Discovery Diversified Income

30 April 2025

Market background

The Fast View

- President Trump's tariffs fuelled market uncertainty and global trade tensions
- China responded with reciprocal tariffs on US goods
- SA finance minister is set to table his third Budget after the collapse of political support for the previous iteration

Performance review

For the month, the portfolio outperformed the benchmark.

The month opened with President Donald Trump announcing sweeping tariffs on nearly all US trading partners, triggering a broad-based sell-off in global markets. Developed market yields initially declined as investors sought safety but later spiked, with US Treasury yields rising notably, reflecting heightening concerns around the US economy and global growth. The sharp market volatility ultimately prompted the US administration to announce a 90-day pause on some tariffs excluding China. By the end of the month, the US Treasury yield curve had steepened, with front-end yields (bonds with a maturity of 1-5 years) lower, 10-year yields broadly unchanged, and 30-year yields higher.

Sovereign bond yields fell in Europe, particularly at the front end of the yield curve. Driving factors included a weaker growth outlook following President Trump's tariff announcements and falling inflation in Europe, pointing to the European Central Bank (ECB) continuing with its rate-cutting cycle.

Emerging markets proved resilient, with the JPM GBI-EM index returning 3.25% for the month. Locally, the rand weakened to above R19/USD from a low of R18.32 due to the dispute in the Government of National Unity about the Budget; however, it rebounded, supported by easing inflation and lower fuel prices as well as relief from the pause in tariffs. Annual CPI inflation decreased to 2.7% year-on-year(y/y) from 3.2% in March, printing well below the South African Reserve Bank's (SARB's) midpoint target of 4.5%.

Risk assets initially sold off sharply amid the heightened volatility. The yield on the South African 10-year bond rose above 10.60% and, at the peak of the sell-off, exceeded 11.10%. However, the month was unchanged after President Trump's 90-day tariff pause cooled the markets. We took advantage of this dislocation by adding duration into weakness and subsequently trimmed exposure as the market recovered towards month-end.

We were underweight inflation-linked bonds (ILBs), which detracted from performance this month.

After weighing on performance in the previous quarter, listed property recovered in April. We used this opportunity to reduce our exposure to the asset class.

Within credit, we added short-dated investment-grade dollar credit, which had been meaningfully impacted during the rally and offered attractive entry points.

In FX, we increased our exposure last month amid the initial turbulence. At the start of this month, we took profits and rotated out of dollars into euros and some emerging market currencies.

Global

April began with President Donald Trump's so-called "Liberation Day," during which he announced sweeping tariffs on nearly all US trading partners. The move raised fears of a potential US recession and heightened market uncertainty. Tensions escalated further when President Trump hinted at firing Federal Reserve (Fed) Chair Jerome Powell due to his dissatisfaction with the direction of monetary policy—though later he clarified he had no intention of doing so, a reversal that reassured markets. In addition, the Fed held rates steady at 4.25%–4.5%, maintaining a cautious tone amid renewed inflationary pressures. Recent tariff announcements have complicated the Fed's outlook, raising concerns that external shocks could stall progress on inflation. While market pricing had initially leaned toward a Q2 cut, Fed officials reiterated the need for greater confidence that inflation is moving sustainably toward its target. In reflection of weaker growth expectations, markets are now pricing approximately 90 basis points (bps) of Fed rate cuts by year-end, up from around 75bps at the start of April. This is despite a more hawkish tone from US Fed Chair Powell, who warned that the larger-than-expected tariffs may lead to more persistent inflation.

Meanwhile, the US and China have agreed to lower tariffs for 90 days in a significant trade war de-escalation. This is after the two countries placed tariffs against each other of 145% (US) and 125% (China). This move was considered to lower global growth, fuel inflation in the US, and create job losses in China.

In the eurozone, the European Central Bank cut interest rates by 25bps to 2.25%, citing continued progress in disinflation. This provided support to European government bond markets. In the UK, the Bank of England (BoE) also cut its interest rate by 25bps to 4.25%, delivering its fourth consecutive rate cut since August 2024. The decision came against a softening domestic inflation, with headline CPI moving closer to the 2% target. Given the pace of disinflation and subdued demand, the BoE appears comfortable with a gradual easing cycle to support the economy.

South Africa

Finance Minister Enoch Godongwana is set to table his third Budget on 21 May 2025 following a Budget dispute between the ANC and DA, which culminated in the Western Cape High Court ordering the suspension of the National Treasury's proposed VAT hike. The minister is now expected to present a revised fiscal framework in which he will outline the Treasury's new plan to cover the R75 billion shortfall brought on by the VAT-hike reversal. While the political environment remains tense, we don't expect these developments alone to trigger a significant repricing in local bonds or the rand. Meanwhile, South Africa's annual inflation rate surprised to the downside, easing to 2.7% in March from 3.2% in February due to a drop in food and oil prices. The print falls below the lower bound of the SARB's target range of 3-6%. The softer print raised hopes that the SARB could begin cutting interest rates sooner than previously signalled. Elsewhere in the economy, the seasonally adjusted Absa Purchasing Managers' Index (PMI) fell by 4 points to 44.7 in April. This marked the sixth consecutive month the index remained in contractionary territory, with respondents concerned by global trade tensions, domestic political uncertainty and excessive rainfall.

Positioning

We are now positioned more defensively, with a focus on preserving capital following the recent market recovery. While we believe the worst may be behind us, we remain cautious given ongoing risks—particularly the continued unpredictability of President Donald Trump's policy direction.

Looking ahead, the upcoming SARB MPC meeting will be key. With inflation subdued, oil prices low, and the rand relatively strong, we believe the likelihood of a rate cut has increased meaningfully. In anticipation, we remain overweight South African government bonds (SAGBs) at the short end of the curve. Should the SARB hold rates steady this month, we believe a cut in July is highly probable.

We have made no further additions to our inflation-linked bond (ILB) holdings, given that domestic inflation remains well contained. In listed property, we reduced our allocation from just over 3% to 2.3%. We continue to monitor the recovery and will look to add exposure selectively as conditions improve.

In credit, we increased our allocation to short-dated US dollar credit, where we continue to see value. We also reduced our overall foreign exchange exposure by 1% and further diversified our currency holdings to include euros and select emerging market currencies.