



## PSG Wealth domestic equity funds of funds and PSG Wealth domestic multi-asset funds of funds (FoFs)

The FTSE/JSE All Share Index (J203T) lost 4.57% in the third quarter, as emerging markets came under pressure from renewed fears over US-China trade relations. Year to date, the ALSI delivered 7.08%, with the gold mining sector specifically having a good run returning 64.68%. However, investor sentiment remains relatively poor, with concerns over domestic economic growth, political uncertainty and global trade fears placing a damper on markets. Emerging markets underperformed developed markets by 5.14% in rand terms over the last quarter, and by 12.35% year to date. The rand weakened by 7.70% against the US dollar and ended the quarter at R15.19 per USD.

All three equity and asset allocation FoFs remain above their peer group averages over three and five years. All these funds have also outperformed their peer group averages over the five-year investment period. The equity and multi-asset high equity FoFs outperformed their benchmarks over the last quarter, while the multi-asset low equity FoF slightly underperformed.

Performance over the quarter was boosted by a recovery over September in some of the underlying managers that have lagged the sector averages over the last 12 to 18 months, due mainly to higher exposure to growth assets. In the case of the multi-asset low equity FoF short-term, underperformance was mainly due to growth asset exposure by some of the more aggressive managers. However, their long-term numbers remain top quartile.

The PSG Wealth equity and asset allocation FoFs are well diversified in terms of investment styles, asset classes and asset class sectors. However, prevailing market conditions are not favourable to all investment styles at all times. It is therefore not uncommon to see some underlying managers underperform the benchmark over the shorter measurement periods.

Over the quarter, the PSG Wealth research team undertook a holistic review of all our domestic FoFs. We did not just consider finer technical details, but more explicitly asked simple but important questions, like:

- How can we make our offering better?
- Where do we experience challenges?
- Are we as competitive as we would like to be?
- Are we delivering on promises?

The idea behind the holistic review was to identify areas in which we can make recommendations in line with the fundamental components, which we often refer to as our three pillars:

- consistent above-sector average returns
- consistent below-sector average risk
- consistent below-sector average fees

**Table 1: Fund performance versus sector average**

Fund	3-Months to 2019/09/30	Rank	1-Year to 2019/09/30	Rank	3-Years to 2019/09/30	Rank	5-Years to 2019/09/30	Rank
PSG Wealth Creator FoF D	-2.83	54	-2.45	94	2.86	41	3.82	40
South African EQ General Sector Average	-3.72	161	-1.61	154	1.22	128	2.40	99
PSG Wealth Moderate FoF D	-0.05	104	0.37	147	4.45	41	5.89	20
South African MA High Equity Sector Average	-0.06	194	2.03	185	3.72	153	4.83	99
PSG Wealth Preserver FoF D	0.92	98	3.73	108	5.58	56	6.73	25
South African MA Low Equity Sector Average	1.15	152	5.03	145	5.42	125	6.01	84

Source: PSG Wealth research team

**Table 2: Asset allocation**

Exposure of the PSG Wealth domestic asset allocation FoFs	Previous quarter		Current quarter	
	PSG Wealth Preserver FoF	PSG Wealth Moderate FoF	PSG Wealth Preserver FoF	PSG Wealth Moderate FoF
Weight	100%	100%	100%	100%
Resources	3.24	6.80	3.08	7.92
Financials (excluding real estate)	6.60	12.12	6.16	12.23
Industrials	10.17	22.97	10.68	20.81
Other equities	0.21	0.24	0.20	0.34
Equity hedges (+ long/- short)		-0.41		
Total equities (exclng real estate)	20.22	41.72	20.11	41.30
Real estate	5.53	4.97	5.33	4.45
Preference shares	0.08	0.02	0.06	0.02
Inflation-linked bonds	9.93	2.07	9.69	2.18
Bonds 7+ years	10.63	14.38	12.69	13.33
Bonds 3-7 years	5.20	1.99	4.12	1.68
Bonds 1-3 years	6.61	1.25	4.49	1.46
Cash, derivatives and money market	20.04	7.59	20.85	6.27
Total non-equities (including real estate)	58.03	32.26	57.24	29.38
Equities	15.54	24.63	16.05	26.37
Real estate	1.27	1.15	1.29	1.18
Bonds	2.91	0.54	2.79	0.53
Other equities			0.55	
Cash, derivatives and money market	2.03	-0.29	1.98	1.25
Total foreign	21.75	26.03	22.66	29.32
Total	100	100	100	100
Total equities	35.76	66.34	36.16	67.67
Total foreign	21.75	26.03	22.66	29.32

Source: PSG Wealth research team

## A summary of research findings and subsequent actions

### PSG Wealth Preserver FoF – Review

The PSG Wealth Preserver FoF's recent and long-term performance, risk metrics and fees were reviewed. The team specifically looked at headwinds and tailwinds which could affect the fund's future performance.

