REZCO

ASSET MANAGEMENT

QUARTERLY INVESTOR COMMENTARY — DECEMBER 2018

PERFORMANCE OVERVIEW

The performance of our funds in the final quarter, and broadly for the year, can be categorised as preserving capital in a tough year. Our local funds performed well and were in the top quartile of their respective categories for 2018. We are pleased to have outperformed our benchmarks and peers, but are also very mindful of the need for our investors to grow their wealth. Bank deposits outperformed balanced funds for the year. This does happen from time to time over short periods, but we would remind investors that over longer periods, balanced funds have historically generated significantly better returns for investors, as the graph below illustrates. We believe that equities will outperform cash for 2019, as the subdued 2018 year (both locally and internationally) has caused exciting pockets of value to build up.

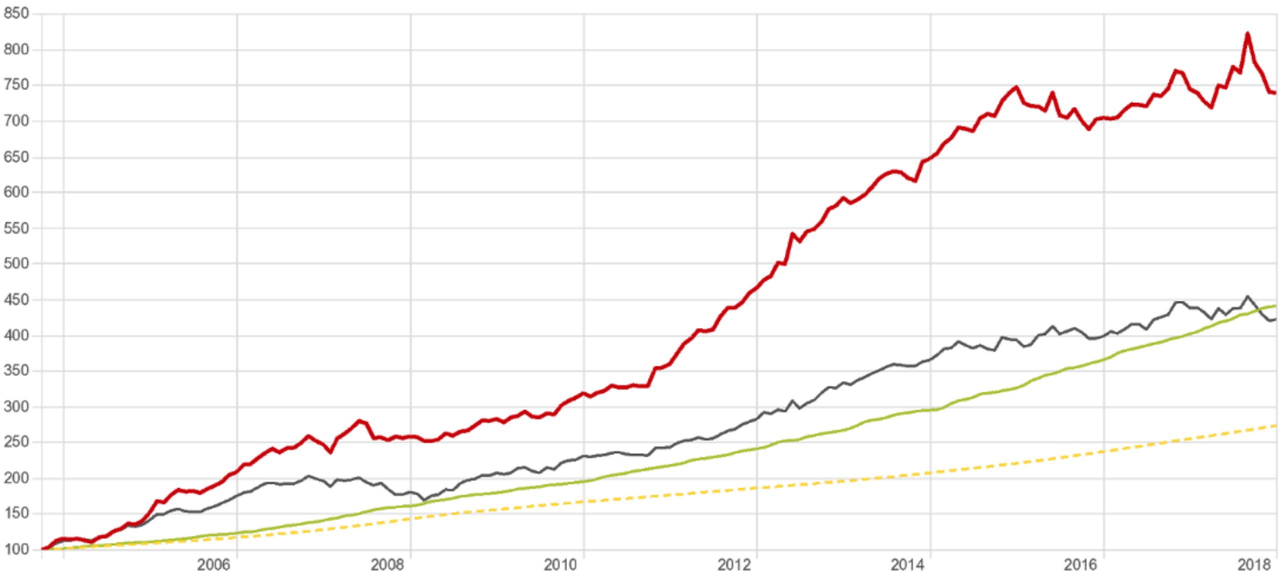
REZCO VALUE TREND FUND

SINCE INCEPTION

CUMULATIVE RETURNS

Time Period: Since Common Inception (2004/10/01) to 2018/12/31

Currency: South African Rand   Source Data: Total Return



Rezco Value Trend A	739.9	STeFI Composite ZAR (Cash)	273.9	Inflation + 5%	441.5
ASISA SA MA High Equity	422.9				

