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NAM CORONATION STRATEGIC INCOME FUND
QUARTERLY COMMENTARY Q1-25

Please note that the commentary is for the retail class of the Fund.

Performance and fund positioning

The Fund returned 0.61% in March, bringing its 12-month total return to 11.1%, which is ahead of cash at 8.3% over the same period. We believe the Fund's current positioning offers the best probability of achieving its cash +2% objective over the medium to longer term.

The first quarter of 2025 was marked by significant shifts in global financial markets that have reverberated through Namibia and South Africa (SA)'s economic landscape. Central banks, including the US Federal Reserve, signalled a cautious pivot, balancing growth concerns with persistent cost-of-living challenges. Global risk sentiment has soured as investors recalibrate their views and appetites amid new tariff policies and a strengthening dollar. The uncertainty on the magnitude of the impact of the Trump administration's tariffs, counter-tariffs by affected countries, the deteriorating diplomatic relationship between the US and SA, and recent tremors within the Government of National Unity (GNU) around the Budget have weakened the appeal of SA assets.

Namibia is navigating a political transition following the swearing in of the country's first female president, Netumbo Nandi-Ndaitwah in March. The new administration faces a myriad of social and economic challenges including high unemployment levels and an increasingly challenging global economic environment. Namibia's prospects remain positive, but several risks including the new administration's policy framework, a volatile commodity market (particularly for the diamond sector which is crucial for the country's revenue) remain.

Namibian government bonds had a challenging quarter, weighed down by ongoing global uncertainty. Yields on the longer end of the Namibian bond curve continued to rise, driven by continued weakness across the benchmark curve. In March, spreads across the curve tightened on average, by 5 bps, with the short end (1-3 years to maturity) seeing the biggest moves down by 25 and 17 bps while the average 4 bps tightening in spreads on the long-end of the curve (bonds with maturities of 15+ years) mitigated some of the benchmark-driven weakness. Treasury Bill yields declined during the quarter, although, there was a slight uptick toward the end of March.

Despite US bond yields compressing 30 basis points (bps) over the quarter, the SA 10-year bond weakened by c.30bps due to SA-idiosyncratic issues (SA-US tensions and uncertainty with regards to Budget outcomes), driven by the steepening of the yield curve (maturities of 10-years plus moving more than shorter maturity yields). The FTSE/JSE All Bond Index (ALBI) and the FTSE/JSE InflationLinked Bond Index (CILI) were both up 0.7% by the end of the quarter, behind cash at 1.83%, but still well ahead over the last 12 months (ALBI 20.16%; CILI 8.93%; cash 8.03%). Emerging markets remained on the back foot through most of the last 12 months; however, in the last quarter, the dollar weakened slightly. The rand was among the beneficiaries, strengthening 2.8% during the quarter, leaving it c.50 cents stronger than the same point last year (18.84 versus 18.33). This helped the local bonds outperform global bonds in dollars (3.53% versus

2.57%) and keeps their performance well ahead of their global counterparts over the last 12 months (23.43% versus 2.10%).

March saw major developed markets' central banks maintaining a cautious stance on policy rates. Rising geopolitical tensions continued to dominate financial market news flow, raising uncertainty, and creating potential headwinds for inflation and economic activity in 2025. Inflation readings, in general, reflected slower-than-expected price moderations.

The Federal Reserve Board (the Fed) left the target range for the federal funds rate unchanged at 4.25% to 4.5% at the March Federal Open Market Committee (FOMC) meeting. The FOMC observed that there has been some moderation in consumer spending, and it is yet to be seen how tariffs will impact consumer spending and investment. The Fed downgraded its expected growth forecast and increased its inflation forecast for 2025 owing to the volatile global trading environment.
US headline inflation slowed down to 2.8% year on year (y/y) in February from 3.0% y/y in January, while core inflation eased to 3.1% y/y from 3.3% y/y. The decline was due to a moderation in food, energy, new and old vehicles, medical care, and transportation costs. There was a slight increase in apparel prices, while housing costs were flat.

The rand ended the month at R18.32/US$1, stronger than its close in the previous month but in line with its Emerging Market peer group. Offshore credit assets and certain developed market bonds continue to flag as relatively attractive. The Fund has utilised a significant part of its offshore allowance to invest in these assets. When valuations are stretched, the Fund will hedge/unhedge portions of its offshore exposure back into rands/dollars by selling/buying JSE-traded currency futures (US dollars, UK pounds, and euros). These instruments are used to adjust the Fund's exposure synthetically, allowing it to maintain its core holdings in offshore assets.

The South African Reserve Bank (SARB) left the repo rate unchanged at 7.5% at the March MPC meeting. Two members voted for a 25bps cut while four voted to hold, signalling a change in the unanimous voting observed in the past meetings. The SARB lowered inflation forecasts for 2025 and noted that growth has been disappointing and having reduced expectations for domestic demand. The MPC seems to be showing a clear preference for higher real rates and a more restrictive stance than seems warranted, despite the lowering of inflation forecasts, well-anchored expectations at the target, and disappointing domestic demand.

SA headline inflation remained unchanged at 3.2% y/y in February, while core inflation slowed to 3.4% y/y from 3.5% y/y. Increases in food and non-alcoholic beverages, housing and household utilities were offset by a decline in fuel prices. Broadly, several factors have helped bring the forecast profile for CPI lower over the past few months. These include currency resilience, falling international oil prices, low food inflation, weak rentals, and the impact of the reweighted CPI basket, which increased the weight of some of the lower inflation components.

