UMTHOMBO ACTIVE BOND FUND REPORT FOR QUARTER ENDED 30 SEPTEMBER 2022

UMTHOMBO
WEALTH

Fixed Income summary

The global economy is at risk of a recession. Slowing growth, rising inflation and higher borrowing costs have put emerging market's debt and exchange rates under further stress.

There has been a profound impact on global risk sentiment and expectations point to the fact that EM central banks are committed to taking the further steps necessary to fight inflation. Fiscal and monetary policy responses will differ as countries balance the need to reduce inflation and protect capital flows amid rising global interest rates, while also facing worsening global and domestic growth prospects.

This quarter, foreign flows into SAGBs lost momentum, amid the broad-based risk-off mood. Following the hawkish comments at Jackson Hole and a higher-than-expected US inflation print, we suspect that foreign investors have become more risk-averse, thus, we forecast that they will remain net sellers of SAGBs. The global stag-flationary theme clearly remains a pertinent bond market driver, but investors are still closely monitoring SA-specific risks.

South African bonds and the local currency remains on the back foot. Like most emerging market currencies, the rand is highly susceptible to global drivers such as U.S. monetary policy. The correlation between the rand and SA government bonds was restored recently, with both weakening and underperforming its peers. Seen in a longer-term context, the rand seems weaker versus its peers compared to bonds. This probably partly reflects a difference in focus horizon, with bonds reflecting the expected support from improved fiscal outcomes and commitment to consolidation, while the rand is more sensitive to the prevailing concerns about the short- to medium-term negative risks to global growth and commodities as well as the near-term pressure from elevated loadshedding levels, which will in the medium- to longer term improve as private sector generation capacity increases. In September, the FTSE/JSE All Bond Index fell 2.11% as yields rose by around 50-bps across the curve.

Although monetary policy globally and locally has turned more hawkish, foreigners' sales of SAGBs were counteracted by banks' 0.8% increased holdings. Banks' demand for SAGBs is also likely to remain muted, given the arrival of floating-rate notes (FRNs) and the SARB's new surplus Monetary Policy Implementation Framework (MPIF). However, locals are likely to continue buying SAGBs from foreigners and banks, now that SAGB yields are fairly high at a time when economic activity is slowing. We still see a risk of this phenomena in the last quarter of the year.

We remain comfortable with our tactical positioning. We remain neutral on the SAGBs going into Q4 2022 as we continue to see both the rand and bonds as undervalued, but they remain on the back foot amid elevated concerns about the severity of the imminent global growth slowdown. We still favour the belly to the long-end area of the yield curve.

In our view, the following key risks are pertinent in global markets thus investors can expect further elevated volatility. Inflation and geopolitics are the biggest threats to investors.

Global Economy – The outlook is stag-flationary, with GDP growth expected to slow below trend and inflation to settle above pre-pandemic levels across both developed and emerging markets.

Global Inflation – Remains sticky and elevated— The key risk to our view is a disanchoring of inflation expectations, which would force central banks to induce a recession in order to quell price dynamics.

Monetary Policy – Major central banks will tolerate above-target inflation as long as it is slowing, with many approaching peak hawkishness.

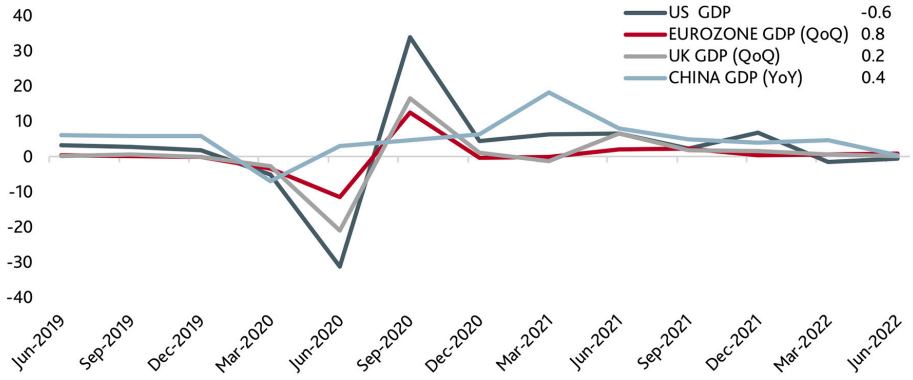
Domestically – Household disposable income will come under pressure after fiscal support measures end, rising energy prices, wage moderation, energy shortage and fiscal consolidation.

Global Economy

The US economy is losing momentum heading into the back half of the year, highlighted by the government's latest report card that showed weaker consumer spending and declines in business and residential investment.

Gross domestic product fell at a 0.9% annualized rate in the second quarter following a 1.6% drop in the first quarter of 2022. While the economy shrank for a second straight quarter meeting one rule of thumb for a recession economists and Federal Reserve Chair Jerome Powell were skeptical, largely due to a strong labour market.

