PSG Flexible Fund

Quarterly portfolio commentary as at 31 December 2018

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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. 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, 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 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%

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.

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.

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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.