Amplify SCI* Flexible Equity Fund

Fund Commentary

Fourth Quarter 2020

Omri Thomas

Chief Investment Officer

Abax Investments

“... recovery continued in the fourth quarter with the fund delivering 8.9% for the period.”

Overview

It seems unlikely that many people will look back on happy memories of 2020. There is surely not a person who has not had their private or professional lives affected by the Covid-19 pandemic – for many, sadly, the effect has even been their loss of livelihood and for others, the loss of life itself. There was much to reflect on over our traditional end of year holiday season, and with the reimposition of a heightened level of lockdown in mid-December we have entered 2021 with a nervous sense of foreboding of what the year may hold in store.

Basic Materials Index that lead the sectoral pack

In a volatile year in which the FTSE/JSE All Share Index first crashed 30% at the height of the pandemic's global spread in late March, it subsequently staged a surprisingly steady 48% recovery from the lows and ended the year up 7% and closing in again on its all-time high of around 60 000 first reached in late 2017.

Most unusually and for the fourth consecutive year it was again the Basic Materials Index (largely Mining) that lead the sectoral pack with a return of 21.2%. In complete contrast Industrials fell 20.7% and Financials were very weak, down 19.7%, lead by the Property sub-sector, down 41% (despite a strong bounce in the fourth quarter of 19%). The Healthcare sector disappointingly recorded a third consecutive year of negative returns, and our local consumer stocks almost all returned negative numbers for the year. Large cap stalwart Naspers' 32.1% gain did much of the hard work combined with the Basic Materials sector to drive the positive return of the All Share index for the year.

The rand has been resilient but outlook is unclear

Despite the worryingly weak state of South Africa's balance sheet and the unlikely prospect of a material change in that in the medium term, combined with a short-term collapse in tax revenue collections caused by the slowdown in economic activity, the rand has proven to be remarkably resilient. Having started 2020 at R14.00 to the US dollar, it weakened by 35% to the weakest point in March touching R19.00 before steadily strengthening and ending the year at R14.69 – a mere 4.25% weaker from where it started the year. This may come as something of a surprise to unitholders and we attribute the strength to the tremendous tailwind South Africa is currently experiencing as most of our export commodities (Platinum Group Metals, Iron Ore, Gold, Manganese and Maize) are all trading at very high levels, while our principal import – Oil – is trading at a very low level. This is having a very favourable impact on our trade balance, while at the same time we are not seeing a deterioration in our capital account flows – despite the ongoing rating downgrades (now deep into junk territory) the ratings agencies are awarding SA. With the yield on SA government bonds now trading higher than the prime rate, it is more expensive for the SA government to borrow money from the banks than it is for the average individual mortgage bond holder. This means there is a higher demand for rands than there is in supply, which is driving the rand strength. The longevity of these conditions is uncertain and means the outlook for the currency is as unclear as ever.

We are guided by the longer-term prospects of the nation's balance sheet and the state's inability to service and repay the debt already in issue and consequently why we consider a weaker currency as the inevitable release mechanism in time as the fiscal cliff we're approaching keeps getting closer.

Portfolio performance

Contributors and detractors

	3m	12m
Amplify Flexible Equity Fund	8.9%	-2.4%
JSE Swix All Share Index	9.9%	2.6%

The Amplify Flexible Equity Fund recovery continued in the fourth quarter with the fund delivering 8.9% for the period. This was mainly driven by the long-awaited recovery in our basket of EURO STOXX notes (CTR +2%), African Rainbow Capital (CTR 1%) and Banks (CTR 2.2%). Our addition to property in the third quarter also contributed to returns in the fourth quarter.

With a tough start to the year the Amplify Flexible Equity Fund's negative return of 2.4% was disappointing. The major detractors from performance were our holdings in ABSA (-2.8%), Sasol (-2.3%) and Old Mutual (-1.3%). All three of these companies staged a recovery to year-end, but not enough to offset the earlier underperformance. Our holdings in Naspers (+3.9%), the Abax Global Equity Fund (+1.2%), PSG (+1.1%) and MTN (+1.1%) softened the blow.

*Sanlam Collective Investments
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Portfolio positioning

Naspers continues to provide a solid investment case

Despite Naspers' stellar performance for the year, it remains one of our largest positions at 5.2% of the fund. The reason for our continued positive disposal towards the company is multifold, but the main points are:

- Exposure to one of the biggest technology markets in the world;
- A deep discount to the value of its underlying investments;
- Highly cash generative; and
- Recent value-unlocking management actions including share buybacks of both Prosus and Naspers.

Positive outlook for Royal Bafokeng Convertible Bond

The Royal Bafokeng Convertible Bond remains one of the largest positions in the fund at 5.8%. We continue to remain positive on the investment outlook due to:

- Decent exposure to the highly sought-after rhodium commodity;
- RBP has lagged the other major platinum producers and remains an attractive take-out target; and
- The commissioning of Styldrift will result in significant cashflow generation for RBP in the next two years, as they experience strong production growth.

Investment thesis on PSG played out well

Our investment thesis on PSG as posted in our second-quarter newsletter played out well, with PSG being one of the top five contributors for the year. Our subsequent receipt of Capitec shares on the unbundling further aided performance. Despite the strong rally PSG remains undervalued relative to its portfolio of assets and we have retained a decent exposure to the company.

Future outlook

World Bank warns the pandemic has pushed tens of millions more people in SA and the rest of sub-Saharan Africa into extreme poverty

Despite the reported success of an effective vaccine, this is not widely available, has not been proven to be universally effective and in any event, we are already learning of mutated versions of Covid-19. So, while not meaning to sound overly pessimistic, we are reluctant to conclude that the worst of the Covid-19-related economic impact is behind us.

The World Bank expects the South African economy to recover by 3.3% in 2021 and return to a 'near potential pace' of 1.7% in 2022 after contracting by an estimated 7.8% during Covid-19-afflicted 2020. However, it warns in its flagship Global Economic Prospects Report, published on 5 January 2021, that the pandemic has precipitated a dramatic fall in per capita income, which has pushed tens of millions more people in South Africa and the rest of sub-Saharan Africa into extreme poverty.

The resultant decline in per capita income is expected to set average living standards back by a decade or more in a quarter of sub-Saharan African economies, with even more severe setbacks in Nigeria and South Africa – home to one-quarter of the region's population.

The bank also notes that South Africa's pre-existing structural constraints, such as persistent power-supply disruptions, are expected to become binding again as economic activity firms.

In addition, debt sustainability concerns may require fiscal consolidation, which, if prematurely implemented, could further soften the country's recovery.

Weaker growth momentum into 2021 partly reflects the lingering impact of the pandemic, as some mitigation measures are envisioned to remain in place.

Despite the negative macro context, valuation levels on many of the stocks we hold are at multi-year lows

Despite this negative macro context, we note with interest that valuation levels on many of the stocks we hold are at multi-year lows. Most SA sectors are also trading at record discount valuation levels versus both Emerging Market and Developed Market peers. Many are well managed and are responding in many ways to cut costs, preserve profitability and find new ways to drive growth in profits.

Interest rates domestically and internationally are at record lows and not expected to rise, so the cost of servicing debt is actually decreasing and this will further boost profits for companies with geared balance sheets.

Putting all the above together, we believe now is not the time to significantly reduce equity exposure, and the risk-return balance favours this asset class. We have therefore retained decent exposure to equities within the fund with hedges over some of our larger positions.

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