US Economy to Narrowly Avoid Recession in 2022-23, IMF Says



Source: Umthombo Research, Bloomberg (as at 30 September 2022)

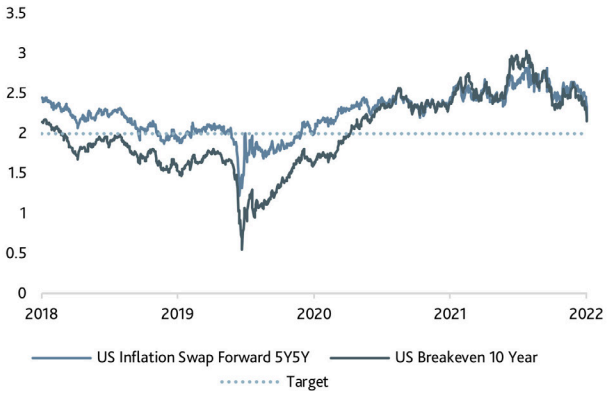
The euro-area economy expanded by more than initially estimated in the second quarter, with the revision revealing greater support from consumer and government spending. Gains in consumption expenditure more than offset a drag from trade. Eurozone GDP rose by 0.8% in Q2 2022. The GDP drop seen in August is just the beginning for Britain's economy-which is probably entering into a prolonged recession. A pronounced downturn over the winter is looming, as rapidly rising rates intensify the squeeze on household budgets. A look at the breakdown of the monthly GDP shows the fall in output was mostly driven by industrial production led by the manufacturing sector. The UK economy expanded by 0.2% in Q2 2022.

China's recovery is weakening after only a short spur in growth after Shanghai's reopening. A surprise drop in July's manufacturing PMI into contraction more than reversed June's rise underlining an abrupt loss of momentum. Looking ahead, the economy is up against serious challenges. The Zero Covid policy is a persistent drag. The property crisis is deepening, with distressed developers cutting investment and falling housing sales crippling demand. Boycotts on mortgages are a sign of a deepening crisis. External demand is also likely to weaken amid slowing global growth. The Chinese economy has grown by 2.5% year-on-year.

Global Inflation

US inflation expectations elevated above 2% target

US inflation expectations



Source: Nedbank, Bloomberg (as at 30 September 2022)

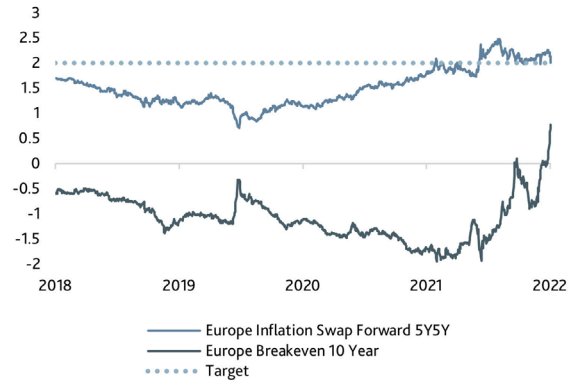
US consumer prices were resurgent, dashing hopes of a slowdown and likely assuring another large interest-rate hike from the Federal Reserve.

The acceleration in inflation points to the high cost of living for Americans, despite some relief at the gas pump. Price pressures are still historically elevated and widespread, pointing to a long road ahead regarding the Fed's inflation target.

The consumer prices rose by 8.3% from a year earlier after peaking at 9.2% in Q1 2022.

Eurozone swap markets more in tune with actual inflation

Europe inflation expectations

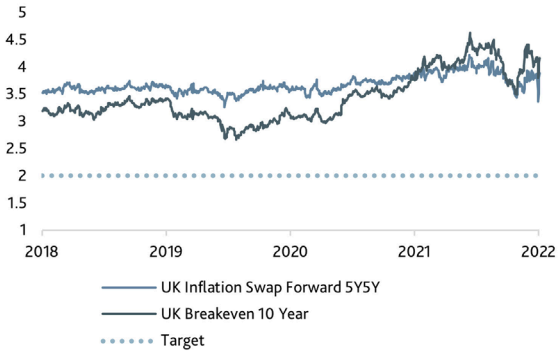


Source: Nedbank, Bloomberg (as at 30 September 2022)

The euro zone's economic crisis intensified with the first ever reading of double-digit inflation and piling pressure on the European Central Bank to keep raising interest rates aggressively. Consumer prices surged 10% from a year ago in September. Energy and food prices once again drove inflation higher, though core CPI also reached an all-time high of 4.8%.

UK inflation remains elevated; expectations rise

UK inflation expectations



Source: Nedbank, Bloomberg (as at 30 September 2022)

UK inflation eased slightly in August, reflecting a monthly drop in fuel prices. Nonetheless, with inflation running nearly five times above target and pressures broadening further the Bank of England will be compelled to deliver another rate hike. Inflation accelerated to 9.9% in August down from 10.1% in July.

China's inflation moderated in in August as sporadic lockdowns suppressed spending and commodity prices fell, giving policy makers enough room to support the troubled economy if needed. The consumer price index rose 2.5% from a year earlier. Factory-gate inflation slowed to 2.3% from 4.2% in July, lower than the 3.2% predicted.

