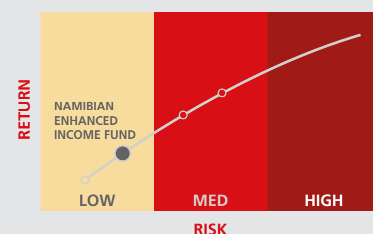
PRUDENTIAL NAMIBIAN ENHANCED INCOME FUND
30 JUNE 2021

PRUDENTIAL PORTFOLIO MANAGERS

QUARTERLY COMMENTARY

MULTI-ASSET

RISK/RETURN PROFILE:



FUND MANAGERS:
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MORNINGSTAR CATEGORY:
Africa Fixed Income

BENCHMARK:
IJG Money Market Index

INCEPTION DATE:
19 June 2014

FUND SIZE:
N$3 136 028

MARKET OVERVIEW

During the second quarter (Q2) of 2021, more progress in vaccine rollouts worldwide, as well as positive corporate earnings reports and economic news, continued to lift equity returns, particularly in developed markets, even as concerns emerged over high valuations. Bonds – both government and corporate credit – also recorded solid performances, retracing some of their Q1 losses and buoyed by reassurances from central banks that easy monetary policies would not be halted any time soon. It was no coincidence that cheaper, out-of-favour equities like Listed Property were among the strongest performers, while more expensive sectors like Resources underperformed.

Meanwhile, the approval of even more US government spending helped support the global growth outlook, as did improving conditions in the UK and Europe. However, emerging market equities lagged those of developed markets, and South African equities broadly underperformed their EM peers due largely to the market's high Resources exposure, after outperforming in Q1. In contrast, South African nominal government bonds posted strong returns compared to those of many other countries over the three months.

In the US, the economy gathered speed as Q1 GDP growth was recorded at a final 6.4% (q/q annualised) and Q1 consumer spending jumped 11.1% y/y, amid a ramp-up in factory production and signs of labour shortages. Bullish sentiment was further stoked by the bipartisan approval of a five-year, US$1.2trn infrastructure spending plan.

At its June policy meeting, the US Federal Reserve (Fed) left interest rates unchanged, easing investor concerns over rising inflation, while also signalling two 0.25% interest rate hikes by the end of 2023. Longer-dated US Treasuries rallied on the accommodative stance, helping flatten the UST yield curve after its steepening trend in previous quarters. This was despite headline consumer inflation of 5.0% y/y in May, its highest rate in nearly 13 years, which policymakers consider to be temporary.

Spurred by the improving growth outlook, US equity markets continued to rally for the quarter (although June gains were more subdued), with the S&P 500 delivering an 8.5% return, the Dow Jones Industrial 30 5.1%, and the technology-heavy Nasdaq 100 11.4% (all in US$).

In the UK, the rapid spread of the Covid-19 Delta variant, in the face of the country's successful implementation of its vaccination programme, proved to be a setback for the economy's anticipated full reopening in June, dampening market sentiment to some extent. The latest GDP figures proved equally bleak as the economy shrank by 6.1% y/y in Q1 2021. In the EU, Q1 GDP contracted by 1.7% y/y, while the European Central Bank (ECB) left interest rates on hold at its June policy meeting. Consumer inflation in the EU rose to 2.3% y/y in May, due largely to a low annual base effect. For the quarter, French equities far outperformed their regional counterparts as the CAC 40 delivered 10.1%, the UK's FTSE 100 5.8%, and the German DAX 4.4% (all in US$).

Japan's economic contraction for Q1 2021 was revised to -3.9% y/y from a previously estimated -5.1% y/y, above market expectations of -4.8% y/y. However, further restrictions to economic activity due to the worsening spread of the Coronavirus, particularly in the Tokyo region, have led many to expect Q2 growth to be weaker. The Bank of Japan left its key short-term interest rate unchanged at -0.1% in June, and also extended the deadline for its pandemic-relief programme from September 2021 to March 2022.

In China, GDP growth slowed to 0.6% q/q in Q1 2021 from 3.2% the previous quarter. The People's Bank of China again left its lending rates on hold in June, while noting in its Q1 monetary report that it was more worried about an uneven economic recovery, weak consumer spending and lack of private business investment than rising prices. For the second quarter of 2021, Japan's Nikkei 225 returned -1.6%, the MSCI China produced 2.3% and Hong Kong's Hang Seng delivered 2.9% (all in US$).

