PSG Equity Fund

Quarterly portfolio commentary as at 31 December 2018
by Shaun le Roux, Greg Hopkins and Gustav Schulenburg

Current context

2018 was a tough year for most investors. After a 'Ramaphoric' start, the JSE experienced its worst year since the global financial crisis. Market sentiment swayed as South Africa's economic reality set in and, compounded by investor aversion towards emerging markets in general, the FTSE/JSE All Share Index ended the year 9% down in rand terms. The rand, having rallied to R11.50 against the US dollar, was trading at R14.35 at year end. Generally, developed markets also disappointed, and while the US largely managed to buck this trend, ongoing uncertainty about trade relations with China and a series of interest rate hikes by the US Federal Reserve spurred market jitters. The S&P 500 closed the year on $2 506.85, down from $2 673.61 on 1 January 2018, after a sharp sell-off in the final quarter.

Our perspective

While it may feel uncomfortable or even frightening, times like these – clouded by fear and uncertainty – tend to present the best investment opportunities. As Warren Buffett once said, "Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold. When downpours of that sort occur, it's imperative that we rush outdoors carrying washtubs, not teaspoons."

We believe that South Africa currently offers a standout investment opportunity. While rolling five-year returns of the FTSE/JSE All Share Index to December 2018 have only been poorer on four occasions over the past 40 years, three-year annualised returns following previous low points averaged around 24%. Furthermore, the domestic-facing companies our portfolios currently hold are, on average, trading at price-earnings ratios of 8 to 9 times. This has created the opportunity for strong potential returns in future.

Similarly, we continue to find value in selected global counters. While overall market valuations remain elevated when compared to history despite recent declines, there continue to be pockets characterised by fear and uncertainty. Here, low prices and low expectations have resulted in quality assets trading at wide margins of safety. A few examples include Brookfield Asset Management, Japan Post Insurance, L Brands and The Mosaic Company; companies our portfolios have held for some time and which we still believe offer attractive return prospects.

Portfolio positioning

Our preference remains for above-average quality businesses trading at wide margins of safety, and preferably on low levels of earnings. This combination increases the likelihood of favourable returns over the long run. We believe that current market conditions are likely to support above-average long-term returns.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Domestic equity	66.7%	Domestic equity	72.1%
Domestic property	1.2%	Domestic property	0.0%
Domestic cash	0.5%	Domestic cash	0.5%
Foreign equity	29.2%	Foreign equity	25.5%
Foreign property	2.2%	Foreign property	1.8%
Foreign cash	0.2%	Foreign cash	0.1%

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

All data as per Bloomberg to 31 December 2018.

Disclaimer

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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.

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Conflict of interest disclosure

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Trustees

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We believe that South Africa currently offers a standout investment opportunity. While rolling five-year returns of the FTSE/JSE All Share Index to December 2018 have only been poorer on four occasions over the past 40 years, three-year annualised returns following previous low points averaged around 24%. Furthermore, starting yields in both the fixed income and equity markets are high. 20-year government bonds are offering yields of around 10%, and the domestic-facing companies our portfolios currently hold are, on average, trading at price-earnings ratios of 8 to 9 times. This has created the opportunity for strong potential returns in future.

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Portfolio positioning

Equity exposure increased in 2018 as the market sell-off presented opportunities: domestic equities increased from 52.6% as at end December 2017 to 54.4% at the end of 2018, while global equities and property increased from 17.3% to 28.5%. Our preference remains for above-average quality businesses trading at wide margins of safety, and preferably on low levels of earnings. This combination increases the likelihood of favourable long-term returns. The fund also bought long-dated South African government bonds in 2018 on account of the attractive real yields and our expectations of equity-like returns from these securities. The R2037 bond represents 6.6% of portfolio value.