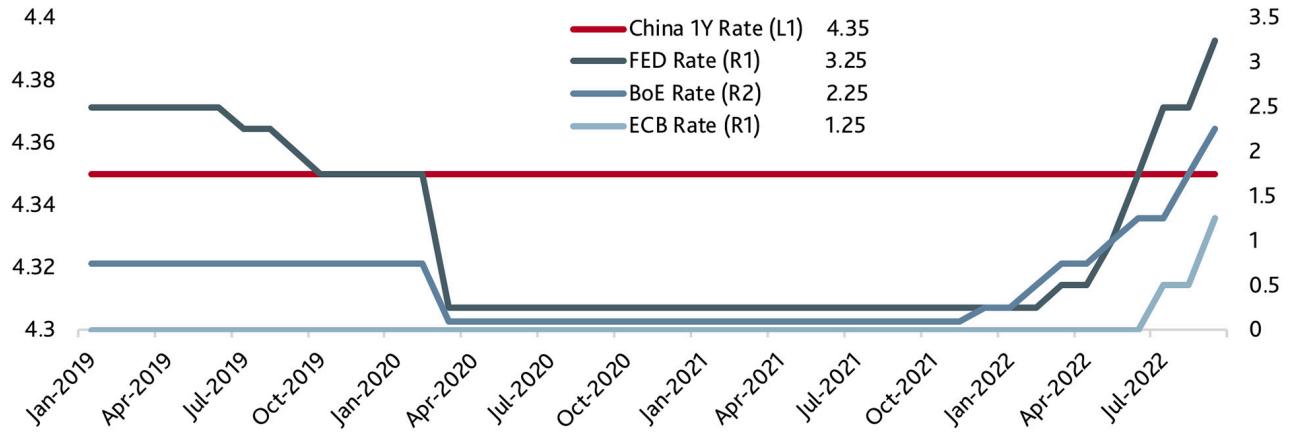
Monetary Policy Dynamics – Global

Most major central banks turned more hawkish, amid concerns that inflation may remain elevated for an extended period. The Fed has hiked rates by 300-bps to 3.25% year-to-date to reign in spiraling inflation, fueled by services sector inflation and rising fuel and food prices. Almost two-thirds of members now see rates peaking next year even higher than the 4.5% markets had priced in. Bloomberg Economics expects the terminal rate to be 5%. The September minutes also indicates FOMC members know their actions will push the economy into recession next year regardless, they are willing to do so to get inflation under control.

The European Central Bank (ECB) hiked rates by 75-bps and is expected to raise rates further because inflation remains far too high and is likely to stay above the target for an extended period into 2024. The BOE has lifted rates by 200-bps to 2.25% year-to-date, while the UK grapples with heightened inflation driven by soaring food and energy prices. The MPC lowered its forecast for peak inflation from more than 13% to less than 11% and suggested a deep recession may be averted because of new Prime Minister Liz Truss' energy relief plan. The bank has resumed its daily purchase operations which include gilts and linkers, as market dysfunction and prospects of fire sales pose a material risk to UK financial stability.

The PBOC has been the only major central bank to adopt an accommodative monetary policy stance as China's Zero-COVID policy has put a damper on economic growth. As a result, the PBOC has cut the 1-year rate by 20-bps so far this year to stimulate growth.

DM policy rates have started to lift - 30 September 2022



Source: Umthombo Research, Bloomberg (as at 30 September 2022)

Market Trends – Global

Global yields have continued to surge higher as central banks maintained their hawkish stance. The Fed has hiked rates on the back of the elevated inflation level resulting in the global reflation theme gripping major markets. Equities have continued to fall in the second half of the year with the MSCI World index down 42% year-to-date, as the Fed rate hikes have dampened risk sentiment. Tech heavy stocks have been the worst hit as growth and earning concerns grip the market. The US Dollar Currency Index (DXY) rose 7.10% in the third quarter, to close at 112.12 as safe-haven support for the USD intensified in September. The US dollar should remain well supported going into Q4 2022 as investors pivoted to the greenback this year as a go-to haven.

Gold was down 8% for the quarter and closed at USD1661. Bullion reversed the earlier rally as the USD strengthened and commodity prices fell on recession fears. Oil prices fell 23% during the quarter and closed at USD88 as global demand concerns dominated the market as central banks hiked rates and economic growth slowed.

Sectoral GDP (real) Q2 2022		
Sector	**% Seasonally adjusted QoQ**	**% Seasonally adjusted YoY**
Agriculture	-7.7	-20.9
Mining	-3.5	-9.6
Manufacturing	-5.9	-3.8
Utilities	-1.2	-1.8
Construction	-2.4	-5.7
Trade	-1.5	0.7
Transport	2.4	6.2
Finance, business	2.4	4.7
Personal services	0.1	3.7
Govt	-1.4	-0.5
GDP	**-0.7**	**0.2**

Source: Umthombo Research, Stats SA (as at 30 September 2022)

Local Economy

After two consecutive quarters of positive growth, the South African economy contracted less-than-expected, with GDP contracting by 0.7% q/q in Q2 2022 dragging GDP back below the fourth quarter of 2019 pre-pandemic level of R1 149 billion.

