PSG Asset Management

PSG Equity Fund

Quarterly Portfolio Commentary as at 30 June 2018

by Shaun le Roux and Greg Hopkins

Current context

A concern raised by many clients on our recent national roadshow is the prolonged absence of investment returns. The concern is well founded. Consider the median three-year returns generated by the following fund categories:

SA Equity General:	3.2%
SA Multi Asset Flexible:	3.8%
SA Multi Asset High Equity:	4.8%
SA Multi Asset Low Equity:	5.8%
Global Multi Asset Flexible:	5.4%

The current environment provides little comfort. Globally, investor confidence has been shaken by (among other concerns) risks posed by faltering trade negotiations and the uncertain impact of continued monetary policy tightening in the US. Locally, investors remain anxious about the ANC's land expropriation policy and the dire state of national, municipal and state-owned enterprise treasuries.

Our perspective

Investing can be likened to running a marathon. The prospect of a downhill fills you with relief but the sight of an uphill is discouraging. Lately, investors have been on a long flat. While many feel a decline is due, the macro environment is suggesting the opposite. What to do?

Don't look back and don't look forward; just focus on the rhythm of your steps. This is what we do, and we find that it helps to keep our emotions in check and our ability to make rational investment decisions intact. We continuously look at the valuations of the securities we've included in our client portfolios to make sure they continue to offer compelling value (as they currently do). As present-day valuations are important drivers of longer-term returns, this makes us less concerned about the near-term trajectory of events. Undervalued inherent quality rewards the patient investor.

Many of the equities our clients currently hold are trading at low double-digit price-earnings (P/E) ratios, which we believe are attractive valuations. This means that returns could be generated both from earnings growth and the expansion of P/E ratios (as markets tend to ascribe higher multiples to growing earnings). In addition to offering this margin of safety, all shares have been through our moat and management analyses. We believe that these companies can overcome macro challenges to protect their profitability and their ability to service debt.

Portfolio positioning

Crowded global stocks remain expensive. As a result, opportunities need to be carefully chosen. We continue to see attractive risk-reward characteristics in many local stocks (especially mid-cap industrials) and selected global opportunities. These securities are out of favour and can be acquired at low valuations on what we consider to be low levels of earnings. The fund's P/E ratio of 12.6 compares favourably to its long-term average, and is well below that of the broader market (the FTSE/JSE All Share Index currently trades at a P/E ratio of 17.2). This is indicative of the attractiveness of the stocks we own, especially when considering the depressed levels of earnings for certain counters.

The fund's exposure to offshore equities has increased in 2018, and is currently 30.8%. This has been due to long-term investment opportunities we have identified in some of the less crowded market areas, such as US retail real estate, niche global retailers and Japanese financials.

The healthy discounts to intrinsic value for the stocks we own give us cause for optimism, and conviction that the fund is well positioned for an uncertain future. We look different to the indices and many of our peers, and may therefore often underperform over the short term. We view this as one of the costs of investing in uncrowded areas but believe that long-term returns should compensate. We also expect our cash holdings to serve as valuable firepower in time.

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Performance

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Trustees

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Many of the equities our clients currently hold are trading at low double-digit price-earnings (P/E) ratios, which we believe are attractive valuations. This means that returns could be generated both from earnings growth and the expansion of P/E ratios (as markets tend to ascribe higher multiples to growing earnings). In addition to offering this margin of safety, all securities across the various asset classes have been through our moat and management analyses. We believe that their issuers can overcome macro challenges to protect profitability and/or their ability to service debt.

Portfolio positioning

Crowded global stocks remain expensive. As a result, opportunities need to be selected carefully and the fund remains relatively conservatively positioned, with 18.3% in cash at the end of June. This is below the long-term average of 26.6%, primarily because we see attractive risk-reward characteristics in many local stocks (especially mid-cap industrials) and selected global opportunities. These securities are out of favour and can be acquired at low valuations on what we consider to be low levels of earnings. The fund's P/E ratio of 12.8 compares favourably to its long-term average, and is well below that of the broader market (the FTSE/JSE All Share Index currently trades at a P/E ratio of 17.2). This is indicative of the attractiveness of the stocks we own, especially when considering the depressed levels of earnings for certain counters.

