The Fund declined 0.4% in the second quarter of 2021 (Q2-21), compared with a benchmark return of 2.7%, which resulted in 3.1% underperformance for the period. The continued underperformance of the Fund is disappointing, yet we believe that the collection of assets held by the Fund still offers compelling long-term risk-adjusted returns with which to deliver on its goal of compounding capital well ahead of inflation.

While we are by no means happy with the short-term underperformance of the Fund over the past year, something to bear in mind is that ~90% of the Funds' investments are offshore, and the ZAR's 17% appreciation in the past year has been a headwind. It should be further acknowledged that the past year has particularly benefitted economically sensitive businesses, as actual macroeconomic numbers vs what was expected in the depth of despair last year have materially outperformed expectations. With this, economically sensitive businesses' actual earnings performance has been significantly ahead of expectations, driving the sharp outperformance of these types of stocks.

The Fund has, and continues to own, far less of these sorts of businesses, which are often lower quality as well. Macro is inherently difficult to predict, as the last 12 months has shown. Thus, we prefer to invest in businesses that benefit from structural tailwinds, led by excellent management teams who ultimately determine the business's long-term success, as opposed to hard-to-predict macroeconomic factors that businesses cannot control. Valuation, however, has always been our guiding principle in determining whether to deploy your fund capital into these sorts of businesses.

We remain focused and confident that the Fund is well-positioned to achieve outperformance over the long term with these key principles in mind.

It appears that our expectation of a disjointed normalisation experience is playing out across different geographies as varying degrees of vaccine coverage are achieved, which continues to create complexity for many businesses that operate across geographies. Emerging variants of COVID-19 are also contributing to increasing uncertainty, and short-term visibility remains low. During the quarter, the largest positive contributors were Alphabet (+13.3%, 0.3% positive impact), Facebook (+14.0%, 0.3% positive impact), Heineken (+14.1%, 0.3% positive impact) and Mercari (+13.1%, 0.2% positive impact). The largest negative contributors were New Oriental Education (-45.3%, 0.7% negative impact), Naspers (-15.0%, 0.7% negative impact) and Tencent Music Entertainment (-27.6%, 0.5% negative impact).

New Oriental Education is a business focused on after-school tutoring of Chinese students. The share came under considerable pressure due to *potential* regulations that could impact the after-school tutoring industry. These regulations could come in the form of restrictions as to when after-school tutoring is allowed, which, if implemented, would materially impact the future growth of New Oriental. Against this backdrop, we conducted extensive expert calls to obtain insight into the potential regulations. From this work, we are more comfortable that even though new regulations will be instituted, they will most likely be less draconian than feared. Thus the negative share price movement appears to be overdone. However, we are cognizant of the risk inherent in this view, and therefore the position has been sized accordingly at 1.2% of Fund, notwithstanding the significant *potential* upside on offer.

Over the past five years, the Fund has generated a positive return of 11.3% per annum (p.a.), over 10 years a return of 15.9% p.a. and, since inception over 20 years ago, 14.1% p.a. (2.6% annualised outperformance).

The Fund ended the quarter with 79.4% net equity exposure, roughly 2% higher than at the end of March 2021 as we found compelling equity opportunities.

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 that do not compensate for the risk undertaken. We did, however, buy South African bonds in the quarter, which now represent 1.6% of the Fund. Our view on the South African fiscal situation has improved somewhat due to record current account surpluses, driven by buoyant commodity markets, a commitment to structural reform as evidenced by the change in regulations toward private power generation, and the acceptance of a private partner for SAA, coupled with a commitment towards austerity regarding the public sector wage bill. Considering this backdrop, we feel the current yields on offer for SA government bonds are compelling enough to have exposure.

The Fund also has c.2.2% invested in global property: largely Vonovia (German residential). Lastly, the Fund has a physical gold position of 3.2%, a 0.82% holding in AngloGold Ashanti, and a 0.74% holding in Barrick Gold Corp, the largest gold miner globally. The gold price is down approximately 9% in USD year to date, but we continue to hold the position for its diversifying properties in what we characterise as a low visibility world with inflation risks. 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.

As the outlook for the future remains uncertain and hard to predict, we take comfort in the fact that the Fund holds a collection of businesses that we feel are attractively priced and can operate in what we deem a highly complex and fast-changing environment. Also, because the Fund is a multi-asset flexible fund, we have access to additional tools to take advantage of dislocations in the market, with the continued increased equity exposure being an example.

Notable buys/increases in position sizes during the quarter were Delivery Hero and Auto1.

Delivery Hero is an online food delivery business with a leading market share position in markets that account for more than 95% of its gross transaction value, which makes it extremely well placed in a winner takes most or at least oligopolistic industry. 67% of their current gross transaction value comes from Asia, with Korea contributing 53% to the group's gross transaction value. MENA then makes up 20%, with Saudi Arabia the key market. We feel there are material, secular tailwinds for food delivery, with the current penetration of home delivery of takeaway food in Delivery Hero's markets only amounting to 32%, which should materially increase due to the consumer value proposition of home-delivered food. Notwithstanding the business being loss-making at a group level, we are encouraged by the positive economics of their more mature regions, which provides a pathway to future overall profitability. The business is attractive based on our long-term assessment of business value.

Auto1 is the leading online used car platform in Europe, providing a significantly better consumer experience for buying and selling used cars. They also act as a key destination for a fragmented European dealer base from which to buy or sell cars. At 1%, online penetration of used car transactions is extremely low across Europe but is set to rise as an increasing number of consumers become accustomed and willing to purchase a used car online due to the materially improved experienced offered by Auto1 (45% of European consumers are willing to purchase a used car online). They are a first mover, have pan-European exposure (important for the vehicle sourcing) and are founder-led (the founders continue to own 25% of the business). The economics of the business has been improving, and the company is already close to breakeven, notwithstanding heavy investments for growth. We are confident that the long-term economics of the business will be attractive, along with the immense future growth prospects.

Vaccines have continued to roll out across the world, and this should continue in the months ahead, with the hope that we are close to the end of the pandemic and its devasting effects. However, further uncertainty has been brought about due to emerging virus variants. Against this backdrop, we remain positive on the outlook for the Fund, which has been built bottom-up, with a collection of attractively priced assets to provide diversification and achieve the best risk-adjusted returns going forward.

Portfolio managers
Gavin Joubert, Marc Talpert and Suhail Suleman
as at 30 June 2021