QUARTERLY COMMENTARY – Q1 2018

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

Economic activity in major economies maintained its strong momentum during the 1st quarter of 2018. Furthermore, consensus forecast for economic growth for both developed and developing economies for 2018 and 2019 have been revised upwards. These upward revisions to economic growth have come despite the increasing risk of "trade wars" as countries are retaliating to the US's imposition of trade barriers and rising policy rates in the US.

Domestic economic data for the 4th quarter of 2017 (released during Q1 2018) showed that the economy is in better shape than previously thought. The domestic economy grew by a quarter-on-quarter annualised rate of 3.1% (1.9% y/y) in the 4th quarter of last year, after recording an upwardly revised 2.3% growth rate in the 3rd quarter. The primary sector (mainly agriculture) remained strong, but encouragingly, both the secondary (manufacturing) and tertiary (trade) sectors rebounded.

Q1 2018 data has been, on balance, encouraging. PMI's, business and consumer sentiment, and mining production have improved while manufacturing production and retail sales have softened, albeit from a strong performance in Q4 2017.

The Monetary Policy Committee (MPC) of the Reserve Bank met twice during the 1st quarter. While both MPC meetings took place after the change in the country's leadership, the situation was very different amongst the two meetings. In the January meeting the economy was still facing significant fiscal and thus rating downgrade risks.

Therefore, while inflation was falling and the economy weak, the SARB kept the repo rate unchanged as five members of the MPC voted for no change and one member voted for a 25 basis point (bp) cut. When the MPC met in March, two of the key risks that the economy was facing in January were gone, namely further fiscal deterioration and the rating downgrade. Furthermore, consumer and business confidence showed a marked improvement. This, together with the fact that the committee's inflation forecast was lowered, led to a 25bp repo-rate cut. Surprisingly, however, the March MPC statement was relatively hawkish and the decision was a close call as three of the seven (a new member was appointed to the MPC) voted for an unchanged repo rate.

The March MPC statement suggests that a further rate cut this year is in the balance. Inflation has continued to decline, but the 1% VAT increase, higher oil prices and base effects suggests that inflation has probably bottomed in the 1st quarter. This, together with the MPC's increased focus on the middle of the inflation target band (4.5%) as where it wants inflation expectations to settle, suggests that a further 25bp cut is not a given. A favorable outcome in the public-sector wage negotiations, if obtained, could be the deciding factor.

2. Market overview

Money market rates continued their downward trend in the 1st quarter of 2018 driven by the favorable outcome of the ANC elective conference which culminated in Moody's decision to not downgrade South Africa's credit rating.

Most of the gains in the money market rates occurred at the end of March when the repo-rate was cut by 25bp. The 3-month Negotiable Certificates of Deposit (NCD) rate decreased by 25bp and ended the quarter at 6.90% while the 12-month NCD rate ended 15bp lower at 7.75%.

At the end of the quarter a hawkish MPC and the apparent bottoming of the inflation cycle had led Forward Rate Agreements (FRAs) to price in a low probability of further cuts for the remainder of 2018.

3. Portfolio activity

At the start of the quarter we actively invested into floating rate paper, as we did not believe that the longer end of the money market curve (7-12 months) offered sufficient risk compensation.

When it became clearer that that the market was moving into a" normal" valuation mode post the Zuma era and a repo-rate cut was imminent, we decided to incrementally increase the portfolio's interest rate risk by investing a portion of the portfolio into high quality longer-term bank deposits. As a result, the portfolio should benefit by holding a significant amount of fixed rate paper at higher yields.

4. Portfolio positioning

Given the strong rally and our view that the MPC of the Reserve Bank may keep the repo-rate unchanged for 2018, longer term fixed rate assets are currently offering significantly less risk compensation than the beginning of the quarter.

We will therefore look to use the liquidity which we have built up in the portfolio to mainly invest into high quality floating-rate bank deposits as funding spreads remain attractive. Given our view that the risk remains of a further repo-rate cut, and the fact that the market is not pricing it in, we will look to invest into longer term fixed rate assets when opportunities are presented. The portfolio maintains a high level of liquidity through call deposits and bank paper.

GRANATE ASSET MANAGEMENT

Part of RMI Investment Managers

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.