The other reason that the fund's cash holding is relatively lower, is that we have taken advantage of the real yields available on the long end of the South African government bond curve. The fund has 6.2% exposure to the R2037, which was yielding around 9.6% at the end of June. We expect attractive real returns given our confidence in the South African Reserve Bank's track record in anchoring long-term inflation.

The fund's exposure to offshore equities has increased in 2018, and is currently 27.3%. This has been due to long-term investment opportunities we have identified in some of the less crowded market areas, such as US retail real estate, niche global retailers and Japanese financials.

The healthy discounts to intrinsic value for the stocks we own give us cause for optimism, and conviction that the fund is well positioned for an uncertain future. We look different to the indices and many of our peers, and may therefore often underperform over the short term. We view this as one of the costs of investing in uncrowded areas but believe that long-term returns should compensate. We also expect our cash holdings to serve as valuable firepower in time.

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by Paul Bosman and Greg Hopkins

Current context

A concern raised by many clients on our recent national roadshow is the prolonged absence of investment returns. The concern is well founded. Consider the median three-year returns generated by the following fund categories:

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Portfolio positioning

Two thirds (67%) of the fund is currently invested in equities, 27% directly offshore and 40% in domestic equities. Changes in local equity holdings over the last quarter included an increase in exposure to RMB Holdings (a FirstRand holding company) from 1.5% to 3.2%. The pullback in price offered an opportunity to increase our exposure to FirstRand, which we believe is a high-quality franchise with good growth potential. Globally, concerns around US retail property remain prevalent and we have continued to increase our exposure to two carefully selected names in this sector, now up to 3.5%.

Eskom's government-guaranteed bonds were included in the portfolio for the first time. The concerns around Eskom (which we share) have resulted in a compelling spread between South African government bonds and guaranteed Eskom bonds. We emphasise that these instruments are not exposing clients to Eskom's credit risk, as National Treasury takes over coupon and capital repayments if Eskom cannot make them. The fund's aggregate exposure to these instruments is 3.6%. We have maintained our position in local government bonds at around 10% and continue to hold a further 10% in immediate liquidity, which comprises offshore cash, money market instruments and a longer-dated negotiable certificate of deposit portfolio.

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Portfolio positioning

Over a third (37%) of the fund is currently invested in equities, 15% directly offshore and 22% in domestic equities. Changes in local equity holdings over the last quarter included an increase in exposure to RMB Holdings (a FirstRand holding company) from 0.9% to 2%. The pullback in price offered an opportunity to increase our exposure to FirstRand, which we believe is a high-quality franchise with good growth potential. Globally, concerns around US retail property remain prevalent and we have continued to increase our exposure to two carefully selected names in this sector, now up to 2.3%.

Eskom's government-guaranteed bonds were included in the portfolio for the first time. The concerns around Eskom (which we share) have resulted in a compelling spread between South African government bonds and guaranteed Eskom bonds. We emphasise that these instruments are not exposing clients to Eskom's credit risk, as National Treasury takes over coupon and capital repayments if Eskom cannot make them. The fund's aggregate exposure to these instruments is 2.8%. We have maintained our position in local government bonds at around 14% and continue to hold a further 27% in immediate liquidity, comprising offshore cash, money market instruments and a longer-dated negotiable certificate of deposit portfolio.

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by Ian Scott and Paul Bosman

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A concern raised by many clients on our recent national roadshow is the prolonged absence of investment returns. This concern is well founded when considering that cash (STeFI Index) has returned 7.2% over the past three years, ahead of the median returns generated by the following fund categories:

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Portfolio positioning

The fund used the recent emerging markets sell-off to add to holdings in South African securities for which we had already built conviction but that are now offering a greater margin of safety. These include negotiable certificates of deposit (NCDs), certain South African stocks and South African government bonds, where we added to longer-dated (15- and 20-year) positions and switched out of 10-year bonds to further along the curve. This has increased the overall fund duration in line with the increase in bond yields.

We selectively participated in state-owned enterprise credit issues, where we deemed credit spreads attractive relative to our fair value criteria. However, we are more cautious on credit names as spreads continue to decline. Where we reduced exposure, we used the proceeds to allocate to additional points across the NCD curve, which has started to offer increasingly attractive real yields at good liquidity. We still find value in the one-year and longer-dated areas of the money market curve, with yields ranging from 8% to 9.2% – well above inflation expectations. We have also identified opportunities in global property. In combination, we believe the fund remains well positioned for investors and savers looking for high real yields at low levels of risk.

