QIR Quarterly investor report Q3

as at 30 September 2017

GRANATE ASSET MANAGEMENT | Part of RMI Investment Managers

Granate Unconstrained Fixed Interest Fund

Collective Investment Scheme (CIS) portfolio

Assets managed by: Granate Asset Management (Pty) Ltd

Managers corner

Granate Asset Management is a boutique investment manager, powered by RMI Investment Managers, that specialises in generating stable and growing income solutions for investors whilst preserving capital.

Granate Asset Management (Granate) is part of RMI Investment Managers (RMI IM) and is the vehicle for 'lifting out' investment teams and providing them with an investment management operating platform to manage client investments. The business is set up to attract investment teams that have the ability to raise third-party client investments off their experience, track record and reputation but understand that it is difficult to establish a business on their own given the financial capital and operational requirements to do so. RMI IM is a supportive non-interfering shareholder that provides working and seed capital, operational infrastructure and distribution capability for the investment teams of Granate. RMI IM and the Granate team members share in the economic success of the business, creating an ownership culture among the investment teams, much like the other affiliates of RMI IM. As a result, this appeals to investment teams that want to be more entrepreneurial by creating a business inside a business rather than the typical salary and bonus structure of traditional investment managers.

Meet your managers

Jonathan Myerson
M.Soc.Sci. (Economics)

Head of Fixed Interest

Prior to starting as Head of Fixed Interest at RMI Specialist Managers (now Granate Asset Management) in December 2015, Jonathan served as the Head of the Fixed Interest Team at Cadiz Asset Management (2006-2015) where he managed the Unconstrained, House View and Inflation-Linked Bond funds. Jonathan's experience includes 11 years of being on the sell-side where he worked as a Fixed Interest Strategist at HSBC (1995-2003) and then at RMB (2003-2006). Jonathan holds a M.Soc.Sci. (Economics) from University of Cape Town.

Managed portfolio since 01 Apr 2016

Managers view

Economic overview

Global economic activity in the 3rd quarter of 2017 continued its broad-based improvement as reflected by economic indicators in major developed and emerging markets. Inflation ticked up moderately in developed markets but remains significantly lower than central bank targets despite tightening labour markets.

Major central banks kept their lending rates unchanged during the 3rd quarter, but the general tune was hawkish. Given economic developments and central bank communications the market has moved to price in a high probability of a policy rate hike in the UK and US this year, but little prospects of higher rates in Japan and the Eurozone anytime soon. In its September meeting the US Federal Reserve confirmed that it will begin implementing its balance sheet normalisation program in October.

Domestic economic data releases during the 3rd quarter suggest that the economy continues to grow after emerging from a recession in the 2nd quarter, albeit at a significantly lower pace. Most production and consumption data releases remain weak as do consumer and business confidence indicators. Alarmingly, private sector investment which declined by 7.5% in the 2nd quarter remains on a weakening trend. The widening growth gap between South Africa and the world economy should be of great concern. However, the still robust global growth suggests that even a small improvement in domestic confidence could result in a strong boost to local growth.

In South Africa, the Monetary Policy Committee (MPC) of the Reserve Bank met twice in the 3rd quarter surprising the market on both occasions. At its July meeting the MPC surprised by lowering the repo rate by 25 basis points to 6.75%. The MPC's decision to cut rates was driven by material downward revisions to the SARB's GDP and inflation forecasts. By September the market was pricing a further 25 basis point rate cut, but the MPC decided to keep it unchanged based on its view that the balance of inflation risks was "somewhat to the upside". Ultimately, the MPC decision seems to have been predicated on 3 interrelated risks: (1) fiscal outlook; (2) outcome of the ANC electoral conference; and (3) rating downgrade.

Given the MPC's reasons not to cut the repo rate in September we consider it unlikely that they will cut again this year. Furthermore, given that inflation will bottom in the 1st quarter of 2018, prospects for further rate cuts in this cycle have declined significantly.

Market overview

Domestic financial assets had a strong 3rd quarter of 2017 outperforming, on aggregate, both developed and emerging aggregates.

The equity sector was the best performing domestic asset class (+9.4%) followed by property (+5.8%) and bonds (+3.2%). Inflation-linked bonds had another poor quarter (+1.1%) underperforming money market (+1.8%). For the 12 months to the end of September all domestic asset classes offered positive inflation adjusted returns other than inflation-linked bonds which lagged inflation by approximately 4%.