Among other large emerging equity markets, in US$ terms Brazil's Bovespa was by far the best performer with a 22.3% return, rebounding from a disastrous Q1, while the MSCI Russia delivered 14.4%. The MSCI India posted a respectable 7.0% and South Korea's KOSPI 6.3%, but the MSCI South Africa and MSCI Turkey both ended in the red with -1.3% and -0.2%, respectively, all in US$.

After gaining over 22% in the first quarter of 2021, the spot price of Brent crude oil rose another 18.2% in Q2, for an increase of 45% so far in 2021, fuelling inflation around the globe. As for commodity prices, most were higher over the quarter with the exception of platinum, which lost 7.4%. The gold price gained 4.5% for the quarter, and palladium was up 3.5%, giving it a 40% gain over the past 12 months. Industrial metals were also stronger: nickel rose 14.6%, aluminium 11% and copper 6%.

Namibia and South Africa

Despite kicking off its vaccination programme in Q1, like South Africa, Namibia experienced an unprecedented third-wave surge in Covid-19 infections during Q2 2021, spurring further lockdown measures from the government. This created a critical oxygen shortage in hospitals and led to more deaths, which the government has tried to combat by setting up public "oxygen banks". Much more remains to be done to slow the infection rate in the country.

Of note was that the Namibia Statistics Agency (NSA) reported that 43% of Namibians are still poor, living in multi-dimensional poverty with limited access to health and education services, and suffering some type of deprivation. Meanwhile, the domestic economy fell deeper into recession, contracting by 6.5% (q/q annualised) in Q1 2021 as it continued to suffer from the effects of the lockdown. Consumer and business spending and investment remained weak. The slowdown was driven by weak performances in most key sectors of the economy, including livestock marketing, mining (largely due lower diamond and gold production), construction, manufacturing, wholesale and retail trade and tourism. However, some signs of improvement were seen in sea cargo volumes and new vehicles sold.

Inflation was still subdued despite rising during Q2 2021, last recorded at 3.8% y/y in May and driven mainly by higher prices for food and housing. During its June MPC meeting, the Bank of Namibia (BoN) decided to keep its repo rate unchanged at 3.75%, following the SARB's steady policy. The BoN said the low rate remained appropriate to support domestic economic activity and safeguard the Namibian dollar's link with the rand, citing the ongoing measures to contain Covid-19 infections which aggravated the weak prospects for domestic growth, as well as low inflation, adequate foreign reserves, and low South African interest rates.

As a percentage of GDP, government debt rose yearly by 6.3 percentage points to 62.0%, however total loans/GDP fell slightly to 6.4%, remaining within the government's ceiling of 10% of GDP. Going forward, the government's budget deficit for FY2021/22 is

ANNUALISED PERFORMANCE	A CLASS	BENCHMARK	B CLASS
1 year	4.8%	4.5%	5.2%
3 years	5.2%	6.4%	5.5%
5 years	5.8%	7.1%	6.2%
7 years	5.9%	6.9%	6.3%
Since inception	5.9%	6.9%	6.3%

Inception date B Class: 19 June 2014

Sources: Prudential, Morningstar & Deutsche Securities

estimated to narrow to 8.6% of GDP, down from 9.5% in the previous fiscal year due to the continuation of the government's expenditure consolidation programme.

In South Africa, economic growth surprised to the upside as Q1 2021 GDP growth measured 4.6% q/q annualised, notably higher than the 2.5% market forecast. Covid-19 vaccine supplies continued to make their way into the country and the government's vaccination programme made headway, but this progress was overshadowed in June as President Cyril Ramaphosa was forced to reintroduce Level 4 lockdown measures in the face of the spreading third wave of Covid infections.

Meanwhile, the South African Reserve Bank kept its benchmark interest rate unchanged at a record low of 3.5% at its 20 May MPC meeting, warning that slow progress on vaccinations, limited energy supply and policy uncertainty continued to pose downside risks to the economic outlook. This was despite the jump in consumer inflation to 4.4% y/y in April and 5.2% y/y in May, attributed largely to the previous low base. The central bank raised its growth forecasts for 2021 from 3.8% to 4.2%, but lowered its projections for 2022 and 2023 to 2.3% and 2.4% respectively. It is also projecting two 25bps interest rate hikes in 2021.