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Performance
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Pricing
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Trustees
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PSG Income Fund

Quarterly Portfolio Commentary as at 30 June 2018
by Ian Scott and Tyron Green

Current context

A concern raised by many clients on our recent national roadshow is the prolonged absence of investment returns. This concern is well founded when considering that cash (STeFI Index) has returned 7.2% over the past three years, ahead of the median returns generated by the following fund categories:

SA Multi Asset Flexible:	3.8%
SA Multi Asset High Equity:	4.8%
SA Multi Asset Low Equity:	5.8%
Global Multi Asset Flexible:	5.4%

The current environment provides little comfort. Globally, investor confidence has been shaken by (among other concerns) risks posed by faltering trade negotiations and the uncertain impact of continued monetary policy tightening in the US. Locally, investors remain anxious about the ANC's land expropriation policy and the dire state of national, municipal and state-owned enterprise treasuries.

Our perspective

Investing can be likened to running a marathon. The prospect of a downhill fills you with relief but the sight of an uphill is discouraging. Lately, investors have been on a long flat. While many feel a decline is due, the macro environment is suggesting the opposite. What to do?

Don't look back and don't look forward; just focus on the rhythm of your steps. This is what we do, and we find that it helps to keep our emotions in check and our ability to make rational investment decisions intact. We continuously look at the valuations of the securities we've included in our client portfolios to make sure they continue to offer compelling value (as they currently do). As present-day valuations are important drivers of longer-term returns, this makes us less concerned about the near-term trajectory of events. Undervalued inherent quality rewards the patient investor.

Our fixed income portfolios are currently yielding more than 9%, which is approximately 4.5% ahead of inflation. In addition to offering this margin of safety, all securities have been through our moat and management analyses. We believe that their issuers can overcome macro challenges to protect profitability and their ability to service debt.

Portfolio positioning

The fund used the recent emerging markets sell-off to add to holdings in South African securities for which we had already built conviction but that are now offering a greater margin of safety. These include government bonds and negotiable certificates of deposit (NCDs).

We selectively participated in state-owned enterprise credit issues, where we deemed credit spreads attractive relative to our fair value criteria. However, we are more cautious on credit names as spreads continue to decline. Where we reduced exposure, we used the proceeds to allocate to sovereign bonds and additional points across the NCD curve, which has started to offer increasingly attractive real yields at good liquidity. We still find value in the one-year and longer-dated areas of the money market curve, with yields ranging from 8% to 9.2% – well above inflation expectations. In combination, we believe the fund remains well positioned for investors and savers looking for high real yields at low levels of risk.

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Performance

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PSG Money Market Fund

Quarterly Portfolio Commentary as at 30 June 2018
by Lyle Sankar

Current context

A concern raised by many clients on our recent national roadshow is the prolonged absence of investment returns. The concern is well founded when considering that cash (STeFI Index) has returned 7.2% over the past three years, ahead of the median returns generated by the following fund categories:

SA Multi Asset Flexible:	3.8%
SA Multi Asset High Equity:	4.8%
SA Multi Asset Low Equity:	5.8%
Global Multi Asset Flexible:	5.4%

The current environment provides little comfort. Globally, investor confidence has been shaken by (among other concerns) risks posed by faltering trade negotiations and the uncertain impact of continued monetary policy tightening in the US. Locally, investors remain anxious about the ANC's land expropriation policy and the dire state of national, municipal and state-owned enterprise treasuries.

Our perspective

Investing can be likened to running a marathon. The prospect of a downhill fills you with relief but the sight of an uphill is discouraging. Lately, investors have been on a long flat. While many feel a decline is due, the macro environment is suggesting the opposite. What to do?

Don't look back and don't look forward; just focus on the rhythm of your steps. This is what we do, and we find that it helps to keep our emotions in check and our ability to make rational investment decisions intact. We continuously look at the valuations of the securities we've included in our client portfolios to make sure they continue to offer compelling value (as they currently do). As present-day valuations are important drivers of longer-term returns, this makes us less concerned about the near-term trajectory of events. Undervalued inherent quality rewards the patient investor.