Because of these purchases, cash levels reduced to 9.9%. We view this as healthy firepower that we can employ if further market disruption occurs.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Domestic equity	47.0%	Domestic equity	54.4%
Domestic cash	16.7%	Domestic cash	9.8%
Domestic gold	0.7%	Domestic gold	0.6%
Domestic bonds	6.2%	Domestic bonds	6.6%
Domestic property	0.7%	Domestic property	0.0%
Foreign cash and gold	0.1%	Foreign cash	0.1%
Foreign equity	25.6%	Foreign equity	25.5%
Foreign property	3.0%	Foreign property	3.0%

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Similarly, we continue to find value in selected global counters. While overall market valuations remain elevated when compared to history despite recent declines, there continue to be pockets characterised by fear and uncertainty. Here, low prices and low expectations have resulted in quality assets trading at wide margins of safety. A few examples include Brookfield Asset Management, Japan Post Insurance, L Brands and The Mosaic Company; companies our portfolios have held for some time and which we still believe offer attractive return prospects.

Portfolio positioning
Equity exposure increased in 2018 as opportunities were presented by the market sell-off. While the fund's weighting to domestic equities was broadly unchanged, exposure to global equities (including foreign property) increased from 20.6% as at December 2017 to 26.4% at the end of 2018. Within equities, our preference remains for above-average quality businesses trading at wide margins of safety, and preferably on low levels of earnings. This combination increases the likelihood of favourable long-term returns.

Real yields on South African government bonds remain attractive and we continued to add to this position in 2018. The additions where mostly in the form of inflation-linked bonds (exposure increased from 0.3% to 3.5% over the year) and government-guaranteed Eskom bonds, in which the fund has an aggregate exposure of 3.6% as at 31 December 2018. (These bonds are guaranteed by National Treasury, which means that national government will pay bondholders if Eskom is not able to do so.) Over the year, the fund's holding in long-dated South African government bonds reduced slightly from 10.3% to 9.5%.

On the back of tightening credit spreads, the fund reduced exposure to credit from 12.9% to 9.0%.

Due to these changes in portfolio composition, overall cash levels (which include long-dated negotiable certificates of deposit) reduced from 14.6% to 7.1% over the year. The fund therefore continues to have plenty of firepower that we can employ if further market disruption occurs.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Domestic equity	37.9%	Domestic equity	40.9%
Domestic cash and NCDs	8.6%	Domestic cash and NCDs	6.7%
Domestic bonds	24.8%	Domestic bonds	25.6%
Foreign equity	25.3%	Foreign equity	23.6%
Foreign cash	0.5%	Foreign cash	0.4%
Foreign property	2.9%	Foreign property	2.8%

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Regulation 28

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Performance

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PSG Stable Fund

Quarterly portfolio commentary as at 31 December 2018

by Paul Bosman, Greg Hopkins and Dirk Jooste

Current context

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Our perspective

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We believe that South Africa currently offers a standout investment opportunity. While rolling five-year returns of the FTSE/JSE All Share Index to December 2018 have only been poorer on four occasions over the past 40 years, three-year annualised returns following previous low points averaged around 24%. Furthermore, starting yields in both the fixed income and equity markets are high. 20-year government bonds are offering yields of around 10%, and the domestic-facing companies our portfolios currently hold are, on average, trading at price-earnings ratios of 8 to 9 times. This has created the opportunity for strong potential returns in future.

Similarly, we continue to find value in selected global counters. While overall market valuations remain elevated when compared to history despite recent declines, there continue to be pockets characterised by fear and uncertainty. Here, low prices and low expectations have resulted in quality assets trading at wide margins of safety. A few examples include Brookfield Asset Management, Japan Post Insurance, L Brands and The Mosaic Company; companies our portfolios have held for some time and which we still believe offer attractive return prospects.

Portfolio positioning

Equity exposure increased in 2018 as opportunities were presented by the market sell-off. The fund currently holds 38.8% in equities (as at 31 December 2018), compared to 36.5% a year ago. This comprises an allocation of 22.6% to domestic equities, 14.6% to foreign equities and 1.6% to foreign property. Within equities, our preference remains for above-average quality businesses trading at wide margins of safety, and preferably on low levels of earnings. This combination increases the likelihood of favourable long-term returns.

