Discovery Strategic Bond

31 May 2026

Market background

May proved a volatile month for US Treasuries, with the conflict in the Middle East continuing to dominate market sentiment. CPI printed at a three-year high (3.8%), fuelling expectations of rate hikes and pushing US Federal Reserve (Fed) members, such as Waller, to shift hawkishly. This drove a sharp sell-off across the Treasury market mid-month, with the 30-year yield briefly touching a post-2007 high. Towards month-end, widespread reports of a 60-day ceasefire extension triggered a market rally, with oil prices falling sharply and inflation fears receding. Softer-than-expected PCE data, the Fed's preferred inflation measure, also helped investors dial back expectations of rate hikes. Although Treasury yields fell from their mid-month peak, they still ended the month higher across the curve, underperforming European markets.

In South Africa, government bond yields fell across the curve, with the 10-year bond falling c.35bps to 8.57%. The fall in yields was supported by increased hopes of a US–Iran agreement, continued inflows into emerging markets and South Africa, tighter South African Reserve Bank (SARB) policy aimed at containing inflation, and Moody's decision to revise South Africa's outlook from stable to positive while affirming its Ba2 sovereign credit rating.

Inflation rose to 4.0% year on year (y/y) in April, from 3.1% in March, while producer-price inflation rose to 4.8%, driven mainly by petroleum-related products and food/beverages. The SARB responded by raising the repo rate by 25 basis points (bps) to 7.0%, citing upside inflation risks, higher oil assumptions and the possibility of second-round effects. The SARB's Quarterly Projection Model and accompanying policy guidance suggest that rates are likely to remain restrictive for the remainder of the year, with expectations pointing to at least one additional 25 basis point hike should inflation risks persist. The rand also strengthened into month-end, supported by the improved sovereign credit outlook and attractive real yields.

Performance review

The portfolio marginally outperformed its benchmark over the month.

Performance was supported by the portfolio's overweight position in South African government bonds, where yields fell across the curve. The portfolio's position in the long-end of the curve was a further boost to performance.

Despite our longer-term constructive view on South Africa, we reduced our duration exposure from a slight overweight position to neutral, and took off some of the flattener given the size of the rally and current volatility in the markets.

At the same time, we increased our allocation to inflation-linked bonds, reflecting the heightened inflation risk in the current environment.

Outlook and strategy

The situation in Iran remains highly volatile and uncertain. The effective closure of the Strait of Hormuz is beginning to create supply concerns across a range of products, most notably oil. These supply pressures are likely to be inflationary, both globally and locally. This risk has increasingly been reflected in recent commentary from central banks, who remain alert to the potential second-round effects of higher energy and input costs.

Against this backdrop, the SARB has recently implemented its first interest rate hike, with a further increase likely in July should current conditions persist.

From a fiscal perspective, South Africa still has some leeway. The expected introduction of a fiscal rule in the Medium-Term Budget Policy Statement in October would likely be viewed positively by the market. This follows Moody’s recent decision to move South Africa to a positive outlook. Rating agencies are likely to look favourably on the introduction of a credible fiscal rule, particularly if it reinforces fiscal discipline and supports debt sustainability over time.

In addition, the next two to three months are expected to be supportive from a coupon-flow perspective. Coupon payments should provide some support to the South African government bond market during what remains a highly uncertain period.

Duration

We reduced our small overweight duration position to neutral.

Curve positioning

We reduced our overweight position in the long end of the yield curve.

Inflation-linked Bonds

We added short-dated linkers as we see potential for the asset class due to higher inflation expectations.

Credit

We have maintained our overweight position amid the geopolitical uncertainty and will continue to look for opportunities to maximise yield within the portfolio.