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

The fund returned -4.7% for the quarter, lagging the index return of -2.1% and dragging the return for the calendar year to -5.6%. Although negative, this represented outperformance of the benchmark return of -8.8%. Over the more meaningful periods of five and 10 years, the fund has generated compound annual returns of 7.3% and 14.6% respectively, compared to index returns of 8.9% and 15.0%. Since inception, the fund has delivered compound annual growth of 12.5%, outperforming the index return of 10.7%.

The fourth quarter was a challenging one for global markets as a litany of worries including a US-China trade war, a no-deal Brexit and a US government shut-down drove indices to their worst year since 2008. The MSCI All Country World Index was down 12.8% for the quarter, with the US market down 13.4% and most others following its lead. Our market fared a bit better, down 4.9% (in rand terms), while the financial sector fared better still, down 2.1% in the quarter. It was a comparably better quarter for the banks which were up 2.5%, while life insurers rose by only 0.1%.

Contributors to fund performance for the quarter came from overweight positions in outperformers Nedbank, PSG Konsult and Standard Bank, as well as underweight positions in underperformers Nepi Rockcastle and Coronation. Detractors from performance came from overweight positions in underperformers Investec, Hammerson and Reinet, and no exposure to outperformers Absa and Capitec.

Looking back on the fund's performance for the year is a source of great frustration, doubtless for investors as much as for us, the managers. While stock-picking within sub-sectors was generally good (Nedbank amongst banks and PSG Konsult amongst other financials), the fund's performance was dominated by the fortunes of the property stocks. The fund has consistently had very little exposure to the SA-listed property sector, and its precipitous decline during the year benefited fund relative performance. The fund did however carry overweight positions in the dual-listed UK retail property stocks Intu and Hammerson, and these positions offset much of this benefit. The two shares sold off significantly during 2018: Hammerson by 40% and Intu by 55% (both in sterling terms). The market appears to have two principal concerns:

- A structural change in the retail model, away from in-store and towards online sales
- The implications of an uncertain Brexit on the UK market more generally

These are both risks that we certainly do not dismiss. Despite the two companies owning premium super-regional retail centres in the UK (as well as France and Ireland in the case of Hammerson), there is no question that the model is changing and that online sales will become an increasing part of retailers' mix. This is likely to put pressure on rentals and the ability to fill space in centres. However, we would consider the quality of both companies' portfolios to be such that they are better able to withstand this headwind than the average shopping centre. The eventual form of Brexit is impossible to call, although it is looking increasingly contested and messy by the day. This will no doubt have some impact on financial markets, as well as on consumer behaviour.

While all of this sounds rather negative, one must return to valuation as an anchor. At the beginning of the year Hammerson traded at a 30% discount to its NAV at that date, and Intu at a 39% discount. One could challenge some of the NAV assumptions, and these businesses' balance sheets carry debt, implying NAVs can be quite geared to any changes in such assumptions. However, at these sorts of discounts the shares traded with some margin of safety. Indeed, the attractiveness of Intu soon became apparent: during the year it received two indicative takeout proposals. Both came from industry insiders – one in fact from Hammerson, and the other from a consortium that included Intu's own chairman. The latter materialised early in the fourth quarter, when the share was trading at 148p, a 59% discount to its disclosed June NAV. The indicative proposal offer was for 215p, not far from where the share had been trading at the time of the Hammerson approach. Disappointingly, the consortium subsequently elected not to proceed with the offer on the grounds of uncertain macroeconomic conditions and potential market volatility (*read: Brexit*) rather than any fundamental concerns revealed during the due diligence process. The share retreated to a level significantly below that at which it was trading in September before the proposal was announced. Today Intu trades at 108p, a 70% discount to its most recently disclosed NAV. Hammerson has been dragged down in its wake, and currently trades at a 58% discount to its June NAV. While we acknowledge the risks noted above, the margin of safety currently implied in these share prices would appear very large.

Notwithstanding our comments above, we have become increasingly concerned about the impact of a disorderly Brexit and took the decision to reduce UK exposure in the portfolio where the margin of safety was not as great. During the quarter we reduced holdings in Investec and Capco and exited our holdings of Nepi Rockcastle and Investec Property Fund. We increased holdings in Old Mutual, Standard Bank, FirstRand and Sanlam, and received additional Nedbank shares as a consequence of the unbundling by Old Mutual of a portion of its shareholding in the bank.

We reiterate our cautious comments of the previous commentary. Despite a positive GDP print for the third quarter, the domestic economic environment remains challenging and the growth outlook weak. We expect little improvement in the run up to the national election in May but remain hopeful that a strong mandate for the incumbent will result in decisive policy action and increased confidence in the second half of 2019.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 31 December 2018