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

After a tough first quarter (Q1-20), the Fund delivered an excellent performance in the second quarter of 2020 (Q2-20), returning 20% for the three months. Year to date (YTD), the Fund has returned -4.7%, ahead of the benchmark return of -5.2%. The aim of the Fund is to deliver outperformance over longer time periods, and, to this end, the since-inception return remains compelling, with alpha of 3.7% per annum, net of fees.

On a daily basis, the economic reality of Covid-19 continues to sink in. The practical implications of producing a vaccine at a global scale means that a lasting solution is likely a few years away, even were it shown to work today. The psychological and economic pain felt as a result of the pandemic has been devastating. Many jobs have already been lost, with the brunt being borne by tourism, restaurants and supporting industries. Each week seems to bring more announcements of retrenchments. Against this backdrop, the performance of stock markets around the world is surprising. While the economic impact and the likely duration of the virus becomes clearer and more alarming, stock markets continue their strong recovery. Despite earnings expectations being lowered meaningfully, the S&P 500 is now flat YTD. Central banks globally have adopted a 'whatever it takes' mantra, and this wall of money needs to find a home.

The strongest performance in our portfolio this quarter came from the platinum-group metals (PGM) miners. Last quarter, we wrote about our surprise at the divergence between PGM share prices and the underlying fundamentals, with producers Northam Platinum and Impala Platinum having fallen 44% and 46% respectively. This reversed in the second quarter, with the shares rising 69% and 54% respectively. South Africa (SA) is the largest source of primary mine supply. While the lockdown will hurt near-term earnings, shutting mines kept supply/demand balances in check and supply tight. We continue to forecast meaningful deficits in the coming years, which underpins our expectations of strong PGM pricing.

The diversified miners also performed strongly over the quarter. Anglo American, Exxaro and Glencore all increased over 30%. China accounts for over 50% of demand for many of the commodities supplied by these diversified majors. China's recovery in economic activity as it emerged from lockdown was sharper and faster than most expected. For example, Chinese steel demand is up YTD. This, coupled with their announced stimulus plans, buoyed commodity prices. On the supply side, curtailments assisted across many commodities. None more so than iron ore, where strong demand, coupled with poor shipments from Brazil's Vale, saw iron ore prices exceed $100/t.

Glencore is a stock we have added to the portfolio fairly recently. We like their particular commodity exposure, with over 40% of normal earnings exposed to so-called electric vehicle metals (copper, nickel and cobalt). The long-term supply-demand outlook for each is promising. We also believe the supply/demand fundamentals for thermal coal, another key commodity for Glencore, remain favourable. The current low thermal coal price renders a large portion of supply loss making. With limited investment in new mines, and growth in power station demand from India and South East Asia, thermal coal prices should trend higher. Their marketing business earns a consistently high return on assets. Concerns related to governance remain the reason that Glencore trades at such a discount to the other major diversified miners. We have done significant research into this matter and are pleased that the company has taken significant steps to improve governance and compliance since listing in 2011. There remains residual risk from the investigation into past practices related to the acquisition of one of their mines in the Democratic Republic of the Congo, particularly relating to the partner involved at the time of the transaction.

While impossible to forecast, we believe the majority of the risk related to this is reflected in the price. Glencore trades on 7 times our assessment of normal earnings (and, more importantly, 6 times our assessment of normal free cash flow [FCF]), which we consider compelling.

The strong share price performance in Naspers and Prosus continued this quarter, rising 23% and 30% respectively. Tencent has been a beneficiary of Covid-19 and an acceleration to a digital economy. Recent results were well ahead of market expectations, with games performing strongly. Naspers/Prosus remains our biggest holding. We reduced our exposure marginally towards the end of the quarter as the share performed strongly.

Aspen shares delivered a 55% return for the quarter. Aspen demonstrated good FCF generation at its interim result. This, coupled with the disposal of its Japanese business, which was approved this year, has allayed investor fears over its levels of debt. Despite initial fears, demand for Aspen's products has remained robust throughout the Covid-19 pandemic. Two avenues provide interesting upside optionality. There is evidence of increased blood clotting in some Covid-19 patients. Anti-coagulants, a key product line for Aspen, is able to assist in this regard. Secondly, early evidence from a UK trial testing the drug Dexamethasone on Covid-19 patients has displayed promising results. Aspen owns the rights to manufacture and distribute the drug in a number of countries. Despite the share price having recovered from its 2019 lows, it still only trades on 8 times our assessment of normal earnings, which does not factor in any upside optionality discussed. We consider this attractive.

We reintroduced Woolworths into the portfolio. Woolworths' SA food business is an impressive business that has continued to take market share. The SA clothing business earnings are at a cyclical low, driven by internal merchandising issues. A new SA clothing CEO and Edgars' business rescue should see earnings recover off a low base. The newly-appointed group CEO, without any legacy attachment to the group's structure, should ensure better capital allocation from here onwards.

SA went into the Covid-19 pandemic with the cupboards bare. Executives had been telling us for two years that the environment was the toughest in memory during the last two decades. Poor growth, erratic electricity supply, policy uncertainty, and evidence of a decade of government corruption coming to the fore contributed to record low consumer and business confidence levels. Government was initially applauded for acting early and decisively in establishing the hard lockdown. Our precarious economic position going into the lockdown was at odds with the severity of our lockdown – SA's rules were some of the most draconian globally. This, coupled with a number of seemingly irrational rules, saw a lot of the initial goodwill dissipate.

Our portfolio was well positioned with our hawkish stance on the SA economic environment. The portfolio has a low weighting to SA-exposed businesses. Outside of our exposure to banks, our SA exposure is more defensive in nature, with holdings in food retailers and hospitals. We have also focused on improving the portfolio quality overall, looking to invest in businesses with good management teams and strong balance sheets.

While the recovery in stock prices has reduced the margin of safety in the market, we are still confident in the holdings in our portfolio, which still show meaningful upside from current levels.

Portfolio managers
Neville Chester and Nicholas Stein
as at 30 June 2020