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

The fund delivered a flat performance in the year to date. Over the past 12 months to end-June 2019, the fund returned -4.1% compared with the 4.5% delivered by the benchmark. The fund has delivered 2.4% return over the past three years, ahead of the benchmark's return of 2.2%, placing it at the top of the leaderboard among its competitors.

It has been a tough year for domestic shares, particularly those belonging to mid- and small-cap categories. Lack of demand, driven by the poor economic growth of the last five years or so, has resulted in companies not being able to pass on price hikes meant to recover stubborn cost increases. The environment has become so competitive that price increases above market tend to result in immediate loss of volumes and market share. Companies' margins are eroded while they attempt to maintain their top line. Concurrently, some see it beneficial to splash hard-earned capital on poorly thought-out acquisitions abroad. Many of these transactions have resulted in value destruction and subsequent declines in share prices.

One such example is Famous Brands, a high-quality food franchising business, vertically integrated into manufacturing and the supply chain. The franchise model is very attractive, generates high margins and has great cash flow conversion. The bulk of the capital is contributed by the franchisees, while the ownership of the brands belongs to the franchisor. Famous Brands has an excellent track record of earnings delivery, even in tough times. However, several years ago they saw it fit to spend R2 billion to acquire little-known UK-based business GBK, which primarily sells burgers and related food items. As is often the case, the general rationale is the need to diversify. Subsequent to the acquisition, the operating environment in the UK worsened and the operational performance of GBK fell well below expectations. Additionally, management had taken on substantial debt to acquire the business. In short, management destroyed a significant amount of value (R800 million impaired) by taking a very high-quality business with strong market positions in the local market and mixing this with a lesser-known business in the UK. As such, Famous Brands has been one of the detractors to fund performance.

However, not all is gloom, as Metair – one of the shares with low exposure to the local consumer – has contributed handsomely to performance over the past year. Metair can be divided into two divisions: energy storage (battery) and auto components. The battery business sells both to original equipment manufacturers (OEMs) and the after-market; and is the largest business of its kind in South Africa. It is seeing good growth, driven by the increased demand of its stop-start battery technology. The OEM components business is also benefiting from the increased local production of vehicles and a step-up in local content required by the Automotive Production and Development Programme. Metair is trading at an attractive multiple of six times our assessment of normal earnings.

During the quarter, we added to the fund's holdings in Exxaro, Royal Bafokeng Platinum and Netcare. We reduced our holdings in Life Healthcare, Distell and Cartrack. We continue to be very cautious, investing in high-quality businesses with strong balance sheets that can withstand the tough economic environment.

Portfolio managers
Alistair Lea and Siphamandla Shozi
as at 30 June 2019