Amplify SCI* Flexible Equity Fund

Fund Commentary | June 2024

Omri Thomas
Chief Investment Officer
Abax Investments

"Valuations currently on offer allow investors to structure long-term inflation-beating portfolios."

Overview

Political uncertainty adds to market volatility

Elections dominated the news in the second quarter (Q2) of 2024. Polls in the UK, France, India and Mexico all added to the market volatility in those regions. with Trump now the frontrunner in the US after Biden's disastrous presidential debate, there may well be more to come.

Optimism from the local elections

In contrast, the South African elections delivered a pleasant surprise for South African investors. With the ANC losing the majority vote for the first time in 30 years, fears around the ANC, MK Party and EFF coalition kept investors wary. Encouragingly, this outcome was avoided and the formation of a Government of National Unity (GNU), that excluded these far left-leaning parties, was well received by the market. The Cabinet was formed on 30 June 2024, the composition of which was largely welcomed by market participants. In a key position, Finance Minister Enoch Godongwana was re-elected, signalling continuity in fiscal policy prudence.

Local assets post positive returns for the quarter

Despite the macro uncertainty, the S&P 500 once again powered ahead, delivering a 4.3% return in the second quarter. However, it was narrowly led by a handful of mega-cap tech and AI-related stocks. In general, developed market equities (MSCI World Index: 2.8%) underperformed emerging markets (MSCI EM Index: 5.0%) as softer US economic data and a rebound in China supported EM equities. Fixed-income markets did little, as a hawkish US Federal Reserve (Fed) and persistent inflation concerns tempered rate cut expectations. US Treasuries remained flat.

Local assets were off to the race as it became apparent that the worst-case election outcomes had been avoided. The FTSE/JSE All Share Index (ALSI) returned an incredible 8.2% for the quarter. Bonds delivered 7.5%, and listed property 5.5%. The rand appreciated 3.6% relative to the US dollar. These returns provide some welcome relief to disenchanted South African investors who have had little to cheer about for quite some time.

Portfolio performance and positioning

Performance

The Amplify SCI* Flexible Equity Fund delivered a return of 5.6% (net of fees, most expensive fee class) for the quarter against the peer group return of 4.2%. Over the past year, the fund has lagged the peers by 2.8%.

Positioning

The fund continues to demonstrate a strong asymmetrical return profile over longer-time horizons, outperforming the FTSE/JSE Shareholder Weighted All Share Index (SWIX) and ranking among the top quartile of the peer group.
We will continue to monitor market conditions and adjust our investment strategy as necessary to achieve our long-term objectives.

Top 5 winners and losers for Q2 2024

Top contributors	Avg. weight	Performance contribution	Top detractors	Avg. weight	Performance contribution
R2040	17.5%	1.7%	TBC Group	2.1%	-0.5%
Absa	5.1%	0.7%	Sasol	3.3%	-0.2%
R2037	4.2%	0.5%	Abax Global Equity	3.6%	-0.2%
Anglo American Autocalls	1.4%	0.4%	MTN	1.7%	-0.1%
Raubex	1.2%	0.4%	Brait	0.2%	-0.1%
Total		**3.7%**	**Total**		**-1,1%**

Local bonds were volatile but rallied hard towards the quarter-end, post the favourable election result benefiting our holdings in the R2037 and R2040.

SA Inc shares including Absa and Raubex also benefited from a flurry of demand for companies exposed to the the South African economy.

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Absa's performance could have been even better if it wasn't for a subdued trading update relative to some of the other banks. Anglo American was also a contributor, as the share price jumped post BHP making an unsolicited offer to merge with the company.

TBC Group, a low-cost financial technology company operating in Georgia, benefits from a low-cost structure and continued digitalisation of the financial services industry with further strong growth expected. Its proximity and political friendship with Russia continues to put a lid on the valuation. Strong earnings growth, share buybacks, as well as an attractive valuation keeps us positive on this holding.

Sasol continued to underperform as the deteriorating chemical prices put pressure on the Sasol share price. At the current P/E ratio of <4x, negative news seems adequately discounted, and we retain our tactical position in Sasol.

