Portfolio Manager Quarterly Comment

Market review

The second quarter kicked off with global markets more optimistic on the economic outlook as developed market economies were vaccinating their populations at a rapid pace and with restrictions easing, even as some areas had smaller bouts of tightening. Emerging markets, however, had been lagging although with the highly accommodative global monetary policy environment providing some support for risk assets despite the US 10-year increasing towards the end the first quarter.

The US Federal Reserve (Fed) helped calm the fears in the market by continually stating that they will let the economy run hot and not tighten liquidity until they see sustained increases in employment and economic activity. On the local front, March CPI came in at 3.2%, closer to the lower end of the SA Reserve Bank (SARB)'s 3-6% target band. This also created room for the SARB to remain accommodative in their stance to support economic activity in the country.

During May, the global reopening theme continued as developed markets continued to have substantial access to vaccines and were able to administer to large parts of their populations, helping the reopening of their economies. In emerging markets, the pace remained slow, with lockdowns being implemented in some regions due to outbreaks. Global markets continued to rise, albeit at a slower pace than the previous month, even as US yields threatened to dampen the optimism. US president Joe Biden tabled a $1.9 trillion infrastructure plan to help boost the recovery and improve infrastructure in that economy.

Inflation in SA came out at 4.4% year-on-year (y/y) for the 12 months to end-April, signalling the end of the very low inflation period as it rose by 1.2% from the previous month. The biggest contributor to the sharp increase in inflation was transport CPI, which increased by 10.6% y/y. The Monetary Policy Committee (MPC) at the SARB kept the repo rate unchanged at 3.5% at their scheduled meeting in May. They raised their GDP forecast to 4.2% while stating that the risks to inflation are now on the upside. The committee did state, however, that they will remain accommodative as the country tries to recover from the impact of the pandemic.

Due to the high vaccination levels in the US, and the increasing pace of vaccinations in Europe, these economies were able to stave off lockdowns as the Delta variant continued to spread. Some emerging market economies, on the other hand, had to increase restrictions. In their June meeting, the Fed delivered a hawkish tone to the market, raising expectations of policy normalisation by forecasting two hikes by mid-2023. This caused aggressive flattening of the 30/5-year and 10/5-year spreads in the US curve.

The South African economy held up better than expected, with the GDP number printing at 4.6% quarter-on-quarter (q/q) in the first quarter of 2021, better than market consensus of 3.2%, and coming from a downward revision of 5.8% q/q in the fourth quarter of 2020. On the inflation front, May CPI came in at 5.2%, from 4.4% in the previous month, with economists calling it as the high point, and inflation is expected to move lower in the coming months, ending the year closer to the mid-point of the SARB's inflation target band. On the fiscal policy side, National Treasury helped boost bonds for the quarter and half year as issuance sizes decreased from R6.6 billion per week to R3.9 billion per week.

We remain quite cautious on our outlook for property. Even in the case of a recovery in 2022, we do not think the sector will get back to 2019 levels anytime soon. There are a number of risks facing the sector in the short term, including further lockdown restrictions and risks of additional rental relief and concessions to tenants. Short-term returns will likely remain volatile given uncertainties relating to the level of dividends and pay-out ratios, but we do anticipate a further rerating in the sector once we get back to a more normalised trading environment and a sustainable growth rate closer to inflation.

It definitely continues to be worth bearing in mind that we are in a relatively soft inflation environment. Clients can take some comfort in the fact that the inflation-adjusted returns are still looking good in positive territory. Our positive yield environment locally is in contrast to the global environment where the vast majority of fixed-income markets are trading at negative real yields. Locally, yields have decreased to record low levels at the 'shorter end of the curve', i.e. the repo rate, which makes products such as the SIM Active Income Fund even more important. For our investors in these funds, we continue to place an emphasis on assets that offer good risk-adjusted return prospects and are appropriate for the current environment.