Discovery Diversified Income

31 July 2026

Market background

The South African Reserve Bank (SARB) surprised markets by leaving the repo rate unchanged at 7.0% in July. Markets had largely priced in a 25-basis point rate hike following June's annual inflation print of 5.0%, with core inflation also rising to 4.1%. The decision highlighted differing views within the Monetary Policy Committee (MPC), with two members voting in favour of a rate hike. Although the SARB revised its short-term inflation forecasts lower, the central bank signalled that inflation is likely to remain above 4% into early next year, still well above its 3% target.

The SARB's interest rate decision and inflation forecast weighed on the rand and prompted a sell-off in longer-dated domestic bonds. The yield curve bear steepened over the month, with the front end remaining relatively anchored, while the belly and long end sold off as markets priced in a more persistent inflation outlook.

While the rand weakened following the SARB's surprise announcement, it showed signs of recovery towards the end of the month against a weaker US dollar. The greenback lost ground on the back of a more dovish-sounding US Federal Reserve (Fed) and easing tensions in the Middle East. By the end of July, the rand traded at around R16.54 to the US dollar, down 0.9% for the month.

Performance review

The portfolio underperformed its benchmark over the month.

Performance was negatively affected by the portfolio's duration exposure and flattener positions. Front-end hedges, positioned to protect against upside inflation risks, lagged the longer end of the curve. This was partially offset by the portfolio's bond options exposure. The portfolio's allocation to listed property also contributed positively over the month, with the sector responding favourably to the SARB's relatively dovish stance.

Outlook and strategy

While the July MPC outcome was interpreted as dovish, we do not believe it represents a material shift in the SARB's reaction function. Inflation risks remain skewed to the upside, and the market has repriced to reflect the likelihood of further policy tightening. We have reduced duration at the long end of the curve in favour of shorter-dated assets, given long duration appears less anchored and more vulnerable to moves higher in global rates.

In the US, the Fed adopted a similar dovish tone, reducing market expectations for further rate hikes. This supported the rand and shorter-dated South African bond yields into month-end. Looking forward, the risk of further steepening in the US yield curve remains, a trend observed towards the end of July and early August. This has the potential to place steepening pressure on the South African yield curve. Given this, we locked in some profits on our FX exposure following the Fed's announcement, capitalising on the portfolio's option positions. This reduced the portfolio's total FX exposure. Given the more supportive outlook for the euro following the Fed's dovish shift, half of the portfolio's foreign currency is now held in euros.

Duration

We reduced our exposure to longer-dated South African government bonds, taking advantage of coupon flows and bond market strength into month-end.

Curve positioning

We shifted the portfolio's curve positioning towards shorter-dated bonds in response to a more dovish stance from global central banks.

Currency

We took profits on foreign-exchange options that shielded the portfolio during July, leaving overall currency exposure closer to neutral.

Property

We increased the portfolio allocation to listed property, taking advantage of capital raisings by preferred counterparties, including Hammerson. Listed property exposure now stands at approximately 4%.

Inflation-linked Bonds

We maintained exposure to inflation-linked bonds at relatively low levels after reducing it the previous month.

Credit

We have started replacing some of the portfolio's local-duration exposure with offshore credit. The shift reflects the combination of persistent domestic upside inflation risks and a relatively healthy global growth backdrop, while also providing attractive yield enhancement relative to domestic government bonds.