SOURCE: MORNINGSTAR

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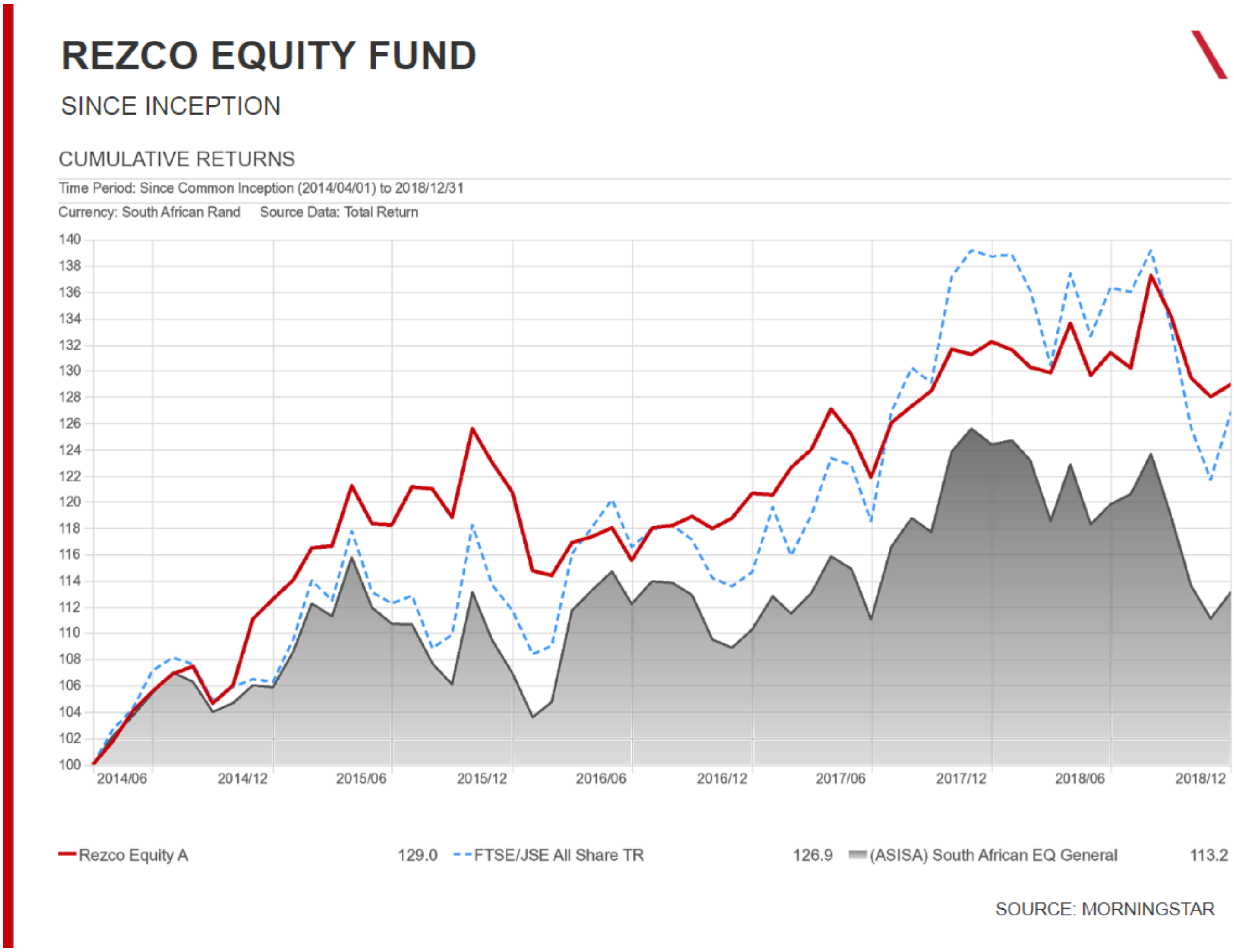
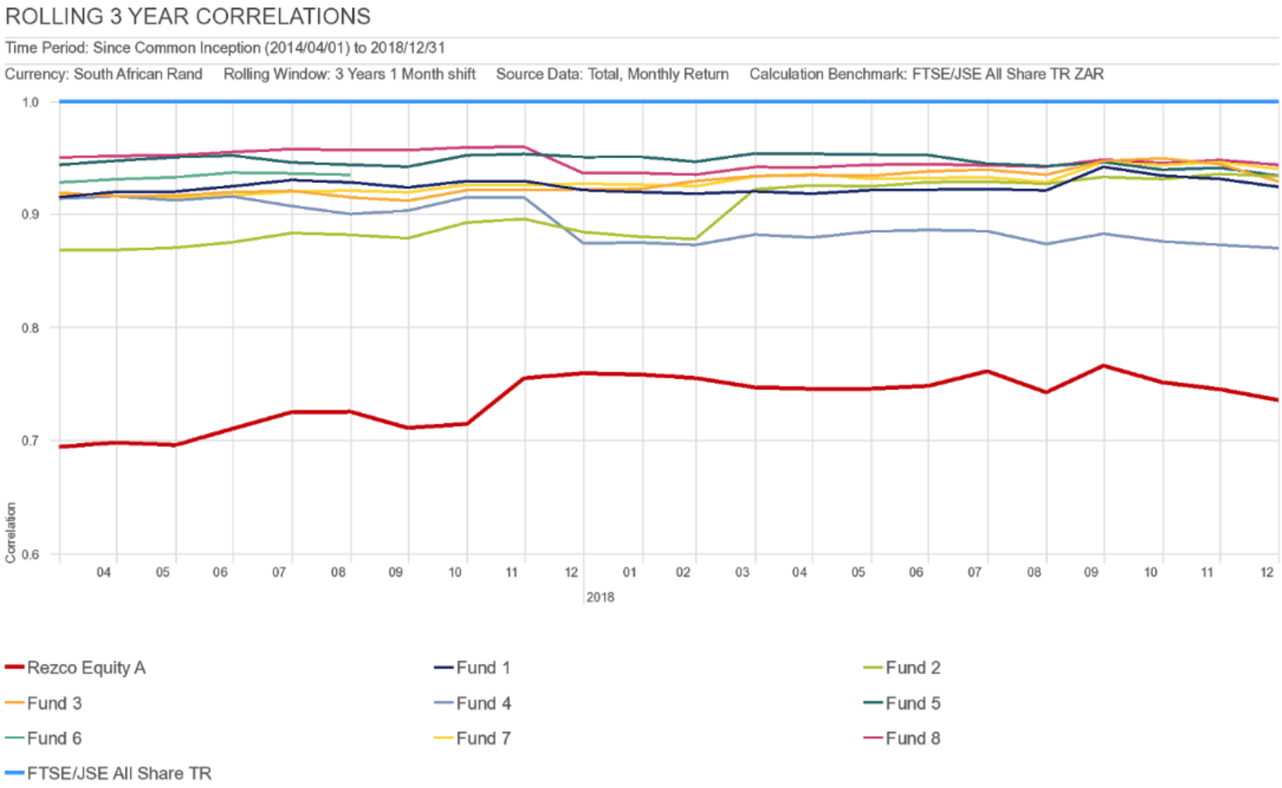
REZCO EQUITY FUND

