

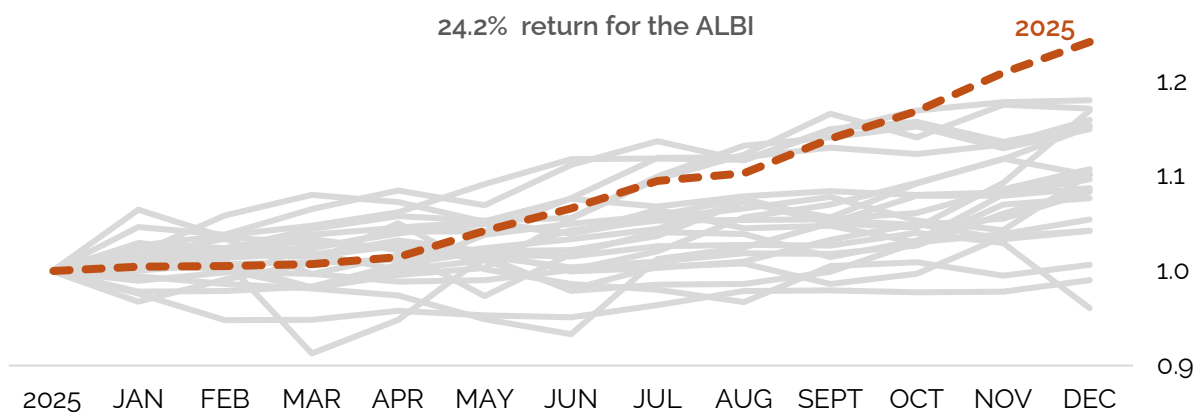
FIXED INCOME & CURRENCY

Outlook for 2026

South African government bonds: As good as it gets?

South African government bonds delivered exceptional returns in 2025. The FTSE/JSE All Bond Index (ALBI) rose 24.2%, the strongest calendar year performance since 2000, following a 17.2% gain in 2024. Improving domestic fundamentals, economic reform momentum and strong foreign inflows drove returns. For offshore investors who left rand exposure unhedged, total returns exceeded 42% in US dollar terms. Naturally, expectations for a repeat performance in 2026 should be tempered.

Graph 1: SA bonds delivered their best performance on record



Source: Fairtree, Bloomberg. As at December 2025

The rally reflects structural rather than cyclical improvements. Inflation fell sharply from around 8% in 2022 to below 3% in 2024, with core inflation only following in 2025. The formal reduction of the inflation target to 3% ±1% represents one of the most important policy reforms in decades. Inflation expectations have declined meaningfully, enhancing central bank credibility.

If inflation settles near target and the real policy rate remains around 2.5–3%, the South African Reserve Bank (SARB) could cut rates by a further 75 basis points, taking the repo rate to 6% or lower and bringing total easing to around 225 basis points. Given policy lags, these cuts



should increasingly support growth, sentiment and investment. A lower inflation target also reduces long-term risk premia and improves export competitiveness.

These improvements are evident in asset pricing. Long-bond yields have fallen almost 400 basis points since the April 2024 election-related stress, the 10-year spread versus US Treasuries is the tightest since 2007, and CDS spreads have narrowed sharply, closing the gap with Brazil. Lower funding costs, improved growth prospects and rising mining revenues should help stabilise debt dynamics. National Treasury's focus on a primary surplus, combined with a potential fiscal anchor, increases the likelihood that the debt-to-GDP ratio peaks and then begins to decline.

While bond valuations are no longer cheap, they are not yet stretched. Inflation may continue to undershoot expectations; the SARB could cut more than the 50 basis points currently priced. Fiscal outcomes may surprise positively again, given conservative revenue estimates and further rating upgrades are possible over the next 12–18 months. We therefore see scope for yields to fall further, though returns are unlikely to match the past two years, potentially limited to low double-digit returns. Risks remain. Political instability, municipal elections later this year, foreign policy missteps, lingering State-Owned Enterprise risks, weaker commodity prices or a hawkish shift by the US Federal Reserve could all weigh on sentiment.

