Discovery Money Market

March 2025

Market background

Fast View:

- The 10-year US treasury yield declined over the quarter amid uncertainty about the US economic outlook
- The Fed held rates steady, citing concerns that US tariffs could stoke inflation
- German reforms drove 10-year bund yields sharply higher
- In SA, the GNU managed to pass the Budget without DA support

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Performance review

US Treasury yields ended a volatile quarter lower, with the 10-year yield falling 36 basis points (bps) to 4.2%. This was driven by weakening global investor sentiment and rising uncertainty around the US economic outlook. By quarter-end, markets were pricing in approximately 75bps of rate cuts in 2025 — 30bps higher than forecast at the start of the year. The US Federal Reserve (Fed) held rates steady, maintaining its projection for two rate cuts this year. Inflation expectations rose sharply in March, with the University of Michigan survey recording the highest long-term outlook in over three decades. Global trade tensions escalated, with new tariffs imposed on China, Mexico, and Canada. In Europe, bond markets were marked by elevated volatility. Despite two 25bps rate cuts from the European Central Bank (ECB), bond yields rose sharply due to shifting fiscal dynamics, particularly increased defence spending. The yield spike was most pronounced in Germany, where loosening fiscal rules led to the biggest daily rise in 10-year bund yields since 1990.

Despite this turbulent backdrop, emerging market (EM) fixed income delivered positive returns. Falling US Treasury yields and uncertainty around tariffs led to a weaker dollar, which supported EM currencies. The JP Morgan GBI-EM local currency index returned 4.3%, with both rates and currency moves contributing. In South Africa, the rand strengthened on contained inflation and low fuel prices. Inflation printed at 3.2% year-on-year (y/y) in February; however, due to the global outlook, the South African Reserve Bank (SARB) held rates at 7.5% after cutting by 25bps in January.

Over the quarter, the one-year fixed-rate negotiable certificates of deposit (NCDs) were broadly flat, tightening by just 3 basis points (bps) from 8.12% at the end of December to 8.09% in March. The market remained largely in a holding pattern during this period, trading in a narrow range. However, NCDs rallied sharply in early April, moving from 8.13% to 7.88% in a matter of days. The rand ended the quarter stronger, rallying from R18.84 to R18.32 after briefly touching a low of R18.08 in mid-March. But April has painted a very different picture. Mounting concerns over the potential collapse of the Government of National Unity (GNU), along with renewed tariff threats, triggered a sharp sell-off in the rand. The currency spiked to a high of R19.65 before settling around R19.50. Despite the rally in the short end of the market, South Africa underperformed relative to other emerging market currencies, as it is easy to trade. Initially, the market was pricing in 2 to 3 rate cuts by the US Federal Reserve in 2025. That has since shifted, with 4 to 5 cuts now priced in as expectations of a potential global recession gain traction. This more aggressive easing path reflects rising concerns about slowing growth and the potential for the Fed to respond decisively in the face of deteriorating global conditions.

For the quarter, the Fund outperformed the benchmark.

Key contributions:

- Floating-rate notes (FRNs) spreads narrowed during the quarter, influenced by regulatory shifts and sustained excess liquidity in the market.

Key detractors:

- A reduction in the repo rate by the South African Reserve Bank (SARB), combined with elevated liquidity levels, is expected to have a negative effect on portfolio performance due to lower yields.

Portfolio activity

Over the first quarter, the portfolio was managed with a cautious stance amid persistent global uncertainty and political risk. In January, as President Donald Trump's second term in office unfolded, we remained vigilant and looked for opportunities to add duration into weakness. Throughout the quarter, we gradually increased our allocation to floating-rate notes while allowing the portfolio's duration to roll in. We also added a small amount of duration in the middle part of the curve when opportunities arose. Despite the challenging backdrop, both the market and the portfolio demonstrated resilience and traded well.

Outlook and strategy

Global: President Donald Trump imposed sweeping 10% tariffs on nearly all US trading partners, including China, the EU, Mexico, and Canada — sparking a sharp sell-off in global markets. This weighed on risk assets and emerging market currencies as fears of a renewed trade war grew. In retaliation, China introduced fresh tariffs on key US exports — including LNG, crude oil, and agricultural goods — and hinted at restricting rare earth exports. Chinese regulators also launched investigations into several US companies, escalating tensions in the ongoing tech rivalry. In response to weaker-than-expected Q1 data, China ramped up economic support measures. President Xi Jinping hosted a high-profile meeting with top business leaders and unveiled new fiscal stimulus: expanded infrastructure investment, support for consumption, and credit facilities for SMEs and real estate. Europe shifted its focus toward defence and industrial resilience. Germany eased constitutional debt limits to facilitate over €1 trillion in long-term spending. The EU launched its €800 billion "ReArm Europe" initiative to boost reindustrialisation and autonomy. Inflation eased slightly, and sentiment improved modestly — though caution remains given external risks. The first quarter of 2025 was dominated by trade tensions, geopolitical realignment, and uneven global growth. With protectionism rising and policy divergence widening, markets remain fragile. A full-scale trade war could significantly slow global growth, particularly in China and Europe. We are monitoring developments closely to assess the impact on portfolio positioning, capital flows, and sentiment.

South Africa: The quarter highlighted the challenges of coalition governance. Disagreements within the Government of National Unity (GNU) delayed the Budget, originally due in February, over a proposed 2% VAT increase. Although the Budget was eventually passed in April, it lacked support from the DA – the second biggest coalition party, raising concerns about GNU cohesion. Inflation remained steady at 3.2% in February, while GDP rose 0.6% in Q4 2024 — narrowly avoiding a technical recession. However, weak manufacturing and mining data persisted. The SARB held rates steady amid global uncertainty and fragile local fundamentals. While 64% of South Africa's exports to the US are minerals — and thus unaffected by US tariffs — sectors like agriculture and motor manufacturing are more exposed. These could face pressure, with knock-on effects on growth and employment.

Positioning

The inflation outlook remains positive from here, and we expect prices to stay low to mid 3% for a significant period, with a slight uptick in the second half of 2025 – but still below the SARB's mid-point target.

The market has priced in close to an additional 50bps of cuts from the SARB, which we think is reasonable given the potential global slowdown concerns. We remain slightly long and will continue to look for opportunities to add duration into weakness.