

PORTFOLIO MANAGER COMMENTARY

What a start to the year it has been! Markets have been climbing ever higher. Against this backdrop, the fund has returned 8.9% for the quarter and 20.3% for the year relative to a strong Industrials Index, up almost 21% over the last year. For the three years to March, the fund returned 29.5% versus 30.2% for the index.

While in America there are tangible signs of a recovery in employment numbers, Europe's buoyancy has come from avoiding any landmines to date. Certainly the rebound in the DAX implies that Germany is expected to avoid the worst. Here in South Africa the consumer has continued to benefit from low interest rates, growing credit extension and real wage increases. But these are not factors we believe can be sustained. Real wage increases have left no room for jobs growth and will negatively impact longer-term competitiveness. While the rand remains relatively strong we will continue to see manufacturers replace jobs with capital equipment.

In other pockets the consumer is facing climbing costs in satisfying basic needs. Maize prices continue to drive food prices up. This is exacerbated by high oil prices, electricity and rate hikes. We have lightened positions in some of the consumer stocks which have run very hard, and reinvested in names which we believe offer better value.

Good inflows during the quarter gave us an opportunity to increase some of our established positions as well as add a few new names to the portfolio. We increased our weight in some of the basic material stocks such as Arcelor Mittal and Mondi.

A disappointing trading update from Clicks allowed us to increase our weight at an attractive price. Clicks should continue to grow in the South African market as corporate pharmacy takes market share. While regulatory change is a threat, its position as an efficient, cost-effective pharmacy group will offer protection.

We added to our position in Mediclinic, a high quality hospital group. Mediclinic offers defensive but steady growth as its leading hospital businesses in Switzerland, Dubai and South Africa ramp up capacity and deleverage. These offshore earnings streams offer currency diversification while reducing the risk of being exposed to a single regulator. We also added to Naspers to reflect more appropriately in the weighting how much upside this counter offers.

In terms of new stocks, we established a position in Illovo which has performed poorly relative to the market. Illovo offers exposure to Africa where isolated markets and structural support from tariffs offer the business protection as it ramps up low-cost production. We also introduced Buildmax, a player in the contract mining space, into the fund. Here strong leadership have been doing the right things in restructuring the business and repricing contracts.

During the period we disposed of a few shares; we sold Mvelaphanda Group to private equity investors better suited to extract the last bit of value from its breakup. We also sold Adcorp where we re-appraised the regulatory risk of this staffing business; risk no longer justified by the multiple at which it was trading. We expect to exit our position in O-line over the next quarter as an attractive offer has been made for the company.

With markets having run hard, valuations are looking stretched in a number of pockets in the industrial area. We continue to rotate into stocks which we believe offer value and where management are building stronger businesses for the long term. In looking forward, potential for further re-rating is limited or may even be negative in some cases. Hence most of the prospective return must come from earnings growth and the ability to pay dividends. The portfolio positioning gravitates increasingly to the business models that can sustain this. Thankfully, we are still finding such opportunities, even in this stretched market.

Portfolio managers

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