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

The financial sector ended the year on a very strong note, delivering 16% for the final quarter. The fund returned 12.2% for the fourth quarter and over more meaningful periods of 5 and 10 years the fund delivered 13.6% and 12.9% relative to benchmark returns of 14.9% and 12.6% respectively. Since inception the fund has returned a compound annual return of 13.6%. The long-term track record of the fund remains respectable relative to peers and the benchmark.

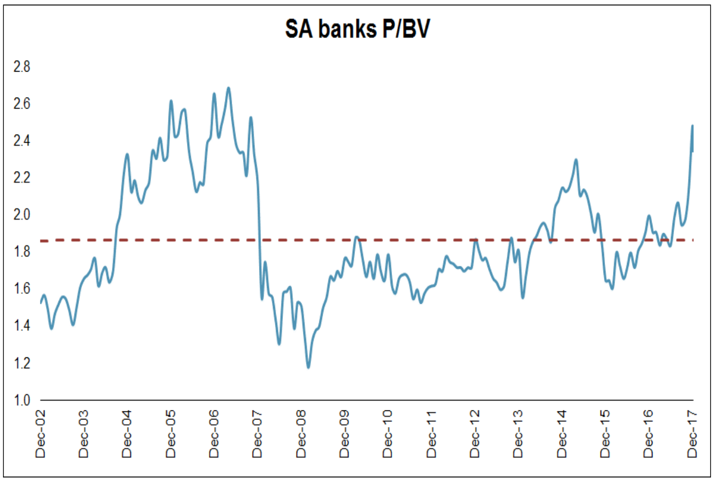
The outperformance by the banking sector relative to the life insurance sector, that characterised the previous quarter, continued. Banks delivered 28.3% for the final quarter, compared to 18.9% from the life sector. Returns from listed domestic property and general financials were modest at 8.3% and 2.8% respectively.

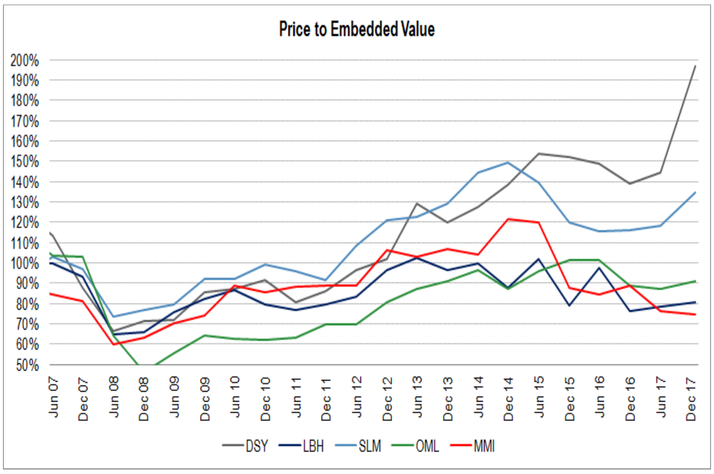
Contributors to fund performance for the quarter were overweight positions in Discovery, Nedbank, and Standard Bank as well as underweight positions in PSG and the domestic property sector. Detractors from quarterly performance include an overweight position in PSG Konsult (where interim results were softer than market expectations; still, we remain positive on the longer-term growth opportunity) as well as in stocks with rand hedge characteristics, including Investec and Hammerson. Underweight positions in Barclays Group Africa and Sanlam also detracted.

The rand strengthened 9% during the quarter and proved to be a material headwind for the rand hedge stocks in the fund. Much of this rand strength came in December after Cyril Ramaphosa was elected as ANC president. The SA economy faces some tough challenges and the possibility of a local currency ratings downgrade to junk status. The ascendancy of Ramaphosa, who is generally viewed as more market friendly than his predecessor, was well received by the market. It now remains to be seen whether the new ANC leadership can overcome the internal conflicts which characterised the run-up to the elective conference and deliver the required fiscal discipline and policy reform. Domestic stocks rallied strongly on the outcome of the ANC conference to levels at which we believe a lot of good news has now been factored into valuations, with little margin of safety should there be any disappointment in execution by the new leadership. We therefore retain the rand hedge holdings in the fund which offer more attractive valuations and ample margin of safety.

During the quarter we took the opportunity to reduce holdings in Standard Bank, Nedbank, Discovery and FirstRand as these stocks rallied and their margin of safety reduced. We increased the fund's positions in Investec, Intu, MMI and Santam, as well as initiating a new position in PSG. The latter is a stock we have always liked, but in the past its valuation has rarely offered the adequate margin of safety we would require to include it in the fund. During the quarter, PSG sold down meaningfully following the financial irregularities which emerged at one of its large shareholders, Steinhoff (formerly a 25% shareholder). While these irregularities did not directly impact PSG or its operations, Steinhoff's decision to sell down its holding to shore up liquidity provided us with an attractive entry point into PSG. The management team of PSG has delivered exceptional shareholder value over the long term and the business currently holds an attractive portfolio of businesses including Capitec, PSG Konsult, Curro and Zeder. We are confident in the PSG management team and their ability to grow and unlock shareholder value in these assets.

Following the strong rally in the quarter, valuations across financial stocks are now looking full. The charts below provide some key valuation metrics for banks (price-to-book multiples) and life insurance companies (price-to-embedded-value multiples) over the long term.





Banks now trade at price-to-book multiples comparable to the valuations last seen before the financial crisis, despite current sustainable return-on-equity levels being lower than those achieved before 2007. The life sector has seen a steady improvement in price-to-embedded-value multiples since the financial crisis, with Discovery and Sanlam showing the strongest re-rating over the last year. Given these valuations, we would caution against expecting returns from the sector over the past decade to be repeated in the next ten years. That said, opportunities for the astute stock picker still exist. Still, in today's environment, it becomes even more important to remain focussed on valuation-driven investing and to avoid the risk of permanent loss of capital by seeking out only those opportunities that offer an attractive margin of safety relative to intrinsic value.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 31 December 2017