Kagiso Global Equity Fund
Quarterly commentary
March 2020

KAGISO Asset Management

The Global Equity Fund was down 34.8% for the quarter underperforming its benchmark, FTSE World Index, which was down 21.5% in US dollar terms. Over one year the fund was down 26.9%, underperforming the benchmark (-10.6%).

Material unforeseen shocks have dramatically changed the economic outlook

1. The 2019 Covid-19 outbreak began negatively affecting Chinese economic activity early in the year.
2. Covid-19 spread worldwide and was declared a global pandemic, with unprecedented negative economic repercussions resulting from the necessary containment measures.
3. The oil price crashed in March due to aggressive supply increases by Saudi Arabia - a very large, low-cost producer, targeted at higher cost competitors. The crash was particularly severe as demand is extremely weak due to the dramatic decrease in global travel resulting from Covid-19 lockdowns.

There is extreme uncertainty around how these economic shocks will evolve, which is forcing the contemplation of a wide range of probable scenarios, ie visibility is very poor. This is vastly different to (and more negative than) the envisioned outlook prior to these shocks.

Market review

Global markets were materially weaker this quarter (down 20.9% in US dollars) with the UK (down 28.8%), Germany (down 26.6%) and France (down 27.8%) underperforming. Within emerging markets (down 23.6% in dollar terms), South Africa (down 40.3%), Brazil (down 51%) and Russia (down 36.3%) underperformed.

Developed country governments have responded to the health care crisis and the resultant pausing of large parts of their economies with very aggressive fiscal stimulus packages. These recent measures, together with a dramatic easing of already extremely accommodative monetary policy (through rate cuts and increased quantitative easing) will most likely temper the permanent economic damage from the crisis. The interventions are also providing a powerful buffer to financial markets for the time being.

The fund has underperformed in the short term

The Global Equity Fund has underperformed the FTSE World Index over the first quarter of 2020 due to our positioning in more cyclically focused companies. Our significant exposure to the Financials and Materials sectors were the largest detractors to performance in the quarter.

Given the material change in prospects for most economic participants across the world, envisaged cashflows from many of our holdings will not emerge as previously expected. These shocks were clearly unforeseen and we could not have been positioned optimally in advance. What we can do is assess the new environment as best as possible and adapt the portfolios appropriately, in line with our investment philosophy.

It is of paramount importance to keep in mind that the month of March has seen extremely high levels of market volatility and apparent performance appears materially different from day to day. In the face of such uncertainty on so many levels and with heightened volatility, it is not useful to consider performance in the short term.

The main detractors from performance were M&G Plc, Aroundtown, Citigroup, Spire Healthcare and Goodyear Tire & Rubber Company. The key positive contributor was JD.com.

Portfolio actions and positioning

Immediate actions

At the outset of the current market turmoil, our initial focus was to systematically assess (across stocks in the fund) the financial strength and balance sheet resilience of each business and the likely near-term cashflow impacts of the economic shocks. We aimed to identify companies that were particularly vulnerable to the Covid-19 containment measures so that we could reduce exposure if prices were not reflecting our concerns.

We took the following actions in portfolios:

- Exposures were lightened in more vulnerable holdings.
- We realised a small cash balance by trimming some outperformers in the fund

Our actions raised a small cash exposure in the fund and it is our view is that there will be opportunities to deploy this cash in the weeks ahead as the shocks take their toll on company results.

Subsequent actions

Our team has been systematically focused on assessing stocks in the portfolio across a range of possible scenarios – vastly different from previous base cases. Team debates and research efforts have been focused on understanding how the business environment has changed, with many likely casualties and consequent attractive opportunities for survivors, even in a weak economy.

Current positioning

Our fund is mainly positioned in companies listed in developed markets, with exposure to a broad range of diversified sectors. Some examples of the global structural themes underpinning some of our holdings include an ageing population (hospitals, financial services), online disruption (e-commerce, payments, logistics), tomorrow’s workforce (automation and robotics) and future mobility (energy storage, components and consumables).

We have maintained our positioning in more cyclically focused companies as we believe that share price levels are currently excessively low and provide very attractive forward-looking returns even if these companies' prospects are lower due to the unforeseen shocks mentioned above. As in previous recessions and business cycles, there will be casualties and not all companies will survive. We have rigorously stress-tested the balance sheets and cash flow assumptions for all the holdings across our portfolio to satisfy ourselves that the companies in our portfolio are likely to endure in a range of economic outcomes.