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

The fund returned -0.7% for the quarter, falling short of the financial sector benchmark which delivered -0.5%. Over more meaningful periods of five and 10 years, the fund has generated compound annual returns of 6.1% and 15.2%, which compare to benchmark returns of 7.6% and 15.8% over the respective periods. Since inception, the fund has delivered compound annual growth of 12.3%, outperforming the index return of 10.5%.

The domestic market rebounded strongly in the first quarter of 2019 (Q1-19). The JSE All Share Index delivered 8.0% and within that, resources (+17.9%) and industrials (+7.4%) outperformed the financial sector. Within financials, banks (-0.8%) and the property sector (+1.3%) outperformed the life sector (-5.5%). These returns were delivered against the backdrop of a weak economy, struggling to deliver jobs or keep the lights on. Eskom remained in the headlines as the country hit Stage 4 load shedding in the middle of March. Years of mismanagement, corruption and underinvestment are finally coming home to roost. Although we appear to have received a temporary reprieve from the worst of load shedding, it has become clear that we are only now starting to understand the full extent of the power utility's problems and that its numerous issues are likely to take years to rectify. Against this challenging economic backdrop, the South African Reserve Bank left rates unchanged at its 28 March meeting and cut its 2019 GDP forecast from 1.9% to 1.3%. The much-anticipated ratings review by Moody's was deferred and South Africa's sovereign credit maintained its investment-grade rating.

Contributors to fund performance for Q1-19 included overweight positions in Quilter, Reinet and Investec as well as underweight positions in Absa and Sanlam. Overweight positions in Discovery, Nedbank and PSG Konsult, as well as an underweight position in Capitec Bank were among the main performance detractors for the period.

During Q1-19, the big four South African banks and life companies delivered their results to December 2018. Among the banks, results came in broadly in line with market expectations, reflecting a tough domestic operating environment. Some signs of growth were also evident as advances picked up late in the 2018 calendar year, and this should provide some support for earnings growth in 2019. While rising, credit losses remain well-controlled and currently below their through-the-cycle levels. The ongoing migration of customers away from using physical bank channels to the online banking platforms has necessitated a heightened focus on the cost line for all the banks. Going forward, cost control is therefore likely to be a key earnings driver for the banks. We believe that FirstRand, Nedbank and Standard Bank, all holdings in the fund, have firm plans to improve their cost-to-income ratios.

Results within the life sector were mixed. Our largest life holding, Discovery, delivered results short of expectations. This was negatively impacted by an unexpected spike in high value mortality claims as well as higher spend on growth initiatives. We view the mortality issue to be of a temporary or cyclical nature while the investment in new initiatives provides attractive growth opportunities for extending the brand. MMI, another fund holding, delivered positive results, reflecting a notable improvement in underlying operations. MMI's dividend was also reinstated and we are optimistic that the investment case for this holding is starting to come through.

On the international side, Brexit uncertainty continues to impact JSE-listed companies that have some of their operations within the UK. At the time of writing, the initial deadline for implementing Brexit (29 March 2019) has come and gone and yet there is still no clarity as to what kind of Brexit, if any, the UK is going to implement. The fund has holdings in Investec, Quilter, Discovery, Intu Properties, Hammerson, FirstRand - all companies with varying levels of exposure to the UK. While the valuations of these companies are attractive, we continue to actively manage the overall fund exposure to the UK in addition to assessing each investment case to ensure that our assessment of intrinsic value is not impaired by Brexit developments.

One of these UK-exposed businesses, Quilter, was a strong performer in the period after releasing results that reflected delivery in line with its stated strategy. The business continued to show consistent growth in assets under management on the back of strong inflows and this translated to operational leverage driving robust earnings growth. Management continue to strengthen the moat around this business by expanding their restricted adviser base with the recent acquisition, Lighthouse. (Lighthouse is a UK-listed adviser group with some 400 advisers.) To date, implementation of their new platform system has been on time and importantly within budget. While the migration to the new systems still presents some risk, a successful delivery of the new platform will allow the business greater efficiency in delivering new products in addition to driving further operating leverage over the long term. Quilter has a multi-year growth opportunity which we believe is not adequately reflected in the current share price. Importantly, this growth profile is likely to remain relatively resilient despite Brexit.

During the quarter, we trimmed holdings in FirstRand, Nedbank and Standard Bank as their share prices increased and margin of safety reduced. We also reduced the Old Mutual Ltd position into strength prior to their results announcement. We took the opportunity to increase the fund's investment in Peregrine, a highly cash-generative asset management business, when its share price came under pressure despite operating fundamentals remaining sound.

While the South African market performance for Q1-19 was strong, the domestic economic backdrop was sluggish. The longer Eskom's challenges prevail, the higher the cost to the economy in terms of lost productivity and rising operating costs leading to business failures and job losses. With the National Elections scheduled in early May, we expect little improvement before then. Decisive policy action will however be required post the election to ensure the economic challenges facing South Africa are effectively addressed.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 31 March 2019