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

Performance

The Fund returned 18.4% for the quarter, ahead of the benchmark return of 17.8%. Since inception, the Fund generated an annualised return of 11.0%, some 1% ahead of the benchmark.

Economic backdrop

Global equity markets built on the momentum established in the first quarter by delivering positive returns, with the MSCI ACWI returning 3% and taking the year-to-date return to 11%. However, the performance was mixed between markets, with the S&P 500 (+4%) and FTSE 100 (+4%) outperforming the Dow Jones Euro Stoxx 50 (-3%) and Nikkei 225 (-8%). Optimism for a soft landing in the US continues to drive markets. Developed market central banks met in June, with the European Central Bank (ECB) administering the first rate cut in the current cycle, while the other central banks (BoE, US Fed) opted to keep policy rates on hold as headline inflation readings remain stubbornly above target range despite food prices continuing to moderate.

After lagging in the first quarter, emerging markets fared better than developed markets in the second quarter, with the MSCI Emerging Markets Index delivering 5%. Within that grouping, SA was strong, with the MSCI South Africa Index delivering a 13% US dollar return (10% in ZAR). On 29 May, South Africans went to the polls to elect a new National Assembly and Provincial legislature. For the first time, the ANC failed to achieve a majority and elected to form a Government of National Unity (GNU), which included the largest opposition party, the Democratic Alliance (DA), as well as the Inkatha Freedom Party (IFP), GOOD and the Patriotic Alliance (PA). Combined, these political parties control 273 seats, accounting for 68% of the seats in the National Assembly. This outcome was well received by the markets, and domestic assets rallied, while the rand strengthened. Going forward, a lot of work still needs to be done by the GNU to deliver positive outcomes for the country and the ailing economy. Given the inherent instability around national unity governments and coalitions in general, the road ahead will likely be rocky, and it remains to be seen whether the GNU results in decision-making paralysis or whether the parties involved are able to work together constructively for the benefit of the country.

Fund positioning and portfolio actions

Within the SA market, financials (+18%) rallied the strongest in the quarter, followed by industrials (+5%) and resources (+4%). Within financials, banks (+20%) outperformed both the life insurance (+18%) and short-term insurance (+11%) sectors. Contributors to Fund performance relative to the benchmark included underweight positions in Reinet, Old Mutual, Remgro and Absa, as well as an overweight in WeBuyCars (WBC). Detractors for the quarter included underweights in Capitec and JSE Ltd as well as overweight holdings in Santam, OUTsurance and Discovery Holdings.

During the quarter, we added to holdings in Standard Bank, FirstRand, Sanlam, Discovery and OUTsurance and these were funded from reductions in holdings of Ninety One, Nedbank, Absa and Reinet. In the March quarterly commentary, we covered in more detail the attractiveness of Standard Bank and FirstRand – both with very strong franchises delivering strong operational results but not fully reflected in their valuations. Discovery Holdings has strong positions in the health administration market in SA, an area under potential threat if National Health Insurance (NHI) is implemented in a way that does not leave room for private medical schemes like Discovery Health to meaningfully participate. NHI, as currently envisaged, is unaffordable and likely to take significant time to implement as envisaged in its current form. We believe that at the current valuation, the Discovery share price discounts a lot of these concerns and offers an attractive investment opportunity.

During the quarter, WBC was unbundled from Transaction Capital (TCP) and separately listed on the JSE. As part of the process, the Fund participated in a market placement by TCP and in addition received shares from the unbundling. WBC, founded in 2001, was built on the premise that the best used vehicle stock is in the hands of private individuals and, therefore, built a business focused on meaningfully improving the experience for private sellers. The company has since expanded its footprint to include 15 vehicle supermarkets, 74 buying pods and more than 340 buyers across the country, as well as establishing a strong, trusted brand. This has enabled them to move from selling fewer than 1 400 vehicles per month in 2017 to over 13 000 per month by the start of 2024. The table below shows that sales and profit have followed suit, compounding at 43% and 40% p.a. respectively.

ATTRACTIVE GROWTH OVER TIME

	2017	2018	2019	2020	2021	2022	2023	*CAGR
Vehicles sold	16 587	29 145	58 343	59 177	88 271	125 812	141 851	43%
Revenue (Rm)	1 580	2 922	5 940	6 479	10 723	17 875	19 965	53%
Profit (Rm)	86	138	311	302	541	762	660	40%

Source: Company financial reports
*Compound annual growth rate

The business enjoys some important moats:

- A national footprint, which brings them closer to customers and facilitates quick response times.
- A rich proprietary database of used vehicle prices, constantly enriched with new data points to refine their algorithms, enabling them to achieve more accurate vehicle pricing in the market.
- Scale and low-cost operations. Using large warehouses located in industrial areas enables WBC to display between 500 and 1 500 vehicles at very low unit costs, much lower than competing dealerships.
- A strong brand which is trusted by consumers.

What does growth for WBC look like going forward? There are between 500k and 550k *new* vehicle sales and between 1.2m and 1.4m *used* vehicle sales each year into a 12.9m car park in SA. In addition to growing share within the used vehicle market, WBC is increasing the pace and ease of selling vehicles which drives the frequency at which vehicles are traded, all adding to the opportunity at hand. WBC margins are also enhanced when they add finance and insurance to the vehicles they sell. The penetration rate of these products is currently at 20%, with scope to go higher. We believe the ability for WBC to continue growing strongly, even in a stagnant economy, is underappreciated in the current share price.

Outlook

The elections in SA have come and gone, and it is now time for the GNU to knuckle down and get to the business of resolving the structural challenges that beset the local economy. There are challenges in important areas such as power, ports, railways, logistics and water. These will no doubt take time to address. The stability of the GNU will also be tested in the process. For this reason, we remain on the look-out for high-quality businesses, like WBC, which can deliver in what is likely to remain a low-growth economy.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 30 June 2024