Kagiso Domestic Balanced Fund

December 2019

Portfolio Manager
Gavin Wood
BBusSc, FFA, CFA

Fund objective

This fund aims to significantly outperform the median manager in the domestic retirement fund manager peer group. The fund has a balanced mandate and investments are diversified across equities, bonds and cash. The fund is actively managed and positioned in the best ideas from the Kagiso bottom-up research process and is Regulation 28 compliant.

Invest with us

Visit our website	www.kagisoam.com
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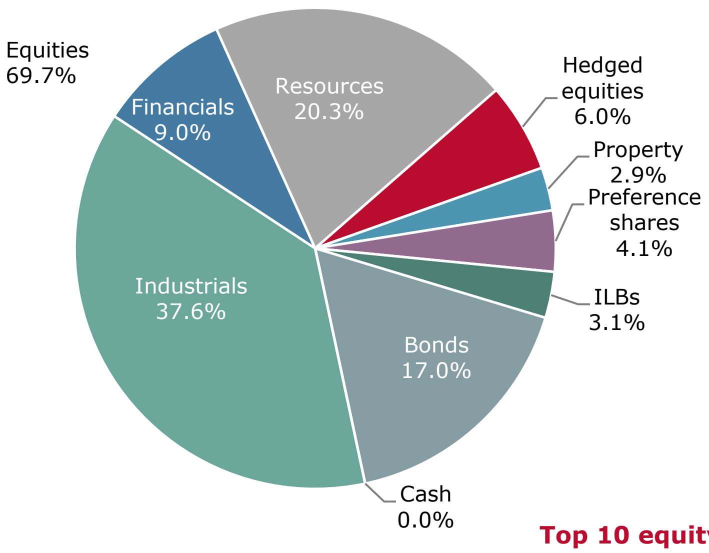
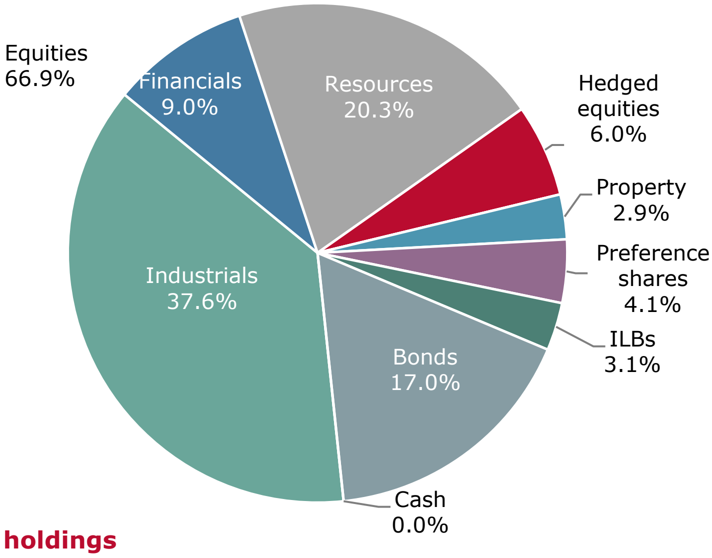
Asset allocation

Quarter ended December 2019



Quarter ended September 2019



Top 10 equity holdings

Quarter ended December 2019

Naspers	12.1%
Northam Platinum	7.7%
Quilter plc	3.6%
AECI	3.6%
Royal Bafokeng Platinum	3.6%
Omnia	3.0%
Aspen	2.5%
Metair	2.5%
Datatec	2.4%
Sasol	2.2%
Total	43.2%

Quarter ended September 2019

Naspers	10.5%
Northam Platinum	8.2%
Clover	4.2%
AECI	3.9%
Royal Bafokeng Platinum	3.4%
Adcorp	3.0%
Metair	2.8%
Quilter plc	2.5%
African Rainbow Minerals	2.3%
Libstar	2.1%
Total	42.9%