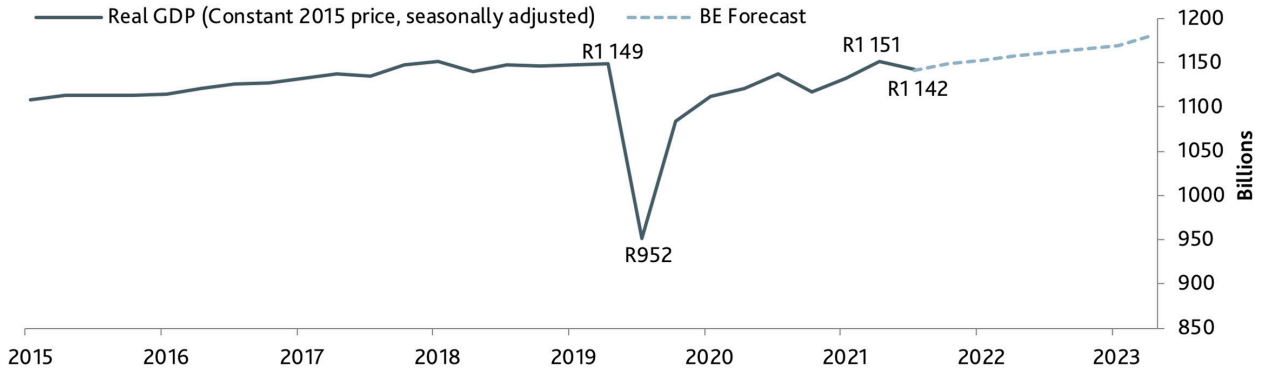
A GDP contraction in 2Q22 was inevitable given the disruptive floods in KZN and arguably even more so owing to the severe worsening in loadshedding.

Both these factors would probably still weigh on GDP momentum in Q3 2022, albeit less than in Q2 2022.

The second quarter contraction was broad-based, with seven of ten sectors recorded negative growth in Q2 2022. Sectors including manufacturing, trade, catering and accommodation were negatively impacted by both the floods in KwaZulu-Natal and power cuts across the country.

Economy's rebound is losing momentum – as at 30 September 2022

South African's GDP is now smaller than before the pandemic struck



Source: Umthombo Research, Stats SA (as at 30 September 2022)

Slow economic growth and mounting price pressures pose a threat to social stability and could complicate efforts to reduce fiscal deficits and debt. Debt is set to peak at 75.1% of GDP in 2024-25 and then gradually decline, while the budget shortfall is forecast at 4.2% of GDP in 2024-25, according to Treasury estimates.

Although load shedding continued into the third quarter, the rebound from the floods and ongoing recovery in the tourism-related sectors should ensure positive GDP growth in Q3 2022. We believe rising interest-rates, an erosion in consumer spending power, supply-chain disruptions stemming from China's Covid Zero measures and war-induced tensions in the European Union are among the risks to the domestic growth outlook for the second half of 2022. The SARB now expects the economy to grow by 1.9% in 2022 from 2.0%, and to expand by 1.4% in 2023 and 1.7% in 2024, above previous projections. This projection matches our base case as we revised our growth forecast to 1.8% from 1.9% in 2022, but risks are squarely to the downside as global growth slows, reducing demand for SA products.

Economic activity in several key emerging EMEA economies has visibly slowed and will continue to do so into 2023. Fiscal and monetary policy responses will differ as countries balance the need to reduce inflation and protect capital flows amid rising global interest rates, while also facing worsening global and domestic growth prospects.

South Africa Inflation

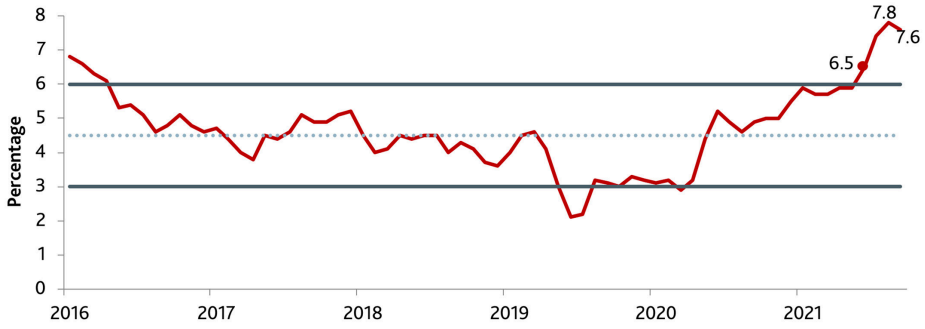
Consumer Inflation - Key Data: August 2022		
	% YoY	% MoM
Headline CPI	7.6%	0.2%
Core	4.4%	0.2%
Food	11.5%	1.7%

Source: Umthombo Research, Bloomberg (as at 30 September 2022)

South Africa's headline inflation eased broadly in line with expectations. After hitting a 13-year high of 7.8% y/y in July, headline CPI inflation moderated to 7.6% in August, above market expectations of 7.5%. Core inflation moderated to 4.4% y/y from 4.6% in in July. As broadly expected, the biggest driver of the easing in headline CPI inflation was fuel inflation, which eased to 43.2% y/y in August from 56.2% in July.

