PSG Asset Management

PSG Equity Fund

Quarterly Portfolio Commentary as at 30 September 2018

by Shaun le Roux and Greg Hopkins

Current context

Emerging markets have underperformed dramatically in 2018, weighed down by rising US interest rates and turmoil in countries like Turkey and Argentina. This backdrop has seen the rand depreciate to the extent that it is trading weaker than it was before the ANC elective conference in December 2017. Domestic assets have suffered sharp declines this year.

We have also witnessed wide divergences in the performances of various global equity markets. The US stock market and economy have continued to perform strongly, with the S&P 500 returning 10.6% for the year to date. In contrast, the MSCI Emerging Markets Index has lost 7.7% and is approaching 20% declines from January highs. The FTSE/JSE All Share Index is down 3.8% year to date, and the FTSE/JSE Shareholder Weighted Index is 8% lower, extending the poor returns of the past four years.

Investor confidence in South Africa matches the gloomy economic backdrop and many domestic assets are trading at or near multi-year lows. Many well-owned stocks on the JSE, including the likes of Steinhoff, MTN, Aspen, Tiger Brands, Mediclinic and Woolworths, have disappointed in recent years and endured aggressive sell-offs. In most cases, starting valuations were high. We continue to avoid stocks that incorporate very high expectations, particularly when we consider how cheaply much of the market trades.

Our perspective

We apply a repeatable investment process, according to which we allocate capital to securities we consider undervalued and take profits where prices are high. The prevailing fear in local markets has given rise to the opportunity to buy higher-quality stocks (particularly mid-cap industrials) at wide discounts to what we think they are worth.

Similarly, global stock markets are characterised by very wide divergences in valuations. This bodes well for returns for investors who are prepared to invest in uncrowded stocks and take a long-term view.

Portfolio positioning

The fund retains healthy exposure to cheap domestic stocks. Due to the combination of low levels of earnings and bear market valuations, we expect excellent long-term returns from this component of the portfolio. Specifically, the fund has continued to add to its Old Mutual position after the unbundling of Quilter, partly funded by a selling of Nedbank. We perceive significant positive asymmetry at current share prices – very limited downside and healthy upside.

Elevated valuations and high levels of profits of popular global stocks – particularly in the US – have seen us reallocate direct offshore exposure towards less crowded ideas in recent times. The global stocks the fund owns trade at healthy discounts to our assessments of intrinsic value. 31.6% of the fund is directly invested offshore.

We continue to avoid stocks that we perceive to be overpriced or where we consider risk to be too high. This has served our clients well in recent years: we have avoided many of the disappointing performers on the JSE as they did not meet the high bar we set for portfolio inclusion. While investing offers no guaranteed fail-safe, we believe that our insistence on a margin of safety places the odds in our clients' favour.

Changes in portfolio positioning

Q2 2018		Q3 2018	
Domestic equity	66.8%	Domestic equity	66.7%
Domestic property	1.4%	Domestic property	1.2%
Domestic cash	0.8%	Domestic cash	0.5%
Foreign equity	25.8%	Foreign equity	29.2%
Foreign property	5.0%	Foreign property	2.2%
Foreign cash	0.2%	Foreign cash	0.2

There may be slight differences in the totals due to rounding.

All data as per Bloomberg to 30 September 2018.

Disclaimer

Collective Investment Schemes in Securities (CIS) are generally medium to long-term investments. The value of participatory interests (units) or the investment may go down as well as up and past performance is not a guide to future performance. Fluctuations or movements in the exchange rates may cause the value of underlying international investments to go up or down. CIS are traded at ruling prices and can engage in borrowing and scrip lending. The Fund may borrow up to 10% of its market value to bridge insufficient liquidity. Where foreign securities are included in a portfolio, the portfolio is exposed to risks such as potential constraints on liquidity and the repatriation of funds, macroeconomic, political, foreign exchange, tax, settlement and potential limitations on the availability of market information. The portfolios may be capped at any time in order for them to be managed in accordance with their mandate. Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and in such circumstances a process of ring-fencing of withdrawal instructions and managed payouts over time may be followed. PSG Collective Investments (RF) Limited does not provide any guarantee either with respect to the capital or the return of the portfolio. Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided.

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 actual investment date, 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 from Morningstar Inc.

Pricing

Forward pricing is used. Unit trust prices are calculated on a net asset value (NAV) basis, which is the market value of all assets in the Fund including income accruals less permissible deductions divided by the number of units in issue.

Company details

PSG Collective Investments (RF) Limited is registered as a CIS Manager with the Financial Sector Conduct Authority, and a member of the Association of Savings and Investments South Africa (ASISA) through its holdings company PSG Konsult Limited. The management of the portfolio is delegated to PSG Asset Management (Pty) Ltd, an authorised Financial Services Provider under the Financial Advisory and Intermediary Services Act 2002, FSP no 29524. PSG Asset Management (Pty) Ltd and PSG Collective Investments (RF) Limited are subsidiaries of PSG Konsult Limited. PSG Collective Investments (RF) Limited can be contacted on +27(21) 799 8000; (toll free) 0800 600 168, via email assetmanagement@psg.co.za.

Conflict of interest disclosure

The Fund may from time to time invest in a portolio managed by a related party. PSG Collective Investments (RF) Limited or the fund manager may negotiate a discount in fees charged by the underlying portfolio. All discounts negotiated are reinvested in the Fund for the benefit of the investors. Neither PSG Collective Investments (RF) Limited nor PSG Asset Management (Pty) Ltd retains any portion of such discount for their own accounts. The fund manager may use the brokerage services of a related party, PSG Securities Ltd.

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Additional information

Additional information is available free of charge on the website www.psg.co.za/asset-management and may include publications, brochures, forms and annual reports.