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

The fund declined by 1.2% in USD (by 5.6% in ZAR due to ZAR strength) in the first quarter of 2018. This was around 2.7% behind its benchmark, largely due to having no bond exposure. Over the past 5 years, the fund has generated a return of 12.1% p.a. (0.8% p.a. ahead of the benchmark) and since inception 19 years ago, it has produced a return of 13.9% p.a. (2.6% p.a. ahead of the benchmark).

The fund ended the quarter with 66.8% of its capital invested in equities (down from 71.4% by end-December 2017), with 65% of the equity exposure being invested in developed market equities, 32% in emerging market equities and 3% in South African equities, largely Naspers. The equity exposure continued to come down gradually over recent months: global equities are clearly not as attractive as they were a few years ago, but we are still able to find good selected value in a number of global stocks. Our negative view on global bonds remains unchanged and we continue to have no exposure to the asset class. The fund has 7% invested in global property: we are still finding selected value in the UK retail/commercial, US retail and German residential property stocks. Lastly, the fund has a physical gold position of 2.4%. The balance of the fund is invested in cash, largely offshore. As has been the case for a number of years now, the bulk of the fund (over 90%) is invested offshore, with very little being invested in South Africa.

The largest new buy in the quarter was Adidas (2.9% of fund). We had previously owned only Nike, Adidas's perennial industry rival. At the time of purchasing Nike in late 2016, the share was unloved by investors due to concerns over its perceived dependence on the US market and the basketball category in general. At the same time, Adidas could do no wrong as product innovations and other general operational improvements led to market share gains in the US and a substantial improvement in brand equity in most operating regions. Other sportswear groups also seemed to be making headway at Nike's expense in the US, most notably Under Armour Inc, which at one point reached an earnings multiple in excess of 40x. Despite our attraction to the industry, we believed that Nike was substantially undervalued and Adidas looked expensive. Fast forward just over a year and Nike's share price has increased by close to 35%, while Adidas lagged significantly, having declined by 5% since March 2017 until time of purchase in January 2018.

The lag in Adidas created a buying opportunity, and the stock has performed very well in this short space of time. The purchase was partially funded by a reduction in the Nike position size, which has gone from over 3% of fund in recent months to a 1% position by end-March. Although both Adidas and Nike may appear optically expensive based on near-term multiples (c.24-25x forward earnings), we believe they have well above average earnings growth prospects in the years ahead, driven by changing consumer habits toward greater fitness and 'athleisure', whilst the companies themselves have identified several routes to raising margins. These include improvements in manufacturing (to lower wasted materials) and increased direct to consumer sales (where the retail mark-up is captured in addition to the usual wholesale margin). In addition to this, Adidas's EBIT margins at c.9-10% are still well below that of Nike at c.13-14%. In some developed markets, and eventually in most large markets worldwide, it is expected to become fairly straightforward for consumers to order a customised shoe or piece of apparel, and have it swiftly manufactured in their country or region via a robotic process, and delivered speedily to their door. The pricing potential, improvement in cost control and lower working capital requirements are all material contributors to our belief in the earnings potential of Nike and Adidas, which are not fully reflected in their respective share prices today.

Global markets are clearly far less attractive than they were one, two or three years ago and the fund's equity exposure will likely continue to decline if equity markets continue to rise. We are however still able to find good selected value in both developed markets and emerging markets, and remain optimistic about the potential returns that can be generated by the fund.

Portfolio managers
Neville Chester, Gavin Joubert, Karl Leinberger, Mark le Roux and Louis Stassen

as at 31 March 2018