Fixed Income
Quarterly Commentary

Quarter 3 2024

Perpetua
INVESTMENT MANAGERS

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	Market returns (%)	Q3 '24	H1'24	2023	2022	2021	2020
Government bonds	U.S. Treasuries	4.74	4.84	4.05	-12.46	-2.32	8.00
	European high yield bonds	3.74	2.83	7.19	-17.18	-2.85	4.05
LATAM	Brazil 10yr	2.48	-1.80	28.55	1.32	-15.15	5.87
	Mexico 10yr	6.02	4.42	9.98	-1.21	-7.74	17.29
	Chile 10yr	10.19	8.80	3.41			
Asia	India	3.86	6.06	8.54	0.98	1.73	11.52
	China	0.87	2.22	5.29	2.20	6.24	3.02
	Japan	2.13	-0.80	-1.39	-3.19	-0.42	-0.39
Africa	South Africa	11.42	20.84	8.14	4.85	2.13	10.94
Credit	U.S. Long IG Corporates	8.21	6.33	10.93	-25.62	-1.13	13.94
	U.S. IG Corporate bonds	5.84	5.74	8.52	-15.76	-1.04	9.89
	U.S. High yield bonds	5.28	6.44	13.45	-11.19	5.28	7.11
	European high yield bonds	3.65	5.09	12.78	-11.13	4.21	1.76
Indices	EM Bond Index (Unhedged)	5.82	6.54	9.09	-15.26	-1.65	6.52
	EM Bond index (Hedged)	5.60	6.33	9.45	-15.65	-1.52	6.19
	EM Sovereign Bond Index (Unhedged)	6.56	6.77	10.96	-17.43	-2.32	5.17
	EM Sovereign Bond Index (Hedged)	6.13	6.36	11.18	-17.24	-2.21	4.98
	DM Bond index	6.77	9.03	23.34	-18.05	21.20	16.05
	ALBI TR Index	10.54	18.81	9.70	4.26	8.40	8.65
Cash (Rate at Period End)	SOFR	4.84	4.84	5.38	4.3	0.05	0.07
	SABOR	7.973	7.973	8.164	6.964	3.865	3.654
	JIBAR	8.05	8.05	8.4	7.258	3.883	3.642
Other asset classes	S&P 500	5.89	10.42	26.26	-18.13	28.68	18.39
	Nasdaq	2.12	10.34	55.13	-32.38	27.51	48.88
	ALSI	9.63	18.61	9.35	3.98	29.31	7.09
	Bitcoin	5.62	-10.38	153.85	-63.94	58.19	304.55
	Gold	13.23	13.23	27.56	-0.28	-3.64	25.12
	Oil	-16.94	-16.94	0.58	10.45	50.15	-21.52
EM Currencies	USDZAR	-5.08	-5.08	6.78	6.90	8.46	4.96
	U.S Dollar (DXY Index)	-4.81	-4.81	2.26	8.21	6.37	-6.69

On my mind

Green shoots yet?

I recently attended a Morgan Stanley conference, where I had the opportunity to hear from some key figures in government including the SARS Commissioner, the CEO of Transnet, the Deputy Director General of the NHI, the Deputy Director of the NPA and the Deputy Minister of Finance. It was a comprehensive line-up, made more interesting by the fact that some of these officials were recently appointed after the GNU was formed.

My immediate observations were:

- The government representatives articulated well-conceived plans, with clear actions and steps to achieve their stated goals.
- A recurring theme was the importance of "working with the private sector"—which I agree is necessary given the scale of the impact required.
- A big focus on the digitisation of government departments to drive efficiency. Currently, the Department of Home Affairs is emerging as the front runner in this regard (claims are that planned reforms could add close to a full percentage point to GDP growth).
- They were candid about the challenges they respectively face, primarily red tape within the bureaucratic government structure and budget constraints.

It was almost amusing to watch each official come up and request more funding, only for the Deputy Minister of Finance to stand up at the end and sternly remind everyone that there will be no handouts or bailouts—and that National Treasury are committed to staying within the fiscal envelope.

This is exactly what concerns me. With a debt-to-GDP ratio nearing 75% and almost 20% of government revenues going toward servicing this massive debt, how can the State efficiently allocate funds for much-needed social and economic reforms?

The answer lies in growth but we seem to be caught in a downward spiral. For growth, we need fully functioning, debt-free SOEs, lower unemployment, a stronger middle class and thriving businesses—small and large—to create jobs. This would lead to infrastructure development and spending, increased consumer spending, savings and capital accumulation. Unfortunately, after years of waste and mismanagement during state capture, we have very little left to work with.

...continued

The good news is there is light at the end of the tunnel of our energy woes. However, Transnet remains the single largest detractor from growth, representing a drag of anywhere between 1-2% to GDP growth. Water is another looming issue that requires attention. There seems to be a sense that it is “a problem for another day”, however, as we have learnt from other service delivery crises, this needs to be addressed right now.

Overall, I left the conference feeling a mix of cautious optimism and justified concern. My sense is a real confidence boost will come when we see good progress on executing structural reforms - particularly Operation Vulindlela delivering positive results, a turnaround in key SOEs with strong governance in place and increased infrastructure investment driving business confidence and capital flows. Only then do we believe that the country has set the foundation to reverse the downward spiral and move towards sustainable growth.

In this edition

With this backdrop in mind, I am pleased to share Perpetua's latest Fixed Income Quarterly Commentary with you. In this quarter’s edition we reflect on key market developments in recent months and provide an updated assessment of our macroeconomic and geopolitical outlook. We see these factors as well as other fundamental drivers continuing to weigh on domestic and global fixed income markets over coming months. Ultimately this connects closely to our fixed income positioning.

Key points of discussion this quarter include:

- The ongoing possibility of a recession in the U.S. and the trajectory of the Fed rate cutting cycle.
- The impact of Trump vs Harris victory on American fiscal policy and economic outcomes.
- The path of likely monetary policy action by the SARB.
- Our reflections on the early days of South Africa’s Government of National Unity and the impact on the domestic economic outlook.
- Our insights on the growing green bond market in South Africa and the investment opportunities it presents.

Enjoy the read!

Pooja Tanna
Head of Fixed Income

Key highlights: *past quarter*

- The Fed finally kicked off its rate-cutting cycle with a greater-than-expected cut of 50bps in September. They followed a number of major central banks that have already started the process, including the European Central Bank (ECB) and Bank of England (BOE).

- The SARB followed shortly with a widely expected rate cut of 25 basis points.

- China surprised markets by announcing a series of unexpected stimulus measures at its September Politburo economic meeting. The package included five major actions: reductions in the reserve requirement ratio (RRR), cuts to the policy and mortgage rates, RMB 800 billion in support for the stock market and additional measures to stabilise the struggling property sector. These steps were taken in response to slowing economic growth, mounting deflationary pressures, a deepening housing market crisis and weak consumer confidence.

- Counter to the global trend of monetary easing is Brazil where the Central Bank of Brazil (BCB) raised the policy benchmark by 25 basis points last week and hinted at more hikes to come. They cited resilient GDP growth, a pressured labour market and rising inflation expectations as factors contributing to their concerns. Given that Brazil's inflation expectations appear to be well-anchored and the real policy rate is already at its highest level in recent years, this move could be more of a political statement, signalling central bank independence ahead of the president's appointment of a new governor.

- On a similar note, the Bank of Japan (BOJ) hiked rates by 25 basis points in July and announced a bond tapering plan, signalling the central bank's growing confidence in the recovery of the domestic economy and its concerns about the weaker yen. This move sparked a dramatic sell-off in global markets, as investors started pricing in the unwind of the carry trade (borrowing at zero or very low interest rates and placing it in higher yielding assets). The BOJ has committed to normalising monetary policy, with a further 25 basis points hike expected in December.

