Portfolio Manager Quarterly Comment

Market review

The first quarter of the year delivered stronger returns from international growth and risk assets as the expectations grew for a softer landing with repeated positive economic data surprises providing solid support for this growing view. In contrast, bond markets traded with a weaker bias as inflation prints surprised on the upside and oil prices continued to rise. Expectations at the start of the year were that monetary policy easing would create a positive backdrop for bonds. In the US, the Fed funds futures were pricing a decline of 125 basis points (bps) in the policy rates, while our local forward rate agreements (FRAs) were pricing in a decline of as much as 95 bps in the 3-month JIBAR rate. These expectations changed significantly in early February, with the release of employment data which showed that the US economy added 353K jobs in January, against expectations of 197K. Similarly, the February report also outperformed expectations with 253K jobs added compared to median expectations of 200K jobs. All the while the message from US Federal Reserve (Fed) officials was that it will be appropriate to reduce rates this year but the current levels of job growth, strength in the economy and inflation that is still above the 2% target, warrant some caution. At the end of the quarter, Fed rate cut expectations have moderated to just 67 bps for the year, with the first cut fully priced in by July 2024. The local FRA market was pricing just one rate cut of 25 bps by November 2024.

Finance Minister Godongwana delivered the 2024/25 budget on 21 February. In the weeks and months leading up to this budget presentation, there had been a proposal for National Treasury (NT) to use revaluation reserves on the Gold and Foreign Exchange Contingency Reserve Account (GFECRA) to offset some of the funding requirement. In the budget presentation NT proposed using as much as R150 billion for budgetary support. This was much higher than the market had expected and indeed our own expectations were that NT would not use GFECRA as there had not been enough consultation on the implications of such a policy change. The market rallied on the day of the budget but subsequently sold off as market participants came to realise that while the GFECRA proceeds will reduce the funding requirement for the year, the government has not taken the necessary steps to fundamentally cut spending. The significantly lower debt/GDP trajectory presented in the budget is predicated on lower debt servicing cost and rather aggressive revenue growth assumptions.

The South African Reserve Bank (SARB)'s Monetary Policy Committee (MPC) kept the repo rate on hold at 8.25% at its meeting in March in a unanimous decision. The decision was in line with market expectations and followed the Fed's decision on 20 March to keep their rates on hold amid growing expectations that the central bank was unlikely to trigger its first rate cut in March given the bumpy trajectory of inflation moving towards the targeted inflation rate of 2%. Although the MPC recognised the improvement in the inflation outlook, it still assesses the risk to the outlook to be on the upside, which suggests a cautious approach going forward. Food inflation was again signalled out as a key risk to the inflation forecasts with the El Niño effect a contributing factor. The SARB revised its inflation forecast for 2024 slightly higher to

5.10% from its previous forecast of 5%. The forecasts for the subsequent years remain stable at 4.60% in 2025 and 4.50% in 2026. This year so far has been characterised by fluctuating expectations of the timing of the first interest rate cut from leading central banks including our own central bank. The rollercoaster of expectations regarding the timing of the first cut was further rocked by recent comments by Fed Chair Powell that there was no rush to start cutting interest rates. The FRA curve has pushed out the expectations for the first rate cut to November from as early as May or July. The Fed funds futures moved from pricing in a decline of 125 bps to just 67 bps for the year, with the first cut fully priced in by July 2024.

The outlook for the fund looks favourable taking into consideration the attractive valuations and real yields available on local assets. More generally, financial market volatility should be expected for the foreseeable future or at least the year ahead. The outlook for financial markets is clouded by the uncertainty regarding how economic growth will pan out in addition to the uncertainty around the inflation trajectory and impact as well as the exact path of monetary policy rates. In all, our funds are currently well positioned with valuations playing to the favour of the performance outlook reflecting the less positive fundamental picture, while we are in a good position to take advantage and allocate capital to new investment opportunities should they arise.