Domestic bonds performed in line with global markets, the yield on the benchmark 10yr bond, after a short spike in the 1st week of the quarter to a yield of 8.91% trended down to a mid-September low of 8.385%. The yield move pattern during the quarter closely resembled the move in US Treasuries, implying that there was little increase in South Africa specific risk in domestic bond yields. This is also confirmed by the strong demand for South African bonds by foreign investors who increased their exposure by a further R30bn during the quarter. The last two weeks of the quarter, however, saw global bond yields coming under pressure, once again following the US Treasury lead. Concerningly, this could be a sign of things to come once Balance Sheet reduction by the US Federal Reserve gains some momentum and global rates rise.

Portfolio overview

We kept a relatively low interest rate risk exposure in the portfolio during the quarter as we maintain the view that the risk to bond yields is asymmetric in an environment of deteriorating policy certainty. This despite the fact that from a cyclical perspective bond yields remain at levels above "fair value".

The portfolio's asset class exposure too remained defensive with property, fixed rate bonds, and inflation-linked bonds at less than half of the portfolio's longer term strategic asset allocation. In the fixed rate space, we cut our exposure to shorter dated maturities. We continued to selectively buy high quality floating rate non-government bonds into the portfolio. In particular, we maintain our preference for subordinated and hybrid bank bonds. However, given the tightening in spreads over the recent while, we have not fully invested new cash flows into this asset class, but have rather allowed for a cash and fixed deposit built up.

Of the more "risky" assets the portfolio's exposure to property remains low with only 4 counters which we believe have longer term good growth prospects. The exposure to inflation-linked bonds has also been ramped up from 2.7% to 6.1%, but remains concentrated in the short-end of the yield curve where valuations appear appealing and their defensive nature is largest. The portfolio does not currently hold any long dated inflation-linked bonds.

Portfolio positioning

We have maintained an uncharacteristically low risk position on the fund for a few quarters as South Africa's economy is performing poorly with long-term implications for interest rates. The 4th quarter holds many domestic and foreign events which we consider to be key for the trajectory of interest rates going forward. In particular, we have focused extensively on the impact of the poor economic performance on the fiscal outlook and what it means for bonds.

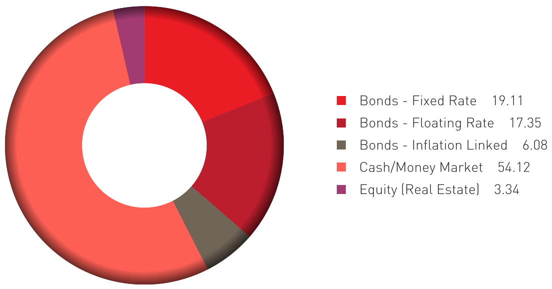
Our bond valuation model is showing that domestic nominal bonds continue to offer better than fair risk compensation. Furthermore, the poor fiscal outlook is at least partially priced into bonds suggesting that it is a good time to increase interest rate risk in the portfolio. Furthermore, with such poor expectations for domestic growth over the next two to three years, we are concerned that the market is underestimating the prospects for a fair bounce in business and consumer confidence (from extremely depressed levels) and its positive impact on growth with some associated fiscal relief. We will therefore look to use the significant liquidity which we have built in the portfolio to move the portfolio closer to its long-term strategic asset allocation holdings which imply increasing interest rate risk to more "normal" levels during the quarter.

Facts and figures

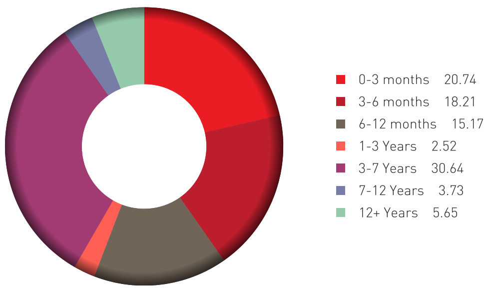
Holdings

Q3 2017

Portfolio allocation (%)

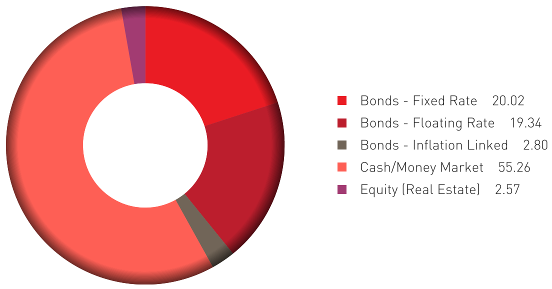


Maturity spread (%)

