"Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it".
Albert Einstein

Like the other seven Wonders of the World, compound interest is not man made. We can't generate compound returns by means of trading, we make good investments and then watch them compound. In this light we are happy to report that there were limited changes to the PSG Equity Fund's significant positions over the last quarter. But no trading doesn't mean that we spent a quarter watching share prices.

In watching the compounding unfold, share prices are secondary and much less interesting. The bit we enjoy is studying the companies' financial reports, listening to their conference calls and, where possible, meeting with management teams.

Over the last quarter the majority of the companies in which our clients are invested reported results for the period ended 30 June 2016 and therefore we have in fact been rather busy. In this commentary we would like to offer a window into how some of our larger holdings are faring, not from a share price point of view but rather from a business point of view. Remember that the unit trust's price is a function of the prices of the underlying securities. These prices are, in the long run, largely a function of the profits which underlying companies generate. Going down yet another layer, profits are, in the medium to long run, a function of whether the business is adding profitable clients and/or volumes.

We have decided to report back on three of the PSG Equity Fund's largest holdings.

Firstrand is currently the fund's largest holding and we were happy to see FNB grow its retail, premium and commercial customer base by an impressive 4%, 8% and 14% respectively. As we have grown accustomed to with this company, new ventures are continuing to grow at a rapid rate. Earnings per share and dividends grew 8% despite a challenging banking environment. Firstrand maintained exceptional balance sheet strength and holds R13.8bn surplus capital which enables stability, dividend resilience and growth initiatives. Referencing Einstein's quote, it's much better to own the bank than to owe it.

Imperial Holdings, SA's logistics and automobile giant, endured very challenging economic conditions both locally and in its foreign markets. Even with an 8% decline in SA new vehicle sales, low consumer confidence and a 27% drop in the rand vs the US dollar during the 2016 financial year, the group still managed to generate free cash flow of R2,5bn and maintain its generous dividend.

Discovery Holdings continues to grow its client base at an impressive rate adding 360,000 clients to its SA Health offering, 932,000 to its UK business and growing gross written premiums at Discovery Insure by 39%. Discovery also has numerous exciting new initiatives which could add handsomely to profits in a couple of years. (One of these initiatives is an entry into the South African banking market.) Discovery managed a slight growth in profits, despite investing R823m in new initiatives. We ascribe tremendous value to management teams who are prepared to take short-term pain (through the income statement) for long-term gain. The market often takes an opposing view, which offers us a buying opportunity.

In the case of Firstrand and Discovery the key individual(s) are aligned with those of shareholders by means of very significant nominal exposure in the form of direct shareholding. At Imperial the situation is different but sufficiently similar. Mark Lamberti, the CEO, does not have significant shareholding but his entire remuneration is in the form of shares which only vest a few years hence. He has elected to receive nil cash salary and nil cash bonus. Mr Lamberti has requested that the amount budgeted for his salary be donated towards tertiary education for the children of staff members. Partnering with such individuals is unlikely to disappoint.

Over the last quarter we had the privilege of meeting the management teams of Super Group, Imperial, EOH, Capitec Bank, Group Five and Hudaco. Meeting these management teams provides us with much deeper insight, not only into their companies but also the relevant and related industries.

All things considered, we are even more convinced that our clients are invested in companies which will endure the competitive pressures of the free market. We will attentively be watching that eighth Wonder of the World roll its magic to the benefit of our clients.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

"Compound interest is the eighth wonder of the world. He who understands it, earns it … he who doesn't … pays it".
Albert Einstein

Like the other seven Wonders of the World, compound interest is not man made. We can't generate compound returns by means of trading, we make good investments and then watch them compound. In this light we are happy to report that there were limited changes to the PSG Flexible Fund's significant positions over the last quarter. But no trading doesn't mean that we spent a quarter watching share prices.

In watching the compounding unfold, share prices are secondary and much less interesting. The bit we enjoy is studying the companies' financial reports, listening to their conference calls and, where possible, meeting with management teams.

Over the last quarter the majority of the companies in which our clients are invested reported results for the period ended 30 June 2016 and therefore we have in fact been rather busy. In this commentary we would like to offer a window into how some of our larger holdings are faring, not from a share price point of view but rather from a business point of view. Remember that the unit trust's price is a function of the prices of the underlying securities. These prices are, in the long run, largely a function of the profits which underlying companies generate. Going down yet another layer, profits are, in the medium to long run, a function of whether the business is adding profitable clients and/or volumes.