We would like to highlight the Rezco Equity Fund's performance as it approaches its five-year track record at the end of March 2019. The Fund targets a 95% allocation (minimum 90%) to high conviction South African listed equity, listed property and commodity positions selected independently from the benchmark. Therefore, the Fund has a low correlation in comparison to other funds in the category, and the market. As illustrated in the graph below, the Fund has produced higher returns than peers and the JSE All Share Index (ALSI), with lower volatility. This performance has been achieved with a Beta of 0.5 since inception, and volatility of 7.5% compared to the ALSI at 10.9%.



CONSISTENTLY LOW CORRELATION TO PEERS

REZCO EQUITY FUND



SOURCE: MORNINGSTAR

GLOBAL MACROECONOMIC VIEW

The fourth quarter of 2018 was dominated by fear of the end of the economic cycle, with expectations of an imminent recession in 2019. In our view, the key trigger of a flattening/inverting US yield curve sent a false signal. This signal triggered a market correction, negative sentiment and significant selling of equities and buying of bonds. It became a self-reinforcing cycle. There are two key areas where we disagree with this:

1. While there is some softening, fairly robust US economic data is pointing towards positive growth in 2019. 2018 was a strong year for economic growth, thus a slowdown in growth can be seen as healthy. A more concerning scenario is an overheating economy that requires central bank intervention. This brings us to our second point below.

2. Recessions caused by an inverting yield curve usually occur when the central bank aggressively hikes short-term rates to dampen an overheating economy. With long-term rates fairly sticky, the yield curve inverts. This is not the current case where recent hikes have been moderate. Rather, it is the long end of the curve which has seen falling yields create the inverting yield curve. This would normally be regarded as stimulatory and would not cause a recession.

