Quarterly commentary

Camissa Stable Fund
June 2022

Camissa Asset Management

The fund was down 3.5% in the second quarter [behind its (CPI + 2%) benchmark of 2.0%], mainly due to the negative performance from long bonds and equities, although mitigated by significant hedging gains. It is up 8.1% over the last year and, since its inception in 2011, has returned 8.2% pa.

Economic backdrop

US economic activity is now well ahead of pre-COVID levels despite strong headwinds from sharply waning fiscal stimulus, much higher consumer inflation and rising short-term interest rates. Consumer resilience is very much evident, stemming from robust labour markets, the buffer from accumulated savings from lockdown periods and higher wealth levels stemming from high house prices and equity markets. Nevertheless consumer confidence has been declining due to the above headwinds.

Europe's economy, while performing reasonably, has been weakening at a time of higher inflation due to energy prices spiking and consumer confidence weakening. The war in Ukraine is impacting directly given its proximity to Europe, but also indirectly via the sanctions on Russia raising energy and agricultural product prices.

In contrast, Chinese economic activity is recovering from a self-enforced slowdown due to targeted urban COVID-19 lockdowns, aided by increased fiscal and monetary stimulus. Property market activity is starting to benefit from some policy easing. Chinese government interventions in many areas of the economy - aligned with longer-term planning (and congruent with sustainably high longer-term growth) - are proving disruptive in the short term. These interventions are targeting more inclusive and less financially risky growth, increased corporate competition in industries where firms are particularly dominant, carbon emission reduction and technological independence.

Similarly, Japanese economic activity is recovering due to the complete lifting of COVID restrictions and continued strong export activity.

The outlook for other emerging economies differs widely, with varied exposures to global supply chain bottlenecks, high energy and agricultural prices, strong mining commodity prices and a moribund tourism industry. In particular, some poorer economies are facing extremely high current food and energy inflation, which is already leading to much increased socio-economic instability risks.

Although South African economic growth has rebounded (slightly faster than expected), the local economy will likely continue to produce low expansion from here, despite continued strength in the primary sectors (mining and agriculture). South Africa continues to battle with excessively high unemployment and a large unskilled population, which increases social instability risks - particularly in the face of rising food and transport prices. Growth continues to be hampered by acutely unstable and inadequate electricity supply, underperformance of key transport infrastructure, weakened and revenue-hungry municipalities and chronically low business confidence. For these reasons, coupled with the very large government debt burden, we remain pessimistic regarding the structural growth rate for the local economy. Additionally, there is a risk that lower future commodity prices (particularly platinum group metals, iron ore and coal) will result in an even weaker outlook.

Market review

Global markets were very weak in the second quarter (down 16.1% in US dollars), with the Hong Kong (up 0.7%) outperforming and Germany and the USA (both down 16.1%) underperforming. Emerging markets were also weak in the quarter (down 11.3%): Brazil (down 25.7%), South Africa (down 22.9%) and South Korea (down 20.8%) underperformed, while China (up 3.5%) outperformed.

In rand terms, the local equity market was down 11.7% in the period. Industrials outperformed (down 2.6%), driven primarily by a strong rebound in Naspers (up 42.3%) and Prosus (up 32.6%). Other standout positive performers included Mediclinic (up 30.4%), British American Tobacco (up 13.6%) and Pick n Pay (up 8.0%). Very weak performances were delivered by MTN (down 30.5%), Aspen (down 30.0%), Life Healthcare (down 22.5%) and Barloworld (down 21.5%).

Financials were weak (down 15.6%), with life insurers down 23.1%, banks down 14.5% and listed property down 11.5%. Hammerson (down 29.7%), Sirius (down 22.5%) and Sanlam (down 21.6%) underperformed, while Resilient (down 2.0%), RMI Holdings (down 3.1%) and Fortress B (down 4.8%) outperformed.

Resources underperformed (down 21.9%) including Goldfields (down 32.9%), Sibanye Stillwater (down 32%) and Anglo Platinum (down 29.0%). Despite being down, Exxaro (down 5.2%), Glencore (down 7.0%) and Royal Bafokeng Platinum (down 9.3%%) outperformed.

SA bonds declined 3.7% in the quarter, underperforming cash (up 1.2%). Foreigners were net buyers of SA bonds in the quarter. Globally, bonds weakened significantly amid much higher inflation and the start of tapering of quantitative easing interventions in the bond market.

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At their last two meetings, the SARB increased the repo rate by 0.5% increments, bringing the rate up to 4.75%. While South African inflation has been below many developed markets recently, it is still rising above the SARB's target band. The SARB is likely to continue normalizing interest rates higher in response, most likely with more front-loaded measures to maintain their inflation-fighting credibility. They will be conscious of the very weak economy and the relatively lower inflation trajectory however and our view is that they will undershoot what is being priced into forward rate markets.

Fund performance and positioning

A weak performance from yield assets (bonds and property) together with a negative contribution from foreign equities, were the key contributing factors to performance. Within local equities, the positive contributors included Prosus, Omnia and ReCM & Calibre. Negative contributors included Anglo Platinum and Northam Platinum, Anglo American, Sanlam and Quilter.

Our global equity holdings contributed negatively to performance and key detractors were Aroundtown, Siemens Energy, Siemens and Philips. JD.Com, Microsoft and Amazon contributed positively.

Our portfolios currently have high exposure to Prosus, PGM miners, Anglo American, Datatec, Sanlam and a diverse range of other mispriced stocks, including an array of deeply discounted local mid-cap stocks.

- We have a high exposure to South African government bonds due to very attractive real yields on offer.
- We remain highly selective within listed property, with a preference for logistics properties.
- We maintain a moderate level of equity market hedging to enable high gross exposure to our high conviction stock picks.

The automotive sector has experienced acute shortages of semiconductors and has therefore been unable to produce enough vehicles to meet the current consumer demand. This has negatively impacted auto catalyst PGM demand, together with reduced vehicle production in China due to their severe lockdowns. Semiconductor supply is now normalizing higher, which should improve vehicle production to more normal levels over the next year, and China is now set to ramp up vehicle production in the months ahead. We retain a high exposure to Northam Platinum, that is expanding by adding low cost, mechanised production in a relatively high commodity price environment. We expect PGM prices to remain high in the near term and then to decline over the medium term and Northam is well positioned to operate profitably at significantly lower commodity prices given its high exposure to low-cost mines.

We maintain a high weighting in Prosus, which continues to be deeply undervalued despite its strong bounce in the quarter. Its key asset, Hong Kong-listed Tencent, has a very bright, long-term future through its underlying exposure to online Chinese economic activity. Tencent's prospects remain excellent, even as it navigates the current period of high and abnormally front-loaded regulatory interventions (many of which are sensible and will lead to healthier and more sustainable future growth).

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