Our money market portfolio offers significant margin of safety, with yields that are approximately 3.2% above short-term inflation. In addition, all securities have been through our moat and management analyses. We believe that their issuers can overcome macro challenges to protect profitability and their ability to service debt.

Portfolio positioning

Money market rates on the negotiable certificate of deposit (NCD) curve remain attractive relative to the current repo rate (6.5%) and headline inflation, which fell to 4.4% in May. Six-month rates are offering 7.4% and one-year rates are over 8.05% – rates last seen in October 2017 after a dismal Medium Term Budget Policy Statement. We therefore see good value in the 6 to 12-month area of the curve, with sufficient real yield on offer to protect against inflation shocks. We have added predominantly in the 6-month area and look to keep duration close to full as headline inflation remains benign. Currently, the Treasury bill market offers better value in the 3-month area than the NCD market. Finally, the fund did not add significantly to corporate paper over the quarter as the market has continued to tighten, offering fewer opportunities for mispricing in quality names. In combination, we believe that the portfolio is positioned to take advantage of attractive cash returns available.

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Money Market

The PSG Money Market Fund maintains a constant price and is targeted at a constant value. The quoted yield is calculated by annualising the average 7 day yield. A money market portfolio is not a bank deposit account. Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and in such circumstances a process of ringfencing of withdrawal instructions and managed payouts over time may be followed. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument. In most cases the return will merely have the effect of increasing or decreasing the daily yield but in the case of abnormal losses it can have the effect of reducing the capital value of the portfolio.

Regulation 28

The fund is managed according to Regulation 28 of the Pension Funds Act. The South African retirement fund industry is governed by the Pension Funds Act No. 24 of 1956. Regulation 28 of the Pension Funds Act prescribes the maximum limits in asset classes that an approved retirement fund may invest in. Exposures in excess of the limits will be corrected immediately, except where due to a change in the fair value or characteristics of an asset, e.g. market value fluctuations, in which case they will be corrected within a reasonable time period.

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PSG Global Equity Feeder Fund

Quarterly Portfolio Commentary as at 30 June 2018

by Philipp Wörz and Greg Hopkins

Current context

Despite an environment of synchronised global growth and unemployment rates across the developed world rivalling multi-decade lows, investor confidence has been shaken. Among other concerns, this has largely been due to risks posed by faltering trade negotiations and the uncertain impact of continued monetary policy tightening in the US. After a strong start to 2018, global markets (as measured by the MSCI World Index) have pulled back 7% since January highs. The MSCI Emerging Markets Index declined 17% in US dollars.

Our perspective

Investing can be likened to running a marathon. The prospect of a downhill fills you with relief but the sight of an uphill is discouraging. Globally, investors have been on a long downhill since the end of the financial crisis, led by the US. While many feel a market decline is due, the macro environment is suggesting the opposite. What to do?

Don't look back and don't look forward; just focus on the rhythm of your steps. This is what we do, and we find that it helps to keep our emotions in check and our ability to make rational investment decisions intact. We continuously look at the valuations of the securities we've included in our client portfolios to make sure they continue to offer compelling value (as they currently do). As present-day valuations are important drivers of longer-term returns, this makes us less concerned about the near-term trajectory of events. Undervalued inherent quality rewards the patient investor.

As has been the case for some time, overall market valuations remain elevated when compared to history. But there continue to be pockets characterised by fear and uncertainty. We have learned over time that some of our best investment opportunities are found in these conditions, which generally result in less competition to buy quality assets on sale.

Many of the equities our clients currently hold are trading at low double-digit price-earnings (P/E) ratios, which we believe are attractive valuations. This means that returns could be generated both from earnings growth and the expansion of P/E ratios (as markets tend to ascribe higher multiples to growing earnings). In addition to offering this margin of safety, all shares have been through our moat and management analyses. We believe that these companies can overcome macro challenges to protect profitability and their ability to service debt.

Portfolio positioning

Over the past 18 months we have sold several long-term holdings as they exceeded our estimates of intrinsic value. A scarcity of compelling new opportunities resulted in the fund holding abnormally high levels of cash – up to 19% in late 2017 and early 2018. However, our team has found some great long-term opportunities over the past few months and equity exposure has increased to 91% at the end of June, after reaching 94% in May.

