CAMmuniqué

CADIZ ASSET MANAGEMENT INVESTMENT UPDATE

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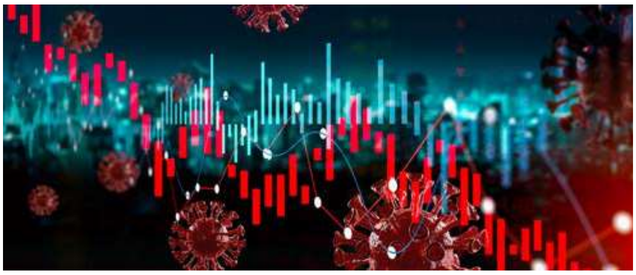
JANUARY 2021

Fixed Interest Review
4th Quarter 2020



MARKET COMMENTARY

Recovery in the global economy was impeded by concerns of second and third Covid-19 waves spreading throughout the globe. The development of vaccines and the election of a new president in the United States lent support to the risk-on trade benefitting emerging markets in general. Although the US stimulus package was only signed into effect very late in the quarter, the finalisation of the post-Brexit agreement helped to keep the risk-on trade alive for most of the period. As post-election uncertainty dissipated, US bond yields reversed their decline, with the 10-year generic US yield increasing to 0.92% by the end of December. European yields retained their negative bias, however, with the German 10-year generic yield ending the quarter at -0.57% and its French counterpart closing at -0.34%.

The local fixed interest environment was not immune to the negative sentiment surrounding the Covid-19 pandemic. After some initial weakness, foreigners turned buyers as the risk-on trade escalated. The South African Medium-Term Budget Policy Statement (MTBPS) presented in October once again emphasised the ailing fiscal position, the contentious nature and existence of the State-Owned Enterprises and further deterioration in government's debt to GDP. Risks to the South Africa's economic outlook include: weaker than expected growth, continued deterioration in public finances, the failure to implement structural reforms and the threat of a second and third wave of COVID-19 infections. It is, therefore, vital that government implement the interventions of its reconstruction and development plan to boost confidence and increase competitiveness should we wish to return to economic growth, and public finances are sustainable. We now turn our attention to upcoming events, such as the February budget and impending ratings reviews.

Inflation-linked bonds had a reasonable quarter as some upward pressure in the food sector lifted inflation measurements, albeit to a limited degree.

The Rand continued to strengthen over the quarter fuelled by the global risk-on trade on the back of progress being made in the implementation of Covid-19 vaccines. From a high of USD/ZAR 16.76 at the start of the period, the local currency ended the year around USD/ZAR 14.69.

Money market yields stabilised over the quarter as no further rate cuts were enacted by the SA Reserve Bank monetary policy committee. Borrowing costs remain low as the effects of the Covid-19 pandemic linger in all aspects of the economy. The long end of the money market curve gave up some of its gains from the previous quarter as demand for this asset class abated.

The bond market (JSE All Bond Total Return Index) was up 6.71% for Q4 2020. Equity markets (represented by the JSE ALSI) were up 9.75% and Inflation Linked Bonds (JSE IGOV index) returned 5.37% for the quarter and cash returned 0.97% for the quarter.

The rolling 12 month returns for bonds were 8.65%, equities 7.00%, and ILBs 4.22% and cash returning 5.39%. »

KEY CONTRIBUTORS AND DETRACTORS FROM PERFORMANCE:

Macro global factors such as the US elections dominated local market price action. This was reflected in fixed income returns over the last quarter of 2020. With the Medium-Term Budget Policy Statement (MTBPS) setting the tone at beginning of the quarter, it set a bearish bias for the yield curve.

The local bond market navigated an uncertain 'budget' month, with foreign investors continuing to sell South African Government Bonds (SAGB) in excess of R13bn. Our funds took advantage of the precarious pricing environment and increased its position in the 7–12-year bucket of the curve. This proved worthwhile as both nominal and inflation linkers outperformed their respective benchmarks for the month of October.

November was met with euphoria in all markets as the positive news of President-elect Biden swept emerging markets. Blue wave trade was what gave momentum in our local bond market, with the All-Bond Index (ALBI) returning +3.28% and Government Inflation-linked Index (IGOVI) delivering +2.02% for the month. Even with the sovereign facing a one notch downgrade from both Moody's and Fitch; the nominal yield curve flattened by 60bps with more appetite for ultra-long bonds. We continued our strategy by adding duration through longer-dated nominal bonds such as the R2048. This area of the curve outperformed the short end and had a positive contribution to performance.

Swinging from the highs of November, bond yields continued to initially rally with differentials in long-dated nominal bonds narrowing. Technical bond spreads such as the R209/R186 gap recorded lows of 327bps this quarter. SAGB's found support from non-residents, with total inflow standing at R19.8bn in December. We continued our strategy of adding duration in the belly to ultra-long end of the linker curve such as I2025, I2046 and I2050.

What detracted from performance, however, was the short end of the real yield curve selling off marginally, while back end bonds rallied 40bps.

POSITIONING AND OUTLOOK:

We are looking for opportunity to extend nominal duration as value opens up in the medium-to-longer-end of the curve. Similarly, inflation-linked bonds may present an opportunity to participate in the longer end of the real yield curve, with potential inflationary pressures building. We intend to hold a cautious strategic position as we examine the impending event risks in the system, namely the National Budget, rating reviews and the Monetary Policy framework. •

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