The Fund declined 6.6% in the third quarter of 2021 (Q3-21. The Fund launched in April 2021 and, as such, does not yet have a meaningful track record.

We continue to challenge our assumptions relating to the investments held, and through this exercise, we feel the Fund is holding a collection of incredibly attractive assets. This is most notable regarding the Chinese companies which the Fund holds, that have been the primary contributor to the more recent underperformance. While the regulatory backdrop in China has undoubtedly changed negatively, and the risk premium associated with Chinese assets has gone up, it remains critical to assess the prospects of each company we own from a bottom-up basis and consider valuation.

The Fund has about 14.5% exposure to Chinese assets, with just under 50% of this exposure concentrated in two assets, namely JD.com and Prosus (indirect exposure to Tencent).

JD.com is a business that should benefit from regulatory changes due to the ending of "pick one" tactics employed by competitors, which ultimately resulted in merchants having to choose only one eCommerce platform to sell on, which negatively impacted JD's assortment and overall customer value proposition. As merchants begin to sell on multiple eCommerce platforms, JD should benefit as their assortment improves, driving their expectation of adding more than 100m customers in 2021 from a starting base of 472m. JD are also well positioned due to their extensive *owned* fulfilment network, which spans more than 1 200 warehouses covering 23 million sqm of space, supported by 200 000 delivery personnel, allowing them to deliver 90% of their packages either on the same day or next day post a customer order. We estimate that the retail business is currently trading on a 12 PE multiple while still generating well below normal profit margins, making the valuation particularly compelling.

Prosus holds a 29% stake in Tencent, which currently represents 138% of its market capitalisation, which doesn't take into account the other non-Tencent assets, which in our view are underappreciated by the market and represent another 34% of Prosus's current market capitalisation based on our assessment of their value. Then, when you consider that Tencent has an investment portfolio of $210 billion that accounts for 38% of its current market capitalisation, coupled with a diversified business spanning games, social networks, fintech and cloud, which are all at different levels of maturity, we feel that notwithstanding the regulatory headwinds facing Tencent's business, they are still well placed to deliver both double-digit revenue and profit growth over the next few years. Our estimate of the look-through Tencent one-year forward PE multiple by owning the asset via Prosus is 9x, which we feel is extremely attractive.

During the quarter, the largest positive contributors were Magnit (+22%, 0.48% positive impact), Aspen (+69%, 0.44% positive impact), Alphabet (+16%, 0.41% positive impact) and Netflix (+21%, 0.32% positive impact). The biggest negative contributors were Tencent Music Entertainment (-50%, 1.09% negative impact), New Oriental Education (0.85% negative impact) and Naspers (-14%, 0.65% negative impact).

Tencent Music Entertainment's performance has been disappointing, and the business will be negatively impacted by regulations, most notably the ending of exclusive music licensing. It should, however, be noted that the vast majority of listening happens via nonexclusive titles. Furthermore, a user's listening experience is more than just access to music, but also how this music is curated and presented to users in a personalised manner, which drives user loyalty. The other segment of their business that is currently under pressure is their live streaming and online karaoke product that has experienced some operational mishaps, combined with increased competition, which is impacting growth. As the live streaming and online karaoke segment represents ~60% of revenue and more than 100% of the combined business profits currently, this will negatively impact the business's short-term revenue and profitability outlook. It is, however, our expectation that these headwinds will abate in time, with the overall business growth supported by continued paying music user growth, which only has ~11% paying ratio (vs Spotify's 45%), along with low monthly subscription revenue per user, at $1.4 per month (vs Spotify at ~$5). The business has ~27% of its current market capitalisation in net cash, and another ~19% in listed investments (2% ownership of Spotify, 2% ownership of UMG and a 1% ownership of Warner) and is trading on a 15% yield based on our 2023 expectation of FCF.

The Fund ended the quarter with 74.8% net equity exposure, roughly 4.5% lower than at the end of June 2021, as we reduced our risk appetite and sold down some US technology stocks, which have performed strongly.

Our negative view on global bonds remained unchanged as a large portion of developed market sovereign bonds offers negative yields to maturity. The follow-on effect is that most corporate bonds also offer yields that do not compensate for the risk undertaken. However, we continued to buy South African government bonds in the quarter, representing 4.25% of the Fund. Our view on the South African fiscal situation has improved somewhat, which, coupled with the fact that we are receiving a ~10% yield on these bonds, is attractive in our view. Furthermore, considering that inflation within South Africa remains controlled, the *real yields* of South African government bonds are the highest in the world.

The Fund also has circa 1.14% invested in global property. Lastly, the Fund has a physical gold position of 3.4%, a 1.52% holding in AngloGold Ashanti, and a 0.69% holding in Barrick Gold Corp. The gold price is down approximately 10% 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. AngloGold Ashanti is down 32% in USD year to date due to operational challenges, but management changes have been made, and thus there is a reasonable likelihood of operational improvements, which should lead to improved business performance and closing the gap between its share price performance and the underlying gold price movement. We have thus been adding to the position. 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.

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 and risk control measures like put options. Current index put option exposure is 8% effective and 32% nominal, as a percentage of Fund, which will shield the Fund somewhat should there be a significant drawdown in equity indices.

Notable buys/increases in position sizes during the quarter were Canadian Pacific Railway and Canadian National Railway, both of which are North American rail operators

The area where these two railway operators have networks is occupied by four players, creating a stable and rational market structure. These assets cannot be replicated, form an important part of the North American supply chain backbone, and have a measure of pricing power that has allowed them to price in excess of their cost inflation over time. Furthermore, over the past few years, the industry has gone through a period of increasing efficiency, which has made them more competitive with trucking driving market share gains for rail. The trucking industry is also facing a driver and truck shortage, leading to price increases, which provides support for rail pricing due to the substitutive nature of the two modes of transport.

Canadian Pacific has arguably the best management team in the North American rail industry and is merging with Kansas City Southern, the Mexican railroad. The combined railroad can offer more efficient single-line service instead of having to interchange, the reliability of which we believe will be highly valued by shippers. We expect Canadian Pacific to generate low double-digit free cash flow per share growth with an attractive starting valuation.

Canadian National Railway benefits from many of the trends mentioned above but has historically been under-managed versus its peers, resulting in inferior operating metrics and resultant shareholder returns. There is, however, an activist investor involved now who is pushing for a management change to address these operational deficiencies. So, while there is a turnaround element associated with this particular investment case, it appears reasonable to assume that change should take place due to shareholder pressure, with initial commitments in this regard already made, which should drive material margin improvements from a comparatively low starting base.

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. 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 to achieve the best risk-adjusted returns going forward.

Portfolio managers
Gavin Joubert and Marc Talpert
as at 30 September 2021