The fund's holdings in domestic cash and negotiable certificates of deposit decreased by 8.9% over the year, from 26.0% to 17.1%. This was because of compelling opportunities in the domestic bond market. Consequently, the fund's allocation to domestic bonds grew by 7.3% to 43.7% as at end 2018. This was largely due to the addition of inflation-linked bonds, where exposure increased from 0.2% to 9.5% – a position that offers attractive real yields and which we believe enhances the all-weather nature of the portfolio. Foreign cash exposure is slightly lower compared to the previous year-end, at 0.4%.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Domestic equity	21.7%	Domestic equity	22.6%
Domestic cash and NCDs	21.0%	Domestic cash and NCDs	17.1%
Domestic bonds	40.2%	Domestic bonds	43.7%
Foreign equity	14.3%	Foreign equity	14.6%
Foreign cash	1.3%	Foreign cash	0.4%
Foreign property	1.5%	Foreign property	1.6%

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PSG Diversified Income Fund

Quarterly portfolio commentary as at 31 December 2018

by Tyron Green & Lyle Sankar

Current context

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Generally, developed markets also disappointed. While the US largely managed to buck this trend, ongoing uncertainty about trade relations with China and a series of interest rate hikes by the US Federal Reserve spurred market jitters. The S&P 500 closed the year on $2 506.85, down from $2 673.61 on 1 January 2018, after a sharp sell-off in the final quarter.

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We also continue to find value in selected global counters. While overall market valuations remain elevated when compared to history despite recent declines, there continue to be pockets characterised by fear and uncertainty. Here, low prices and low expectations have resulted in quality assets trading at wide margins of safety. A few examples include Brookfield Asset Management, Japan Post Insurance, L Brands and The Mosaic Company; companies our portfolios have held for some time and which we still believe offer attractive return prospects.

Portfolio positioning

We are starting to see less opportunity in shorter-dated government bonds, as the five-year government bond is yielding around 8.0% while five-year bank negotiable certificates of deposit (NCDs) offer close to 8.8%. We have therefore gradually been reducing exposure to short-dated government bonds and expensive corporate bonds, and allocating cash to longer-dated NCDs and government bonds. Cash levels remain healthy, with the fund holding 45.0% in cash and NCDs. This is dry powder that we expect to employ if the opportunities we currently see in many domestic securities become more widespread.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Domestic equity	4.5%	Domestic equity	4.8%
Domestic preference shares	0.5%	Domestic preference shares	0.4%
Domestic cash and NCDs	43.0%	Domestic cash and NCDs	45.0%
Domestic bonds	46.4%	Domestic bonds	45.1%
Foreign equity	3.5%	Foreign equity	2.9%
Foreign cash	1.0%	Foreign cash	0.9%
Foreign property	1.1%	Foreign property	0.9%

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

All data as per Bloomberg to 31 December 2018.

Disclaimer

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Regulation 28

The fund is managed according to Regulation 28 of the Pension Funds Act. The South African retirement fund industry is governed by the Pension Funds Act No. 24 of 1956. Regulation 28 of the Pension Funds Act prescribes the maximum limits in asset classes that an approved retirement fund may invest in. Exposures in excess of the limits will be corrected immediately, except where due to a change in the fair value or characteristic of an asset, e.g. market value fluctuations, in which case they will be corrected within a reasonable time period.

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.

Yield

The yield for the portion attributable to fixed income instruments is calculated daily on an annualised basis and is based on the historic yield of the fixed income instruments. The fund returns include returns from property and equity instruments.

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 portolio 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.

Trustee

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Additional information

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Current context

2018 was a tough year for most investors. After a 'Ramaphoric' start, the JSE experienced its worst year since the global financial crisis. Market sentiment swayed as South Africa's economic reality set in and, compounded by investor aversion towards emerging markets in general, the FTSE/JSE All Share Index ended the year 9% down in rand terms and the FTSE/JSE South Africa Listed Property Index closed 25% down. The rand, having rallied to R11.50 against the US dollar, was trading at R14.35 at year end. However, the year was more favourable to fixed income markets. The Alexander Forbes Short Term Fixed Interest (STeFI) Index delivered a total return of 7.3% and the FTSE/JSE All Bond Index yielded 7.7%, both achieving positive real returns by outperforming inflation of 5.2%.

