Kagiso Global Equity Fund
Quarterly commentary
September 2021

KAGISO
Asset Management

The fund was down 4.9% this quarter, underperforming its benchmark of FTSE World Index (down -0.4%). The fund outperformed its benchmark over the past year, returning 36.3% (versus the benchmark 29.3%).

Economic backdrop

Rapid rollouts of effective vaccines have been substantially completed in most developed markets and normal activity is resuming in those regions, limiting further scarring in services sectors (particularly tourism and leisure). Unfortunately, lingering vaccine hesitancy and slow vaccine rollout programs among less wealthy nations is delaying economic recovery. It appears that the virus will remain endemic in years to come, albeit with significantly reduced danger to society.

In the near-term, it seems that many developed economies are growing at above trend levels post their pandemic recoveries. This stronger demand backdrop together with the disruptive effects of past lockdowns is resulting in severe temporary logistical challenges and supply shortages in certain electronic components, energy sources, commodities and labour markets. Enduring economic trends may be visible only when fiscal support and monetary stimulus tapers off more meaningfully and when supply chains are functioning more normally.

Following a rapid resumption of economic activity back to pre-crisis levels, the Chinese economy has slowed somewhat due to energy shortages, supply constraints and isolated hard lockdowns. Chinese government interventions in many areas of its economy, which are aligned with its longer-term planning, are proving very disruptive. It is targeting more inclusive and less financially risky growth, carbon emission reduction and technological independence.

The South African economy has continued to recover slowly and in an uneven fashion, with high commodity prices (particularly platinum group metals, iron ore and coal) significantly supporting economic growth. High soft commodity prices, a favourable exchange rate and good weather are substantially buoying the agricultural sector. South Africa is lagging the global recovery considerably, showing signs of permanent economic scarring from lockdowns and years of state mismanagement. We have very high unemployment, a large unskilled population, unstable electricity supply, underinvestment in key transport infrastructure, weakened and revenue-hungry municipalities and chronically low business and investment confidence. For these reasons, and the very large government debt burden, we remain pessimistic regarding the structural growth rate for the local economy.

While economic revival plans are well articulated, they still rely too heavily on implementation from weakened state institutions, do not draw sufficiently on private sector co-operation and are still hampered by political unwillingness to take unpopular but necessary actions. The failure to hold the line with regards to critical government sector wage negotiations recently is a prime example. Recent actions to liberalise private sector electricity production are a modest step in the right direction. In addition, actions to rebuild crime fighting and tax collection capabilities are now bearing fruit with progress evident on both fronts.

The medium-term outlook for emerging economies is extremely varied at present, with differing exposures to volatile energy prices (importers versus exporters), strong commodity prices, the decimated tourism industry and differing impacts from the management of the pandemic and efficacy of vaccine rollouts. Due to recovering domestic demand and some signs of increased inflation, policy interest rates have started normalising higher from the extraordinarily low crisis levels.

Market review

Global markets were flat in the quarter (up 0.1% in US dollars), with Hong Kong and Germany underperforming (down 14.1% and 4.0% respectively) while the USA (up 0.6%) and Japan (up 2.7%) outperformed. Emerging markets were weak in the quarter (down 8.0%), with particularly poor performances from China (down 18.1%) and Brazil (down 19.5%).

Extremely high developed market fiscal and monetary stimulus, which are being sustained (and in the case of the USA, increased) into the recovery phase, are providing a powerful support for financial markets and have led to dramatic increases in general asset prices. We expect increased volatility when fiscal stimulus inevitably wanes, if inflation emerges at last and when interest rates rise from their extremely low levels.

Fund performance and positioning

The fund's underperformance relative to the benchmark over the third quarter of 2021 was due to weaker performances from some of our Industrial, Health Care and Materials holdings. Our Communication Services and Consumer Discretionary sectors contributed to positive absolute and relative performance in the quarter.

We benefited from a rebound in share price from Prudential during the quarter and saw a positive contribution from Inpex due to higher oil and gas prices. Other notable positive contributors in the quarter were Nutrien, Siemens, Bodycote and Boston Scientific. Disappointing share price performances from Nisshinbo, Bayer, Dupont and Siemens Energy were the main detractors in the quarter.

The fund has maintained underweight positions in the Communication Services, Consumer Discretionary, Consumer Staples, Information Technology and Utilities. The sectors where the fund continues to have overweight exposure are the Energy (Kinder Morgan and Inpex), Financials (Prudential, M&G, US bank exposure, Just Group), Materials (DuPont, Evonik and Johnson Matthey), Industrial (SKF, Bodycote, Siemens, Timken, Siemens Energy) and Real Estate (Aroundtown, Unibail-Rodamco-Westfield, Grand City) sectors.

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, pharmaceuticals, financial services), tomorrow's workforce (automation and robotics), future mobility (energy storage, components and consumables), food security (crop protection, fertilisers, seeds and aquaculture) and green energy transition (wind and hydrogen power).

We have maintained our positioning in high quality cyclical companies as we believe that share price levels are still low relative to their long-term prospects and they should provide very attractive forward-looking returns.

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