

# Discovery Money Market

September 2024

## Market background

### The Fast View

- Cooling US inflation and expectations of further rate cuts led to a sharp fall in US Treasury yields
- US Fed cut interest rates by 50 basis points (bps) for the first time in four years
- Beijing announced a co-ordinated stimulus plan to revive its economy
- The rand found support in a weaker US dollar and a positive shift in sentiment towards the South African economy
- Performance in the money market benefitted as markets began to price in central bank rate cuts

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## Performance review

Falling inflation and interest rate cuts provided a boost to many fixed income markets. Interest rate cuts in the US led to a sharp fall in Treasury yields. As was expected by some, the US Federal Reserve (Fed) reduced interest rates for the first time in four years in its September meeting. After much debate across markets, a larger 50bps cut reflected a slowing labour market and increased confidence around inflation dynamics.

Given the backdrop of falling developed market bond yields, weaker US dollar and increased appetite for risk, emerging market (EM) fixed income and currencies delivered a strong performance.

Performance in the money market benefitted as markets began to price in central bank cuts as inflation continued on a downward trajectory. Over the period, one-year fixed-rate negotiable certificates of deposit (NCDs) rallied significantly by 73 basis points (bps) from 8.95% at end of September to 8.22%.

Cash, as measured by the STeFI Composite Index, recorded a 2.05% return for the quarter. The rand strengthened against the greenback and euro but lagged against pound sterling.

For the quarter, the Fund outperformed the benchmark.

### Key positive contributions:

- Spreads in floating-rate notes (FRNs) remained attractive over the quarter and we took advantage of this in recent months, with the excess yield over benchmark rates continuing to be a positive contributor to



performance.

#### Key negative contributions:

- With excess liquidity in the market, there were limited opportunities in the very short end of the cash yield curve.

## Portfolio activity

We continued to add duration over the quarter, while also finding opportunities to add floating-rate notes at attractive spreads.

## Outlook and strategy

**Global:** The US economy remains resilient based on available data, while Europe has lagged. We do expect the US economy to be weaker this year coming off the strong performance from 2023. The US labour market has cooled, but we continue to see robust job creation. With the inflation leg of the Fed's mandate now grinding to a halt, we believe that going forward, labour data will be the main determinant of the timing and quantum of further policy normalisation. Elsewhere, Europe and China continue to grapple with lukewarm cyclical data and structural issues. Although inflation is contained in China, a miss in Q2 GDP print and an uneven recovery so far dims the outlook for commodity exporting countries and EMs more broadly. The end of the quarter witnessed a revival when Beijing announced a coordinated stimulus plan. While capital market sentiment has risen strongly, concerns over the trajectory of the economy remain. The call for increased fiscal spending, and the implementation of rate cuts raised market expectations for additional stimulus, particularly on the fiscal front. The focus on stimulating domestic consumption renewed optimism for long-awaited measures aimed at stimulating demand. We continue to monitor escalating geopolitical tensions, especially in the Middle East, as any escalation here is likely to have an inflationary impulse through higher oil prices, while investor attention has now begun to laser in on the tail risks of the upcoming US election and its implications for capital markets.

**South Africa:** SA growth is showing signs of improvement due to some positive developments, including increased electricity supply, easing of the logistics crisis at the ports which should improve productive capacity and exports, moderating inflation and lower interest rates, which should alleviate some of the pressure on the consumer, while the two-pot system withdrawals are also expected to have a short-term boost to households. We have already seen GDP (+0.4% in Q2 2024 from a revised flat print in Q1 2024) improve on the back of no loadshedding for a full quarter. Manufacturing was a notable rebound in Q2, as was construction, while agriculture pulled back. Eskom's Generation Operational Recovery Plan has seen a marked improvement in reducing unplanned outages, while carrying out more planned maintenance. The energy availability factor has trended consistently above 60%, and at the time of writing, the country has enjoyed six months without any loadshedding. With this trend expected to continue to, we are more optimistic on the growth prospects for 2H2024.

#### Positioning

The South African Reserve Bank (SARB) assesses the risk to inflation to be balanced, whereas previously they were on the upside. The rand continues to benefit from disinflationary trends abroad and locally, supported by strong gold prices, also finding support from the formation of the Government of National Unity, which has seen a more optimistic outlook begin to take shape on South African assets. Our terms of trade have thus improved, as have interest rate differentials following the Fed and SARB cuts.



We expect inflation to average 4.5% in 2024 (vs. SARB at 4.6%) and 4.1% in 2025 (vs. SARB at 4.0%), while the SARB has made material downward revisions to their core inflation forecasts.

While we see further policy normalisation to come from the SARB, we expect a shallow cutting cycle going forward. We believe valuations appear fair in the money market, which has rallied a fair amount. We continue to look for opportunities to add duration.