PSG Global Flexible Sub-Fund

Quarterly Portfolio Commentary as at 30 September 2018

by Philipp Wörz 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. 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	
Equity	65.0%	Equity	65.6%
Property	8.0%	Property	6.6%
Cash* *Includes 1.7% gold	27.0%	Cash* *Includes 1.2% gold	27.8%

Q2 2018		Q3 2018	
US	34.3%	US	32.1%
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	27.8%

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

All data as per Bloomberg to 30 September 2018.

General information and risks

Collective Investment Schemes (CIS) in securities 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. 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. The fund may borrow up to 10% of the market value to bridge insufficient liquidity.

Past performance is not a reliable indicator of future results and you may get back less than you originally invested. This publication is for private circulation and information purposes only and does not constitute a personal recommendation or investment advice or an offer to buy/sell or an invitation to buy/sell securities in the fund. The information and any opinions have been obtained from or are based on sources believed to be reliable, but accuracy cannot be guaranteed. Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided.

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The Fund's risk and reward category may not capture all material risks to which the Fund may be subject, such as:

Geopolitical Risk - investments in equities issued or listed in different countries may imply the application of different standards and regulations, exposure to changes in laws or restrictions applicable to such investments, changes in exchange control regulations or price volatility.

Liquidity Risk - in extreme market conditions some equities may become hard to value or sell at a desired price.

Exchange Rate Risk - The Fund may invest in equities denominated in currencies other than US Dollars, this exposes the Fund to fluctuations in exchange rates.

Default Risk - One or more bond or other debt instrument issuers could become unwilling or unable to make their scheduled payments to the Fund.

Further information on risks may be found in the "Risk Factors" section in the Fund's Prospectus.

Performance

All performance data for a lump sum, net of fees, includes 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 23:59 (CET) on each dealing day. Actual annual figures are available to the investor on request. Figures and benchmark quoted are from Morningstar, Inc. Prices are published daily and available on the website www.psgkglobal.com/global-asset-management/funds and in the daily newspapers. PSG Fund Management (Malta) Ltd does not provide any guarantee with the respect of the capital or the return of the portfolio.

Performance Fee

7% of the net trading gain calculated on the NAV at each valuation point. The performance fee is calculated on a "High Water Mark" basis. In the event of the portfolio outperforming the High Water Mark, a performance fee of 7% of the net trading gain above the High Water Mark calculated on the NAV at each Valuation Point will be levied. The performance fee is calculated on the average NAV for the period 1/10/2015 - 30/9/2018.

Base fee	1%
Performance fee example at HWM	0.62% Assume gross performance of 8.92%. This results in a performance fee of 0.62% (8.92% x 7%) resulting in a nett performance of 8.3% (US inflation + 6%)
Fee hurdle	High Water Mark
Sharing ratio	7%
Minimum fee	1%
Maximum fee	Uncapped, with a since inception High Water Mark the fund's highest total TER since inception of TER was 2.11% per annum
Current Total Expense Ratio (TER)	1.70%

Frequently Asked Questions on Performance Fees are available on the website www.psg.co.za/asset-management/Performance-Fee-Frequently-Asked-Questions.

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.

Cut-off times

The cut-off time for submitting investment transactions is twelve noon one business day prior to dealing day.

Company details

PSG Fund Management (Malta) Limited as General Manager is licensed by the Malta Financial Services Authority ("MFSA") and Vistra Fund Services (Guernsey) Limited as Administrator is licensed by the Guernsey Financial Services Commission ("GFSC"). The fund is a UCITS compliance fund regulated by the MFSA. The Management of the fund has been delegated to PSG Asset Management (Pty) Limited, which is registered with the South African Financial Sector Conduct Authority as a registered Financial Service Provider (FSP no. 29524) and is licensed to operate under the Financial Advisory and Intermediary Services Act, 2002.

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Additional information

Additional information is available free of charge on the website www.psgkglobal.com and may include publications, brochures, forms and annual reports.