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

The fund delivered a return of 2.2% for the quarter which was behind the benchmark return of 2.9%. While the short-term performance is disappointing, our aim is to deliver outperformance over longer-term time periods. To this end, the fund's returns since inception are compelling, with alpha of 4% per annum, net of fees. The South African market started 2018 with a rally of optimism in local counters, driven by foreigners buying into the positive economic growth story after the ANC elective conference. This rally has faltered as the reality of weak reported results by domestic companies has revealed an economy that is still under pressure. While we are cautiously optimistic on the change in political leadership, we also recognise that the structural reforms needed will be tough to implement.

Despite domestic valuations becoming more palatable, we remain very selective with our local investment exposure. We have increased our holdings in both Standard Bank and Nedbank. Underlying economic improvement as well as market share gains should contribute to good advances growth. This, together with stringent cost control, will lead to improving returns on equity. Both banks also have reasonable exposure to African economies which are recovering strongly off very depressed bases. At current share price levels, we think their ratings do not fully reflect these companies' ability to deliver low teens earnings growth and decent dividend returns in the medium term.

During the quarter, Old Mutual (which is a Top 10 holding in the fund), implemented the first phase of its managed separation process. The company split into Quilter Cheviot (the UK wealth business) and Old Mutual Ltd (which mainly consists of Old Mutual Emerging Markets and a 55% stake in Nedbank). We continue to think that both components are attractive investments. Quilter is well placed across the value chain to benefit from the growth in retirement capital as a result of pension reforms in the UK. Old Mutual Ltd owns a mature but cash generative life insurance business and there should be further value unlock when it unbundles a c.35% stake in Nedbank in the coming six months.

Our exposure to rand hedge shares have had a mixed performance. Naspers and Mondi have performed well, while shares such as British American Tobacco (BTI) and Intu (ITU) have lagged. We think BTI is a compelling investment opportunity from a local and global perspective. Valuation multiples are at an all-time low due to investor concerns around changes in nicotine consumption due to the introduction of next generation products. BTI is introducing its own portfolio of next generation products and is continuing to compete strongly in traditional combustible cigarettes. We think the risk of disruption by new entrants is limited due to onerous regulatory barriers and that the traditional incumbents will prevail in this growing sector of the tobacco industry. ITU has come under further pressure as Hammerson retracted its buyout offer. This potential commercial deal as well as others e.g. the potential Klépierre/Hammerson deal and potential split of the Capco business, are starting to highlight the value that is emerging in the property sector. ITU now trades at a 50% discount to its underlying NAV, providing us with a sufficient valuation buffer.

The volatility we are seeing from macro-driven global flows of money into and out of our market is unsettling and disruptive. We will remain constant in applying our long-term valuation driven process to help us identify the right holdings for the fund, regardless of the macro theme of the moment. We believe this patience and discipline will deliver strong results and support your returns over the medium to long term.

Portfolio managers
Neville Chester and Pallavi Ambekar
as at 30 June 2018