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

Fund positioning

The quarter was one marked by the extreme volatility that we have, more recently, come to expect from the capital markets. After a very strong start to the year, the markets gave up almost all their gains as an American-specific banking crisis roiled global markets. Initially just the failure of two mid-size US banks, the crisis ended with the hurried sale of Credit Suisse and the forced writedown of its high-yielding additional tier one (AT1) debt. This impacted negatively on equity and debt markets, but cool heads and immediate responses from central banks appear to have prevented further panic. The banking system was never at risk as this was not a credit crisis, but a liquidity crisis exacerbated by the speed of communication and panic. As such, we viewed the extreme March sell-off as a buying opportunity for several asset classes.

With the very strong start to the year, we had taken the opportunity to lighten our overall equity position, mainly by selling down SA equity and moving part of this into global equity and part into cash and bonds. Domestic listed equity remains compellingly cheap, but we thought it prudent to reduce the size of the overweight which, with hindsight, positioned us better for the market volatility to come. In our domestic equity allocation, we remain overweight resources and global equities that are listed in SA, and underweight pure domestic businesses. Having said that, we are overweight SA banks, and have further added to these positions as they sold off in sympathy with the mid-size US bank crisis. The local banks all reported results in the last month, and they have all without fail delivered very strong growth in earnings on well capitalised bases, resulting in strong pay-outs to shareholders. It is absurd to see such strong banks, trading on already low multiples, sell off in the face of a US liquidity-driven banking crisis which has no implications for SA.

The key factor that has been mentioned in all the recent results and trading updates for domestic businesses has been the negative impact that load shedding is having on their operations. What was manageable under stage 2 or 3, has had a nonlinear impact on companies as it hits stage 5 and 6. The inability to provide a stable and consistent power supply is eroding the industrial base in SA and resulting in loadshedding translating into job shedding. Without a genuine and meaningful improvement in the basic electricity infrastructure, the country will remain mired in low to no growth, with negative outcomes for a variety of asset classes. The good news is that Government's lifting of the private power provision cap, from 1MW to 100MW to unlimited, has enabled the private sector (once Government got out of the way) to start projects for self-provision. Even without the network access to wheel this power to other users, this will be a significant benefit to the overall grid as somewhere in excess of 10GW is planned to come online. Considering the current deficit is in the order of 6GW, this will deal with the medium-term issues and alleviate loadshedding in 18 to 24 months' time. It also provides a superb lending opportunity for the banking sector, with borrowing requirements in the order of R300 billion being required to fund this development. In the short term, we remain wary of companies that are heavily impacted by loadshedding and its attendant costs. Those without strong pricing power are particularly at risk.

Global markets, which were already looking more attractively valued at the beginning of the year, took another hit on the back of the US banking crisis. As we outlined earlier, we don't think this is a crisis of anything like the magnitude of 2008 and, as a result, we see this primarily as an opportunity to add exposure to good quality businesses. What the US crisis is likely to result in, is an earlier end to the rate hiking cycle. While central banks have stood firm so far, it will undoubtedly influence the rate setting policy in the US Federal Reserve Board (the Fed). The crisis also results in a tightening of financial conditions in the US, doing part of the job of the Fed. As markets start to anticipate the end of the rate hiking cycle, we believe we will start to see equity markets re-rate.

One of the compelling opportunities in the offshore markets has been credit. While credit spreads in SA have remained very tight and generally unattractive, global spreads for particular names have been attractive. A further opportunity arose when, on the forced merger of Credit Suisse with UBS, its risky AT1 debt was written down to zero. As long-time investors in banks and bank paper, we are well aware of the risks inherent in these type of instruments, and how different wording can result in very different outcomes. The major dislocation in bond markets due to this writedown also presented us with the chance to buy good quality credits higher up the risk curve at very attractive, equity-like returns. Global sovereign debt is still unattractive, and the majority of our sovereign debt exposure is to the SA Government, where bond yields in excess of 11% compensate investors for risk with very high real yields.

While we have had fairly limited property exposure in the portfolio, one of our biggest property holdings, Attacq, benefited from the announcement of a major transaction whereby a third party would invest in their main asset at very attractive levels. This saw the share price perform strongly and vindicate our view that they have exposure to possibly the most attractive precinct in SA – the Waterfall area in Midrand.

Fund performance and outlook

The Fund has an objective for delivering long-term returns ahead of benchmark and ahead of inflation. The last three years, which are the three that started with the beginning of the Covid lockdowns, have been exceptionally strong, with the Fund delivering an annual return of 19.4% over this period despite the tumultuous conditions local and global economies have faced. While one can never forecast the exact nature of future returns, these are mostly determined by your starting point. At the moment, we think the forward-looking returns for the asset classes within the Fund are exceptional and position the portfolio well to deliver on its mandate.

Portfolio managers
Neville Chester, Nicholas Stein, and Nicholas Hops
as at 31 March 2023