A further drop in the petrol price in September would lead to more easing in transport inflation, and this is likely to be a major driver of lower inflation rates in the near term. We have now revised our inflation forecast slightly down in line with the MPC and risks to inflation outlook remain to the upside. With that said, we believe July to have been the peak in the inflation cycle and headline inflation to return into the SARB's target range only in the 2Q23.

South Africa Inflation rate (YoY) above the Ceiling - 30 September 2020



Source: Umthombo Research, Bloomberg (as at 30 September 2022)

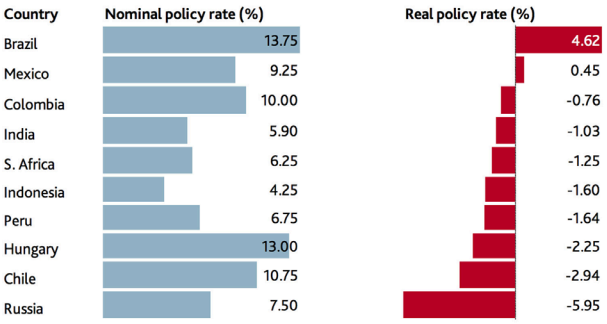
Monetary Policy Dynamics – South Africa

In line with our and market expectations, the SARB hiked rate by 75-bps to 6.25% in September to anchor inflation expectations. SARB MPC turns more hawkish, driven by Fed, and have over the past three meetings clearly signaled and demonstrated that its priority is to avoid the mistake made by several other central banks of under-estimating the pervasiveness of inflation. We believe the SARB will remain more hawkish, preferring to anchor inflation expectations close to the 4.5% midpoint of its target range.

We currently forecast another 75-bps hike in November 2022, with a possible 25-bps in January 2023. While we acknowledge the upside risks to our forecast, we foresee the money market's expectation that the SARB will outpace the Fed as excessive.

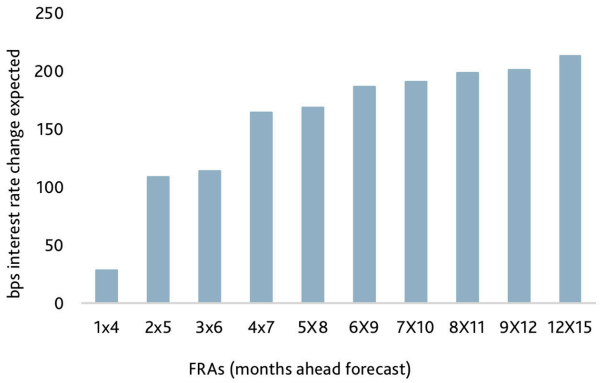
Brazil and Mexico Stand Out - 30 September 2022

The two countries are rare among EM peers in terms of offering positive real interest rates



Source: Umthombo Research, Bloomberg (as at 30 September 2022)

FRAs are still too hawkish - 13 Oct 2022



Source: Umthombo Research, Bloomberg (as at 30 September 2022)

The short-dated Forward-rate agreements (FRAs) seem reasonable but overly hawkish from the 5x8 FRA onwards. The SARB has also tilted towards being more hawkish in response to rising upside inflation risks. In our view, SA doesn't have to match the Fed's pace of rate hikes, but the money market implies that SA will ultimately outpace the Fed's hikes, notwithstanding weaker growth, and inflation domestically, which seems unlikely.

However, the SARB's strong commitment to anchoring inflation (expectations) is positive for the rand and bonds, although they have already been factoring in a credible central bank. The SARB would probably only become less hawkish and pre-emptive relative to the model once the bank is certain that SA will not incur the same inflation problem that emerged in many other countries.

Credit Risk Profile – South Africa

All three rating agencies have a "stable" outlook on SA's ratings			
	Moody's	S&P	Fitch
Local currency rating	Ba2	BB	BB
Outlook	Stable	Stable	Stable
Foreign currency rating	Ba2	BB-	BB
Outlook	Stable	Stable	Stable

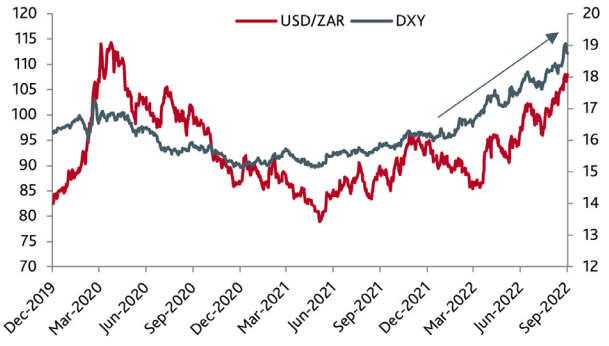
Source: Umthombo Research, Bloomberg (as at 30 September 2022)

In July, Fitch affirmed SA's long-term foreign and local currency debt ratings of 'BB+' with a stable outlook. The commodity price boom uplifted SA's tax take and buttressed its GDP growth recovery beyond the initial pandemic-related lockdown woes. Moreover, SA's fiscal deficit and debt burden were alleviated by the GDP rebasing. Overall, we think these trends (albeit transitory) have been sufficient to avert any negative credit rating action in the near term.

