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

The past quarter has been another tough period, with most capital markets around the world under pressure. The US equity market has remained the exception with returns having continued to be elevated by earnings growth supported by tax cuts and the short-term strength of the US economy. The fund returned -1.5% for the quarter. While this was a disappointing outcome, the long-term since inception return of 15.6% per annum remains 2% ahead of benchmark.

The level of risk in global markets remains elevated as US President Trump ratchets up the rhetoric with major trading partners, especially China, and as Brexit and weakness in specific EU economies raise concerns around the levels of global growth going forward. Despite these evident risks, the US equity market continues to be well supported and has hit new highs, raising concerns around market participants having far too benign an outlook. The steady rise of the 10-year US Treasury rate has seen a poor return for the US bond market and raises further concerns over what the hike in this benchmark rate will mean for equity valuations as well as the repricing of debt in markets where, for the past 10 years, debt funding has been exceptionally cheap. Brexit has weighed heavily on UK markets, with a combination of a weak currency and lack of confidence dragging down local stocks. With the end date for Brexit looming in six months' time, there is precious little scope for last minute negotiations and the risks of the UK falling out of Europe without a proper plan are elevated. Europe is also suffering from the latter as well as new concerns around the rise of populist governments to the left and right of the political spectrum. Italy's new government roiled local debt markets by taking an aggressive positioning on fiscal spending to spur growth, although most of this has since been reversed. In the east, the Chinese yuan has been under pressure, given concerns around a trade war and its impact on the local economy.

Emerging markets have not fared any better, with Turkey and Argentina punished heavily for adopting diametrically opposing policies. Turkey refused to hike rates aggressively and appointed potentially compromised individuals to key finance roles. In turn, Argentina appointed market-friendly individuals into their finance roles, aggressively hiked rates and received a bailout from the International Monetary Fund. Both markets sold off heavily with currency and bond markets being punished. In addition, Russia was impacted by further sanctions and generally raised political rhetoric around the country's actions in western countries.

Emerging market equities and bonds have borne the brunt of the sell-off and look incredibly attractive at these levels. This is not a rerun of the 1998 emerging markets crisis when most of these markets were heavily indebted, and usually in hard currencies. The weakness in local currencies has already had a stark impact on terms of trade and we are seeing these improvements feed through into the fiscal numbers. From current levels, most emerging market equity and bond markets offer very compelling returns and we remain overweight emerging markets within our offshore component.

Globally, we continue to reduce exposure to what looks like a very expensive US market in favour of the rest of the world, where valuations are more reasonable. We have not yet made the move to buy into developed market debt markets, although with US yields as things stand at 3.2%, they are close to the point at which we would start adding.

Local equity markets have had a torrid period, with several of the rand hedge shares, which should have benefited from the recent rand sell-off, not doing very well for stock-specific reasons. Naspers has performed poorly on the back a bad run from Tencent, despite the welcome announcement of the unbundling of their Multichoice business. British American Tobacco has also performed poorly in hard currency over fears of a rapid shift to reduced risk nicotine products. This has impacted the ratings of tobacco stocks globally. Domestic stocks have also performed poorly, as many sectors have been exposed by the very poor macroeconomic backdrop and weak consumer and have seen significant earnings declines. Those sectors whose earnings have held up, such as the banks, have still sold off as the rand has weakened and fears of rising interest rates and potential further downgrades of sovereign debt have weighed on sentiment.

Within our equity component, we continue to have a bias towards high-quality, more defensive South African businesses, the banks, and those dual-listed multinational companies which we think are offering exceptional value. Within our domestic stocks we held a large position in MTN, which was severely impacted by new allegations made by the Central Bank of Nigeria and the Nigerian Attorney General. Upon review, these allegations appear baseless and purely designed to extract money from a profitable Nigerian mobile operator. The company has chosen to defend itself fully against these claims and the share price has since made some recovery, but remains exceptionally cheap and likely to remain so until these outstanding issues are resolved.

The equity market has taken an uncompromising and brutal stance on any disappointment and we have seen a number of shares fall anywhere between 10% and 30% on results announcements. While this is an uncomfortable and unpleasant period in the markets, the size of such movements is often what gives the patient investor the opportunity to make great long-term investments. Our large holding in Anglo American was made in such times during the resource sector sell-off in late 2015 and early 2016 and has proven again the benefits associated with patient, well researched investing. With local equity markets down over 9% since the start of the year, we are adding to our overall South African equity exposure now as we think this offers compelling value on a medium-term horizon.

Our holdings in listed property have continued to languish as the sector remains tainted by the collapse in share prices of the Resilient group. In addition, we have seen a number of property companies reduce their guidance amid tough trading conditions in the office and retail sectors. Given that we have avoided most of the overvalued companies, we have not seen any large losses, but there has been no marked capital gains either. With our basket of domestic property names trading on an average yield of 12.6%, they remain compelling investment ideas in this low-growth market. The UK-listed property companies have also been a drag on performance, with Intu, in particular, holding back performance, despite an improving rental income outlook. On an 8% yield in pounds and trading at a 50% discount to our estimate of fair value, it offers compelling value. At the time of writing this commentary, this has been recognised as a potential offer has emerged from an investment consortium.

Domestic inflation has remained firmly below 6% despite the weaker rand and higher oil price as the state of the consumer has prevented manufacturers and retailers from passing price pressures on. In this environment, buying government bonds on yields in excess of 9% looks compelling, locking in 3% to 4% real yields. We have added to our fixed rate exposures so that more than 10% of the portfolio is now at fixed rates. Despite the sell-off in global bonds, we have not yet added any holdings to the portfolio.

2018 has been a tough year for South Africa, the consumer and this portfolio. Despite the challenges of a stalled economy and difficult stock market, we now find ourselves being more positive given the very low valuations of most assets, outside of US equities. We expect the portfolio to deliver strong growth in the medium to long term from this base.

Portfolio managers
Neville Chester and Pallavi Ambekar
as at 30 September 2018