Portfolio Manager Quarterly Comment

Market overview

The US Federal Reserve (Fed) kept interest rates unchanged at their March meeting as economic activity remained resilient and inflation sticky. Chairman Powell emphasised the Fed remains fully committed to bringing inflation down to its 2% target. For 2024, they kept their forecast of the number of cuts at a maximum of three. Accordingly, the market's expectations for cuts are also down to no more than three in 2024 from six to seven cuts at the end of 2023. Powell said that the committee will continue its data-dependent approach and evaluate data and rate hike decisions on a meeting-by-meeting basis.

Locally, the SA Reserve Bank (SARB)'s Monetary Policy Committee (MPC) kept the repo rate unchanged at their March meeting with a unanimous vote just like in January. The overall tenor of the meeting was cautious as they continued to assess risks to the inflation outlook as tilted to the upside. They upwardly revised their CPI inflation forecasts and now expect CPI inflation returning to the mid-point about one year later in 4Q25.

In the fourth quarter of 2023, SA GDP rose by a mere 0.1%, lower than the expected 0.3%, implying that the SA economy narrowly avoided a recession. Six out of 10 industries contributed to this growth, with the transport sector contributing the most and expanding by 2.9%. Agriculture and trade experienced steep declines of 9.7% and 2.9%, respectively.

The 4Q23 SA unemployment rate increased to 32.1% from 31.9% in 3Q23, as the number of unemployed persons increased by 46k to 7.9 million. At the same time employment fell by 22k to 16.7 million, after rising for eight straight quarters, and the labour force rose by 25k to 24.6 million.

The most important take from the budget is National Treasury (NT)'s decision to draw down a portion of the SARB's Gold and Foreign Exchange Contingency Reserve Account (GFECRA), utilising R150 billion over the next three fiscal years, to help finance the borrowing requirement.

Fitch ratings affirmed SA's sovereign credit rating at BB- with a stable outlook. They noted that the credit rating is constrained by weak economic growth, large inequality, rising public debt and a slow projected path of fiscal consolidation. They forecast GDP growth of 0.9% in 2024 and 1.3% in 2025 amid electricity supply shortages and logistics problems. The International Monetary Fund upgraded its global growth forecast for 2024 slightly by 0.2% to 3.1%, but lowered its SA growth forecast significantly by 0.8% to 1%.

Headline CPI increased to 5.6% year-on-year (y/y) in February from 5.1% y/y in December. Core CPI rose from 4.5% y/y to 5% y/y. PPI inflation rose from 4% y/y to 4.5% y/y. The rand weakened from 18.26 in December to 18.88 in March vs the US dollar. The 10-year SA government bond yield weakened from 11.05% in December to 12.02% in March. The trade balance increased slightly from a surplus of R13.9 billion in December to a surplus of R14 billion in February.

The money market yield curve did a slight positive butterfly movement, with the belly rates decreasing slightly and the short and long wings remaining roughly unchanged. According to the forward rates the market now expects the first interest rate cut towards the end of the year.

What SIM did

Quality corporate credit and RSA Treasury Bills (TBs), which are yielding higher than JIBAR rates, were added to the portfolio. The combination of corporate credit, high-yielding RSA TBs, negotiable certificates of deposit (NCDs) and floating-rate notes (FRNs) will enhance portfolio returns.

SIM's strategy

Our preferred investments would be a combination of fixed-rate notes, FRNs and quality corporate credit to enhance returns in the portfolio. With the MM yield curve up to one year remaining steep, fixed-rate bank notes are potentially still relatively more attractive than FRNs. Bank FRN spreads have started to increase now and are becoming attractive again. Only some RSA TB tenors yield higher than bank NCDs offering relative value.