Abax Balanced
Prescient Fund Commentary

Q4 2021 Commentary

Market Overview

It has been two years since the world learnt about the outbreak of a coronavirus strain in Wuhan, China. What followed is now well documented and we are still dealing with the after-effects and ever-increasing mutations of the COVID-19 virus. Yet most global stock indices are at or close to all-time highs. This asset price inflation has of course been driven by huge global monetary and fiscal stimulus.

It was a good year for risk assets. The MSCI World Index added 22.3%. It is worth noting that the strength of the MSCI World Index was driven by a fairly narrow set of companies - the six largest companies listed in the US (Apple, Google, Microsoft, Facebook, Amazon and Tesla) gained 41% on average for the year - made an outsized contribution given that combined they have a larger market capitalization than any other stock market in the world! This lack of market breadth suggests a crowding in these popular areas of the market and that some caution is warranted.

Emerging markets, in contrast, retreated 2.5%, primarily on the on the back of waves of Chinese regulatory reforms that look set to undermine corporate profitability and dent investor confidence.

On the local front we finally had some joy. The Capped SWIX added 27.1%, with solid returns posted from all the major sectors. Despite the strong year (the first in many), the local market still appears reasonably valued, with no real signs of any excesses building up yet.

Over the course of the year we've spoken about reflation, stagflation and stimulus, but what's clear now is that we have ended up with good old inflation. The non-transitory kind. Global central banks have taken note, but markets so far have largely ignored the introduction of tighter monetary policy toward the end of the year. What is for certain, however, is that 2022 will experience significantly more tightening, both in terms of asset purchases and potential rate hikes. A more challenging year may play out in 2022 given the combination of this stimulus withdrawal and the high overall starting market valuations in many geographies.

Fund Performance

Returns (%, annualised)(Inception Date 30-12-2011)

	1-m	3-m	1 yr	3 yrs	5 yrs	7 Yrs	10 Yrs	Incep.
ABAX Balanced Prescient Fund	4.2	10.8	31.1	14.7	10.3	9.6	11.4	11.4
Balanced Benchmark	3.2	7.3	20.3	11.5	8.0	6.9	8.8	8.8

* All performance shown is net of fees

Best and worst periods (%)

Best 12-months	40.5
Worst 12-months	-15.7

The Fund produced a net return of +31.1% for the year, which was pleasing in both absolute and relative terms (peergroup + 20.3%).

The end of 2021 marked the 10-year anniversary of the Fund. Over this period, the fund has a produced a satisfactory net return of +11.4% pa, which compares favourably to the peergroup return of 9.2% pa and positions the fund amongst the top cohort of peers.

Our investment approach of sensible asset allocation and stock selection combined with searching beyond the traditional to try and add value via a broader range of assets and strategies has been consistently applied over the first decade of the funds existence. This approach enables us to construct portfolios from a more diversified set of risk premia (sourced from areas of the market where less people are looking) in the attempt to improve risk-adjusted returns for our investors. These strategies include the ability to analyse business across the capital structure and invest in hybrid securities where the most favourable risk-reward payoff exists (our convertible bond exposure, for example, has made a material contribution to the fund over the years); the inclusion of quality smaller and mid-sized business in the portfolio that can add value over a full market cycle; the bespoke structuring of investment notes to produce pay-off profiles that align with the objectives of the fund; and the inclusion of cost-effective hedging strategies (at an individual security or asset class level) to help manage risk.

We will continue to work hard to further refine and improve our approach in the hope that we will again deliver satisfactory results for our investors over the next decade.

Contributors and detractors

During 2021, there were a number of large contributors to the performance of the fund which can broadly be grouped as follows: contributions from key fund holdings (British American Tobacco, Anglo American, Firstrand, BMW - collectively +4.1% CTR); positions that were subject to corporate action (Royal Bafokeng Platinum, Distell, Vivo energy, Imperial Logistics – collectively +7.0% CTR); high quality mid-sized and smaller sized businesses that delivered outstanding operational results (Transaction Capital, PSG Konsult, Pepkor, Combined Motor Holdings – collectively +3.1% CTR); Hybrid securities (European and Japanese Autocalls, Sappi and Brait and Platinum Converts – collectively +3.0%); specific Property opportunities (Simon Property Group, Spear, Dipula – collectively 1.8% CTR); and our allocation to SA Government Bonds which we increased materially over the course of the year (1.3% CTR).

