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

The Fund has had another decent quarter, delivering a return of 7.3%. It remains the best performing small and mid-cap fund over 1, 3 and 5 years, delivering a return of 9,7% per annum for the past three years, which we consider reasonable versus inflation and competitor funds.

The strong performance from mid- and small-caps in the past year has largely remedied the long-term performance numbers of the Fund. We have moved from seeing some outstanding investment opportunities to a more normal environment, where many shares are now closer to being fairly valued. Where we see value right now, we also see risk and are having to weigh up whether to invest in lower quality, riskier shares with lots of upside versus sticking with better quality companies that offer less upside but more visibility. As we have discussed in previous commentaries, we favour the latter approach.

The two largest buys in the quarter were Reinet and Spar.

Reinet is an unusual share for a small-cap fund to buy in that it has historically been a proxy for British American Tobacco (BAT) - one of the largest shares on the JSE and historically the largest part of Reinet. While BAT still represents some 30% to 40% of the value in Reinet, Pension Insurance Corporation (PIC) now accounts for about 50% of the value. PIC is involved in the pension risk transfer market in the UK, where corporates are looking to offload pension liabilities to someone who can better manage and fund them. This is a growing market, with only about 10% of the UK's pension liabilities insured to date, with this number expected to grow to around 30% by 2030. PIC is one of the largest players in this market and is set to benefit from this growth.

100% of Reinet's assets are also earners of hard currency. With the rand strength we have seen over the past year, it strikes us as an opportune time to increase the Fund's exposure to rand-hedge shares. Reinet is also trading at an all-time high discount to its underlying asset value of 40%.

Spar is the Fund's largest holding and a company much liked by us. It is a good example of the type of share that we enjoy holding – a quality, defensive business superbly managed at a fair price. Today Spar trades on a one-year forward PE of roughly 13 times, but that includes a negative contribution from its new Polish business. If we calculate Spar's normal earnings – i.e. what it should earn when all its operations are running normally, then it trades on a normal PE of just above 10 times. We think that is a low multiple for a business of this quality and is why we have been adding to our holding in Spar

The two largest sells in the quarter were the JSE and Liberty Holdings.

While we like many aspects of the JSE, we are becoming a bit concerned about two factors. The first is the JSE's reliance on the fees generated from trading in Naspers and Prosus shares, and the second is the JSE's reliance on fees from its BDA system.

On the first point, trade in Naspers and Prosus makes up close to 20% of the equity trade value on the JSE. Our sense is that, over time, Naspers will try and reduce its size on the JSE, which it has already done. More trade is then likely to migrate to Prosus on offshore exchanges.

On the second point, fees earned from transactions through the BDA system makes up nearly 20% of JSE revenues. This system is used for both regulatory oversight and reporting purposes and is mandatory for JSE customers to use. There is a chance that BDA becomes non-mandatory in time, probably coinciding with a move to a Central Counterparty Clearing mechanism. This could have an impact on the JSE.

Liberty Holdings was a small holding in the Fund that we decided to exit. Although cheap, it is a somewhat challenged business, with many credible competitors operating without the burden of legacy systems and ways of doing business.

We had seen strong flows into the Fund in the past few months, having experienced outflows in the wake of Covid-19 a year ago when share prices were plummeting. Unfortunately, this tendency of investors to panic when there is bad news and emboldened when share prices are going up is nothing new. It happens time and time again and typically means that the average investor in the Fund does not receive the returns that I quoted at the start of the commentary. It is difficult to invest at a time of maximum pessimism, but it is the best time to do so.

Portfolio manager
Alistair Lea
as at 30 June 2021