Our perspective

While it may feel uncomfortable or even frightening, times like these – clouded by fear and uncertainty – tend to present the best investment opportunities. As Warren Buffett once said, "Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold. When downpours of that sort occur, it's imperative that we rush outdoors carrying washtubs, not teaspoons."

We believe that South Africa currently offers a standout investment opportunity and starting yields in fixed income markets are high: 20-year government bonds are offering yields of around 10% and 5-year bonds around 8%. Short-term interest rates have come in since the last quarter, with the one-year negotiable certificate of deposit (NCD) reducing from 8.3% to 8.2% and the five-year NCD reducing from 9.3% to 8.8%. This implies that the market has built in lower interest rate increases since the last quarter. We still do not expect the South African Reserve Bank to embark on an aggressive hiking cycle.

We anticipate further market noise around the National Budget in February and in the run-up to the May general elections, but believe that local fixed income markets have created the opportunity for strong potential returns in future.

Portfolio positioning

We are starting to see less opportunity in shorter-dated government bonds, as the five-year government bond is yielding around 8.0% while five-year NCDs offer close to 8.8%. We have gradually been reducing exposure to government bonds and expensive corporate bonds, and allocating cash to longer-dated NCDs.

Cash levels remain healthy, with the fund holding 70.9% in cash and NCDs. This is dry powder that we expect to employ if the opportunities we currently see in many domestic securities become more widespread.

Changes in portfolio positioning

	Q3 2018	Q4 2018
Domestic bonds	35.6%	29.1%
Domestic cash and NCDs	64.4%	70.9%

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

All data as per Bloomberg to 31 December 2018.

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Yield

The yield is calculated daily on an annualised basis. The calculation is based on the historic yield of fixed income instruments.

Performance

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Current context

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Our perspective

While it may feel uncomfortable or even frightening, times like these – clouded by fear and uncertainty – tend to present the best investment opportunities. As Warren Buffett once said, "Every decade or so, dark clouds will fill the economic skies, and they will briefly rain gold. When downpours of that sort occur, it's imperative that we rush outdoors carrying washtubs, not teaspoons."

We believe that South Africa currently offers a standout investment opportunity. Short-term interest rates have come in since the last quarter, with the one-year negotiable certificate of deposit (NCD) reducing from 8.3% to 8.2% and the five-year NCD reducing from 9.3% to 8.8%. This implies that the market has built in lower interest rate increases since the last quarter. We still do not expect the South African Reserve Bank to embark on an aggressive hiking cycle. We anticipate further market noise around the National Budget in February and in the runup to the May general elections, but believe that local fixed income markets have created the opportunity for strong potential returns in future.

Portfolio positioning

The fund reduced its exposure to shorter-dated NCDs and added to longer-dated NCDs and RSA National Treasury Bills, which currently offer more attractive yields. This extended the fund's maturity profile and increased its overall liquidity.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Linked NCDs/ Floating-rate notes	21.4%	Linked NCDs/Floating-rate notes	15.0%
Step rate notes	11.9%	Step rate notes	12.5%
NCDs	41.0%	NCDs	21.3%
Treasury bills	24.0%	Treasury bills	49.4%
Call deposits	0%	Call deposits	0.3%
Corporate bonds	1.7%	Corporate bonds	1.5%

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

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Money Market

The PSG Money Market Fund maintains a constant price and is targeted at a constant value. The quoted yield is calculated by annualizing the average 7 day yield. A money market portfolio is not a bank deposit account. 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 total return to the investor is made up of interest received and any gain or loss made on any particular instrument. In most cases the return will merely have the effect of increasing or decreasing the daily yield but in the case of abnormal losses it can have the effect of reducing the capital value of the portfolio. Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided.

Regulation 28

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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.

