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

During the second quarter of 2019 (Q2-19), global financial markets continued to be dominated by a shift in investors' interest rate expectations and the unfolding trade war saga, primarily between the US and China. Markets are now discounting almost three cuts of 25 basis points (bps) each in the US before the end of the year, a stark contrast to only six months ago when the expectation was for at least one rate increase during the calendar year. This shift occurred against the backdrop of a more benign inflationary outlook, including the outlook for wage pressures in the US where the economy is operating at an historically low unemployment rate, and a weakening global growth outlook that has spooked central banks around the globe into a more dovish viewpoint.

This weaker growth outlook was exacerbated, if not caused, by the uncertainty created by the increasingly hostile trade war rhetoric between the US and many of its major trading partners. The slightly more conciliatory tone from the US towards the end of the quarter also helped to settle investors' fears. Unrelated issues such as the continued uncertainty around Brexit, political turmoil in France and some self-inflicted headwinds in emerging economies, such as Turkey, also helped lower growth estimates. To contextualise this shift in sentiment, it is worth noting that the US 10-year Treasury now trades at around 2.00%, down from a high of around 3.35% in the fourth quarter of 2018. Central banks have responded to these changes in the macroeconomic outlook by signalling their willingness to come to the rescue with a more accommodative monetary policy, either through the lowering of interest rates or (in the case of the European Union) a resumption of quantitative easing.

Markets continued to take comfort from these dovish developments by bidding up risky assets, with the MSCI All County World Index returning 3.6% in Q2-19 on a net basis, bringing the year-to-date return to an unimaginable 16.2%. The rolling 12-month number is now positive again, with a return of 5.7%, and the three-year number is 11.6% p.a., a very respectable number given the uncertainties that faced investors over this period. Developed markets once again outperformed over the quarter, with the emerging market universe negatively impacted by the trade war developments and some of the country-specific issues referred to above. The US was the star performer, with some help from stronger earnings growth than seen in the rest of the world and a further re-rating in the market.

As mentioned above, fixed-interest assets performed well, benefiting from a downward shift in the yield curve since the beginning of the year. Credit spreads also tightened, helping performance in the asset class even more. Listed property had a muted second quarter, after a very strong first quarter of the year. Logistics assets continued outperforming other property classes. Gold had a strong quarter, not surprising given the lower opportunity cost on the shift in forward interest rates and the continued political uncertainty. Most industrial metals had a poor quarter on the back of a weaker growth outlook, except for iron ore where supply disappointments supported the price. The oil price was down slightly this quarter after a strong first quarter.

The fund was defensively positioned over the quarter, and hence missed out on the continued bull market in equities. Fortunately, strong stock selection helped to limit the underperformance. Since the beginning of the year, the fund has returned 13.9% (well ahead of the benchmark). While the absolute return numbers over one and two years are weak (between 1% and 3% p.a.), the seven-year number of 6.1% p.a. is satisfactory. Relative to the benchmark, the fund is ahead of benchmark over three and seven years, and marginally behind over other periods. Since inception, the fund is still ahead of its benchmark, despite its heavy cash exposure over this period.

As mentioned above, with the benefit of hindsight, our equity exposure was too low and our cash holdings were too high, given the strong rally in global bonds.

Over the quarter, long-held equity positions such as Blackstone, Charter Communications, Adidas, and Carlyle contributed the most to fund performance, with British American Tobacco (after a strong first quarter) and Intu Properties (and other property holdings) detracting the most. Some of the other notable contributors over the longer term include Altice US, Facebook, Airbus, and Pershing Square. Other detractors were Aspen, L Brands and Imperial Brands.

Our fixed interest positioning was also too conservative, but the gold position contributed strongly. Stock selection in the property bucket was poor, as we still favour those portfolios with higher retail exposure, given that we believe they offer compelling value.

We previously shared in detail our enthusiasm about the prospects for the alternative asset managers, a sector which at some point made up over 15% of the total portfolio. Our thesis that these best-in-class operators will continue to raise assets for their new fund offerings has played out, probably stronger than we anticipated. That was despite more volatile markets and scepticism about their abilities to continue generating superior returns for the investors in their funds. As their share prices recovered over the last few years, we have reduced our overall exposure by selling out of KKR and Fortress, and significantly reduced the Apollo position.

Over the last few months, all our remaining holdings announced plans to convert from limited partnerships (that benefited the main principals or original founders from a tax perspective) to public corporations that will pay slightly more tax, but make the shares more investable to all investors (inclusion in indices, no tax uncertainty). The share prices reacted very positively to this news and post quarter end, Carlyle was the last to make their decision known. The reason for highlighting these developments to our investors is again to point out the advantages of taking a longer-term view when considering investment positions. We remind each other of these learnings all the time when patience starts wearing thin with regard to a position that doesn't perform according to expectations! However, there will be cases where we have to admit that we were wrong, in which case the best action is to cut that position despite crystallising a loss. Active investment management remains an art as much as it is a science.

We continue to be reasonably conservatively positioned in terms of asset allocation. We are concerned that the benign interest rate outlook may not materialise and could be very disappointing to investors who are expecting central banks to come to their rescue. We have reduced the gold exposure somewhat after the recent rally, but are disappointed that the precious metal did not perform more strongly, given the favourable backdrop.

Portfolio managers
Louis Stassen and Neil Padoa
as at 30 June 2019