Key indicators

Equity markets (total return)	End of quarter figure
Latest consumer price inflation (CPI % YoY)	3.6%
Repo rate (%)	6.5%
3m JIBAR	6.8%
10-year government bond yield	9.0%
Key asset classes (total return)	**Quarterly change**
MSCI World Index (USD)	8.6%
FTSE/JSE All Share Index	4.6%
FTSE/JSE Listed Property Index	0.6%
BEASSA All Bond Index	1.7%
Commodities and currency	**Quarterly change**
Platinum ($/oz)	9.5%
Gold ($/oz)	3.0%
Rand/US Dollar (USD)	-7.5%

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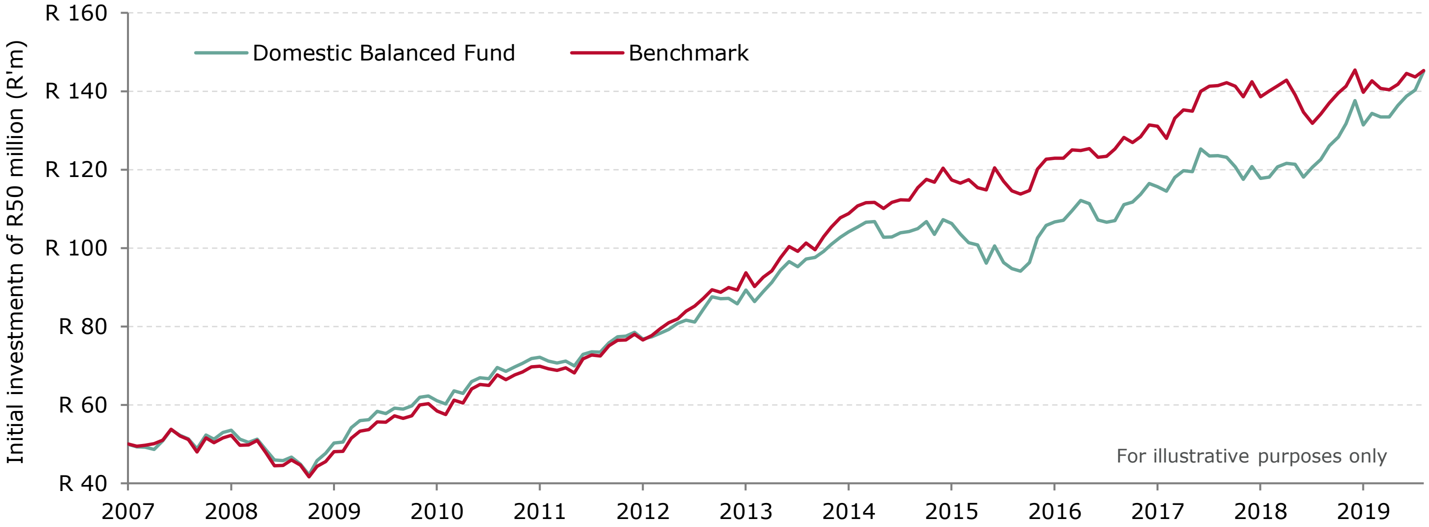
Performance[1]



Source: Kagiso Asset Management, I-Net

Annualised performance

	Fund	Benchmark[2]	Outperformance
1 year	18.3%	7.1%	11.2%
3 years	10.7%	4.7%	6.0%
5 years	6.8%	5.0%	1.8%
10 years	9.4%	9.7%	-0.3%
Since inception	8.8%	8.7%	0.1%

[1] Fund performance figures are gross of management fees and Capital Gains Tax and net of Withholding Tax. Calculations are based on a lump sum investment, with income reinvested and all performances are annualised. Please note that market and exchange rate fluctuations may affect the value, price or income of investments. Past performance should not be used as a guide for future performance.

