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

Macro overview

Globally equity markets suffered as increased geopolitical risks overshadowed 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 of a US/China trade war on the global economy, we anticipate increased levels of volatility as the rhetoric surrounding global trade continues. The portfolio remains defensively positioned, and while this has been a drag on performance in 2017, we believe it to be the correct and prudent approach.

In South Africa, 'Ramaphoria' continued to inspire a further rally in local assets. The election of Cyril Ramaphosa as leader of the ANC and president of the country was a much-needed step in the right direction for SA. However, what has proven surprising has been the pace and impact of consequent changes that he has announced. Although the economic outlook for the country has improved, we would caution that many local assets have already priced in a fair amount of the good news. It is important to note that the nation still faces a number of structural challenges and there are risks associated with the implementation of some of the proposed changes.

Fund performance

The fund has the dual mandate of beating inflation by 4% over time and protecting capital over all rolling 18-month periods. While the fund has delivered on its objective of capital protection, it has failed to achieve the target of inflation plus 4% in the recent past (longer term returns remain ahead of benchmark), which has been disappointing. Given this disappointing performance, below we unpack the asset class returns over the rolling one, three and five year periods, with the aim of providing better context to the underperformance.

Figure 1: 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%*

It has been a tough investment environment, as illustrated above, where real returns across asset classes have been far lower than the historical trend.

- Domestic equity performance has lagged the index over all these periods, which has been disappointing. It is important that returns are viewed in the context of the portfolio being constructed to outperform inflation and not the relevant equity benchmark. That said, the defensive positioning of the portfolio has detracted from performance, as have the large holdings in dual listed rand hedge stocks.
- Domestic property exposure has generated alpha relative to the SAPY index over all periods as the portfolio has had no exposure to the Resilient Group. However, returns for both the fund and the sector did not beat the required inflation plus 4% benchmark.
- We are pleased with the performance of our domestic bonds, which, despite their conservative positioning, have either matched or outperformed the performance of the ALBI over all periods.
- Offshore assets have 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 defensive nature of this portfolio, with only 55% of the offshore assets allocated to equities.

Portfolio activity

Over the quarter, we took advantage of the market sell-off, increasing 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 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 normalised earnings) price earnings ratio and 5% dividend yield, the regulatory concerns have been more than priced in, giving us 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 exposure to local government bonds as, in our view, valuations are not attractive on a risk-adjusted basis.

No meaningful changes were made to the fund's offshore asset allocation. 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 striving to build diversified portfolios that can absorb unanticipated shocks. We will remain focused on valuations and seek to take advantage of whatever attractive opportunities the market presents to generate inflation-beating returns for 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