Discovery Strategic Bond

August 2024

Market background

The Fast View

- Global bonds rallied on expectations of more aggressive rate cuts in the US
- EM bond markets benefitted from a dovish Fed and a softer US dollar
- The Bank of Japan's (BoJ's) surprise rate hike on July 31 ignited a tumultuous unwind in currency carry trades
- SA yield-oriented assets generated strong returns over the period

To read more, please click here.

Performance review

For the month, the portfolio outperformed the benchmark.

Global bonds rallied during the month as traders priced in more aggressive rate cuts by the US Federal Reserve (Fed) against a backdrop of softening economic and inflation data. The yield on the US 10-year Treasury fell below 3.85%, reaching levels not seen in the past year.

Meanwhile, EM fixed income had another strong month in August, supported by the weaker job numbers coming from the US, and softer inflation numbers. In South Africa, we saw another strong month for sovereign bonds as yields declined to year-to-date lows during the month amid improved investor sentiment toward South African assets under the recently established Government of National Unity (GNU), with further support coming from a significantly stronger rand over the period.

The JSE All Bond Index generated a return of 2.35% for the month. All tenors across the curve outperformed and our duration positioning added positively to performance. We tactically added duration on US treasuries, which added value.

We remain underweight inflation-linked bonds (ILB) amid a slowdown in inflation expectations.

The yield-enhancing investment-grade credit component continued to add value.

Outlook and strategy

Global: The global environment appears more supportive of interest rate cuts. The US economy remains resilient based on recent GDP data, although we are beginning to see signs of weakness emerging. We expect the Fed to cut rates by at least 75 basis points (bps) this year. Although inflation is contained in China, a miss in Q2 GDP print and an uneven recovery so far dims the outlook for commodity exporting countries and EMs more broadly. We continue to monitor developments in geopolitics, especially in the Middle East, as any escalation will cause oil prices to edge higher, unravelling the disinflationary environment.

South Africa: Risks to growth have shifted slightly to the upside. The formation of the centrist GNU has continued to improve sentiment toward South Africa. We expect Q3 data on business and consumer confidence index to improve further. Eskom has further announced its outlook for the summer period, forecasting a scenario of possibly no-load-shedding due to structural generation improvements. This improvement in the availability of electricity has helped the economy expanding by 0.4% in the second quarter of 2024 after no growth was recorded previously. Inflation also softened to 4.6 in July, down from 5.1% - further anchoring itself on the South African Reserve Bank's (SARB's) midpoint target. Stable global oil prices and a stronger rand have led to further cuts in petrol and diesel costs. This decrease will lead to the softening of inflation. We expect the SARB to kick start its rate cutting cycle with a 25bps cut in September.

Positioning

From a positioning perspective, we remain overweight in South African government bonds (SAGBs), which remain very attractive on valuation grounds.

We remain underweight ILBs, preferring nominals instead, as the disinflationary trend continues.

Investment-grade credit remains a neutral allocation in our portfolios, as we prefer sovereign debt instead. Spreads have tightened in recent years on the back of too much demand amid a slowdown in issuance.