Quarterly Commentary as at 30 June 2018

Melville Douglas

SA Bond Fund

Fund Review

During the quarter we used the bonds sell off to opportunistically increase the duration position of the fund. At bond yields above 9.0% on the benchmark R186 we were buyers of bonds and we also used the sell off to restructure the sector exposures in the fund. We reduced our long duration exposure to the ultra-long end of the bond yield curve slightly and increased exposure to the belly of the curve. The fund however remains long the ultra-long end of the yield curve and overall its modified duration is neutral relative to the ALBI benchmark's modified duration. As a strategy to enhance the fund's performance through yield pickup we participated in new credit issuance auctions and were allocated our full allocation we had bid for. We bought the high quality Mercedes Benz 3 year floating rate paper when it came to market. During the quarter the fund performed slightly below its benchmark (6 basis points below) and this can be attributed to the relatively long duration position compared to its benchmark while bonds sold off during the period.

Market Overview

Global events, including heightened concerns around global trade, higher interest rates and a strong USD collectively dampened risk appetite and emerging markets experienced large scale capital outflows. The domestic market was not spared as foreign investors sold domestic assets, including bonds, in droves during the quarter, resulting in a sharp sell-off in bond yields. The benchmark R186 yield to maturity at one stage rose to levels above 9.0%. From an economic point of view the quarter was characterised by a mixed bag of economic data with first quarter GDP and trade statistics disappointing. Despite the weakness in local currency and higher oil prices, headline inflation surprised on the downside with the latest data, printing at 4.4% y/y. The South African Reserve Bank left interest rates unchanged at 6.5%.

Looking Ahead

We expect interest rates to remain unchanged in the near term as inflation continues to surprise on the downside and demand remains lacklustre. We believe that bonds above 9.0% offer good value for long term investors and have been increasing our duration by increasing our exposure to longer dated bonds and have been increasing our holding in credit opportunistically. Our duration positioning is currently in line with the benchmark.