Discovery Money Market

31 December 2024

Market background

The Fast View

- The Fed cut rates by 25 basis points as expected
- Risk assets struggled as the Fed signalled fewer rate cuts in 2025
- Trump's inauguration and speech to indicate the direction of the markets in the new year
- Global headwinds continued to test the resilience of emerging market assets
- Inflation is under control in SA; further rate cuts are anticipated

Performance review

Yields in developed markets firmed as the US Federal Reserve (Fed) signalled a slower pace of rate cuts in 2025. The US 10-year Treasury yield fluctuated during the quarter but ultimately rose by 79 basis points (bps) to close at 4.57%. This comes after the initial reaction to Donald Trump's US election victory reflected concerns over elevated fiscal risks and higher inflation expectations.

As expected, the Fed lowered interest rates by 25 bps in December. The interest rate cut followed a slight uptick in inflation, which rose to 2.7% year-on-year (y/y) in November, up from 2.6% in October. Fed Chair Jerome Powell indicated a lack of urgency to cut rates, resulting in a scaling back of market expectations around the speed of monetary policy easing in 2025. Treasury yields subsequently fell back following Trump's market-friendly Treasury Secretary nomination but soon resumed their rise on signs of sticky inflation and hawkish forecasts from the Fed – with the Fed's 'dot plots' pointing to just two rate cuts in 2025, down from four in its previous meeting.
The US dollar continued to appreciate against major currencies following Trump’s re-election, as reflecting market expectations that while inflationary policies might emerge during Trump's presidency, they are unlikely to significantly weaken the dollar.

South African Bonds (SAGBs) experienced fluctuations in the final months of the year, largely on the back of global headwinds. The JSE All Bond Index delivered a flat 0.43 % return over the final quarter.
Over the quarter, one-year fixed-rate negotiable certificates of deposit (NCDs) rallied by 8 bps from 8.22% in October to 8.12% by the end of December. Initially, repricing was higher during the quarter as the market repriced the pace of rate cuts and uncertainty around US policies. Still, NCDs finished on a stronger note as the market consolidated, and stronger local inflation data helped yields rally into year-end.

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For the quarter, the Fund outperformed the benchmark.

Key contributors:

- Spreads in floating-rate notes (FRNs) continued to compress over the quarter as both regulatory changes and excess liquidity impacted funding spreads.

Key detractors:

- As the South African Reserve Bank (SARB) cuts the repo rate, both lower yields and excess liquidity will impact the portfolio negatively.

Portfolio activity

We selectively added duration into weakness at the beginning of the quarter but allowed duration to roll-in as the market rallied into year-end. We continue to look for opportunities to add floating rate notes at attractive spreads.

Outlook and strategy

Global: We expect markets to be nervous heading into the inauguration of Donald Trump as the 47th president of the United States on 20 January. Trump's first 100 days in office will offer us more insight into legislative priorities. Tariffs continue dominate newsflow, and if implemented, they could potentially decide the trajectory of growth and inflation through a myriad of channels. The main threat to worldwide growth and financial markets would stem from a general increase in tariffs, which could add to growth challenges in Europe and China. On the other hand, there is potential for global growth prospects to improve if China implements proactive fiscal stimulus or if Germany adopts a more relaxed fiscal policy post-election, which could counter the existing negative outlook regarding the Euro area. The overall implications for growth, inflation, and policy are intricate and differ across various economies. Meanwhile, China has introduced a comprehensive stimulus plan to counter economic challenges. The plan focuses on boosting domestic consumption and stabilizing growth. Key measures include increased fiscal support for households, the issuance of ultra-long special bonds, monetary policy easing, and targeted support for the real estate sector. Given the previous experience with tariffs back in 2019, we believe the Fed will try push through tariff-infused inflation, and continue to normalise policy through 2025.

South Africa: South Africa's inflation rate slightly ticked up in November to 2.9% y/y, up from a four-year low of 2.8% y/y in October, driven by a slower deceleration in fuel inflation. While inflation ticked up, it remains well below the SARB's target range of 3-6%; fuelling expectations of a further rate cut by the SARB at its January policy setting meeting. Therefore, we expect the SARB to remain cautious but continue to cut interest rates, albeit at a slower pace. The SARB has cautioned about the risks of policy reversals in the global economic environment. South Africa's third-quarter gross domestic product (GDP) contracted. Despite this, the SARB maintains optimism for medium-term economic growth as structural reforms under the newly formed 'Government of National Unity' (GNU) unfold. Positively, business confidence rose to 45 in Q4, its highest reading since Q1 2022, and annual retail sales surged by 6.3% in October, marking its strongest growth since July 2022. The Government of National Unity (GNU) faces significant challenges in delivering on its promises to improve the country's economic prospects. Political and economic stability, along with sustained policy implementation, will be critical for fostering recovery and long-term growth.

Positioning

The inflation outlook remains positive from here, and we expect prices to stay low to mid 3% for a significant period, with a slight uptick in the second half of 2025 – but still below the SARB's mid-point target.

The market has priced in an additional 50bps of cuts from the SARB, which we think is reasonable. We remain slightly long and will continue to look for opportunities to add duration into weakness.