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

The Fund returned 12.9% for the quarter, benefiting from strong financial sector. Over the past year, the Fund generated a strong absolute return of 44.1% off a low base. Since inception, it has delivered an annualised return of 10.9%.

Despite the strong recent returns, medium term returns for the sector remain anaemic - a consequence of its fortunes being largely tied to a low growth domestic economy.

Several positive political developments took place in the first half of the year, hinting at steps towards meaningful structural reform to support economic growth. This included the commitment to allow power self-generation of up to 100 megawatts, the sale of a majority stake in SAA, and concrete steps against high profile politicians involved in corruption, most notably the arrest of former President Jacob Zuma. This narrative has faded somewhat over the past quarter, and much of the goodwill that was starting to build was undone by the riots and looting that occurred in KwaZulu-Natal and parts of Gauteng in the first two weeks of July. Consumer confidence undoubtedly took a knock, but the accumulation in personal savings by those still employed will probably be put to use sooner or later. More importantly though, these incidents have further dented already low levels of business confidence and will put the brakes on sorely needed direct investment by both domestic and international corporates. The incident has also increased the longer-term risk of a loss of skills due to emigration, something this country can ill-afford.

Banks delivered strong returns for the quarter, with a return of 15%, outperforming life insurers (12%) and non-life insurers (-4%). During the period, most of these companies released half-year or year-end results to June. A high-level observation is that the provisions for bad debts put through by banks at the onset of Covid-19 a year ago have proven to be adequate (if not excessive), whereas the provisions for mortality claims raised by life companies were insufficient, and further top-ups were required for the impact of the third and potential subsequent waves. Consequently, banks delivered strong earnings growth off a very depressed base due to significantly lower bad debt charges, while life insurance earnings performance was more muted. Stripping out some of the noise from Covid-19 provisioning, however, shows that core earnings growth remains under pressure.

Corporate action was a notable theme this past quarter. Standard Bank made an offer to buy out minorities in Liberty Life and RMI announced its intention to restructure the business. The Standard Bank offer for Liberty is consistent with a general trend of convergence in financial services. It should fully align the businesses, maximising the potential client base and providing scale benefits. The Fund does not hold shares in Liberty but has a significant holding in Standard Bank at 13.9% of Fund.

Like many holding companies, RMI has seen the discount (at which it trades to the value of its underlying parts) widen over the last few years. We believe this undervalues some of the attractive assets it owns, including OUTsurance, an unlisted short-term insurer with a strong history of delivering earnings growth while achieving high levels of cash flow conversion. We have had many engagements with RMI management over the years as to how this value could be unlocked and were pleased to note the restructuring announced in September. RMI intends to unbundle its holdings in Metropolitan Momentum and Discovery to shareholders, leaving a smaller, more focused company with its major holdings in short-term insurance (OUTsurance and Hastings). RMI have also committed to pay out 50% free cash flow to shareholders. Although a capital raise in the form of a rights issue will be required to achieve this, the restructuring and higher payout are an undoubtable positive. We hope that these are the first steps on a journey to further improve shareholder returns, by passing through more of the underlying dividends. The Fund has a 3.7% holding in RMI.

Contributors to Fund performance relative to benchmark for the quarter include underweight positions in underperformers Reinet and Capitec, and overweight positions in Ninety One and RMI. Detractors include underweight positions in outperformers Old Mutual, Remgro and Liberty, and an overweight position in Nedbank. Activity was unusually high during the quarter due to a change in the Fund's benchmark to exclude property companies. We increased the Fund's holdings in FirstRand, Standard Bank, Capitec (amongst the banks), and Sanlam, Old Mutual and Discovery (amongst the insurers). This was funded through reductions in the Fund's holdings in Reinet, Quilter, RMI and Ninety One.

Over the past year, overweight positions in the banks, in particular Nedbank and Investec, have contributed positively to returns relative to the benchmark. However, this has been offset by a few positions, particularly overweight positions in wealth manager Quilter and asset manager Ninety One. We believe these are attractive businesses – they are capital light, highly cash generative and are exposed to specific drivers in the UK and global savings markets. What we particularly like about them is their positive operational gearing to rising asset markets, such as we have seen over the past 12 months. These are both dual-listed businesses so we will consider their performance in pounds. Over the past year, the MSCI World Index has risen 22% in GBP, yet the Quilter share price is up only 11% and Ninety One up 17% (rand strength over this period has resulted in lower returns in local currency terms.) If one were to argue that Covid-19 created a lot of noise in markets in 2020, and instead rewind to pre-crisis levels: the Quilter share price is down 11% since the beginning of 2020, while the MSCI World Index is up 26%. Ninety One only listed on 16 March last year - in the eye of the Covid-19 storm - so the price discovery at the time was likely highly distorted (although off this base, the price has increased 70% against and a 60% rise in the MSCI World Index). We remain somewhat perplexed by the share price performance of these businesses – the market either does not believe that the operational gearing we anticipate will materialise, or it takes a different view of the quality of these businesses and therefore the rating assigned to them. Despite reducing our holdings slightly during the quarter, both remain overweight positions in the Fund.

We continue to see valuations as attractive in the sector, but caution that the growth environment in which many of these businesses operate remains low. In addition, competition in the more lucrative profit pools continues to intensify. The winners in this environment are likely to be those that are able to manage costs tightly, while adapting their business models to deal with ongoing disruption. We feel that the Fund is appropriately positioned for this.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 30 September 2021