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

The fund returned 3.8% for the quarter, aided by its limited exposure to fixed rate bonds. The fund has performed well against its peer group over all meaningful longer time periods.

The MSCI All Country World Index ended the quarter +0.5% in US dollars (+10.7% over a rolling 12 months). Our emerging market exposure detracted from performance, as risk aversion saw the MSCI Emerging Market Index declining by 8.0% for the period (+8.2% over a rolling 12 months). The fund reduced its weighting in global equities in the first half of the year, as valuations have become increasingly stretched and risks increasingly elevated (from trade wars to economic populism to geopolitics).

The JSE All Share Capped Index returned 2.9% for the second quarter with a strong contribution from the resources sector (+20%). The industrial sector, with its large rand hedge counters also rose during the period, ending up 4%. Domestic-heavy sectors such as financials and property ended the quarter down 6.0% and 2.2% respectively. The pressure on domestic stocks came about as the exuberance, which had been priced into most domestic shares following the ANC's December elective conference, was not supported by near-term results.

The fund continues to hold large positions in several of the JSE-listed offshore stocks. These positions are held for stock-specific, as opposed to thematic reasons. The post-elective conference rally in domestic stocks provided an opportunity to take profits in certain domestic stocks and add to names including Naspers, British American Tobacco and AB Inbev (ABI). One of the largest positions in the fund is British American Tobacco - a high quality, globally diversified stock trading at the very attractive valuation of 12x forward PE. The share has de-rated along with global staples, although the sell-off was amplified by regulatory fears and concerns around the industry transition from combustibles to new generation products. We believe the company to be well positioned for this move. ABI is the world's largest brewer, but growth wobbles (as emerging market currencies crashed), coupled with the recessionary environment in which its Brazilian business had to operate, have led to a de-rating. ABI is an extraordinary company and it is evolving. We believe it has learnt important lessons from SAB and we expect the business to succeed in delivering organic top-line growth in the years ahead.

As the domestic rally reversed and the rand weakened, we took the opportunity to add to our positions in domestic, high quality defensive names. Our preferred names remain the hospital stocks (Netcare and Life Healthcare) as well as food producers and retailers. We still have limited exposure to economically sensitive domestic companies because valuations do not yet offer a sufficient margin of safety, in our view.

The strong performance in resource stocks has been driven by robust pricing across most commodities. The Chinese government has demonstrated a real commitment to improving environmental conditions in the country, with increased ministerial powers and stringent enforcement of winter production cuts in sectors like steel. The environmental clampdown is creating short-term supply disruption and premiums for higher quality metals spiked over the winter season as producers focused on efficiency. Restrictions on permitting are likely to encourage cleaner, more efficient production over time. The proposed South African mining charter was also released in mid-June, bringing some clarity to the domestic sector. The charter confirmed the recognition of "once empowered, always empowered", reducing the risk of ongoing dilution of ownership for equity holders. Requirements for new mining rights as well as for the renewal of existing mining rights are relatively onerous and will increase investment hurdles for new projects. Anglo American and Northam remain our largest holdings, while Mondi and Sasol (a beneficiary of strong oil prices) were reduced on the back of strong performance.

Domestic financial stocks came under broad-based pressure, giving up most of their post-elective conference gains. The weakness provided an opportunity for us to build a holding in FirstRand, a well-run domestic bank which has built a leading retail franchise despite competitive markets. The bank continues to execute impeccably and should benefit from a pickup in domestic growth. It trades on <12x PE.

Global bond yields increased in response to the US hiking rates and an increasing aversion to risk. This vindicated the fund's low weight in fixed rate bonds (both offshore and locally). Foreign selling of South African government bonds drove sharply rising domestic yields (and negative returns with the All Bond Index down 3.8% in the quarter). This offered an opportunity to build a position in government bonds at attractive levels. Although valuations reached attractive levels in the domestic market, this was not the case in global markets. In our view, yields are simply too low to justify the risk that comes with rising levels of indebtedness and an increasingly reckless disregard for fiscal discipline from many of the world's leading economies.

The property market declined 2% in the quarter. We continue to avoid most of the counters within the Resilient stable and find more value in the A property sector as well as blue chip domestic names such as Growthpoint, Redefine and Investec Property Fund.

Markets have had a tumultuous start to the year as the first-quarter domestic rally rapidly reversed in the second quarter. As always, valuation remains our beacon in these turbulent times and we have used the volatile price environment to build positions in some attractively priced shares.

Portfolio manager
Karl Leinberger, Sarah-Jane Alexander and Adrian Zetler
as at 30 June 2018