Key highlights: *current quarter*

- **US:** This quarter will be focused on the elections as we face a close race between Harris and Trump, the outcome of which will have far-reaching economic and fiscal impacts. We are still calling for a recession in the first quarter of 2025 and, as a result, we believe the current easing cycle of 250bps is adequately priced.

- **South Africa:** We remain constructive on S.A. as it is supported by both local and global tailwinds driving rallies across all asset classes. However, we have not yet seen meaningful offshore inflows. Current foreign ownership of domestic debt stands at 24.6% as at end August 2024, compared to a record high of 42.8% in March 2018. If lower yields in the US contribute to stronger emerging market flows, we anticipate continued strength in South African bonds, equities and the ZAR.

- **India:** India remains a bright spot in the global economy, with resilient growth fuelled by strong domestic consumption and government investments in infrastructure. With GDP around 8% over the past few years, the fastest among major world economies, and inflation not expected to fall to 4% anytime soon, the RBI has little reason to rush rate cuts. We see a long road of continued strength, supported by strong foreign inflows due to the inclusion of Indian government bonds in the JP Morgan GBI-EM index. It currently stands at a 3% weight but is scheduled to reach 10% by March 2025. Valuations are rich but we believe the sustained demand from offshore investors will allow bonds to grind lower. As such we remain vigilant to optimal entry levels.

- **China:** While last week's policy pivot exceeded market expectations, aiming to stabilize the stock market and halt the property market's decline, two key points remain to consider:
  - Will this be enough to trigger reflation?
  - Have they done enough to achieve their growth target of 5% over the next 12 months?

  While these measures may boost investor sentiment in the short-term, ongoing debt deflation and depressed consumer sentiment indicate deeper issues that could hinder a full cyclical recovery. The effectiveness of these policies will be closely monitored.

  Key policy catalysts to watch in the coming quarter include:
  - October 2024 – NPC Standing Committee Meeting: expect RMB 1-2 trillion in a supplementary budget to boost consumption and support local government financing.
  - December 2024 – Politburo Meeting: anticipate a 10-20bp policy rate cut and a 25-50bp reduction in the reserve requirement ratio (RRR) by year-end.

- **Japan:** Japan is in a unique position among major economies. After years of ultra-loose monetary policy, the BOJ initiated rate hikes aiming to control inflation and manage yen depreciation. Interest rate differentials and opposing actions by central banks could lead to repatriation of flows into Japan. With general elections likely on October 27, the BOJ is expected to hold policy steady at its October 31st meeting. Despite PM Ishiba's recent dovish turn, Japan is still expected to continue with monetary policy normalisation, providing a tailwind for the yen but a headwind for JGBs and equities, which are already under pressure despite China's market rally.

Our positioning

- **Overweight South Africa:** We maintain our overweight position in South African government bonds, where we expect further rate cuts. We have extended modified duration in the past quarter to capitalize on the favourable environment. However, our valuations indicate that SAGBs, particularly the long end, is in expensive territory. We remain vigilant to potential risks, both domestic and global, that could derail this rally.

- **U.S. Treasuries:** We took profit on our short-term U.S. Treasuries, which we believe has adequately priced the cutting cycle.

- **Opportunities in Asia and LATAM:** In Asia, we are monitoring developments in Japan, where further monetary tightening could create opportunities in the Yen. In India, robust economic growth presents long-term opportunities in yields. In LATAM, we are closely watching Brazil, where the commencement of a rate hiking cycle is making local yields increasingly attractive within emerging markets.

Global macroeconomic outlook

Global macroeconomic outlook

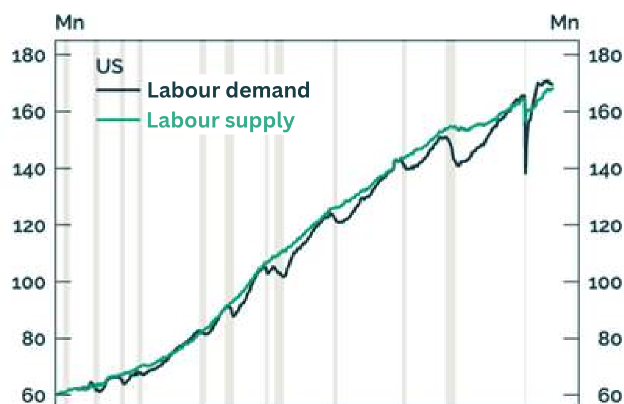
As has been the case in the recent past, much of the global macroeconomic outlook revolves around developments in the U.S.
The key questions everyone is asking:

- Will there be a recession?
- How deep will the cutting cycle be? Is it correctly priced?
- Harris or Trump?

Recession or not?
The Fed delivered a super-sized cut in their last meeting with Powell suggesting that it was a vote of confidence that inflation is under control, despite robust economic activity in the U.S.

However, the weakening labour market is concerning, and this rate cut appears to be a proactive move to instil confidence in the economy. It's worth noting that labour market data is a lagging indicator. By the time the numbers are released, the impact has already taken place. We expect labour supply to surpass labour demand by late 2024 or early 2025 [Figure 1]. Once that occurs, unemployment will rise rapidly, creating a self-reinforcing cycle.

Figure 1: Labour supply closing in on labour demand

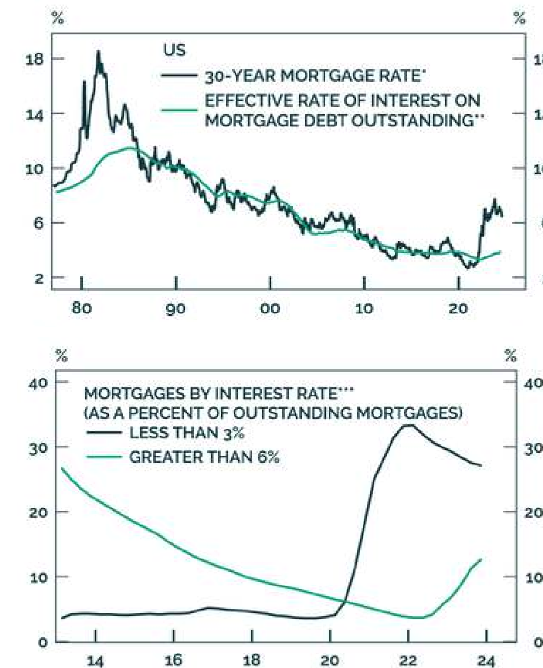


Source: BCA Research

Additionally, the following leading indicators are troubling:

- The housing market is showing renewed signs of stress, with the number of housing units under construction down by 8.3% since the start of the year.
- Excess pandemic savings have been depleted with the personal savings rate at an all-time low of 3.4% vs. an average of 7.4% in 2019.
- Total consumer credit jumped to an all-time high of $5.1 trillion while total consumer debt has doubled in 14 years. Revolving debt, which includes credit cards, hit a new record of $1.4 trillion. Meanwhile, credit card delinquencies soared to 9.1%, the highest level in 12 years.
- The average mortgage rate that homeowners pay, will rise next year as low-rate mortgage debt rolls off and is replaced with high-rate debt [Figure 2]. Even with the Fed commencing their rate cutting cycle, the impact will only be felt with a lag.