We have decided to report back on four of the PSG Flexible Fund's largest holdings.

Berkshire Hathaway continues to be an insurance provider of choice with premiums earned in the first half of 2016 exceeding those of the comparable 2015 period by 10%. Expressed differently, premiums earned increased by about $2bn over the half year. To put this number in context, it almost equates to the market value of the entire Imperial Holdings. Berkshire's earnings per share grew by a very satisfactory 15.4% over the period. Berkshire continues to have tremendous balance sheet strength with its insurance operations holding Statutory Surplus capital of $124bn.

Firstrand is currently the fund's largest holding and we were happy to see FNB grow its retail, premium and commercial customer base by an impressive 4%, 8% and 14% respectively. As we have grown accustomed to with this company, new ventures are continuing to grow at a rapid rate. Earnings per share and dividends grew 8% despite a challenging banking environment. Firstrand maintained exceptional balance sheet strength and holds R13.8bn surplus capital which enables stability, dividend resilience and growth initiatives. Referencing Einstein's quote, it's much better to own the bank than to owe it.

Imperial Holdings, SA's logistics and automobile giant, endured very challenging economic conditions both locally and in its foreign markets. Even with an 8% decline in SA new vehicle sales, low consumer confidence and a 27% drop in the rand vs the US dollar during the 2016 financial year, the group still managed to generate free cash flow of R2,5bn and maintain its generous dividend.

Discovery Holdings continues to grow its client base at an impressive rate adding 360,000 clients to its SA Health offering, 932,000 to its UK business and growing gross written premiums at Discovery Insure by 39%. Discovery also has numerous exciting new initiatives which could add handsomely to profits in a couple of years. (One of these initiatives is an entry into the South African banking market.) Discovery managed a slight growth in profits, despite investing R823m in new initiatives. We ascribe tremendous value to management teams who are prepared to take short-term pain (through the income statement) for long-term gain. The market often takes an opposing view, which offers us a buying opportunity.

In the case of Berkshire Hathaway, Firstrand and Discovery the key individual(s) are aligned with those of shareholders by means of very significant nominal exposure in the form of direct shareholding. At Imperial the situation is different but sufficiently similar. Mark Lamberti, the CEO, does not have significant shareholding but his entire remuneration is in the form of shares which only vest a few years hence. He has elected to receive nil cash salary and nil cash bonus. Mr Lamberti has requested that the amount budgeted for his salary be donated towards tertiary education for the children of staff members. Partnering with such individuals is unlikely to disappoint.

Over the last quarter we had the privilege of meeting the management teams of Super Group, Imperial, EOH, Capitec Bank, Group Five and Hudaco. Meeting these management teams provides us with much deeper insight, not only into their companies but also the relevant and related industries.

All things considered, we are even more convinced that our clients are invested in companies which will endure the competitive pressures of the free market. We will attentively be watching that eighth Wonder of the World roll its magic to the benefit of our clients.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

"Compound interest is the eighth wonder of the world. He who understands it, earns it.....he who doesn't.....pays it". Albert Einstein

Like the other seven Wonders of the World, compound interest is not man made.
We can't generate compound returns by means of trading, we make good investments and then watch them compound. In this light we are happy to report that there were no material any changes to the fund's significant position over the last quarter.

No trading doesn't mean that we spent a quarter watching share prices.

In watching the compounding unfold share prices are secondary, and much less interesting, the bit we enjoy is studying the companies' financial reports, listening to their conference calls and, where possible, meeting with management teams.

Over the last quarter the majority of the companies in which our clients are invested reported results for the period ended 30 June 2016 and therefore we have in fact been rather busy. In this commentary we would like to offer a window into how some of our larger holdings are faring, not from a share price point of view but rather from a business point of view. Remember that the unit trust's price is a function of the prices of the underlying securities. These prices are, in the long run, largely a function of the profits which underlying companies generate. Going down yet another layer, profits are, in the medium to long run, a function of whether the business is adding profitable clients and/or volumes. We have decided to report back on four of the fund's largest holdings.

Firstrand is currently the fund's largest holding and we were happy to see FNB grow its retail, premium and commercial customer base by an impressive 4%, 8% and 14% respectively. As we have grown accustomed to with this company, new ventures continue growing at a rapid rate. Earnings per share and dividends grew 8% despite a challenging banking environment. Firstrand maintained exceptional balance sheet strength and holds R13.8bn surplus capital which enables stability, dividend resilience and growth initiatives. Referencing Einstein's quote, it's much better to own the bank than to owe it.