Emerging market local debt: Attractive opportunities

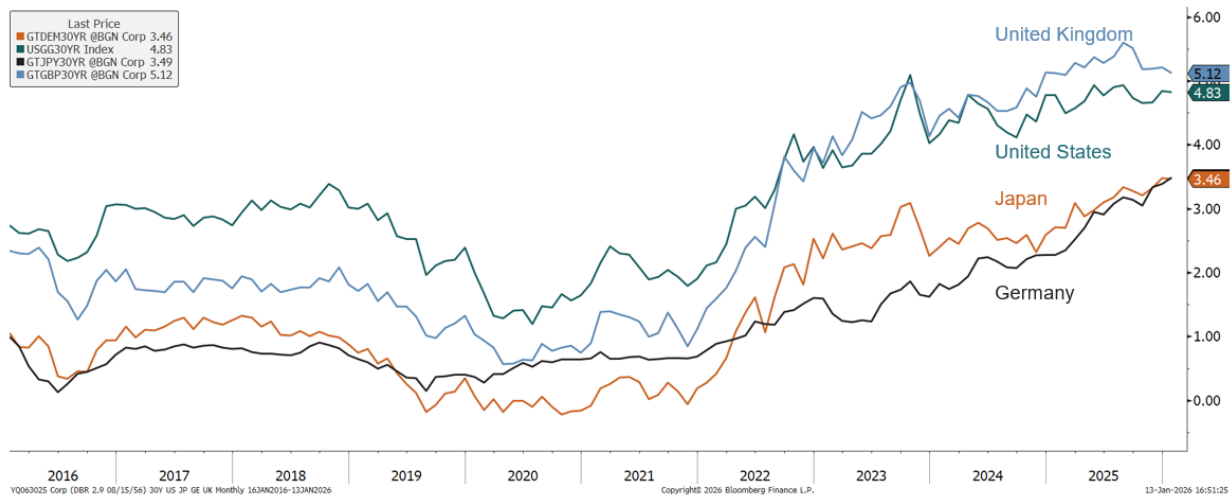
Other high-yielding emerging market bond markets also look attractive. Latin American countries, such as Brazil, Colombia and Peru, face elections this year, which may create reform momentum but also short-term volatility, often an opportunity for investors. Strong carry, low volatility and sustained demand continue to support emerging market local debt.

Global government bonds: Dispersion among developed market rates

The most likely path for the front end of the US government curve remains lower. Easing inflation and a soft labour market may give the Fed scope to cut more aggressively than currently priced. High debt levels, fiscal pressure and monetary policy uncertainties may keep long-term yields somewhat elevated, leading to a bull-steepening of the yield curve. Outside the US, expected rate cuts by the European Central Bank and Bank of England should support bond markets, but the positive fiscal thrust in Europe may keep longer yields higher. We believe UK fiscal concerns fade over the coming year, leading to lower long-term yields. Japan remains the outlier, where fiscal stimulus and rising inflation could prompt faster-than-expected tightening.



Graph 2: Back-end bond (30-year) yields rose on fiscal dynamics



Source: Fairtree, Bloomberg. As at December 2025

Credit: Late-cycle dynamics are a headwind

Credit spreads are tight across the US, Europe and South Africa. While fundamentals remain solid, late-cycle dynamics increase the risk of spread widening and higher defaults. In multi-asset portfolios, we prefer equity and duration exposure over credit risk.

Currencies: Rand benefits from a weaker US dollar

The rand showed strong appreciation despite weak growth, political uncertainty and foreign policy pressures. It appreciated 13.8% against the US dollar, the best annual performance since 2009, and strengthened broadly against dollar-bloc currencies, Asia and most emerging market peers. Three factors underpinned this move: US dollar weakness, strong demand for emerging market assets and improving domestic fundamentals. These forces should remain supportive, though we expect more modest gains in 2026.

The US dollar remains vulnerable.

On real effective exchange rate and purchasing power parity measures, it appears to be 10–20% overvalued. The US twin deficit—large fiscal and current account gaps—continues to rely

