

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

Performance and fund positioning

The Fund returned 1.05% in June, bringing its 12-month total return to 11.06%. The latter is ahead of cash (+7.74%) and the Fund's benchmark (+8.54%) over the same one-year period. We believe the Fund's current positioning offers the best probability of achieving its cash +2% objective over the medium to longer term.

Local bonds delivered good returns in July. The FTSE/JSE All Bond Index (ALBI) returned 2.73%, with the long end of the curve (bonds with maturities of 12+ years) up 3.89%. The belly of the curve (bonds maturing in 7-12 years) closed 2.95% higher over the month, while medium-term bonds (maturing in 3-7 years) posted 1.94%, and short-term bonds (maturing in 1-3 years) returned 0.74%. Cash returns came in at 0.59% for July, while inflation-linked bonds (ILBs) were also up 0.59% over the month.

July brought a myriad of economic data releases, including GDP data, monthly inflation readings, and central bank meetings. There were some notable GDP improvements in the US, while China's growth remained flat, and the Euro area struggled to grow against a tariff-infused backdrop. Inflationary pressures remain sticky and are keeping core inflation elevated.

The US economy grew by 3.0% quarter on quarter (q/q) in the second quarter of 2025 (Q2) from a contraction of 0.5% q/q in the first quarter of 2025 (Q1). The increase largely came from a significant drop in imports and an uptick in consumer spending, which were partly offset by muted government spending and a decline in fixed capital investments. The sharp rebound in growth largely reflects volatility from trade policy shocks rather than being a sign of economic strength, as domestic growth drivers grew modestly.

The Federal Reserve Board (the Fed) left the target range for the Federal Funds Rate unchanged at 4.25%-4.50% for the fifth consecutive time at the July Federal Open Market Committee (FOMC) meeting. The post-meeting statement noted concerns about rising inflation, while growth was assessed to have moderated. With tariff-related price pressures beginning to emerge, recent data has become increasingly important in guiding monetary policy, reinforcing the Fed's data-dependent approach amid largely unrealised trade policy risks.

US headline inflation accelerated to 2.7% year on year (y/y) in June from 2.4% y/y in May, while core inflation ticked up to 2.9% y/y from 2.8% y/y. The increase came from a rise in energy and food prices. Tariff-sensitive goods such as appliances, apparel, equipment, and household furnishings also posted price increases. Elsewhere, housing costs moderated, airline fares, as well as new and used vehicle prices declined.

China's economy grew by 1.1% q/q in Q2, down from 1.2% q/q growth in Q1. Growth was supported by a rebound in exports, strong industrial production, and continued fiscal support for infrastructure investments. While manufacturing investment held up, the ongoing property downturn and cautious consumer sentiment moderated the pace of domestic demand recovery. The economy is expected to lose more momentum in the third quarter, as exports weaken following the expiration of the China-US trade truce in mid-August.

China's headline inflation increased to 0.1% y/y in June from deflation of 0.1% y/y in May, while core inflation increased to 0.7% y/y from 0.6% y/y. The uptick came from increases in prices for apparel, healthcare and education. Transport costs fell and food prices dropped at a slower pace. Producer price inflation continued to fall, down 3.6% y/y in June from a deflation of 3.3% y/y in May.

The rand ended the month at R18.220/US\$1, weaker than its close in the previous month but weaker than its Emerging Market peer group. Offshore credit assets and certain developed market bonds continue to flag as relatively attractive. The Fund has utilised a significant part of its offshore allowance to invest in these assets. When valuations are stretched, the Fund will hedge/unhedge portions of its offshore 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) voted unanimously to cut the repo rate by 25bps to 7% at the July Monetary Policy Committee (MPC) meeting. Furthermore, Governor Lesetja Kganyago announced that the MPC was shifting to a 3% preferred inflation target from the current 4.5%. The official target range is still 3%-6% and will only change once an agreement is reached with National Treasury, and it is announced by the Minister of Finance, now likely at the Medium-Term Budget Policy Speech in October. The accompanying modelling also revised the inflation baseline significantly lower to reach 3.0% by end-2027 and now centres at a 3% steady state. The driver of the lower forecast is a combination of an assumed wider output gap (lower growth), a stronger currency, and a downward adjustment in unit labour costs (wages) as critical lower expectations are embedded.