Imperial Holdings, SA's logistics and automobile giant, endured very challenging economic conditions both locally and in its foreign markets. Even with an 8% decline in SA new vehicle sales, low consumer confidence and a 27% drop in the Rand vs the USD during the 2016 financial year, the Group still managed to generate free cash flow of R2,5bn and maintain its generous dividend.

Berkshire Hathaway continues to be an insurance provider of choice with premiums earned in the first half of 2016 exceeding those of the comparable 2015 period by 10%. Expressed differently, premiums earned increased by circa $2bn over the half year. To put this number in context, it almost equates to the market value of the entire Imperial Holdings. Berkshire's earnings per share grew by a very satisfactory 15.4% over the period. Berkshire continues to have tremendous balance sheet strength with its insurance operations holding Statutory Surplus capital of $124bn.

Discovery Holdings continues to grow its client base at an impressive rate adding 360,000 clients to its SA Health offering, 932,000 to its UK business and growing gross written premiums at Discovery Insure by 39%. Also Discovery has numerous exciting new initiatives which could add handsomely to profits in a couple of years. (One of these initiatives is an entry into the South African banking market.) Discovery managed a slight growth in profits, despite investing R823m in new initiatives. We ascribe tremendous value to management teams who are prepared to take short-term pain (through the income statement) for long-term gain. The market often takes an opposing view, which offers us a buying opportunity.

In the case of Firstrand, Berkshire Hathaway and Discovery the key individual(s) are aligned with those of shareholders by means of very significant nominal exposure in the form of direct shareholding. At Imperial the situation is different but sufficiently similar. Mark Lamberti, the CEO, does not have significant shareholding but his entire remuneration is in the form of shares which only vest a few years hence. He has elected to receive nil cash salary and nil cash bonus. Mr Lamberti has requested that the amount budgeted for his salary be donated towards tertiary education for the children of staff members. Partnering with such individuals is unlikely to disappoint.

Over the last quarter we had the privilege of meeting the management teams of Super Group, Imperial, EOH, Capitec Bank, Group Five and Hudaco. Meeting these management teams provides us with much deeper insight, not only into their companies but also the relevant and related industries.

All considered we are even more convinced that our clients are invested in companies which will endure the competitive pressures of the free market. We will attentively be watching that eighth Wonder of the World roll its magic to the benefit of our clients.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

"Compound interest is the eighth wonder of the world. He who understands it, earns it.....he who doesn't.....pays it". Albert Einstein

Like the other seven Wonders of the World, compound interest is not man made.
We can't generate compound returns by means of trading, we make good investments and then watch them compound. In this light we are happy to report that there were no material any changes to the fund's significant position over the last quarter.

No trading doesn't mean that we spent a quarter watching share prices.

In watching the compounding unfold share prices are secondary, and much less interesting, the bit we enjoy is studying the companies' financial reports, listening to their conference calls and, where possible, meeting with management teams.

Over the last quarter the majority of the companies in which our clients are invested reported results for the period ended 30 June 2016 and therefore we have in fact been rather busy. In this commentary we would like to offer a window into how some of our larger holdings are faring, not from a share price point of view but rather from a business point of view. Remember that the unit trust's price is a function of the prices of the underlying securities. These prices are, in the long run, largely a function of the profits which underlying companies generate. Going down yet another layer, profits are, in the medium to long run, a function of whether the business is adding profitable clients and/or volumes. We have decided to report back on four of the fund's largest holdings.

Firstrand is currently the fund's largest holding and we were happy to see FNB grow its retail, premium and commercial customer base by an impressive 4%, 8% and 14% respectively. As we have grown accustomed to with this company, new ventures continue growing at a rapid rate. Earnings per share and dividends grew 8% despite a challenging banking environment. Firstrand maintained exceptional balance sheet strength and holds R13.8bn surplus capital which enables stability, dividend resilience and growth initiatives. Referencing Einstein's quote, it's much better to own the bank than to owe it.

Imperial Holdings, SA's logistics and automobile giant, endured very challenging economic conditions both locally and in its foreign markets. Even with an 8% decline in SA new vehicle sales, low consumer confidence and a 27% drop in the Rand vs the USD during the 2016 financial year, the Group still managed to generate free cash flow of R2,5bn and maintain its generous dividend.

