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

Macro overview

Globally equity markets were on the back foot in the first quarter of 2018 as increased geopolitical risks outweighed the benefits of a relatively strong global economy and continued progress in the orderly normalisation of monetary policy in the US. Given the backdrop of elevated market levels in the US and the potential damaging impact a trade war between the US and China could have on the global economy, we would anticipate increased levels of volatility as the rhetoric surrounding global trade continues. We have been more defensively positioned and although this has been a drag on performance in 2017, we believe one should be prudent given the elevated risks.

In South Africa, 'Ramaphoria' continued to inspire a further rally in local assets. The election of Cyril Ramaphosa as leader of the ANC was a much needed step in the right direction for SA, but what has proven surprising has been the pace and impact of consequent changes that he has announced. Although the economic outlook for country has improved with the changes being implemented, we would caution that many local assets have already priced in a fair amount of the good news, without consideration for some of the structural challenges we still face as a nation and risks around implementation of some of the proposed changes by the new leadership of the ANC.

Fund performance

The fund has the dual mandate of trying to beat inflation by 3% over time and protecting capital over all rolling 12-month periods. Whilst we were able to protect capital, the fund unfortunately has not achieved is inflation plus 3% target in the recent past (longer terms returns are still ahead of benchmark), which has been disappointing. Given the poor performance we wanted to unpack the returns over the rolling one, three and five year periods to shed more light on the reasons for the underperformance.

The table below illustrates the index performances for the rolling one, three and five year periods:

Asset Class	Index	1 yr	3 yrs	5 yrs
Domestic equity	Capped Swix	8.0%	3.8%	10.4%
Domestic property	SAPY	-7.1%	-0.5%	7.1%
Domestic bonds	ALBI	16.2%	8.6%	7.7%
Domestic cash	Stefi	7.5%	7.2%	6.6%
Offshore assets	50% ACWI/50% UST Bills	-2.3%	4.8%	11.4%

A few comments of the fund's specific performance over these periods:

- The fund's performance has to be seen in the context of the tough investment environment experienced in the recent past where real returns across asset classes (as illustrated above) have been far lower than the historical trend.

- Domestic equity performance for the fund has lagged the performance of the index over a rolling one and three year basis, but has been in line over a rolling five year basis. These returns must be seen in the context of the portfolio being constructed to outperform inflation and not the relevant equity benchmark. The portfolio has been more defensively positioned which has been a drag on performance as has been our large holdings in dual listed rand hedge stocks.

- Domestic property performance for the fund has generated alpha relative to the SAPY index over these periods as we have not had exposure to the Resilient Group, however returns for both the fund and the sector have not been able to beat the required inflation plus 3% benchmark.

- We are very pleased with the performance of our domestic bonds, which has either matched or outperformed the performance of the ALBI over the period, despite being much more conservatively positioned.

- The offshore assets has been a drag on performance over the rolling one and three year periods. The continued strengthening of the rand relative to major developed market currencies has been a headwind to the fund's performance. In hard currency the fund's performance has generally lagged global equity markets given the more defensively positioned nature of this portfolio with only 50% of the offshore assets allocated to equities.

Portfolio activity

We took advantage of the market sell-off during the quarter to increase the fund's allocation to domestic equity through the purchase of index futures and adding to our positions in British American Tobacco and Investec. We trimmed our holding in Naspers and exited positions in Foschini, Mr Price and Coronation during the quarter on the back of strong share price performance and reduced margin of safety.

British American Tobacco remains one of the fund's top holdings. We have used the recent share price weakness on the back of regulatory concerns in the US to add to our holding. We believe that on a 13x forward (11x our assessment of normalized earnings) price earnings ratio and 5% dividend yield the regulatory concerns have been more than priced in and one is getting access to one of the best businesses in our market at a very attractive valuation.

We reduced the fund's allocation to domestic property by trimming positions in Growthpoint, Hammerson and Redefine into strength.

We further reduced the fund's exposure to local government bonds during the quarter given our view that valuations are not attractive on a risk-adjusted basis.

We made no meaningful changes to the fund's offshore asset allocation during the quarter. We believe the fund's offshore allocation remains appropriate given the benefits of diversification, value in the underlying offshore assets and our expectation of future SA rand weakness.

Outlook

In an incredibly uncertain world, we continue to strive to build diversified portfolios that can absorb unanticipated shocks. We will remain focused on valuations and will seek to take advantage of whatever attractive opportunities the market present us to generate inflation-beating returns for our investors over the long term. While we are cognisant of the fact that we have not delivered inflation-beating returns in the recent past, we remain confident that the positioning of the portfolio and our investment approach for these absolute return portfolios should deliver inflation-beating returns consistent with its long-term track record.

Portfolio managers
Charles de Kock and Duane Cable
as at 31 March 2018