It was a challenging quarter for markets, and the fund returned -10.1% for the quarter. Since inception, it has averaged an annualised return of 17.1% relative to its benchmark return of 14.4%. Over 10 years, the fund has averaged a return of 16.3%, slightly outperforming its benchmark. The fund has performed well relative to its peers over all meaningful time periods.

The South African economy dipped into recession with second quarter GDP of -0.7%, well below the consensus expectations of growth of +0.6%. Against the backdrop of a very weak economy, the South African Reserve Bank was still able to leave the repo rate unchanged at 6.5%, as the inflation outlook continues to look relatively benign. In September, President Cyril Ramaphosa announced a new economic stimulus package which included a number of supply and demand side reforms aimed at both raising productivity and public sector-driven investment projects. These include: R50 billion expenditure reprioritisation focused on infrastructure spend; easing of work and travel visa requirements; employment tax incentives; initiation of a spectrum auction process; and prioritising mining and mineral investments as a key focus area (facilitated through the revised Mining Charter). While there are no quick fixes to the many structural problems plaguing the South African economy, the stimulus package is a step in the right direction and should start contributing to economic growth in 2019.

The rand continued to weaken during the quarter, depreciating 3% against the US dollar and just over 2% against the euro. Global monetary policy tightening, the risk of escalating trade wars, broader emerging market risk aversion and weak South African economic fundamentals continue to leave the currency vulnerable.

Notwithstanding the fund being well positioned for the weaker rand, some of the fund's large positions in offshore stocks had a very disappointing quarter:

- Naspers declined 12% during the quarter on the back of a pullback in the Tencent share price. Tencent's recent quarterly earnings were disappointing and short-term earnings expectations have been revised downwards due to the restructuring of certain Chinese government departments and the subsequent delays in the licensing of new online games. Chinese authorities have also proposed new regulations around protecting minors from the adverse effects of online games, which has created uncertainty in the Chinese gaming sector. We believe that the licensing delays will be a temporary disruption to the business and will resume in due course. Furthermore, our interpretation of the new proposed gaming regulations for minors is that they will favour strong, responsible incumbents like Tencent. As such, we remain optimistic on the longer-term prospects for Tencent's online gaming business and are still very encouraged by the opportunities it has in growing its advertising, financial services and cloud businesses. In addition, Tencent has an outstanding investment portfolio, the value of which we believe is still very underappreciated by the market. In the case of Naspers itself, we are very encouraged by Naspers' management's actions around portfolio optimisation and the steps taken to reduce the discount to its underlying intrinsic value. In this regard, Naspers management announced that it would proceed with the unbundling of Multichoice – most likely to be completed in the first quarter of 2019.
- The MTN share price declined 18% during the quarter after the surprise announcements from the Central Bank of Nigeria (CBN) and the Nigerian auditor general that MTN was in violation of certain foreign exchange control regulations and that it should repatriate $8 billion back to the country and pay an additional $2 billion in back-taxes. These actions have created widespread uncertainty and are undermining the investment case for foreign investment in Nigeria. As market pressure increased, the tone of more recent public announcements has been less aggressive and more constructive. While these events were extremely disappointing, we believe a worst-case scenario is more than reflected in the current MTN share price (even with Nigeria at a zero value we still see upside from current share price levels). Furthermore, we remain hopeful that rationality prevails, and an amicable resolution can be found;
- Aspen fell 34% on worse-than-expected full-year results and the lower-than-expected proceeds from the sale of its infant-milk business. With the collapse in the share price, its historical growth algorithm of doing value-accretive mergers and acquisitions has now been significantly curtailed. Nevertheless, the stock is trading on around a 10x one-year forward price earnings multiple and about 9x our assessment of normal earnings – which we believe is too cheap for a global pharmaceutical business with best in class management;
- The Mediclinic share price was down 17% for the quarter. Despite geographical diversification, the group has faced regulatory headwinds across its international businesses. We believe it is pursuing the correct strategy; delivering high clinical quality, investing across the continuum of care, and driving efficiencies. While pressure on tariffs will remain as systems struggle under rising healthcare costs, players that can demonstrate high quality and better efficiency should be more robust and still earn acceptable returns on capital. Mediclinic is now trading on 13x one-year forward earnings and 9x our assessment of normal earnings, which we think is very attractive for a business of this quality.

Apart from our holdings in rand-hedge stocks, some of our consumer-facing domestic holdings also faced a very challenging quarter, with stocks like Distell (-22%), Pioneer (-18%), Tiger Brands (-20%), Rhodes (-12%) and Netcare (-11%) also experiencing double-digit share price declines. At this point, we are asking ourselves is the weakness a cyclical or structural phenomenon? Has the earnings quality of food producers and retailers structurally changed? We don't believe so. A low volume growth environment is extremely challenging for management to navigate in an economy with high structural inflation. Only a small recovery in economic growth will significantly ease this burden. This issue has been exacerbated by the current low food inflation environment and, for producers, by additional imports on shelf because of a strong rand at the beginning of the year. As such, we believe some of these pressures will abate and continue to add to the consumer stocks.

Performance attributions over the past three years have been boosted by our holdings in Naspers, Mondi, Spar and Pick n Pay, while our underweight position in MTN also contributed meaningfully to performance. During the quarter, our overweight positions in British American Tobacco, Curro and Spar, and our underweight position in Naspers all contributed to performance.

Portfolio activity during the quarter was limited to recycling capital into existing holdings which have underperformed recently, and we believed were more attractive on a relative basis, including Naspers and some of the domestic consumer-facing names.

This has undoubtedly been a very challenging environment for the fund in terms of both absolute and relative performance. However, in such turbulent times we remain committed more than ever to our disciplined valuation-driven approach to stock-picking and portfolio construction. Given current valuations of the stocks we own, we are more excited than ever about prospective returns for the fund going forward.

Portfolio managers
Sarah-Jane Alexander and Adrian Zetler
as at 30 September 2018