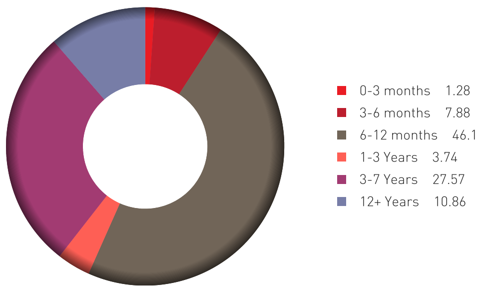


Q2 2017

Portfolio allocation (%)

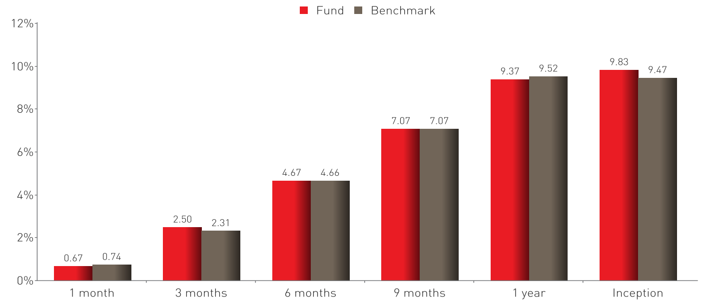


Maturity spread (%)



Performance

Returns (%)



Cumulative for all periods less than 1 year, annualised for all longer periods.

Fund: Granate Unconstrained Fixed Interest Fund Class A (Inception 1 April 2016)   Benchmark: STeFI Composite Index x 1.25

All portfolio performance is calculated for a portfolio/portfolio class. Individual investor returns may differ as a result of fees, actual date(s) of investment, date(s) of reinvestment of income and withholding tax. Annualised returns, also known as Compound Annualised Growth Rates (CAGR), are calculated from cumulative returns; they provide an indication of the average annual return achieved from an investment that was held for the stated time period. Actual annual figures are available from the Manager on request. All portfolio performance figures quoted (tables and charts where present) are as at 30/09/2017, based on a lump sum investment, using NAV-NAV prices with income distributions reinvested on the ex-dividend date. CPI/Inflation figures, where present, are lagged by one month. Cash figures, where present, are STeFI Composite Index returns. All figures quoted in ZAR. Source: Morningstar and/or Momentum.

Information

Granate Unconstrained Fixed Interest Fund

R 308.95 million

Class	Status	Direct Retail	Cost Ratios as at 30 June 2017				FYE	Price, Participatory Interests and AUM			MDD
			TER (%)	TC (%)	TIC (%)	From	TER (%)	NAV Price (cpu)	Units in issue	Size (Rands)	
A	Open	Yes	1.02	0.03	1.05	4 Apr 2016	1.02	104.71	14,855,188	15,556,119	
B	Open	No	0.80	0.03	0.83	4 Apr 2016	0.80	104.78	68,200,872	71,461,664	
B2	Open	No	0.52	0.01	0.53	12 Apr 2017	N/A	104.74	211,859,149	221,918,797	
C	Open	No	0.06	0.02	0.08	5 Jul 2016	0.06	104.98	10,801	11,339	

Class, Status, Direct Retail: A portfolio may have multiple classes, each of which may be open or closed to new investment, not all classes of a portfolio are available for direct retail investment as the different classes may be designed for/accessible to different investor types.

Cost Ratios: The Total Expense Ratio (TER) is the percentage of the net asset value of the class of the Financial Product incurred as expenses relating to the administration of the Financial Product. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. A current TER may not necessarily be an accurate indication of future TER's. The disclosed TERs are shown as an annual percentage based on data for the period from the date shown to 30 June 2017. The Transaction Costs Ratio (TC) is the percentage of the net asset value of the Financial Product incurred as costs relating to the buying and selling of the assets underlying the Financial Product. Transaction costs are a necessary cost in administering the Financial Product and impact Financial Product returns. The TC should not be considered in isolation as returns may be impacted by many other factors over time including market returns, the type of Financial Product, the investment decisions of the investment manager and the TER. The disclosed TC is shown as an annual percentage based on data for the period from the date shown to 30 June 2017. The Total Investment Charges (TIC) is the sum of the TER of the relevant class and the TC of the Financial Product and is shown as a percentage depicting the annual costs relating to the investment of the Financial Product. Cost ratios are calculated using historical actual and/or estimated data and are provided solely as an indication/guide as to the annual expenses/costs that could be incurred. These ratios do not represent any current/actual charges or fees.

