Kagiso Islamic Global Equity Fund
Quarterly commentary
June 2021

KAGISO Asset Management

The fund was up 2.2% this quarter, underperforming its benchmark of FTSE World Index (up 7.7%). The fund underperformed its benchmark over the past year, returning 36.8% (versus the benchmark 40.2%).

With the unexpected pandemic market shock now more than a year behind us and materially changed economic prospects for the companies and economies in which we invest, we are pleased with the extent of our fund's rebound and outperformance.

Economic backdrop

Rapid rollout programs of (very effective) vaccines have substantially progressed in many developed markets, with laggard countries (like Germany and Japan) rapidly catching up. This is allowing a faster return to more normal activity in those regions, limiting further scarring in services sectors (particularly tourism and leisure). Unfortunately, several less wealthy nations are enduring continued heavy Covid-19 impacts, accompanied by slow vaccine rollouts. This is delaying their economic recoveries. It currently appears that the rate of vaccine rollouts is insufficient to contain the virus worldwide and, with mutations occurring where the virus is raging, it is likely that negative economic effects will endure for an extended period of time.

Developed market consumer and corporate health appears to have been largely preserved through extensive and ongoing fiscal and monetary support. Labour markets are reasonably healthy and are thus far showing resilience where government sponsored furlough schemes are ending. In the USA, the level of fiscal support has increased further this year and is currently providing a positive and enduring boost for the global economy. In the near-term it seems that many developed economies are growing at above trend levels post their pandemic recoveries. Nevertheless, sustainable economic conditions may be visible only when fiscal support and monetary stimulus meaningfully tapers off more meaningfully and the reality of permanent job losses manifests.

Following a rapid resumption of economic activity back to pre-crisis levels, the Chinese economy is once again growing strongly. This is largely due to the successful early containment of the pandemic, government stimulus (which boosted infrastructure and residential investment in particular) and surprisingly strong exports and manufacturing activity. Initially exports were buoyed by temporary Covid-19-related goods demand and thereafter sustained by improving global activity. Consumer spending has recovered (showing reasonable growth off pre-crisis levels) but confidence remains lackluster. Pre-crisis risks, however, 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 has continued to recover, with consistently high commodity prices (particularly platinum group metals and iron ore) significantly supporting economic outcomes and the agricultural sector remaining buoyant. However, with an ineffective vaccine rollout, recurring Covid-19 variant surges continue to hamper the recovery of our services sectors. South Africa is lagging the global recovery considerably, showing signs of permanent economic damage from the lockdown and years of state mismanagement. We suffer from a very depressed labour market, unstable electricity supply, weakened and tax-hungry municipalities and chronically low business and investment confidence. For these reasons, we remain pessimistic regarding the structural growth rate for the local economy (which we believe has severely weakened in recent years) and have been wary of extrapolating a short-term cyclical growth rebound too far into the future when valuing cash flows.

While economic revival plans are well articulated, they still rely too heavily on implementation from weakened state institutions and do not draw sufficiently on private sector participation. However, recent actions to liberalise private sector electricity production are a step in the right direction. In addition, actions to rebuild crime fighting and tax collection capabilities are advancing, although still far from sufficient and far too slowly. A full 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.

The shocking and tragic recent looting unrest and resultant sapping of business confidence and economic damage (particularly in KwaZulu-Natal) are another reminder of the long-term structural growth impediments we face. Recurrent social instability and unrest is an unfortunate inevitability given very high levels of unemployment and inequality.

The medium-term outlook for developing economies varies widely at present, with differing exposures to volatile energy prices (importers versus exporters), strong other commodity prices, decimated tourism industries and differing impacts from the management of the pandemic and progress of vaccine rollouts. Due to recovering domestic demand and some signs of increased inflation, policy interest rates have started normalising higher in these economies from the extraordinarily low crisis levels.

Market review

Global markets were once again strong this quarter (up 7.9% in US dollars), with France up 10.0%, the UK up 5.7% and the USA up 8.5%. Within emerging markets (up 5.1% in dollar terms), Brazil (up 23.8%) and Russia (up 14.4%) outperformed, while South Africa (down 1.3%) lagged. Over the last 15 months global equity markets have recovered very strongly from the March 2020 lows (up 67% overall).

Extremely high developed market fiscal and monetary stimulus measures are providing a powerful support for financial markets and have led to dramatic increases in general asset prices. We expect increased volatility and weakness in many now buoyant areas when fiscal stimulus inevitably wanes, if sustained inflation emerges at last and when interest rates rise from their extremely low levels.

Fund performance and positioning

Our equity holdings contributed negatively to performance over the quarter, with negative contributors being Siemens Energy, Ballard Power Systems, Zimplats and Panasonic. Spire Healthcare, Nisshinbo, Hitachi and Inpex contributed positively. The fund maintained underweight positions relative to benchmark in the Communication Services, Consumer Staples and Utilities sectors. The zero weight in Financials is a function of the Sharia screening mandate. Sectors the fund had overweight exposure relative to benchmark are in the Materials (Dupont De Nemours and Evonik Industries), Healthcare (Bayer, Johnson & Johnson, Pfizer and Gilead Sciences) and Energy (Neste and Inpex Corporation) 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, healthcare equipment), online disruption (e-commerce), tomorrow's workforce (automation and robotics), Food security (fertilisers, farm efficiency, alternative feed sources) and future energy and mobility (renewable energy, energy storage, components and consumables). During the quarter we added positions in Zimplats Holdings, Yara International and Ballard Power Systems. We sold out of our positions in Vale SA and Amgen Inc as they reached our fair values and we trimmed positions in Dupont de Nemours, Hella and Lyondellbasell Industries. We added to our positions in Siemens and Nisshinbo Holdings.

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