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NAM CORONATION STRATEGIC INCOME FUND

QUARTERLY COMMENTARY Q3-25

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

Performance and fund positioning

The Fund returned 0.95% in September, bringing its 12-month total return to 9.23%, which is ahead of cash (7.81%) 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 third quarter of 2025 (Q3-25) highlighted the delicate balance between geopolitics and markets. Rising tensions in the Middle East, renewed US trade protectionism, and South Africa's (SA) governance challenges underscored persistent political risks, yet financial markets remained resilient. Global bonds rallied as the Federal Reserve Board (the Fed) cut rates for the first time in this cycle and inflation trended lower. Emerging market bonds continued to benefit from structural resilience and ongoing policy rate cuts, with several central banks extending their easing cycles to support growth. SA assets displayed resilience despite lingering concerns around fiscal consolidation and the pace of inflation target reforms. This can be attributed to a more stable investor sentiment on the back of improved clarity from the Government of National Unity (GNU), contained inflation data, and increased expectations of further interest rate cuts.

The FTSE/JSE All Bond Index (ALBI) gained further ground in Q3-25, delivering a 6.94% return for the quarter and extending its 12-month performance to 14.51%. The SA 10-year bond yield tightened by a further 50 basis points (bps) during the quarter; however, performance was strongest in the maturities of greater than 12 years as the yield curve flattened (bonds in the 20-30-year area rallied by 10-20bps more than the 10-year bond). Inflation-linked bonds (ILBs) staged a modest recovery, gaining 5.11% over the quarter, bringing their one-year return to 7.66%. This is still well behind nominal bonds but at least ahead of cash (1.76% quarter to date [qtd] and 7.56% over 12 months). The rand remained volatile but continued to strengthen against the US dollar, slightly outperforming its peers over the quarter. Continued US dollar weakness has bolstered returns from Emerging Market (EM) fixed income assets, which have helped SA bonds outperform developed market bonds (the FTSE World Government Bond Index returned -2.32% qtd and 1.59% over 12 months in rands).

The rand ended the month at R17.270/US$1, stronger than its close in the previous month but weaker than its EM 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 offshore assets become expensive (or relatively cheap), the Fund may adjust its foreign currency exposure by buying or selling currency futures on the JSE (typically in US dollars, UK pounds, or euros). This helps the Fund fine-tune its exposure to global markets without having to sell its offshore investments.

September was dominated by central bank meetings, with the majority of them maintaining their monetary policy settings. Inflation readings remain sticky, and inflationary pressures continue to be mixed.

Nonetheless, forecasting economic performance remains a challenge amidst a highly uncertain global trading environment.

The Fed cut the Federal Funds rate target range by 25bps, moving the range to 4.0%-4.25% at the September Federal Open Market Committee meeting. The Fed noted that economic activity had moderated in the first half of the year and that the labour market dynamics were soft. The unemployment rate had edged up slightly, although it remains low relative to historical levels. The Fed reiterated that it would proceed with caution and future rate decisions will be data dependent.

US headline inflation edged up to 2.9% year on year (y/y) in August from 2.7% y/y in July, while core inflation was unchanged at 3.1% y/y. The main drivers of the uptick were increases in food, energy, and vehicle prices. Shelter, apparel, and services costs remained steady.

The SA economy grew by 0.8% quarter on quarter (q/q) in the second quarter of 2025 (Q2-25), following growth of 0.1% q/q in the first quarter of the year. On the production side, growth was supported by the agricultural sector as well as a rebound in activity from a weak base in the mining, manufacturing, and trade industries. Transport, storage, and communications detracted. On the expenditure side, positive contributions came from household and government spending, which were enough to offset weak gross fixed capital formation and negative net exports. If sustained, the Q2-25 momentum could lift real GDP above 0.8% in 2025, setting a more positive base for 2026. However, critical to this improvement will be a stronger recovery in private capital expenditure, which has picked up but remains fragile.

The SA Reserve Bank (SARB) left the repo rate unchanged at 7% at the September MPC meeting. The MPC noted resilient global growth despite ongoing geopolitical and tariff-related uncertainty. SA's Q2-25 GDP print was a positive surprise, prompting upward revisions to growth forecasts. At the same time, inflation numbers were also revised up from July's very low base to reflect higher food and fuel inflation and higher administrative prices.

