STANLIB Multi-Manager Absolute Income Fund

Commentary: 30 September 2018

STANLIB

Market overview

The global trade war between the United States and China continued to dominate headlines during the quarter. The US intensified tariffs on Chinese goods and China retaliated. Despite the tussle between the two economic giants, the US economy remains strong. This is visible in the rally of the US dollar and their robust labour market. These positive developments gave the Fed room to hike interest rates in September from 2.0% to 2.3%.

Unfortunately, the higher developed market (DM) interest rates and stronger US dollar do not bode well for emerging market (EM) assets such as South Africa, and most EM countries saw their currencies weaken. SA fared worse than its EM peers as signs of poor economic growth surfaced during the quarter, resulting in SA moving into a technical recession.

SA equities lost 1.6% over the quarter, driven largely by poor returns from industrials. SA property lost 1.0%, while SA bonds returned 0.8%, driven largely by short-dated instruments which gained 1.9%. The 12+ are of the curve returned 0.4% and SA cash gained 1.7%.

Asset class performance and risk statistics

Asset class	Q3 2018	1 year	3 years p.a.	5 years p.a.
FTSE/JSE ALSI	-2.2%	3.4%	6.7%	8.0%
Financials	*2.8%*	*8.1%*	*4.6%*	*10.9%*
Resources	*5.2%*	*27.1%*	*15.7%*	*1.0%*
Industrials	*-7.8%*	*-7.7%*	*2.5%*	*7.7%*
FTSE/JSE Capped SWIX	-1.7%	0.4%	4.5%	7.4%
Bonds ALBI	0.8%	7.1%	7.8%	7.2%
Cash STeFI Composite	1.8%	7.3%	7.3%	6.8%
All Property Index (ALPI)	-1.5%	-14.0%	-3.5%	6.1%

Risk statistics since launch		
Lowest rolling 12-month return	3.96% (12 months ended January 2014)	
Highest rolling 12-month return	10.1% (12 months ended January 2015)	
	Fund*	Benchmark
Maximum drawdown	-1.1%	-1.9%
Portfolio volatility	1.6%	2.7%

Source: STANLIB Multi-Manager.

Portfolio review

The Fund returned 1.6% net of fees for the quarter, which was very pleasing considering the performance of risk assets in the financial market turmoil. Over three years, the Fund returned 8.1% after fees, well ahead of income fund peers at 7.4% and almost 3% above inflation. This performance showcases the appropriateness of the Fund for an investor seeking inflation beating returns, but with limited downside risk.

Aluwani returned an excellent 2.3% for the quarter, gross of fees. Exposure to listed property remains very low and has assisted performance. Despite yields becoming much more attractive from a valuation perspective, they maintained a fairly low duration position on the back of a deteriorating domestic backdrop and continued global headwinds. In addition, Aluwani started to increase exposure to ILBs to position for a rising inflation environment.

Investment grade credit has continued to provide consistent yield-enhancing returns for Investec, insulating them from prevailing market conditions. Excess demand over supply continues to underpin the local credit market. Investec maintained their offshore exposure in order to balance local interest rate-sensitive risks and, more specifically, to offset rand weakness. Their modified duration is at 1.4 years, taking on more duration risk than Prescient and Aluwani.

Prescient used the recent upwards move in fixed interest market yields to further gradually increase duration in the fund. With local inflation expected to remain within the target band and growth remaining subdued, they see little risk of the SA Reserve Bank increasing rates more than what the market is expecting. The fund remains above its target benchmark for the year, outperforming the ALBI 1-3. Performance came predominantly from good quality credit. Their allocation to listed property detracted marginally over the year relative to peers, but long-term performance remains solid.

Portfolio positioning and outlook

The Fund's modified duration remains relatively low at one year. This will protect investors against possible interest rate hikes in SA. The fund has a small property allocation of around 3%, as well as some diversifying global exposure. Overall, the underlying managers are seeing more fixed interest opportunities and have been increasing duration marginally. A large portion of the Fund is positioned towards safer, high quality floating rate bank exposure and government debt, with select credit exposure used to increase the yield produced.

In addition to further rate hikes in the US, we expect trade wars to continue dominating headlines and this could weigh heavily on EM sentiment. Local asset prices have retreated to levels that may provide a good entry points for investors. However, the global and SA environment remains highly uncertain and we continue to emphasize the importance of having a long-term focus when making investment decisions.

***Duration** – a measure of the sensitivity of the price of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years.*

Portfolio managers

Jennifer Henry
Head of Portfolio Management:
Retail Clients
BCom(Hons), CFA, FRM

Richo Venter
Portfolio Manager
BCom(Hons)
(cum laude), CFA

TRUSTEES: Standard Chartered Bank, 4 Sandown Valley Crescent, T: 27 11 217 6600
STANLIB Collective Investments (RF) Pty Limited Reg. No. 1969/003468/07 17 Melrose Boulevard, Melrose Arch, 2196
PO Box 203, Melrose Arch, 2196 **T:** 0860 123 003 **W:** stanlib.com and/or stanlibmultimanager.com

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