

# BALONDOLOZI

— INVESTMENT LEADERSHIP —

## BALONDOLOZI MODEL BOND FUND

September 30, 2023

### FACT SHEET

#### INVESTMENT OBJECTIVE

The fund seeks to outperform the All Bond Index by 1% per annum without taking on excessive market risk.

#### INVESTMENT STRATEGY

This fund seeks out a high level of income which is consistent with the preservation of capital over the medium term. To meet its objective, the fund actively allocates between South African money market instruments, government bonds, corporate bonds and hybrid instruments. Although the fund aims to preserve capital over the medium term, capital depreciation is a possibility over the short term. Quantitative techniques such as the use of derivatives are employed to fine tune strategy and hedge risk factors.

#### FUND INFORMATION

Fund Classification	South African - Interest Bearing - Variable Term
Benchmark	ALBI
Risk Profile	Moderately Conservative
Fund Managers	Fannuel Tigere, Itumeleng Mojaki, Christopher Pratt, Sindisiwe Mahlangu (Analyst)
Inception Date	01 March 2013
Fund Size	R4068 million
Currency	SA Rands
Administration	Prescient Management Company (RF) (Pty) Ltd
Trustees	Standard Bank
Regulator	Financial Sector Conduct Authority (FSCA)
Regulation 28	Compliant

#### FEES

Initial & Exit Fees	Nil
Total Investment Charge	0.34%
Portfolio TER	0.34%
Management Fees	0.30%
Transaction Costs	0.00%
Audit Fees	0.00%
Other Costs	0.00%
Vat	15.00%
Pricing	Daily at 17:00

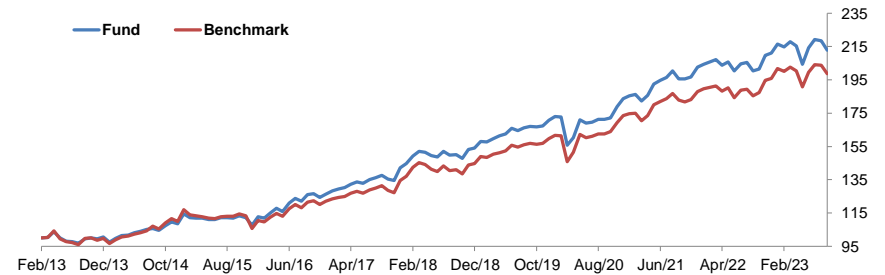
#### RISK RATIOS

	<i>Fund</i>	<i>Benchmark</i>
Annualised Return	7.40%	6.71%
Sharpe Ratio	0.29	0.19
Sortino Ratio	0.38	0.26
Max Drawdown	-9.84%	-9.75%
Drawdowns	45	46

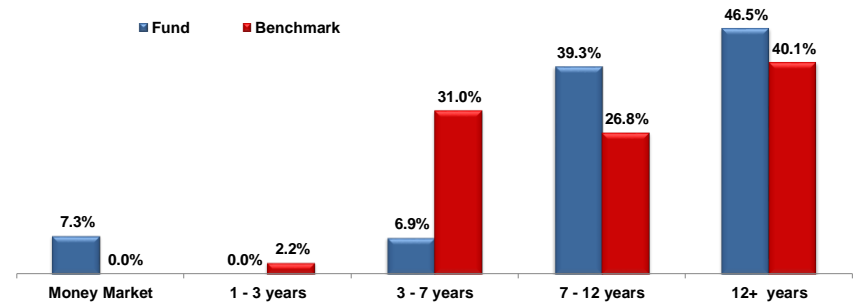
#### PERFORMANCE (Gross of fees)

	<i>Fund</i>	<i>Benchmark</i>
Sep-23	-2.52%	-2.37%
Year to Date	0.82%	1.47%
Rolling 12 months	6.21%	7.20%
Return p.a. since inception	7.40%	6.71%
Return since inception	112.86%	98.82%
Highest Rolling 1-year Return	17.49%	21.23%
Lowest Rolling 1-year Return	-2.35%	-5.61%

#### GROWTH OF R100 INVESTED AT INCEPTION



#### SECTOR ANALYSIS



## FUND COMMENTARY

Despite the moderation of inflation globally, the hawkish stance from central banks continues. In addition to the dramatic slowdown in global growth, rising global interest rates are also increasing the danger of financial stress in emerging market and developing economies.

Nominal government bonds returned -2.36% (GOVI); vanilla credit bonds delivered -2.05% (OTH); inflation linked bonds returned -1.07% (CIL) and cash returned 0.63% as indicated by the STeFi Call Index in Sep 2023. Overall, the ALBI (All Bond Composite Index) returned -2.34% for the month.

During the same period; the yield for the R186 (benchmark bond) rose by +55 basis points to end the month at 9.42%. Concurrently, the R2048/R186 spread ticked down by -5 basis points to 347 bps whilst medium-term break-evens widened by +0.49% to 6.48%. Foreigners sold bonds worth -R36.3 billion as yields sold-off during the month of Sep 2023.

Overall, the fund delivered -2.52% for the month against the benchmark return of -2.37%. Underperformance was led by sector allocation as the curve steepened. The fund performance was dragged by duration -0.10% and sector allocator -0.05%. However, credit contributed 0.01%, and the fund does not hold an ILBs.

