The Fund declined 0.64% in the first quarter of 2021 (Q1-21), compared with a benchmark return of 5.38%, which resulted in 6.02% underperformance for the period. The main driver of the benchmark performance has been the JSE's strong equity returns off a low base (Capped SWIX up 54.2% over the past 12 months), 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.

After strong alpha generation over the past three years (3.6% per annum), it is disappointing to have underperformed both in Q1-21 and over the last 12 months. Notwithstanding this short-term relative underperformance, we are pleased with the Fund's absolute return of 15.4% delivered over the last 12 months. While one can expect the Fund to underperform its benchmark in the short term, we remain focused and excited that the Fund is well-positioned to achieve outperformance over the long term.

Volatility remains high across the markets as Covid-19 vaccines roll out across the world, with large disparities between both overall population vaccination rates and the speed at which rollouts are happening. This will most likely result in a disjointed normalisation experience across geographies, a complex reality for a globalised interconnected world.

Short-term visibility remains a challenge, and we expect this to continue to drive volatility. The largest positive contributors in the quarter were Naspers (+15%, 0.49% positive impact on Fund performance), Alphabet (+20%, 0.45% positive impact) and Tencent Music Entertainment (+10%, 0.35% positive impact). The Fund incurred unrealised losses on a collection of put option and short index positions that provided valuable protection historically but detracted from performance this quarter due to a buoyant market. Collectively, these put options and short index positions had a 0.7% negative impact during the quarter; however, they continue to provide the Fund with protection should there be a market selloff. Outside of this, the other notable negative detractors were Unity Software (-34%, 0.38% negative impact on Fund performance), our physical gold position (-9%, 0.34% negative impact) and the London Stock Exchange Group (0.28% negative impact).

Over the past five years, the Fund has generated a positive return of 11.1% per annum (p.a.), over 10 years, a return of 16.2% p.a. and, since inception over 20 years ago, 14.3% p.a. (2.7% annualised outperformance).

The Fund ended the quarter with 77.8% net equity exposure, roughly 5% higher than at the end of December 2020 as we found compelling equity opportunities.

Our negative view on global bonds remained unchanged as a large portion of developed market sovereign bonds offers negative yields to maturity, with the follow-on effect that most corporate bonds also offer yields that do not compensate for the risk undertaken. Only 1% of the Fund is invested in bonds, which is largely made up of a 0.51% position in L Brands (owner of Victoria's Secret) corporate bonds.

The Fund also has circa 1.85% invested in global property: largely Vonovia (German residential). Lastly, the Fund has a physical gold position of 3.4%, a 1% holding in AngloGold Ashanti, and a 0.8% holding in Barrick Gold Corp, the largest gold miner globally. The gold price is down approximately 13% in US dollars year to date, but we continue to hold the position for its diversifying properties in what we characterise as a low visibility world. The balance of the Fund is invested in cash, primarily 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 and some achieving rapid success in their vaccination drives while others are faltering. This will potentially result in a world where the paths to normalisation worldwide are quite different, which can continue to create a disruptive operating environment for many businesses. However, the pandemic will only end when the world is vaccinated at an individual country level, and thus notwithstanding real issues surrounding equitable access to vaccines, there is hope that access improves in the coming months. This future scenario however still has many unknowns associated with it, creating an environment characterised by uncertainty and disruption.

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 increased equity exposure being an example.

Notable buys/increases in position sizes during the quarter were Nintendo, Porsche and Vinci.

Nintendo is a gaming company founded in 1889 as a Japanese playing card business but moved into video games in 1977. They have a long history of releasing successful video game titles, and they own leading franchises such as Super Mario, The Legend of Zelda, Animal Crossing and Pokémon. Nintendo creates both the games and the hardware on which these games are played, which have often driven innovation in the gaming hardware space. The company is obsessed with quality and, as such, have been slower than peers to monetise their world-class intellectual property (IP). This provides them with a significant opportunity, and there have been some positive indicators that the business will take advantage of this opportunity. The business's new CEO (since 2018) appears more flexible and willing to open monetisation avenues compared to his predecessors, and this approach is evidenced by their more aggressive moves into films, theme parks and mobile games – all important monetisation touchpoints for their IP. We believe the business is under-earning versus its long-term potential and currently trades on 17x our estimate of 2022 earnings, which should continue to grow at a high single-digit rate and is further supported by an approximately 3% dividend yield.

Porsche is a holding company, with its major assets being its 53% ownership in VW common stock, the carmaker. VW is the second-largest auto manufacturer globally and owns brands such as VW, Audi, Porsche and Lamborghini. We are positive on VW's underlying business, with a key element of the investment case being their transition from an internal combustion engine auto manufacturer to an electric engine auto manufacturer. Management is confident that in this transition, notwithstanding huge investments ($86 billion between now and 2025), electric vehicle sales growing in the mix will not be dilutionary to margins and based on our FY2022 estimates of free cash flow, VW is trading on an approximate 8% free cash flow (FCF) yield. Porsche is then trading at a 24% discount to its shareholding in VW, which we don't believe is fundamentally justified.

Vinci is one of the world's largest concessionaires and construction contracting companies. They own irreplaceable, high-quality toll roads (with a non-commuter focus) with high visibility due to the long-term nature of the concession contracts. They then also operate a collection of airports, which are currently under pressure due to the travel disruption caused by Covid-19, but which we believe are still attractive assets that should rebound and be supported by the continuing structural growth trend of leisure travel. Finally, they have a highly efficient and risk control obsessed building contracting business that contributes 80% of group revenue but 24% of net income. More recently, they have acquired a business that gives them exposure to renewal energy concessions expected to grow rapidly in the future. Due to the nature of their customer contracts, it is a business that should deliver highly visible earnings and FCF driving healthy double-digit total shareholder returns in hard currency, which is attractive, especially considering the inflation-linked nature of earnings.

As vaccines roll out across the world (with initial real-world data indicating they are working well to reduce the hospitalisation and fatality risks associated with Covid-19), there is reason to be optimistic that the devasting effects of the pandemic are closer to ending. However, there remains uncertainty as to when the entire world reaches a level of vaccination that allows life to return to normal. However, against this backdrop, we remain positive on the Fund's outlook, which has been built bottom-up, with a collection of attractively priced assets to provide diversification in order to achieve the best risk-adjusted returns going forward.

Portfolio managers
Gavin Joubert, Marc Talpert & Suhail Suleman
as at 31 March 2021