FIXED INCOME QUARTERLY COMMENTARY
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A *whipsawed* bond market

It's been a wild ride in the bond market over the last quarter. Managing an income fund during these levels of volatility is not for the faint hearted. The bond market at the end of May was in crisis territory, down almost 5% for the month after an already negative month in April (please see last month's commentary). This was driven by rumours of political missteps regarding our government officials supplying Russia with arms. The market was fearing the potential of sanctions or very important trade partnerships being at risk. Coupled with the concerns that the impact Eskom could have on our economy, it was fertile soil for a negative reaction.

by Bronwyn Blood

Roll forward a month later and there is a certain level of calmness prevailing. Inflation seems to be coming under control, loadshedding has reduced to "reasonable" levels, and diplomatic ties with important allies seem to be intact, meaning a lower likelihood of sanctions or a visit from Mr. Putin. The market deemed South African bonds to be offering some value again. When contemplating the market over the past quarter, it feels akin to being whipsawed – a tough environment to manage an income fund which has an objective of achieving consistent positive real returns with minimal volatility.

How has the Granate BCI Multi Income Fund fared during this volatile quarter?

The ALBI lost 1.5% over the past quarter versus the Granate BCI Multi Income Fund gaining 1.25%. This performance is an extension of what the fund has achieved over the longer term. In addition, the fund is offering an attractive yield of 10.4%.

Since COVID the market has changed significantly and accordingly we have changed our asset allocation to suit the macroeconomic backdrop we find ourselves in. We pride ourselves on being nimble and flexible and utilising all the opportunities across the broad spectrum of different assets in the fixed interest space. We have for a while been reducing exposure to government bonds and increasing exposure to money market and floating rate assets. This has been driven by the same reasons fixed deposit rates are looking attractive, increased short-term interest rates. This enabled the fund to avoid some of the volatility that existed during the quarter.

If we continue to manoeuvre the fund to avoid these large sell offs and capitalise on the opportunities when the market is pricing in excessive amounts of risk, overtime it should lead to outperformance. But make no mistake, avoiding volatility does not mean performance in a straight line (as you would find in a fixed deposit), investors need to expect some negative months to achieve higher returns over the longer term, and be comfortable with this.

Income fund versus a fixed deposit?

Our clients are frequently asking us about the benefits of the Granate BCI Multi Income Fund compared to a bank deposit. We think the answer lies in the fact that neither one nor the other is better, they just serve different purposes and objectives.

When is a fixed deposit a good option?

Interest rates are at the highest levels that they have been at since 2009, something borrowers are feeling in the debt repayments that they owe. At the same time banks are promoting eye catching rates on fixed deposits for those who are sitting on some cash.

Fixed deposits are very good vehicles for those who seek a certain outcome. They guarantee (assuming the bank does not collapse) an interest rate for the term of the commitment so you know exactly how many rands you will have at maturity. *Certainty is an alluring prospect*.

In a scenario where you are certain that you will not need the invested money prior to the maturity date, and you have no need for your investment to necessarily keep up or outpace inflation, a fixed deposit is a very good vehicle. A key consideration for investors when

committing their hard earned savings for a fixed term is how attractive (or unattractive) rates will be when the term comes to an end.

An income fund alternative?

Income funds are unit trusts that focus on generating income, aiming to optimise the return from a wide range of interest-bearing instruments such as money market instruments and bonds issued by corporate entities and governments. Investors are therefore not exposed to a single bank, but rather to a wide range of institutions, thus diversifying your investment. The intention is to outperform a cash investment such as a fixed rate deposit. In the case of the Granate BCI Multi Income Fund, we aim to deliver returns that exceed the short-term fixed cash rates by 2% with an eye on delivering returns of inflation + 3% over the longer-term. This is roughly what the All-Bond Index (ALBI) has delivered over the past 20 years, but at much higher volatility. Managing volatility is a critical part of delivering the return objectives, we aim to protect our investors as much as possible from this. The fund however will not be immune to the ebb and flow of market moves so that feeling of daily certainty is not on offer in the same way it would be in a fixed deposit.

The fund is being managed by a team of skilled professionals who perpetually allocate capital across the many different fixed income asset classes, navigating and capitalising on the opportunities that arise, particularly when markets are pricing in extreme negative emotions. This differs from a bank deposit where a single investment decision is made at a point in time.

A unit trust offers daily liquidity. There are no set dates at which the investment must be accessed or costs attached to accessing your savings when life happens.

A cautionary tale for comparing fixed deposits to income funds

At the end of May when the bond market had performed so badly it was tempting to compare the future interest rate that a bank fixed deposit was offering to the seemingly lower returns that income funds had delivered in the recent past. Investors should be mindful of comparing "apples with apples". When comparing past returns of an income fund against future interest rates of a bank deposit, it's important to remember that these are simply not comparable. Perhaps a better method for comparison would be to evaluate the returns an income fund has delivered over a certain period (we would suggest a minimum of three years) and then contrast that against the interest rates a bank would have offered you three years ago. Additionally, be mindful of the fact that the interest rates quoted for a bank fixed deposit could mean very different things according to the compounding convention of that investment. Some quoted rates look extremely juicy by calculating this rate over five years versus the convention of quoting the equivalent effective annual interest rates, thus overstating reality. This renders it very difficult to achieve accurate comparisons between what is on offer.

Investors must also remember that bank fixed deposits only offer liquidity according the terms you that were agreed. You can withdraw your money prior to the maturity of that investment, but there are usually penalties, which then have the effect of eroding yields that are offered in the first place.

Finally, because a fixed deposit has a finite investment term, the investor faces reinvestment risk at the end of the term which means one should be very certain of the investment horizon and then choose the appropriate term to match this.

Granate is a people business.

We are committed to creating a rich and rewarding culture through our shared values. Granate is configured thoughtfully and intentionally so that our team can thrive for the benefit of our clients. We care about the same things you do and are *relentlessly* **committed to protect and grow your savings**.