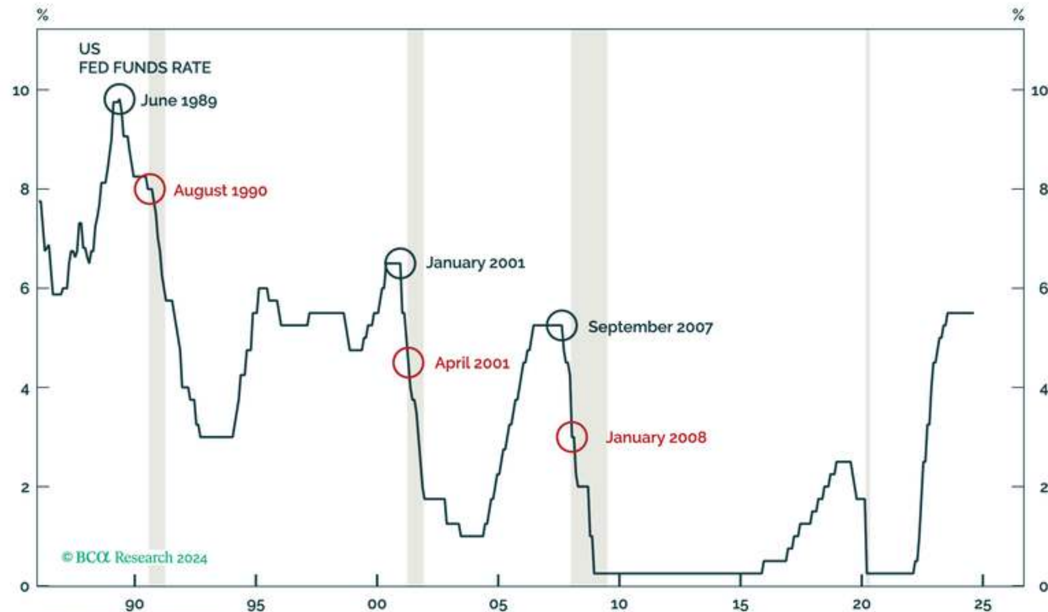
Figure 2: The mortgage rate will rise next year even if the rate on new mortgages falls



Source: BCA Research

The question is whether the Fed has acted in time. History suggests that it is not such a simple matter. When the Fed started cutting rates in January 2001, the recession started 3 months later. A few years later, after the Fed began cutting rates in September 2007, the recession began four months following the commencement of the cutting cycle [Figure 3]. Historical precedent shows that recessions often follow shortly after the Fed begins cutting rates, raising questions about whether the Fed's move has been timeous enough to avoid a downturn.

Figure 3: Recessions often start not long after the Fed begins cutting rates



Source: BCA Research, Federal Reserve

Our assessment: Risk of a recession remains

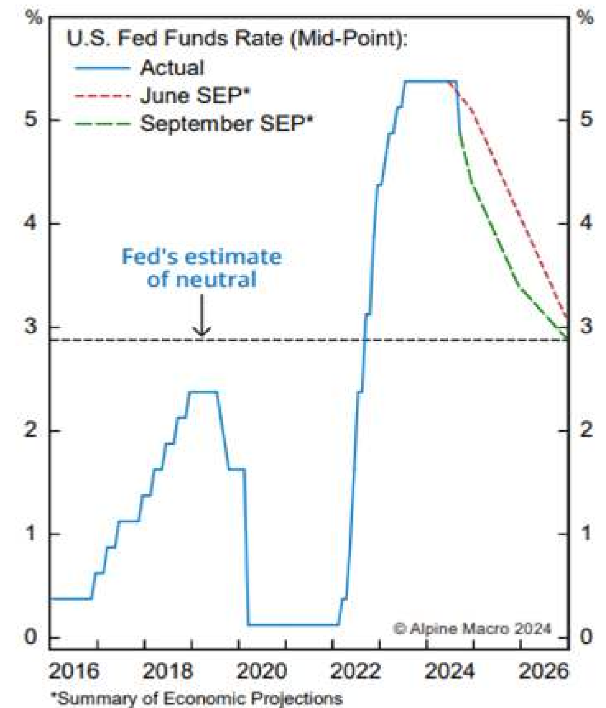
While the Fed's recent rate cut may signal confidence that inflation is under control, several key indicators suggest that the risk of a recession remains. The weakening labour market, declining housing construction, dwindling pandemic savings and rising consumer debt all point to underlying economic vulnerabilities. As we move into 2025, the lagging effects of these developments will be critical to monitor with potential consequences for unemployment and broader economic stability.

Depth of the cutting cycle

Updated projections show that monetary policy will gradually return to neutral by the end of 2026 [Figure 4].

The dot plot indicates another 50bps cut by the end of this year, with a further 100bps in 2025 and 50bps in 2026, projecting a neutral rate of around 2.9%.

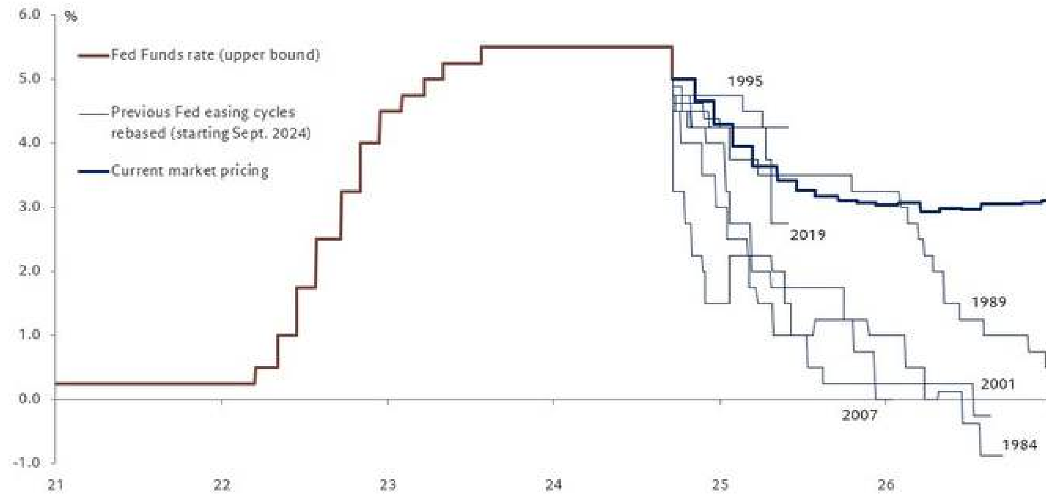
Figure 4: FOMC members see a gradual return to normal



Source: Alpine Macro

It remains to be seen whether a total of 250bps in rate cuts will be sufficient, or if the Fed will need to implement deeper cuts. Historically, the Fed has typically cut more during previous cycles [Figure 5]. This time, however, the potential difference may lie in a higher neutral rate.

Figure 5: Fed pricing vs. previous easing cycles



Source: Bloomberg

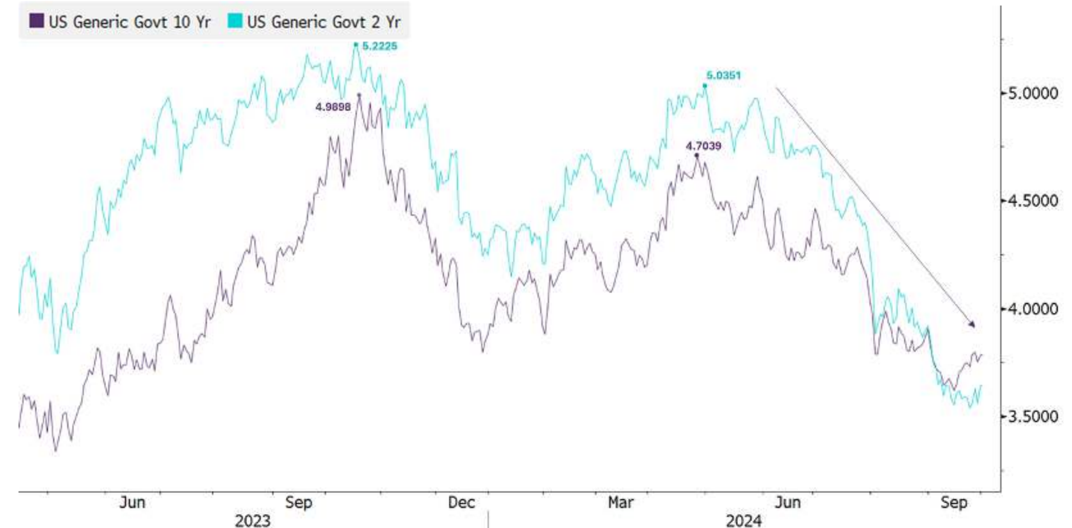
However, if the economy faces increased recessionary pressures, the Fed may be forced into a more aggressive cutting cycle than currently anticipated. As such, we remain vigilant and will closely monitor economic indicators to determine if the Fed's dot plot will be sufficient or if more substantial cuts will be necessary.

