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

Performance

The Fund returned 8.1% for the fourth quarter of 2022 (Q4-22) which delivered a strong rebound after a soft third quarter. This takes the return for the year into positive territory (+3.9%). Since inception, the Fund has generated 10.6%, outperforming the benchmark by 1.2% p.a.

Almost a year after Russia's surprise invasion of Ukraine, an end to the war remains unclear. The effects of the war on an already challenging inflation problem were significant, and during the year, policymakers set about raising rates to combat the highest inflation seen in decades across developed markets. While inflation is now seen to have peaked in most developed economies, the risk of persistence above central bank targets remains high, both as the war in Ukraine continues to threaten energy and food prices and as the broader base of price pressors (which have emerged in many developed countries) are likely to take time to subside. December saw a moderation in the pace of rate hikes from major central banks, moving from 75 basis points (bps) increments to 50bps increments by the Federal Reserve Board (the Fed), the Bank of England and the European Central Bank. Yet, all of them signalled that the job is by no means complete. Central banks have reiterated their willingness to sacrifice growth by taking policy rates into restrictive territory to ensure inflation does not become entrenched. While global markets rallied in the quarter, with the MSCI All Country World Index (ACWI) delivering +9.8% in US dollars, returns for the year for the ACWI remained negative at -18.4%.

In South Africa (SA), the economy grew stronger than expected at 1.6% quarter on quarter (q/q) in the third quarter of 2022 following a contraction of 0.7% q/q in the second quarter of 2022. Structurally however, the SA economy continues to struggle to generate sustained, long-term growth. Ageing and underinvested infrastructure, as well as poorly run state-owned entities are significant growth constraints. High levels of unscheduled power outages rendered Eskom unable to increase planned maintenance sufficiently to reduce the high levels of loadshedding experienced during the second half of 2022. The resignations of Eskom's CEO and COO during Q4-22 add further uncertainty. The Phala Phala fiasco was a reminder of just how fragile the political situation is. The rand weakened on the back of this but recovered some of the losses on the more positive outcomes of December's ANC elective conference to end the year 6% weaker relative to the US dollar. President Cyril Ramaphosa's re-election alongside several of his allies should enable ongoing, albeit slow, reform.

Fund positioning

The SA market, as represented by the JSE All Share Index, delivered a strong +15.2% in Q4-22, bringing returns for the year to +3.6%. Within this, the resources (+16.1%) and industrials (+15.7%) sectors outperformed financials (+12.9%) for the quarter. Within financials, banks (+15.0%) continued to outperform the life sector (+4.3%). In the last three years, the extent of divergence between returns from the banking sector (+9.0% p.a.) and the life sector (-7.7% p.a.) is significant. Through this Covid impacted period, banks have fared better operationally than life companies, with bank earnings recovering strongly and expected to exceed their pre-Covid levels by 2022. The life sector has struggled with Covid-inflated mortality claims, weak equity markets, low growth, and competitive pricing in the risk space. The de-rating in life insurance valuations has been significant and the sector trades at single-digit earnings multiples and high single-digit dividend yields, albeit with limited growth prospects. We believe there is an opportunity to own the stronger franchises within the sector, such as Sanlam and Discovery, at very attractive valuations. Both stocks are represented in the Fund.

In contrast, the banks continued a strong operational earnings recovery. While costs and credit losses are normalising, good revenue growth (advances and rising rates) enabled the banks to deliver healthy profit growth. Given reasonable balance sheet strength, corporate and retail clients are expected to withstand rate hikes. Out of the big four banks, Absa has delivered the highest returns this year after delivering strong earnings growth off its pre-Covid base, driven by market share gains and good operating leverage. Whilst the share price has risen, multiples remain low in absolute terms and versus its peers. With board and management succession issues resolved, and the Barclays separation complete, we expect Absa to continue delivering against its long-term targets. Absa, FirstRand, Nedbank and Standard Bank are all well represented in the Fund.

With the fall in equity markets during the year, shares in asset management businesses came under pressure and under-performed the financial sector for the year. Falling markets impact the level of assets under management and consequently the revenues earned by asset managers, therefore near-term earnings prospects are impaired. The long-term picture is less vulnerable, however, provided the asset manager has a strong franchise value that is able to attract net inflows and grow assets under management over the long term. We believe Ninety One falls into this category and the recent sell-off in the shares offers an attractive opportunity to add to the Fund's holding. Ninety One has a strong brand, extensive distribution and a compelling long-term investment track record. The business is diversified, both in terms of product lines and geographically, and the management team is aligned with shareholders via their 28% shareholding in the business. Following the weakness in the share this year, Ninety One trades on just under 12 times forward PE and offers an 8% forward dividend yield. We used this opportunity to add to the Fund's holding.

Contributors to Fund performance relative to the benchmark for the quarter included underweight positions in Remgro and Old Mutual as well as an overweight position in OUTsurance. Detractors included underweight positions in Investec and Capitec Bank as well as overweights in Transaction Capital and RMI Holdings. During the quarter, we added to Fund holdings in Capitec Bank, St James's Place Plc, Absa, Nedbank and Ninety One. These were funded from Transaction Capital, RMI Holdings and FirstRand.

Outlook

Amid challenges often lie attractive opportunities. SA is facing significant challenges on many fronts, and these will affect all businesses operating in this country. Many franchises will decline, but there will also be winners who use the challenges to take market share and grow. We aim to continuously seek out such businesses and to acquire them for the Fund at valuations offering sufficient margin of safety relative to risks in the investment.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 31 December 2022