The recent Trump administration tariffs, combined with the loss of business confidence in SA due to the GNU instability, risk placing growth on a lower path. Real policy rates in SA are now at the most restrictive levels that they have been at since the early 2000s when inflation was in double digits, growth was c.4%, and SA was only starting its inflation-targeting journey. Inflation is now very much under control at 4.5%, but growth prospects remain in the doldrums. Why is it, then, that the SARB maintains real policy rates north of 4% when the historical norm has been 1.5%-2%? It is implicitly targeting inflation at a lower point (3%-3.5%). We maintain that a lower inflation target over the longer term is beneficial; however, the high cost of funding in the local economy at a point when growth is faltering, is throttling the recovery, and rates should be 100bps to 150bps lower given current conditions. Unfortunately, the SARB is probably going to remain on this path, at best keeping rates stable going forward, unless global growth forces its hand. This might happen as the effects of the tariff hikes make their way through to the global economy.

At the end of March, shorter-dated SA fixed-rate negotiable certificates of deposit (NCDs) traded at 8.27% (three-year) and 8.77% (five-year), with both maturities slightly lower compared to the end of the previous month. Our inflation expectations suggest that the current pricing of these instruments remains attractive due to their lower modified duration and, hence, high breakeven relative to cash.
In addition, NCDs have the added benefit of being liquid, thus aligning the Fund's liquidity with the needs of its investors. The Fund continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

SA's recent Budget turmoil highlights the very difficult task that the country faces given its excessive debt load. On face value, the Budget sticks to its fiscal consolidation path by financing all new expenditure (increased front-line workers, Social Relief of Distress Grant and funding costs) through increased revenue measures (VAT hike, bracket creep and use of unallocated reserves). However, the increased expenditure is recurring and fixed, implying any fall off in growth and thus revenue, will create a larger funding shortfall. As a result, this will further reduce fiscal buffers and increase the risks of a higher debt load going forward.

Anaemic growth is at the heart of SA's fiscal mess. The formation of the GNU, which included the probusiness DA, helped bolster investor sentiment and removed downside tail risk from SA's policy choices. While we have not yet seen significant policy shifts, the presence of the DA in the coalition government was enough to halt deterioration, reduce slippage, and prioritise needed reforms, fostering an environment in which growth could accelerate towards 2%. This is still substantially lower than what's needed but higher than that of the last decade. At the time of writing, it seems very likely that this arrangement will not continue in its current form, that is, the DA will either leave the GNU or be removed from its current positions within government. This will be a significant step back in SA's recovery story and places the fiscal rehabilitation in great peril. Much of the reform process was started before the formation of the GNU and will definitely continue, but the risk is that the urgency behind implementation fades, lowering the growth trajectory. In addition, the recent Trump tariff actions will lower global growth, maybe not into recession, but enough to hurt a small export-driven economy on the southern tip of Africa.

The changes in the global landscape have become less favourable for risk and emerging market assets. The effects of a global trade war will leave global growth floundering, and export-driven economies will struggle in such an environment. The slowdown in global growth, once the immediate inflationary shock retreats, should compel global monetary policy to turn supportive, thus supporting global developed market fixed income. SA's recent political turbulence makes it ill-placed in an unfriendly world. Local inflation should remain relatively well behaved, but a growth slowdown will have negative consequences for the country's finances, suggesting a further risk premium needing to be priced into local bond yields. This would be further solidified if the GNU is reconfigured in a manner that is less supportive of growth and business. SA bonds are at risk of a wider repricing in yields, and bond portfolios should remain neutral but ready to take advantage of weakness when it prevails. In addition, ILBs should be present in portfolios to provide some risk offset should the worst outcome materialise.

SA's listed property sector was down 1.54% over the month, bringing its 12-month return to 20.13%. Operational performance will remain in the spotlight as an indicator of the pace and depth of the sector's recovery. The current increase in the cost base, due to higher administered prices and second-round effects on deteriorating infrastructure in much of the country, will weigh on the sector's earnings in the coming year. We believe that one must remain cautious given the high levels of uncertainty around the strength and durability of the local recovery.

SA credit spreads are at historically tight levels due to low levels of issuance and large swaths of capital looking for a home with reduced volatility. The use of structured products, such as credit-linked notes (CLNs), has become ubiquitous within the local market. This sector has grown exponentially over the last five years and has reached a market size of over R100 billion. However, only a third of this market reprices, creating an inaccurate representation of asset volatility and pricing. CLNs mask the underlying/see-through credit risk as the issuing entity (predominantly local banks) is seen as the primary credit risk.

The increased usage of CLNs has not expanded the pool of borrowers; rather, it has only served to concentrate it. This is due to the ability to limit the volatility of these instruments by not marking them to market based on the underlying asset price movements. The combination of attractive yields and no volatility is an opportunity that not many would pass up, unless, of course, transparency of pricing is important to the underlying investor. As a result, there can be significant unseen risks within fixed income funds. Investors need to remain prudently focused on finding assets of which the valuations are correctly aligned to fundamentals and efficient market pricing. Except for a few opportunities, we view the local credit market as unattractive relative to other asset classes.

Outlook

We remain vigilant of the risks from the dislocations between stretched valuations and the local economy's underlying fundamentals. However, we believe that the Fund's current positioning correctly reflects appropriate levels of caution, while its yield of 9.25% (gross of fees) remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected portfolio performance over the next 12 months. As is evident, we remain cautious in our management of the Fund. We continue to invest only in assets and instruments that we believe have the correct risk and term premium to limit investor downside and enhance yield.

Portfolio managers

Nishan Maharaj and Mauro Longano
as at 31 March 2025