SA headline inflation ticked up to 3.0% y/y in June from 2.8% y/y in May, while core inflation slowed to 2.9% y/y from 3.0% y/y. The data reflected a rise in food prices (meat and dairy), which were partly offset by falling fuel prices. The latter is set to change in July as the higher oil price will see retail fuel prices increase after a long decline. Food and fuel prices are likely to push headline inflation higher in the coming months, but core pressures remain benign.

At the end of July, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 7.70% (three-year) and 8.24% (five-year), with both maturities lower compared to the end of the previous month. 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 have continued their underperformance over the last quarter, primarily due to the SARB maintaining the real policy rate at elevated levels and realised inflation being below expectations for an extended period. However, inflation is currently close to, if not at, its trough, and we expect it to average 4%-4.5% over the next 12 months. This, combined with high starting real yields, makes ILBs quite attractive relative to certain nominal bonds. ILBs are also less correlated to nominal bonds, given their inherent risk-protection attributes. These are present since inflation in SA has historically been very closely tied to the performance of the currency. And because the currency is the release valve for any SA-specific (and global risk-off) difficulties, it has a direct feed through to inflation. This makes ILBs a good risk offset to hold in a portfolio, specifically in uncertain times. The valuation argument for owning ILBs with a maturity of less than six years remains very strong as these instruments provide a decent uplift relative to their nominal counterparts.

The global landscape remains uncertain; however, emerging markets have continued to outperform developed markets. South African Government Bonds (SABGs) have flourished as local anxiety has eased and expectations for a lower inflation target have bolstered prospects for a lower repo rate. They are now trading at or close to fair value, and to see a further rerating, one would need to see a significant change in fiscal prospects or monetary policy accommodation. Anchoring inflation at 3% will take longer, thus delaying any tailwinds for bonds from further policy easing and achieving substantial fiscal consolidation would require growth in excess of 2%-3% p.a. Global bond flows have turned more supportive of Emerging Markets, given their relatively cleaner balance sheets, and could support further compression in bond yields if that trend gains momentum. Valuation suggests that the best value on the yield curve sits in the 10- to 15-year maturity band and in ILBs with a maturity of less than six years.

The local listed property sector was up 4.38% over the month, bringing its 12-month return to 25.7%. The durability of the operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. The current increase in the cost base, due to higher administered prices and second-round effects on deteriorating infrastructure in much of the country, will weigh on the sector's earnings in the coming year. We believe that one must remain cautious given the high levels of uncertainty around the strength and durability of the local recovery.

Local credit spreads are at historically tight levels due to low issuance volumes and a large amount of capital seeking a home with reduced volatility. The use of structured products, such as credit-linked notes (CLNs), has become ubiquitous within the local market. This sector has experienced exponential growth over the last five years, reaching a market size of over R100 billion. However, only a third of this market replicates, creating an inaccurate representation of asset volatility and pricing. CLNs mask the underlying/see-through credit risk as the issuing entity (predominantly local banks) is seen as the primary credit risk.

The increased usage of CLNs has not expanded the pool of borrowers; rather, it has only served to concentrate it. This is due to the ability to limit the volatility of these instruments by not marking them to market based on the underlying asset price movements. The combination of attractive yields and no volatility is an opportunity that not many would pass up, unless, of course, transparency of pricing is important to the underlying investor. As a result, there can be significant unseen risks within fixed-income funds. Investors need to remain prudently focused on finding assets whose valuations are correctly aligned to fundamentals and efficient market pricing. Except for a few opportunities, we view the local credit market as unattractive relative to other asset classes.

Outlook

We remain vigilant of the risks from the dislocations between stretched valuations and the local economy's underlying fundamentals. However, we believe that the Fund's current positioning accurately reflects the appropriate level of caution, while its yield of 8.8% (gross of fees) remains attractive in relation to its duration risk. We continue to believe that this yield is an adequate proxy for expected portfolio 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 2025