GRANATE ASSET MANAGEMENT

Part of RMI Investment Managers

QUARTERLY COMMENTARY – Q2 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 positive momentum during the 2nd quarter of 2018 despite growing concerns around a slowdown in global trade due to higher trade barriers.

Domestic economic data for the 1st quarter of 2018 (released during Q2 2018) showed that the economy is in worse shape than previously thought. GDP contracted at a seasonally adjusted quarter-on-quarter annualised rate of 2.2% (0.8% y/y), after recording a 3.1% growth rate in the 4th quarter of 2017.

The manufacturing and mining sectors (making up 7.7% and 12.5% of GDP) contracted by 9.9% and 6.4%, respectively, together contributing 1.6% to the GDP contraction. The agriculture sector, after growing by an average annualised rate of 35% in 2017 contracted by 24.2%, to cut a further 0.7% off GDP growth. Positive contributions came from the finance sector (1.8%) which contributed 0.3% towards growth followed by general government services which makes up 14.9% of GDP and grew by 1.8%.

Q2 2018 data has been, on balance, disappointing. PMI's, retail sales, mining and manufacturing production have all disappointed, posing further downward risk to GDP growth for 2018.

The Monetary Policy Committee (MPC) of the Reserve Bank met once during the 2nd quarter and decided (unanimously) to keep the repo rate unchanged at 6.5%.

The MPC's hawkish statement was consistent with its growing focus of an inflation target of 4.5% (rather than 3%-6%). In its assessment, while the inflation forecast has remained broadly unchanged, the risks have moved to the upside due to the higher oil price, a weaker rand, higher electricity prices, and a reversal of capital flows to emerging markets. Importantly, however, the Governor reiterated that "…MPC attempts to 'look through' the first-round effects of such (supply side) shocks and to react to second-around effects". Inflation expectations and wage settlements are key in this regard.

2. Market overview

In the 2nd quarter of 2018, Money Market rates reversed the downward trend experienced in the 1st quarter, where the money market curve flattened. The 3-month Negotiable Certificates of Deposit (NCD) rate increased by 6bps and ended the quarter at 6.96% (Q1: 6.90%) while the 12-month NCD rate ended 38bps higher at 8.125% (Q1: 7.75%).

Market expectations of higher policy rates was the primary reason for the higher money market rates in the 2nd quarter; after pricing in no repo-rate hikes for the year in May, the market had moved to price in a 70% probability of a rate hike by the end of the year and at least two 25 basis points (bps) rate hikes by the end of 2019. This move in rates coincided with move in the rand that weakened significantly in the month of June.

The weaker rand certainly poses a risk that the SARB will move on rates sooner than previously expected. However, a surprisingly weak economy and the absence of demand pull inflation suggests rates on hold for the year.

3. Portfolio activity

At the start of the quarter our view was that longer term fixed rate money market assets (7-12 months) was not offering sufficient risk compensation as the money market curve was not pricing in any additional repo-rate hikes for the next 12 months. At that stage, we were predominantly investing into floating rate paper which displayed better value as funding rates remained attractive.

However, during the quarter, as fixed rate money market rates moved higher we used the additional liquidity built up in the portfolio to increase our interest rate exposure. We accomplished this by buying the longer term fixed rate money market assets which offered positive risk compensation. Thus, the portfolio should benefit by holding these higher duration money market assets at higher yields.

4. Portfolio positioning

While the money market curve continues to price in multiple hikes in the repo-rate over the next year, our current view is that the SARB is likely to keep the repo-rate on hold for that period. As indicated previously, the reason for our view is the local weak economy and the absence of demand pull inflation. The risk to this view is a significantly weaker rand which could result in higher inflation and thus increases in the repo-rate.

We will therefore continue to use the additional liquidity built up in the money market portfolio to invest into longer term fixed rate money market assets which offer positive risk compensation. Currently the portfolio is slightly more invested into floating rate bank paper but this is likely to change as we invest into longer term fixed rate money market assets. The floating rate notes do however offer some protection as these instruments will benefit if the SARB increases the repo-rate at future meetings.

The money market portfolio maintains a high level of liquidity through call deposits and bank paper.

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.