Portfolio Manager Quarterly Comment

Market overview

The Fund delivered good returns over a relatively challenging investment period locally as well as globally with resulting spillover effects into our local market during the last 12 months and particularly again in the third quarter. Global investment returns did not bear much fruit during the first half of the year and came accompanied with a fair share of volatility. Global developed market equities ended the first half of the year relatively flat with emerging market equities down more sharply, while local South African equities finished the first half marginally negative, although all of these were bumpy rides along the way. International bond and credit markets remained under pressure amid rising global tensions and the US Federal Reserve (Fed) continuing on their path of monetary policy normalisation, with four hikes in the target range for the federal funds rate during the last 12 months. Investment-grade credit in the US has had a particularly bad start to the year and delivered negative returns for the first half, even underperforming US equities over this period, and the performance continued to face headwinds in the third quarter with spreads still facing a bit of upward pressure. Emerging market fixed-income markets have had a tough year so far with emerging market sovereign and credit indices finishing the first half in negative territory, both in local currency and hard currency terms, which was subsequently followed by another bout of volatility in the third quarter. Emerging market currencies were under pressure in the third quarter, with the Turkish Lira finishing the quarter down 24% and the Argentinian Peso down 30%. The South African Rand was not left unscathed and finished the quarter 12% weaker.

The upward pressure on local interest rates during the third quarter resulted in the All Bond Index underperforming cash and now also for the year to date. Looking more closely at the path of local interest rates and the bond market performance it was quite a bumpy course so far this year. The first quarter of the year delivered stellar returns from local fixed-interest assets on the back of 'Ramaphoria' and positive local sentiment, with the trend subsequently turning around sharply in the second quarter as international factors took centre stage and weighed on local bond market performance. Foreigners were significant sellers of local bonds during the second and third quarter of the year and significant net foreign sales so far this year.

Local inflation numbers surprised on the downside during the quarter, with CPI measuring 4.9% year-on-year (y/y) in August and down from 5.1% in July. CPI goods slowed to 5% y/y while services held steady at 5% y/y. Core CPI – which is CPI excluding food, non-alcoholic beverages, petrol and energy – eased to 4.2% y/y in August from 4.3% in July and is now back to the level prior to the 1% VAT hike in April. The moderating core inflation is consistent with the more subdued domestic demand conditions. We expect inflation to remain contained within the SA Reserve Bank (SARB)'s 3-6% target band going into 2019 and 2020.

The asset allocation in the SIM Active Income Fund has worked well so far this year and we are relatively pleased with the overall outcomes and positioning of the Fund. The Fund has managed to deliver performance during volatile market circumstances which were driven by swings on the local as well as the international front. The Fund has been able to participate in market strength but has also been more insulated from market volatility than could otherwise have been the case, especially considering the events and market movements during the year. The Fund's investment objectives are always a key consideration when evaluating the overall positioning and underlying investments. This has continued to prove to work well for the Fund as the performance has managed to keep pace with the local market during periods of strength, while in addition we have had scope available to take advantage of investment opportunities during market weakness and when interest rates trade higher.

The mandate of the SIM Active Income Fund is orientated towards higher quality assets and it is also important to remember that the SIM Active Income Fund does not utilise offshore exposures. Offshore asset allocation brings the potential for associated currency diversification benefits and an expanded investable universe. This opportunity set could have added value, especially during the last 12 months as we witnessed big moves in the local currency, in particular reversals over shorter periods than is otherwise more generally the case. The Fund has performed well when considering the risk-adjusted real returns delivered as compared to both inflation and other assets classes. When looking at the return of the SIM Active Income Fund compared to inflation, the Fund has performed as good as it can be expected to. Going forward it should reasonably be expected that the performance will again normalise closer to historic norms.

The Fund has had low exposure to listed property assets over the last 12 months, but the limited exposure nevertheless detracted from performance. The positioning was based on valuations with the subsequent weakness in the listed property sector during the year, in particular during the second quarter, giving us the opportunity to take advantage with selective buying opportunities. However, the allocations remain selective and limited with consideration to the continued weakness in the sector. The listed property sector is quite attractively price even when taking into consideration that the fundamental outlook for the sector looks weak.

The investment case for the Fund remains a compelling one: the orientation of the Fund towards quality assets in an environment where local fixed-interest assets are offering attractive income-generating returns and good value at current levels. This rings even more true when remembering that we are still in a low return environment globally and yields on developed market bonds are still at ultra-low levels. The Fund is also a good alternative when considering that return expectations should likely be moderated for risky asset classes where valuations remain on the higher end and the global outlook has deteriorated. Economic growth expectations should be moderated and this would also weigh on risk assets as weaker earnings should be expected to follow suit. Lastly, the US Fed is still on a path of policy tightening, which makes US cash look more attractive but also brings with it the potential to impact valuations more generally. All of this suggest that the SIM Active Income Fund continues to be an attractive income solution, especially in the current global environment.