Berkshire Hathaway continues to be an insurance provider of choice with premiums earned in the first half of 2016 exceeding those of the comparable 2015 period by 10%. Expressed differently, premiums earned increased by circa $2bn over the half year. To put this number in context, it almost equates to the market value of the entire Imperial Holdings. Berkshire's earnings per share grew by a very satisfactory 15.4% over the period. Berkshire continues to have tremendous balance sheet strength with its insurance operations holding Statutory Surplus capital of $124bn.

Discovery Holdings continues to grow its client base at an impressive rate adding 360,000 clients to its SA Health offering, 932,000 to its UK business and growing gross written premiums at Discovery Insure by 39%. Also Discovery has numerous exciting new initiatives which could add handsomely to profits in a couple of years. (One of these initiatives is an entry into the South African banking market.) Discovery managed a slight growth in profits, despite investing R823m in new initiatives. We ascribe tremendous value to management teams who are prepared to take short-term pain (through the income statement) for long-term gain. The market often takes an opposing view, which offers us a buying opportunity.

In the case of Firstrand, Berkshire Hathaway and Discovery the key individual(s) are aligned with those of shareholders by means of very significant nominal exposure in the form of direct shareholding. At Imperial the situation is different but sufficiently similar. Mark Lamberti, the CEO, does not have significant shareholding but his entire remuneration is in the form of shares which only vest a few years hence. He has elected to receive nil cash salary and nil cash bonus. Mr Lamberti has requested that the amount budgeted for his salary be donated towards tertiary education for the children of staff members. Partnering with such individuals is unlikely to disappoint.

Over the last quarter we had the privilege of meeting the management teams of Super Group, Imperial, EOH, Capitec Bank, Group Five and Hudaco. Meeting these management teams provides us with much deeper insight, not only into their companies but also the relevant and related industries.

All considered we are even more convinced that our clients are invested in companies which will endure the competitive pressures of the free market. We will attentively be watching that eighth Wonder of the World roll its magic to the benefit of our clients.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

"Compound interest is the eighth wonder of the world. He who understands it, earns it.....he who doesn't.....pays it".
Albert Einstein

Like the other seven Wonders of the World, compound interest is not man made.

We can't generate compound returns by means of trading, we make good investments and then watch them compound. In this light we are happy to report that there were no material changes to the holdings in or asset allocation of the PSG Stable Fund over the last quarter.

No trading doesn't mean that we spent a quarter watching share prices.

In watching the compounding unfold share prices are secondary, and much less interesting, the bit we enjoy is studying the companies' financial reports, listening to their conference calls and, where possible, meeting with management teams.

Over the last quarter the majority of the companies in which our clients are invested reported results for the period ended 30 June 2016 and therefore we have in fact been rather busy. In this commentary we would like to offer a window into how some of our larger holdings are faring, not from a share price point of view, but rather from a business point of view. Remember that the unit trust's price is a function of the prices of the underlying securities. These prices are, in the long run, largely a function of the profits which underlying companies generate. Going down yet another layer, profits are, in the medium to long run, a function of whether the business is adding profitable clients and/or volumes. We have decided to report back on the PSG Stable Fund's three largest holdings as well as Discovery, a position to which we have gradually been adding for many months now. We are proud to report that:

Firstrand is currently the fund's largest holding and we were happy to see FNB grow its retail, premium and commercial customer base by an impressive 4%, 8% and 14% respectively. As we have grown accustomed to with this company, new ventures continue growing at a rapid rate. Earnings per share and dividends grew 8% despite a challenging banking environment. Firstrand maintained exceptional balance sheet strength and holds R13.8bn surplus capital which enables stability, dividend resilience and growth initiatives. Referencing Einstein's quote, it's much better to own the bank than to owe it.

Imperial Holdings, SA's logistics and automobile giant, endured very challenging economic conditions both locally and in its foreign markets. Even with an 8% decline in SA new vehicle sales, low consumer confidence and a 27% drop in the Rand vs the USD during the 2016 financial year, the Group still managed to generate free cash flow of R2,5bn and maintain its generous dividend.

