Over the past year, the fund returned 2.7%, slightly below its benchmark return of 3.7%. The fund has delivered 3.7% and 7.2% over three and five years respectively.

The past couple of quarters have been a see-saw ride. What started as Ramaphoria in the first quarter, rallying just about every domestic stock, quickly turned sour in the second quarter as various economic data laid bare the dire state of the economy. Coupled with the prospect of rising US interest rates and the impending trade war, this pushed the currency weaker against the dollar. The economic sensitive sectors such as the clothing retailers that had been pushed to stratospheric levels, have come back and are starting to look interesting. It is still our view that the local economy should improve over the next 3-5 years. Certain businesses will benefit more than others. Such businesses are likely to be those that are very well managed, have significant moats around their business and generate good free cash flows. Hence, we continue to favour strong businesses as the core holdings of the fund.

Having said that, we are not afraid to buy businesses that are in a turn-around stage and offer significant upside to fair value. For example, one of the largest contributors to performance over the past year is one such business. Altron Group had been a detractor for several years, as some of its underlying businesses became loss-making in a deteriorating economic environment. The introduction of a strategic shareholder enabled the business to be restructured, which resulted in long-term value emerging and priced properly. The share has now more than doubled from its lows, and we remain positive about its future upside potential.

One of the largest detractors is Invicta, a distribution business, supplying mainly bearings to the mining sector, as well as capital equipment to the farming industry. A combination of a downturn in mining and drought in farming had presented us with an opportunity to buy this very well-run business. During those tough times management took steps to restructure the group, take out costs, and put the business on a very good footing. When the environment started improving, it saw an acceleration in earnings growth. The share rallied, and we halved our position as it approached our fair value. At the back of our minds we had always been uncomfortable with the BEE deal that was structured a few years ago, which had resulted in massive tax savings. Further, in our valuation we had always tried to normalise for it by valuing the business on a full tax rate. Management had repeatedly given the market their assurances that everything was above board with this deal. In the end, it turned out that everything was not in order after all, as Invicta now needs to repay a large sum of money to the South African Revenue Service as a result of the structure of the deal. When the news broke, its share price tanked. In hindsight, we could have sold more shares earlier. Having said that, given where the share price currently trades, we believe the market is certainly undervaluing the business, and as such we continue to hold it.

During the quarter we added Pan African Resources, a small low-cost gold mining company, to the portfolio. The bulk of the company's earnings are from tailings treatment projects. It is also very geared to the rand gold price. The share price peaked above 450c but is now trading just above 130c. Management had been on an acquisition spree over the past few years, which not only resulted in them making a poor acquisition (Evander) but also led to them taking their eye off the ball in day-to-day operations, which is evidenced by poor recent performance. Management seems to have heeded shareholders' call to focus on fixing current operations. A major restructuring is underway, which should result in improved business performance.

We continue to be cautious on the overall state of the domestic economy. As such, the bulk of the fund is invested in high quality counters that should continue to generate reasonable returns even in a tough economic environment. It is in these times that our long-term focus allows us to pick deeply undervalued businesses that have been mispriced by the market, which contributes positively to subsequent performance of the fund.

Portfolio managers
Alistair Lea and Siphamandla Shozi
as at 30 June 2018