Abax Global Equity detracted slightly as the rand strengthened over the quarter.

Top 5 winners and losers for the last 12 months

Top contrib-utors	Avg. weight	Perfor-mance contri-bution	Top detrac-tors	Avg. weight	Perfor-mance contri-bution
R2040	15.3%	1.9%	Sasol	2.5%	-1.3%
R2037	3.5%	1.0%	MTN	1.5%	-0.9%
Dipula Property	2.1%	0.7%	Hello Group	1.3%	-0.6%
Raubex	1.0%	0.6%	Brait	0.4%	-0.4%
R2044	4.3%	0.6%	Balwin Proper-ties	0.9%	-0.3%
Total		**4.8%**	**Total**		**-3.5%**

Our long duration in bonds were the major contributors to performance over the last 12 months, as the market embraced a positive South African election.

Property shares rallied over the last quarter of 2023 on the back of the bond rally and optimism about improving property fundamentals. Dipula Property continues to trade at an attractive discount to its net asset value.

Raubex also benefited from interest in SA Inc shares, and currently has a record order book, boding well for earnings growth in the coming years. Delayed spend and neglected maintenance on South African roads "paves the way" for medium-term earnings growth.

As mentioned, Sasol continues to underperform as pressure on chemical prices reduced earnings expectations. Sasol faces various challenges, from low chemical prices, a declining gas reserve, high debt levels and carbon taxes but to name a few. Despite this, the share is discounting the negative news and is trading at an attractive valuation. This is, however, not a core holding of the fund and we will look to reduce our position into strength.

MTN continues to be plagued by uncertainty regarding potential tariff increases by the Nigerian regulator. This places a strain on their ability to extract cash from Nigeria. MTN has an attractive fintech business offering high earnings growth that will become more material to the group in time. MTN trades at a 10x forward P/E on a low earnings base.

Both Hello Group, alongside JD.com, detracted from performance as negative sentiment towards Chinese equities remain. Both companies have net cash on their balance sheet with enterprise valuations of between 2-4 times. This effectively means that the companies "earn" their market cap in 2-4 years.

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Brait was under severe pressure as a deeply discounted rights offer was announced. The company is trading at a large discount to the post-rights NAV and we intend to follow our rights.

Outlook and positioning

Risk premium to invest in SA is lower

Local bonds were volatile but rallied hard towards the quarter-end post the favourable election result. We were quite active given the large moves, but interestingly ended the quarter with a similar allocation to bonds compared to where we started. We are of the opinion that the risk premium required to invest in SA is lower now than it was prior to the election, so despite the strong rally in bonds, they still appear reasonable.

US Treasuries at 4.5% represent the highest yields in nearly 20 years and provide useful diversification benefits in times of economic slowdown or market drawdowns. We have maintained our modest allocation.

The South African equity market continues to be attractively priced, both on a relative and absolute basis. We prefer quality counters and global businesses that can grow over time, rather than those that are simply dirty cheap but are not value-creating companies. Several of our domestically focused businesses have rallied hard and although they are no longer mouth-wateringly cheap, they are still attractive propositions.

We view US equities to be on the expensive side, especially on a relative basis. Interestingly, the narrowness in the US market has increased further, and the bulk of the performance has been contributed by a small handful of popular tech stocks. Our preference remains for Chinese equities, offering an attractive risk-return pay-off profile and compelling opportunity set, but are cognisant of the risks and will therefore limit our maximum overall position.

Positioning

We maintain a defensive positioning and have taken some profits into the recent strength but retain a healthy exposure to a further South African recovery with attractively priced growth assets. Valuations currently on offer allow investors to structure long-term inflation-beating portfolios. Current conditions are conducive to structure capital-protected notes, and this currently constitutes 11.3% of the fund. The fund is diversified with a healthy balance between growth assets and capital protection, seeking maximum capital growth with two-thirds of the upside and one-third of the downside of the equity market.

INTELLIGENT IMPACT THAT MATTERS