FYE: The disclosed Financial year end TERs (total expense ratios) are shown as an annual percentage based on data for the 1 year period to 30 June 2017. No Financial year end TERs (total expense ratios) are disclosed for portfolios/portfolio classes that had not been in existence for 1 year as at the relevant financial year end.

Price, Participatory Interests and AUM: Data as at 30 September 2017

MDD: CIS regulations require a minimum disclosure document (MDD) to be compiled for all CIS portfolios, which must be viewed by an investor at point of sale. A link to the MDD that corresponds to the date of this QIR has been provided in the table above (for the relevant class of the portfolio) and we recommend that you review the MDD for further details on this portfolio.

Important information

Disclosures

Portfolio

Momentum Collective Investments (RF) (Pty) Ltd (the "Manager"), registration number 1987/004287/07, is authorised in terms of the Collective Investment Schemes Control Act, No 45 of 2002 (CISCA) to administer Collective Investment Schemes (CIS) in Securities. The Manager is the manager of the Momentum Collective Investments Scheme, and MMI Holdings Ltd is a full member of the Association for Savings and Investment SA. Standard Bank of South Africa Limited, registration number 1962/000738/06, is the trustee of the scheme.
Granate Unconstrained Fixed Interest Fund is a portfolio of the Momentum Collective Investments Scheme and Granate Asset Management (Pty) Ltd, registration number: 2015/090537/07, an authorised financial services provider ("FSP") under the Financial Advisory and Intermediary Services Act No. 37 of 2002 ("FAIS"), FSP number: 46189, is the investment manager of this portfolio.
Granate Unconstrained Fixed Interest Fund is an incubator portfolio, operating under an agreement entered into between the Manager and Granate Asset Management (Pty) Ltd, registration number: 2015/090537/07, an authorised FSP under FAIS, FSP number: 46189. An incubator portfolio is a third party named portfolio bearing the name of the FSP who intends to apply to the Registrar to be approved as a manager within three years from approval of the portfolio, where the FSP undertakes financial services of a discretionary nature, as contemplated in FAIS, in relation to the assets of the portfolio. The Manager retains full legal responsibility for all third party named portfolios under the Momentum Collective Investments Scheme. This information is not advice, as defined in the Financial Advisory and Intermediary Services Act (No. 37 of 2002). Please note that there may be representatives of the FSP acting under supervision. Your financial adviser may be a related party to the FSP and/or the Manager of this portfolio. It is your financial adviser's responsibility to disclose details of any conflicts of interests that may apply, as well as all fees that they receive, in relation to an investment in this portfolio.
Granate Unconstrained Fixed Interest Fund is a portfolio that derives its income primarily from interest-bearing instruments. The yield (where present) is current and calculated daily.
The main source of risk in this portfolio is interest rate risk, to a lesser extent credit risk; liquidity risk and exchange rate risk also apply. Capital losses can occur if, for example, one of the issuers of an instrument held by the portfolio defaults. In this event, losses will be borne by the portfolio and its investors.

Collective Investment Schemes (CIS)

CIS are generally medium to long-term investments. The value of participatory interests may go down as well as up and past performance is not necessarily a guide to the future. CIS are traded at ruling prices and can engage in borrowing and scrip lending. The CIS may borrow up to 10% of the market value of the portfolio to bridge insufficient liquidity. Different classes of units apply to portfolios, which are subject to different fees and charges. A schedule of fees and charges and maximum commissions is available on request from the Manager. The Manager reserves the right to close and reopen certain portfolios to new investors from time to time in order to manage them more efficiently in accordance with their mandate. Portfolios are valued daily at approx. 15h00, latest prices can be viewed at www.momentuminv.co.za and in some national newspapers. Forward pricing is used. Instructions must reach the Manager before 15h00 to ensure same-day value. The Manager does not provide any guarantee, either with respect to the capital or the return of this portfolio. Additional information on the proposed investment including, but not limited to, brochures, application forms and the annual report and any half yearly report can be obtained, free of charge, at www.momentuminv.co.za or on request from the Manager.

Any forecasts and/or commentary included in this document about the expected future performance of portfolios, asset classes or the market in general are not guaranteed to occur.

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Contact details

Scheme

Momentum Collective Investments Scheme

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Registration no.: 1987/004287/07

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