Berkshire Hathaway continues to be an insurance provider of choice with premiums earned in the first half of 2016 exceeding those of the comparable 2015 period by 10%. Expressed differently, premiums earned increased by circa $2bn over the half year. To put this number in context, it almost equates to the market value of the entire Imperial Holdings. Berkshire's earnings per share grew by a very satisfactory 15.4% over the period. Berkshire continues to have tremendous balance sheet strength with its insurance operations holding Statutory Surplus capital of $124bn.

Discovery Holdings continues to grow its client base at an impressive rate adding 360,000 clients to its SA Health offering, 932,000 to its UK business and growing gross written premiums at Discovery Insure by 39%. Also Discovery has numerous exciting new initiatives which could add handsomely to profits in a couple of years. (One of these initiatives is an entry into the South African banking market.) Discovery managed a slight growth in profits, despite investing R823m in new initiatives. We ascribe tremendous value to management teams who are prepared to take short-term pain (through the income statement) for long-term gain. The market often takes an opposing view, which offers us a buying opportunity.

In the case of Firstrand, Berkshire Hathaway and Discovery the key individual(s) are aligned with those of shareholders by means of very significant nominal exposure in the form of direct shareholding. At Imperial the situation is different but sufficiently similar. Mark Lamberti, the CEO, does not have significant shareholding but his entire remuneration is in the form of shares which only vest a few years hence. He has elected to receive nil cash salary and nil cash bonus. Mr Lamberti has requested that the amount budgeted for his salary be donated towards tertiary education for the children of staff members. Partnering with such individuals is unlikely to disappoint.

Over the last quarter we had the privilege of meeting the management teams of Super Group, Imperial, EOH, Capitec Bank, Group Five and Hudaco. Meeting these management teams provides us with much deeper insight, not only into their companies but also the relevant and related industries.

All considered, we are even more convinced that our clients are invested in companies which will endure the competitive pressures of the free market. We will attentively be watching that eighth Wonder of the World roll its magic to the benefit of our clients.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

The value of cash

The value of holding a significant cash amount in a portfolio is often questioned by various investors. At PSG Asset Management we view cash as an integral part of our risk management process in portfolio construction. Cash is the asset class that we revert to when we find less or no value in other asset classes at that time. We will happily sit in cash until opportunities arise in markets when quality goes on sale.

A good example of this was when we held no government bonds for some years before the latter part of 2015, when government bonds "went on sale" due to the unexpected changes in finance ministers. When markets become more uncertain and quality is sold at below average prices, it is then that we find the best opportunities to deploy cash. Holding cash in these situations becomes a powerful tool which can be used to deploy into bargains.

The one drawback of cash in the period from 2011 to 2014 was that short rates were so low that cash instrument yields were below inflation; in other words, the real yields (after inflation) were negative. Due to the more pro-growth stance of the South African Reserve Bank Monetary Policy Committee (MPC) in that time period, the Repo rate was lowered to 5%, while headline consumer price inflation (CPI) averaged around 6%. During that time, holding high cash balances in portfolios yielded returns below inflation, making the decision to sit in cash for an extended period of time challenging.

We have witnessed a change in the stance of the current MPC, where the focus has shifted from a largely pro-growth stance, to a more nuanced approach of balancing inflation targeting and economic growth. The current MPC has clearly stated that inflation expectations have to be anchored and that SA has to maintain a higher real policy rate to maintain currency and inflation stability. This resulted in the MPC increasing the Repo rate by 200 basis points in two and a half years, a protracted hiking cycle in SA terms. This has sent an important message to the market that the MPC remains committed to its inflation targeting mandate, notwithstanding the fact that economic growth in SA is low.

What this means for our investors?

Cash instruments are now yielding above the long-term average inflation rate. Holding cash is beneficial against the negative effects of inflation. We do not have to take massive term interest rate risks to achieve high real yields in holding these instruments as they are short- to medium-term in nature. We see that banks are willing to pay high real yields on these instruments to borrow money from investors like ourselves. We believe it is a good opportunity for our clients when we find high real yields at low risk.

We have allocated to longer dated bank NCD's as they remain attractive on a real yield basis given the level of risk and the expected path of inflation and interest rates. SA government bonds also remain an attractive asset class, due to the high real yield being offered as well as the low credit risk and high liquidity of these instruments. The outlook for economic growth remains low coupled with a temporarily elevated inflation. This is not a backdrop that is negative for fixed income. Global macro-factors support the "search for yield" argument and we have witnessed large foreign inflows into SA bonds. We are adding to the bond position on specific points of the nominal curve where the real yield has become more attractive given the duration risk.