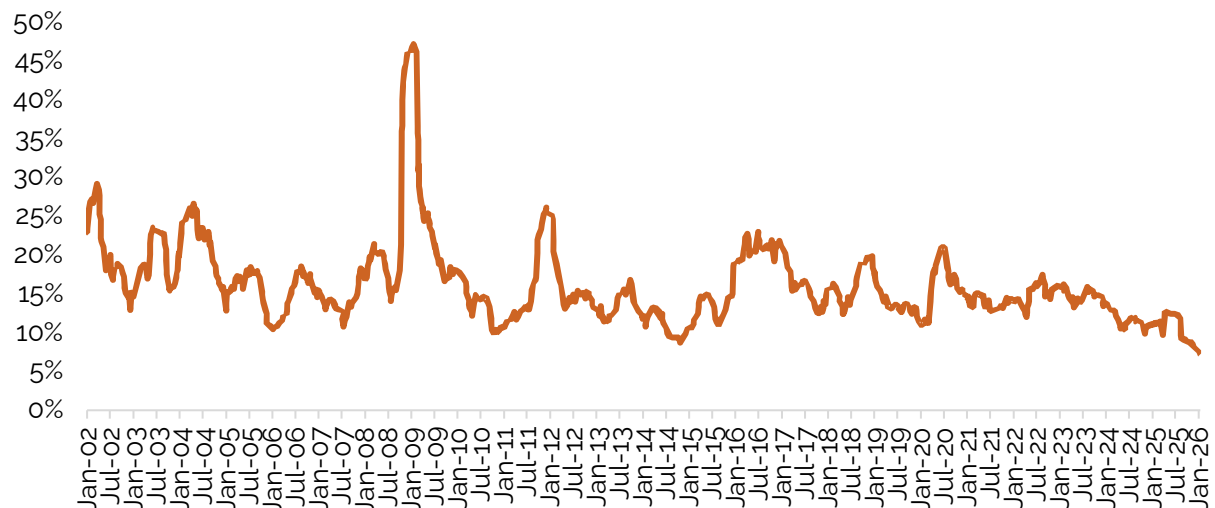


on external portfolio inflows. As investors reassess US exceptionalism and diversify away from US assets, these flows are becoming less reliable. Policy uncertainty and questions around the dollar's safe-haven and reserve-currency status have further eroded confidence. Investors who benefited from years of unhedged dollar exposure are increasingly raising hedge ratios. Monetary policy dynamics also favour a weaker dollar, with the Federal Reserve expected to ease further in 2026, lagging other core central banks.

Strong demand for emerging market assets should support emerging market currencies.

Fundamentals in emerging markets are strong, and valuations are attractive. Lower US rates, firmer metal prices, lower oil prices, China's resilience and subdued market volatility provide a constructive backdrop for emerging markets and emerging markets carry trades.

Graph 3: Rand volatility has dropped, making the currency more attractive – 90-day USD/ZAR volatility annualised



Source: Fairtree, Bloomberg. As at January 2026.

Importantly, low and stable inflation across many emerging markets provides policymakers room to ease without undermining risk premia, as fiscal dynamics have improved relative to developed markets. Consensus expects emerging markets growth to accelerate from 4.2% in 2025 to 4.3% in 2026, and we expect more assets to flow into the asset class.



Local factors continue to support the rand.

The rand benefits from a lower country risk premium as reflected in the fall in 10-year CDS from around 3% to 2.4%, a sovereign rating upgrade by S&P Global and removal from the FATF grey list. The lower inflation target, gradual economic reform, attractive valuations and high real interest rates have lifted.

Author



Jacobus Lacock

Fixed Income Portfolio Manager & Macro Strategist

Jacobus joined Fairtree in 2011 and is a Multi-Asset Portfolio Manager & Macro Strategist as well as a Fixed Income Portfolio Manager in the Investment team. Prior to joining Fairtree, he spent five years at Goldman Sachs Asset Management in London, where he served as UK Head of Fixed Income and Currency Product Management. He holds a Bachelor of Commerce Honours degree in Economics from the University of Stellenbosch and is a CFA® charterholder.

Disclaimer:

Fairtree Asset Management (Pty) Ltd is an authorised financial services provider (FSP 25917). Collective Investment Schemes in Securities (CIS) should be considered medium- to long-term investments. The value may go up as well as down, and past performance is not necessarily a guide to future performance. CISs are traded at the ruling price and may engage in scrip lending and borrowing. A schedule of fees, charges, and maximum commissions is available on request from the Manager. A CIS may be closed to new investors to allow it to be managed more efficiently in accordance with its mandate. Performance has been calculated using net NAV-to-NAV numbers with income reinvested. There is no guarantee regarding capital or returns in a portfolio. Prescient Management Company (RF) (Pty) Ltd is registered and approved under the Collective Investment Schemes Control Act (No. 45 of 2002). For additional information, such as fund prices, fees, brochures, minimum disclosure documents, and application forms, please visit www.fairtree.com.