There were no major noteworthy detractors from absolute performance over the year, but the fund did experience small losses from some of our Index hedges (-0.5% CTR), our combined position in Naspers and Prosus (-0.3% CTR) and an allocation to Turkish Bonds that was initiated toward year end post an initial sell-off but where we were clearly too early or simply wrong (-0.3% CTR).

Fund Positioning

During the year the focus shifted to rampant developed market inflation and the subsequent move by central banks to withdraw stimulus/liquidity at a faster pace than originally expected. We still believe central banks have thus far managed this process well but admit that 2022 will be more challenging given the overall reduction in global stimulus, the move to higher rates and high overall market valuations. We think a slightly more cautious approach is warranted at his juncture and retain a well-diversified portfolio with a more defensive bias than that with which we began 2021.

The largest change to the portfolios over the year was the increase in our bond exposure from 4.4% at the start of the year to the current allocation of 19.1%. We believe local nominal bonds are attractively valued. With medium-term inflation expectations at around 5%, 10-yr bonds infer a risk premium of about 5% - a level typically more associated with equities! Over the course of 2021, strong commodity prices led to good export revenue, tax revenue overruns and a fiscal picture that benefitted significantly from this windfall. On the back of this Fitch unexpectedly changed South Africa's credit rating outlook to stable from negative in December while keeping the rating at BB-; improved fiscal and credit metrics were cited. The improved fiscal position (debt/GDP ratio now peaking at around 78%), anchored inflation expectations and low (albeit rising) global bond yields makes the SA bond risk premium seem excessive.

The increase in bond exposure has largely been funded through a reduction in equity exposure. As previously mentioned, quite a few holdings were subject to corporate action which effectively prompted us to realise the value of those holdings. These include Royal Bafokeng, Distell, Imperial, Vivo and Tower Property. We have also trimmed some of the holdings that have performed exceptionally well over the period in order to reduce their weightings and lock-in gains.

There is still an opportunity for a further rerating in local equities as the South African equity market continues to trade at a significant discount to its own history as well as other global markets. We also take comfort that the fund continues to invest in a diversified range of high-quality businesses.

We believe US equities are on the expensive side. We prefer more rationally priced European and Emerging market equities to their American counterparts. Our global equity composition reflects these considerations, but as always, we stay mindful of having a well-diversified portfolio of assets.

Having started the year fully weighted to risk assets, we have used the opportunity of strong market conditions to rotate to a more balanced portfolio in terms of asset class allocations. We still retain a healthy weight to equities, we have a decent exposure to SA bonds that we believe can deliver healthy real returns, and retain exposure to some interesting hybrid opportunities that we feel can provide equity like returns with lower risk.

Important Information

Collective Investment Schemes in Securities (CIS) should be considered as medium to long-term investments. The value may go up as well as down and past performance is not necessarily a guide to future performance. CIS's are traded at the ruling price and can engage in scrip lending and borrowing. A schedule of fees, charges and maximum commissions is available on request from the Manager. A CIS may be closed to new investors in order for it to be managed more efficiently in accordance with its mandate. There is no guarantee in respect of capital or returns in a portfolio. Performance has been calculated using net NAV to NAV numbers with income reinvested. The performance for each period shown reflects the return for investors who have been fully invested for that period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestments and dividend withholding tax. Full performance calculations are available from the manager on request.

Annualised performance shows longer term performance rescaled to a 1-year period. Annualised performance is the average return per year over the period. Actual annual figures are available to the investor on request. Highest and lowest is returns for any 1 year over the period since inception have been shown. NAV is the net asset value represents the assets of a Fund less its liabilities.

Prescient Management Company (RF) (Pty) Ltd is registered and approved under the Collective Investment Schemes Control Act (No.45 of 2002). For any additional information such as fund prices, fees, brochures, minimum disclosure documents and application forms please go to www.abax.co.za.

*The forecasts are based on reasonable assumptions, are not guaranteed to occur and are provided for illustrative purposes only.

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