Discovery

# Discovery Money Market Fund

## Market background

*Fast View*:

- Sharp upward moves in US yields weighed on global fixed income markets
- The Bank of Japan made its first interest rate hike in 17 years, effectively ending its negative interest rate policy
- EM sovereign debt had a mixed quarter, while corporate debt had a strong start to 2024
- EM currencies came under pressure over the quarter from the strong US dollar given the rise in US Treasury yields
- In the SA money market, one-year fixed-rate NCDs remained unchanged over the quarter

To read more, please click here.

## Performance review

Minutes released in February from the US Federal Reserve's (Fed) January meeting showed that most of its members thought moving too quickly to cut rates carried a bigger risk than keeping policy tighter for longer. US Treasury yields rose and the US dollar strengthened, and by the end of February, only 85 basis points (bps) of cuts were priced in by the market. Overall, US Treasury yields rose across the curve, with the 10-year Treasury yield rising from 3.88% to end the quarter at 4.20%. In Europe, 10-year yields climbed across the continent over the quarter, notably in Germany and France, with yields in the UK also rising. This was largely due to the currently high correlation between US and other government bond markets. In Japan, the main developments over the quarter came in March, as the Bank of Japan (BoJ) made its first interest rate hike in 17 years, effectively ending its negative interest rate policy. The bank's yield curve controls were also scrapped. The Bloomberg Barclays Global Aggregate Bond Index ended the quarter down 2.1% in US dollar terms.

It was a mixed quarter for emerging market sovereign debt from a performance perspective. The local bond index (JP Morgan Government Bond Index-EM) fell by 2.1%, with this being driven entirely by EM FX, while local bond returns were a slight positive (+0.2%). EM currencies came under pressure over the

quarter from the strong US dollar given the rise in US Treasury yields over the period. Locally, the JSE All Bond Index ended the quarter down 1.8%. In the money market, one-year fixed-rate negotiable certificates of deposit (NCDs) remained unchanged over the quarter, yielding 9.125%. The quarter was not without volatility, with the market initially rallying ahead of the Fed's FOMC meeting, with the short end of the US curve pricing in close to 175bps in Fed cuts at the start of the year to doubting if we would even get 75bps in Fed cuts by the end of the quarter. The short end of the SA market largely following suit. Cash, as measured by the STeFI Composite Index, delivered +2.11% over the same period. The rand managed to recoup some of losses in March but still ended the quarter down against the greenback, euro, and pound sterling.

For the quarter, the Fund outperformed the benchmark.

### Key positive contributions:

- Spreads in floating-rate notes (FRNs) remained attractive over the quarter. We continued to take advantage, locking into FRNs at attractive spreads and the excess yield over benchmark rates continues to be a positive contributor to performance.

### Key negative contributions:

- Excess liquidity in the market meant that there were fewer opportunities in the very short end of the cash yield curve.

## Portfolio activity

We continued to add floating-rate notes at attractive spreads.

## Outlook and strategy

### Global

Amid the intricate tapestry of global economies, resilient growth seems to be weaving a diverse range of perspectives. inflation is trending lower, growth is proving to be resilient, and corporate profits are holding ground, especially amid the AI frenzy. The 'soft landing' story has grown more legs, but beneath the surface, some fissures are emerging, revealing a shifting landscape; The US labour market is now showing signs of cooling from fever pitch, with job openings coming down by c.25% from early 2022 peaks, auto and credit card default rates have risen to pre-pandemic levels, similarly, high yield default rates are picking up momentum in the corporate space, while commercial real estate delinquencies continue to make news headlines. For the FOMC, delaying rate cuts on sticky inflation could see the soft-landing that is priced by markets morph into a mild recession, while premature delivery of rate cuts could trigger a rebound in inflation. We believe the Fed will continue to be data dependent, with the first cut only coming in the second half of the year. Across the Atlantic, the eurozone economy has surprised to the upside on the back of lower gas prices than initially feared pre-Russo-Ukrainian war, a recovery in bank lending, and the turning tide in global manufacturing output. We are likely to see the ECB deliver rate cuts before the Fed. Elsewhere, Japanese economic activity has also exceeded expectations, while wage growth and inflation have moved toward BOJ targets. The BOJ took the first

steps toward policy normalisation but still maintained a dovish posture while doing so, therefore, we do not expect more policy tightening any time soon.

In emerging markets (EMs), many central banks have already started to relax monetary policy (i.e., Mexico, Brazil, Hungary) as most EM central banks had already begun raising interest rates before their developed market counterparts. Indeed, disinflation has happened more quickly compared to developed markets. Some continue to raise interest rates due to FX shortages and runaway inflation, while others such as South Africa and India are standing pat as they wait for more evidence of a sustained deceleration in prices. Emerging market fundamentals have demonstrated resilience throughout the period of interest rate hikes, despite the challenges posed by US 'exceptionalism' and the slowdown in growth from China. We anticipate a positive shift in the narrative for EM in 2024. Expectations point to strong growth, although much of this relies on China's recovery. Newsflow from China remains a mixed bag given deflationary trends and property sector malaise. However, the 5% growth target set for 2024 seem too be a harbinger of more significant policy support to come, and this will provide the tailwind for emerging markets.

## Local

SA narrowly avoided a technical recession in Q4 2023 but only just. Demand conditions remain challenging and business activity lukewarm, with factory activity slipping back below the 50-point mark after a robust expansion just a month earlier. Ongoing power outages and logistical challenges at the ports have slightly improved in recent months which is encouraging. We expect rates to remain higher for longer and cuts to only come in the second half of the year. We welcome the extension of tenures on the MPC and addition Dr Mampho Modise as Deputy Governor as they signal institutional stability and policy certainty in a pivotal year for South Africa. Looking ahead, we expect growth to be a beneficiary of lower stages of loadshedding, some easing conditions at the ports, cooling inflation, and the subsequent relaxation of monetary policy. In politics, the noise continues to ratchet up as we approach the momentous National Elections in May. We are already seeing some of the uncertainty being priced into the local bond market.

## Positioning

While US exceptionalism continues, the rand continues to find support in bullion prices amid geopolitical tensions and concerns on sticky inflation. Locally, higher fuel prices have brought pressure on prices in the first quarter. The SARB left interest rates unchanged at 8.25% at its March meeting, highlighting upside risks to food inflation from dry and hot weather conditions, while rand weakness presents further risks as rate cuts get pushed further back in major economies. Wage negotiations in the mining sector have also come above inflation forecasts.

We expect inflation to average 5.1% in 2024 and to slow down to 4.5% in 2025 (SARB 5% in 2024, in line at 4.5% 2025).

We remain constructive on money market yields and believe they are fairly valued. We will look for opportunities to add duration into weakness.

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