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Trustees

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PSG Global Equity Feeder Fund

Quarterly portfolio commentary as at 31 December 2018
by Philipp Wörz and Greg Hopkins

Current context

2018 was a tough year for most investors, despite a strong start. Global markets hit record highs in January, and the market environment in developed markets overall – and the US specifically – was relatively benign over the first nine months of the year. The MSCI World Index rose 3.8% and the S&P 500 Index rose 9.0% for the year to September. However, events took a turn for the worse in the last few months of the year. Investor sentiment swayed as the realities of rising interest rates, geopolitical concerns and generally elevated market valuations set in. The MSCI World Index declined 13.8% in the final quarter of 2018 and the S&P 500 Index was down 14.0%. Emerging markets, which in contrast to their developed counterparts had struggled for most of the year, continued their disappointing run. In combination, this resulted in global markets experiencing their worst annual performance since the financial crisis. For 2018, the MSCI World Index declined 10.4% (a total return of -8.2% including dividends), the S&P 500 Index fell by 6.2% (-4.4% total return) and the MSCI Emerging Markets Index was down 16.6% (-14.5% total return).

Our perspective

A year ago, we cautioned against the unusually low levels of fear and high levels of complacency in markets, which were reflected in 14 consecutive monthly gains by the S&P 500; its longest ever historical run. Overall, global equity valuations are not yet at levels we perceive to be highly attractive. In many cases, valuations were too stretched and have merely normalised somewhat. There are, however, pockets in global markets where investor fear has become pervasive. This has resulted in price action that is now presenting a number of opportunities where valuations can be likened to those available in the midst of a bear market. These tend to be in the more cyclical parts of the markets, where low expectations and low prices have resulted in quality assets trading at wide margins of safety. These include Brookfield Asset Management, Japan Post Insurance, Mosaic & Co, L Brands and Liberty Global. Most of these are companies we have held for some time and which we believe offer even better return prospects post the recent sell-off.

Portfolio positioning

After the sharp rise in asset prices throughout 2017 and early 2018, we harvested many of our existing holdings as they approached and exceeded our estimates of intrinsic value. Expensive markets and a lack of new high-conviction opportunities saw some buildup of cash in early 2018. As communicated in previous commentaries, we allocated capital to select opportunities over the course of 2018, mainly in Japanese financials, US retail real estate and the global fertilizer industry. With global markets and existing holdings coming under severe pressure in the last quarter of 2018 (and in December specifically), we increased conviction levels across the portfolio (particularly in Japanese financials), which resulted in cash reducing to 1.2% of fund value. At the end of December 2018, the fund's top 10 holdings accounted for 54.9% of the fund.

We are disappointed with the fund's drawdown in the last quarter of 2018 but maintain the view that the holdings in the portfolio are of above-average quality and now trade at even wider margins of safety (and generally, on low levels of earnings). Low share prices, wide discounts to intrinsic values and a cheap portfolio valuation of around 10 times earnings generally bode well for strong long-term returns.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Domestic equity	4.5%	Domestic equity	6.2%
Domestic cash	0.3%	Domestic cash	0.3%
Foreign equity	76.2%	Foreign equity	85.0%
Foreign property	7.2%	Foreign property	7.6%
Foreign cash	11.8%	Foreign cash	0.9%

Q3 2018		Q4 2018	
US	39.1%	US	42.4%
Europe	6.0%	Europe	5.6%
UK	12.6%	UK	12.7%
Asia ex Japan	6.1%	Asia ex Japan	7.2%
Japan	9.5%	Japan	13.9%
Canada	9.7%	Canada	10.0%
Africa	4.5%	Africa	6.1%
Other	0.4%	Other	0.5%
Cash	12.1%	Cash	1.6%

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

Please note that this commentary is for the US dollar-denominated PSG Global Equity Sub-Fund. The PSG Global Equity 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 31 December 2018.