Our assessment: U.S. Treasury two-year yields have priced in full rate cuts

Yields on two-year notes have slumped circa 150bps in the last quarter pricing in an aggressive rate cutting cycle [Figure 6]. At the current yield of 3.55%, the two-year maturity is pricing in around 260bps of rate cuts, implying a terminal rate of 2.75%.

Given our forecast of a terminal rate at 2.75%, we believe two-year treasuries are largely aligned with market expectations. This has reinforced our decision to exit short-end positions and shift towards longer maturities on the curve, where we see better opportunities for returns.

Figure 6: U.S. Treasuries have seen a massive rally in the last quarter

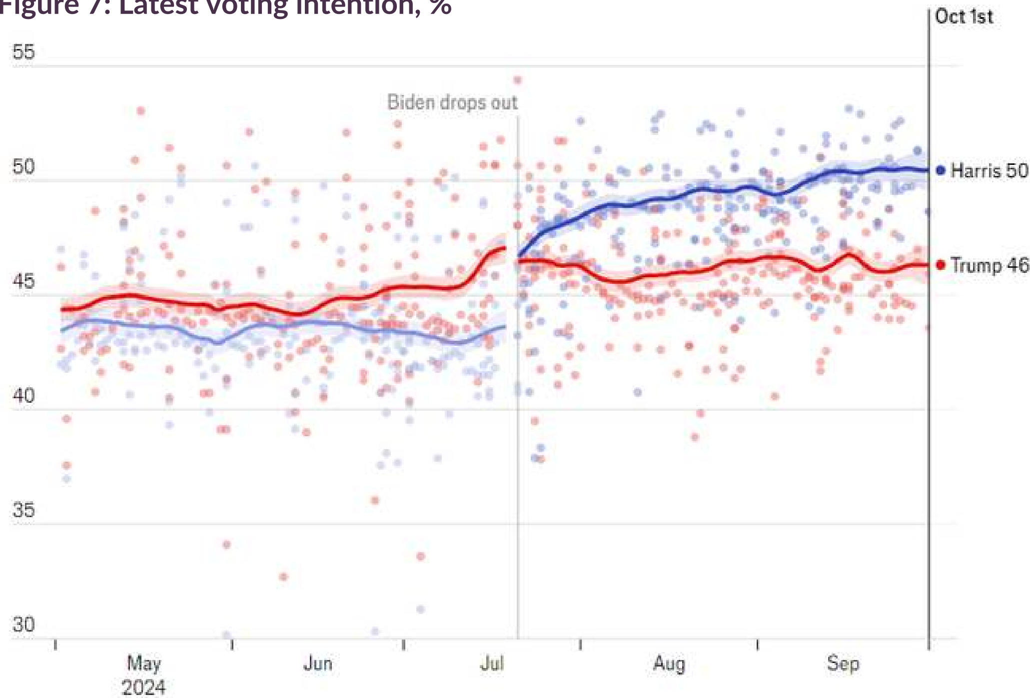


Source: Bloomberg

Harris or Trump

Polls still reflect a close race, with post-debate data showing that Harris has taken the lead by a very small margin in terms of the popular vote [Figure 7]. However, it's still a murky picture when considering the so-called battleground states for electoral college votes which will ultimately determine the winner.

Figure 7: Latest voting intention, %



Source: The Economist, US election 2024. Accessed on 3 October 2024.

Voting patterns in most of the 50 states in the U.S. almost always results in the same party winning a majority. However, there are 7 battleground states which are more hotly contested, namely North Carolina, Arizona, Georgia, Nevada, Pennsylvania, Michigan and Wisconsin.

As it stands, recent polls suggest there is less than one percentage point separating the two candidates in several of these states, including Pennsylvania which offers up the highest number of electoral votes in the group, and therefore makes it easier for the winner to reach the 270 votes that is needed to win the presidential election [Figure 8].

Figure 8: Margin of lead in the seven battleground states

	Margin of lead
North Carolina (16 electoral votes)	Harris <1
Georgia (16)	Trump <1
Arizona (11)	Trump +1
Pennsylvania (19)	Harris +1
Nevada (6)	Harris +2
Michigan (15)	Harris +2
Wisconsin (10)	Harris +2

Source: 538/ABC News. Accessed at BBC on 30 September 2024.

Fiscal impact of a Harris vs. Trump presidency

The spending and tax plans being discussed by Kamala Harris and Donald Trump could have a big impact on the federal deficit.

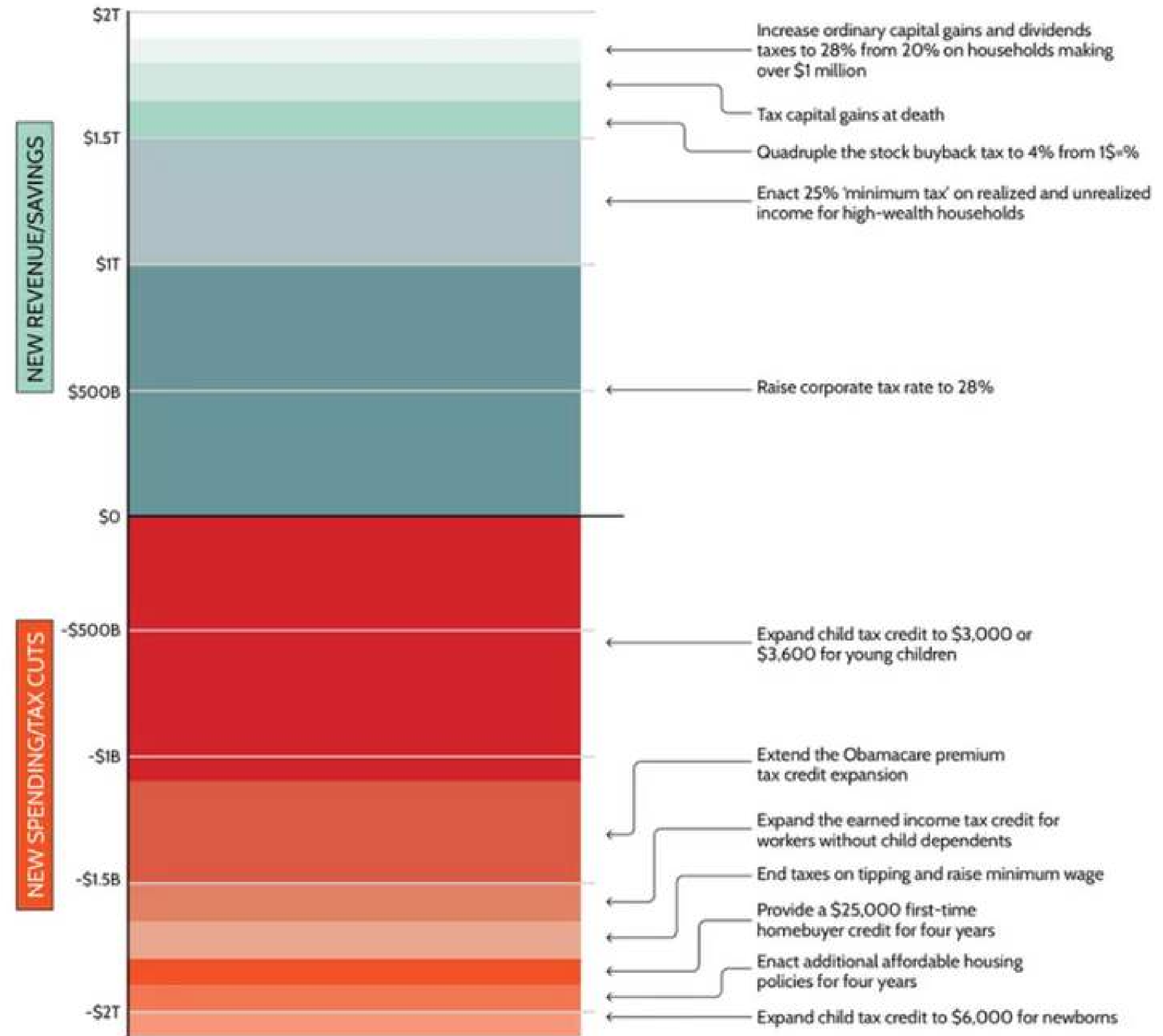
Breaking down their plans:

