

PORTFOLIO MANAGER COMMENTARY

The start of 2012 saw a continuation of the positive sentiment trend in global equities experienced during the last quarter of 2011, with the MSCI World Equity Index returning 11.7% over the first quarter, taking the total return to 20.3% over the last 6 months. Investors chose to focus on the positive aspects associated with the announcement of a further €1 trillion liquidity injection by the ECB in the form of low cost, long term funding to the European region's banking system to try and resolve the Greek debt crisis. Economic data releases in the US continued to surprise on the upside, pointing to a more sustainable recovery in that region, while in China fears of a hard landing subsided further, despite an official announcement around lower future expected economic growth. The 12-month lagging return from global equities has now turned marginally positive (+1.1%), emphasising just how vicious the sell-off during the third quarter of 2011 has been.

Emerging equity markets outperformed the world indices by a small margin, although China lagged the overall MSCI Emerging Markets Index. Over the last 12 months emerging markets have however still lagged the overall MSCI World Index by almost 10%. Within the developed markets there was not a large divergence in performance over the quarter, highlighting the fact that this rally really represents a change in overall sentiment, rather than changes in specific regions' economic outlooks. Global bond markets reflected the same trend, with traditional safe haven markets selling off, and peripheral European countries experiencing an improvement in borrowing costs. The gold price also retreated somewhat, again reflecting the increased risk appetite of investors. Some of these trends are being reversed as we write this commentary, indicating how fragile these developments are.

In our opinion, a fair number of these positive developments address the symptoms of the current crisis, but not the roots. We continue to expect anaemic economic growth out of the European block for a while, while governments come to the realisation that ultimately they will have to live within their means. Austerity measures are not a thing of the past, and we anticipate the US to announce some further measures once the presidential election is out of the way. Even the US Fed has expressed caution of the sustainability of the US recovery. On the other hand, more emphasis is being placed on the social costs associated with austerity programmes, with the anticipated pushback from voters gaining momentum in some of the more fragile political systems.

The fund performed well against this backdrop, returning 6.8% over the quarter (in US dollars). This takes the fund back to a zero return in dollars over the last 12 months. The positive short-term results mean that over most periods the fund has now achieved its outperformance target of cash plus 3%. Since inception the fund has achieved an annualised outperformance of 7.7% in dollar terms. In rand terms, the fund performance was a bit more subdued over the quarter due to rand strength, but significantly better over the last 12 months given the weakness we saw in the currency during the third quarter of last year.

While we benefited from our significant exposure to equities, the other asset classes also performed well. Property stock selection was good, aided by a strong rebound in the prices of our Japanese holdings and improved sentiment in Singapore towards the asset class. Fixed interest credit was repriced upwards on the greater demand for risk. Our gold positions were neutral, and natural gas once again disappointed badly. There was some positive news towards the sector as some producers announced cuts to production and future drilling, but this position remains our biggest detractor to performance since inception.

Some of our equity holdings that performed particularly well include Great Wall Motor, Microsoft, Apple, Yum Brands and Circle K.

We have continued to reduce equity exposure into the rally, mainly through selling of futures. We have added slightly to our property holdings, particularly in Europe, where valuations now more than reflect the dire economic outlook in our opinion. Some corporate action has provided a short-term boost to this region, but we think more positive price action can be expected over the longer term.

Resulting from the rising equity market, a lot of our holdings are now closer to our estimates of their fair values, prompting us to re-evaluate their positions in the portfolio. We have also increased the fund's exposure to more defensive businesses, which should help to protect the fund further in the event of a sharp reversal in equity market fortunes.

The fund has started the year on a good note, but we remain concerned that the clouds that darkened the horizon during the third quarter of last year have not passed, and we thus remind investors and potential clients not to raise their expectations too high. Investment market cycles often reflect the human cycles of fear and greed, and in our opinion we have very quickly and without much fundamental change in the underlying situation, moved from the former to the latter...

Portfolio managers

Tony Gibson and Louis Stassen