PSG Income Fund

Quarterly Portfolio Commentary as at 30 September 2018
by Tyron Green & Greg Hopkins

Current context

Emerging markets have underperformed dramatically in 2018, weighed down by rising US interest rates and turmoil in countries like Turkey and Argentina. This backdrop has seen the rand depreciate to the extent that it is trading weaker than it was before the ANC elective conference in December 2017. Domestic assets have suffered sharp declines this year and many are trading at or near multi-year lows.

Locally, the growth outlook remains weak. This will continue to place pressure on the fiscus, as revenue collection is unlikely to show significant improvement. Furthermore, expectations for shorter-term inflation have risen: in addition to the weaker rand, oil prices have continued to climb (recently resulting in dramatic petrol price increases) and the cost of electricity is also expected to rise over the next four years. This is on the back of the National Energy Regulator's decision to allow Eskom to claw back certain costs, starting with an increase of about 4% by April 2019. The market is now looking to the upcoming medium-term budget policy statement on 24 October, as it is expected to provide key direction on growth initiatives and government's capacity to meet fiscal targets.

Our perspective

We apply a repeatable investment process, according to which we allocate capital to securities we consider undervalued and take profits where prices are high. The prevailing fear in local markets has given rise to the opportunity to buy South African bonds at wide discounts to what we think they are worth.

Interest rates offered by negotiable certificates of deposit (NCDs) are at similar levels to November 2017, when political and fiscal uncertainty was at an all-time high. 12-month NCDs are yielding roughly 8.3% and 60-month NCDs around 9.3%, an attractive real yield given the latest inflation number of 4.9% (August 2018). The market has therefore started to build in expectations of significant interest rate increases, guided by a more hawkish tone from the South Africa Reserve Bank (SARB). (At the SARB's Monetary Policy Committee meeting in September, three members voted to increase the repo rate.) While we believe that the bar for interest rate cuts has risen significantly in the short term, we do not expect the SARB to hike as aggressively as the market has begun to price in. As such, the margin of safety on money market interest rates has increased.

Portfolio positioning

Rising yields have seen us add to South African government bond positions. It is our view that risk is underwritten by the track record and credibility of the SARB in sustainably anchoring inflation expectations within the target band. We have also swapped some of our shorter-dated NCDs for longer-dated, higher-yielding counterparts. In addition, we sold lower-yielding corporate bonds.

Cash levels remain healthy, with the fund holding 64% in cash and NCDs. This is dry powder that we expect to employ if the opportunities we currently see in many domestic securities become more widespread.

Changes in portfolio positioning

Q2 2018			Q2 2018 Restated*	Q3 2018
Fixed-rate notes	67.4%	Domestic bonds	43.3%	35.6%
Floating-rate notes	25.3%	Domestic cash and NCDs	56.7%	64.4%
Domestic cash and NCDs	7.3%			

**Reclassified to align with other fund disclosures.*
There may be slight differences in the totals due to rounding.

All data as per Bloomberg to 30 September 2018.

Disclaimer

Collective Investment Schemes in Securities (CIS) are generally medium to long-term investments. The value of participatory interests (units) or the investment may go down as well as up and past performance is not a guide to future performance. Fluctuations or movements in the exchange rates may cause the value of underlying international investments to go up or down. CIS are traded at ruling prices and can engage in borrowing and scrip lending. The Fund may borrow up to 10% of its market value to bridge insufficient liquidity. Where foreign securities are included in a portfolio, the portfolio is exposed to risks such as potential constraints on liquidity and the repatriation of funds, macroeconomic, political, foreign exchange, tax, settlement and potential limitations on the availability of market information. The portfolios may be capped at any time in order for them to be managed in accordance with their mandate. Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and in such circumstances a process of ring-fencing of withdrawal instructions and managed payouts over time may be followed. PSG Collective Investments (RF) Limited does not provide any guarantee either with respect to the capital or the return of the portfolio. Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided.

Yield

The yield is calculated daily on an annualised basis. The calculation is based on the historic yield of fixed income instruments.

Performance

All performance data for a lump sum, net of fees, include income and assumes reinvestment of income on a NAV to NAV basis. Annualised performances show longer term performance rescaled over a 12 month period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Performance is calculated for the portfolio and individual investor performance may differ as a result thereof. The portfolio is valued at 15h00 daily. Income distributions are net of any applicable taxes. Actual annual figures are available to the investor on request. Prices are published daily and available on the website www.psg.co.za/asset-management and in the daily newspapers. Figures quoted are from Morningstar Inc.

Pricing

Forward pricing is used. Unit trust prices are calculated on a net asset value (NAV) basis, which is the market value of all assets in the Fund including income accruals less permissible deductions divided by the number of units in issue.

Company details

PSG Collective Investments (RF) Limited is registered as a CIS Manager with the Financial Sector Conduct Authority, and a member of the Association of Savings and Investments South Africa (ASISA) through its holdings company PSG Konsult Limited. The management of the portfolio is delegated to PSG Asset Management (Pty) Ltd, an authorised Financial Services Provider under the Financial Advisory and Intermediary Services Act 2002, FSP no 29524. PSG Asset Management (Pty) Ltd and PSG Collective Investments (RF) Limited are subsidiaries of PSG Konsult Limited. PSG Collective Investments (RF) Limited can be contacted on +27(21) 799 8000; (toll free) 0800 600 168, via email assetmanagement@psg.co.za.

Conflict of interest disclosure

The Fund may from time to time invest in a portolio managed by a related party. PSG Collective Investments (RF) Limited or the fund manager may negotiate a discount in fees charged by the underlying portfolio. All discounts negotiated are reinvested in the Fund for the benefit of the investors. Neither PSG Collective Investments (RF) Limited nor PSG Asset Management (Pty) Ltd retains any portion of such discount for their own accounts. The fund manager may use the brokerage services of a related party, PSG Securities Ltd.

Trustee

The Standard Bank of South Africa Limited,
Main Tower, Standard Bank Centre,
2 Hertzog Boulevard,
Cape Town, 8001
Tel: +27 21 401 2443
Email: Compliance-PSG@standardbank.co.za

Additional information

Additional information is available free of charge on the website www.psg.co.za/asset-management and may include publications, brochures, forms and annual reports.