Quarterly Commentary
as at 31 March 2020

MelvilleDouglas
A Member of Standard Bank Group

Melville Douglas
High Alpha Fund

Fund Review
The fund achieved a negative return of 21.2% for the first quarter of 2020 against the benchmark's negative return of 26.6%. Our underweight exposure to many SA consumer facing counters helped the relative return of the fund. We were underweight banks for the quarter and began to incrementally increase the exposure towards the backend of the quarter given the extreme valuations. The fund managed to avoid some large index holdings which had a difficult quarter. An example is Sasol, where the fund did not have any exposure. The fund does not hold global equity, unlike many of the peers. This remains a SA equity fund. Having said this, the fund does have many international counters within the portfolio that help diversify South African risk. These counters helped the relative performance as the Rand lost 28% of its value against the US Dollar over the quarter.

Market Overview
The JSE Capped SWIX had an extremely poor start to the year, returning negative 26.6% for the first quarter of 2020. The spread of the Coronavirus outside China and the slow responses from many countries has manifested itself in lockdowns globally to contain the virus. The result is an almost certain global recession and equity prices in the first quarter have reflected the impact on companies in general. The length of the shutdowns remains key as the longer the shutdowns persist, the more permanent the economic effects will become as corporate failures and unemployment will ratchet up. Many governments have reacted with unprecedented monetary and fiscal policy to stimulate the demand side of the economy. These measures however have a finite life and moving out of lockdown in a responsible manner remains paramount. We have case studies from China, South Korea and evolving studies from EU5 which suggest that lockdowns are containing the virus, but the situation remains fluid.

In South Africa, we were downgraded to junk status by Moody's on 27th March 2020. While the timing was unfortunate, it was not unexpected and market prices did not react negatively given much of the downgrade was priced in. The downgrade will have negative effects on the fragile economy. The South African government does not have the fiscal resources to prop up the economy through the downfall. SA corporates, where possible will have to absorb much of the economic fallout. SA will need to ride the coat tails of a fiscally induced recovery outside our borders once the world moves out of lockdown.

Looking Ahead
Global recession is looming, and South Africa will most likely have a more prolonged recovery period post the lockdown given the limited resources we have at our fiscal disposal. The SARB has intervened thus far and has some headroom to move further with interest rate cuts given the benign inflation outlook and the extremely low interest rates globally.

The important numbers to watch remain the Coronavirus containment as this will guide the length of global lockdowns. Once the lockdowns are behind the world, there are stimulatory efforts that could push a global recovery, but time is of the essence. We will only be able to get more clarity on the damage and potential recovery once the world is up and running, but this must only be done in a responsible manner given the vast social implications of the Coronavirus.

We have done work on balance sheets, as we believe strong balance sheets are more important that short to medium term earnings now. Some strong balance sheets that we believe will have opportunities on the other side of the economic downturn appear to have a reasonable valuation. Now, more than ever, stock selection and diversification are paramount.

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The commentary gives the views of the portfolio manager at the time of writing. Any forecasts or commentary included in this document are not guaranteed to occur.

Melville Douglas

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