The tough investment climate in the mid- and small-cap space has continued, with the fund down 9.7% over the past year. The fund's five-year compound annual growth rate of 2.7% is below inflation and shows how difficult it has been to produce decent returns, bearing in mind that the fund was the second best performing fund in the mid- to small-cap space over this period. The Top 40 Index is up 6.1% over the past year, driven by the 42% improvement in the resource index.

The biggest decision we are faced with right now is whether to invest part of the fund in shares that have performed particularly poorly in the past few years and now offer significant upside to our estimate of fair value. As a general rule, we have avoided doing this as history has taught us that a business in distress often takes more time than one would expect to turn things around. Furthermore, the business climate in South Africa is not exactly providing any tailwinds to a recovery. However, in a few instances, the market reaction to a poor performing company is so severe that we can no longer ignore the mispricing of the asset. We are cautious in our approach in these instances and will typically manage risk by keeping position sizes modest, usually below 2% of fund. Omnia is a good example of the above, having fallen to a 10-year low. We discuss it in more detail below.

Over the past year, the largest contributors to the fund's performance have been the holdings in Altron and Northam Platinum (Northam). Altron has been a very satisfying investment. Firstly, we bought our position close to where the share price bottomed and were then involved in facilitating the entry of Value Capital Partners (VCP) as shareholders. This was the catalyst for the recovery, which the fund is now benefiting from.

Likewise, our position in Northam was built at a time when platinum stocks were heavily out of favour. Our analysis showed that the platinum group metals (PGMs) would be in material deficits for many years to come, driven by weak supply following years of underinvestment in the industry, as well as robust demand as car manufacturers faced increasingly stringent emissions standards, driving demand for PGMs in catalytic converters.

The biggest detractors to fund performance over the past year has been the holding in AngloGold Ashanti and Implats. AngloGold has performed very well over the last 12 months, driven by a recovery in the gold price as well as increased company-specific optimism due to the appointment of a new CEO. We view the company as overvalued given that it trades on 15.5 times normal earnings. We feel there are significant operational hurdles to achieve these earnings, such as the extension of mine lives and ramping up the key Obuasi mine in Ghana.

Like with Northam, Implats has been a fantastic performer in the past year off a low base, driven by a strong improvement in the rand PGM price basket. Our view is that Implats is a lower-quality business than Northam, owning mines that are higher up on the cost curve. As such, we have preferred to take our PGM exposure via Northam.

The largest additions to the fund in the quarter were the purchases of Omnia and Wilson Bayly Holmes-Ovcon (WBHO). Omnia has been very weak over the past year or so, falling from around R150 per share at the end of the first quarter of 2018, to less than R50 today. To be fair, the business has not performed well and while a decline in the share price was justified, the extent to which it declined was not. When a business is under pressure and the share price falls rapidly, the entry point is always difficult to pick. At R60 per share, we think Omnia is significantly undervalued, and have started to build a position. The business will report a loss for its 2019 financial year, versus our assessment of normal earnings of above R10 per share.

WBHO has also been a poor performing share of late, driven mainly by the recent weak interim results which were heavily impacted by a large loss-making contract from its Australian civils business. This is not their first slip-up in Australia, and the market is now anxious that WBHO management may have lost their 'midas' touch – their long track record of managing risk and avoiding large contract mistakes. Our feeling is that WBHO remains the leading construction counter in South Africa and is the prime beneficiary of the demise of many of its competitors. On a normal PE of around 6 or 7 times, coupled with a very strong balance sheet, we think WBHO is attractive.

The fund's largest sales in the quarter was the position in Adcorp and the trimming of the Spar position. Both counters have done well for the fund and Adcorp in particular no longer offers enough upside to justify a holding; especially considering the outlook for the employment market, and the industry in which it operates. Spar remains a large holding in the fund, but we trimmed the position size in order to raise funding for other ideas.

Portfolio managers
Alistair Lea and Siphamandla Shozi
as at 31 March 2019