The PSG Flexible Fund: equity-like returns at lower risk

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Basic fund information:

Fund name:	PSG Flexible Fund
Fund size:	R7.7 billion (as at end March 2016)
ASISA sector:	Multi Asset – Flexible
Benchmark:	Inflation plus 6%
Managers:	Shaun le Roux and Paul Bosman

The fund aims to deliver equity-like returns at lower levels of risk

The PSG Flexible Fund has been managed in terms of its current mandate and benchmark since 1 November 2004. Since then, the fund has aimed to provide investors with equity-like returns, but at lower levels of risk. It is therefore appropriate for investors who want near-equity returns, but with significantly less volatility. Since 2004, the PSG Flexible Fund has delivered a compounded annual return of 17.5% at a standard deviation of 9.8%. Over the same period, the FTSE/JSE All Share Index (ALSI) has produced a compounded annual return of 17.4%, but at a standard deviation of 15.6% (as shown in Table 1).

Asset allocation is crucial to the fund meeting its objectives

The fund has a flexible asset allocation mandate and falls into a sector that allows this flexibility. In fact, the PSG Flexible Fund has the most flexible mandate of all the PSG Asset Management funds. The fund has traditionally had a simple asset allocation. Equity exposure can vary from 0% to 100%, and up to 25% of the fund may be invested outside South Africa. Historically, the fund's equity exposure has varied between 60% and 100%, with an average exposure of 75%.

Asset allocation is done based on opportunity. If we can find many undervalued shares, we have a higher equity exposure and a lower cash exposure. If we can find fewer opportunities, we are happy to wait patiently, during which time the fund will have a higher cash exposure.

Capital allocation is done patiently. There is not a lot of trading in the fund as we wait for opportunities to arise. Unlike a pure equity fund, which must have an equity exposure of between 75% and 100% at all times, the PSG Flexible Fund does not have this limitation.

When company valuations are high, the fund tends to have a higher level of cash, and vice versa. For example, in 2007, we began to find fewer and fewer companies that met our investment criteria. This was primarily due to the fact that high-quality, well-managed companies were not trading at a sufficient margin of safety. When these companies reached what we felt were their intrinsic values, we therefore sold them and were unable to use the proceeds of these sales effectively. At the time, the cash in the fund was at relatively high levels.

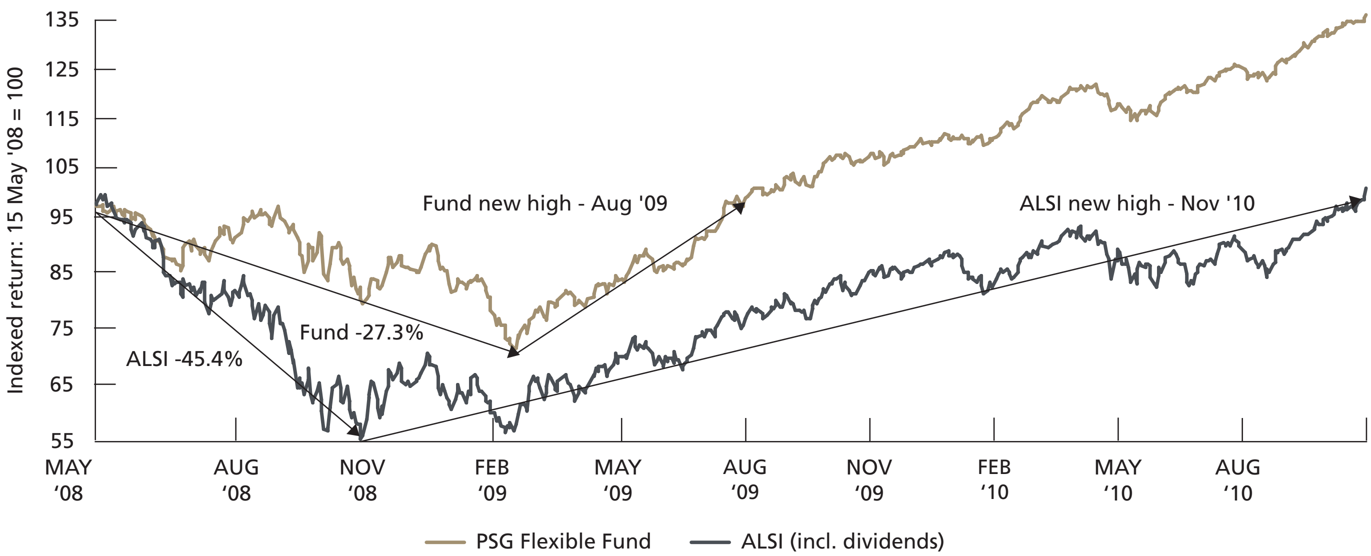
During the financial crisis of 2008, the fund was well positioned to both limit the drawdown in its value and then, as valuations became ever more attractive, to take advantage of the sale-level prices. As a result, the fund was able to buy shares in companies that had become substantially cheaper. During the crisis, the value of the ALSI fell 45.4%, while the value of the fund only fell 27.3%. Within 15 months, the fund had recovered to its pre-crisis valuation, whereas the ALSI took twice as long. By the time the ALSI recovered, the value of the fund had grown by 35% from its pre-crisis level (as shown in Graph 1).

