

NAM CORONATION STRATEGIC INCOME FUND

QUARTERLY COMMENTARY Q3-26

Please note that the commentary is for the retail class of the Fund.

Performance and fund positioning

The Fund returned 0.33% in September, bringing its 12-month total return to 7.8%, which is ahead of cash (12m: 7.2%) over the same period. We believe the Fund's current positioning offers the best probability of achieving its objective over the medium to longer term.

The memorandum of understanding between the US and Iran unravelled in early July amid renewed military strikes and attacks on commercial shipping and expired in August without a durable settlement. Consequently, Brent crude reversed much of its second-quarter (Q2) decline, rising by about 42%. It briefly exceeded US\$107 in September as Strait of Hormuz disruptions were compounded by attacks affecting Saudi Arabia's alternative Red Sea export route.

However, by the end of the third quarter of the year (Q3), Middle Eastern exports had nearly recovered to pre-war levels, but negotiations remained unresolved. The risk of a sustained US\$100-plus oil price and the associated global inflation- and interest-rate consequences therefore re-emerged as a central vulnerability for the macroeconomic outlook. Global bond markets have been (and continue to be) tormented by a combination of higher policy rate expectations and a higher global risk-free rate, as the US 10-year bond pushed emphatically through the psychological 5% level. This has deflated sentiment as risk assets remain on the back foot, heading into the final quarter of the year.

Namibian government bonds had a challenging quarter, weighed down by the global bond selloff and a weaker local fiscal backdrop. Over the quarter, yields widened across most of the curve with the GC53 moving above 12.0% for the first time since issuance by quarter-end. The front end of the curve widened by an average of 22 basis points (bps), followed by the belly at an average of 24bps. The long end bore the brunt of the selloff, with long-end yields widening by an average of 41bps amid under-allocated auctions and limited demand for duration. We would argue that long-end yields are not yet at fair levels, given that the mid-year budget review arrives on a weaker revenue, alongside the FMD outbreak and the possibility that the Venus FID slips into '27. The spread over South Africa (SA) has tightened by an average of 20bps at the front end and belly, and by 4bps at the long end, as SA yields rose even more. This suggests relative value has held up, but it does little to offset the absolute pressure on duration. Treasury bills delivered steady but modest returns of 1.8% over Q3 '26 as Bank of Namibia maintained the repo rate at 6.75% at the August MPC meeting.

South African assets proved more resilient than they were during the initial shock in the first quarter of the year, although nominal bonds surrendered part of their strong Q2 recovery. The 10-year SA government bond (SAGB) yield increased by c. 50 basis points (bps) to c. 9% at the end of September, as higher oil prices, rising global yields, and renewed inflation concerns weighed on duration. The FTSE/JSE All Bond



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Index (ALBI) was down 0.68% for the quarter, behind cash at 1.69% and inflation-linked bonds (ILBs) at 1.45%.

The weakness was concentrated at the longer end of the nominal curve, with bonds in the seven- to 12-year and 12-year+ sectors returning -0.71% and -1.47%, respectively. Over 12 months, the ALBI returned 12.82%, compared with 6.76% from cash, and 15.45% from ILBs. Year to date, ILBs have retained their defensive advantage, returning 6.81% versus 4.99% from cash and 3.54% from nominal bonds. Despite the poor short-term performance of the SA bond market, it remains well ahead of global bonds, which have widened significantly. This is evidenced by US 10-year bond yields, which are 100bps higher than at the start of the year, and many other developed market bond yields that are 50-100bps higher since the start of the year.

In March of this year, when the Middle East conflict reignited, SA's inflation was 3% and the nominal repo rate was 6.75%, placing the real repo rate well into restrictive territory. This provided a robust departure point from which SA's monetary policy could navigate the precarious landscape. Since then, inflation has averaged well above 4%, necessitating two 25bps rate hikes by the South African Reserve Bank (SARB) to dampen possible second-round effects. Our updated forecasts, which incorporate a higher-for-longer oil price and higher food prices due to the El Niño effect in 2026/2027, now see inflation averaging 4.4% in 2026 and 2027. We expect it to peak well above 5% in the first quarter of 2027, before returning to a 3.5% average in 2028. This might necessitate a further increase in the repo rate by the SARB; however, due to the 'stagnationary' impact of the oil price shock, we believe that the Bank would be reluctant to deliver a further three rate hikes as the market is currently pricing. The outlook for the oil price remains uncertain, and risks for inflation are broadly balanced from here on. However, growth risks are skewed to the downside, with estimates already revised down for this year and next. This will weigh on the SARB's decision going forward, especially as the commodity boom starts to fade and the local growth engine remains sluggish. A reduction in monetary policy rate expectations could thus be a tailwind for bond performance.