The research team's suggested course of action was to add an additional manager to diversify exposure (from five to six) (limiting the impact of one to two managers underperforming), which would allow us to have exposure to more aggressive managers (long-term alpha drivers) and be able to provide a sufficient number of managers (and complementary positioning) to support these managers as they tend to be more volatile (+ larger risk of drawdowns).

The research team identified a shortlist of potential managers (based on quantitative and qualitative factors). Each of these managers underwent detailed qualitative and quantitative assessments.

After reviewing the simulations of each proposed change and the effect it would have had historically, as well as the qualitative research going forward, the fund committee agreed to increase the number of underlying managers in the PSG Wealth Preserver FoF from five to six, by adding the Investec Cautious Managed Fund.

We expect this will limit the impact on FoF performance when long-term alpha-driver funds underperform. Further, we anticipate this will enhance the short-term resilience of the fund without compromising its longer-term return prospects.

### PSG Wealth Moderate FoF – Review

The consistency of the Moderate FoF's performance, risk metrics and fees were reviewed. The team specifically looked at headwinds and tailwinds which could affect the fund's future performance and investigated short-term underperformance from underlying managers.

The research did not identify concerns over existing managers after extensive qualitative and quantitative reviews, but did highlight the need for further diversification within the FoF return mix. Specifically, this recommendation is focused on increasing consistency of performance and protecting the FoF against any one or two managers underperforming in the short term.

**Table 3: Sector allocation**

Equity exposure of the PSG Wealth Creator FoF		Previous quarter	
		Current quarter	
		PSG Wealth Creator FoF	PSG Wealth Creator FoF
Domestic equity sectors	Resources	23,3	23,7
	Financials	20,6	21,9
	Industrials	35,5	34,8
	Other Equities	1,3	
	Equity Hedges ( + Long/ - Short)		
Total Domestic Equities		80,7	80,4
Total Foreign Equities		14,1	15,3
Total Equities		94,8	95,6

Source: PSG Wealth research team

**Table 4: Sector allocation**

Non-equity exposure of the PSG Wealth domestic fixed interest FoFs		Previous quarter		Current quarter	
		PSG Wealth Enhanced Interest Fund	PSG Wealth Income FoF	PSG Wealth Enhanced Interest Fund	PSG Wealth Income FoF
Domestic non-equities (incl. real estate)	Real estate		3.02		2.94
	Preference shares		1.31		1.28
	Inflation-linked bonds		5.61		6.04
	Bonds 7+ years		12.76		11.92
	Bonds 3 – 7 years		10.90		10.12
	Bonds 1 – 3 years		11.67		11.29
	Cash, derivatives and money market	100	43.14	100	45.18
	Total domestic non-equities (incl. real estate)	100	88.26	100	88.78
Foreign non-equities (incl. real estate)	Real estate		0.78		0.87
	Bonds		5.59		4.35
	Other				1.11
	Cash, derivatives and money market		2.42		2.08
	Total foreign non-equities (incl. real estate)		8.79		9.63
Total non-equities (incl. real estate)		100	97.04	100	98.41

Source: PSG Wealth research team

The research team's proposal was thus to add an additional manager to diversify exposure (from five to six), thus adding a complementary return stream to the existing manager mix. Our view is that adding an additional manager should increase the consistency of performance and decrease short-term volatility and drawdowns in the solution.

The research team identified a shortlist of potential managers based on qualitative and quantitative assessments. Each of these managers underwent detailed qualitative and quantitative assessments.

After reviewing the simulations of each proposed change and the effect it would have had historically, as well as the qualitative research going forward, the fund committee approved the addition of the Nedgroup Core Diversified Fund as a sixth manager in the portfolio.

The fund has been on our radar for some time, and multiple interviews took place with the manager over the last 18 months. We anticipate that adding the fund will reduce the volatility in the solution and should lower the total investment cost (TIC).

### PSG Wealth Creator FoF – Review

No changes were recommended for the PSG Wealth Creator FoF, although it was also reviewed. The fund is performing well and has been very resilient despite recent underperformance from some underlying managers.

