Discovery Diversified Income

31 July 2025

Market background

Global markets navigated a wave of macro headlines in July, with trade policy and tariffs once again the main talking points. By the end of July, the US had secured trade deals with several major partners, extended deadlines for others (notably China), and enforced higher levies on holdouts across various key markets. The South African government was unable to reach a trade agreement, meaning that the country currently faces up to 30% tariffs on exports to the US, effective early August.

Overall, US Treasury yields ended the month higher across the curve. There was a sharp rise in yields mid-month, reflecting fears around the potential dismissal of Fed Chair Powell and signs that trade tariffs had begun to feed through to consumer prices. However, yields began to fall back, as fears of an escalation in trade tensions faded somewhat after several negotiated deals featured less punitive tariff measures than initially anticipated. The Fed left its monetary policy unchanged at its end-of-month meeting. The accompanying statement struck a marginally dovish tone, but Powell made a more hawkish speech in the press conference, prompting markets to scale back expectations for further policy easing.

Domestically, fears about the Government of National Unity (GNU) dissipated, as support for the Appropriation Bill led to the final passing of the proposed budget. The bond market rallied as a result and the yield curve flattened as long-term rates fell. Inflation has remained well contained and the South African Reserve Bank (SARB) has shifted its focus towards the lower end of the target range of 3-6%. Based on its optimistic view on inflation, the SARB announced a 25bps interest rate cut to bring the repo rate down to 7% - the third interest rate cut so far this year.

Performance review

The portfolio outperformed its benchmark over the month.

The portfolio benefited from its positioning in longer-dated bonds – this area of the market rallied, as noted above.

More generally, performance was driven by the portfolio’s duration exposure, given the SARB’s cut in interest rates and shift in focus towards the lower end of the target inflation range, as outlined earlier.

Outlook and strategy

The outlook for South Africa is constructive, with the government seemingly moving on from its previous internal issues. Although trade tariffs imposed by the US remain a threat to potential growth, we are optimistic about the possibility of a trade deal being agreed over the next few months.

The SARB's change in inflation focus is based on the view that inflation expectations will fall quite quickly; while inflation remains contained, we will be carefully monitoring inflation dynamics and how market participants adjust their expectations.

Duration

We have maintained our overweight positions in nominal bonds but remain watchful of inflation dynamics and expectations, as noted above.

Curve positioning

We continue to favour long-dated bonds as we believe the fiscal outlook remains stable and the yield curve can continue to flatten.

Currency

Given the tariff-related uncertainty noted above, we have positioned the portfolio to weather potential negative events for the rand by holding downside protection (via options), while continuing to have modest overseas currency exposure.

Property

While the portfolio's overall property exposure remains largely unchanged, our rotation of positioning across the sector has resulted in a slight increase.

Linkers

While we are underweight inflation-linked bonds (ILBs) and our preference remains towards nominal bonds – which stand to benefit from benign inflation dynamics – we do see some value in short-dated linkers as the breakeven rate has fallen substantially.

Credit

There is no change to our outlook on credit, which continues to favour banks and strong investment-grade issuers.