Amplify SCI* Defensive Balanced Fund

Fund Commentary | February 2024

Kim Silberman
Economist and Macro Strategist
Matrix Fund Managers

"In equities, we continue to position defensively, still seeing elevated risks as global growth slows. Global earnings expectations still appear elevated in this context, particularly into the second half of this year."

Local overview

SA Budget and fiscal realities

The main budget deficit for 2023/24 is likely to be at least R50 billion more than budgeted in February 2023, due almost entirely to overspending. We expect GDP growth will also disappoint and that the deficit is likely to total around 5.4% of GDP, versus 4.7% budgeted.

Tax revenue is growing at 2.5% year-on-year (y/y), slightly slower than the 2.7% y/y estimated in February 2023's budget, which, if sustained, would leave National Treasury about R3.5 billion short by the 31 March fiscal year-end. Non-tax revenue is running R4 billion behind budget.

Year-to-date (YTD) spending is up 5.2% y/y, well ahead of Treasury's budgeted 1.7% y/y. At this rate, spending will be R68 billion over budget for the full fiscal year. Around R18 billion of unbudgeted expenditure YTD has been for transport, R4 billion for police, R5 billion for defence, R5 billion for National Treasury, R5 billion for local government, R5 billion for servicing debt and R11 billion for provinces.

Excluding debt service costs, Treasury has managed to contain main budget spending growth in 2023/24 at 3.3% YTD, which is commendable considering inflation has averaged 5.5%. In real terms, non-interest spending has contracted by 1.7%. Treasury had budgeted for non-interest main budget spending to contract 0.7% in nominal terms, or a phenomenal 6.1% in real terms. This was never realistic. Looking ahead main budget non-interest spending is projected to grow 3.9% y/y in 2024/25, or -1.1% in real terms. Considering the likelihood of a higher spending base in 2023/24, even if Treasury stays within their extremely conservative budget, government will spend R68 billion more than allocated in 2024/25.

What has National Treasury sacrificed?

This begs the question, what is being sacrificed? Essentially, Treasury has cut transfers to provinces and municipalities marked for infrastructure – both new build and maintenance – and reallocated it to wages and the social relief of distress (SRD) grant. Over the three-year Medium Term Expenditure Framework (2024/25 to 2026/27), Treasury has increased the allocation to wages and the SRD grant by R250 billion and has funded this by reducing the infrastructure budget by R200 billion and raising an extra R50 billion in taxes through bracket creep. By their own admission this is detrimental to growth but is politically "unavoidable".

Global overview

US rate cuts in 2024 affirmed

US Federal Reserve (Fed) Chair Jerome Powell gave testimony on Thursday, 7 March that rate cuts can and will begin in 2024, putting paid to rising bets that the Fed may not cut rates and that the next move could be a hike. His comments provided much-needed guidance and should reduce uncertainty and compress risk premia in fixed-income asset classes.

We believe the Fed took comfort from the steep and persistent decline in Supercore PCE inflation (Services PCE less Energy and Housing), which slowed in February to 3.1% from 3.5% in January. This measure is key with respect to the wage-price spiral since employment inflation lags the index by three quarters. The interest rate markets imply that there will be 100 basis points (bps) of cuts by the Fed to December 2024, up from 88 bps at the start of March.

INTELLIGENT IMPACT THAT MATTERS

Amplify SCI* Defensive Balanced Fund

Fund Commentary | February 2024

Kim Silberman
Economist and Macro Strategist
Matrix Fund Managers

"In equities, we continue to position defensively, still seeing elevated risks as global growth slows. Global earnings expectations still appear elevated in this context, particularly into the second half of this year."

ECB anticipates rate cuts in June

In the European Union (EU), analysts have taken comments made at the European Central Bank (ECB)'s March meeting to infer that cuts will begin in June. The ECB lowered their forecasts for average inflation in 2024 to 2.3% from 2.7% in December. EU CPI is expected to average 2% in 2025 and 1.9% in 2026. The EU is expected to grow 0.6% in 2024 in real terms. Strong economic activity from the 'post-pandemic' reopening of the economy has faded, while the drag from tight financing conditions and elevated consumer uncertainty remains significant. Forward-looking survey indicators remained in contractionary territory on average in the first two months of 2024. Nevertheless, declining inflation and robust wage growth, in the context of a still tight labour market, should underpin households' purchasing power in the first half of this year.