Harris's proposals [Figure 9] would cost over $1.2 trillion over 10 years which largely compose of:

- Expansion of the child tax credit
- Expanding income tax credit for lower income workers
- Providing a $25,000 tax credit for first-time home buyers
- Expanding affordable care act subsidies

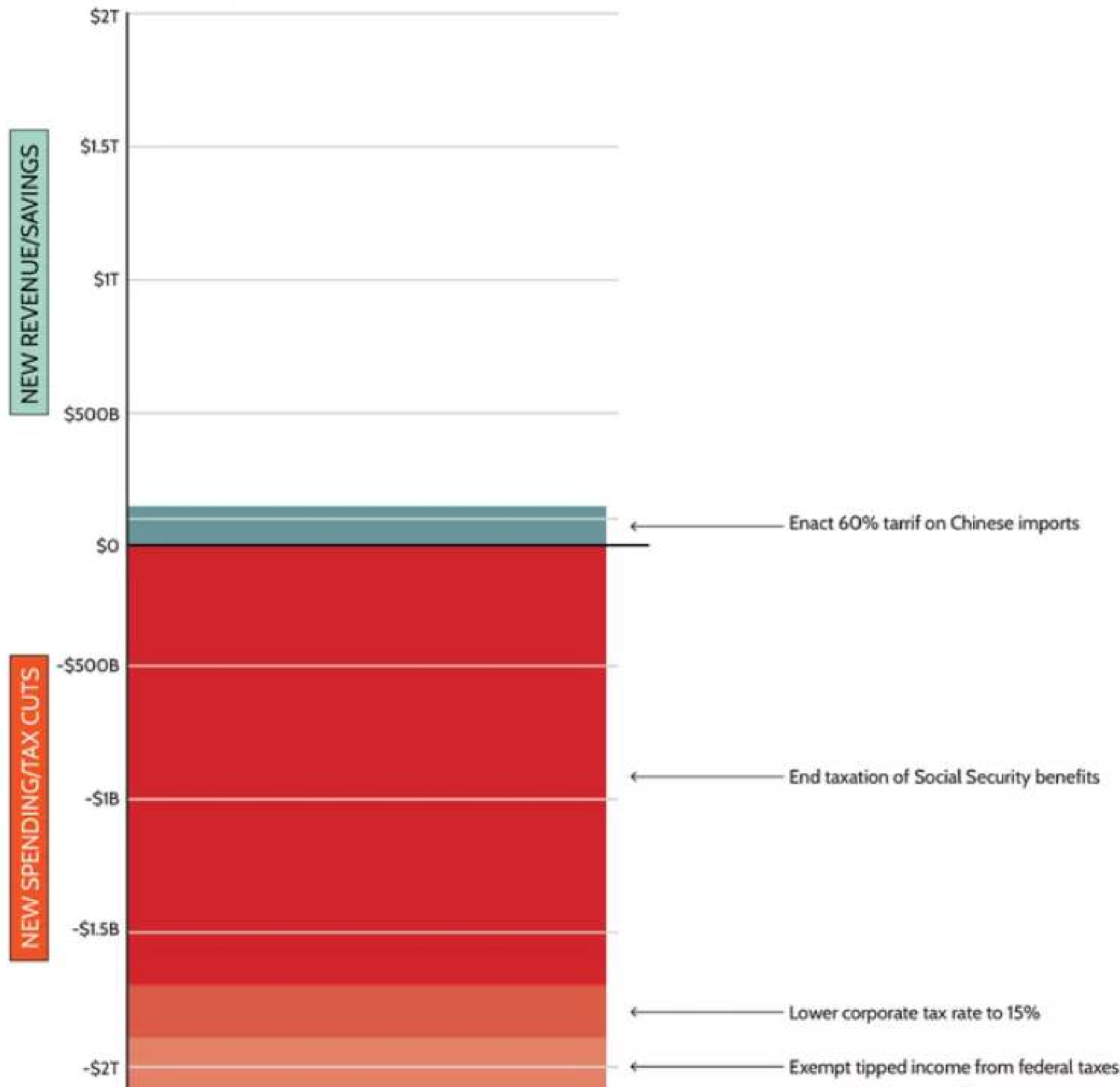
This would be financed by proposed tax hikes on the wealthy and corporates (increasing the corporate tax rate to 28% from 20% and a 25% billionaires tax).

Figure 9: A closer look at the cost of Harris's proposals



Source: Committee for a Responsible Federal Budget

Figure 10: A closer look at the cost of Trump's proposals



Source: Committee for a Responsible Federal Budget

Trump's policies [Figure 10] will cost up to $4 trillion over 10 years:

- The costliest proposal is ending the tax on social security benefits
- Lowering the Corporate tax rate to 15%

This would largely be funded by an increase in tariffs which would not bring nearly enough to cover the tax breaks, let alone put a dent in the national debt.

In summary, the race between Harris and Trump remains extremely close, especially in key battleground states. As the election approaches, we expect more uncertainty and market volatility. On the fiscal side the candidates have different approaches: Harris plans to increase taxes on the wealthy to fund social programs, while Trump proposes major tax cuts and relies on tariffs to offset the cost.

The outcome of the election will have significant implications for the economy and government spending in the years to come.

Our assessment: Both proposals would likely stimulate short-term growth and potentially boost employment, which could result in longer-term effects of higher inflation and subsequently rising interest rates. While Harris's proposal places less strain on the fiscus, Trump's plan puts substantial pressure on the deficit with limited offsetting measures.

Local macroeconomic outlook

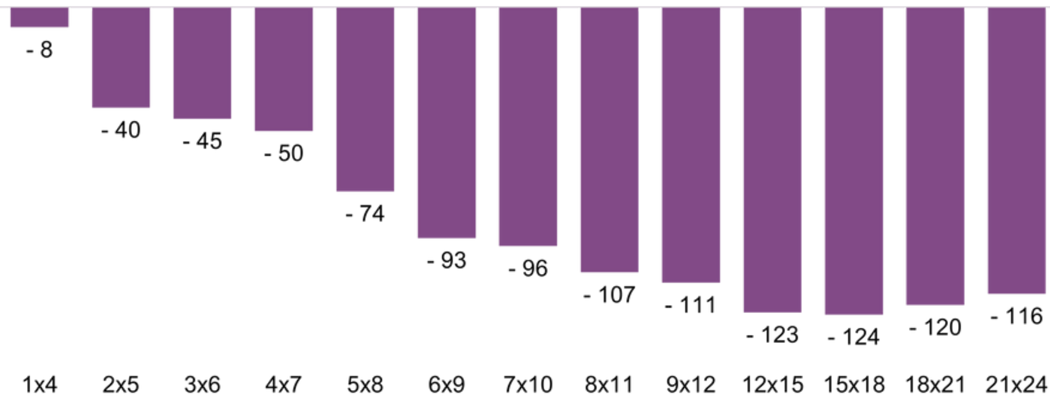
Local macroeconomic outlook

Local rate cutting cycle expected to be shallow

The Fed's 50 basis-point rate cut marked the beginning of an easing cycle. This reduces the risk (but does not eliminate the possibility) of a U.S. economic hard landing and allows EM central banks to follow suit with rate cuts, providing a catalyst for EM assets to rally.

SARB followed with a cautious 25bp cut and a shallow cutting cycle is expected over the course of 2025 [Figure 11].

