Melville Douglas STANLIB Bond Fund

Minimum Disclosure Document as at 31 December 2016

Quarterly Commentary

Following the outcome of the US presidential election in November - the "Trump rally" – meant many markets recorded reasonable returns for the year. In SA the ALBI managed a 15.4% return as high starting yields compressed during the course of the year, along with a strengthening rand. At the beginning of the year was little to be positive about the state of flux that had been thrust upon South Africa. As a result, many SA investors will be glad to start 2017 on a less anxious note. The Fund delivered a return of 14.3% for the year, its conservative approach to duration meant that it underperformed a largely political event driven bond market.

The themes that characterized 2016 were not consistent: on the one hand "deglobalisation" and falling bond yields, and on the other rising commodity prices and reflation. Commodity prices bottomed out in January and then rose strongly, suggesting a cyclical recovery, but bond yields continued to de- cline, responding to weak growth signals, monetary accommodation and safe-haven demand. The year began with Japan announcing it would implement a negative policy rate, and the Japanese 10-year yield dipped below zero as a result. More unexpected was the response of the yen, which strengthened substantially against the US dollar, exactly the opposite of what was intended. The declining-yield phenomenon was eventually enough to push German 10-year bond yields into negative territory as well; and the final straw was Brexit. In SA, political events caused a lot of volatility, but did not change the overall positive direction of the rand or the decline of bond yields, notwithstanding the looming threat of a credit rating downgrade. Some of the tensions that were evident in 2016 will continue to play out in 2017. The US will need to adjust short term interest rates to reflect the reality of a higher inflation rate and fuller employment; the impact of the Trump administration's growth policies could exaggerate the tension. The impact of higher US interest rates on other regions will also be an issue, unless growth accelerates to higher levels. More supportively, the global earnings cycle appears to have turned positive and should provide a stronger underpin. Bond yields are likely to rise further as growth and inflation push on. Europe in particular will remain a potential source of politically-generated volatility as the year goes on, since there are a number of upcoming elections (Germany, France, Netherlands) which may produce disruptive changes. For SA investors, the local earnings cycle should turn positive and inflation should decline; the potential for inter- est rate cuts later in the year should thus become clearer and better outcomes than in 2016 are thus likely. As elsewhere, however, political issues remain a potentially disruptive overlay and policy implementation will need to be properly executed. The prospect of a foreign debt rating downgrade has not gone away. Investors will need to remain diversified and cautious, but at this point can be hopeful of a better, if not less volatile, year.

The portfolio presently reflects a tactically neutral duration position as we envisage a combination of lower inflation differentials and the country risk spread to work in favour of lower yields.