Please note that the commentary is for the retail class of the Fund.

Performance

In a challenging quarter for SA-facing stocks, the Fund returned -7.0%, slightly ahead of its benchmark. Over the past 12 months, the Fund returned 9.2% and, since inception, has generated an annualised return of 10.4%, 1% ahead of its benchmark.

Global equity markets posted a strong start to the year, with the MSCI ACWI returning 8% in Q1-24. The performance was broad-based across developed markets, with the S&P 500 Index up 11%, the Dow Jones Euro Stoxx 50 up 10% and Japan's Nikkei 225 rising 21%, finally surpassing its previous high (in 1989!).

Much of this performance has been driven by the growing conviction that the US economy will achieve a soft landing despite an extremely sharp 525 basis points rise in the fed funds rate over 18 months. Economic growth remains strong, unemployment is remarkably low, and inflation has moderated from a peak in the high single digits in 2022 to the low three percents, albeit above the US Federal Reserve's 2% target. While expectations for the extent and timing of rate cuts have moderated, absent any unforeseen shocks, it seems clear that the next move in rates is down.

Emerging markets fared less well, returning 2% for the quarter. Much of the attention is focused on weak economic growth in China, which has disappointed since its reopening after Covid lockdowns due to high debt levels and a distressed property market. Global bond markets returned -2% for the quarter, lagging equities as yields rose from their recent lows at the end of December 2023.

South Africa faces ongoing challenges as the key enablers of a functioning economy continue to falter – power, ports and logistics and, increasingly, water infrastructure. This backdrop was reflected in local market returns: the FTSE/JSE Capped SWIX Index was down -2% for the quarter (with domestic-facing sectors such as banks and retailers declining by more), and the FTSE/JSE All Bond Index -2%, despite high attractive real yields on offer. The rand lost 2% against the US dollar over the quarter.

The financial index declined 8% for the quarter, led by a -10.5% return from asset managers and investment holding companies. Life insurers declined -9.0% and banks 7.0%. Contributors to fund performance relative to the benchmark included an underweight position in Remgro and overweight positions in short-term insurers Santam and OUTsurance. Detractors included an underweight position in Capitec and overweight positions in UK wealth manager St James's Place and Discovery.

Portfolio actions and positioning

During the quarter, we added to holdings in Sanlam, FirstRand and OUTsurance, and funded this from reductions in holdings of Nedbank, Reinet and NinetyOne.

FirstRand and Standard Bank comprise the Fund's two largest holdings and together make up 40% of the Fund. Both companies' share prices have had a challenging start to the year, down 13% and 11% respectively, despite reporting what we consider to be strong financial results in March. In the case of FirstRand, it appears concerns over the impact of regulatory action in the UK relating to previously paid motor finance commissions are weighing on investors' minds. This is an industry-wide issue and is likely to result in some form of remediation being paid to customers by FirstRand's MotoNovo business. It is early in the process, so quantifying the impact of this is an exercise in educated guesswork. However, the scenarios that we have run suggest that the R45bn (or £1.9bn) reduction in FirstRand's market capitalisation in the first six weeks of the quarter discounted an excessively negative outcome. FirstRand remains a business with an exceptionally strong franchise, achieving industry-leading advances growth with comparatively low credit losses and generating high ROEs. We increased the Fund's exposure to FirstRand during the quarter.

Standard Bank produced a particularly strong result, growing earnings per share by 26% in 2023. The group benefited from high endowment sensitivity to rising interest rates, strong trading income in its markets business and a particularly robust performance in its Africa Regions business, which grew earnings by 49% and now makes up 42% of group earnings. The first two drivers of the result (endowment and trading income) are probably at cyclical highs, and we think the group will be challenged to grow real earnings off this base in the short term. However, the Africa Regions business is likely to be a long-term growth driver for the group, having built a strong franchise on the continent at a time when many global banks were withdrawing. It operates in 18 sub-Saharan countries (excluding SA), has grown earnings strongly over the long term (18% CAGR over the past 10 years), and generates attractive returns given the risk profile (28% ROE in 2023). This makes an attractive differentiator for a business otherwise exposed to a low-growth SA market.

Outlook

The upcoming national elections in May are likely to attract much attention. Polls suggest that the ANC will likely drop below a 50% majority and will need to enter a coalition to remain in power. The extent of the shortfall will determine their likely partner. A significant shortfall will require a coalition with a larger party, and the options here will probably produce very divergent market reactions. We are not in a position to predict the outcome any more accurately than the polls. But regardless of any favourable policy changes that may result, it will take many years to correct the structural problems that beset the SA economy.

For this reason, we remain extremely cautious about the economic outlook for South Africa and, similarly, the prospects for domestic-facing businesses. We continue to believe that high-quality businesses are likely to be the winners in this low-growth scenario, and hence, these companies feature strongly in the portfolio. FirstRand and Standard Bank are two such businesses.

Portfolio managers
Neill Young and Godwill Chahwahwa
as at 31 March 2024