Quarterly commentary

Kagiso Global Equity Feeder Fund

December 2020

The fund was up 9.5% this quarter, meaningfully outperforming other Global general equity funds (up 1.3% on average) and is up 6.0% over 1 year (underperforming the 20.3% competitor average). This followed a very sharp fall in the first quarter amid the market crash as the unexpected COVID-19 crisis stalled economic activity across the world.

Economic backdrop

A severe COVID-19 resurgence has necessitated renewed partial lockdowns across the world, which is delaying economic recovery. The successful development of vaccines has shielded the world from more negative global health and economic scenarios, but the timing of the economic recovery in different regions and the extent of further scarring (particularly in services sectors like leisure and tourism) depends critically on the effectiveness of the vaccine rollout. In addition, the immense increase in global government debt due to aggressive fiscal stimulus will retard future, long-term growth. On the whole, uncertainty remains very high.

Positively, the global economy entered the crisis in a strong position, with healthy consumer dynamics in most developed markets and a moderating, but still strongly growing, Chinese economy. Developed market consumer and corporate health appears to have been largely preserved through extensive fiscal and monetary support. Consumer indications (discretionary retail sales, vehicle purchases and housing activity) have fared better than initially expected and increased cumulative savings (from less spend under lockdowns) bodes well for future consumption under more normal conditions. Nevertheless, economic conditions will be put to the test only when fiscal support and monetary stimulus tapers off and the reality of permanent job losses manifests.

Following a rapid resumption of economic activity back to pre-crisis levels, the Chinese economy is now growing strongly. This is largely due to the successful early containment of the pandemic, government stimulus (which boosted infrastructure investment in particular) and surprisingly strong exports and manufacturing (buoyed by temporary COVID-19 related goods demand) - despite weak consumer confidence and spending. However, pre-crisis risks remain: a disruptive moderation and rebalancing of economic growth (away from fixed asset investments and towards consumption) and potential further deterioration in geopolitical relations.

The local economy is being negatively impacted by the strong resurgence of COVID-19 and will require an effective vaccine rollout to resume its recovery. The economy shows signs of permanent damage (scarring) from years of mismanagement (particularly, a very depressed labour market, unstable electricity supply and chronically low business confidence and investment) and the combined restrictions of the lockdowns. While economic revival plans are well articulated, they still rely too heavily on policy implementation from weakened state institutions and do not draw sufficiently from private sector cooperation. Economic prospects, under more normal medium-term conditions (household consumption in particular), have weakened substantially from before the crisis. It is clear that our post-crisis economic recovery will take meaningfully longer than the rest of the world due to the inherent structural weaknesses of the South African economy, with increased risk due to unsustainably high sovereign debt.

Positively, high commodity prices (in particular platinum group metals and iron ore) are significantly supporting economic outcomes and the agricultural sector is having a few good seasons.

The medium-term outlook for emerging economies is extremely varied at present, with differing exposures to volatile energy prices (importers vs exporters), the decimated tourism industry and differing impacts from the management of the pandemic and efficacy of vaccine rollouts.

Market review

Global markets were strong again this quarter (up 14.1% in US dollars), with Japan up 21.2%, France up 20.7% and the UK up 17.2%. Within emerging markets (up 19.8% in dollar terms), South Korea (up 35.0%) and Brazil (up 36.6%) outperformed. 2020 has been a very strong year for global equity markets (up 16.5% overall).

Governments in developed countries responded to the health care crisis and the resultant pausing of large parts of their economies with aggressive fiscal stimulus packages. Together with a dramatic easing of monetary policy (rate cuts, increased quantitative easing and other unconventional measures), this has tempered economic scarring from the COVID-19 crisis. The interventions, which are being sustained into the recovery phase, are providing a powerful buffer 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 underlying fund’s significant outperformance of the FTSE World Index over the fourth quarter of 2020 was due to the strong performance of some of our Industrials, Materials, Real Estate and Financial holdings.

We saw positive contributions from some of our quality industrial companies in this quarter, led by Bodycote, Timken, SKF and Siemens Energy. Our financial holdings (Prudential, M&G and the US banks) also had a strong quarter, while Dupont and Evonik were positive contributors in the Materials sector. Aroundown and Unibail-Rodamco-Westfield led the gains in our Property holdings. Only Bayer and Sarana Menara negatively impacted performance in the quarter.

The fund maintained significant underweight positions in the Communication Services, Information Technology, Health Care and Utilities sectors in the past 3 months. The sectors where the fund had overweight exposure are in the Energy (Kinder Morgan and Inpex), Financials (Prudential, M&G, US bank exposure, Just Group), Materials (DuPont, Covestro, Evonik, Corteva and Johnson Matthey), Industrial (SKF, Bodycote, Siemens, Timken) and Real Estate (Aroundtown, Unibail-Rodamco-Westfield, Grand City) sectors.

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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), Food security (fertilisers, farm efficiency, alternative feed sources) and future mobility (energy storage, components and consumables).

Despite the strong bounce-back in several of our holdings during the quarter, 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.