The research team noted that adding the Fairtree Equity Fund as the sixth manager has added a lot of value and has reduced the impact of two managers underperforming in the short term (PSG AM and Old Mutual). Within an equity mandate, the longer minimum investment horizon (of 7 years) allows for more, high active-share/high tracking error managers. Overall, the FoF is doing relatively well, and we believe the current composition remains good.

### Fund changes (Equity and multi-asset FoFs)

In summary, the domestic FoF research resulted in the following changes within the equity and asset allocation FoFs:

#### PSG Wealth Preserver FoF

- Investec Cautious Managed Fund added as a sixth manager to the FoF.

#### PSG Wealth Moderate FoF

- Nedgroup Investments Core Diversified Fund added as a sixth manager to the FoF.

#### PSG Wealth Creator FoF

- No change

### Asset/sector allocation within equity and multi-asset FoFs

The composition of the PSG Wealth Creator FoF changed slightly over the quarter, as the underlying managers increased their exposure to offshore equities and domestic financials while lowering exposure to domestic industrial shares.

**Table 5: Sector allocation**

Equity exposure of the PSG Wealth Creator FoF		Previous quarter	Current quarter
		PSG Wealth Creator FoF	PSG Wealth Creator FoF
Domestic equity sectors	Resources	23.25	23.31
	Financials	21.99	20.63
	Industrials	35.83	35.46
	Other equities	0	1.28
	Equity hedges (+ long/- short)		
Total domestic equities		81.07	80.67
Total foreign equities		13.71	14.12
Total equities		94.78	94.79

Source: PSG Wealth research team

The underlying managers of the PSG Wealth Preserver FoF have further increased their domestic longer-dated bonds and cash, while reducing their allocation to property, local and offshore. The underlying managers of the PSG Wealth Moderate FoF have increased their exposure to domestic equities and cash, while decreasing offshore cash. Offshore assets were reduced by 2.20% over the quarter.

### PSG Wealth fixed interest funds

The PSG Wealth Income FoF performed on par with the average fund in its peer group over the last quarter and over three years. The PSG Wealth Enhanced Interest Fund has outperformed the average money market fund over the last quarter, one-year and three-year investment periods ending September 2019.

### PSG Wealth Enhanced Interest – Review

The PSG Wealth Enhanced Interest Fund is performing as expected and delivering on its objectives. However, certain headwinds and tailwinds have been identified. We are reviewing the segregated mandate in the portfolio and debating converting this fund into a fund of funds (FoF).

### PSG Wealth Income FoF – Review

The PSG Wealth Income FoF is doing reasonably well, but the fund research team is not completely satisfied with the portfolio's resilience over the short term.

Although the fund composition is balanced, the higher beta managers in the solution have experienced more pressure than we think is ideal. The research team has therefore recommended adding an additional lower beta manager to this FoF to diversify exposure and support the more aggressive managers whose performance tends to be more volatile.

Possible alternatives were identified and each of these managers underwent detailed qualitative and quantitative assessments. After identifying and discussing the relevant headwinds and tailwinds the committee reviewed recommended changes proposed by the research team to add an additional manager(s) to diversify exposure (limiting the impact of one to two managers underperforming) and possibly introduce a sector split/style exposure (traditional/multi-asset/credit), which could benefit the FoF by obtaining exposure to areas currently not used.

After reviewing the simulations of each proposed change and the effect it would have had historically, as well as the qualitative research going forward, the committee agreed to add the Momentum Income Plus Fund to the solution. It is a high-yield income fund (focused on credit instruments) with a low correlation to traditional income funds. By doing so, we are aiming to reduce volatility and anticipate a slightly lower TIC in the solution going forward.

### Asset/sector allocation within fixed income funds

The managers in the PSG Wealth Income FoF have increased their exposure to domestic inflation-linked bonds, medium- and long-term bonds, while reducing exposure to domestic property and short-dated bonds. Longer-dated domestic bonds had another strong quarter, outperforming the shorter-dated domestic bonds by 1.30%. Listed property delivered 0.10% for the quarter but remains a significant detractor over the last 12 months, with the sector scraping together a return of 0.10%, well below domestic bonds (10.90%).

**Table 6: Fund performance versus sector average**

Fund	3-Months to 2019/09/30	Rank	1-Year to 2019/09/30	Rank	3-Years to 2019/09/30	Rank
PSG Wealth Income FoF D	2.19	49	7.76	51	8.10	27
South African MA Income Sector Average	2.18	93	8.49	75	8.02	60
PSG Wealth Enhanced Interest D	1.96	1	7.99	1	8.08	1
South African IB Money Market Sector Average	1.84	31	7.51	31	7.61	26

Source: PSG Wealth research team