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

Performance

The Fund returned 5.2% for the quarter (Q1-23), benefiting from its meaningful exposure to equities (particularly global) built up during 2022. The Fund has performed well against its peer group over all meaningful time periods.

Fund positioning

The first quarter of 2023, in keeping with the last few years, was full of surprises. Global markets responded to fluctuating sentiment; rising strongly through January before pulling back and then regaining much of what they had lost in the final days of the quarter. The MSCI All Country World Index (ACWI) ended the quarter up 7%. The Fund has been active throughout this volatility. We started the year with a healthy exposure to global equities built up during market weakness in 2022. Early market strength in the first quarter provided an opportunity to trim this position before re-adding equity exposure on the back of market weakness in March.

Central banks continued to raise rates, bringing some high-profile casualties. Rapid rate rises triggered an asset-liability mismatch at Silicon Valley Bank (SVB), America's 16th largest bank, which resulted in its failure. Mark-to-market losses on longer-dated Treasuries were realised as investors withdrew deposits. Regulatory rescues in the US seem to have subsequently calmed markets, but not before the contagion wrought by the failure of SVB (and Signature Bank) contributed to the demise of Credit Suisse (CS), which has been wracked by scandals over the last few years. In an attempt to stem financial market panic, the Swiss government engineered CS's takeout by Swiss investment bank, UBS. Banking turmoil has increased the risk of recession, although the US consumer (and the economy) have remained resilient thus far.

The relaxation of Covid restrictions in China buoyed consumer demand, with strong sales reported by luxury goods companies and the like. While the risks of investing in China remain heightened, we continue to find outstanding businesses with solid growth prospects and healthy balance sheets. A business like JD.com is trading on an undemanding multiple yet is a strong beneficiary of recovering consumer confidence.

Rebounding Chinese demand was insufficient to support oil prices (Brent -7% in Q1-23), which languished on the back of a mild Northern hemisphere winter. A surprise cut by Opec announced in early April has lifted oil closer to its January levels (Brent $85).

After a volatile quarter, global bond yields ended slightly lower, with the index +3% for the quarter (Bloomberg Barclays Global Aggregate Bond Index [BBGAB]), but still -8% over 12 months. Bond yields are closer to normal levels, but still offer inadequate compensation for heavily indebted sovereign balance sheets. The Fund has no exposure to developed market sovereign bonds. This is consistent with its positioning for many years. Unlike the narrow credit spreads in South Africa (SA), global credit bonds offer more attractive pricing. We have built up a basket of credit names trading on high single-digit hard currency yields.

The SA economy continues to struggle, hampered by heightened levels of loadshedding and failing infrastructure. These factors, combined with falling prices of key metals (coal and PGMs), will weigh on export revenues in 2023. Fiscal sustainability is further undermined by the recent high public sector wage settlement. Whilst high real yields support a position in SA government bonds, the Fund is underweight given the better risk-adjusted returns offered by growth assets (both global and local equities). The FTSE/JSE All Bond Index delivered a return of +3% for the quarter. A 50 basis points (bps) rate hike in the last few days of the quarter surprised the market as domestic inflationary pressures are not demand driven.

The FTSE/JSE Capped Shareholder Weighted Index (SWIX) returned 2% for the quarter. The pricing of SA equities remains attractive with broad value across resources, global stocks listed on the JSE, and domestics.

The Financials Index (ex-property) was flat for the quarter. The banks (Absa Group, FirstRand, Nedbank, Standard Bank) reported another set of strong earnings. Despite the headwinds facing the domestic economy, banks remain surprisingly constructive on their outlook. Credit losses are expected to remain within range and investment in self-generation projects should drive strong corporate advances growth. The Fund has a reasonable holding in the banks given their attractive dividend yields and ability to sustain and grow earnings. No contagion from global events is expected for the local banking sector.

We remain concerned about the earnings outlook for life insurers. Their mass businesses compete against cost-effective bank distribution, while the underwritten life franchises face stiff competition for market share as insurers try to find enough volume to feed their fixed cost bases in a market that is not growing. The Fund does not own the life insurers, preferring positions in the banks and other financials. Transaction Capital disappointed with the announcement that ongoing economic headwinds had forced a significant restructuring in SA Taxi. Whilst we attributed limited value to SA Taxi even prior to this announcement, the market reacted brutally; writing down not just SA Taxi but also taking a significant haircut to the overall value of the company. We believe that WeBuyCars and Nutun are worth significantly more than the current Transaction Capital share price and justify a holding in the company. The ongoing support of funders will be critical in achieving our assessment of fair value.

The resource sector was down -5% for the quarter. China's reopening was insufficient to meaningfully lift demand. Prices were generally weaker with the energy basket coming off the invasion highs of a year ago. Despite meaningfully cutting exposure to diversified miners in 2022, the Fund has retained a holding in Glencore and Anglo American. Both offer attractive free cash flow streams, even at more normal commodity prices. We expect energy markets to be tight over the medium term as demand remains robust during the transition to lower carbon energy sources and the lack of investment in new capacity over the last few years constrains supply. We have diversified our energy holdings across a basket of names to reduce company-specific risk. Resource holdings are the lowest in many years given the underweight positions in both PGMs and gold.

The Industrials Index performance (+14%) was buoyed by strong performances from many of the global stocks listed in SA. Aspen, Richemont, Bidcorp, Anheuser-Busch InBev and Naspers/Prosus are all meaningful holdings that contributed to performance. For various stock-specific reasons, we believe these businesses will continue to grow earnings and we have retained our holdings. Domestic stocks offer good stock picking opportunities but avoiding value traps is critical. We favour businesses with strong business models that can grow and pass on inflationary pressures to customers. ADvTECH is one such business where careful cost management is enabling management to contain fee increases at inflationary levels, and as a consequence grow enrolments strongly.

The portfolio has limited property exposure, preferring to use its risk budget in equities. The property sector has lagged equities (5-year -4% CAGR). A weak economy and loadshedding undermine the medium-term outlook.

Outlook

While headwinds exist in both global and domestic markets, we believe growth assets (enhanced by good stock picking) should deliver good returns over the medium term. A diversified portfolio of global equity (and some global credit) should provide attractive risk-return benefits, supplementing a basket of cheaply priced local equities.

Portfolio managers
Karl Leinberger and Sarah-Jane Alexander
as at 31 March 2023