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

Reflecting on the performance of the Fund in previous quarters, the portfolio experienced its weakest ever quarter in the first three months of 2020, delivering a 31.2% decline in the unit price. In the subsequent two quarters, the Fund recovered, returning 16.8% in the second quarter of the year (Q2-20) and 9.3% in the third (Q3-20). This demonstrates often typical investor behaviour of overreacting to bad news, and the opportunity that is presented if one is able to stay level-headed in difficult times. While it is never easy in the heat of the moment, the last three quarters have once again taught us how to approach the next crisis, which will no doubt come when we least expect it.

From a longer-term perspective, the Fund's one- and three-year declines of 5.7% and 3.2% respectively make it the best-performing Fund in its category over both time periods.

It is interesting to note the divergence in the performance of the various JSE indices over the past year. The mid- and small-cap indices (our investable universe) are down 14.9% and 17.6% respectively, while the large cap index is up 6.2%. The mid- and small-cap indices are effectively a reasonable proxy for the performance of South African (SA) businesses, while the large-cap index is very much driven by the dual-listed shares, including Naspers, Prosus and the diversified miners. It is clear then that the average company doing business in SA is really struggling, while the opposite is true for the miners and Naspers. While it is difficult to know if this trend will continue, what is clear is that very little good news is priced into many of the shares in our universe. A good example of this is Cashbuild, which peaked at R500 per share in early 2018. During this quarter, we bought shares at R140.

The largest additions to the Fund in the quarter were the purchase of The Foschini Group (TFG) and Cashbuild.

Much like Cashbuild, TFG shares peaked at over R230 in early 2018. We were able to buy in this quarter at below R70. The business has certainly not been immune to the effects of Covid-19, with all of its stores impacted by lockdowns. What Foschini seem to have done, however, is to take advantage of this crisis by buying a distressed asset in Jet. In Jet, Foschini have bought what we would consider to be a reasonable retail business for a price of R480m. Jet generates revenue of around R5bn, and, if we assume an operating margin at half the TFG group margin of 14% before the Covid-19 crisis (which is potentially too conservative, given the improved store rental terms we speculate they have been able to negotiate), Jet would generate R350m of operating profit, or R252m after tax. It thus appears that TFG have been able to buy Jet on less than a 2x price-to-earnings (PE) ratio. It couldn't have been easy for TFG management to commit to this acquisition in the heat of the Covid-19 crisis (it was announced on 13 July 2020), but it would seem to us that it might end up being an inspired and value-enhancing deal.

Cashbuild is a superbly managed business that we have held in the Fund in the past, but had since, in our opinion, become overvalued. However, following a 72% correction from its peak, it again offered value. Coincidentally, Cashbuild has also used this crisis wisely by making what looks to be an astute acquisition of the Building Company (owner of the Buco and Penny Pincher brands, among others). The same back-of-a-napkin analysis of the acquisition, assuming the acquired business can generate a 3.5% operating margin (less than Cashbuild's approximate 5% margin), shows that Cashbuild has bought the business on just over a 5x PE ratio, before any synergy or scale benefits. Again, we commend management for acting counter-cyclically and not wasting a good crisis.

The Fund's largest two sales over the quarter were the JSE and Netcare.

The JSE was a beneficiary of the Covid-19 crisis, with equity trade volumes and values spiking as a result of the extreme volatility. As such, the share outperformed. Going forward, we think things are going to be tougher for the exchange as things settle down. The share does not offer the upside we see in many other shares and we therefore sold out.

Netcare's fortunes have deteriorated since the onset of Covid-19. While it is clear that, in the short term, Covid-19-related business is more than offset by lack of elective surgeries, it is the medium- to long-term that concerns us most. Netcare and all the hospital groups derive most of their business from medical aid members. Medical aid membership is largely dependent on employment, which has taken a hit in the past few months and may well not recover to pre-Covid-19 levels in a while. Add to this the trend towards the use of hospital networks as a more affordable option, and the outlook for hospital groups looks rather tough.

Portfolio manager
Alistair Lea
as at 30 September 2020