Momentum AM Inflation-Linked Bond Fund

Unitised Funds | Pooled Portfolio Range

30 September 2016

momentum asset management

Fixed Income Strategies

Fixed Income

Product profile

The Momentum AM Inflation-Linked Bond Fund is an actively managed inflation linked bond portfolio that seeks to generate out performance relative to the Inflation Linked Bond Index over the long-term. This portfolio is ideally suited to clients with a low-medium risk profile who require inflation linked, fixed income returns. In addition the fund is also suited to clients seeking to customise their investment strategies through the use of specialist investment portfolios, or where member choice options are available to the members. This portfolio is also available as a segregated mandate.

Investment strategy

Active management, aimed at generating superior performance, is achieved by extracting value from several inflation-linked sources. These sources include:

- Duration;
- Yield curve;
- Credit;
- Alternative strategies

The Momentum AM Inflation-Linked Bond Fund reflects the Fixed Interest Team's best investment view, which takes advantage of opportunities in each of the above areas. Views are taken across a diverse set of opportunities within the inflation linked bond market and risk limits are constrained within the framework of a defined mandate.

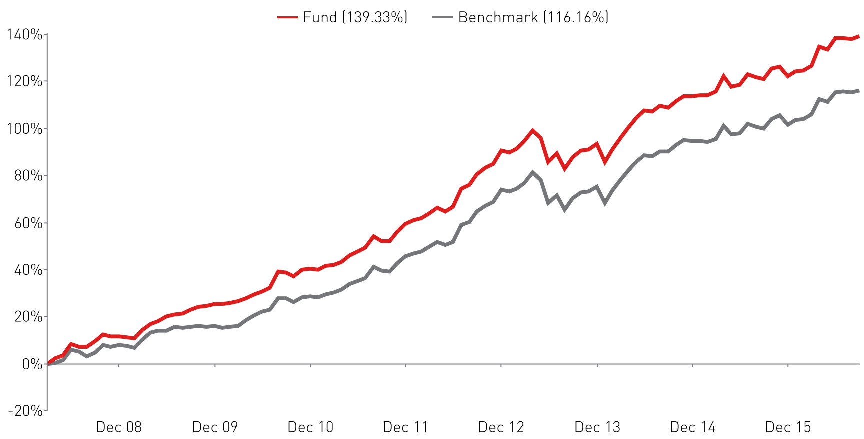
Performance objective

The Fund's objective is to outperform the Barclays Inflation Linked Bond Index ("ILBI").

Fund details

Inception	1 April 2008
Minimum investment size	No minimum investment
Termination	30 days written notice
Market value	R 460.07 million
Benchmark	
Barclays Inflation Linked Bond Index ("ILBI")	
Prior to August 2010 the Fund was not benchmark cognisant.	
Fund Managers	
Conrad Wood	
BCom (Economics), CFA	

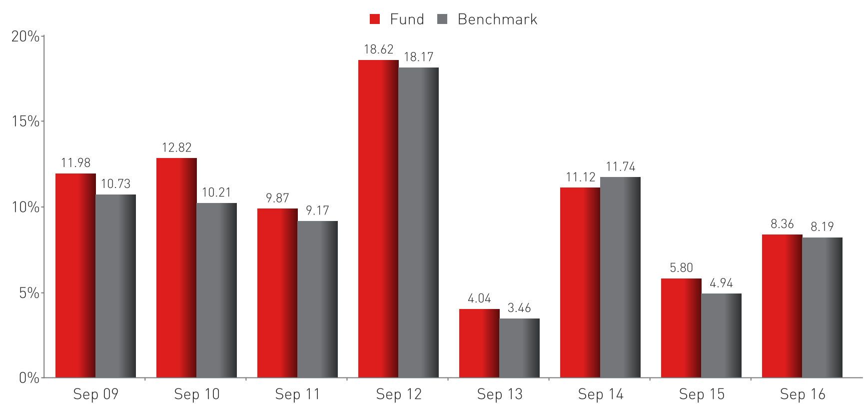
Cumulative performance since inception



Performance – returns (%)

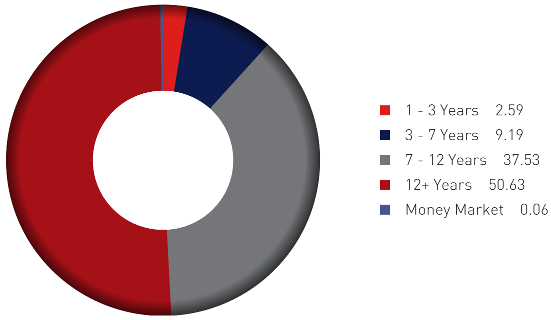
	Fund	Benchmark
Quarter	0.43	0.42
1 year	8.36	8.19
3 years	8.41	8.25
5 years	9.47	9.17
Inception	10.81	9.48

