CORONATION
TRUST IS EARNED™

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

Performance and fund positioning

The Fund returned 0.93% in June, bringing its 12-month total return to 11.47%, which is ahead of cash at 7.82% and its benchmark at 8.63% over the same period. We believe the Fund's current positioning offers the best probability of achieving its cash +2% objective over the medium to longer term.

Geopolitical risks and US policy uncertainty increased market volatility in the second quarter of 2025 (Q2). Developed market bond yields rose, with US 30-year Treasury yields exceeding 5%, driven by tariff policies, rising deficits, and concerns about inflation. Emerging market bonds faced volatility from US trade policies, but fundamentals remain robust in these markets, with many central banks continuing to cut rates, boosting local currency bonds. South African (SA) assets recovered from the shock of April's "Liberation Day" tariffs and anxiety about the stability of the Government of National Unity (GNU), boosted by expectations of a lowering of the inflation target later this year.

The FTSE/JSE All Bond Index (ALBI) returned 2.28% in June, bringing its return for Q2 to 5.88% and to 18.36% over the last 12 months. Over both these periods, bonds with a maturity of less than 12 years performed the best, as yields in this area saw significant compression. The SA 10-year bond yield compressed by c. 70 basis points (bps) over the last quarter and 145bps over the last 12 months. However, yields on bonds with a maturity of greater than 10 years saw less compression, keeping the 20-year bond yield more than 100bps above that of its 10-year counterpart. Inflation-linked bonds (ILBs) continued to underperform both nominal bonds and cash, with a return of 0.62% over the last month, 0.88% over the quarter, and 7.29% over the last 12 months. The rand has underperformed its emerging market peer group over the last year but still has a positive performance versus the US dollar, which has pushed SA bond performance above that of the FTSE World Government Bond Index in rand terms (+0.17% month-to-date, +1.05% quarter-to-date, +5.59% for the last 12 months).

June's economic data was mixed, with inflation readings remaining sticky and central banks taking a cautious approach to further easing. Geopolitical tension heightened between Israel and Iran, causing a temporary spike in oil prices. Geopolitical risks remain a possible hindrance for global market performance in 2025.

The Federal Reserve Board (the Fed) left the target range for the Federal Funds Rate unchanged at 4.25%-4.5% at the June Federal Open Market Committee (FOMC) meeting. The post-meeting statement noted concerns for increasing inflation and a lower economic growth outlook as the main reasons for the hold. The Fed also revised unemployment rate and core inflation forecasts marginally upwards, citing increased uncertainty in global markets. Financial markets are pricing in 50bps of rate cuts for the year.

US headline inflation slightly increased to 2.4% year on year (y/y) in May from 2.3% y/y in April, while core inflation remained unchanged at 2.8% y/y. The uptick came from increases in food, transportation, and used as well as new vehicle prices. Elsewhere, energy costs declined, and shelter inflation was muted.

China's headline inflation fell 0.1% y/y in May, unchanged from April's deflation. Food and transportation costs remain very weak, while apparel and tourism-related costs increased. Producer Price Inflation also continued its deflationary streak, falling 3.3% y/y in May compared to a deflation of 2.7% in April.

The rand ended the month at R17.70/US$1, stronger 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.

SA headline inflation remained unchanged at 2.8% y/y in May, and core inflation was also unchanged at 3.0%. Food and non-alcoholic beverages contributed positively to headline inflation, while transport costs detracted following a fall in fuel prices in May. Tensions in the Middle East have temporarily led to a spike in oil prices, and the ongoing under-recovery in retail fuel prices suggests a possible July fuel price hike. Nonetheless, several factors continue to underpin a benign outlook for inflation: food inflation remains modest, and demand-related pricing is weak, with rentals, in particular, serving as a strong anchor to core inflation. We expect these trends to continue; however, base effects could see inflation accelerate modestly later in 2025.

Budget 3.0 was finally passed on 21 May 2025. Despite the collective sigh of relief on the passing of the budget, we must not lose sight of the fact that the underlying budget still came with a larger expenditure envelope. A significant R180 billion (in addition) will be spent over the next three years on a combination of infrastructure, wages, the extension of the Social Relief of Distress grant, and an increase in frontline worker headcount. The intention is that this will be funded by the contingency reserve (R21 billion), a reallocation of provisional expenditure (R81 billion), and the balance in revenue measures (bracket creep, unannounced additional policy measures, and increased revenue collection by SARS). All of the expenditure put in place cannot be rolled back, but revenue measures rely on growth outcomes. Thus, if growth continues to disappoint, the funding gap and, consequently, the debt-to-GDP ratio (debt:GDP) are at risk of further increasing. As it stands, we still have debt costs averaging 6% of GDP over the forecast period, consuming well over 20 cents of every rand collected as revenue. This does not place SA in a zone of comfort.

To consolidate our debt position, we need to run primary surpluses in the years to come. That is, we must spend less than we receive (before interest payments). Based on our current funding rate, growth rate, and debt:GDP, we need to spend 2%-3% less than our revenue (effectively running primary surpluses of 2%-3%) to ensure debt:GDP does not increase further. Spending less will prove difficult given the current high levels of unemployment and deteriorating infrastructure. Budget 3.0 highlighted this with its increased expenditure envelope. This only leaves increasing revenue by 2%-3% per year as a viable alternative, and, since revenue depends on growth, we would need real growth in excess of the stated 2%-3% per year in order for debt to stabilise at current levels.

At the end of June, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 7.77% (three-year) and 8.25% (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 a decent exposure to these instruments (with fewer floating than fixed), but we will remain cautious and selective when increasing our 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 currency performance, and because the currency is the release valve for any SA (and global risk-off) specific 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 strong, as they provide a decent uplift relative to their nominal counterparts.

The global landscape remains uncertain; however, Emerging Markets have continued to outperform developed markets. SA Government Bonds 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 band and in ILBs with a maturity of less than six years.

The local listed property sector was down 0.24% over the month, bringing its 12-month return to 25.89%. 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 reprices, 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 with 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 8.91% (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 30 June 2025