Areas we have been allocating capital to over the past few months include global real estate (especially in US retail real estate companies such as Simon Property Group and Washington Prime Group); niche retailers L Brands and Pandora; European cable operator Liberty Global; and Japanese financial companies Japan Post Insurance and Resona Holdings. Conversely, an area that remains popular is global technology. While we had large holdings in this space in the past, we continue to believe that the odds are now stacked significantly against investors.

The fund's equity holdings are considerably cheaper than the market, but in our view are of at least similar quality to the average company in the index. This gives us cause for optimism, and conviction that the fund is well positioned for an uncertain future.

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Feeder funds

A Feeder Fund is a portfolio which, apart from assets in liquid form, invests in a single portfolio of a collective investment scheme, which levies its own charges and which could result in a higher fee structure for the feeder fund.

Performance

All performance data for a lump sum, net of fees, include income and assumes reinvestment of income on a NAV to NAV basis. Annualised performances show longer term performance rescaled over a 12 month period. Individual investor performance may differ as a result of initial fees, the date of reinvestment and dividend withholding tax. Performance is calculated for the portfolio and individual investor performance may differ as a result thereof. The portfolio is valued at 15h00 daily. Income distributions are net of any applicable taxes. Actual annual figures are available to the investor on request. Prices are published daily and available on the website www.psg.co.za/asset-management and in the daily newspapers. Figures quoted are Morningstar Inc.

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PSG Global Flexible Feeder Fund

Quarterly Portfolio Commentary as at 30 June 2018

by Philipp Wörz and Greg Hopkins

Current context

Despite an environment of synchronised global growth and unemployment rates across the developed world rivalling multi-decade lows, investor confidence has been shaken. Among other concerns, this has largely been due to risks posed by faltering trade negotiations and the uncertain impact of continued monetary policy tightening in the US. After a strong start to 2018, global markets (as measured by the MSCI World Index) have pulled back 7% since January highs. The MSCI Emerging Markets Index declined 17% in US dollars.

Our perspective

Investing can be likened to running a marathon. The prospect of a downhill fills you with relief but the sight of an uphill is discouraging. Globally, investors have been on a long downhill since the end of the financial crisis, led by the US. While many feel a market decline is due, the macro environment is suggesting the opposite. What to do?

Don't look back and don't look forward; just focus on the rhythm of your steps. This is what we do, and we find that it helps to keep our emotions in check and our ability to make rational investment decisions intact. We continuously look at the valuations of the securities we've included in our client portfolios to make sure they continue to offer compelling value (as they currently do). As present-day valuations are important drivers of longer-term returns, this makes us less concerned about the near-term trajectory of events. Undervalued inherent quality rewards the patient investor.

As has been the case for some time, overall market valuations remain elevated when compared to history. But there continue to be pockets characterised by fear and uncertainty. We have learned over time that some of our best investment opportunities are found in these conditions, which generally result in less competition to buy quality assets on sale.

Many of the equities our clients currently hold are trading at low double-digit price-earnings (P/E) ratios, which we believe are attractive valuations. This means that returns could be generated both from earnings growth and the expansion of P/E ratios (as markets tend to ascribe higher multiples to growing earnings). In addition to offering this margin of safety, all shares have been through our moat and management analyses. We believe that these companies can overcome macro challenges to protect profitability and their ability to service debt.

Portfolio positioning

Given the current backdrop and available opportunity set, the fund remains relatively conservatively positioned. As at end June, it held 27% in cash, slightly above its long-term average of 21%.

Over the past 18 months we have sold several long-term holdings as they exceeded our estimates of intrinsic value. This resulted in a record-high cash level of 38% in January. However, our team has found some great long-term opportunities since, which has resulted in an increased equity allocation of 73% at the end of June.

Areas we have been allocating capital to over the past few months include global real estate (especially in US retail real estate companies such as Simon Property Group and Washington Prime Group); niche retailers L Brands and Pandora; European cable operator Liberty Global; and Japanese financial companies Japan Post Insurance and Resona Holdings. Conversely, an area that remains popular is global technology. While we had large holdings in this space in the past, we continue to believe that the odds are now stacked significantly against investors.

The fund's equity holdings are considerably cheaper than the market, but in our view are of at least similar quality to the average company in the index.

This gives us cause for optimism, and conviction that the fund is well positioned for an uncertain future. We also believe that cash will continue to serve as valuable firepower in time, despite the potential drag on short-term performance.

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