The fund returned -9.2% for the quarter. Since inception it has averaged an annualised return of 17.9% relative to its benchmark return of 15.0%. Over 10 years the fund has averaged a return of 16.5%, outperforming its benchmark by 0.6% p.a. It has moderately underperformed its benchmark over the five-year period (by 0.2% p.a.). The fund ranks as the top-performing fund amongst its peer group over all meaningful time periods.

Locally, the good news following the ANC's elective conference in December 2017 has continued into the first quarter of 2018. Cyril Ramaphosa was sworn in as state president in February, shortly followed by a major cabinet reshuffle in which he made some credible appointments in certain key ministries. This decisiveness together with a sound 2018/19 Budget was rewarded when Moody's raised the outlook for South African sovereign debt from negative to stable and kept the sovereign rating at Baa3, keeping the country included in the Citi World Government Bond Index. GDP data for the fourth quarter of 2017 beat expectations at 3.1% q/q versus the market expectation of 1.8%. Improving inflation expectations gave the South African Reserve Bank the room to cut the repo rate by 25 basis points to 6.5% and opened the door to further rate cuts later in the year. In terms of the post-Zuma governance clean-up: the NPA announced former president Zuma would face corruption charges that were dropped nine years ago and that South African Revenue Service head, Tom Moyane was suspended. The newly appointed mining minister Gwede Mantashe announced that he would revise the mining charter, a move welcomed by the mining industry. Although we have yet to see all this good news translate into improved corporate earnings, we are confident that the economy is once again headed in the right direction.

Performance attributions over the past three and five years have been boosted by Naspers, Mondi, Pick n Pay, Pioneer Food Group, MTN and Cartrack. During the quarter, the fund's relative underweight position in Naspers boosted relative performance although its weak share price performance had a negative impact on absolute returns. Some of our domestic stock picks, i.e. Netcare, Spar and Pick n Pay also contributed to performance for the quarter, while our position in Curro was a detractor. We remain optimistic about Curro's long-term potential given the growing demand for private education in South Africa.

During the quarter, the fund's largest holding – Naspers – sold a small portion of its Tencent stake and realised close to $10 billion. Naspers management have proven to be astute allocators of capital over time and these funds have been earmarked for redeployment into other attractive e-commerce opportunities with significant upside potential. We view this active asset allocation decision as a positive, however the discount at which Naspers trades at relative to its underlying holdings has continued to widen. This discount, along with the attractive fundamentals and outlook for Tencent (which we have discussed at length in past commentaries) continues to make Naspers a compelling investment opportunity.

The British American Tobacco (BTI) share price declined by 16% during the quarter – mainly on the back of regulatory concerns around the threat of the US Food and Drug Administration's intention to reduce nicotine consumption. This is not the first (and certainly not the last) time that tobacco companies will face regulatory headwinds in the markets in which they operate. However, we continue to believe that these concerns are overblown and that the market is underappreciating the pricing power, stable earnings and cash flow generation inherent in the business. Furthermore, we are optimistic on the earnings opportunity from next generation products and the synergies that can be extracted from the recently completed Reynolds deal. BTI is currently trading on a 13.4x one year forward P/E multiple and 10.4x our assessment of normal earnings. This is incredibly cheap for a globally diversified business of this quality and BTI is now the second largest position in the fund at almost 10% (including the indirect BTI exposure held through Reinet).

Other portfolio activity during the quarter continued to be centred on increasing exposure to a selected basket of attractively priced domestic stocks. This included – amongst others – Life Healthcare, Zeder, HCI and Cartrack. We also used the overhang from the Steinhoff debacle to initiate a position in Steinhoff Africa Retail (STAR). The bulk of STAR's value sits in Pep and Ackermans. These are high-quality retail brands with a fantastic track record of return on capital, earnings growth and cash flow generation. The risk of contagion from the announced Steinhoff accounting irregularities in December has continued to weigh on its share price. We believe the risks are more than reflected in STAR's current share price and regard the risk/reward profile as attractive.

Portfolio managers
Sarah-Jane Alexander and Adrian Zetler
as at 31 March 2018