The Fund appreciated 3.2% in the third quarter of 2020 (Q3-20), compared with a 2.3% return of the benchmark, resulting in 0.9% alpha for the period. After a strong absolute return in the prior quarter (of 13.4%), it was encouraging to generate continued positive absolute returns and alpha.

This quarter was less eventful compared to the first six months of the year, which exhibited extreme volatility. The largest positive contributors in the quarter were Alibaba (+30%, 0.7% positive impact), Salesforce (+31%, 0.6% positive impact) and JD.com (+25%, 0.5% positive impact). The Fund incurred *unrealised* losses on a collection of put option and short index positions, which provided valuable protection in the first quarter of this year but detracted from performance this quarter. Collectively, these put options and short index positions had a 0.9% negative impact during the quarter, but having them continues to provide the Fund with protection should there be a market selloff. Outside of this, the one other notable negative detractor was Unibail-Rodamco-Westfield (-37%, 0.3% negative impact), which came under renewed pressure post the announcement of a proposed rights issue to deleverage the balance sheet.

Over the past five years, the Fund has generated a positive return of 15.4% per annum (p.a), over ten years a return of 16.8% p.a and, since inception over 20 years ago, 14.8% p.a (3.3% annualised outperformance).

The Fund ended the quarter with 69.2% net equity exposure, slightly lower than at the end of June.

Our negative view on global bonds remained unchanged as a large portion of developed market sovereign bonds offer negative yields to maturity, with the follow-on effect that most corporate bonds also offer yields which do not compensate for the risk undertaken. Only 1.4% of the Fund is invested in bonds, which is largely made up of a 0.6% position in L Brands (owner of Victoria Secret) corporate bonds.

The Fund also has c.2.8% invested in global property: largely Vonovia (German residential) and Unibail (European and US retail property). Lastly, the Fund has a physical gold position of 3.9%, along with a 0.7% holding in Barrick Gold Corp, the largest gold miner globally. The physical gold position was added to during the quarter for its diversifying properties. The balance of the Fund is invested in cash, largely offshore. As has been the case for many years, the bulk of the Fund (over 90%) is invested offshore with very little exposure to South Africa.

The markets remain volatile as the Covid-19 pandemic continues to cause disruption around the world, with various governments responding in different ways, which continues to create a disruptive operating environment for many businesses. The Fund is positioned in a manner without taking a strong view as to when normalisation will occur across the world, as the last nine months have indicated once again that trying to predict the future is inherently difficult. The Fund holds a collection of businesses which we feel are attractively priced and can operate in what we deem a highly complex and fast changing environment

Notable buys/increases in position sizes during the quarter were NetEase, RELX Plc and Visa.

NetEase is the second largest gaming company in China with a long history of successful execution over its more than 20-year history. Notwithstanding the material tailwind Covid-19 provided their gaming business, which has been sustained as life in China has normalised, NetEase has also been very successful in incubating new businesses and creating immense shareholder value. Outside of their gaming business, which we feel still has good growth potential in China, along with significant potential outside of China, NetEase own the second-largest music streaming service in China, which operates in a duopoly with Tencent Music Entertainment. The online music streaming market in China should experience long duration growth due to currently low-paying rates along with very low average revenues per user. NetEase also own a rapidly growing online education business (Youdao) which separately listed late last year, with NetEase still holding c.58%. Both the online music business and the online education business are lossmaking, but should start to contribute both profits and cash flow to the combined group in the next 18-24 months. NetEase also has just under 20% of their market capitalisation in cash and trades on a c.6.5% 2021 free cash flow (FCF) to enterprise value yield, which we feel is attractive.

RELX is a global provider of information-based analytics and decision tools for professionals and business customers. Their revenue is largely recurring in nature due to subscriptions and being usage-based, which is deeply embedded into customer workflows. They have highly recognised brands within the scientific, legal and risk analytic markets and have done a good job over the years to transition their products to the digital realm. Their risk analytic business is made up of a significant proprietary dataset, which is hard to replicate and creates real value for their clients (ie: insurers) who access it to make critical business decisions. Growth should be driven by continued penetration into existing clients and expanding their service offerings. The business is highly cash generative as most of their revenue is received in advance, and the bulk of their FCF has been returned to shareholders in the past. We estimate the business should be able to grow earnings in the high single digits which, coupled with a c.2.5% dividend yield, should generate double-digit total returns in hard currency.

Visa is a business the Fund has owned for many years due to our positive view on the structural growth drivers supporting the business fundamentals, being a continued transition from cash to electronic means. We believe that Covid-19 has potentially accelerated this transition due to rapid increases in ecommerce penetration and a behavioral shift away from handling cash. We acknowledge there are some headwinds brought about by a curtailment in travel but believe this is transitionary as opposed to permanent and, ultimately, the move away from cash has been accelerated due to the pandemic. Cashless penetration (as a percentage of personal consumption) globally was just under 50% last year - up nearly 20% from a decade ago. We expect this trend to continue, with penetration approaching 70% over the next decade. This is supportive of growth for Visa, with the business generating very high incremental margins due to low incremental costs in supporting these additional volumes. Against this backdrop, we expect high single-digit revenue growth, which should translate to low double-digit earnings growth.

We are now just over nine months into the Covid-19 pandemic, yet there still remain many unknowns as to the ultimate length, how governments will respond and what permanent consumer behaviors will manifest post the pandemic. However, against this backdrop we feel the portfolio has been built bottom up, whilst ensuring adequate diversification with limited exposure to potential hard-to-predict future trends.

Portfolio managers
Gavin Joubert, Marc Talpert & Suhail Suleman
as at 30 September 2020