We remain positive on valuation in specific areas of the credit market and will continue to search for real yields that are attractive at the appropriate level of risk. We have maintained equity exposure in counters that offer attractive risk.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

The value of cash

The value of holding a significant cash amount in a portfolio is often questioned by various investors. At PSG Asset Management we view cash as an integral part of our risk management process in portfolio construction. Cash is the asset class that we revert to when we find less or no value in other asset classes at that time. We will happily sit in cash until opportunities arise in markets when quality goes on sale.

A good example of this was when we held no government bonds for some years before the latter part of 2015, when government bonds "went on sale" due to the unexpected changes in finance ministers. When markets become more uncertain and quality is sold at below average prices, it is then that we find the best opportunities to deploy cash. Holding cash in these situations becomes a powerful tool which can be used to deploy into bargains.

The one drawback of cash in the period from 2011 to 2014 was that short rates were so low that cash instrument yields were below inflation; in other words, the real yields (after inflation) were negative. Due to the more pro-growth stance of the South African Reserve Bank Monetary Policy Committee (MPC) in that time period, the Repo rate was lowered to 5%, while headline consumer price inflation (CPI) averaged around 6%. During that time, holding high cash balances in portfolios yielded returns below inflation, making the decision to sit in cash for an extended period of time challenging.

We have witnessed a change in the stance of the current MPC, where the focus has shifted from a largely pro-growth stance, to a more nuanced approach of balancing inflation targeting and economic growth. The current MPC has clearly stated that inflation expectations have to be anchored and that SA has to maintain a higher real policy rate to maintain currency and inflation stability. This resulted in the MPC increasing the Repo rate by 200 basis points in two and a half years, a protracted hiking cycle in SA terms. This has sent an important message to the market that the MPC remains committed to its inflation targeting mandate, notwithstanding the fact that economic growth in SA is low.

What this means for our investors?

Cash instruments are now yielding above the long-term average inflation rate. Holding cash is beneficial against the negative effects of inflation. We do not have to take massive term interest rate risks to achieve high real yields in holding these instruments as they are short- to medium-term in nature. We see that banks are willing to pay high real yields on these instruments to borrow money from investors like ourselves. We believe it is a good opportunity for our clients when we find high real yields at low risk.

We have allocated to longer dated bank NCD's as they remain attractive on a real yield basis given the level of risk and the expected path of inflation and interest rates. SA government bonds also remain an attractive asset class, due to the high real yield being offered as well as the low credit risk and high liquidity of these instruments. The outlook for economic growth remains low coupled with a temporarily elevated inflation. This is not a backdrop that is negative for fixed income. Global macro-factors support the "search for yield" argument and we have witnessed large foreign inflows into SA bonds. We are adding to the bond position on specific points of the nominal curve where the real yield has become more attractive given the duration risk.

We remain positive on valuation in specific areas of the credit market and will continue to search for real yields that are attractive at the appropriate level of risk.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

The world around us (and investing) is always uncertain

Prior to the UK referendum on exiting the European Union (Brexit), most pollsters predicted a comfortable victory for the Remain camp and, in a similar fashion, forecasters widely expected the Colombian people to vote in favour of ratifying the proposed peace deal between the government and FARC guerrillas. They were wrong on both accounts.

As we told investors at our most recent roadshow, it is important to be aware that future outcomes are inherently uncertain, even though popular opinion often tries to suggest otherwise.

A PSG Asset Management we spend very little time in trying to predict uncertain future outcomes (such as the upcoming US presidential election) but instead focus our efforts on understanding company fundamentals and valuations in a bottom-up fashion. This results in the construction of diversified portfolios that should deliver on their objectives no matter what the future holds.

