

Portfolio Manager Quarterly Comment

Market review

Like a stuck record the message keeps repeating itself ... ‘Global equities had another strong quarter’, with the MSCI World Index rising by another 7.7% in US dollar terms. Even after accounting for some currency appreciation, global equities in rand terms were still up by 4.2% – not as buoyant as some other quarters in the recent past, but attractive returns nevertheless and handsomely outperforming global bonds, which delivered negative returns in rand terms. And as economic recovery lifts the earnings growth prospects across all sectors, global markets experienced some further rotation towards sectors that still traded at big discounts due to previous lack of growth, such as financials and property.

The same effect played itself out in the local market, with the FTSE/JSE SA Listed Property Index (SAPY) up by just over 12% and financials the best performing equity sector with a return of just over 8%. But unlike the global markets, the local bond market was quite strong – as evidenced by the All Bond Index (ALBI) delivering a return of almost 7% for the quarter – and apart from financials, the rest of the local equity market could not keep up with bonds. Some heavyweights such as Naspers and the platinum sector even experienced significant declines (as discussed in the equity section of this report), resulting in the local broad equity indices all being either close to flat or even slightly down for the quarter. Our equity house view has overweight positions to Naspers and platinum counters, with an underweight position in financials, which caused some headwind to our local equity performance for the quarter. From an asset allocation perspective our portfolio benefited from its decent exposure to local bonds. And some recent additional exposure to bonds and property proved to be fortuitous and was validated by the quarter’s market movements mentioned earlier.

In the foreign portion of the portfolio, the continued avoidance of bonds and increased positions in growth assets turned out to be beneficial. Apart for our emerging market exposure this quarter saw a near identical repeat of the performance drivers witnessed in the previous quarter. On the positive side, the investment in global financials again performed well, assisted by a continued rotation to value-offering sectors as growth is becoming less scarce. The global property exposure that we continued to add to in recent quarters also performed very well, again outperforming equities and contributing positively to returns. And the portable alpha solution also had a particularly good quarter and added value above its own expected trend return. But with equity markets staying buoyant, our real asset exposure continued to lag the broader equity market, while our emerging market exposure unfortunately also faced a headwind over the quarter relative to developed market equities.

Local asset classes all remain priced for long-term returns above the trend returns we expect for them and we continue to hold exposure to all of them, funded from cash where the return prospects remain poor. Foreign assets though are generally more expensive and offer less than long-term trend returns. The return prospects are best for global property, where capacity expansion in recent years has been muted and where trend returns do seem possible. But both global equities and bonds seem to be offering below-trend returns, with equities still offering more than bonds. We therefore maintain the zero exposure to global bonds and rather target foreign property and equities.

Rising inflation continue to pose a devaluation risk to both global bonds and equities. A current strong bout of inflation in the US did initially lead to market jitters, but these dissipated again when it emerged that the inflation was caused by supply disruptions in a narrow sector of the economy and is likely to be transitory in nature and therefore will probably not lead to any action by the US Federal Reserve to

tighten monetary policy. But the risk of a sustained increase in inflation is rising and will continue to pose a derating threat due to current high market valuations. We therefore continue to seek protection for a portion of our equity exposure against sudden market corrections.