The agency has warned that Eskom's rotational power cuts will hamper South Africa's economic growth while socio-political issues will exacerbate risks. A higher growth path for South Africa principally depends on the pace and depth of reform implementation efforts. At this stage, we expect no further changes in either the outlook or the rating from any of the three major rating agencies in 2022.

Matrix - South African Rand

ZAR reversed gains in the losses seen in 1Q - 30 September 2022



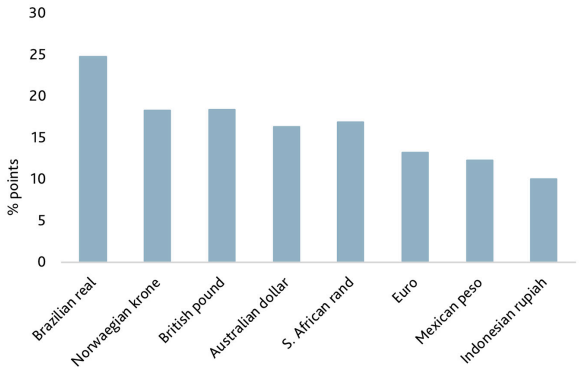
Source: Umthombo Research, Bloomberg (as at 30 September 2022)

A rally in the US dollar, supported by safe -haven demand, sent emerging-market assets sliding in Q3 2022 as traders weigh global growth risks. The US Dollar Index (DXY) rallied 17.19% for the year as safe-haven support for the USD intensified in September. The Bloomberg Cumulative FX Carry Trade Index for 8 emerging market currencies dropped a further 4.41% in 3Q22 after ending 2Q22 5.13% lower, and now down 9.93% over the 12-months period ending 30 September 2022.

EM FX sold off due to concerns of aggressive tightening by the Fed and other major central banks, and recession fears in the US. Weaker global growth and war between Russia and Ukraine also added to markets' risk-off sentiment. Some emerging-market central banks were fairly early to hike policy rates starting mid-2021 and are now being rewarded for it. Currency outperformance in Mexico and Brazil is driven by positive real rates.

More Volatility - 30 September 2022

One-month implied vol of some G-10 currencies are now much higher than many EM counterparts



Source: Umthombo Research, Bloomberg (as at 30 September 2022)

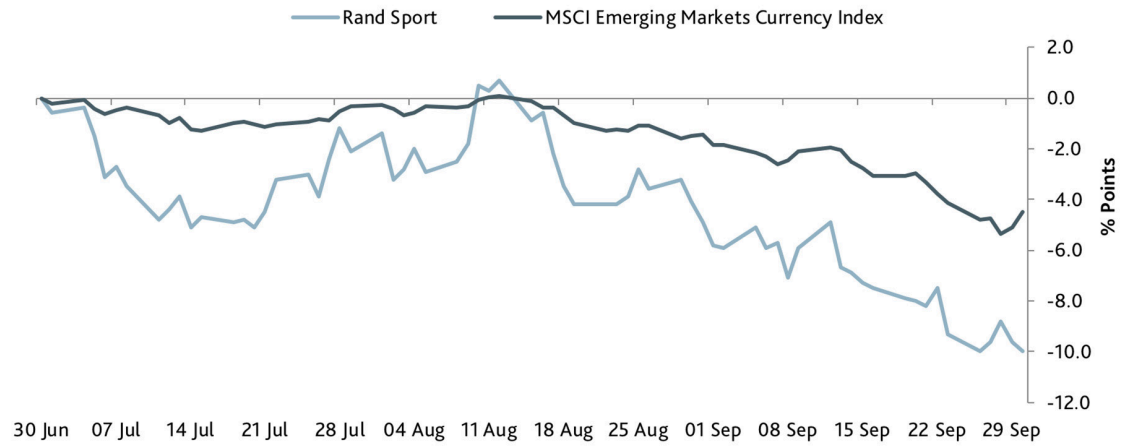
The local currency securities have been whipsawed this year by global developments, from the war in Ukraine to energy squeezes in Europe and political turbulence in the UK. Options traders are taking note. Expected volatility in G7 currencies has surged above that of emerging markets for the first time since March 2020, according to JPMorgan Chase & Co. indexes.

The rand has declined 11.10% against the dollar this quarter, making it one of the worst performing developing-nation currencies over the period. Like most emerging market currencies, the rand is highly susceptible to global drivers such as U.S. monetary policy.

