EFFICIENT WEALTH

it's what we do

Update on **NAVIGA** income portfolio

Flexible income funds can invest in various income-generating instruments, such as bonds, property, and global, to enhance the yield above money market rates. The ongoing Russia-Ukraine crisis resulted in negative market sentiment and higher inflation expectations, which have had a negative impact on these asset classes.

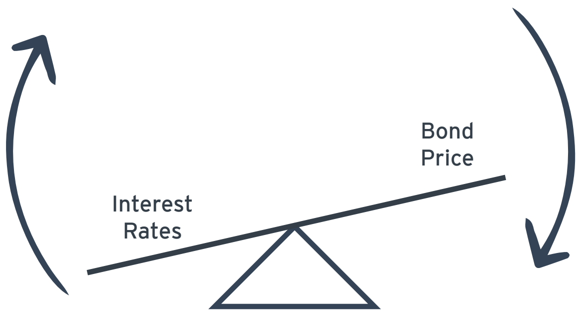
WHAT ARE BONDS?

An entity, such as a government, a bank, or a corporate, will issue a bond whereby it borrows funds at an agreed-upon rate for a specific period, such as one, three, five years, or even longer. Every six months, the entity pays a coupon (interest). At the end of the term (maturity date), the capital is repaid by the borrower to the lender.

BOND TYPES	INTEREST RATES
Nominal bonds	Fixed
Inflation-linked bonds	Linked to inflation
Floating-rate bonds	Variable

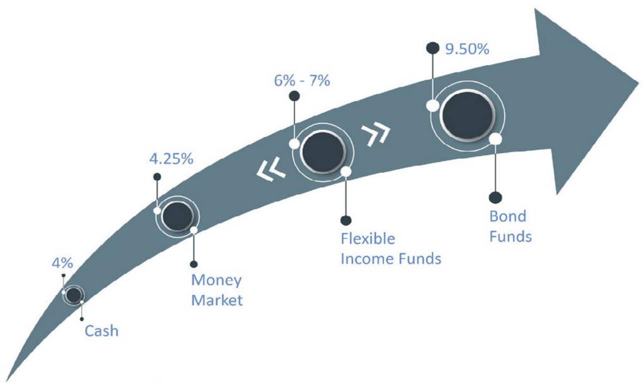
HOW ARE BONDS PRICED?

Bonds are issued at a fixed interest rate for a specific term. The yield is determined by the risk of the entity that issues the instrument. Banks and corporates tend to pay a higher interest rate than the government, and South African bonds offer a higher yield than developed markets. Although the capital to be repaid remains the same, the capital amount during the term can vary, owing to a change in interest rates (bond yields). As illustrated, the capital value of a bond declines when interest rates rise. This is to compensate new investors for higher yields in the market.



WHY INVEST IN BONDS?

Short-term rates, such as money markets, remain below inflation. As illustrated by the yield curve, bonds offer much higher yields than cash. Flexible income funds can actively move between cash and bonds to manage the interest rate risk in a portfolio. Flexible income funds offer a higher yield than cash and inflation.



Approximate yields as at 28 February 2022

PORTFOLIO CHANGES

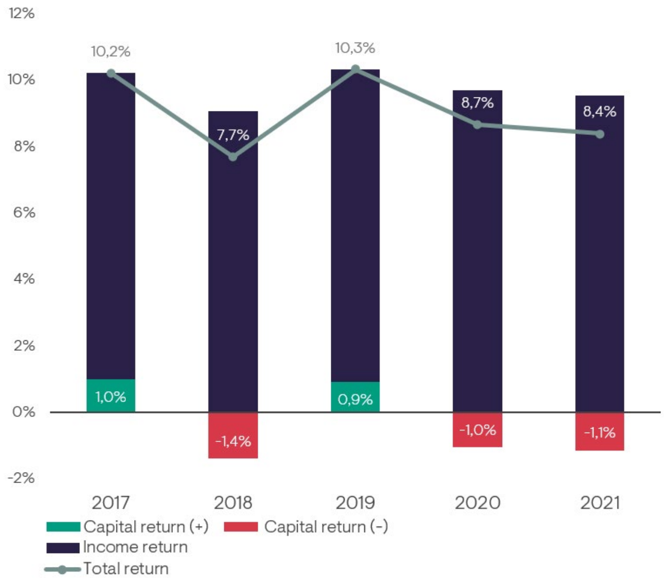
The Investment Committee removed the 5% allocation to Coronation Bond during December 2021. Although this fund performed well during 2021, the committee decided to rather allocate this exposure to the Visio BCI Unconstrained Fixed Interest Fund, which can actively manage the interest rate risk (duration) of the bond exposure. This was supplemented with an additional 5% allocation from Select BCI Fixed Income (Anchor). Although the overall interest rate (duration) of the portfolio remained the same, the flexibility of the duration management improved. Visio performed well year-to-date, considering the volatile bond market.

CONCLUSION

Volatility is managed by blending fund managers with different skills and experience within the income asset classes. The underlying fund managers can actively change the exposure to the different income instruments. There are, however, no guarantees that the income portfolio will always outperform cash or protect capital over short periods of time. The portfolio's objective is to protect capital over all periods of six months and longer, and to achieve significantly less volatility than the bond indices. Over the medium to long term, the Naviga Income Portfolio outperformed cash (see the link to our Fact Sheet).

Bonds have been volatile during 2022 thus far. Although flexible income funds delivered a small capital loss over the short term, investors will benefit from higher yields in the future. Below is the annual return of bonds. Despite delivering negative capital returns for some of the calendar years, the total return of South African bonds was much higher than cash and inflation. We remain confident that flexible income funds will continue to outperform cash over the medium to long term, as bonds offer attractive yields.

ALBI returns for the last 5 years



Source: Bloomberg, Ninety One, 14 January 2022

Click here to go to the Naviga Income Portfolio Fact Sheet.