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

After a difficult year, the final quarter of 2018 proved to be the most challenging period of all, as weak South African markets plummeted further on the back of concerns about the local economy and rising political rhetoric ahead of the 2019 elections. Appetite for emerging markets weakened further as the prospect of rising rates in the US offset the potential for economies to improve on the back of lower oil prices. Increasing concerns about Eskom's financial position and the resumption of load shedding put further pressure on the local market into the end of the quarter. The fund declined by 4.9% over the quarter, in line with the market return for the period.

The major disappointment this quarter was the withdrawal of the bid for Intu by a consortium which included Intu's current major shareholder, the Peel group. Despite a successful conclusion of the due diligence, the other partner in the transaction decided to withdraw at the last minute, as concerns over Brexit were heightened by the UK Prime Minister Theresa May's acrimonious relationship with her own party. The deal's collapse was disappointing, as the Brexit risks were evident before the bid was made. We remain convinced of the value in Intu and continue to engage with the board to ensure that the value is unlocked for all shareholders.

The best performing portion of the portfolio remains our resources position. Anglo American held a successful capital markets day, where the projected production from most of its operations was upgraded. In addition, prices for most of Anglo's commodities have remained strong, meaning that their balance sheet will have de-geared and should be in a very strong position. Exxaro has also performed well, and recently announced further value accretion from the finalisation of its exit from Tronox, the mineral sands business. The proceeds from the sale of their final stake should be received in 2019, the majority of which will be returned to shareholders.

After selling down our holding in Mondi earlier in the year, we have started to build up a position again. The market appears to be overreacting to reports of capacity increases entering the market and ignoring significant capacity currently being taken out of the market, as China halts the importation of scrap paper into its mills. The share has fallen around 30% from its highs and looks very attractive at current levels.

On Christmas Eve, MTN notified shareholders that they had received notice from the Central Bank of Nigeria that is was reversing the US$8bn penalty it had applied to MTN. This potential claim had been hanging over the company's head for the past few months and it was pleasing to see its complete reversal and that MTN was no longer being viewed as being guilty of avoiding exchange controls. A smaller administrative cost has been incurred as a result of the banks' involved with MTN not fulfilling their duties, and the company will look to recover these costs from the relevant banks. This means MTN can proceed with the planned listing of MTN Nigeria and can also repatriate profits from Nigeria, which will support its current dividend policy. The company's Nigerian operation has continued to perform exceptionally well despite all the noise around the forex issues.

Naspers has been under pressure due to the poor performance of Tencent, which is disappointing given that the management team are doing the right things to unlock the discount on the rump. They have tidied up the investment portfolio; exiting poor-performing businesses and successfully monetising others, such as Flipkart (Naspers successfully sold its stake to Walmart).

The company will list the video entertainment business in the first half of 2019 and unbundle it to shareholders, unlocking the discount on this part of the group. Tencent has, however, set the direction for the Naspers share ever since the introduction of Chinese legislation preventing new games from being launched and monetised in China. This caused Tencent's share price to fall significantly from its all-time high achieved earlier in the year. Towards the end of December, it was announced that the gaming regulatory approval process had resumed, and we expect this to normalise in the coming months, which should positively support both the Tencent and Naspers share price.

British American Tobacco continues to be weak on the back of concerns about the rise of next-generation, vaping and heat-not-burn products. On top of this, the US regulator announced its intention this quarter to ban menthol cigarettes - a significant part of the company's US portfolio. This ban has been instigated as the regulator looks to prohibit flavoured vaping capsules, which have targeted under-age consumers. We don't believe that the scientific research exists to substantiate these claims, which will be necessary for the regulator to prove in order to apply the ban. In addition, should menthol cigarettes be banned, their market exit will likely take over five years and is unlikely to significantly reduce the number of smokers, as consumers will shift to normal combustible cigarettes. British American Tobacco is now exceptionally cheap, trading on a single-digit PE multiple and a high single-digit dividend yield.

Our main exposure to the South African economy remains through banking stocks. These shares have not performed particularly well, based on the concerns around the economy. The banking stocks have, however, continued to deliver reasonable growth despite the challenging environment. Nedbank and Standard Bank, which make up the bulk of our banking exposure, have strong balance sheets and should benefit handsomely from any uptick in the economy.

We recently initiated a position in Shoprite. The FMCG retailer has had a tough semester, recording its first decline in earnings in many years. A weak overall market was further hurt by currency weakness in its African operations and teething problems at a number of its distribution centers. This has seen the share price decline, creating a decent entry point into a high-quality business.

After many years of strong double-digit returns, we cautioned the market in 2015 not to expect those levels of return to be maintained. We have now experienced three years of poor returns and, while this has been a disappointing period for us, the potential return from the South African equity markets now looks exceptionally strong. Off this base, we expect the markets and the fund to perform strongly in the years ahead.

Portfolio managers

Neville Chester and Nicholas Stein

as at 31 December 2018