Emerging markets with access to cheaper funding and that have comparatively lower twin deficits and higher potential growth and are commodity exporters, will likely benefit from potential growth as well as likely benefiting the most from this global recovery. Highly indebted markets with weak growth prospects will likely remain laggards. With that said, we revised our forecast for the USD-ZAR to trade in the R17.50/$ to R18.00/$ range in Q4 2022.

The rand has performed worse than emerging peers inthe third quarter - 30 September 2022

Normalised as of 06/30/2022



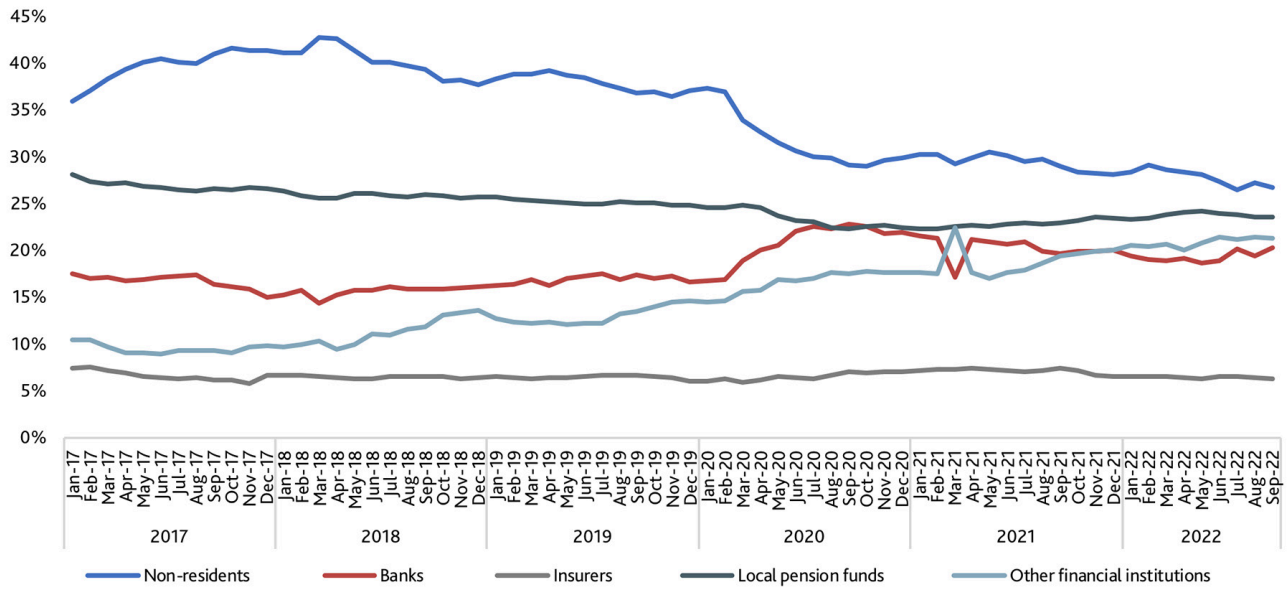
Source: Umthombo Research, Bloomberg (as at 30 September 2022)

Bond Market Trends – South Africa

Foreign investors remain net sellers of SAGBs, while local real money accounts continued to support the curve. In September, foreign investors decreased their SAGB holdings by 0.5% to a low of 26.8%. According to National Treasury data, foreigners' sales were counteracted by banks' 0.8% increased holdings.

Following the hawkish comments at Jackson Hole and a higher-than-expected US inflation print, we suspect that foreign investors have become more risk-averse thus, we forecast that they will remain net sellers of SAGBs. Meanwhile, insurers were net sellers of SAGBs in the month, reducing their total SAGB holdings by 0.1pp to just 6.3%. However, we expect insurers to become modest net buyers of SAGBs again in the coming months, especially as flooding and COVID-19 related claims subside.

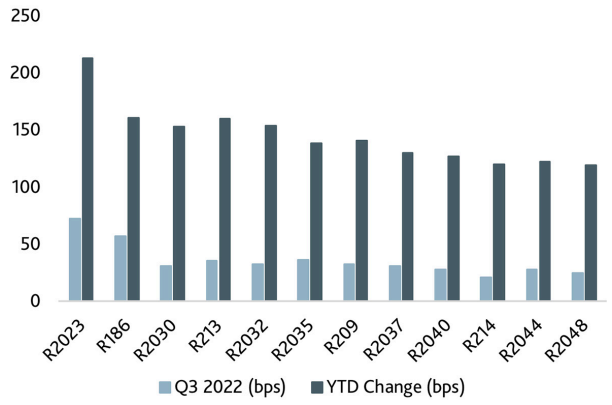
Local pension funds and other financial institutions increased their holdings - 30 September 2022



Source: Umthombo Research, National Treasury (as at 30 September 2022)

SAGB curve flattens, prompted by tighter monetary policy

SA Yields Curve Change (bps)



Source: Umthombo Research, JSE MTM (as at 30 September 2022)

SA bonds have been on the back foot in the quarter amid global risk-off sentiment. In September, SAGBs sold off, with yields trading at more than 11% and are higher than most of its peers. Global factors, including a tighter monetary policy stance, higher global inflation rates and a higher US Treasury yield continue to put upward pressure on local yields which is partly offset by positive fiscal dynamics. SABG yields rose by between 40-bps and 60-bps across the curve in September.

