Discovery Diversified Income

30 November 2024

Market background

The Fast View

- Government bond yields generally fell in developed markets, predominantly in Europe, while volatile in the US, and Japan bucked the downward trend
- The US dollar continued its strong run versus peers, aided by hawkish Fed comments
- In emerging markets, yields recovered from a Trump victory following the nomination of Scott Bessent as Treasury Secretary
- In SA, inflation eased further, while the SARB delivered another rate cut

Performance review

For the month, the portfolio outperformed the benchmark.
Yields in advanced economies declined in November, with the US 10-year yield falling by 12 basis points (bps) to end the month at 4.17%. Leading to the US elections, markets had pre-empted Donald Trump's victory, which led to yields rising. However, there was stabilization as markets reassessed their positions, as they were considering policy changes – especially trade policies that might lead to a higher inflation outlook. In addition, a cautious and measured tone from US Federal (Fed) Chair Jerome Powell caused markets to lower their expectations of aggressive rate cuts in 2025. However, markets reacted positively to Trump's announcement of Scott Bessent as Treasury Secretary. This led to a bond rally in emerging markets.

In South Africa, inflation printed below 3% year-on-year (y/y) in October, which further boosted the local bond market. Yields fell across the curve with positive gains registered across all tenors. As a result, the JSE All Bond Index delivered a 3.03% return over the month, recovering losses from October. Our positioning on the curve, most of which is in the mid-dated area, was rewarded.
We remain underweight inflation-linked bonds (ILB), as inflation continues to cool further.

After SA-listed property contracted last month, as yield-oriented assets came under pressure, the sector gained back 1.69% in November.

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

The foreign exchange (FX) component of the portfolio continued to add value as the US dollar firmed against a basket of its G10 peers.

Outlook and strategy

Global

As inflation continues to cool down, investors eyes continue to be glued on the US president Donald Trump, to monitor his policy approach and their impact on capital markets. The US dollar continued its recent strong run versus a global basket of currencies, helped by the slightly more hawkish comments from Powell. Despite this, we still expect a 25bps points cut form the Fed in their upcoming meeting in December.

South Africa

The South African Reserve Bank (SARB) cut interest rates by 25bps to 7.75% in November as inflation eased lower to 2.8% y/y in October. Although inflation seems under control, the SARB did signal potential upside risks to inflation in the medium term as geopolitics could cause some rand weakness. However, we expect the central bank to cut rates by at least another 50bps this easing cycle.

Positioning

From a positioning perspective, we maintain a positive view on South African government bonds (SAGBs), which remain attractive on valuation grounds and relative to other asset classes in the fixed income universe. We reduced risk in the Fund in the run-up to the US election and strong economic data in the US. As dynamics stabilised in recent weeks, we have reassessed our positions, and added duration back into the portfolio, as well as adding to our US Treasuries exposure. Furthermore, December is a big coupon month; therefore, we expect some support for the market as cash is paid to bondholders. The month also brings about the last bond auction until January. Therefore, we remain constructive over the period.

We remain underweight Inflation-linked bonds (ILBs), as the asset class remains less favourable relative to other asset classes amid a weaker inflation profile. We expect inflation to continue to remain low over the medium term.
We increased exposure to local listed property during the month. Over the medium term, we maintain a positive outlook on the sector but remain selective in our allocation and will continue to tactically seize opportunities in high-quality names where we see fair value.

Investment-grade credit remains a neutral allocation in our portfolios, as we prefer sovereign debt instead. Spreads have tightened in recent years due to increased demand and a slowdown in issuance. Our bottom-up views remain consistent, with a preference for assets with defensive credit qualities.

In portfolios permitting FX exposure, we believe it is prudent to retain a small allocation to a basket of offshore currencies. We had increased the exposure to the US dollar ahead of the US election and have now reduced some of that exposure as SA’s terms of trade improve due to the lower oil price.