Figure 11: The forward rate agreement (FRA) curve is pricing in only a sum total of 100bps in the current easing cycle.



Source: Bloomberg

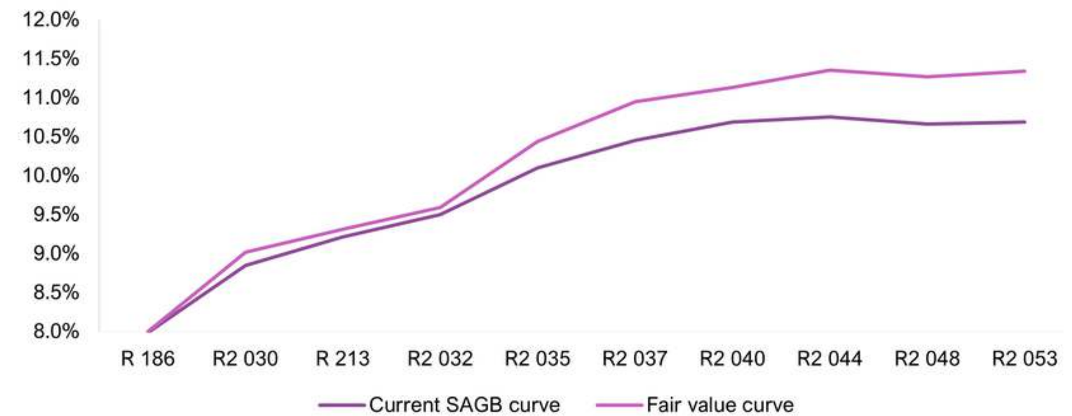
South African Government Bonds (SAGBs): pricing vs. fair value

The ultra-long end of the curve appears expensive [Figure 12], as it prices in a debt-to-GDP ratio of 71-72%, compared to our forecast of 74-75%.

Positive developments from the Government of National Unity (GNU) are a step in the right direction, but tangible economic improvements are likely to take time to materialise. The finance ministry's strict fiscal policy, aiming for a debt-to-GDP ratio below 70% within the next decade, underscores this long-term focus.

In the shorter term, while the front end of the yield curve appears fairly priced (with the SARB repo rate at 7% and the Fed funds rate at 3%, in line with expectations), we remain cautiously optimistic about South African assets. The potential for an EM rally is on the horizon, but the current pricing of SAGBs remains on the high side. Given these valuations, there is reason to tread carefully in this environment.

Figure 12: Our fair value curve is projected higher than the current SAGB curve



Source: Bloomberg, Perpetua Research

Key takeaways

- While there is potential for a rally in emerging markets, South Africa faces unique structural challenges that could temper optimism. Continuous issues and underperformance at various stated- owned enterprises as well as mismanagement at municipalities impact economic growth, unemployment and the fiscus. To stabilize the fiscus, the economy must grow, and this requires a state that can operate efficiently across all sectors—whether in energy, rail, ports, crime, home affairs, and more.

- The GNU faces an onerous task ahead, but its first priority must be to address internal conflicts before tackling external problems.

- Our view is to maintain a long position on SAGBs while staying vigilant. Given the overvaluation at current levels, it would not take much to disrupt the current situation. Any number of factors could cause yields to retrace, so we remain watchful.

- Monitor fiscal consolidation efforts closely. As the government attempts to rein in debt levels and implement strict fiscal policies, its ability to execute these plans will be key. Successful reform initiatives could improve market confidence and support long-term growth, but failure to address inefficiencies could further strain the economy and investor sentiment.

Feature: The GNU is going through real tests

The investment markets and investors have responded positively to the introduction of Government of National Unity (GNU) that was formed after the recent national elections. Domestic bonds and the shares of most companies that have exposure to South Africa have rallied since then. The Rand has strengthened as well, a sign that confidence in how the country is governed, is slowly returning.

We wrote about this in our Q2 Fixed Income Quarterly Commentary, pointing out that the GNU or a multi-party coalition is a positive step towards ensuring that government involves more political parties instead of being run by solely by the previously majority ANC party. Clearly a regime that was dominated by one party had been experiencing serious challenges, especially when it comes to growing the economy, creating employment, curbing corruption and ensuring good governance standards.

However, we also cautioned that the differing ideologies (as presented in their election manifestos) by the political parties involved in the GNU will undoubtedly pose serious challenges in ensuring that the coalition runs smoothly. This especially applies to policy issues. We wondered how the coalition government would handle disputes, especially between the two dominant parties, the African National Congress and the Democratic Alliance. We still do not know how they will manage conflicts over current issues which arise as they govern together. The Memorandum of Understanding that they signed lacks detail on this.

We recently noted the dramatic political theatre over the past weeks over the signing of the Basic Education Laws Amendment Act (BELA). The DA threatened that if the President signed the Act into law it would jeopardise the coalition. President Ramaphosa proceeded with the signing, however promising to review the two contentious clauses that were the cause of major disagreement.

We are now wondering whether the President is acting in good faith by allowing further consultation and engagements regarding the two clauses in the BELA Act or the DA was simply arguing for show? More confusing is that the Minister of Basic Education (a DA member) boycotted the signing ceremony but made it clear that she would still implement the law. Obviously, the DA does not want to alienate in voters by agreeing to policies that go against its ideologies.

Our reading of all this is that, despite the noise, the two big parties in the coalition seem committed to doing everything in their power to stay in the coalition because they have no attractive alternatives. We view this positively and it supports the positive momentum that we see in our investments markets.

Patrick Ntshalintshali
Portfolio Manager & Macrostrategist

ESG: Fixed income investment opportunities amidst decarbonisation efforts

Climate change, driven by global warming, is a critical environmental crisis with far-reaching implications on the global economy and society. Efforts to combat this crisis have seen significant milestones, such as the 2015 Paris Agreement, which set binding limits on greenhouse gases. Countries have detailed their plans through nationally determined contributions (NDCs), while the private sector has also increasingly committed to reducing emissions.

A major national stride in the past quarter was the signing of the Climate Change Bill by President Cyril Ramaphosa in July 2024. This bill provides a legal framework for reducing greenhouse gas emissions, building climate resilience, and fostering job opportunities in the green economy, while minimizing job losses.

The shift to a climate-resilient future offers investment opportunities, especially in our fixed-income funds. Opportunities lie in projects and activities that companies undertake to climate-proof their operations. These include renewable energy like solar, wind, and hydroelectric power to reduce dependence on fossil fuels.

As investors, we are pivotal in driving climate action and supporting the transition to a sustainable, low-carbon economy, through providing and allocation the capital needed to support the energy transition. Additionally, our influence on corporate behaviour can steer capital towards climate-positive outcomes, therefore contributing to the goals of the Paris Agreement.

The thematic bond market is growing

The thematic bond market provides a variety of instruments designed to finance projects with specific environmental, social, or governance (ESG) objectives. Like traditional bonds, these instruments offer a fixed return. The key difference is the guarantee that the proceeds are exclusively used for sustainable endeavours. Table 1 provides an overview of the various instruments in the thematic bond market and their specific objectives.