Performance – annual returns (%)

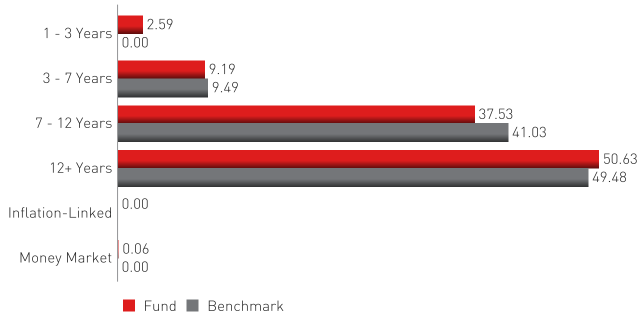


Performance shown is gross and includes all income reinvested, for periods over 1 year the returns are annualised. Source: Momentum Asset Management.

Portfolio composition: term to maturity



Portfolio & Benchmark weightings (%)



Quarterly commentary as at 30 September 2016

Inflation-linked bonds (ILB's) faded badly this quarter as the improving inflation outlook caused potential investors to be somewhat more circumspect. Real yields rose across the curve, detracting from the total return of ILB's for the quarter. The benchmark ILB index delivered 0.42%, which lagged cash (Stefi 1.86%) and substantially underperformed nominal bonds (ALBI 3.42%) for the period. The total return from ILB's can be divided into two components – the monthly inflation and yield accrual and the mark-to-market of the capital value invested due to the move in the real yields.

The first component of return is the monthly accrual from the yield on the bonds and the inflation uplift. This component of the total return was much lower than last quarter, although still ahead of cash, at 2.04%, with 1.57% from inflation uplift and around 0.48% from yield accrual. The second component of the return is determined by the move in real yields of the bonds. Real yields rose around 14 bps on average, thereby generating capital losses to the tune of 1.62%. These two components combined thus explain the index total return of 0.42%.

Real yields have moved out of their recent range and traded up to an average 1.90%. They still look too low to us on a number of measures that we look at. Inflation looks set to come down aggressively later this year, placing upward pressure on real yields. S.A. ILB yields remain among the lowest against EM peers and are around fair on a spread to U.S. real yields. The risk to us is that the trend from this quarter repeats itself and inflation eases, with real yields selling off further. This would drag ILB returns down and we expect them to struggle to outperform cash.

Portfolio overview

Our cautious view on ILB's has led us to run exposure close to the minimum permissible by the mandate (60%), as inflation looks set to peak and decline fairly significantly. The outsized performance in nominal bonds continues to frustrate us and while we have had bond exposure in the portfolio, it has not been big enough given the performance generated by nominal bonds. We have a healthy cash weighting given the view that ILB and nominal yields should be higher, although our preference is for nominal bonds to outperform ILB's.

Portfolio positioning

Duration / Allocation – the duration of the portfolio has been reduced over the quarter, largely through selling of a portion of the nominal bond exposure given the significant rally in yields. The portfolio has 63% in ILB's relative to its mandated minimum of 60%. This indicates our view that ILB's are expensive on a medium-term horizon, but do offer some protection if inflation really runs away on the upside in a weak rand environment. We would need real yields to move around 50 basis points higher before adding material exposure to ILB's. In addition, nominal bond exposure is around 5% of the portfolio (down from 10% last quarter).

Yield curve – the real curve is very flat and we favour medium-dated ILB's over longer-dated ones, while the nominal bond curve is likely to continue

Contact details

Kevin Milne | Fund Specialist | +27 (0)21 658 7078 | +27 (0)82 900 3407 | kevin.milne@momentum.co.za

Disclaimer

Momentum Asset Management (Pty) Ltd
13th Floor, Tower 2, 102 Rivonia Road, Sandton, 2196. Private Bag X9959, Sandton, 2146.
Telephone +27 (0)11 505 1000   Facsimile +27 (0)11 505 1440   AM.Info@momentum.co.za   www.momentum.co.za/assetmanagement
Momentum Asset Management, registration number 1987/004655/07, VAT No. 4200149096, is an authorised financial services provider,
FSP licence number 623 and an approved Retirement Fund Administrator (No. 24/34).
Directors: E Gouws | D Lessing | A Nortjé | M Vilakazi.
Company Secretary: V Mngambi.