GRANATE
ASSET MANAGEMENT

Part of RMI
Investment Managers

QUARTERLY COMMENTARY – Q4 December 2017

Granate *SCI Money Market Fund

Fund Profile

The objective of the Granate SCI Money Market Fund is to provide investors with a way to participate in a diversified portfolio of money market instruments that ordinarily are either not available or offer a lower yield to retail investors. The primary performance objective of the portfolio is to obtain a high level of current income as is consistent with capital preservation and liquidity. Capital gains will be of an incidental nature. The portfolio is managed in accordance with CISCA and Regulation 28 of the Pension Funds Act. The portfolio will be allowed to invest in listed and unlisted financial instruments (derivatives) as allowed by the Act from time to time, in order to achieve the portfolio's objective.

This is an ultra-conservative portfolio that caters for an extremely low risk tolerance, and is designed for minimum capital fluctuations and volatility. It carries a short time-frame for investment. There are no growth assets in this portfolio and it is a cash-based investment. The ultraconservative portfolio aims to yield returns that are higher than bank deposits and typically higher than inflation. Capital protection is of prime importance.

The portfolio is bound by the exposure limits as per the ASISA fund classification structure applicable to South African - Interest Bearing - Money Market Portfolios. Money market instruments with a maturity limit of less than thirteen months, the average duration of the underlying assets may not exceed 90 days and a weighted average legal maturity of 120 days.

1. Economic overview

Global economic activity in the 4th quarter of 2017 continued to improve and the business cycle upswing is now in its 9th year as interest rates remain low and inflation is, in most countries, below target despite tightening labour markets. 2018 is promising to build on last year's momentum as financial conditions and improved sentiment combine to provide another year of synchronized global growth.

Domestic economic data activity remained relatively weak in the 4th quarter, although the economy is expected to have maintained positive growth after expanding by a quarter-on-quarter annualized rate of 2% (0.8% year-on-year) in the 3rd quarter. The SARB composite of leading indicators continues to improve as does the ABSA PMI which recorded its 4th consecutive increase, albeit remaining below the all-important 50 level for a 6th month. While a significant confidence boost will support economic growth over the next quarter or two, South Africa's growth is likely to remain below trend for the foreseeable future.

Major central banks continued to communicate to the market a more hawkish outlook for interest rates, although it is only the US (FOMC) and the UK (BOE) that raised policy rates among the main central banks during the quarter.

The FOMC remains by far the most hawkish major central bank and after raising its lending rate 3 times in 2017 (from 0.75% to 1.5%) and embarking on shrinking its balance sheet is expected to continue its tightening policy in 2018.

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In South Africa, the Monetary Policy Committee (MPC) of the Reserve Bank met once in the 4th quarter (November) and left the repo rate unchanged at 6.75%, a unanimous decision by the six MPC members. The November statement set a more hawkish tone than in September (although with the same decision despite a split MPC vote) as the committee considered risks to the inflation outlook to have increased, mainly due to higher international oil prices and a weaker rand exchange rate. Risks to growth, on the other hand, were deemed to be on the downside. The decision was also affected by the "rapidly deteriorating fiscal position" which the statement said "…could potentially reduce the scope for further monetary policy accommodation".

While two of the three main upside risks to domestic inflation raised by the MPC (weaker currency, Eskom price increases, and higher international oil prices) have subsided, currency weakness is likely to return as fiscal consolidation remains a challenge that will not vanish anytime soon. This means that Moody's will likely downgrade South Africa's credit rating to below investment grade and tax hikes will keep inflation from remaining at or below the middle of the target range. Therefore, we think that the MPC will change its view on the risks to inflation to be balanced, but keep the repo rate unchanged for the foreseeable future.

2. Market overview

South African financial markets had a nervous and volatile quarter as investors faced the difficult task of weighing up the probabilities of different ANC elective conference outcomes.

While the deteriorating fiscal position presented at the Medium Term Budget Policy Statement (MTBPS) had led the 3-month and 12-month Negotiable Certificates of Deposit (NCD) rates higher, the positive outcome of the ANC elective conference reversed some of the losses which had been priced by the market.

The 3-month NCD rate increased by 17.5 basis points and ended the quarter at 7.15% while the 12-month NCD rate ended 12.5 basis points higher at 7.90%, despite reaching high of 8.375% post the November MPC meeting. At the end of the quarter a better inflation outlook had led Forward Rate Agreements (FRAs) to price in a 25-basis point interest rate cut in the first quarter of 2018.

3. Portfolio activity

At the start of the quarter we reduced the interest rate risk of the portfolio, as we did not believe that the longer end of the money market curve offered sufficient risk compensation.

When rates ticked higher in the quarter, we incrementally increased the portfolio's interest rate risk by investing a portion of the portfolio in high quality longer-term bank deposits. However, given the economic and political uncertainty, we still felt it prudent to keep the portfolio relatively defensively positioned by holding larger cash positions and more short-term deposits than the portfolio would ordinarily have.

4. Portfolio positioning

Given the strong December rally and our view that the MPC of the Reserve Bank is likely to keep the repo-rate unchanged for 2018, longer term fixed rate assets are not offering sufficient risk compensation because the market is already pricing in a repo-rate cut for the first quarter of 2018.

We will therefore look to use the significant liquidity which we have built up in the portfolio to incrementally invest into high quality floating-rate bank deposits as they offer superior risk compensation. We will also look to invest into longer term fixed rate assets as opportunities are presented. The portfolio maintains a high level of liquidity through call deposits and bank paper.

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Granate SCI Money Market Fund – Portfolio Manager Profile

Vaneshen Naidoo (MSc - Eng, CFA)

Vaneshen joined Cadiz Asset Management in 2006 as a graduate and during this time analysed the credit and property sectors for the fixed interest and multi asset class teams. He was responsible for the Money Market Unit Trust. In December 2015 he joined Granate Asset as a Portfolio Manager.

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Disclosures

The portfolios were managed by Momentum Collective Investments (RF)(Pty) Ltd prior to 28 November 2017. Sanlam Collective Investments (RF) (Pty) Ltd, a registered and approved Manager in Collective Investment Schemes in Securities and the Manager retains full legal responsibility for the co-brand portfolios. Collective investment schemes are generally medium- to long-term investments. Past performance is not necessarily a guide to future performance, and that the value of investments / units / unit trusts may go down as well as up. A schedule of fees and charges and maximum commissions is available from the Manager on request. Collective investments are traded at ruling prices and can engage in borrowing and scrip lending.

The Manager does not provide any guarantee either with respect to the capital or the return of a portfolio. Performance is based on NAV to NAV calculations with income reinvestments done on the ex-div date. Performance is calculated for the portfolio and the individual investor performance may differ as a result of initial fees, actual investment date, date of reinvestment and dividend withholding tax. The manager has the right to close the portfolio to new investors in order to manager it more efficiently in accordance with its mandate. A money market portfolio is not a bank deposit account. The price is targeted at a constant value. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument and in most cases the return will merely have the effect of increasing or decreasing the daily yield, but that in the case of abnormal losses it can have the effect of reducing the capital value of the portfolio.

Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. Seven day rolling yield is calculated by taking into account the interest earned by the fund during a 7 day period minus any management fees incurred during those seven days. Income funds derive their income primarily from interest-bearing instruments. The yield is a current and is calculated on a daily basis. Annualised return is the weighted average compound growth rate over the period measured. The portfolio management of the funds is outsourced to Granate Asset Management (Pty) Ltd (FSP no. 46189), an authorised financial services provider in terms of the FAIS Act.