Table 1: Prominent thematic bond types

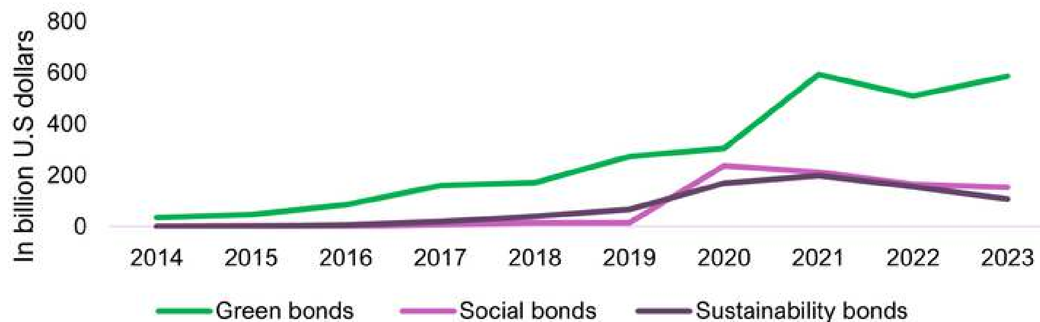
Type of bond	Purpose
Green bonds	Fund projects with positive environmental impacts, such as renewable energy and clean transportation
Social bonds	Finance projects aimed at achieving positive social outcomes, like affordable housing and healthcare
Sustainability bonds	Support projects that deliver both environmental and social benefits
Sustainability - linked bonds	Link financial characteristics to the issuer's performance against sustainability targets
Blue bonds	Finance ocean conservation and sustainable use of marine resources
Gender bonds	Promote gender equality and the empowerment of women

While all these bonds are designed to channel capital towards sustainable development goals (SDGs) and supporting the transition to a more sustainable economy, green bonds are particularly notable for their liquidity and the volume of issuance, making them a favourite among investors. They are crucial for enhancing resilience against climate impacts and overall environmental sustainability.

Understanding the global green bond market

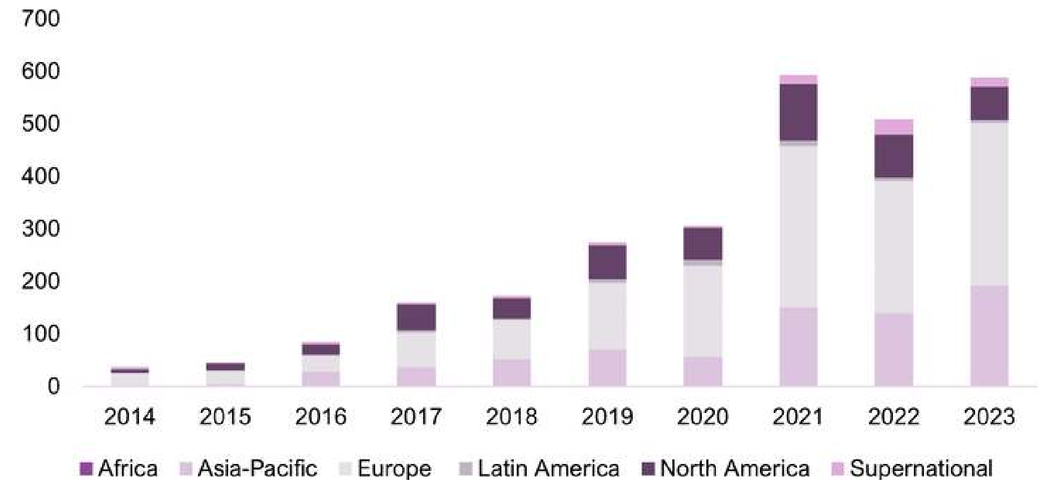
The global green bond market has experienced significant growth since 2014, driven primarily by increased global warming awareness and worldwide efforts to address climate change, according to the climate bonds initiative. Figure 1 shows the global cumulative green, social and sustainability issued between 2014 and 2023 and Figure 2 illustrates the global issuance by region for the same period.

Figure 1: Cumulative themed bonds issued worldwide between 2014 and 2023



Source: Climate bonds initiative

Figure 2: Green bonds issued by region from 2014 to 2023 (in billion U.S. dollars)



Source: Climate bonds initiative

Asia-Pacific and Europe lead in green bond issuance, peaking at nearly $500 billion in 2021. These regions also excel in renewable energy adoption and innovation and in green building initiatives, showing a correlation between green bonds and climate projects progression.

Both regions are also making significant strides in creating a supportive environment for green bond investments, ensuring that investors are protected and incentivized to contribute to sustainable development. For example, the European Union has a Green Bond Standard, which sets strict criteria for what qualifies as a green bond. This helps investors identify which projects are truly green, reducing the risk of investing in “greenwashing”, and ensures that their investments align with their sustainability goals.

In contrast, the green bond market in emerging markets (excluding China) is still in its infancy. This could be attributed to lack of regulatory support challenges and greater macroeconomic priorities for these regions such as building market infrastructure for traditional bonds (e.g trading platforms, verification bodies) before considering thematic bonds. While the themed bond market has many unique characteristics, the investment fundamentals follow similar patterns as the traditional market – to attract a diverse range of investors, it must offer:

- attractive returns
- ensure investor protection
- contribute causally to global efforts to address challenges like social inequality and carbon emissions reduction to combat climate change.

South Africa, Morocco and Nigeria collectively account for about 93% of the green bond issuance in Africa. Many African countries have neither issued a green bond nor developed the regulatory frameworks to support their issuance. South Africa stands out in both the issuance of green bonds and in the regulation that support their issuance. It is currently the only African country with an established green finance taxonomy. Launched in April 2022, South Africa's Green Finance Taxonomy is benchmarked on EU standards and aims to provide a clear classification system for green investments. This makes a case for the importance of clear policies in the development of green bond market.

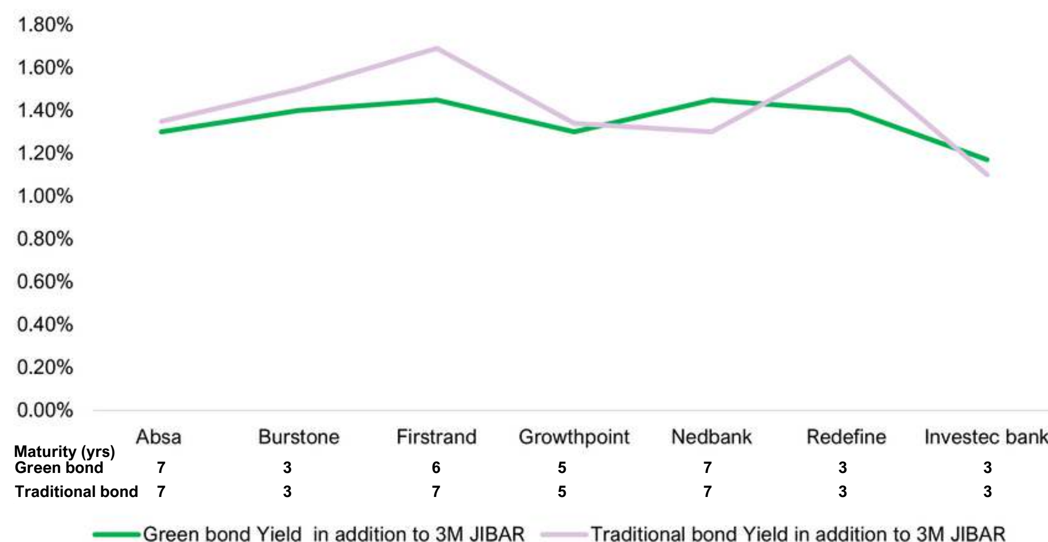
Overview of the South African green bond market

The themed bond market in South Africa, supported by the government, financial institutions, and companies, is seeing rapid growth in green bonds specifically. Prominent examples of issuance include the City of Cape Town's R1 billion green bond issued in 2017, which was launched during a severe drought to fund sustainable water management and other environmental projects. The Development Bank of Southern Africa issued its first green bond in 2021, proceeds were to target projects hat promote climate mitigation and adaptation, thereby supporting a sustainable and equitable transition to a low-carbon economy and the achievement of the Sustainable Development Goals.

Companies listed on the Johannesburg Stock Exchange (JSE) are also increasingly issuing green bonds as part of their sustainability strategies. So far, over 50 green bonds have been issued by 11 companies. The issuers include the big five banks, four property companies, one diversified global miner, and one chemicals company [1]. The banks and property companies are the most frequent corporate issuers of green bonds locally.

