Quarterly Commentary as at 30 June 2018

MelvilleDouglas
A Member of Standard Bank Group

Melville Douglas

Income Fund Ltd - USD Class

Fund Review

The objective of the Class Fund is to provide a return in excess of its benchmark in US Dollars, whilst seeking to maintain a high degree of capital preservation, by investing primarily in quality global fixed interest securities, and, where in the opinion of the Investment Manager, direct investment in fixed interest securities will not achieve sufficient diversification to achieve the Class Fund's objective, in other collective schemes, money market instruments and cash that will maximise total returns in US Dollars. The Fund's performance for the period was 0.00% versus the Fund's benchmark return of -0.14%.

Market Overview

Global bond markets continue to be buffeted by trade tensions and whilst the final outcomes and subsequent net effect on growth conditions remain uncertain, the immediate negative impact on sentiment has been enough to keep a lid on the yield normalisation process in the quarter. In addition, questions about the sustainability of the global growth path continue to be asked given its long tenure and recent soft patch. However, we remain constructive as global Purchasing Manager Indices (PMI's) are consistent with a global growth rate of 3% this year and if anything, a natural softening in the data reduces the near term risk of overheating, allowing the long-held goldilocks recovery to live on – not too hot, not too cold.

Most Central Banks remain keen to press on with withdrawing the massive stimulus measures enacted since the Credit Crisis, the challenge is for this to be achieved at a pace that does not derail growth. It is worth remembering that monetary conditions, even after seven interest rate hikes in the US, remain extremely accommodative by historical measures. The length of the economic expansion in the US is within a whisker of an all-time record and for that reason alone, some will be tempted to pre-emptively throw in the 'risk' towel and allocate to medium to long-dated government yields at current levels. For us, many measures still suggest it is too early to adopt that strategy as ten-year US yields at 2.86%, or more alarmingly, ten-year German yields at 0.30%, remain unfavourable from a risk/reward perspective.

Looking Ahead

The US Federal Reserve (Fed) raised interest rates for the seventh time in the current cycle to 2% in June and we continue to expect an additional hike every quarter through to the end of 2019 at least. The move was highly anticipated and in itself not a market moving event, however, the tone of the meeting was moderately more hawkish than expected as the Fed upped their rate projections for 2018 as well as all important growth and inflation forecasts. Despite its maturity, the US's economic expansion exhibits no real signs of letting up with unemployment now at 3.8% and gross domestic product (GDP) expected to have rebounded sharply to 4%-plus in the second quarter. The economy has yet to feel the full benefit of President Trump's tax reforms and infrastructure spending and the question is rightly being asked whether these extra stimuli were necessary given the current strong growth conditions. This is turn raises the odds of the Fed possibly 'falling behind the curve' (although this is not currently our base case), whilst also doing little good for the country's debt pile and deficits in the coming quarters and years. With the Fed's balance sheet reduction process in full flow and the spectre of higher debt issuance on the horizon we remain cautious. In addition, many technical factors, including real returns and term premiums, continue to suggest yields at the longer end of the maturity spectrum remain too low.

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The ongoing normalisation of yields may have stalled somewhat in the quarter as factors such as current trade tensions have boosted safe-haven assets but we believe this represents little more than a pause in an ongoing rising yield environment and as such, the Fund remains defensively positioned. Uc qrsai rm msp nmqgrgtc amltgargmlq ml rfc SQ Bmjj_p _lb rfgq f_q n_gb mdd ugrf _l _nnpmvgk_rc 2# rp_bc+ucgefrcb p_jjwgl rfc os_prcp, Uc f_b jmle _pescb rf_r* mtcp rfc qfmpr rm kcbgsk rcpk _r jc_qr* rf_r rfc qfccp ucgefr md nmqgrgtc glrcpcqr p_rc _lb wgcjb bgddcpclrg_jq gl rfc SQ umsjb mtcppgbc rfc jmlecp rcpk lce_rgtc p_kgdga_rgmlq md Npcqgbclr Rpskn%q r_v asrq _lb gldp_qrpsarspc qnclbgle nj_lq _lb rfc asppclaw umsjb gl n_pr pc+amsn qmkc md rfc jmqqcq _aapscb gl 0./5, Rfc jmlectgrw md rfc asppclr p_jjw gq ksaf f_pbcp rm a_jj _lb ugjj _jkmqr clrgpcjw `c bcagbcb `w rfc qgxc md rfc e_n `crucclfgefcp wgcjbgle SQ emtcplkclr `mlbq _lb rfcgp pcqncargtc amslrcpn_prq, Rfc Dslb pck_glq /..# _jjma_rcb rm rfc SQ Bmjj_p `sr uc amlrglsc rm u_raf grq bgpcargml tcpw ajmqcjw,

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