Global inflation risks from Red Sea disruptions muted so far

The ECB has provided useful scenario analyses of the risks from shipping disruptions in the Red Sea and the Gulf of Aden. Attacks by Houthi rebels on cargo vessels passing through the Bab-el-Mandeb Strait have reduced transit volumes by about 70% since the beginning of December. The ECB approximates that 12% of global crude oil shipments and 10% of all global seaborne trade by volume pass through the Suez Canal. However, according to the analysis, 'oil tankers transiting the region are largely unaffected and only a few oil companies have suspended operations in the area'. If the conflict results in partial closure of the Strait of Hormuz, this would have more significant economic effects given the 20% volume of oil trade that takes place via this route.

While oil prices are unaffected, freight costs for shipping containers have significantly increased along specific routes. Freight between Asia and Europe takes about 30% longer owing to shipping rerouting around the Cape of Good Hope, and has resulted in increased demand for container shipping capacity. As a result, higher transportation costs could feed into higher consumer prices. Shipping delays could also disrupt supply chains and January's PMIs indicated that suppliers' delivery times rose for countries more exposed to disruptions.

Market performance

SA Cash was a notable performer in February

Global equity markets strengthened in February returning 4.3% in US dollar terms. The US outperformed, returning 5.2% while emerging market equities returned 4.8%. South Africa was among the worst performers, with equities down 5.6%.

The rand sold off 2.9% in February on dollar strength, but as at 8 March it was back at R18.68, where it ended January as the dollar weakened in response to signs of continued moderation in US inflation; the US Dollar Index is trading at 102.0, after rising to 105.0 in mid-February.

Domestically, in February, SA cash was the best performer and returned 0.65% in rand terms. SA bonds lost 0.6%, while the World Government Bond Index returned a positive 1.3% and US long bonds returned 2.3% over the month in US dollar terms.

INTELLIGENT IMPACT THAT MATTERS

Amplify SCI*
Defensive Balanced Fund

Fund Commentary | February 2024

Kim Silberman
Economist and Macro Strategist
Matrix Fund Managers

"In equities, we continue to position defensively, still seeing elevated risks as global growth slows. Global earnings expectations still appear elevated in this context, particularly into the second half of this year."

Portfolio performance and positioning

Performance

The fund delivered a positive performance of 0.3% after fees for the month, resulting in a net 12-month return of 7.5%. Contributions to return for the month were from foreign equity (+0.4%), foreign money market (+0.3%) and domestic money market (+0.2%). Domestic property (-0.1%), domestic bonds (-0.1%) and domestic equity (-0.4%) all detracted from the monthly return.

Positioning

We continue to favour a well-diversified portfolio with money market and floating-rate note holdings comprising 33% of the portfolio, local equity exposure of 20%, foreign equity at 8%, property exposure at 5% and foreign money market at 9%. Our exposure to domestic bonds is 25% of the fund resulting in a duration of 1.8 years at the fund level.

We view the current high levels of the money market (9% on 1-year negotiable certificates of deposit) as an attractive volatility-adjusted building block to contribute to achieving our real return objective. Implied real yields offered by government bonds of around 6% are appealing.

We anticipate some modest easing in the SA repo rate commencing in the third quarter of 2024. We see a normalised repo at around 7.25% or 100 bps lower than the current setting. We do not anticipate the South African Reserve Bank to commence with rate cuts before either leading global central banks start cutting or the local elections have run its course.

In equities, we continue to position defensively, still seeing elevated risks as global growth slows. Global earnings expectations still appear elevated in this context, particularly into the second half of this year. The fund is overweight media/tech, healthcare and industrials, and underweight resources and food retailers.

INTELLIGENT IMPACT THAT MATTERS