The South African real yields are among the highest in emerging markets and remain attractive at an absolute level and relative to EM peers. Market and our estimates suggest inflation likely peaked in July, which should see some of the upward pressure on bond yields ease. That said, much uncertainty remains, and we expect respite for bonds from the inflation front to be only marginal as we head towards the last quarter of this year.

SAGB curve flattens, prompted by tighter monetary policy

SA Yield Curve - Long End

Source: Nedbank Research, Umthombo Research, Bloomberg (as at 30 September 2022)

In Q3 2022, the FTSE/JSE All Bond Index (ALBI) was up only 0.60% in local currency but slumped -9.46% in dollar terms as the rand reversed 11.10% in the same period. This puts the ALBI's Q3 2022 returns worse than the WGBI at -7.61% and the EMBI at -4.20%. We remain comfortable with our tactical positioning. We remain neutral on the SAGBs going into Q4 2022 as we continue to see both the rand and bonds as undervalued, but they remain on the back foot amid elevated concerns about the severity of the imminent global growth slowdown. We still favour the belly to the long-end area of the yield curve.

Portfolio review

Performance for the quarter ended 30 September 2022

Performance	Bond Portfolio	Benchmark	
30-Sep-22	Umthombo Active Bond	FTSE/JSE All Bond Index	Alpha
1 Month	-1.98%	-2.11%	**0.13%**
3 months	0.76%	0.60%	**0.16%**
6 months	-2.95%	-3.14%	**0.19%**
YTD	-0.91%	-1.34%	**0.43%**
1 Year	2.25%	1.48%	**0.77%**
2 Year	6.97%	6.83%	**0.14%**
3 Years	6.28%	5.73%	**0.55%**
5 Years	7.62%	7.13%	**0.50%**
Number of years	**6.42**		
Since Inception: Gross Returns	70.69%	64.28%	**6.41%**
Since Inception: Ann. Returns	8.80%	8.15%	**0.66%**
*Volatility	7.03%	7.80%	
*Downside Risk	4.05%	4.56%	
*Sharpe Ratio	0.09	0.08	
*Sortino Ratio	0.16	0.14	
*Tracking Error	1.07%		
*Information Ratio	0.61		

Source: Maitland, Bloomberg (as at 30 September 2022)

Top 10 Portfolio holdings

Active Bond Top 10 Bond Holdings as at 30 September 2022

NAME	CODE	% OF PORTFOLIO
1. REPUBLIC OF SOUTH AFRICA	R2048	12.25%
2. REPUBLIC OF SOUTH AFRICA	R2032	9.12%
3. REPUBLIC OF SOUTH AFRICA	R2037	8.55%
4. REPUBLIC OF SOUTH AFRICA	R2035	8.47%
5. REPUBLIC OF SOUTH AFRICA	R2044	8.08%
6. REPUBLIC OF SOUTH AFRICA	R2040	7.45%
7. REPUBLIC OF SOUTH AFRICA	R2030	6.86%
8. REPUBLIC OF SOUTH AFRICA	R213	3.80%
9. REPUBLIC OF SOUTH AFRICA	R209	2.97%
10. REPUBLIC OF SOUTH AFRICA	R214	2.53%
TOTAL		**70.09%**

Source: Maitland (as at 30 September 2022)

Umthombo Active Bond Fund - Portfolio Positioning

	Q4 2021	ALBI (Q4)	Q1 2022	ALBI (Q1)	Q2 2022	ALBI (Q2)	Q3 2022	ALBI (Q3)
Modified duration	6.56	**6.35**	6.48	**6.59**	6.32	**6.57**	6.03	**6.12**
Running yield	9.41%	**9.51%**	9.08%	**9.63%**	9.59%	**10.27%**	9.37%	**10.47%**
Cash & 0-1yr	0.98%	**0.00%**	6.20%	**0.00%**	7.46%	**0.00%**	9.89%	**0.00%**
1-3yrs	3.81%	**4.30%**	3.72%	**0.33%**	3.88%	**0.32%**	3.86%	**0.77%**
3-7yrs	14.84%	**19.24%**	10.76%	**20.59%**	10.57%	**20.42%**	11.37%	**19.90%**
7-12yrs	22.96%	**27.81%**	21.84%	**28.61%**	22.40%	**29.10%**	21.67%	**29.28%**
12+ yrs	57.41%	**48.66%**	57.48%	**50.47%**	55.68%	**50.16%**	51.76%	**50.05%**

Source: Maitland, Bloomberg (as at 30 September 2022)

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30 June 2022

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