Quarterly Comment

The Fund performed in line with its benchmark in 3Q2016, delivering a return of 3% over the quarter, lagging the peak of the bond market rally seen in August.

Globally, the third quarter was somewhat less volatile for most markets, though SA certainly managed to produce a quota of political disturbance that sent equity markets and the rand reeling in August, only to recover as the quarter closed – the rand strengthened 7% against the US dollar over the quarter and is now where it was prior to Nenegate, even after the most recent political flare up.

Developed market central banks in general have disappointed over the past few months, in that they have not met expectations by substantially increasing the amount of monetary accommodation. Markets now appear to have accepted that aggressive monetary policy has reached or is near its limits. It's also notable that this year leadership has come from cyclical sectors (materials and energy) and emerging markets, which would normally be an indicator of a world in a strong growth phase with rising inflation. This is not the case, so sustainability must be suspect, but there are certainly indicators that modest growth has taken hold at least in the US, and that the employment and credit cycles are working. In the rest of the world, particularly in Europe and Japan, things are much less sure. As a result, there is increasing pressure for governments to take on more of the adjustment burden by increasing spending. But it isn't clear that there is much scope for significantly higher government deficits, and even if where there is, the quantum will pale into against the flexibility that central banks have. Still, the political pressures are now significant, as the US election shows, and over the next year or so there are more upcoming electoral events which will surely keep the pressure high.

There are plenty of sources of volatility (political and economic) and even if economies begin to perform better and at a higher level of growth, the impact on corporate earnings may not be direct. Margins are already wide by historical standards and with higher commodity prices and wage pressures, profitability may prove hard to sustain even with better revenue growth. SA is faced with another credit rating review in December and it is not clear that enough has been done to avert a downgrade; more decisive action and control is needed for the state-owned enterprises and other threats to fiscal stability remain.

The portfolio positioning remains tactically underweight duration, and we remain vigilant with volatility likely to rise as the credit rating review in the last quarter approaches. Fortunately, the inflation pass-through from repeated exchange rate shocks has been mild so far and inflation although outside the target band appears to be contained. As always, there will be opportunities, but we will be very focused on real yields available to investors and the associated risks.