

The local listed property sector was down -3.92% over the month, bringing its 12-month return to -5.11%. Operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. The current poor growth outlook, combined with an increase in cost base due to higher administered prices and second-round effects on loadshedding, will weigh on the sector's earnings in the coming year. We believe that one must remain cautious due to the high levels of uncertainty around the strength and durability of the local recovery.

Outlook

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 9.99% (before 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
Nishan Maharaj and Mauro Longano
as at 31 March 2023