Improved results but valuation gaps still wide

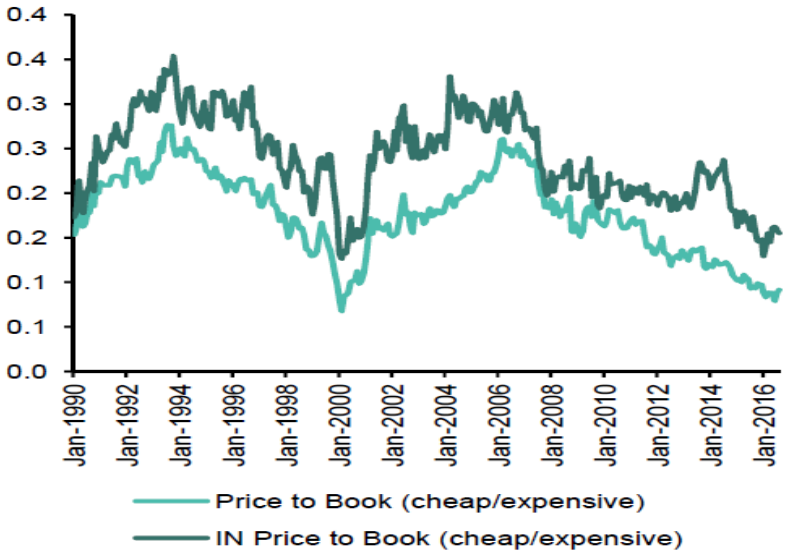
In previous commentaries we wrote about the divergences that we have been observing within valuations on global equity markets and the opportunities this has thrown up for bottom-up, price sensitive investors such as ourselves.

Although most of 2016 has still been plagued by uncertainties, the reversal of last year's performance trends continued which has resulted in cheaper, less popular stocks outperforming some of the more expensive high quality companies that dominated market performance over previous years. While valuation divergences are still extreme it is positive to note that the performance of the fund is well ahead of the market (MSCI World Index) both year to date and over the past 12 months.

We are still of the opinion that many high quality so-called "defensive" companies are materially overpriced or at best should lead to poor investment returns going forward while good quality, slightly more cyclical companies, present a great opportunity to long term investors. We have made the point that we are finding that value stocks are the cheapest they have been in relative terms since the tech bubble of the late 1990s.

The chart below shows the relative median valuation (as measured by Price to Book) of the most expensive quintile of US stocks (the top 20%) relative to the cheapest quintile (the bottom 20%), both on an index level and within industries (shown as Industry Neutral (IN) in the chart) going all the way back to 1990.

Chart 1: Valuation of industry-neutral and non-industry neutral price/book



Source: MSCI, Thomson Reuters, Bernstein Research

As can be seen in the chart, not only are cheap stocks as cheap relative to their expensive counterparts as was last seen in the dot-com boom, but even within industries the valuation gap is at extreme levels. This is especially encouraging as it allows us to construct diversified portfolios without taking excessive sector or industry risk.

If we look at the fund's holdings at the end of the quarter, valuation of the equities in the fund was attractive with an average price to earnings ratio (PE) of 13.7 times and price to book ratio (P/B) of 1.4 times. This compares well to that of the MSCI World Index which was trading at a PE of 21.5 times and P/B of 2.16 times at the end of September.

Significant changes were made during the third quarter

Portfolio turnover has generally been low and we continue to have high conviction in the fund's top holdings. Companies in the fund's top 10 remained relatively unchanged over the quarter, with the exception of **Softbank** which we significantly reduced after our calculation of its discount to intrinsic value narrowed. This was predominantly due to the large increase in the share price of its key investment in **Alibaba** from $80 to $109 and a recovery in US telecoms operator **Sprint** which saw its share price increase from $4.50 to $6.92.

An addition to the top 10 was **Qualcomm** which we initially added to the fund in the 1st quarter and we significantly increased our conviction in **Yahoo Japan** which we deem to be materially undervalued given its long-term earnings power which its current investment programme is temporarily disguising.

It is also pleasing to report that we continue to find new opportunities and have introduced a number of new holdings to the fund which we expect to be the source of future returns.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management

The world around us (and investing) is always uncertain

Prior to the UK referendum on exiting the European Union (Brexit), most pollsters predicted a comfortable victory for the Remain camp and, in a similar fashion, forecasters widely expected the Colombian people to vote in favour of ratifying the proposed peace deal between the government and FARC guerrillas. They were wrong on both accounts.

As we told investors at our most recent roadshow, it is important to be aware that future outcomes are inherently uncertain, even though popular opinion often tries to suggest otherwise.

A PSG Asset Management we spend very little time in trying to predict uncertain future outcomes (such as the upcoming US presidential election) but instead focus our efforts on understanding company fundamentals and valuations in a bottom-up fashion. This results in the construction of diversified portfolios that should deliver on their objectives no matter what the future holds.

