Quarterly Commentary as at 31 March 2018

MelvilleDouglas
A Member of Standard Bank Group

Melville Douglas

Income Fund Ltd — GBP Class

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The stage appears to be set for another hike in UK interest rates, with the market now discounting a move in May. The Bank of England's Monetary Policy Committee (MPC) have recently been eschewing a more hawkish tone but we expect the pace of any subsequent tightening to be at a much more moderate pace than in the US. UK GDP is trending at a positive yet subdued level relative to many other developed economies but importantly, inflation remains stubbornly higher than the MPC's 2% target rate. However, inflationary pressures are expected to moderate further in the coming months as the fall-out from the post-BREXIT slide in Sterling continues to subside.

Against the backdrop of a firm employment market, which finally appears to be driving wages in the right direction, the spending power of the UK consumer should increase sufficiently to keep growth chugging along despite ongoing BREXIT uncertainties. The Fund's duration strategy remains in sync with our negative view on global bond markets, namely a defensive bias on the belief that the outlook for the UK has improved and perhaps more importantly, rising US government bond yields still have the propensity to lift yields in other developed markets.

A more hawkish Bank of England and some tentatively positive news on BREXIT negotiations have proved sufficient enough to allow Sterling an almost 2% trade-weighted gain in the quarter. The Fund's currency allocation strategy remains biased to Sterling, however, continues to hold moderate weightings to both the US Dollar and Euro as insurance against the uncertainties that BREXIT may bring in the coming quarters. Ultimately, the UK economy has a habit of doing 'just fine' under sometimes difficult circumstances and that trend will likely continue but an aggressive tightening cycle is not on the cards just yet and Sterling may remain range bound until the BREXIT dust settles – which is some time away yet.

Overall, the Fund's strategy remains one of limiting potential downside risk in an environment where we expect yields to continue to rise in the coming quarters. Ongoing synchronised global growth, less accommodative central bank policies and increased inflationary pressures should ensure that global government bond yields continue to normalise. We aim to continue to gradually increase the duration of the Fund at more attractive yield levels as this process unfolds