Sanlam

Portfolio Manager Quarterly Comment

Market review

The quarter began on fears of a Delta variant-induced Covid-19 wave spreading globally, with the US and Europe relaxing restrictions due to high vaccination levels. Markets were boosted by the approval of the $550 billion infrastructure bill in the US, while there was a high amount of intra-month volatility as markets were digesting a relatively hawkish US Federal Reserve (Fed) statement, arguing that the high inflation experienced is transitory, and will slow to closer to target. US bond yields fell during July, together with European bond yields as the European Central Bank changed their mandate to a more symmetric target. Yields in the US fell by 25 basis points (bps) to end the month at 1.22%, while yields in Germany also fell by 25 bps to end at -0.46%. Locally, the South African Reserve Bank (SARB) kept rates unchanged at their July meeting, highlighting risks being to the upside as we have reached the bottom of the cutting cycle. Inflation for the month of June came out at 4.9%, falling from the previous month. Bonds delivered 0.80% for the month, as the 3-7-year and 7-12-year bonds outperformed their long-end and front-end counterparts. Foreigners also sold R6.8 billion in bonds, while the SARB reported a R251 million increase in their bond holdings.

In August, the world was rocked by the fleeing of the president of Afghanistan from his own country, fearing a return into power by the Taliban. The world witnessed gripping scenes of citizens flooding airports and hanging onto planes to escape. The markets had a really muted reaction to this, as focus was on the rapidly spreading Delta variant and the upcoming Jackson Hole address by Fed chair Jerome Powell. In his speech, he went to lengths to explain that the current inflation increases are transitory, and they expect it to come back to the targeted 2% by next year, and also explained that a tapering of asset purchase do not signal upcoming rate hikes. This led to a rally in global risk assets, with the S&P 500 rising 2.9%, while bond yields rose 9 bps in the 10-year area. On the local front, South Africa experienced the long tail of the third wave of the Covid-19 pandemic, leading to the country remaining in the higher level 3 lockdown. The impact of the pandemic remained evident in the unemployment numbers, as they remained at some of the highest levels ever experienced in the country – reaching 34.4%. The local currency moved quite dramatically during the month, reaching a high of 15.30 against the dollar, but closed 0.6% stronger to end the month at 14.52. Bonds delivered good returns at 1.73% for the month, with the long-end outperforming at 2.49%, even as foreigners continued selling bonds.

As we moved into September, the world was starting to return to a closer state of normalcy as restrictions were being eased. South Africa also started to exit the third wave and local restrictions were eased to level 2, and then finally to level 1 at the end of the month. Fears of inflation persisting for longer than expected by central banks gripped the global markets, with oil and natural gas prices increasing, together with supply shortages hitting Europe and China. US and European yields increased by 18 bps and 20 bps respectively, as US equity markets fell by 4.8%. On the local front, the SARB kept the policy rate on hold again at 3.5%, while also increasing their GDP forecast for 2021 to 5.3%, and having a constructive view on inflation. The All Bond index didn't escape the negative market sentiment, as it fell 2.12% in the month, bringing the total return for the quarter to 0.37%, underperforming cash at 0.95% and inflation-linked bonds at 2.02%.

It 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, and now make 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 which offer good risk-adjusted return prospects and are appropriate for the current environment.