

## Kagiso Stable Fund

March 2021



The fund was up 7.7% last quarter, ahead of its (CPI + 2%) benchmark of 1.5%. This was mainly as a result of local equity returns and positive performance from our yield assets. The fund has returned 7.8% pa over the last five years (3rd best fund), ahead of its benchmark of 6.0% pa. Since its inception in 2011, the fund has returned 8.0% pa.

With the pandemic market shock now a year behind us, we are pleased with the extent of our fund's rebound and resumption of inflation-beating performance. The shock was unexpected and materially changed the economic outlook and the prospects for the companies and economies in which we invest. At the time of the shock, we raised a little extra cash, assessed the new prospects for our holdings and other potential options and pivoted the portfolio accordingly. Although, many of our holdings were slow to rebound, we are pleased that our fundamental views are proving justified.

We have also significantly increased our South African long bond exposure, given the very steep yield curve and consequent very high carry we earn in these, with the additional expected prospect of capital gains.

As always, we are guided by the price the market offers us relative to future cashflow prospects of any investment.

### Economic backdrop

Rapid rollout programs of very effective vaccines are underway in the USA, the UK and Israel, with other rich countries accelerating after slow starts. This increases the probability of 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 another Covid-19 surge, accompanied by very slow vaccine rollout programs. This is delaying their economic recoveries. It appears that the rate of vaccine rollouts is insufficient to quell the virus worldwide and, with mutations arising where the virus is raging, it's likely that negative economic effects are likely to endure for an extended period. Uncertainty remains 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 and ongoing fiscal and monetary support. In the USA, the level of fiscal support has increased further this year and will be a positive and enduring boost for the global economy. Consumers have fared better than initially expected and increased cumulative savings (from less spend during lockdowns and direct forms of fiscal stimulus) bodes well for future consumption under more normal conditions. Nevertheless, enduring economic conditions may be visible 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 once again 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). This is despite continued lackluster 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.

Due to relatively moderate lockdown restrictions the local South African economic recovery was not meaningfully derailed by the strong second wave of Covid-19 infections. Nevertheless, a much more effective vaccine rollout will be needed to continue the recovery in services sectors. Positively, continued high commodity prices (particularly platinum group metals and iron ore) are significantly supporting economic outcomes and the agricultural sector is very buoyant. The economy shows signs of permanent economic damage (scarring) from years of state mismanagement (particularly, a very depressed labour market, unstable electricity supply, weakened and tax-hungry municipalities and chronically low business and investment confidence) and the restrictions of the lockdowns.

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 co-operation. Although on a strong recovery path from very low levels, it is clear that 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. Economic growth prospects, under more normal medium-term conditions (household consumption in particular) have weakened substantially relative to before the crisis.

The medium-term outlook for emerging economies is extremely varied at present, with differing exposures to volatile energy prices (importers vs 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 are beginning to normalize higher from extraordinarily low crisis levels.

### Market review

Global markets were strong again this quarter (up 5.0% in US dollars), with the USA up 6.2%, France up 5.3% and the UK up 6.1%. Within emerging markets (up 2.3% in dollar terms), South Africa (up 12.3%) and Russia (up 5.0%) outperformed, while Turkey (down 20.2%) and Brazil (down 10.6%) lagged. Over the last twelve months global equity markets have recovered very strongly from the March 2020 lows (up 54.8% overall).

In rand terms, the local equity market was up 13.1% this quarter, with mid-caps (up 9.4% for the quarter versus large-caps up 13.2%) still underperforming since the start of 2020 (down 6.4% versus large-caps up 19.8%). Resources outperformed (up 18.8%), PGM miners (up 29.4%) outperformed again, while gold miners (down 0.9%) lagged. Standout performers included Sasol (up 58.4%) and Anglo American Platinum (up 49.1%).

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Industrials were also strong (up 12.4%) - primarily due to Naspers (up 17.0%). Standout positive performers included Motus (up 53.7%) and telecommunication stocks MTN (up 44.3%) and Telkom (up 37.9%). Retailers were generally strong, with Massmart (up 30.9%) and Truworths (up 29.8%) outperforming. Brait (down 30.0%), Clicks (down 4.9%) and Multichoice (down 3.8%) all lagged.

Financials underperformed (up 2.3%), with listed property (up 6.4%), banks (up 2.8%) and life insurance (down 1.0%). Hammerson (up 33.7%), Coronation (up 26.9%), Capital and Counties (up 21.7%) and Investec plc (up 20.0%) outperformed, while Discovery (down 13.7%), Liberty (down 4.9%) and Santam (down 4.3%) underperformed.

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.

SA bonds returned -1.7% for the quarter after a strong recovery in the second half of 2020. Cash returned 0.9% for the quarter. Global emerging market bonds traded weaker following rising US treasury yields. Markets are increasingly discounting rising inflation in the US, post the large fiscal stimulus aimed at supporting a pandemic hit economy, although US real yields are still negative. Foreigners continued to be net sellers of SA bonds this year.

The SARB remains content to maintain its very accommodative monetary policy, given low inflation expectations and very weak demand conditions, keeping the repo rate at 3.5% at the March meeting. Local inflation will be benign over the medium-term, given the weak economy and stronger rand, despite rising oil prices and higher food inflation.

### Fund performance and positioning

Very strong performance from our local equities together with positive returns from bonds, were the main contributors to performance. Material contributors this quarter included our PGM miner holdings (Anglo Platinum and Royal Bafokeng Platinum), Anglo American, MTN and Metair.

Our global equity holdings contributed positively to performance, with standouts being Inpex, Johnson Matthey, Siemens, Prudential and Kinder Morgan. Detractors included Ontex, Aroundtown and Siemens Energy.

It's very evident that companies with stronger balance sheets, better business models and flexible, more adaptable management teams are outperforming in the recovery period and we believe the outperformance will be even more pronounced in the weaker economy in the years ahead. We are maintaining exposure to such companies, at the right price.

Our portfolios contain a diverse selection of local mid-cap holdings offering very attractive upside.

Within equities, we maintain our high exposure to low-cost, growing PGM miners. We expect a sustained acute shortage in PGM metals when global economic activity normalises, due to structural supply impediments, demand from tightened emission regulations, increased jewellery demand and a rapidly growing hydrogen energy sector. Current share prices offer attractive near-term free cash flow yields, even if commodity prices were much lower.

- We have a high exposure to South African government bonds due to very attractive real yields on offer.
- We remain guarded on corporate credit exposure, with relatively low credit exposures, mainly in short-term credit instruments of well-capitalised financial sector companies.
- We remain highly selective within listed property, although maintain high exposure to certain preferentially positioned A-shares.
- We maintain a high level of equity market hedging, given generally high market levels, and to enable high gross exposure to our best stock picks, with the lower net equity exposure, befitting a lower risk multi-asset class fund.

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