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

The Fund had a strong quarter, returning 16.6% while also slightly outperforming the benchmark. The Fund has outperformed the benchmark by 2.4% per annum (p.a.) since inception. However, over the last five- and ten-year periods, the Fund is still behind the benchmark, as we continue to battle against the massive outperformance of the large benchmark constituents.

Following on from the record decline in equity markets during the first quarter of 2020 (Q1-20), the second quarter of the year (Q2-20) saw a rapid recovery. Unprecedented levels of fiscal and monetary stimulus by governments and central banks around the world have given credibility to the Covid-19 response and hope to markets of a quick economic recovery, causing a rotation back into risk assets. South Africa (SA) is no different, with the South African Reserve Bank cutting the repo rate by 275 basis points the year to date. However, we remain concerned about how well the country comes out of this, having come into this crisis on a weak footing, and the limited ability to provide financial support to businesses and households. The Q1-20 GDP numbers came out with a 2% decline and marked the country's third quarter of negative growth. While the rand blew out in Q1-20, the level has seen little improvement in this quarter and saw only a small strengthening of 3%.

Q2-20 was also the first full quarter of lockdown in SA. As trading updates came from our companies, earnings expectations were adjusted, and shares were repriced based on their prospects through the challenging 12 to 18 months that lies ahead.

As a result of this, many of our top contributing positions came from SA domestic businesses in which the Fund is underweight. Clicks, Bidvest, Life Healthcare and Tiger Brands were all positive contributors in the period. After a long period of benchmark outperformance, Richemont, by far our biggest underweight, finally came through, as the impact of the current climate started to weigh on luxury goods demand and the company's earnings. Our largest contributor to performance was Aspen, which we have written about in previous commentaries. It remains our second biggest overweight.

The Fund's defensive exposure to food businesses, which helped performance in Q1-20, hurt in this quarter. Pick n Pay and Spar were the two biggest negatives in the period. While Distell and Zeder are other companies worth mentioning in this space.

The biggest buy for the Fund this quarter was Woolworths. After not owning the stock for some time, its material underperformance became too difficult for us to ignore. In Woolworths Food, you have one of SA's best businesses, making up around 40% of our assessment of normal earnings and fair value. It is defensive and continues to gain market share, with its high levels of product innovation. The remaining businesses consist of Clothing & Home SA, Country Road and David Jones. All three divisions are operating well below normal and offer upside in revenue and profitability. The opportunity to take out costs in David Jones is a material underpin to this, and, up to this point, the market has taken a very dim view of management's ability to execute on this aspect. We are more constructive on this and, for investors willing to take a longer-term view, we see an attractive risk-versus-reward opportunity from a business that trades on 7 times earnings three years out, offering a 7.5% dividend yield three years out.

The other material buy for the quarter – and a new Fund position too – is The Foschini Group (TFG). We have written previously about the perils of apparel retail, and how much more volatile it is than food retail. This remains the case, but valuation remains our primary focus when allocating capital to any investment. Over the last three to five years, TFG has been the market-leading sales-grower in SA, alongside discount retailer Pepkor. This is an impressive achievement and talks to how well the group has executed on strategy. This includes a portfolio of the right brands to sell, carrying the right product, and investments in a quick-response supply chain and technology in-store that all make buying from them more appealing. This is a good business, trading ahead of the peer group, and well-priced on a single-digit PE multiple three years out, also offering dividend yield in excess of 5%.

Other noteworthy buys include Anheuser-Busch InBev, which we have been buying throughout the year, and Bidcorp, which has looked expensive to us for a while, but started to offer good value in the quarter. Both are well-positioned, rand-hedge businesses, that we feel enhance the quality of the portfolio.

To fund these purchases, we reduced some of the strong outperformers (Aspen and Prosus), big positions that have held up (British American Tobacco) or whose investment case had largely been realised (like Zeder, which sold its stake in Pioneer Foods to PepsiCo).

As the third quarter kicks off, we are excited about what new challenges and opportunities the market will present. The portfolio is well-diversified and is not tied to a single view of the world, especially one as uncertain as this. We feel it holds strong businesses, and that positions are underpinned by attractive valuations.

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Portfolio managers
Adrian Zetler and Tumisho Motlanthe
as at 30 June 2020