Table 1: Performance of the PSG Flexible Fund since 2004

	PSG Flexible Fund	Sector ranking	Benchmark (Inflation +6%)	Average cash holding	ALSI
Since 1 Nov '04	17.6%	2nd out of 13	11.9%	26.4%	17.4%
10 years	15.1%	4th out of 29	12.1%	25.5%	12.1%
5 years	15.3%	12th out of 47	11.6%	28.2%	11.8%
3 years	16.1%	6th out of 52	11.6%	28.6%	11.6%
2 years	11.0%	13th out of 59	11.5%	33.5%	11.5%
1 year	5.9%	15th out of 66	13.0%	35.6%	13.0%
Volatility (5 years)	8.0%				11.3%
Positive months	72.3%				65.0%

Sources: Morningstar, PSG Asset Management

Graph 1: Performance of the PSG Flexible Fund versus the ALSI (2008 - 2010)



Sources: Morningstar, PSG Asset Management

Our experienced Equity Investment Committee helps the fund managers decide in which shares to invest

PSG Asset Management has a well-established equity process. Our Equity Investment Committee consists of 10 members who are all fund managers or analysts. Since 2004, these committee members have received 10 industry awards for the funds that they have managed.

The team spends most of their time researching companies listed not only on our local exchange, but also on stock exchanges across the world. We look for companies that have a sustainable competitive advantage (a moat), are well managed and that are trading at less than we believe they are worth (a margin of safety). In many instances, we have invested where the company's management has a large shareholding, or where a large strategic shareholder exists. We believe that when the interests of management and shareholders are aligned, management teams tend to act with a long-term focus in their mutual interests.

The outcome of our Equity Investment Committee's research is our local and global buy lists. These lists include our best ideas, and are used by our fund managers to populate the funds that they manage. Fund managers can use their discretion when it comes to constructing portfolios, but they use the buy lists as their main tool. As a result, our funds' holdings overlap significantly with the buy lists. Ultimately, fund managers take responsibility for their fund's performance.

Generally, the shares in the fund do not change very often, due to the fund's long-term focus

Once we have bought the shares in the fund, we are content to wait patiently for them to re-rate. Due to this long-term focus, the holdings in the PSG Flexible Fund do not change very frequently. We like to buy when there is fear and panic in the market and tend to be cautious during times of greed and complacency. The total valuation of the shares in the fund has always been lower than that of the ALSI, an indication of its more conservative risk profile.

The fund should continue to offer market-beating returns to investors going forward

The fund is currently invested in local and global companies that we believe meet our investment criteria. These include companies such as Berkshire Hathaway, Sainsbury, Super Group, Anglo American and FirstRand that have strong brands and that are selling at bargain prices. The weighted average price-to-book ratio of the fund was at the lowest it had ever been in the first quarter of this year – even lower than it was during the financial crisis. This bodes well for the future returns of the fund and, as a result, for its investors.

At the end of the first quarter, the fund's local equity exposure was 45.8% and was well diversified across geographies and industries.