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

Performance and fund positioning

The Fund returned 0.88% in May, bringing its 12-month total return to 12.36%, which is ahead of cash at 7.89% and its benchmark at 8.71% 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.

Local bonds delivered good returns in May. The FTSE/JSE All Bond Index (ALBI) returned 2.73%, with the long end of the curve (bonds with maturities in 12+ years' time) up 3.62%. The belly of the curve (bonds maturing in 7-12 years) closed 3.64% higher, while medium-term bonds (bonds maturing in 3-7 years) posted 1.74% and short-term bonds (bonds maturing in 1-3 years) returned 0.81%. Cash returns came in at 0.61%, while inflation-linked bonds (ILBs) were up 0.45%.

May data was dominated by sticky inflation readings. Central banks continue to monitor inflation expectations, taking a cautious approach to further easing. While GDP data has been relatively strong, despite trade tensions intensifying, growth is expected to slow in the second half of 2025 (H2-25) as uncertainty reflects in weaker activity.

The Federal Reserve Board (the Fed) left the target range for the Federal Funds Rate unchanged at 4.25%-4.5% at the May Federal Open Market Committee (FOMC) meeting. The post-meeting statement noted an uncertain outlook for inflation, with the risk of higher unemployment in an increasingly challenging environment for rate setting. The Fed reiterated its assessment of activity as resilient, with limited hard data reflecting weakness in broader economic activity. Fed Chair Jerome Powel cautioned that tariffs present headwinds to bringing down inflation and that the US economy is at risk of stagflation.

US headline inflation slowed to 2.3% year on year (y/y) in April from 2.4% y/y in March, while core inflation was unchanged at 2.8% y/y. Energy, food, and services inflation moderated at the margin.

China's headline inflation fell 0.1% y/y in April, unchanged from March's deflation. Food and transportation costs remain very weak, while apparel and recreation costs increased.

The rand ended the month at R18.00/US$1, weaker than its close in the previous month but in line with 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 (SA) economy grew by a meagre 0.1% q/q in Q1-25 from 0.4% q/q in Q4-24. From the production side, four out of 10 industries contributed positively to growth, of which agriculture was the most meaningful, followed by transport, trade, and financial services. From the expenditure side, household expenditure and exports contributed positively, but disappointingly gross fixed capital formation remains a significant drag. Lower inflation and interest rates should provide some support for household spending into the second quarter of 2025, but bracket creep and the absence of any meaningful job creation or investment activity leaves real GDP growth expectations below 1% for 2025.

The South African Reserve Bank (SARB) cut the repo rate by 25bps to 7.25% at the May MPC meeting. The SARB lowered its inflation forecasts given the persistent undershoot, as well as the stronger exchange rate, lower oil prices, and the removal of the VAT hike. The MPC expects inflation in 2025 to average at 3.2% on the back of moderating food inflation and declining fuel prices. The MPC also revised its global and domestic growth forecasts lower, factoring in increased uncertainty and the potential impact of the US tariff increases. Given the benign inflation environment, nonresponsive domestic demand, and building global growth headwinds, we think there is room for an additional 25bps cut at the July MPC meeting, taking the repo rate to 7.0%.

SA headline inflation accelerated slightly to 2.8% y/y in April from 2.7% y/y in March, while core inflation fell to 3.0% y/y from 3.1% y/y. The main driver of the uptick was an increase in food and non-alcoholic beverages inflation, which was partly offset by a drop in transportation costs. We expect these trends to continue and for base effects to see inflation accelerate modestly in H2-25.

At the end of May, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 7.88% (three-year) and 8.37% (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.

The changes in the global landscape have become less favourable for risk and emerging market assets. The effects of a global trade war will leave global growth floundering, and export-driven economies will struggle in such an environment. The slowdown in global growth, once the immediate inflationary shock retreats, should compel global monetary policy to turn supportive, thus supporting global developed market fixed income. Local inflation should remain relatively well behaved, but a growth slowdown will have negative consequences for the country's finances, suggesting a further risk premium needs to be priced into local bond yields. This would be further solidified if the GNU does not accelerate reforms in a meaningful way. SA bonds are at risk of a wider repricing in yields, and bond portfolios should remain neutral but ready to take advantage of weakness when it prevails. In addition, ILBs should be present in portfolios to provide some risk offset should the worst outcome materialise.

The local listed property sector was up 2.32% over the month, bringing its 12-month return to 32.54%. 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 levels of issuance and large swaths of capital looking for 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 grown exponentially over the last five years and has reached 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 of which the 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 correctly reflects appropriate levels of caution, while its yield of 8.95% (gross of fees) remains attractive relative 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 May 2025