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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

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PSG Global Flexible Feeder Fund

Quarterly portfolio commentary as at 31 December 2018
by Philipp Wörz and Greg Hopkins

Current context

market environment in developed markets overall – and the US specifically – was relatively benign over the first nine months of the year. The MSCI World Index rose 3.8% and the S&P 500 Index rose 9.0% for the year to September. However, events took a turn for the worse in the last few months of the year. Investor sentiment swayed as the realities of rising interest rates, geopolitical concerns and generally elevated market valuations set in. The MSCI World Index declined 13.8% in the final quarter of 2018 and the S&P 500 Index was down 14.0%. Emerging markets, which in contrast to their developed counterparts had struggled for most of the year, continued their disappointing run. In combination, this resulted in global markets experiencing their worst annual performance since the financial crisis. For 2018, the MSCI World Index declined 10.4% (a total return of -8.2% including dividends), the S&P 500 Index fell by 6.2% (-4.4% total return) and the MSCI Emerging Markets Index was down 16.6% (-14.5% total return).

Fixed income markets experienced similar swings, with the US 10-year government bond selling off to a yield of 3.25% in November before ending the year at 2.64%. Only last month market participants were expecting a series of interest rate hikes by the US Federal Reserve in 2019, while this is no longer the case.

Our perspective

A year ago, we cautioned against the unusually low levels of fear and high levels of complacency in markets, which were reflected in 14 consecutive monthly gains by the S&P 500; its longest ever historical run. Overall, global equity valuations are not yet at levels we perceive to be highly attractive. In many cases, valuations were too stretched and have merely normalised somewhat. There are, however, pockets in global markets where investor fear has become pervasive. This has resulted in price action that is now presenting a number of opportunities where valuations can be likened to those available in the midst of a bear market. These tend to be in the more cyclical parts of the markets, where low expectations and low prices have resulted in quality assets trading at wide margins of safety. These include Brookfield Asset Management, Japan Post Insurance, Mosaic & Co, L Brands and Liberty Global. Most of these are companies we have held for some time and which we believe offer even better return prospects post the recent sell-off.

Portfolio positioning

After the sharp rise in asset prices throughout 2017 and early 2018, we harvested many of our existing holdings as they approached and exceeded our estimates of intrinsic value. A lack of new high-conviction opportunities resulted in a record-high cash level of 38% in late January 2018. As communicated in previous commentaries, we allocated capital to select opportunities over the course of 2018, mainly in Japanese financials, US retail real estate and the global fertilizer industry. This resulted in cash levels averaging 27% over the first nine months of the year. With global markets and existing holdings coming under severe pressure in the last quarter of 2018 (and in December specifically), we increased conviction levels in a number of these holdings. As a result, the fund ended the year with 20% in cash and 80% in equities. While significantly reduced, we view this cash balance as healthy firepower to be employed if we see further market disruption or as high-quality opportunities go on sale.

We are disappointed with the fund's drawdown in the last quarter of 2018 but maintain the view that the holdings in the portfolio are of above-average quality and now trade at even wider margins of safety (and generally, on low levels of earnings). Low share prices, wide discounts to intrinsic values and a cheap portfolio valuation of around 10 times earnings generally bode well for strong long-term returns.

Changes in portfolio positioning

Q3 2018		Q4 2018	
Domestic equity	3.5%	Domestic equity	4.7%
Domestic cash	0.8%	Domestic cash	0.8%
Foreign equity	62.1%	Foreign equity	68.7%
Foreign property	6.5%	Foreign property	6.7%
Foreign gold	1.2%	Foreign gold	0.0%
Foreign cash	25.9%	Foreign cash	19.1%

Q3 2018		Q4 2018	
US	32.0%	US	34.6%
Europe	4.8%	Europe	4.5%
UK	10.6%	UK	10.2%
Asia ex Japan	5.0%	Asia ex Japan	5.8%
Japan	7.7%	Japan	11.7%
Canada	8.1%	Canada	8.2%
Africa	3.5%	Africa	4.7%
Other	0.4%	Other	0.4%
Cash	27.9%	Cash	19.9%

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 31 December 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 portfolio 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 portolio 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

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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.