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

The Fund had a tough second quarter of the year (Q2-21) after a good initial three months, finishing the quarter 2.6% behind the benchmark and 1% over the six months to end-June. It was a tough quarter from an absolute return perspective as well, with the Fund down 1.79%. Since its inception, the Fund has beaten the benchmark by 2.3% per annum, although recent years have been slightly behind. We are optimistic about the value represented in the portfolio, with Naspers, British American Tobacco and a collection of South African-focused stocks looking particularly attractive.

The Fund continued to buy cheap South Africa (SA) stocks in the quarter, including Altron, HCI and MPact, while funding these from Richemont, Bytes and Woolworths.

Last quarter we spoke about the strong earnings results coming out of SA-focused stocks. Since then, this has continued and picked up steam, with an increasing number of reported results coming in ahead of expectations. Across the board, we have seen companies cut their cloth and resize cost bases to maintain profitability in a lockdown-impacted revenue environment. Some of these cost cuts are temporary and will reverse when revenues return to the impacted business, but some will be permanent and select companies will have improved their normal earnings power through this period. Our net buys mostly fell into this category during the quarter.

The largest contributor to performance in the quarter was Distell, which has returned 43%, contributing 60 basis points (bps). In May, Heineken approached Distell with a potential offer to acquire the majority of its business. We believe that Heineken will benefit from Distell's established footprint on the African continent and their strong brand portfolio, which include Amarula, Savanna and Klipdrift, amongst others. Distell is a growth business with a long runway ahead of it, both in SA and in select African countries, as they invest in and roll out their multi-category portfolio of brands. A high-quality business that trades below our assessment of fair value, it gives us sufficient comfort to maintain our position. Should the board and major shareholders be able to extract as high a price as possible for the business from Heineken, that would be a bonus.

The largest detractor in the quarter was our large underweight position in Richemont. Richemont continued its strong post-pandemic run, as jewellery sales have gone from strength to strength to an all-time high at the end of the quarter. Richemont is the owner of a truly unique brand in the Cartier jewellery business, having seen double-digit euro revenue growth for more than 15 years. Hard luxury goods have been resilient in the recovery from the pandemic as wealthy buyers, unable to spend on international holidays, have repurposed their spending towards this category. While the runway for Richemont to keep growing the jewellery business is clear, as branded jewellery grows from low levels, we believe this is more than discounted in the current share price.

The second-largest detractor in the period was Naspers/Prosus, taking away 44bps from relative performance as it declined nearly 15% over the three months. This decline followed a strong run in Q1-21, which left Naspers flat for the first six months of the year. Two key factors have contributed to this underperformance. The first is the Naspers/Prosus share swap that was announced in May. The second is the tightening up by the Chinese authorities on technology firms when it comes to deemed monopolistic behaviour and data security. There is a concern in the market that the Naspers/Prosus share swap creates added complexity and may orphan the Naspers asset. We believe that it may not be the final iteration and that more steps will be taken down the line specifically to unlock the discount at the Naspers level.

While there has been no direct action by the regulator on Tencent, there has been focus on some subsidiary companies, and the risk remains that at some point Tencent receives similar attention. We do not dismiss this risk but believe that the impact on Tencent's three key business verticals is unlikely to materially reduce the asset's long-term value, especially when bought at a large discount through Naspers/Prosus. In the gaming business, the Chinese government has already tightened regulations, and Tencent are compliant, they also have a strong international component to this business. Stringent consumer data protection within Weixin (WeChat, Tencent's super app) and the open nature of this platform reduce the likelihood that the advertising business is targeted. We see the risk of regulatory intervention at its highest in the fintech business; here, we gain comfort that payments, which carry a lower regulatory risk than other financial products, make up 70% of the business and the non-payments business is in line with the new regulation. There is a lot of uncertainty, but our analysis leads us to believe that Tencent is broadly on the right side of the regulatory bodies.

We remain optimistic on the outlook for the Fund going forward. We are on the lookout for opportunities to increase exposure to SA industrial stocks that are being mispriced by the market. In our largest position, Naspers/Prosus, we believe that continued strong operational performance and regulatory certainty will be good for the share price from these levels.

Portfolio managers
Tumisho Motlanthe and Nicholas Hops
as at 30 June 2021