After registering a value of 4.7% in Jul 2023, headline inflation for Aug 2023 was 4.8% (consensus 5.2%). On the same note, the price for Brent crude oil rose by 6.18%, to end the month at \$92.2 per barrel and the Rand depreciated against the Dollar by -0.26% to close at R18.92 per dollar. The seasonally adjusted Kagiso Purchasing Managers' Index (PMI) nudged up by 5.9 index points to reach 50.7 in Aug 2023.

In accordance with market expectations and following a 25bps increase in July, the Federal Reserve reaffirmed its target range for the interest rate at a 22-year high of 5.25%–5.5% in September 2023, but it did hint that there might be another increase this year. The annual inflation rate increased for the second consecutive month, rising to 3.7% in August from 3.2% in July, exceeding market expectations of 3.6%. Inflation has increased as a result of rising oil prices over the last two months, base effects from last year, and other factors. The US unemployment rate increased marginally to 3.8% from 3.5%, above market estimates of 3.5%. US initial jobless claims showed some tightness in the labour market adding to further interest rate hiking. The number of new filings edging up slightly to 204k, below consensus expectations of 214k. In comparison to the first quarter's upwardly revised 2.2% growth, the US economy expanded at an annualized pace of 2.1% in the second quarter of 2023. Consumer expenditure increased far more slowly than anticipated (by 1.7% in the second estimate against 0.8% in the first estimate), but non-residential fixed investment, exports, and residential investment all saw increases. 3.3% more was spent by the government, in accordance with the earlier projection. The Fed forecasts 2.1% economic growth for 2023.

The European Central Bank (ECB) increased interest rates by 25 bps citing the expectation that inflation will moderate. However, upside risk still remain as reflected by average inflation projections revised higher to 5.6% for 2023 due to a spike in energy prices. This increased both the rate on the deposit facility and refinancing operations to a high of 4% and 4.5%. The annual consumer price inflation rate reading came at 4.3% in September 2023, below market expectations of 4.5%. Services, non-energy industrial products, and food, alcohol, and tobacco all saw slower price growth than the overall increase of 5.5%, 4.7%, 4.2%, and 9.7%, respectively. Energy prices also continued to decline (-4.7% vs. -3.3%). Meanwhile manufacturing in the region deteriorated as shown by the decline in Eurozone Manufacturing PMI to 43.4 in September from 43.5 in the previous month. The reading persisted in indicating that the industrial sector is extremely vulnerable and weak in the face of declining demand.

Following a flat first quarter, the Eurozone's economy expanded by 0.1% in the second quarter of 2023, lower than initial expectations of 0.3%. Demand growth was presumably aided by an easing of price pressures. However, the economy of the single currency region continues to be burdened by rising interest rates and declining confidence. France and Spain showed consistent growth rates expanding 0.5% and 0.4%, while Germany's GDP remained stagnant, and Italy's economy unexpectedly contracted. However, worries about the state of the bloc's economy continue, and there is rising scepticism about its capacity to avert a recession, particularly given the gloomy outlook for Germany.

China's slow economic recovery appears to have hit a wall, with declining retail sales, manufacturing output, pricing power, and loan growth in September. This setback increases the likelihood that China would miss the originally set 5% growth objective by the central government and raises concerns about slow third-quarter growth. Despite a sharp decline in mortgage rates, China's struggling real estate market exhibited symptoms of deterioration in September with declining home prices, weakening real estate prices, and weak sales. The People's Bank of China has reiterated its commitment to upholding currency stability in light of the yuan's roughly 5.5 percent decline against the dollar this year. Consumer prices in China increased by 0.1% yoy in August 2023, below market expectations of a 0.2% increase and following the country's first monthly decline in more than two years, which was 0.3%. The Caixin China General Service PMI decreased from 51.8 to 50.2 in September 2023, signaling the softest growth in services activity since the year's beginning. Both business activity and new orders grew the least in 2023 to date, as demand remained weak despite several support measures. After reaching a six-month high of 51.0 in August, China's Manufacturing PMI dropped to 50.6 in September 2023, falling short of market expectations of 51.2.

Locally, in line with expectations, the South African Reserve Bank (SARB) held the benchmark repo rate unchanged at 8.25% during its September 2023 meeting with two members of the Committee advocating a 25-basis point rise, while the other three preferred to keep rates unchanged, but stressed that the struggle against inflation was far from over. Fuel and food costs have mostly influenced the trend of South Africa's headline inflation rate. Fuel price inflation is much greater in 2023 (from -3.1%) than it was in the previous meeting, and it will reach 5.8% in 2024. The SARB's prediction for 2023 food price inflation is still strong and substantially unchanged at 10.4% (from 10.3%). The prediction for 2024 stays the same at 5.2%. In recent months, both oil prices and the prices of commodities exported have increased. As the current account deficit rises from the anticipated 2.0% of GDP this year (from 1.9%), to 3.0% of GDP in 2024, and to 3.4% of GDP in 2025, South Africa's external finance needs will rise. These patterns in supply and demand allowed the Bank to increase its estimate of GDP growth from 0.4% in July to 0.7%. The bank also noted that the rand has declined over the past year, losing 10% of its value against the US dollar, and is exhibiting considerable volatility in response to periods of risk-on and risk-off trading. This still suggests that South Africa is still stuck in the stagflation quagmire.

Given this backdrop, fundamental suggests there is value in bonds with long-term bonds offering value, while behavioural models are oversold, and technical models suggest that yields are likely to rally. The fund closed the month with a long duration view. However, the managers will not hesitate to take short term opportunities offered by the volatility in the markets. Since credit spreads are widening, the fund will minimize exposure to credit and target high quality names to benefit from the yield pick-up whilst minimising the risk of widening spreads.