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

The fund appreciated by 10.5% in the 2nd quarter of 2018, which was 2.4% ahead of its benchmark. The fund has now appreciated by 4.4% year-to-date, with ZAR depreciation playing a large role in the return as c. 90% of the fund is invested offshore. In terms of individual contributors year to date, Airbus (+32%) is the largest contributor and has added 1% to the fund's return, while Alphabet, Facebook, Adidas, Amazon and KRR have all added between 0.5% and 0.8%. Kroton is the largest negative contributor and took 1.6% from the fund's return. Over the past 5 years, the fund has generated a return of 12.6% per annum and since inception 19 years ago it has produced a return of 14.3% per annum (2.7% p.a. ahead of the benchmark).

The fund ended the quarter with 71.2% of its capital invested in equities, with 64% of the equity exposure being invested in developed market equities, 31% in emerging market equities and 5% in South African equities. Our negative view on global bonds remains unchanged and we continue to have no exposure to the asset class. The fund has 7.3% invested in global property: we are still finding selected value in the UK retail/commercial, US retail and German residential property stocks. Lastly, the fund has a physical gold position of 2.4%. The balance of the fund is invested in cash, largely offshore. As has been the case for a number of years now, the bulk of the fund (over 90%) is invested offshore, with very little being invested in South Africa.

Over the past several years, the fund has generally had low exposure to the tobacco companies. The reason for this was two-fold: a) concern over the very long-term prospects for these businesses (declining volumes, increasing regulation and even more health awareness and b) valuation (they had benefited from the general upward re-rating of all consumer staples). Over the more recent past there have been 2 key changes. Firstly, the development of successful reduced risk products (vaping and 'heat not burn' [HNB] devices) has meant that for the first time in decades far safer alternative products are available and as a result total tobacco/nicotine consumption has started to increase instead of decline. And secondly valuation: sharp declines (c. 25% this year) in the share prices of both British American Tobacco (BAT) and Phillip Morris International (PMI) have brought their valuations down: BAT to c. 13x Dec 2018 earnings and a 5.1% dividend yield and PMI to c. 16x Dec 2018 earnings with a 5.3% dividend yield. As such, we believe that for the first time in several years these stocks are now very attractive. We had been increasing the BAT position in the first part of the year, and in the 2nd quarter we bought a new 4.3% position in PMI. BAT is now a 4.3% position and as such the fund's overall global tobacco exposure (BAT and PMI) is now 8.7%.

The tobacco companies still have many of the qualities that have always made them very good businesses - most importantly pricing power, stable earnings, very high return on capital and high free cash flow conversion. In addition, they now have attractive long-term growth prospects in our view, due to having reduced risk products in their portfolio that provide an attractive healthier alternative to traditional cigarettes. In summary, the 2 main categories of reduced risk products (vaping and HNB) do not involve burning, and it is largely the burning (combustion) and subsequent release of chemicals of traditional cigarettes that create the health issues. By avoiding combustion, the risk reduced products eliminate the biggest issue with traditional cigarettes, which in turn is what makes them appealing. Both BAT and PMI have vaping and HNB products, with BAT being the global leader in vaping and PMI the global leader in HNB, with their IQOS (I Quit Ordinary Smoking) product. In our view, there is room for both products as they have different appeals, and being global leaders respectively, there is a high probability of BAT and PMI taking disproportionate incremental market share and hence increasing their overall global market share. PMI's next generation products (NGP) already contribute 13% of the group revenue and PM have an aspiration to grow that to c. 40% of revenue by 2025 through a c. 4-5x increase in NGP total revenue from $ 4 billion to c. $ 18 billion. To put this $ 18 billion into context, PMI's total group revenue was $ 29.7 billion in 2017.

In terms of other new buys in the fund, we bought a 1% position in Anheuser Busch InBev (AB InBev), which has gone from being a market darling ('great management team') to being very much disliked ('only cost-cutters'), and the share price has followed this sentiment. Perhaps the truth is somewhere between these two extremes, but in our view global beer remains a very attractive industry (oligopolies in many markets, strong brands, premiumisation opportunities, stable earnings, high return on capital and amongst the best free cash flow generation of any business), and within this industry there are 2 gorillas AB InBev and Heineken, both of which have attractive long-term prospects and both of which the fund now owns. We continue to rate the AB InBev management team highly, and believe that what they may not know about branding/segmentation, etc. (which is very little according to the bear view) can be learnt from the SABMiller (SAB) assets that they acquired or be brought in. AB InBev have a globally diversified business, with a strong presence in Africa (both South Africa and the rest of Africa), Brazil, Colombia, Mexico, China and the US. Almost 60% of profits come from (lower consuming and hence faster growing) emerging markets. AB InBev trades on c. 19x 2018 free cash flow (with SAB revenue and cost synergies still coming, Brazil profits being below normal, Africa and China amongst other regions growing at a rapid rate, etc.) and with a 4% dividend yield, which we believe is attractive for an asset of this quality.

Global markets are clearly far less attractive than they were 3 or 5 years ago and the fund's equity exposure will likely continue to decline if equity markets continue to rise. We are however still able to find good selected value in both developed markets and emerging markets, and remain optimistic about the potential returns that can be generated by the fund.

Portfolio managers
Neville Chester, Gavin Joubert, Karl Leinberger, Mark le Roux and Louis Stassen
as at 30 June 2018