The FTSE/JSE ALSI was roughly flat for the second quarter, returning 0.05%, while the FTSE/JSE Capped SWIX All Share Index, which we use as the equity benchmark for most of our client mandates, returned 0.6%.The standout sector was Listed Property (the All Property Index) with an 11.1% total return. Financials delivered 7.5% and Industrials eked out 0.8%, but the Resources Index returned -5.0%. This performance reflected the value still seen in "SA Inc" counters, which have lagged during the recovery, and the growing view that Resources shares may be reaching the end of their bull run.

Namibia's NSX Overall Index returned 3.5% over the three months, helped by sound performances from Financial and Industrial stocks, while Resources weighed on returns. Resources delivered -0.9%, while Industrials produced 7.6% and Financials 7.7% for the quarter. Healthcare eked out a 1.5% return.

SA bonds posted a strong 6.9% return (as measured by the FTSE/JSE All Bond Index), remaining sought-after sources of yield for global investors compared to many other sovereign bonds. SA inflation-linked bonds produced 3.0% (Composite ILB Index) on the back of somewhat softer demand for inflation protection, and cash (STeFI Composite) delivered 0.9%. Namibia's All Bond Index also gained ground, returning 3.4% for the quarter. Namibia's IJG Money Market Index delivered 1.0% in Q2 2021.

Finally, the Namibian dollar and rand appreciated against the major global currencies over the quarter, rising strongly from their oversold position in April and May before retracing some gains in June. They gained 3.3% against the US dollar, 3.1% versus the pound sterling and 2.4% against the euro over the three months.

PERFORMANCE

The fund delivered 1.6% (net of fees) for the quarter ending June 2021 outperforming its benchmark by 0.6%. For the 12 months ending 30 June 2021, the fund returned 4.8% (net of fees in N$), while the benchmark returned 4.5% over the same period.

Investments in SA and Namibian fixed-rate and inflation-linked bonds, SA property and international assets (hedged back into rand) contributed positively to overall fund returns.

STRATEGY AND POSITIONING

The fund continues to hold at least 45% of its assets in Namibia by investing in the Prudential Namibian money market unit trust fund and short dated Namibian government bonds. The remainder of the fund is invested in the South African Enhanced Income Fund.

In the second quarter of 2021 we made a few changes to the **offshore allocation** of the fund. We purchased US dollar-denominated SA government bonds which we hedged back into rand using currency futures. These purchases were funded from the sale of SA government bonds. We maintained our exposure to **US high yield corporate bonds** while selling our holdings of US dollar-denominated **Growthpoint bonds**.

We reduced our positioning in **SA listed property**, which has been the best-performing sector (and asset class) so far this year, recording a 20.1% return over the six months to the end of June 2021. Earnings have been broadly flat, and our modest positioning therefore reflects our belief that risks around property company earnings remain high, combined with the continuing relatively high debt levels in the sector. We have ensured that we are holding high-quality companies with strong balance sheets within our small exposure to the sector.

SA nominal bonds enjoyed strong returns in the second quarter, and the fund benefitted from this exposure. We continue to be constructive on this asset class and the fund's exposure is tilted towards shorter-dated maturities, which we believe offer attractive medium-term returns compared to cash.

We maintained our exposure to **SA inflation-linked bonds (ILBs)** during the quarter even though the gap between ILBs and cash real yields narrowed on the back of the rally in ILBs (as the 10-year ILB rallied by 80bps), while cash real yields remained steady. ILB real yields are still attractive compared to their own history and our long-run fair value assumption of 2.5%, hence we are constructive on this asset class. Relative to cash, we believe the medium-term return outcome for ILBs will be superior.

We believe that **SA cash** offers poor prospective real returns and have therefore allocated capital to more attractive asset classes, as mentioned above.

Lastly, the fund benefited from an increase in **Namibian money market** yields across most tenors, most notably in the six- and 12-month tenors which increased by an average of 30bps from where they were the previous quarter. Floating rate spreads over three-month JIBAR also increased somewhat, averaging around 60bps at quarter end. ■

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Sources: Prudential, Morningstar & Deutsche Securities