Discovery Money Market

Quarter ending June 2024

Market background

The Fast View

- The US Fed left rates unchanged while signalling one rate cut expected late this year
- The Japanese yen slid to its lowest level since 1986 and household spending falls
- Another mixed quarter for EM fixed income, as politics and central banks take centre stage
- In SA, elections brough with them significant volatility, but in the end the formation of a government of national unity was seen as an investor friendly outcome
- In the money market, NCDs rallied a fair amount, notwithstanding election volatility during the quarter

To read more, please click here.

Performance review

For the quarter, the portfolio outperformed the benchmark.

The US Federal Reserve (Fed) left rates unchanged at a range of 5.25%-5.50% for the seventh consecutive meeting in June, while signalling rates might be cut once this year.

It was a mixed quarter for EM sovereign debt markets. Starting on the local debt side, the JP Morgan GBI-EM fell 1.6% over the quarter. This was driven by EM FX (-2.2%), which weakened from the strength of the US dollar and an unwinding of carry trades in Latin America. Conversely, hedged EM local bonds returned a positive 0.5%, despite the rise in developed market bond yields. Locally, the JSE All Bond Index ended the quarter up 7.49% as the was a market-friendly outcome as the ANC entered into a Government of National Unity with the DA, IFP and other smaller parties.

In the money market, we had a selloff into election risks, and then we saw a post-election rally, and Fed cuts being priced into the market. Over the quarter as a whole, one-year fixed-rate negotiable certificates of deposit (NCDs) rallied a fair amount, ending the quarter at 8.95% from 9.12% at the end of March. Notwithstanding significant volatility over the period, much of the risk premium priced into local assets began to dissipate following a positive outcome in the elections and the formation of a government. Furthermore, it now appears that a September or November cut by the South African Reserve Bank (SARB) is now in play. Cash, as measured by the STeFI Composite Index, delivered +2.06% over the quarter. The rand ended the quarter strong, firming against the US dollar, euro, and pound sterling over the same period.

For the quarter, the Fund outperformed the benchmark.

Spreads in floating-rate notes (FRNs) remained attractive over the quarter, especially on the longer end of the maturity curve. We continued to take advantage of this in recent months, with the excess yield over benchmark rates continuing to be a positive contributor to performance.

With excess liquidity in the market, there were limited opportunities in the very short end of the cash yield curve.

Portfolio activity

We continued to add duration over quarter and will continue to seize opportunities to extend duration further into any weakness going forward.

Outlook and strategy

Current economic context: Amid the intricate tapestry of global economies, resilient growth continues to weave a diverse range of perspectives. Inflation expectations have moderated, with divergence in growth across individual economies, while the US and EMs look more resilient, the latter further boosted by an upside surprise in Q1 GDP growth in China.

South Africa: SA growth is showing signs of improvement, but challenges persist. Factory floor activity contracted for the second straight month although at a slower pace, with the manufacturing PMI coming in at 45.7 in June, from 43.8 the previous month amid weak demand conditions. Meanwhile, Eskom's Generation Operational Recovery Plan initiated in March 2023 has seen a marked improvement in reducing unplanned outages. The energy availability factor has trended consistently above 60%, reaching 65% by the end of June. The logistics crisis has similarly stabilised, with Transnet implementing several measures aimed at improving efficiency and reducing backlogs. The rand continues to find support in bullion prices and more recently found support following the formation of a coalition government which deemed more investor friendly. At its April Monetary Policy Review, the South African Reserve Bank (SARB) noted that expectations for easing sometime this year remain broadly intact.

Positioning

Global inflation notably eased over the course of 2023 and the trend downward continues in most countries around the world, with the notable exception being Argentina (276% year-on-year in May). Hopes of further and more accelerated moderation have, however, been tempered by stubborn core inflation, while food and energy refuse to budge. In the developed world, inflation is expected to converge more rapidly toward long-term target levels compared to EMs. The inflation outlook in EMs must contend with fluctuations in currencies and commodity prices.

Locally, the SARB views risks to the inflation outlook to be broadly balanced. Headline inflation stood at a four-month low of 5.2% y/y in May, still above the SARB's preferred target of 4.5%. Core inflation (which excludes volatile items such as food and energy) stood at a three-month low of 4.6% y/y over the same period, from 5% in February. We believe the path back to the 4.5% mark will remain a slow and rocky one.

We expect inflation to average 4.9% in 2024 (4.4% in 2025), compared to the SARB at 5.1% in 2024 (4.5% in 2025).

We remain constructive but maintain caution and a nimble approach on money market yields. We are not looking to add duration aggressively at these levels, given a lot has already been priced in. We will continue to look for better entry levels.