Abax Balanced
Prescient Fund Commentary

Q4 2023 Commentary

Prescient

Overview

The last quarter of the year marked a sharp reversal in expectations regarding the path of inflation and interest rates. At the end of Q3 market participants expected overnight rates in the US to move higher in the short term, and to average 4.4% p.a. for the following 5-year period. By year-end, with inflation falling and the eagerly awaited FED 'pivot' finally materialising, these expectations had shifted materially lower. Rates were now forecasted to fall in the short term and to only average 3.5% p.a. over the following 5 years – a massive decrease of nearly a full a percentage point per annum.

This sharp reversal in rates expectations fuelled a strong rally in equity and bond markets in the final quarter of the year. Whether or not inflation is now truly under control remains to be seen and we are left wondering if the sharp fall in rates may in fact be a signal that economic growth may be set too slow.

For the 2023 year, the MSCI All Country World TR Index moved 22.1% higher, strongly outperforming the MSCI Emerging Market TR Index which returned +9.9% in USD. Within Emerging Markets, the standout negative performance came from China (MSCI China TR Index -11.1% in USD), as investors continued to flee the market in the face of an economy that is struggling to recover post Covid; and the fear that further regulatory interventions by the government will impede company profitability.

Local Equity markets were again a relative disappointment, with continued loadshedding and low growth thus far limiting the ability of the market to re-rate from depressed valuation levels. The Capped SWIX TR Index delivered a lacklustre +7.2% in ZAR (flat in USD) for the year.

Global Bonds recovered sharply toward year-end and returned 4.9% in USD for the year. Local bonds, produced a credible 9.7% in ZAR (+2.3% in USD) for the year, despite much intra-year volatility and a sharp steepening of the curve as investors started to question the ability of the government to service and repay its longer-dated debt.

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	17.2	17.2	18.0	13.6	10.7	10.7	11.5
Balanced Benchmark	12.3	12.3	10.5	9.2	7.4	6.9	8.3

* All performance shown is net of fees

Best and worst periods (%)

Best 12-months	40.5
Worst 12-months	-15.7

Source: Morningstar, January 2024

The Abax Balanced Prescient Fund produced a return of +17.1% (net of fees, highest fee class) for the year. This compares to the peergroup average of +12.3%. Over longer periods the fund has produced double-digit annualised returns and is ranked amongst the top quartile of the peergroup.

All asset classes (unusually) contributed positively to the fund over the year, with global equities contributing approximately half of the fund's total return.

Largest contributors at a stock level were all foreign securities. These included Google (position maintained), the BMW Preference Share (materially reduced) and Shell (sold). The R2037 South African government bond also contributed strongly due to its large weighting in the fund.

The only material detractor (>0.5% CTR) was Transaction Capital which we have discussed in detail in previous reports. Our original thesis was clearly mistaken and we failed to act decisively on the deteriorating macro conditions that upended their SA Taxi business. In the course of Q4 we sold our small remaining position when the stock jumped substantially from lows. Although there is still much value should the businesses navigate current difficult conditions, the range of potential outcomes is wide and we have found better risk/reward payoffs elsewhere post the bounce in share price.

Fund positioning

We still believe local bonds are attractively valued (at time of writing the SA 10-yr bond yield was close to 11.5%) with inflation expectations anchored around 5.5% and global rates having peaked. This implies a prospective real return pretty much in with the long-run equity risk premium. But we do not view SA bonds as a risk-free asset (as we do US bonds) and therefore will limit our overall allocation accordingly.

As mentioned in the last quarterly report, global fixed income has become an investable asset class for the first time in many years. Although less exciting than 3-months ago (post the strong Q4 rally), US Treasuries yielding close to 4% (versus 1.5% at the beginning of 2022) still offer some value and strong diversification benefits.

We have been selectively adding to our local equity exposure during weakness experienced by certain stocks (Absa, Anglo American, BTI, Prosus) whilst at the same time trimming some stocks that had performed well (most notably Firstrand, Capitec and Ninety One). The South African equity market continues to be attractively priced, both on a relative and absolute basis. Unfortunately, we've seen little buying interest from foreign or domestic investors. We retain our preference for quality counters that can tough it out despite the headwinds.

We view US equities to be on the expensive side, especially on a relative basis, although outside of the large mega cap stocks there are still many interesting opportunities. We have retained our weighting to these stocks but have overlaid some downside derivative protection which is unusually affordable at present. European and UK equities have been big underperformers and continue to offer good value.

Within the Chinese equity market there are many interesting opportunities at extremely compelling valuations. We have incrementally been increasing our weighting to these ideas over the course of the year, and our buying accelerated in Q4. As we are cognisant of the manifold risks of investing in China we will try and manage this at a portfolio level by both limiting our total maximum exposure to this market and by also diversifying across a number of holdings with varied business models operating in different industries.

Conclusion

We see the current opportunity set as reasonable rather than exciting, but find some comfort in the fact that at present opportunities are widely spread across different geographies and asset classes, which is not always the case. We are therefore able to construct a well-diversified and hopefully robust portfolio. The portfolio currently favours higher-quality but undervalued stocks with strong balance sheets that can cope with higher interest rates and uncertain macro conditions. We have hedges overlaying some of our equity beta which should offset some general market weakness if it materialises.

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