

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, The fund was up 2.2% in the third quarter in line with its (CPI + 2%) benchmark of 2.3%, mainly due to a strong performance from local equities and asset allocation actions. It is up 7.6% over the last year and, since its inception in 2011, has returned 8.3% pa.

Economic backdrop

The level of US economic activity remains healthy despite strong headwinds from sharply rising interest rates, waning fiscal stimulus, notably higher consumer inflation and concerning geopolitical tensions. The US labour market has been resilient thus far and household balance sheets remain robust, although consumer confidence has declined. The US dollar has strengthened considerably this year as the Federal Reserve Bank has lead globally with interest rate hikes to tackle high inflation.

Europe's economy has been weakening, with higher inflation (exacerbated by a weakening currency), spiking energy prices and very low consumer confidence. The war in Ukraine continues to impact directly given its proximity to Europe, but also indirectly via the sanctions on Russia raising energy and agricultural product prices.

Japanese economic activity has seen solid recent recovery due to the complete lifting of COVID restrictions (improving business sentiment and private consumption) and continued strong export activity - all against a backdrop of an extremely loose monetary policy and very weak yen.

Chinese economic activity has been very slow to recover as the self-enforced slowdown resulting from targeted urban pandemic lockdowns has extended, aided by increased fiscal and monetary stimulus. Property market activity, while still very weak, is slowly benefitting 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.

The outlook for other emerging economies differs widely, with varied exposures to high commodity prices (energy, metals and agricultural prices) and persistently weak tourism activity. Some poorer economies in particular are facing extremely high food and energy inflation, which is leading to increased socio-economic and fiscal instability.

Although the South African economy has rebounded, it will most likely grow slowly from here - despite continued strength in the primary sectors (mining and agriculture). South Africa continues to have excessively high unemployment and a large unskilled population. This exacerbates social instability, particularly in the face of rising food and transport prices. Growth is also constrained by an inadequate and acutely unstable electricity supply, underperformance of 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, despite signs of some incremental government moves towards economic reforms. 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 weak in the third quarter (down 6.1% in US dollars), with the Hang Seng (down 20.2%) and Germany (down 11.5%) underperforming. Emerging markets were also weak in the quarter (down 11.4%), with underperformance from China (down 22.4%), South Korea (down 17.9%) and South Africa (down 12.0%), while Turkey (up 16.3%) and India (up 6.8%) outperformed.

In rand terms, the local equity market was down 1.9% in the period. Industrials outperformed (down 1.3%) driven by strong performances by Tiger Brands (up 19.3%) and Woolworths (up 15.3%). Other standout positive performers included Shoprite (up 11.5%), AVI (up 10.8%) and Mediclinic (up 9.9%). Weak performances were delivered by Prosus (down 9.9%), MTN (down 9.2%), Bidcorp (down 7.8%) and Vodacom (down 6.9%).

Resources were weak (down 1.9%), including Kumba Iron Ore (down 20.8%), Harmony (down 17.8%) and Northam (down 8.4%). African Rainbow Minerals (up 23.8%), Glencore (up 13.9%) and Exxaro (up 10.2%) outperformed.

Financials underperformed (down 4.6%), with life insurers down 6.9%, banks down 4.4% and listed property down 3.4%. Capital and Counties (down 23.6%), Capitec (down 21.6%) and Sirius (down 19.9%) underperformed, while Absa (up 18.5%), Momentum (up 17.7%) and Fortress B (up 15.2%) performed positively.

SA bonds increased by 0.6% in the quarter, underperforming cash (up 1.4%). Foreigners were large sellers of SA bonds in the period. Globally, bonds weakened significantly amid much higher inflation expectations and continued tapering of quantitative easing interventions in the bond market.

At their last two meetings, the SARB increased the repo rate by 0.75% increments, bringing the rate up to 6.25%. 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 normalising interest rates higher in response, potentially with more front-loaded measures to maintain their inflation-fighting credibility. They will, however, be conscious of the very weak economy and the relatively lower inflation trajectory and we believe that they will undershoot what is being priced into forward rate markets.

Fund performance and positioning

A very strong performance from our local equities together with positive contributions from yield assets (bonds and property), were the key contributing factors to performance. Within local equities, the positive contributors included Grand Parade Investments, Datatec, Telkom and Transpaco. Negative contributors included Northam Platinum, MTN and Prosus.

Our global equity holdings contributed negatively to performance and key detractors were Associated British Foods, Aroundtown, Siemens Energy, Philips and Bayer. Netflix, Timken, Boston Scientific and Keysight Technologies all contributed positively.

- 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.
- We maintain a moderate level of equity market hedging to enable high gross exposure to our high conviction stock picks.

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

We continue to maintain a high weighting in Prosus, which continues to be deeply undervalued. Its key asset, Hong Kong-listed Tencent, has a very bright, long-term future through its 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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