Improved results but valuation gaps still wide

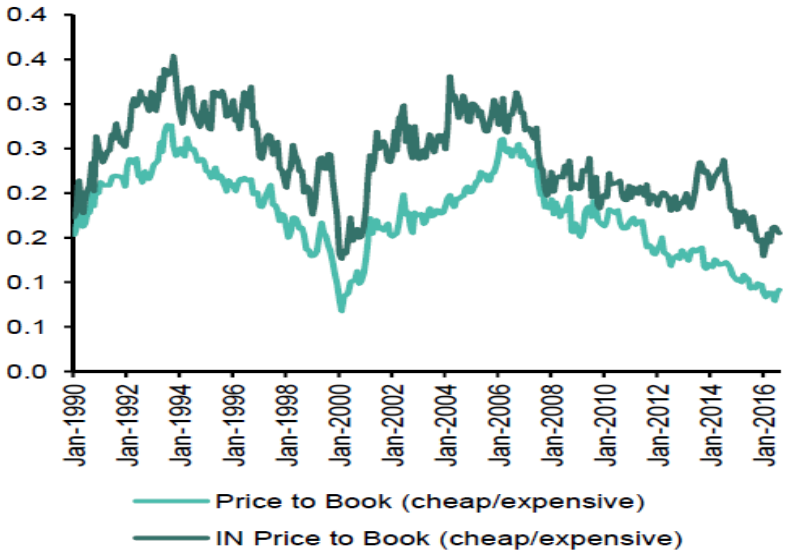
In previous commentaries we wrote about the divergences that we have been observing within valuations on global equity markets and the opportunities this has thrown up for bottom-up, price sensitive investors such as ourselves.

Although most of 2016 has still been plagued by uncertainties, the reversal of last year's performance trends continued which has resulted in cheaper, less popular stocks outperforming some of the more expensive high quality companies that dominated market performance over previous years. While valuation divergences are still extreme it is positive to note that the performance of the fund is well ahead of the market (MSCI World Index) both year to date and over the past 12 months.

We are still of the opinion that many high quality so-called "defensive" companies are materially overpriced or at best should lead to poor investment returns going forward while good quality, slightly more cyclical companies, present a great opportunity to long term investors. We have made the point that we are finding that value stocks are the cheapest they have been in relative terms since the tech bubble of the late 1990s.

The chart below shows the relative median valuation (as measured by Price to Book) of the most expensive quintile of US stocks (the top 20%) relative to the cheapest quintile (the bottom 20%), both on an index level and within industries (shown as Industry Neutral (IN) in the chart) going all the way back to 1990.

Chart 1: Valuation of industry-neutral and non-industry neutral price/book



Source: MSCI, Thomson Reuters, Bernstein Research

As can be seen in the chart, not only are cheap stocks as cheap relative to their expensive counterparts as was last seen in the dot-com boom, but even within industries the valuation gap is at extreme levels. This is especially encouraging as it allows us to construct diversified portfolios without taking excessive sector or industry risk.

If we look at the fund's holdings at the end of the quarter, valuation of the equities in the fund was attractive with an average price to earnings ratio (PE) of 13.7 times and price to book ratio (P/B) of 1.4 times. This compares well to that of the MSCI World Index which was trading at a PE of 21.5 times and P/B of 2.16 times at the end of September.

Significant changes were made during the third quarter

Portfolio turnover has generally been low and we continue to have high conviction in the fund's top holdings. Companies in the fund's top 10 remained relatively unchanged over the quarter, with the exception of **Softbank** which we significantly reduced after our calculation of its discount to intrinsic value narrowed. This was predominantly due to the large increase in the share price of its key investment in **Alibaba** from $80 to $109 and a recovery in US telecoms operator **Sprint** which saw its share price increase from $4.50 to $6.92.

An addition to the top 10 was **Qualcomm** which we initially added to the fund in the 1st quarter and we significantly increased our conviction in **Yahoo Japan** which we deem to be materially undervalued given its long-term earnings power which its current investment programme is temporarily disguising.

It is also pleasing to report that we continue to find new opportunities and have introduced a number of new holdings to the fund which we expect to be the source of future returns.

At the end of September the PSG Global Flexible Fund had 15.5% of its assets in cash which will allow us to take advantage of opportunities if and when they arise.

MANAGEMENT COMPANY: PSG Collective Investments (RF) Limited, 1st Floor, PSG House, Alphen Park, Constantia Main Road, Constantia 7806
Tel: +27 (21) 799 8000, Email: asset.management@psg.co.za, Website: www.psg.co.za/asset-management