



Review

The year thus far has been turbulent to say the least. Many of the themes playing out in the early stages of the year experienced a sharp reversal as the South African political and currency upheaval took its toll.

Much of our domestic positioning for the first quarter of the year was premised upon a number of themes playing out. We expected deflationary forces such as an ongoing recovery of the ZAR to feed through into imported goods and fuel prices along with food deflation supported by improved rainfall and higher crop output. These coupled with a recovery of the SA economy, driven largely by global growth and the recovery in commodity prices were to lay a productive foundation for lower interest rates and rising growth all of which would support the SA consumer and credit environment. These factors combined to form our bullish outlook on the SA economy. We have also held a generally constructive view on the resource sector as the structural changes allowed for significant free cash flow generation and generally improved commodity price outlook.

In line with the above views, the portfolio through the first quarter was dominated by beneficiaries of an improved economic outlook in SA, a stronger ZAR and commodity plays. The sharp drawdown in commodity and resource prices from February onwards has hurt this outlook and in South Africa the political unravelling led to much uncertainty and currency volatility. Although the net ZAR fallout has been limited as foreign investors continue to search for yield and invest in our bonds, the long term economic impact is not yet clear and domestic sectors such as banks and retailers have suffered as a consequence. These factors mentioned above have created some challenges this year for the fund however we have repositioned and revisited our outlook given the current circumstances and are confident of our performance going forward.



OffShore Exposures

With regard to the fund performance and positioning outside of SA this has been a far easier process. Our high level of conviction around India and the secular growth story playing out has remained intact. It is our view that the government's structural reforms and commitment to infrastructure development, as well as demographic tailwinds, and a services oriented economy all serve to sustain the attractiveness of India as an investment destination. Our focus in this economy has been mainly on financial services, infrastructure and more recently information technology, all sectors with gearing to the high growth environment.

The US reflation trade has had mixed results as the Trump administration encounters significantly more challenges than some expected. This lack of traction has been felt mostly in financials and commodities. We still cautiously hold the view that deregulating the banks will provide significant additional revenue generation along with the ability to grow margins in a rising rate environment.

Technology remains a successful investment for us as global trends are accelerating and pervasive and have long term sustainability.



Looking Ahead - Opportunities

In South Africa, much like Brexit, the true impact of political uncertainty is not yet fully measured as major decisions by corporates and individuals are potentially delayed, impacting investment, spending and capital formation. In addition the credit environment is likely to remain constrained. Having said that, we still believe that the worst is behind us and SA will show a growth recovery over this year and the next, albeit at a slower pace than first thought.

We are still constructive on the commodity space over the longer term with strong free cash flow generation a key supportive metric. The ongoing investment in infrastructure by China (internally and via the Belt and Road initiative) is a key component to this view.

We retain the view that precious metals remain short-term, opportunistic plays only. We see PGM as structurally challenged given the long term auto outlook and above ground supplies.

We believe that Europe will continue to gain traction in both growth and inflation on a slow and steady basis, and offers value relative to the US market which we believe has run too far in the short term. Global earnings momentum is still robust, supported by the recovery in energy prices and the continued technology trajectory. However, earnings multiples mostly reflect this growth and as such we are becoming more cautious in the near term.

Looking Ahead - Opportunities



China, as ever, remains a risk to the global economy but we expect them to manage themselves out of these challenges.

The pullback in commodity prices from over-heated levels is healthy and necessary to remove some of the speculative positions from the market. We believe we are once again at attractive entry levels in the resource space with a medium term view given the improving outlook for global growth. Of key importance is China and we are keeping a close eye on the de-leveraging risk however it is not our base case that there is a structural slowdown.

The Indian economy continues to be a shining light in the global economy with growth expected to be in excess of 6.5% for the next few years.

In Technology, long term trends and opportunities abound, the world we live in could be unrecognisable in less than 10 years from now. The challenge for us as money managers is to tap into these opportunities without taking excessive risk in both nature and timing. We strive to identify those trends that provide accessible opportunities, both negative and positive. To name only a few of such trends and impact areas - autonomous electric vehicles (lithium, auto manufacturers, PGM miners), AI learning, cloud computing and data analytics (biotech, healthcare, industry), the evolution of retail (both bricks and mortar and non-material retail). This space will continue to provide opportunity via secular growth stories and we will focus on market leaders with the ability to both invest in growth and monetise existing revenues.

Overall we are fairly cautious in the near-term with extremely low volatility globally despite the geopolitics and heightened local political risk, the impact of which has yet to be priced in. We are positioned with a moderately defensive bias overall.