One of the benefits of the Middle East crisis and US dollar debasement has been a boost to precious metals and, thus, an increase in SA's terms of trade. This is generally a short-term phenomenon; however, the magnitude of the move has provided a profound boost to fiscal revenues. National Treasury has remained restrained on the spending front and committed to fiscal consolidation, which has helped stabilise the deficits and debt load. We should continue to see some improvement in the fiscal dynamics over the next 18-24 months, as the budget deficit moves below 4% and debt stabilises below 80% of GDP. Treasury has also made great strides in reducing borrowing costs by diversifying into alternate borrowing pools and reducing its reliance on fixed rate bond issuance. The combination of this and better fiscal outcomes has allowed Treasury to reduce its issuance in fixed nominal bonds, helping support the compression in bond yields and reducing SA's debt service cost. In addition, as bonds have rallied, the discount at which Treasury issues bonds at the weekly auction has also reduced, thus creating a self-reinforcing cycle of better borrowing outcomes.

These developments have been well received and alleviate pressure on government finances in the short term. Unfortunately, SA's debt load still remains high, and in order to see metrics progress towards investment grade norms, growth needs to be much higher than the current 1.5%-2% projections over the



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medium term. In fact, growth needs to be in excess of 3% for a meaningful period to see a significant improvement in debt metrics. This, as we know, can only be achieved through substantial reforms in network industries, governance, service delivery, ease of doing business, and the security cluster. As such, although we remain positive on fiscal developments in the short term, we remain reluctant to build these into our long-term expectation for SA's government finances.

September was defined by a shift to hawkish policy rate outlooks as elevated inflation readings forced monetary tightening to resume, while some central banks opted to hold and see how the inflation picture would evolve. Inflation readings continue to accelerate on the back of rising energy costs, while other domestic price pressures have been more subdued.

The Federal Reserve Board (the Fed) raised the target rate range by 25bps to 3.75%-4.00% at the September Federal Open Market Committee meeting. Fed Chair, Kevin Warsh, noted that inflation had been 'too high for too long' and cited the increase in energy prices as the primary catalyst for the increase in policy rate. The Fed acknowledged labour markets remained close to full employment and economic activity showed some resilience. With no forward guidance, current market pricing is for three more 25bps hikes over the next year, although weaker labour market data and a modest undershoot of core personal consumption expenditures inflation in Q3 may ease some near-term pressure.

US headline inflation held steady at 3.4% year on year (y/y) in August, while core inflation eased to 2.4% y/y from 2.5% y/y. A rise in energy costs was the main contributor to the inflation uptick. Food, apparel, housing, and medical services costs moderated, so did used car prices.

The rand ended the month at R16.42/US\$1, weaker than its close in the previous month but unchanged since the last quarter, and stronger than its Emerging Market (EM) peer group. Offshore credit assets and certain developed market bonds continue to flag as relatively attractive. The Fund has utilised a significant part of its offshore allowance to invest in these assets. When offshore assets become expensive (or relatively cheap), the Fund may adjust its foreign currency exposure by buying or selling currency futures on the JSE (typically in US dollars, UK pounds, or euros). This helps the Fund to fine-tune its exposure to global markets without having to sell its offshore investments.

The SA economy contracted by 0.2% quarter on quarter (q/q) in Q2 following a 0.4% q/q growth in Q1. From the production side, weakness was concentrated in the mining, manufacturing, and trade sectors, while agriculture and finance were marginally positive. From the expenditure side, the composition was mixed: household spending supported growth, while muted government spending was a positive factor. However, subdued gross fixed capital formation and negative net trade (as imports significantly exceeded exports) were the main detractors. The outlook for coming quarters remains mixed, with incoming data more positive, but the anticipated additional shock to inflation is likely to dent this in coming months.

The SARB voted unanimously to raise the repo rate 25bps to 7.25% at the September MPC meeting. The SARB's statement messaging strongly focused on the need to contain second-round effects and anchor inflation expectations. Headline inflation is now seen above 5% in Q4 and the first quarter of next year, moderating slowly to 3% by the end of 2028. Food and core goods inflation are seen as buffers in the near

term. Growth for 2026 was revised down to 1.2% from 1.4% following a below-expectations contraction in Q2 and risks to growth were assessed to be on the downside.

