Quarterly Commentary as at 30 September 2019

MelvilleDouglas
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Dynamic Strategy Fund

Fund Review

The fund had a pleasing return for the year to date having achieved a return of 10.1% for the nine months ending September 2019. The fund returned 3.9% over a twelvemonth period, which is slightly below the inflation of 4.3% for that period. Year to date the fund SA equity is up 7.2%, well ahead of the SWIX return of 4.3% and similar to the ALSI return of 7.1%. The primary driver of equity markets has been the resource sector, which was up 13% year-to-date on the back of much stronger precious metal prices. The offshore component continued to provide a pleasing contribution to overall portfolio performance, up 24% in ZAR to September. In addition, the fixed income component, as represented by investments in the bond market, slightly outperformed cash holdings for the nine-month period ending September as well as over the preceding twelve-month period. As noted, market performance was driven primarily by resources, with the top seven performing shares (including Implats with a 159% return) being resource shares. ABI was the top non-resource counter up 52.8%, which represents 2.7% of the SA equity in the fund. Fortunately, the fund had no exposure to index heavyweight Sasol, which was down 40% for the nine months.

Market Overview

After one of the strongest and broadest rallies across every major asset during the first half of the year, asset class returns have been more modest during the third quarter of 2019 with global bonds outperforming global equity. Even so, global equity markets are still up 17% for the calendar year to date, a very good result given the uncertain geopolitical and macro backdrop, and much stronger than most other asset classes. The US continue to dominate regional returns and Developed markets outperformance over Emerging markets persist. The same holds true for the US dollar which has (not for the first time) strengthened on a trade weighted basis. The strong returns can primarily be ascribed to the change in tone by the Federal Reserve and much lower global government bond yields. But leading indicators have continued to deteriorate as the trade war between the US and China escalated, indicating tougher times ahead. At the same time, business and consumer confidence turned down sharply due to the heightened uncertainty caused by the trade spat and increased geopolitical tension. Global manufacturing and industrial production retreated, and investment spending has come to an abrupt halt as global trade turned negative.

Looking Ahead

In South Africa, local company valuations have fallen below long-term averages, because growth remains a concern. SA GDP continues to disappoint but is expected to record a marginal improvement during 2020. Weak consumer and business confidence continues to hamper economic growth. This is exacerbated by the declining global back drop, with declining economic indicators being pronounced in Europe and also starting to manifest in other major markets, such as the USA and China. Given the difficult global and domestic growth scenarios it is expected that the local equity market with continue a difficult and volatile path.

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The benign interest rate outlook from the SARB as well as other central banks and high real local bond yields has helped local bond markets. This environment of high real SA yields provides a compelling investment opportunity and we are likely to increase our bond weighting in the fund. We believe that risks to the South African sovereign downgrade remain, however the rating agents are prepared to give the new administration some time to bring envisaged changes and as such the risk is not imminent and this should support the bond market. The outlook is not expected to change much in the near term as the current economic expansion appears decisively late cycle. The good news is that global central banks are on alert to inject additional liquidity and fiscal support could be on offer again. At the same time, non-manufacturing activity and consumer spending have remained robust and have benefited from a combination of low levels of unemployment, positive real disposable income growth and loose monetary policy. But while the global economy is adjusting to a period of slower growth, risks remain, and small unexpected events could provide the spark for the next economic downturn.

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.

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