Gilt Fund

Market context

Fast View:

- The 10-year US treasury yield declined over the quarter amid uncertainty about the US economic outlook
- The Fed held rates steady, citing concerns that US tariffs could stoke inflation
- German reforms drove 10-year bund yields sharply higher
- In SA, the GNU managed to pass the Budget without DA support

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Performance

For the quarter, the portfolio outperformed the benchmark.

US Treasury yields ended a volatile quarter lower, with the 10-year yield falling 36 basis points (bps) to 4.2%. This was driven by weakening global investor sentiment and rising uncertainty around the US economic outlook. By quarter-end, markets were pricing approximately 75bps of rate cuts in 2025 — 30bps higher than forecast at the start of the year. The US Federal Reserve (Fed) held rates steady, maintaining its projection for two rate cuts this year. Inflation expectations rose sharply in March, with the University of Michigan survey recording the highest long-term outlook over three decades. Global trade tensions escalated, with new tariffs imposed on China, Mexico, and Canada. In Europe, bond markets were marked by elevated volatility. Despite two 25bps rate cuts from the European Central Bank (ECB), bond yields rose sharply due to shifting fiscal dynamics, particularly increased defence spending. The yield spike was most pronounced in Germany, where loosening fiscal rules led to the most significant daily rise in 10-year bund yields since 1990.

Despite this turbulent backdrop, emerging market (EM) fixed income delivered positive returns. Falling US Treasury yields and uncertainty around tariffs led to a weaker dollar, which supported EM currencies. The JP Morgan GBI-EM local currency index returned 4.3%, with both rates and currency moves contributing. In South Africa, the rand strengthened on contained inflation and low fuel prices. Inflation printed at 3.2% year-on-year (y/y) in February; however, due to the global outlook, the South African Reserve Bank (SARB) held rates at 7.5% after cutting by 25bps in January.

For our fixed-income portfolios, the first quarter of 2025 was focused on protecting capital.

Local political risk added to global uncertainty, weighing on sentiment and the performance of South African Government Bonds (SAGBs). In response, we reduced duration across the portfolio to limit downside risk.

Inflation-linked bonds (ILBs) contributed positively, supported by inflation risks linked to global tariff escalation.

Our allocation to investment-grade credit continued to deliver yield-enhancing value.

Overall, cash delivered acceptable returns and offered stability in a risk-off environment, while other asset classes detracted from.

Outlook

Global: President Donald Trump imposed sweeping 10% tariffs on nearly all US trading partners, including China, the EU, Mexico, and Canada — sparking a sharp sell-off in global markets. This weighed on risk assets and emerging market currencies as fears of a renewed trade war grew. In retaliation, China introduced fresh tariffs on key US exports — including LNG, crude oil, and agricultural goods — and hinted at restricting rare earth exports. Chinese regulators also launched investigations into several US companies, escalating tensions in the ongoing tech rivalry. In response to weaker-than-expected Q1 data, China ramped up economic support measures. President Xi Jinping hosted a high-profile meeting with top business leaders and unveiled new fiscal stimulus: expanded infrastructure investment, support for consumption, and credit facilities for SMEs and real estate. Europe shifted its focus toward defence and industrial resilience. Germany eased constitutional debt limits to facilitate over €1 trillion in long-term spending. The EU launched its €800 billion "ReArm Europe" initiative to boost reindustrialisation and autonomy. Inflation eased slightly, and sentiment improved modestly — though caution remains given external risks. Trade tensions, geopolitical realignment, and uneven global growth dominated the first quarter of 2025. With protectionism rising and policy divergence widening, markets remain fragile. A full-scale trade war could significantly slow global growth, particularly in China and Europe. We are monitoring developments closely to assess the impact on portfolio positioning, capital flows, and sentiment.

South Africa: The quarter highlighted the challenges of coalition governance. Disagreements within the Government of National Unity (GNU) delayed the Budget, originally due in February, over a proposed 2% VAT increase. Although the Budget was eventually passed in April, it lacked support from the DA – the second biggest coalition party, raising concerns about GNU cohesion. Inflation remained steady at 3.2% in February, while GDP rose 0.6% in Q4 2024 — narrowly avoiding a technical recession. However, weak manufacturing and mining data persisted. The SARB held rates amid global uncertainty and fragile local fundamentals. While 64% of South Africa's exports to the US are minerals — and thus unaffected by US tariffs — sectors like agriculture and motor manufacturing are more exposed. These could face pressure, with knock-on effects on growth and employment.

Positioning

Local political risk added to global uncertainty. Therefore, we reduced SAGB exposure and shifted focus from the long to the short end of the yield curve. Central banks are expected to cut rates more than anticipated, supporting shorter maturities.

Our ILB exposure gradually increased as it provided positive returns amid inflation concerns.

We maintain a neutral stance on credit, which has been stable and additive to portfolio returns.

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