Abax Balanced
Prescient Fund Commentary

ABAX investments

Q1 2023 Commentary

Prescient

Overview

Markets climbed the proverbial ‘wall of worry’ in the first quarter of 2023. Although there is much to worry about, it seems that after the poor showing from equities last year, investors came into 2023 light on risk assets, and the fear of missing out tempted them to reengage at the first sign of strength.

The markets hyper-focus (excessive, in our view) on short-term inflation prints and the path of interest rates got rudely interrupted in March, when some of the first cracks resulting from rate hikes totalling 4.75% in the course of just 12 months began to manifest themselves.

The run on Silicon Valley Bank – which had severely mismatched its assets and liabilities – created a global panic that required emergency liquidity to be injected into the system, an effective about-turn on recent tightening measures. Within just a few days, the market went from pricing in an additional three hikes from the FED, to three cuts. Not since the credit crisis of 2007/8 had bond volatility been as high.

The JSE All Share Index returned 5.2% for the quarter (Capped SWIX All Share 2.4%), with nominal bonds (ALBI) returning 3.4% and inflation-linked bonds (ILBI) returning 1.1%. Property performed poorly (-5.1%). The rand weakened 4.1%.

On the offshore front, equity markets had an exceptional quarter with the MSCI World Index returning 7.9% and the MSCI Emerging Markets Index returning 4.0% for the quarter. Global bonds also enjoyed a solid quarter with the FTSE World Bond Index returning 3.5%.

Fund performance and contributors/detractors

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

	YTD	1 yr	3 yrs	5 yrs	7 Yrs	10 Yrs	Incep.
ABAX Balanced Prescient Fund	7.0	14.3	24.0	11.8	10.0	10.9	11.4
Balanced Benchmark	4.2	5.0	15.1	7.6	6.2	7.2	8.2

Best and worst periods (%)

Best 12-months	40.5
Worst 12-months	-15.7

* All performance shown is net of fees

Source: Morningstar, April 2023

The Fund produced a return of +7.0% (net of fees, most expensive class) for the quarter. This compares to the peergroup average of 4.5%. Over the past year, the fund is up 14.3% (vs peergroup of 5.0%). Over longer periods, the fund is ranked amongst the top quartile of the peergroup.

Top contributors to the funds’ performance came from our 19% allocation SA Bonds (+0.9% CTR); the combined position in Google and Meta (+1.0% CTR); Luxury companies Richemont and Moncler (+0.7% CTR); the BMW Preference share - a cheaper entry into already cheap BMW (+0.6% CTR) and finally Prosus (+0.5% CTR). We have subsequently sold our positions in Meta and Richemont, and trimmed our position in BMW.

The largest and only material detractor from performance came from our holding in Transaction Capital (-0.8% CTR). The company released an unexpected profit warning and restructuring of their Taxi finance business (25% of profits). This part of their business has been severely impacted by post-Covid commuter trends, high fuel prices, high parts prices, low fare increases and more recently the impact that loadshedding has had on congestion (taxi’s completing fewer trips). This, along with higher interest rates, has made it much more difficult for the taxi operators to service their debts. We were aware of these headwinds in the Taxi business and had trimmed our position slightly. But we underestimated the extent of the problems which was clearly a mistake.

Fund performance and contributors/detractors (Cont..)

Furthermore, the release of the profit warning could not have come at a worse time – smack bang in the middle of the Silicon Valley Bank/Credit Suisse induced financial panic. It seems foreign holders of the shares decided to dump everything they had as all sorts of irrational fears got priced into the shares. At one point the shares had fallen cumulatively by 70%. They have subsequently rallied nearly 50% from the lows, but remain at half the level they were prior to the profit warning. We believe that even with a much reduced taxi operation their remaining businesses (We Buy Cars and the Loan Collection business) have a value materially above the value the market currently ascribes to the business. We used the weakness to add to our position.

Fund positioning

The headwinds facing global risk assets are unlikely to abate soon. Years of excess and easy money are not usually dealt with that quickly. It feels like the stresses induced by the sharp rise in rates have just begun to show themselves. In the US earnings projections still seem way too optimistic given that inflationary pressures must still impact record corporate profit margins.

The Chinese economy is at a different stage of its economic cycle relative to the West, and over the quarter some of the news flow was more business friendly. This market has been a pariah for the past few years and in our opinion is a fertile hunting ground for opportunities. However, given our lesser understanding of the dynamics at play in this market, we will limit our individual position sizes (and overall allocation) to Chinese stocks.

We have continued to trim positions in a number of stocks that have performed well. It seems to us that there are viable alternatives to taking equity risk at present. SA Bonds, yielding over 10%, are offering returns in the region of inflation + 5% (not far off a traditional equity risk premium) and for the first time in over a decade - given the massive spike in rates in the US - hard-currency cash and bonds are also interesting.

Our overall allocation to equities and listed property has drifted lower from about 80% a year ago to just over 60% today. The remainder of the portfolio is made up of a mix of local and offshore nominal bonds, inflation-linked bonds, credit bonds (floating and fixed), convertible bonds and cash which provide and attractive yield underpin for the portfolio.

Conclusion

In order to try and manage the many risks (known and unknown) that global economies and companies are currently contending with, we have endeavored to build a robust portfolio. WE have done this by being well diversified across asset classes, geographies and individual securities; by favouring high quality but undervalued stocks (preferably well off their highs) with strong balance sheets that can cope with higher interest rates (and have the firepower to repurchase shares if they deem appropriate); by hedging some of our equity beta with derivative overlays; and by trying to seek out the parts of the capital structure with a risk/reward best suited to the objective of the fund.

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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