Abax Absolute
Prescient Fund Commentary

ABAX investments

Q4 2023 Commentary

Prescient

Quarterly Overview

Similar to 2022, the fourth quarter saw a strong rebound from depressed levels across asset classes and geographies. The inflection point in markets in late October, from arguably very oversold levels, correctly anticipated the Fed pivot announced in December. The more dovish tone an d declaration that policy rates have peaked and are likely to decline by around 75 basis points in 2024 was a clear shift from the September commentary and resulted in a 'risk' on scenario into year end. In contrast the ECB and BOE remained hawkish giving little indication on the timing and extent of possible rate cuts in 2024. The market is, however, still pricing in much more bullish scenarios for all three regions. Locally rates also benefited from lower global rates. Although the MPC kept rates on hold in November the tone was still cautious on inflation, especially around higher food and fuel prices. C urves steepened somewhat, however, as fiscal risks still remain very real given the impact of load shedding on growth, lower tax revenue due to weak commodity prices and public wage pressure going into an election year.

With this backdrop the US 10 year yield declined 69bps to 3.88% for the quarter while the UK and EC B generic 10 year yields decline 90 bps and 87bps respectively. US equity markets continued the strong H1 performance with an 11.7% return during the quarter to end the year 26.3% higher. This supported the MSCI All World index that returned 11.1% and 22.8% for Q4 and the 2023 respectively. Despite a 7.9% recovery in Q4 emerging market equities still lagged with a 10.3% USD return for 2023. EM performance was dragged down by China that still struggles to accelerate growth post severe lockdown restrictions, mainly due to a lacklustre property market and a regulatory risk overhang. Chinese equities declined 4.2% for the quarter and 11% for the year.

Locally the SA All Bond Index returned 9.7% for the year of which an 8.1% contribution came in the fourth quarter. Cash returns were healthy at 8% for the year and Inflation Linked bonds also returned an impressive 6% for Q4 to end the year at 7.1%. After a dismal first three quarters equities recovered in Q4 with the Capped Swix Index returning 8.2% to end the year 7.9% higher. The JSE listed property sector returned 10.2% for the year after a 16.4% rebound in Q4. Although the rand strengthened 3% against the US dollar in Q4 it still depreciated 7.8% during 2023

Fund Positioning

Returns (%, annualised)(Inception Date 29-01-2010)

	YTD	1 yr	3 yrs	5 yrs	7 Yrs	Incep.
Abax Absolute Prescient A	11.8	11.8	9.9	9.3	8.5	9.1
CPI + 3%	8.7	8.7	9.3	8.2	8.1	8.4
Peergroup	11.1	11.1	8.5	7.9	7.0	7.8

* All performance shown is net of fees

Best and worst periods (%)

Best 12-months	21.4
Worst 12-months	3.8

Source: Morningstar, January 2024

The weak local bond and equity markets during Q3 and October afforded us the opportunity to tactically add exposure to both asset classes either by buying outright or reducing hedges where appropriate. Although valuations were optically attractive, in absolute terms and relative to history, we remain cognisant of the significant fiscal risks and dire state of the SA economy at present with structural low growth due to energy constraints, poor governance in the public sector, the crises at Transnet and increasing fiscal demands in terms of social grants, SOE support, wage inflation and interest expenses. The medium-term budget policy statement signalled some prudence on Treasury's part but we remain sceptical on execution, especially with national elections looming large in 2024. Treasury's commitment to limit bond issuances, talk around the introduction of a fiscal anchor and the supposed once off benefit of releases from the still poorly understood Gold and Foreign Exchange Contingency Reserve Account (GFECRA) were significant positives following the MTBPS. The strong, broad asset class rebound late in Q4, especially in local bonds where the 10-year proxy (R2032 government bond) rallied 113 bps during Q4, gave us an excellent opportunity to again lighten some of our tactical positioning in bonds and equities. We increased our strategic allocation to inflation linked bonds that are currently offering returns firmly in excess of 4% above inflation. Our local property exposure remains small given risks around oversupply in office space, a weak retail environment and high interest rates.

Within local equities we found stock selection challenging during Q4 with some of our larger holdings experiencing some stock specific and regulatory headwinds. Valuations, however, remain compelling with the MSCI SA fwd PE at <10x, a 25% discount to its 10yr average and at a 17% discount to Emerging Markets. In addition, dividends remain healthy, and our rigorous hedging program again smoothed out some of the volatility. The portfolio continues to retain a preference for banks over discretionary consumer businesses since the endowment effect still benefits banks, while consumer balance sheets remain stretched. We believe that commodities should perform better in 2024 on a possible rebound in the Chinese economy, less restrictive policy rates, a weaker US dollar, and depressed inventories. We further see value in select non-resource rand hedge counters that carry a substantial weight in our locally listed equity market.

Offshore bonds sold off aggressively early in the quarter and gave an excellent opportunity to add duration at yields nearing 5% on the US 10 year. Post the December rally valuations are less compelling but still fair and we maintain healthy exposure due to the excellent diversification benefits and the outside chance of a hard landing later in 2024. We continue to tread cautiously around US equity but see value in Europe, the UK and a few select Chinese counters.

Conclusion

The Abax Absolute Prescient Fund returned 4.2% for the final quarter and 11.8% for 2023, outperforming the peer group average by 0.8% net of fees and comfortably ahead of our CPI + 3% target for the year. Over 3 and 5 years the fund outperformed the return target by 0.6% and 1.1% p.a. respectively and peer group by a slightly higher margin. The fund's second and no less important objective of capital stability has been displayed once again through a volatile period that included significant global economic challenges, policy shifts and geopolitical events. During 2023 the SA equity market had six negative months with an average loss of 3% and bonds had five negative months with an average loss of 1.9%, while the fund only had three negative months with an average drawdown of 85bps.

Although the picture on global policy rates have turned favourable the market is already pricing in a significantly more bullish scenario than guided by central banks. Inflation is moderating rapidly but still far from target rates. Geopolitical tension remains and the wars in Ukraine and Palestine continue unabated. Locally the Eskom and Transnet woes continue while the pending national elections also introduce significant uncertainty. That said, valuations of local equity, bonds, inflation linkers and cash rates remain reasonably attractive. Global equities excluding the US also offer good opportunities, but we remain cautious around the elevated valuations in the US. Offshore bonds still offer value post the recent rally and add valuable diversification benefits to the fund. We believe our conservative approach, good diversification, high cash yields and hedging strategies should provide stable returns while tactical asset allocation can assist in achieving, and hopefully exceeding, our dual objective of inflation beating returns and capital stability.

Important Information

This document was issued on 22 January 2024.