Therefore, our funds are positioned for a “goldilocks” economic environment. At the same time, we are keeping a close eye on the US/China tensions and are cautious of risks that present themselves at the end of cycles. The sharp, negative turn in sentiment led to broad basket-type selling of equities, regardless of their fundamentals; this creates excellent investment opportunities through careful stock picking.

LOCAL MACROECONOMIC VIEW

As South Africa approaches national elections, we can expect a great deal of political noise, campaigning, and news coming from the Zondo Commission. As South Africans, it is easy to get caught up in all of this hype. However, when we step back and look at the bigger picture we come to the following key points:

- The South African economy is grinding along waiting for business confidence to lift as the ANC reforms and takes South Africa along a path of correction to create a self-reinforcing investment cycle. This is going to take time and there will be hiccups, but broadly speaking the key drivers are expected to be SOE reform, Public-Private Partnership projects and infrastructure spending.

- President Ramaphosa did not convincingly win the December elective conference in 2017 – it was a draw. He has carefully been building support to create the much stronger position that he is in now. He has not been able to move quickly, but a strong election victory for the ANC may give him the boost he needs.

- South African equity valuations have reduced and, more importantly, earnings expectations have now moderated after the disappointing results during 2018. Valuations are reasonable and there are good opportunities. South African Financials and select Industrials are two key sectors to which our funds are exposed.

KEY INVESTMENT THEMES FOR 2019

- **Platinum Group Metals (PGMs):** While the "dieselgate" story is now old, what has emerged is a growing consensus that to fix the problem of achieving regulatory approval in emission tests, higher loadings of palladium or platinum are required. At the same time, standards are increasing. The combination of catch-up from previous cheating, and globally advancing emission standards is expected to squeeze commodity prices higher. Futhermore, the government's focus in China is shifting towards fuel cell technology (high platinum user) as subsidies are reduced on electric vehicles.
- **Suppliers to the semiconductor industry:** The market has reacted very negatively to semiconductor price decreases and volatility in the inventory cycle (recent de-stocking). We expect a *volume* supercycle in semiconductors with lower prices driving higher volumes in the industry. The funds have invested in suppliers to the industry (gases, machines, wafer, services). As volume grows, we expect these high-quality companies, which benefit from global oligopolies, high barriers to entry and highly technical products, to re-rate significantly off depressed levels.
- **Global Financials:** The funds are exposed globally to innovative insurance companies benefiting from the use of technology and wellness trends. US national banks that we hold (JP Morgan and Bank of America) have the tailwind of cutting total branches, while at the same time expanding their geographic reach, cutting costs, implementing technology (regional banks at some stage will battle to

compete) and the improving regulatory environment. Valuations are undemanding, offering good quality and sustainable growth over a multi-year period.

- **South African Industrials and Banks:** We are confident that, over time, President Ramaphosa and his team will rebuild South Africa. While many investors may rush to the listed retail groups for exposure to this theme, we see select South African Industrial shares and Banks as the best exposure. The core needs of our country are to fix SOEs (many opportunities for the big banks), large infrastructure projects (banks and industrials benefit) and to regain some of South Africa's lost competitiveness (suppliers to South African manufacturing and mining industries). As the private sector gains in confidence and allocates capital within the country, rather than the previous track record for attempting offshore growth, South African Industrials and Banks are set to benefit. With regards to retail, we largely see headwinds for the sector, and have limited exposure given the relatively high valuations, and the core issue of insufficient same-store sales negatively impacting margins.

CONCLUSION

Timing market cycles is not a perfect science, but what is usually true is that a change in the direction of a cycle does not simply follow due to a lapsed time period. Rather, it is the previous cycle that *causes* the next cycle. So, in today's context, while this expansionary cycle is long compared to history, it is worth noting that it does not appear to have overheated sufficiently to bring on the next phase in the cycle – a recession. We are cautiously exposed to equity shares that will benefit as global growth positively surprises against recessionary fears.

GRATITUDE

We would like to express our thanks to all our investors for your continued support. We wish you much joy, peace and growth for 2019.

ROB SPANJAARD
Chief Investment Officer

SIMON SYLVESTER
Co-Portfolio Manager