

Current context

Emerging markets have underperformed dramatically in 2018, weighed down by rising US interest rates and turmoil in countries like Turkey and Argentina. 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 US remains the standout performer when taking a longer-term view. Despite the often-cited nine-year (and counting) global bull market, many major markets are still below pre-global financial crisis (GFC) highs when measured in US dollars. While the picture looks a bit better when accounting for dividends, the US market has strongly outpaced all others over the period since pre-crisis highs (see Table 1).

Table 1: Selective market performances* since the GFC

	% Total return from GFC low (in USD incl. dividends)	% return from pre-GFC high (in USD)	% Total return from pre-GFC high (in USD incl. dividends)
S&P 500	420%	87%	136%
MSCI World	310%	34%	80%
Australia AS30	293%	-18%	50%
JSE All-share	218%	-16%	17%
MSCI Emerging Markets	203%	-22%	6%
FTSE 100 (UK)	187%	-28%	9%
CAC 40 (France)	184%	-24%	13%
Topix (Japan)	176%	2%	30%
Shanghai Composite	99%	-49%	-35%

*Returns in USD, not annualised, for each individual market GFC low and pre-GFC high to 28 September 2018.

Sources: PSG Asset Management; Bloomberg

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. While a favourable economic backdrop in the US and good earnings growth support current high valuations, we are not willing to own securities when expected long-term returns will likely be low (at best) and the risk of capital loss is high. Fortunately, global stock markets continue to be characterised by very wide divergences in valuations, which bodes well for returns for investors who are prepared to invest in uncrowded stocks and take a long-term view.

Portfolio positioning

Elevated valuations and high levels of profits of popular global stocks – particularly in the US – have seen us reallocate exposure towards less crowded ideas over the past year (as we have written about in previous commentaries). Over the most recent quarter, the fund sold its remaining shareholding in Berkshire Hathaway. When we invested in the company many years ago, it was trading at a significant discount to its cheap underlying holdings. In our view, this is no longer the case. While Berkshire Hathaway remains a great company, it therefore no longer satisfies our requirement for a wide margin of safety. We also exited Imperial Brands, Qualcomm and Nordstrom after their share prices rallied strongly and exceeded our estimates of intrinsic value.

We have previously written about the opportunity in Japanese financial companies and added to the fund's positions over the past quarter. Collectively, Japanese financials accounted for 7.7% of the fund, compared to 5.4% in June. The fund also added to its positions in Babcock International, Transocean, Old Mutual, L Brands and Glencore during bouts of share price weakness.

From a regional perspective, 32% of the fund was invested in US-listed equities as at quarter end. This may appear high, given the extended valuations in that market. However, it should be noted that only 10% of the fund's holdings have direct exposure to the US economy. Holdings are also in areas that are currently unpopular and uncrowded, such as real estate and retail.

The fund's equity holdings are of similar quality but significantly cheaper than the average company in the market. Additionally, these holdings are trading at cheap valuations relative to their own histories, and on below-normal earnings levels. This gives us cause for optimism that the fund is well positioned to deal with the uncertain environment investors currently face.

Cash levels remain healthy, with the fund holding 27.8% in cash. This is dry powder that we expect to employ if the opportunities we currently see in uncrowded securities become more widespread.

Changes in portfolio positioning

Q2 2018		Q3 2018	
Domestic equity	3.3%	Domestic equity	3.5%
Domestic cash	0.6%	Domestic cash	0.8%
Foreign equity	61.0%	Foreign equity	62.1%
Foreign property	8.0%	Foreign property	6.5%
Foreign gold	1.7%	Foreign gold	1.2%
Foreign cash	25.5%	Foreign cash	25.9%

Q2 2018		Q3 2018	
US	34.3%	US	32.0%
Europe	4.6%	Europe	4.8%
UK	11.9%	UK	10.6%
Asia ex Japan	5.2%	Asia ex Japan	5.0%
Japan	5.4%	Japan	7.7%
Canada	7.5%	Canada	8.1%
Africa	3.3%	Africa	3.5%
Other	0.5%	Other	0.4%
Cash	27.3%	Cash	27.9%

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

Please note that this commentary is for the US dollar-denominated PSG Global Flexible Sub-Fund. The PSG Global Flexible Feeder Fund is 100% invested in the underlying US dollar fund. However, there may small short-term valuation, trading and translation differences between the two funds.

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.

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 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 portfolio 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.

Trustees

The Standard Bank of South Africa Limited,
Main Tower, Standard Bank Centre,
2 Hertzog Boulevard,
Cape Town
8001
Tel: +27 21 401 2443
Email: Compliance-PSG@standardbank.co.za

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.