[2] The benchmark is an estimate for December

Risk statistics

	Fund	Benchmark[2]
Annualised monthly volatility	9.3%	9.0%
Annualised monthly tracking error	4.0%	n/a
Information ratio*	0.0	n/a
Sharpe ratio	0.2	n/a
Maximum gain#	38.4%	33.7%
Maximum drawdown#	-21.6%	-22.6%
% Positive months	62.5%	64.5%
Beta vs benchmark	0.9	1.0

* Information ratio = $\frac{\text{outperformance}}{\text{tracking error}}$

Consecutive months of change in the same

Benchmark Median return of Alexander Forbes SA Manager Watch: BIV Survey

Launch date 1 May 2007

Fund size R 1,186.24 million

Fund mandate Prudential regulation compliant domestic balanced fund

Vehicle Pooled

Minimum investment No minimum

The fund was up this quarter (6.4%), materially outperforming the benchmark by 4.3%. This quarter's outperformance was due to a positive contribution from local equities. Over the last three years, it has returned 10.7% pa, well ahead of the benchmark (up 4.7% pa). The fund has returned 8.8% pa since its inception in 2007.

Economic backdrop

Global economic growth, though still reasonably buoyant, has decelerated further from the high rates of recent years especially given a continuing moderation in Chinese growth. Increased US trade tariff uncertainty seems to have caused sustained weak business confidence, particularly in the global manufacturing sector (especially in Europe and Japan). Growth expectations have recovered moderately as weak industrial production is being offset by consumption growth, which remains healthy due to sound labour markets. Major central banks have abruptly ended their tightening and begun loosening monetary policy, as well as signaling more accommodation should economic activity deteriorate.

US economic activity has been moderate, but, despite healthy consumption and a recovering housing sector, weaker manufacturing production (due to trade tensions) and the waning of fiscal stimulus effects is now weighing on growth.

In Europe, generally strong consumption and good growth in France, Spain, Ireland and Greece is partially offset by very weak manufacturing activity, particularly in Germany. This is affected by slower Chinese growth and a contracting global automotive market. Manufacturing in Japan has been similarly affected and near-term local consumption will now be weaker post a consumer tax hike. In both Europe and Japan, industrial weakness is being partially offset by increased fiscal stimulus.

Overall growth in China remains healthy but continues to moderate as the government acts to rebalance the economy and reign in credit excesses and as export growth is affected by increased trade tariffs. Infrastructure investment and manufacturing-related growth is most affected, although the economy is benefitting from domestic stimulus.

Emerging market growth has eased in line with slower global growth but remains healthy, particularly in Indonesia and Brazil. South Africa, Russia and Turkey remain the laggards. Sharply falling inflation expectations allowed for an aggressive rate cutting cycle in 2019.

In South Africa, growth slowed notably in the third quarter with persistently low business confidence, contracting fixed investment and lackluster consumption activity amidst a steadily deteriorating labour market. A resumption of severe electricity supply disruptions in the fourth quarter will decrease near-term prospects further. Continued progress in improving governance (strengthening of corruption fighting institutions and improving corporate governance and senior leadership at SOCs) is being accompanied by frustratingly slow economic policy action in the face of a deteriorating fiscal position.

Market review

Global markets were higher in the last quarter (up 8.7% in US dollars) with the USA (up 9.1%), Germany (up 9.6%) and the UK (10.8%) outperforming. Within emerging markets (up 11.9%), South Africa (up 13.2%, the dollar return benefiting from an 8% appreciation in the currency over the period), Brazil (up 14.1%) and Russia (up 17.1%) outperformed. 2019 has been a very strong year for global equity markets (up 28.4% overall).

In rand terms, the local equity market was positive this quarter (up 4.6%) with the resources sector (up 13.5%) outperforming - gold and platinum miners strengthened again (up 26.1% and 47.0% respectively). Standout performers included Sibanye Stillwater (up 71.1%), Impala Platinum (up 50.6%) and Northam Platinum (up 48.7%).