SA's headline inflation ticked up to 4.4% y/y in August from 4.3% y/y in July, while core inflation edged down to 4.1% y/y from 4.2% y/y. The overall inflation data showed limited evidence of a broadening of price pressures, with headline inflation benefiting from limited inflation in food prices, and a moderation in electricity prices. However, the outlook for fuel prices has deteriorated materially, and services inflation is still uncomfortably high. We expect headline inflation to average 4.4% in 2026, noting the risk of further tightening by the SARB.

At the end of September, shorter-dated fixed-rate negotiable certificates of deposit (NCDs) traded at 8.35% (three-year) and 8.63% (five-year), weaker over the quarter and similar to the nominal moves during the period. Our inflation expectations suggest that the current pricing of these instruments remains attractive given their lower modified duration and, hence, high breakeven relative to cash. In addition, NCDs offer the added benefit of liquidity, thereby aligning the Fund's liquidity with its investors' needs. The Fund continues to hold decent exposure to these instruments (fewer floating than fixed), but we will remain cautious and selective when increasing exposure.

At current levels, if inflation materialises at 4.4% over the next year, the front end of the ILB curve (given market implied breakevens are below 4.4%), still offers a pickup relative to the equivalent nominal bonds. However, in the event that expectations shift towards a more material move lower in nominal bond yields due to a change in economic expectations around growth and debt, portfolios should concentrate exposure in nominal bonds.

The quarter under review has served as a reminder that SA bonds do not operate in a vacuum: the renewed oil shock, a US 10-year yield above 5%, and a repricing of SARB expectations were enough to erase part of the Q2 recovery, despite improving domestic fundamentals. Yet, the starting point remains attractive. At a 10-year yield of c. 9%, nominal bonds offer a real yield of close to 4.5% against our medium-term inflation forecast and a carry of c. 200bps over cash, with risks more tilted towards lower policy rates than current market pricing. The ALBI should deliver returns in excess of cash even if the curve does not move; and double-digit returns if yields converge towards lower historical levels, with the 12- to 15-year area of the curve offering the best risk-adjusted outcome. A material rally beyond current levels, however, would require more than the good news already in the price: it needs a sustained reduction in the repo rate, growth above 2%, and a visible decline in the debt burden. Only the first of these is plausible within our three-year horizon. We therefore position portfolios with a core overweight in nominal bonds concentrated in the 12- to 15-year sector and maintain a front-end allocation to ILBs as a defensive hedge against a prolonged oil shock.

The SA listed property sector was up 0.49% over the month, bringing its 12-month return to 20.3%. The cost savings due to the implementation of solar and increased payout ratios helped bolster the sector's performance. Dividend yields have repriced to fairer levels, and together with the improved dividend growth outlook, the total return prospects are above those of bonds, which could support the sector. Rate hikes and/or a weaker growth outlook due to the Middle East conflict could erode optimism about the



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sector's prospects. We believe that one must remain selective and cautious, given the high levels of uncertainty around the strength and durability of the economic recovery.

SA credit spreads are at historically tight levels due to low issuance volumes and a large amount of capital seeking a home with reduced volatility. The use of structured products, such as credit-linked notes (CLNs), has become ubiquitous within the SA market. CLNs have not expanded the pool of borrowers; rather, it has only concentrated it. These instruments can limit volatility by not marking them to market based on the underlying asset price movements. As a result, there can be significant unseen risks within fixed income funds. Investors need to remain prudently focused on finding assets whose valuations are correctly aligned with fundamentals and efficient market pricing. Except for a few opportunities, we view the SA credit market as unattractive relative to other asset classes.

Outlook

We remain vigilant about risks from dislocations between stretched valuations and the underlying economic fundamentals. However, we believe the Fund's current positioning accurately reflects the appropriate level of caution, while its yield of 8.62% (gross of fees) remains attractive relative to its duration risk. We continue to believe that this yield is an adequate proxy for expected portfolio performance over the next 12 months. As is evident, we remain cautious in our management of the Fund. We continue to invest only in assets and instruments that we believe have the correct risk and term premium to limit investor downside and enhance yield.

Portfolio managers

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as at 30 September 2026