

It has been a tough year, not only for the fund but for the entire market. The fund returned -10.7% over the twelve months, slightly below the benchmark return of -9.9%. In the last five years, the fund has had two major drawdowns (i.e. years in which both the fund and the benchmark delivered negative returns). These years were 2018 and 2015 (in which the fund lost 7.5%). As a result, despite delivering double-digit returns in the remaining years, the impact of these drawdowns has caused our five-year return to be an underwhelming 3.6% p.a.

Given this performance, investors may question whether equities remain an attractive asset class. The answer is decidedly yes. The fund's 10-year returns are still very healthy, at 11.4% p.a. - comfortably beating inflation over that period. It is the proximity of the drawdowns that have made five-year returns look pedestrian. However, one can take comfort by looking at the history of the fund: in the year that followed every major drawdown, the fund has delivered a double-digit return. This performance is driven by low starting valuations that generally follow any major drawdown, especially those of high-quality shares that are sold indiscriminately alongside poor-quality shares.

One such high-quality share we have recently acquired is UK-based financial services business Quilter. It was spun off from Old Mutual when the managed separation took place and the South African business was listed separately. Quilter is an integrated financial services player offering advice, platform, multi-manager and direct fund management services. The UK pension fund market is undergoing massive regulatory restructuring, moving away from defined benefit (DB) to defined contribution (DC) structures. This is set to unlock significant long-term benefit for integrated players such as Quilter who should be able to capture more of these flows to in-house products. The resultant cost opportunity and positive operational leverage has the potential to drive significant earnings growth over the medium term. However, the share price has been weak, mainly driven by Brexit fears. We think the impact of Brexit should be benign, due to its operations being largely UK-based and its funds having an international bias. Operationally, things are going well for Quilter, having last year posted decent maiden results. It currently trades at 10 times on our assessment of normal earnings, which we think is rather attractive.

Over the past year, one of the main contributors to fund performance was PSG Konsult. This business's operations in South Africa are similar to that of Quilter in the UK (described above). It has a sizeable financial adviser base, backed by a formidable IT platform. They also have in-house asset management and short-term insurance businesses. Due to changes in regulations, it has become increasingly difficult for independent advisors to operate as stand-alone businesses. PSG Konsult offers these advisers a home where they don't have to worry about various regulatory-related issues while enjoying a world-class back office provided to them in exchange for a share of revenue. The consolidation of the adviser network still has many years to run and we expect PSG Konsult to be one of the major beneficiaries of this trend.

The biggest detractor to fund performance over the past year has been our holding in Dawn, a manufacturer, distribution and warehousing group. A few years ago, we participated in the recapitalisation of the company in the belief that this would give it the headroom to successfully restructure its operations. Unfortunately, this coincided with a brutal business environment, which has made the turnaround extremely difficult, despite management's best efforts.

Markets have had a tumultuous start to 2019. We continue to exercise caution, looking to own very high-quality companies with strong moats and balance sheets that are able to withstand a continuation of tough times. As always, valuation remains our beacon in these turbulent times and we have used the volatile price environment to build positions in attractively priced shares.

## Portfolio managers

**Alistair Lea and Siphamandla Shozi**

as at 31 December 2018