Financials were up 2.8% with life insurance (up 5.2%) outperforming and banks generally weaker (Nedbank down 5.5%, Standard Bank down 3.6% and Absa Group down 2.3%).

Industrials were down 0.1%). Among large companies, British American Tobacco (up 6.3%) was again strong, while MTN (down 14.3%) and Richemont (down 1.9%), underperformed. Naspers was flat (down 0.2%), outperforming its underlying exposure to Prosus (down 4.8%). Retailers were mixed, with Woolworths and Truworths underperforming (down 11.8% and 7.2% respectively) and Clicks and Mr Price outperforming (up 19.3% and 15.3% respectively). Telkom (down 50.7%) was particularly weak.

The local market was positive for the year (up 12.1% following an 8.5% contraction in 2018) with divergent sectoral performances. Industrials were up 11.2%, financials were flat (up 0.6%) and resources were up 25.3%.

SA bonds returned 1.7% for the quarter – in line with cash. This brings the 2019 performance of SA bonds to 10.3%, with cash returning 7.3%. Foreign flows into our bond market were positive in the last quarter, but still negative for the year. Despite an increasingly fragile fiscal picture, we continue to believe longer dated bonds offer attractive returns, due to well-anchored inflation prospects and very substantial implied real yields.

For several years, extreme and unconventional monetary stimulus in the form of price agnostic asset purchases have distorted asset prices across the globe. Global bond yields have retreated to very low levels (pricing in exceedingly low levels of future long-term inflation), corporate bond credit spreads are depressed, and equity prices are high, especially in large cap stocks and sectors where growth prospects are well appreciated.

US bond yields are moderately higher than the record low levels of 2016, accompanied by tentative signs of wage-led rising inflation (although yields in other developed markets are close to record lows). Recent trade tensions between the US and its key trading partners has negatively impacted the global growth outlook and central banks are undertaking pre-emptive easing measures in an attempt to avert material economic deterioration.

Fund performance and positioning

Excellent local stock selection as well as fixed interest instrument selection were the main contributors to performance.

Strong local equity contributors this quarter included Northam Platinum, Quilter, Omnia and Aspen. Key detractors included Adcorp and Altron.

Our decision to increase exposure to risky assets towards the end of 2018 (after substantially weaker markets), together with an excellent local stock selection this year, has led to material outperformance. We have more exposure to South African bonds than in recent years due to very attractive real yields on offer. Credit spreads have compressed meaningfully in the domestic market and we are circumspect about exposure to corporate credit where spreads may not adequately compensate for the additional risk.

Despite a global backdrop of reasonable, but weaker, economic growth(as Chinese economic growth continues to trend lower) and a very weak local economy, we remain positive on the outlook for our equity holdings, given very attractive market ratings relative to our assessment of their prospects.

With the outlook for the South African economy remaining weak in the medium term, we continue to hold material positions in unpopular or neglected areas of the SA equity market where we find idiosyncratic investment cases offering improving prospects that are not wholly dependent on the economy performing. We have high exposure to mid-cap industrial stocks where we see compelling stock-specific potential, coupled with low market prices. Over two thirds of our SA equity exposure across our funds lies outside of the top 50 largest shares.

We are optimistic that more normal financial conditions are proving to be a much better environment for stock picking. We retain a particularly high exposure to a selection of local mid-cap stocks which offer compelling upside from a number of diverse stock specific factors that are providing positive performance, uncorrelated to the general market, and some of them (like Omnia) are new positions in the fund.

Omnia is a diversified chemical group that supplies chemicals and specialised services to the chemical, mining and agricultural sectors in Africa and has generally delivered good returns on capital over the long-term. The business has spent a considerable amount (in excess of R5 billion) on new investments, which we expect to result in meaningful cost savings. The company underperformed materially in 2019 due to cyclical headwinds in several of their end markets and a weak balance sheet following years of heavy investment (and poor working capital management). The company was forced to do a rights issue presenting an attractive opportunity to build a meaningful position in our funds.