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

The fund delivered a year-to-date return of 9.8%, which was marginally behind the benchmark return of 11.1%. While the short-term performance is disappointing, our aim is to deliver outperformance over longer-term time periods. To this end, the fund's returns since inception are compelling, with alpha of 3.5% per annum, net of fees.

Resources were up 2.4% for the quarter to end June 2019 (Q2-19), despite signs of slowing global growth and fears around trade wars. A big driver of the resource sector performance was iron ore, which continued its strong run and rose 37.3% in Q2-19, after having risen 16.3% in Q1-19. A combination of strong China-driven demand and weak supply (exacerbated by the Vale tailings dam disaster) led to the perfect storm for iron ore producers, with current prices well above incentive prices and marginal cost. What to do with the iron ore windfall will no doubt be topical in the upcoming results season for those companies with exposure to the red metal.

During the quarter, we introduced Sasol. This was largely funded by selling out of BHP Billiton, which performed strongly on the back of robust iron ore prices discussed above. The Sasol share price declined meaningfully when the company announced that its Lake Charles Chemicals Project (LCCP) would both cost more to deliver and produce a lower normalised level of profitability. We had long harboured concerns around capital allocation at Sasol in general and the LCCP project specifically. However, we now feel that these concerns are adequately discounted in the Sasol share price. As the project nears completion, execution risk should reduce and the group earnings base is anticipated to increase by between 20% and 30%.

The British American Tobacco share price declined during the period (-15.7%) as fears relating to low nicotine regulation in the US market resurfaced. British American Tobacco has faced a slew of potential regulatory headwinds in its US business, exacerbated by volume declines in traditional tobacco as new generation products gain traction. We believe the underlying fundamentals of the business remain intact, with strong pricing power, improving cost controls and de-gearing continuing to drive earnings. In addition, we believe new generation products are lower-risk products and present an opportunity to grow the overall market. British American Tobacco trades on 9.1 times one-year forward earnings and a 7.3% dividend yield. We believe this to be very attractive for a stock of this quality and it remains a large position in the fund.

Despite the conclusion of the much-awaited South African election, local sentiment deteriorated during Q2-19. The election result was broadly in line with expectations, with the ANC maintaining its majority rule despite a slight decline in support. The appointment of a new and smaller cabinet was a positive development, reinforcing the message of fiscal discipline. However, the ruling party remains plagued by factional tensions, frustrating the ability of the president to deliver on much-needed reform. Policy uncertainty lingers, as reflected in divisive debate on land issues and South African Reserve Bank reform. Eskom's balance sheet problems remain an overhang. The government has signalled its commitment to support Eskom financially, though the underlying state of Eskom's generation and transmission assets remain unclear. These factors combined to weigh on consumer and corporate confidence levels and were reflected in a very weak Q1 GDP print of -3.2% (released during Q2) – dragged down by manufacturing and mining, in particular. Results released during the second quarter, and the accompanying subdued tones of management, reinforced how challenging the underlying economic situation is. The weak domestic economy, contained inflation and favourable global interest rate expectations have increased the likelihood of future local rate cuts.

In this environment, domestic stocks reported weak results, with even defensive stocks struggling to defy the pressures of several years of a weak domestic economy and high structural inflation. We expect these headwinds to persist and remain cautious on businesses heavily exposed to the domestic economy, with exposure to domestic stocks mostly through banks and defensive counters, such as food retailers. The fund remains underweight domestic SA stocks.

Political turmoil reigned on in the UK with the resignation of Prime Minister Theresa May during the quarter. The Brexit process is becoming increasingly disorderly, with the risks of a hard Brexit growing by the day.

We have reduced our Investec holdings. This is partly a function of managing overall UK exposure (primarily held via Quilter), given the Brexit comments above. Additionally, while the bank "rump" is optically cheap, we increasingly question what Investec's moat/competitive advantage is.

We are happy with current valuation levels and portfolio positioning. We believe prospective returns from this base will prove attractive.

Portfolio managers
Neville Chester and Nicholas Stein
as at 30 June 2019