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

Performance and fund positioning

The quarter began with the headwind of US President Trump announcing a broad package of import tariffs on most of their trading partners, resulting in a rapid sell-off of most risky assets. However, as the quarter progressed, the majority of asset classes staged a recovery, as either the implementation date of tariffs was delayed or, in some cases, countries and sectors received a reprieve from most of the previously announced tariffs. The local sector followed a very similar pattern to most other local asset classes, with a strong rerating post the initial shock of the tariff announcement, resulting in a quarterly return of 11%, in line with that of local equities, while it rerated relative to bonds. From a relative performance viewpoint, the sector gained ground against the FTSE/JSE All Share Index (ALSI) and FTSE/JSE All Bond Index (ALBI) over most time periods and has outperformed both indices for every meaningful period for the last five years, with the Covid lows of H1-2020 (when uncertainty on rental payment existed) being included in the base period.

Locally, it seems the market has shrugged off the ongoing underlying tension that exists within the GNU. Instead, it is focusing on some of the more positive economic news flow and, although with reservations, the potential impact of an officially lower inflation target, which is part of leading bond and property yields lower. Unit trust-linked capital flows into sector-specific funds remain mostly negative, although the momentum is gradually shifting, with the rolling 12-month flows turning less negative as the year progresses. The FTSE/JSE All Property Index's (ALPI) one-year forward dividend yield is 8.1%, and that of the Fund is 8.2%.

Delivering a return of 9.7% for Q2, the Fund underperformed the ALPI benchmark, but despite this, it gradually closed the underperformance gap over 12 months. Positions that added to the relative performance for the quarter include the overweight positions in UK names Hammerson and Shaftesbury Capital, which had a poor showing in Q1; Fairvest B and Equites; as well as underweight positions in Growthpoint and Hyprop. Unfortunately, some of our relative positioning in NEPI Rockcastle, Burstone and Fortress (overweight) as well as MAS, SA Corporate, Redefine and Vukile (underweight) detracted more value than what was added by the positive relative positioning. During the quarter, the largest increase in exposure occurred in NEPI Rockcastle, as relative price weakness created an opportunity to actively increase the Fund's overweight position. We utilised the opportunity of share price strength, based on potential corporate action and/or change in strategy driven by a proposal by its largest direct and indirect shareholder Prime Kapital, to sell out of MAS. Although we did not capture the full extent of the price run as Prime Kapital altered the proposal on the table three times and Hyprop entered the fray as potential suitor, we believe the proposed change in strategy and/or outcome related to Hyprop becoming a major shareholder present uncertainty to the implementation, which could once again create a shareholder stalemate. Other noticeable disposals include reducing the Fund's exposure to Growthpoint, Equites and Hyprop.

The results season of companies with a February or March reporting period concluded in July. Distributable earnings per share growth for this reporting season came in at 1.3%, while dividend per share growth came in at 1.0%, with an average payout ratio of 86.8%. As has been the case for the last few quarters, offshore-focused companies were once again the laggards. When the offshore names are excluded from these numbers, the SA-centric names delivered distributable earnings and dividend per share growth of 2.8%, with an average payout ratio of 89.5%. Although the growth numbers are lagging behind those of companies that reported with a December reporting period three months earlier, the growth represents an improvement over this subset of companies six months prior, where both distributable earnings and dividend per share growth were still negative.

A key sector trend beyond the reporting season during this past quarter is the more expansionary tendencies of local companies, either through asset acquisitions or potential corporate actions and equity placements in lieu of a transaction or to create balance sheet capacity. Companies that raised capital on the front foot, related to stronger share prices and pending transactions, include Fairvest, Hyprop, Spear REIT, and Lighthouse. Meanwhile, SA Corporate conducted a private placement as prescribed by some of its debt funders. Sector average balance sheet health has improved since the heightened concerns during Covid, but in a few instances reported vs. covenant interest cover ratios are tight, as is the case for SA Corporate, therefore an unexpected placement. With the interest rate cycle now firmly on the descend, any covenant concerns should dissipate.

MSCI released its annual SA property index for 2024, a good barometer of the state of direct commercial property in South Africa, as it covers circa two thirds of the total investable direct commercial market with most listed players contributing. Ungeared direct property delivered the best annual total return since 2015 at 11.5% (split 8.5% income and 3.2% capital return), with industrial once again the stellar outperformer with a 15.1% total return. The strong performance compared to recent years was led by a significantly improved capital return, driven by enhanced income growth. Capital values are now back above pre-Covid levels. On the capital front, landlords have increased their spending into their own portfolios, driving rental growth, while the investment market has gained momentum.

Two other industry bodies released relevant sector data. The SA Property Owners Association (SAPOA) released its Q1-25 office vacancy survey. After more than two years of continuous improvement, office vacancy levels seem to be consolidating around current levels, being 13.6% for Q1-25 and down from the recent post-Covid highs of 16.7% as at Q2-22. At the city level, marginal decreases in vacancies in Cape Town and Johannesburg were offset by marginal increases in Tshwane and a larger one in eThekwini. Cape Town continues to have the lowest vacancy of the major cities at 6.3%. All of Cape Town's office nodes now have vacancy levels below where they were when the national office vacancy rate peaked in Q2-22, signalling consistent demand and effective stock absorption in the region.

The SA Council of Shopping Centres (SACSC) published retail trading data related to Q1-25. The weighted average year-on-year (YoY) growth in trading densities took a step lower in 1Q-25 to 3.3%, from 4.1% in 4Q-24. It was led lower by a decline in growth momentum in convenience and small regional centres, despite these categories still delivering the strongest growth at 4.7% and 3.6% respectively. A slowdown in the growth momentum out of supermarkets, apparel tenants and food services appear to be the likely cause for this overall slowdown.

Outlook

The first half of the year experienced two distinct quarters, but ultimately the 6% return delivered is tracking a normalised through-the-cycle annual return of 10% to 15% that an investor should expect from the sector. This takes the starting yield and normalised dividend growth into account. Operationally, we are not expecting major diversions from the recent trends experienced, which should result in mid to high single-digit net operating income growth. Vacancies have stabilised, underpinned by very low industrial vacancies, while positive rental reversions are more consistently being achieved within the retail sector. In addition, as confirmed by the SAPOA vacancy survey, the office sector, which has been the laggard in recent years, is consolidating with stable vacancies and a positive shift in asking rentals for available space, being 3.5% higher y-o-y vs. 6.2% lower y-o-y one year ago. On the cost side, as per the MSCI 2024 index and confirmed by recent results, operating cost growth has stabilised, led by much lower R&M spend (which captures generator and diesel spend) due to lower loadshedding. As pointed out last quarter, this is supported by the improved cost ratios coming from the benefit of solar as alternative energy source.

As experienced in Q2-25, in the short term, we expect the sector to be at the mercy of global events, either political or economic, as most of the tangible inputs into earnings are on a firm footing while the current interest rate cycle is fairly priced into the market. Global investor sentiment and risk appetite are therefore the key drivers that could move the sector either way in the short term while locally a more recent stronger bond market could provide a solid underpin for the sector, although risk appetite from both local and offshore investors may wane depending on the news flow out the GNU.

Portfolio managers
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as at 30 June 2025