While we have analysed the most recent issuances of all these 11 companies, Figure 3 compares the 7 companies who have both traditional and green bonds in issuance. Our assessment reveals that the yield (at issuance) on the issuer's green bond often trades lower compared to same issuer's traditional bonds with similar characteristics (duration, type of issue, issue date, and size). In addition to the 3-month JIBAR, we do note that the coupon rates and margins of the corporates we have analysed are relatively similar for the most recent issuances of the same companies' green bonds.

Figure 3: Yield differences (at issuance) between green bonds and traditional bonds issued by the same corporate



Source: Perpetua Research

[1] Absa, FirstRand, Investec, Nedbank, Standard bank, Growthpoint, Burstone, Nepi Rockcastle, Redefine, Anglo American and AECI

Our ESG integration approach for the green bonds market

The green bonds we assessed are attractive in terms of fundamentals. However, our portfolio's current lack of exposure to them is due to the following matters that we believe require further clarity before we are comfortable to invest.

- **Broad and non-specific scope:** the bonds we assessed are not tied to specific, pre-disclosed projects with measurable benefits, making it hard to assess risks and opportunities. This lack of specificity and detail can potentially lead to greenwashing, where bonds are labelled "green" without significant environmental improvements.
- **Need for greater transparency and accountability:** the proceeds may be used for general corporate purposes by some of the issuers. This makes it challenging to hold management accountable to the set environmental targets. We would prefer specific pre-disclosure of the projects and initiatives along with stringent performance targets.
- **Verification challenges:** while the JSE's listing requirements include that issuers must facilitate an independent review and certification to ensure positive environmental impact and provide post-issuance impact reporting, investors cannot independently verify this information. We must rely on the issuer's statements.

To gain the comfort we would need to invest, we would need to see mitigation in the concerns mentioned above and the establishment of stable, robust frameworks such as a universal standard for quantifying green bonds. These frameworks should effectively mitigate the risk of greenwashing and ensure that the environmental benefits of these instruments are genuine and accurately represented.

As responsible investors, we are cognisant that our role doesn't end here: we will continue assessing and valuing green opportunities to support the growth of the green bond market but also contribute to broader environmental sustainability goals.

This process will involve:

- **Verification:** our analysis will include third-party verifications to ensure the issuance is genuinely green during our research phase.
- **Engagement:** we will also be active stewards, engaging with green bond issuers, government entities and policymakers, either independently or alongside other investors, to advocate for higher standards of transparency and accountability.
- **Collaboration:** we believe that maintaining the integrity and building the capacity of the South African-themed bond market requires collaborative efforts from all participants, including us as investors.

This is part of our fiduciary duty and impact investing, ensuring that these bonds meet environmental sustainability criteria while mitigating greenwashing risks in our portfolio.

Balancing potential and caution

Green bonds can provide not only environmental benefits but also competitive returns. We are, however, prudent at this juncture as we aim to quantify and assess their environmental impact. We will continue to monitor their development as they remain part of our investable universe. Staying informed about advancements in this area is part of our commitment to investing with clarity, conviction, and discipline.

Nomfundo Mdluli
Sustainability Analyst

Fixed income team

Delphine Govender is Perpetua's CIO and portfolio manager. She has ultimate responsibility over the investment function and capability; this includes accountability over investment performance; ensuring the integrity of the investment philosophy is maintained; the investment process is consistently applied (and refined where required) and that team succession planning is considered. Delphine has portfolio management responsibilities over all asset classes and supervises the portfolio managers and analysts (alongside the other portfolio managers). She is a qualified CA(SA) and CFA charterholder.

Pooja Tanna is the portfolio manager for Perpetua's fixed income products which include the following strategies - Enhanced Cash, Domestic Bond Fund, and Flexible Fixed Income Fund. She also manages the fixed income assets within Perpetua's multi-asset class funds.Pooja has over 18 years' financial services experience of which the past 17 years has been spent directly in the field of fixed income – across fixed income trading, interest rate structuring, derivatives trading and portfolio management. She holds a BSc and BSc Hons degree in Mathematical Statistics.

Patrick Ntshalintshali is one of Perpetua's equity and balanced portfolio managers. He is responsible for the portfolio risk management aspects of the equity portfolios and direct mentoring of analysts. He is also a Director of Perpetua and fills the role of Portfolio Risk Manager. Patrick has over 28 years' experience in the investments industry spanning primarily listed equity investments as well as private equity. Patrick has gained this experience at Old Mutual Investment Group, Syfrets Managed Assets, Mtungwa Investment Holdings and Vunani Fund Managers. He holds a BCom Hons degree and an EDP.

Nomfundo is a Sustainability Analyst and joined the firm in April 2023. Nomfundo is responsible for contributing to sustainability, responsible investing and ESG specialist tasks at the firm. Nomfundo joined the firm from Just Share (Cape Town) where she was an ESG Analyst since 2021. Prior to that Nomfundo spent a year at First Avenue Investment Management as a Trainee Equity Analyst. Nomfundo holds a BCom Economics and Econometrics and a post graduate diploma in Financial Markets.

Thabiso Mohlakoana is a Trainee credit investment analyst. She primarily focused on supporting Pooja in the Fixed income capability specifically in respect of credit research. Thabiso devotes a significant part of her time to the fundamental analysis of the credit of issuers. Thabiso is a recent graduate and has just completed her Honours (with distinction) in Economic Analysis and Financial Markets at UCT which included Economics, Applied Economic Modelling and Econometrics, Corporate Finance and Equity Valuation, Securities Legislation, Futures, Options and Derivatives and Fixed Income.

Invest with us

Mandate	Fund strategy
Perpetua Domestic Balanced	The Perpetua Domestic Balanced portfolio is a multi-asset class portfolio investing in equities, bonds, cash and commodities in South Africa, subject to the restrictions of Regulation 28. The Fund is managed in a manner to deliver returns above long term target of SA CPI+5%. The strategy benefits from Perpetua's top-down macro driven asset allocation process combined with bottom-up fundamental asset class research and stock-picking.
Perpetua Global Balanced	The Perpetua Global Balanced portfolio is a multi-asset class portfolio investing in equities, bonds, cash and commodities in the domestic and global markets subject to the restrictions of Regulation 28. The Fund is managed in a manner to deliver returns above long term target of SA CPI+5%. The strategy benefits from Perpetua's top-down macro driven asset allocation process combined with bottom-up fundamental asset class research and stock-picking.
Perpetua Cash Enhanced	The Perpetua Cash Enhanced portfolio is designed for investors who have a need for a competitive return while avoiding any capital loss in the short term. It will aim to deliver returns 1.0% per annum above the Short-Term Fixed Interest rate (SteFI) benchmark before fees, and will do so by investing in short-term credit opportunities, notes, derivatives, short-dated government bonds and collective investment schemes/funds.
Perpetua Flexible Fixed Income	The Perpetua Flexible Fixed Income portfolio provides investors with a blend of stability, income and capital appreciation. The fund aims to deliver outperformance against the BEASSA ALBI benchmark by investing in credit opportunities, duration positions, structured notes, derivatives and alternative strategies. The fund aims to minimise volatility by utilising the various instruments in the fixed income universe.
Perpetua Domestic Bond portfolio	The Perpetua Domestic Bond portfolio seeks to generate capital and interest returns by investing primarily in South African government, parastatal and corporate bonds. The portfolio aims to deliver excess returns by investing in fixed income instruments offering superior yields which actively managing duration and credit, thereby limiting downside risk.

For more information on our products, view them on our website.

Perpetua Investment Managers
5th Floor, The Citadel, 15 Cavendish Street, Claremont 7708
PO Box 44367, Claremont 7735, South Africa
Telephone + 27 21 674 4274
Telefax +27 21 674 4599
info@perpetua.co.za
www.perpetua.co.za

DIRECTORS: DD Govender CA(SA) CFA, K Govender CA(SA) PG Dip Tax (Natal) P N Ntshalintshali B Com (Hons) AMP, R S M Ndlovu B Bus Studies (Hons), A de Swardt B Com (Hons), R Moloto B Com

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