

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

The final quarter of 2025 set the stage with cautious momentum. Globally, easing inflation pressures and a broadening shift toward monetary policy normalisation supported fixed income markets. In contrast, prevailing geopolitical tensions, elevated sovereign issuance, and lingering trade frictions underscored a more complex risk environment. US policy easing gathered traction as growth moderated, while emerging markets continued to benefit from improving external balances and targeted rate-cutting cycles. Against this global backdrop, South African (SA) bonds were supported by improving domestic sentiment, greater policy coherence under the Government of National Unity (GNU), and contained inflation outcomes, despite ongoing concerns around fiscal consolidation and structural reform execution. Entering 2026, the active and intense Chinese Year of the Fire Horse, markets appear positioned to reward discerning investors who can move decisively with conviction – balancing agility with discipline as global and domestic policy signals evolve. The SA bond market had a remarkable year with yields compressing significantly across the curve. The 10-year SA government bond (SAGB) ended the year at 8.2%, while the 30-year SAGB compressed by more than 200 basis points (bps) to 8.95%. This propelled the performance of the 12-year-plus area of the curve to 31.21% for the 2025 calendar year, which is well ahead of the FTSE/JSE All Bond Index's (ALBI) return of 24.24%. Nominal bond returns far outstripped the returns from other fixed income assets, with cash returning 7.28% over the year and inflation-linked bonds (ILBs) returning 15.4%.

Despite the recovery in ILB performance in the fourth quarter of 2025, their returns still remain well below nominal bonds over a longer horizon. Over three years, ALBI returned 16.89% while the FTSE/JSE Composite Inflation Linked Bond Index (CILI) delivered 10.04%. Over five years, ALBI returned 12.54% and CILI 9.91%, and over 10 years, ALBI returned 11.48% and CILI 6.5%. The rand was not underdone, with a pronounced appreciation against the dollar, closing the year at R16.56/US\$ (versus R18.84/US\$ at the end of 2024), generating a 12.06% return, which was in line with its emerging peers. This, combined with local bond performance, outshone global bond returns, with the FTSE World Government Bond Index (WGBI) only returning 7.55% in dollars, compared to the 41.28% from the ALBI dollar equivalent.

Over the last five years, nominal bonds (the ALBI) have generated a return in excess of 6% of cash (12.54% versus 6.32%). This was on the back of the increased embedded risk premium in SA assets and specifically SA bond yields due to the Covid fiscal hangover. When compared to the pre-pandemic decade (2010-2020), nominal bonds produced a return of 8.85% versus cash at 6.52%, putting the excess return just above 2%, the impact of this outlier event is clear. Currently, the ALBI's yield of c.8.5% versus the c.6.5% expected from one-year cash sits more in line with the latter, and is a needed step change in investor return expectations, given the moderation in SA bond yields. In addition, it is important to consider the possible return expectations for nominal bonds under various scenarios, but with an understanding of what the forecasted levels imply.

The first thing to point out is that the ratio between cash and bond yields is now close to its tightest level since 2010. This implies that the breakeven for bond yields relative to cash is quite low. That is, the bond curve only needs to widen by 0.35%-0.45% (depending on whether one includes the roll down) before nominal bond performance equates to expected one-year cash returns. This is equivalent to a 2% reduction in the return relative to available yield.

Viewed in a historical context, 10-year SAGB yields are currently trading at 8.2%, below their average level over the past decade. This is not to say that they could not go further; however, the circumstances that led to that lower average yield were quite unique and specific to the first half of that decade. Globally, the economy was still recovering from the depths of the Great Financial Crisis (GFC). Then, global policy rates were at zero (the Federal Reserve Board funds rate averaged 0%), global bond yields were at all-time lows (the US and German 10-years' averaged 2%-2.5%), and SA had just been included in the WGBI due to it being rated investment grade by all three of the major rating agencies.

These were indeed special times that facilitated lower bond yields across the emerging markets complex, and SA differentiated itself positively versus its peer group, as indicated by its yield spread versus the JP Morgan Emerging Markets Index. The recent SA bond performance has been so staggering that SA local yields are within a sniff of their tightest spread levels when compared to their emerging market counterparts.

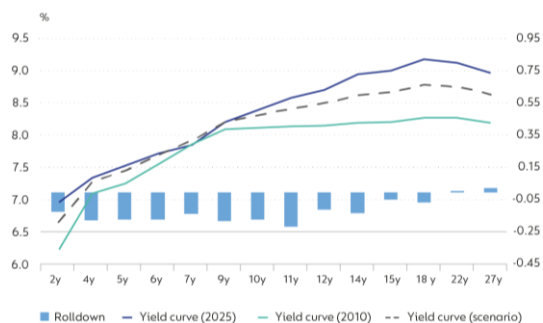
One might argue that the recent adjustment in the inflation target, combined with the positive showing at the 2025 Medium-Term Budget Policy Statement (MTBPS), has positioned SA strongly on its recovery path. However, a large part of the improved outlook that came through in the MTBPS was attributable to better mining revenue due to higher precious metal prices and adjustments to all inflation-related expenditure, which provided a significant saving over the forecast period. Low growth remains a key inhibitor to true fiscal consolidation, and real growth closer to 3% is now needed to stabilise the deficit and debt profile.

