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

Performance

The Fund returned 5.9% for the third quarter of 2024 (Q3), bringing 12-month returns to 19.8%. The Fund has benefited from its high allocation to equities (both global and local) that have delivered strong returns over the past 12 months. The Fund has performed well over meaningful periods, both in absolute terms and relative to the peer group.

Fund positioning

Q3 marked another strong quarter for global markets, with the MSCI All Country World Index returning 7% for the quarter (USD), bringing year-to-date (YTD) returns to 19%. Global economic growth remained robust, notwithstanding some signs of consumer stress. Global inflation continued to ease, supporting rate cuts across many markets. The US Federal Reserve surprised the market with a 50 basis points (bps) cut in September (ahead of market expectations of 25bps).

Market returns for the quarter were broader than the recent experience, with strength across the US market as well as in many of the regional markets which had previously lagged. Emerging markets rose strongly, with the MSCI Emerging Markets Index up 9% for the quarter in USD (+17% YTD), buoyed by a resurgent Chinese market. We continue to believe that there are rich stock-picking opportunities in global markets. Portfolio holdings are diversified, both geographically and by sector. The basket includes compounders, long duration stocks as well as value stocks. Given the attractive upside to fair value, we have retained a large allocation to offshore equity.

China finally pulled the trigger on stimulus, announcing a raft of measures in September. The Chinese market rallied strongly, with the MSCI China up 21% for the quarter. Despite meaningful moves in share prices, the largely consumer-facing businesses held in the portfolio continue to trade at undemanding valuations given their earnings quality and strong underlying growth delivery. Increasingly shareholder-friendly allocation of capital should compound returns for shareholders.

Geopolitical tensions intensified as Israel broadened its field of military operations with targeted operations across Syria and Lebanon. These actions raise the risk of further regional escalation. The oil price firmed in response. This was only days after hitting a 12-month low (oil traded below $70/barrel in September) on the back of Saudi Arabia's announcement that it was preparing to abandon its $100 oil target price and increase production by year end. Gold and oil are trading above our assessment of their long-term fair value, with prices artificially inflated given geopolitical uncertainty. The Fund has little exposure to either.

The Bloomberg Barclays Global Aggregate Bond Index (USD) returned 7% for the quarter in USD (4% YTD), buoyed by the prospects of falling inflation and further rate cuts. The Fund continues to have no exposure to developed market sovereign bonds, given our view that yields offer insufficient compensation for heavily indebted sovereign balance sheets. However, the Fund has a sizeable holding in offshore credit bonds. These bonds trade on attractive, high single-digit US dollar yields while offering diversified exposure across multiple geographies and sectors. This presents a compelling alternative to the risks inherent in South African (SA) government bonds and the narrower credit spreads in our domestic credit market. Given the compelling opportunities in global equity and global fixed income, we continue to make full use of the Fund's offshore capacity.

It was a very positive quarter for SA assets. Sentiment has improved dramatically, with the GNU performing well. It appears to be committed to driving reform and finding solutions in a consultative way at the national level. The prospects for increased infrastructure investment and private-public partnership are good. At the time of writing, SA has been free of loadshedding for the more than 190 days. The consumer is experiencing relief in the form of fewer power outages, lower fuel prices, falling food inflation and a stronger rand. September saw the first 25bps rate cut and the outlook is for more to follow. The much-improved consumer outlook should drive credit extension, with the first signs of growing bank appetite already evident. Regulatory changes will enable consumers to access savings previously unavailable (without resignation) via the "two-pot" retirement system. These factors are driving improved confidence and a more favourable near-term outlook for the domestic economy. South African domestic assets rallied in response. The FTSE/JSE Capped Shareholder Weighted Index (CSWIX) returned 10% for the quarter (16% YTD) while the FTSE/JSE All Bond Index returned 11% for the quarter (17% YTD). The currency strengthened 5% against the USD during the quarter (+6% YTD). The likelihood of a stronger rand has increased, given encouraging developments from the GNU and a constructive environment for emerging market assets (lower US interest rates, China stimulus). We bought additional ZAR currency exposure during the quarter.

Despite the optimism, SA faces many headwinds. The country's assets and infrastructure remain profoundly damaged by a decade of mismanagement. Decades of underinvestment in infrastructure cannot be fixed overnight. Municipal service delivery and water (quality and availability) are deeply worrying. The long-term fiscal outlook also remains concerning. The starting level of sovereign debt is high. Despite the GNU's commitment to fiscal discipline, we see constrained growth in government revenues and an inability to meaningfully contain expenditure driving a rising debt-to-GDP ratio. Notwithstanding a better near-term outlook, GDP growth remains insufficient to correct this over the medium term. Given these headwinds, the Fund is underweight government bonds.

The Fund's preferred domestic asset remains SA equities which have delivered pleasing returns over the past year (CSWIX +25% over one year). Holdings include global stocks listed on the JSE and selected resources and domestic stocks. Performance at a sector level reflects the strong performance of domestic shares, with the heavily domestic Financials Index up 14% for the quarter (24% YTD) and the Industrial Index up 12% for the quarter (18% YTD). The Resources Index lagged, declining 1% for the quarter (flat YTD).

Amongst the domestic shares, the Q3 results season saw an even wider gap between winning and losing businesses. The weak economy resulted in a larger number of domestic counters reporting results below market expectations. In this environment, stock picking remained critical. The winning businesses held in the portfolio prospered despite the tough domestic economy. Examples include ADvTECH, Capitec and OUTsurance all of which have reported exceptional results since our previous commentary. ADvTECH enrolments are rising, driven by the high-quality education they offer at a competitive price. Capitec, with its strong consumer value proposition, is continuing to deliver share gains in retail banking, insurance and more recently business banking. The benefits of scale are evident in the rising profitability of its retail transactional franchise. Ongoing investment in lowering fees across the business and retail bank should deliver further share gains. OUTsurance also has a strong emphasis on providing good value to consumers through disciplined, scientific underwriting, combined with a strong focus on cost efficiency. This has enabled OUTsurance to build sizeable and profitable businesses across SA and Australia. We expect OUTsurance to continue gaining share across these markets.

The Fund holds an underweight position in the resources sector, given reasonably full valuations. China's shift to less infrastructure-heavy growth remains a headwind to demand, contributing to a weaker outlook for many commodities. The Fund's underweight position in gold shares has weighed on performance over the year given the spike in the gold price. At these levels, we believe gold equities are overvalued and offer poor medium-term return prospects.

The Fund's position in property has delivered strongly, with the sector +19% over the quarter and +30% YTD. The sector has benefited from its heavy domestic exposure and the prospects of lower financing charges. A key portfolio holding like Attacq has shown good underlying delivery and has a positive outlook, boosted by its flagship Waterfall Estate property.

Outlook

The Fund continues to have a meaningful allocation offshore. We believe the attractive prospects of this diversified basket of global equities and credit continue to merit the holding. These offshore holdings are supplemented by domestic assets, predominantly SA equities. Domestic assets have rerated in expectation of a better outlook. We are cautiously optimistic that better days lie ahead. However, given SA's structural challenges, we continue to believe that the large offshore allocation will play an important role in achieving diversification and delivering compelling risk-adjusted long-term returns.

Portfolio managers
Karl Leinberger and Sarah-Jane Alexander
as at 30 September 2024