Discovery Diversified Income

31 August 2026

Market background

Fixed income markets came under pressure. South Africa's 10-year bond yield ended August at around 8.74%, its highest level since mid-month, as a firmer US dollar and hawkish remarks from US Federal Reserve (Fed) Chair Kevin Warsh reinforced expectations that US rates would stay higher for longer; Warsh argued inflation had not slowed meaningfully even as he reaffirmed his commitment to the Fed's target, while renewed Middle East tensions weighed on risk sentiment and pushed oil prices higher. Long-dated yields eased into month-end after the US Treasury caught markets off guard, announcing a doubling of its buyback operations for longer-dated debt in August. Locally, headline inflation eased to 4.3% year-on-year in July from 5.0% in June, below consensus expectations of 4.5%, but still above the South African Reserve Bank's 3% target. Most of July's disinflation was fuel-driven, as fuel prices slowed, while core inflation edged up slightly to 4.2% from 4.1% the previous month.

The rand strengthened through most of August, trading down to below 16.00 against the US dollar — its strongest level since late February, as bouts of dollar weakness and rising gold prices (a tailwind for a major gold-producing economy) supported the currency, before Warsh's hawkish Jackson Hole remarks introduced some late-month volatility.

Performance review

The portfolio underperformed its benchmark over the month.

Positive gains from duration were offset by weaker listed property performance: the property component weighed on performance as the sector gave back some of the prior three months' strong gains, though we maintain a positive outlook on the sector. More positively, the inflation-linked bond component added to performance, as did the yield-enhancing credit allocation. FX exposure was kept light through the month, and we took profits ahead of Jackson Hole late in the month, thus reducing FX drag on performance.

Outlook and strategy

South Africa's fiscal position remains encouragingly strong. National Treasury has managed the fiscal position well, with revenue running ahead of forecasts, largely on the back of the commodity boom. Gold and platinum prices remain elevated, while coal has recently joined the trend. At the same time, expenditure remains tightly controlled, debt-to-GDP has been kept in check and bond issuance has been steadily reduced. Overall, this provides a more supportive backdrop for the local bond market. The risk case is increasingly coming from offshore rather than domestically. Developed-market yields have been moving steadily higher as concerns regarding fiscal slippage in global markets grow. This effectively means that while South Africa's fiscal position remains supportive, rising global yields have become a more persistent headwind for the local bond market.

Duration

We have added duration in the 30-year area, which has underperformed and now offers more attractive entry levels.

Curve positioning

We have layered hedges at the short end at what we consider attractive levels. With fewer than 50 basis points of SARB hikes priced in and the Fed adopting a more hawkish tone, the portfolio is positioned to benefit should inflation surprise to the upside.

Currency (ONLY FOR Diversified income and Dynamic Income portfolios)

We ran very light FX exposure over August, holding an overweight position in euros rather than dollars to limit the drag from negative dollar sentiment, and took profit on that position going into Jackson Hole towards the end of the month. Following the Fed's more hawkish remarks, we have since increased dollar exposure going into month-end.

Property

Listed property remains very attractive, given the attractive yields and double-digit dividend growth across much of the sector. We maintain an overweight allocation.

Inflation-linked bonds

We maintain an overall neutral allocation to inflation-linked bonds, with some short-dated exposure to hedge against upside risks to inflation.

Credit

Our view remains positive on corporate bonds. Since July, we have been rotating out of local-duration exposure into offshore investment-grade credit — reflecting persistent domestic upside inflation risks and a relatively healthy global growth backdrop, and continuing to provide attractive yield enhancement relative to domestic government bonds.