PSG Asset Management

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.

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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.