SA headline inflation eased to 3.3% y/y in August from 3.5% y/y in July, while core increased to 3.1% y/y from 3.0% y/y. There was a surprise moderation in food prices and a reduction in transport costs, which helped limit headline gains. Services inflation remained steady, while administered prices and utilities costs increased. A combination of base effects and, at the margin, less favourable fuel price dynamics should see CPI tick up to 4% in the coming months, although August's print will help lower the trajectory. The latest inflation numbers create a less challenging trajectory for the MPC to navigate than before. Coupled with very contained core price pressures, supportive currency and oil price dynamics, as well as a moderation in the recent inflation expectations survey, should bolster the case for a rate cut.

Namibian markets moderately tracked the positive regional trend during the quarter. Government bonds delivered steady returns as yields eased slightly, reflecting expectations that the Bank of Namibia may follow the South African Reserve Bank's eventual policy easing. The Namibia dollar strengthened alongside the rand, providing some relief on import costs but weighing modestly on export competitiveness. Overall, market sentiment remained cautiously optimistic, supported by stable macroeconomic conditions and improved liquidity in local assets.

At the end of September, SA shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 7.54% (three-year) and 7.97% (five-year), with both maturities 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.

Despite the recovery in ILBs over the last quarter, they still remain poor performers relative to cash and bonds over the long term. The general assumption is that the lower inflation target should result in a poor outcome for ILBs. However, it is important to differentiate between the various parts of the ILB curve and their sensitivity to policy rates. The five-year ILB is very sensitive to the real policy rate. Over the last few years, the SARB has maintained the real policy rate quite high to force inflation lower. This has acted as a floor for how low five-year ILB yields can go. Our expectation is for the real policy rate to move lower from here over the next year, towards 2.5%, as the SARB reduces the repo rate and inflation heads slightly higher. Consequently, five-year ILBs (or shorter) could likely track lower as well, from current levels of 4.3%.

The current five-year ILB is at 4.3% versus the coincident real policy rate at 3%. If the real policy rate does decrease to 2.5% as we expect, it makes sense for the five-year ILB (or shorter) to track lower by at least 50bps. This will result in a total return of 9%, even if inflation averages 3% over the period (9.5% if inflation averages 3.5% over the period), meaning the five-year nominal bond will need to rally by more than 50bps to keep pace. This is unlikely given that we only expect the repo rate to move lower by another 50bps over the next year. Therefore, five-year ILBs still make an attractive alternative to allocating to shorter-dated nominal bonds. They also provide portfolios with inherent protection in the event of a risk-off environment, due to their lower correlation to nominal bonds during these periods.

The global landscape remains uncertain; however, emerging markets have continued to outperform developed markets. SAGBs have flourished as local anxiety has eased and expectations for a lower inflation target have bolstered prospects for a lower repo rate. They are now trading slightly below fair value. Global bond flows have turned more supportive of EMs, given their relatively cleaner balance sheets, and could support further compression in bond yields if that trend sustains its momentum. The accumulation of risks suggests that some caution is warranted in allocating more capital to SAGBs at current yields; however, shorter-maturity ILBs offer an attractive alternative allocation, given the possibility of a lower real policy rate. As such, we would advocate for a neutral position in SAGBs, weighted more towards the 10- to 12-year area, with a decent allocation to shorterdated ILBs in bond portfolios.

Namibian bonds showed steady performance during Q3 2025, with the IJG All Bond Index returning 4.0% and the IJG Inflation-Linked Bond Index (ILB) delivering 1.3%. While yields tightened considerably across the short-to-belly of the curve, the Namibian yield curve strengthened by an average 23bps. The belly of the curve (bonds maturing in 7-12 years) closed 2.33% higher over the month, while medium-term bonds (maturing in 3-7 years) posted 1.07%, and short-term bonds (maturing in 1-3 years) returned 0.71%. The GC40 and GC50 bonds outperformed with 1-month returns of 4.58% and 4.38% after 50bps and 42bps yield compressions. Treasury bills remained anchored by the repo rate which was maintained at 6.75% at the August MPC meeting. Given the elevated demand, yields across the Namibian curve tightened during the quarter.

The SA listed property sector was down 1% over the month, bringing its 12-month return to 11.43%. The durability of the 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 issuance volumes and a large amount of capital seeking 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 experienced exponential growth over the last five years, reaching 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 absence of 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 SA credit market as unattractive relative to other asset classes.

Outlook

We remain vigilant of the risks from the dislocations between stretched valuations and the economy's underlying fundamentals. However, we believe that the Fund's current positioning accurately reflects the appropriate level of caution, while its yield of 8.49% (gross of fees) remains attractive in relation 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 30 September 2025