SA's debt to GDP is expected to average close to 80% over the forecast period, which is a far cry from its 45% average over the last decade. In fact, despite SA's recent bond outperformance relative to US Treasuries and its emerging market counterparts, longer term fiscal metrics remain quite poor. SA's debt to GDP has doubled since the start of the millennium, while debt across both emerging and developed markets has increased only marginally by multiples of between 1.2 times and 1.6 times. In addition, SA's growth has been lacklustre, underperforming emerging and developed economies in the last five years despite very strong bond performance. These metrics would have to see a dramatic turnaround to justify the current levels and relative valuation on SA bond yields.

Therefore, at current levels, it seems that SA bond valuations have run ahead of fundamentals, baking in a fair deal of good news, requiring a significant acceleration in reform momentum to propel SA's growth closer to the required 3%. However, the yield curve remains quite steep, and the cut in issuance at MTBPS has helped flatten the curve significantly. It is possible that with inflation now likely to be anchored at least below 4% and the administration's focus on fiscal consolidation, the steepness might reduce further. However, here again, one has to consider very carefully which area of the yield curve offers the most amount of value.

Rolldown or carry-on bonds occur when yield curves are normal (upward sloping). Longer maturity bonds offer higher yields than those with a shorter term to compensate for higher risk. As a bond approaches maturity (rolls shorter), its yield should naturally fall towards the lower yields of shorter dated bonds. In analysing the current yield curve, all bonds up until the 15-year area of the curve offer significant rolldown. The way to interpret the following figure is to imagine that nothing changes on the yield curve and to move forward in time by one year. Rolldown is the expected change in those yields as they move towards the shorter yields.

SA YIELD CURVE ANALYSIS



Source: Coronation

At the start of 2010, SA's fiscal accounts were in good order, and the yield curve reflected this optimism. The 10-year yields were slightly lower than current yields, and the curve was much flatter in the 10-, 20-, and 30-year areas. Notably, the 20- and 30-year bonds were trading 10bps above the 10-year! This is in contrast to the current levels of 0.8% from the 20-year bond and 0.5% from the 30-year bond.

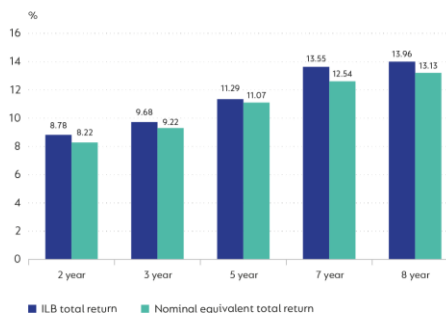
If the shape of the yield curve changed to reflect similar dynamics as 2010, then the ALBI would return 11.3% over the next year. However, based on SA fundamentals in 2010 versus now, this seems starry eyed. An optimistic scenario (dashed blue line in Figure 6) would be a move in the shape of the yield curve to somewhere in between the current shape and 2010, which would generate an ALBI return of 9.8%. Both of these calculations make no assumption of a parallel shift of the curve (synchronised rise/fall across interest rates), just a change in shape as reflected in the graph. As stated earlier, a 0.35%-0.45% parallel shift higher in the yield curve would wipe out c. 2% of total return over a year. So, under a best-case, realistic scenario, where the curve flattens past 10 years, as shown by the dotted line, and yields shift uniformly upwards by 0.35%-0.45%, one can expect an ALBI return of c. 7.8-8% over the next year. This is still favourable relative to cash but would require, at minimum, a continuation of positive global risk sentiment and expedited SA reform momentum. It is clear, however, that the superior rolldown offered by the sub-15-year area of the curve justifies a decent allocation.

Notwithstanding the South African Reserve Bank's (SARB) commitment to keep inflation anchored at the ratified target of 3%, external developments, specifically regarding emerging market currencies, have benefited the rand/dollar cross, and lower oil prices have further assisted in keeping SA inflation in check. Our forecasts currently have inflation averaging closer to 3% if the rand strength is sustained and oil prices stay the course (recent developments in South America might further help to moderate long-term oil expectations).

This could provide further room for the SARB to ease interest rates quicker and lower (c. 50bps) than our current expectation of a 6.25% repo rate by year end. To a large extent, this seems to have been factored into bond and interest markets; however, shorter dated ILBs still have real yields in excess of where the real policy rate could settle by year end. If inflation does average 3% this year, there should be no reason why the SARB should not revert to a neutral real policy rate of 2.5%, which still leaves room for 3- to 7-year ILBs to compress from the current levels in excess of 4%.

The following figure shows the total return of ILBs versus nominal bonds, assuming ILB yields compress 1% and inflation materialises at 3% over the next year. Nominal bonds are assumed to similarly compress by 1% in such a scenario, although in a scenario where the repo settles at 5.75% versus our current expectations of 6.25%, the move would not be so large. It is quite clear that for front-end exposure out to seven years, ILBs remain the superior value proposition.

ILB VERSUS NOMINAL TOTAL RETURN



Source: Coronation

As SA enters 2026, the bond market reflects a transition from recovery-driven returns to a more mature phase of the cycle, where valuation discipline and curve selection will be paramount. While the global backdrop of easing inflation and policy normalisation remains broadly supportive, much of the easy compression in local yields has already occurred, leaving limited margin for error should growth or reform momentum disappoint. In this environment, consistent with the symbolism of the Year of the Fire Horse, successful bond investing will require measured decisiveness – favouring carry and rolldown in the belly of the curve, selective exposure to real yields at the front end, and a disciplined approach to risk premia. SA bonds continue to offer value relative to cash and their global peers, but future returns are likely to be earned through careful positioning rather than broad-based yield compression.

Portfolio managers

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As at 31 December 2025