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

The second quarter of the year created even more uncertainty after the turbulent first quarter. Investors' minds were increasingly occupied by the growing prospect of an intensifying trade war between the US and its major trading partners. President Trump and his administration seem intent on even turning long-term allies into enemies, with their erratic but ongoing comments about putting America first with regards to trade. This has led to a series of tit-for-tat reactions from predominantly China, but even countries like Canada and trading blocs such as the European Union have resorted to reactive measures to try and drive home the fact that the US should behave in a responsible way in a global trading village. While one can contextualize these measures as relatively small in a global trading context, investors have been spooked as it is difficult to predict if and when these irrational actions will stop. In addition, down the line these actions have a direct impact on monetary policy and, as such, create more uncertainty.

With regards to the latter issue, we remain of the view that investors are too complacent about the potential level of normal interest rates in the long term. An analysis of the yield curve shows that while the US Federal Reserve (Fed) has clearly and continuously communicated its intention to increase interest rates two more times during 2018, only half of the market believes that to be true. In addition, the market only discounts a 10% probability of further rate hikes in 2019, while the Fed has indicated its intention (all other data points being equal) to raise rates twice during 2019. We are monitoring these statistics closely, as it could affect the equity risk premium in the medium term.

Against this backdrop, the MSCI All County World Index (ACWI) returned 0.5% over the quarter, resulting in the year-to-date number still being slightly negative. Over the last year the index return was 10.7%, slightly above the three-year annualised number of 8.2% p.a. Returns in local currencies were on average more than 2% higher, but the stronger US dollar curbed reported returns in that currency. The US dollar was on average about 4%-6% stronger than most of the other major currencies. Among developed markets, Japan was the laggard by a modest margin. Given the increased concerns from investors about a possible full scale trade war, it was no surprise that emerging markets underperformed their developed counterparts by over 8%, with more than half of this number being attributed to weaker currencies. The fund has been somewhat sheltered against these moves given our decision to hedge the bulk of our emerging market currency exposures. Within the emerging market universe, Brazil was the notable underperformer, given the increasingly complex situation on the domestic political front. Over the last 12 months (and over longer time periods), developed markets have now marginally outperformed emerging markets.

Within sectors, energy was the standout performer this quarter given the stronger oil price. Financials underperformed given the trade war concerns and their potential impact on monetary policy. Telecommunication services were also weak. Over the last 12 months energy and information technology were the strongest sectors, with telecoms and consumer staples underperforming the benchmark by around 15% and 11% respectively. Global bond markets continued to come under pressure this quarter, as investors further adjusted their interest rate expectations. Longer-term yields
increased slightly in the US. In addition, the strength in the US dollar resulted in negative returns in dollar terms for most developed markets. The overall benchmark index returned -2.8% (in US dollars) over the quarter, resulting in a marginally positive over the last 12 months. The US 10-year bond is now trading more than 50 basis points higher than a year ago.

Global property on the other hand had its best quarter in some years, returning 5.5% (in US dollars) over the quarter despite the strong US dollar. The US and Australian markets were the strongest (both yielding around 10% in local currency terms). The improved performance of this asset class was due to stronger than feared underlying profitability from Real Estate Investment Trust portfolios in markets such as the US, as well as a slight rerating as investor concerns about the demise of physical property in light of continued online penetration dissipated somewhat. These portfolios continue to trade at attractive valuation levels in our opinion, despite the stronger quarter. The global property benchmark index returned 6.7% over the last 12 months, significantly ahead of global bonds.

Commodities were mixed over the quarter, with the oil price being the stand-out performer, increasing by 13%. Gold was down 5.5%, erasing all its gains towards the end of last year, and ending the last 12 months almost flat. Platinum was also down 8.4% during the quarter.

The fund marginally outperformed its benchmark over the quarter, but the last 12 months have been tough in terms of relative performance. However, we are excited about the prospects for the positions in our portfolio, but caution against too high expectations given where the various asset classes are trading.

The fund's asset allocation made a marginally positive contribution to performance over the quarter given the strength in the property sector. Over the last 12 months asset allocation however detracted, as we remained underweight equities which performed the best in relative terms. This was to some extent compensated for by our overweight position in property.

In terms of underlying asset class attribution, our equity holdings slightly underperformed their equity benchmark over the last three months, while the 12-month period was very tough. For the quarter, our most notable equity winners include stocks like Altice, Pershing, and Imperial Brands, which have all detracted in the past. Other positive contributors were Facebook, Alphabet, KKR and Advance Auto Parts. Laggards included Porsche and Tata (on the back of trade war worries), Intu Properties, the airline holdings (on the back of a higher oil price), and the Brazilian educational stocks (as the economy continued to shrink in the face of the political and economic crisis). Our two big tobacco positions, British American Tobacco and Philip Morris, also detracted (discussed in more detail below).

In reflection on the poor outcome of the last 12 months, it is clear that some of the portfolio's larger equity positions have detracted meaningfully. Altice, the tobacco stocks, the US pharmacy retailers, L Brands and Tata Motors were the big negatives. In most of these cases the investment thesis still holds, and we continue to be encouraged about the prospects of these companies. The developments in the US pharmacy sector are being monitored closely, with the potential entry of Amazon in that space. Conversely, Amazon was actually our biggest positive contributor over that time.

Our property holdings underperformed the benchmark over the quarter, but did satisfactorily over the last year. Credit performed well both over the shorter and the longer term, but our physical gold position detracted based on a weak gold price. Our decision to hedge some of our currency exposures added to performance more recently given the underlying strength in the US dollar.

In last quarter's report we discussed our motivation for significantly increasing the fund's exposure to tobacco stocks. We continue to do more research and have increased our conviction about the prospects for this sector in the light of continued changes in consumer preferences for the next generation products (which include both vaping and heat-not-burn products). The fund now has about 11% exposure to the sector (as a percentage of equity), primarily in British American Tobacco, a stock we have worked on extensively given its dual listing on the JSE, and Philip Morris International, the owner of the iconic Marlboro brand outside of the US. Philip Morris' share price came under significant pressure after investors were disappointed with its growth in heat-not-burn product sales in Japan. The sector is trading at a discount of over 30% to its historical average rating, and while we expect investor uncertainty to continue given all the relevant news flow expected over the next few years, we think patient investors will be well rewarded.

More recently, we have also introduced Mondelez to the portfolio. This branded snack and confectionary group has been punished by investors worrying about branded consumer groups' abilities to continue taking price increases in the light of the rise of instore brands and lacklustre US-packaged food sales growth. We think the market underappreciates the fact that only 25% of Mondelez' sales are in the US, with about 40% of group sales coming from emerging markets, where its portfolio of brands is very strong and growing. The market seems to have lumped the stock with other US-centric names like Kraft and Campbell Soup where lethargic growth prospects have scared investors. In addition, the market also tends to price these stocks as bond proxies, and with the normalisation of longer-term interest rates, investors have shied away from holding consumer defensives. We consider this to be an opportunity to increase the fund's exposure to high quality holdings like Mondelez, Anheuser Busch and Reckitt Benckiser.

Prospects for the various asset classes are subdued in our opinion, and investors should calibrate their expectations accordingly. Nevertheless, we keep finding exciting opportunities in the various categories, and whilst mindful of overall portfolio risk, we are selectively including some of these in the portfolio.


Portfolio managers
Louis Stassen and Neil Padoa
as at 30 June 2018