QUARTERLY INVESTOR COMMENTARY JUNE 2019

There is a profound tension between globally synchronised, stimulative and market supporting monetary policy, and heightened geopolitical risks, notably US/China. These two opposing forces combine poorly with a market, which, due to being late cycle and flows-driven (passive, quants etc.), is overly sensitive to changes in sentiment and newsflow. Risks are high as correlations rise in a market sell-off, and given South Africa is an emerging market, foreign selling of bonds correlates with the falling equity market. The reverse happens on short-term good news. Thus, we see this sideways and volatile market continuing, but with the risk of a significant market crash as monetary policy may not always provide the support needed to counter economic or geopolitical risks.

Given the risks, Rezco funds have been positioned cautiously, generally lagging on the upswing but outperforming when markets fall. Stock picking has also added significant value – in the noise of the markets, some good quality opportunities get missed. Overall, the strategy has been working well over the last year, but to the quarter ended June 2019 lagged strong markets, which were driven by central bank easing.

SOUTH AFRICA: ECONOMIC OUTLOOK

The South African economy remains under pressure. We have not yet seen any major structural reform to boost growth, and efforts to address corruption have been limited. The SARB remains relatively hawkish, supported by their view that monetary policy is not the solution to SA's poor growth, and that the upper inflation band may be too high. The country's balance sheet is under pressure; we expect a worse than consensus budget deficit driven by lower tax collections and a lack of positive resolve on SOEs. Political fighting is slowing progress and hurting confidence, both locally on the consumer and business side and for foreign investors in SA equities and bonds.

SA INC: POSITIONING AND VIEWS

Our investment style looks for companies with growing earnings on reasonable valuations; something difficult to achieve given the weak macro. The risk of value traps is high. That being said, there are some good opportunities, especially in the mid cap space (we avoid small cap companies due to their business and liquidity risks). The traditional SA Inc names largely include the big retailers and banks – the funds have had little exposure to these names as we see broad consumer headwinds. We are also avoiding local property where we think only half the bad news is priced in: 1) there is a very tough operating environment highlighted by large rental reversions in office and retail; 2) property companies have been under-spending on maintenance and over-paying on dividends relative to operating cash flow less maintenance expenses.

We still see significant downside risks for the SA listed property sector. These shares represent most of the SA Inc basket, and thus we have had to work hard to find good opportunities without taking unnecessary risk. The key contributors to fund performance have been companies with internal growth stories like Transaction Capital and Afrimat, and mid caps that have been mispriced such as Alexander Forbes and Investec Australia Property Fund. The funds have also benefited from a high exposure to the Platinum Group Metals sector, where we see continued tailwinds through higher demand for use in auto catalysts.

AVOIDING LANDMINES ON THE JSE

Being benchmark agnostic and not under weighting companies with poor prospects or risky governance has resulted in the funds avoiding most of the big SA listed landmines, and we have avoided the recent companies hit by corporate governance scandals. This is a function of our style, and we expect it to be repeatable.

Where we have made mistakes is in buying a company with expected good earnings growth where the growth has not materialised (i.e. we forecast growth incorrectly), and then holding onto the share given the now perceived value post a sell-off. Sappi is a share we have held which fits this profile. We have also made the opposite mistake, selling a share that has fallen too far – the capitulation trade. AngloGold fits this profile well where we sold at ~R100 before a major rally to R250. We try to learn from our mistakes, but we do know there will be mistakes in the future. If we stay focused on our style (avoid value shares with no growth or tailwinds) and remain benchmark agnostic with independent thinking, we hope to continue avoiding investments with big share price drawdowns. We see avoiding these risks as key to contributing to the portfolios risk management – we do not rely on diversification to wash over mistakes. The reason being is the 'mistakes' often perform worst in a market correction; this is also when correlation increases. Fund drawdowns are thus extended.

TRADING IN A SIDEWAYS MARKET

The funds have also increased trading – this is a pro-active and thought through decision. The logic is as follows:

- Locally: we do not see SA Inc shares reaching new highs given the tough macroeconomic environment, but volatility is high. Good businesses are trading in ranges. It makes sense in this environment to sell a business when it reaches what we view at the time as near peak levels, and buy when it falls into the lower part of its range. While it is much better to buy (and hold long term) good quality businesses with earnings growth and tailwinds on reasonable valuations, we cannot decide what the market gives us and good opportunities are limited on the JSE. Our investment style is benchmark agnostic, and therefore we will not underweight a share we do not like – the allocation will be 0%.
- Globally: the tension between geopolitical risk and monetary stimulus results in increased stock volatility, while the lack of economic growth makes it difficult for share prices to trend upwards.

This trading strategy represents a small portion of the fund allocation at any one point in time, and we are careful not to buy any company hoping for a bounce. We will only buy a company with a good valuation and long-term story; we are not looking for low quality, oversold businesses that may bounce for us to exit. Furthermore, we are disciplined about our trading, tracking decisions carefully and avoiding passively holding shares without conviction.

Incremental Strategy: Internally, we call it by a cricket analogy of 'hitting singles'. We are not trying to take high risks by trading. On the contrary, we are trying to reduce risk by selling out of shares when they hit peaks. The moves are small and incremental, but they do add up.

REZCO EQUITY FUND: PERFORMANCE STATISTICS

Finding good quality growth opportunities in companies within the R7bn to R30bn market cap zone, trading out of shares when they reach peaks given the rangebound market, independent thinking and avoiding the landmines has resulted in the Rezco Equity Fund performing in line with the ALSI with:

- 0.5 beta
- lower drawdowns
- lower volatility
- low correlation to peers and the market

The Fund targets being 95% invested with a minimum of 90%, and only invests in SA listed companies. This makes it a great building block within the SA equity allocation in a portfolio.

REZCO EQUITY FUND

PERFORMANCE

As of Date: 2019/06/30 Currency: South African Rand Peer Group: Open End Funds - ASISA Sector (South Africa) - (ASISA) South African EQ General

	6 Months	1 Year	2 Years Ann.	3 Years Ann.	5 Years Ann.	Since Inception
Rezco Equity A	6.8	4.9	6.3	6.0	5.5	37.8
Peer group quartile	3	1	2	1	1	1
FTSE/JSE All Share TR	12.2	4.4	9.6	6.9	5.8	42.4
(ASISA) South African EQ General	7.5	1.5	4.6	2.7	2.9	21.6

RISK AND DOWNSIDE PROTECTION

Time Period: Since Common Inception (2014/04/01) to 2019/06/30 Source Data: Total, Monthly Return Peer Group: Open End Funds - ASISA Sector (South Africa) - (ASISA) South African EQ General Risk-free Rate: STeFI Composite ZAR

	Return	Peer group quartile	Std Dev	Down Capture Ratio	Up Capture Ratio	Beta	Tracking Error
Rezco Equity A	6.3	1	7.7	48.1	62.5	0.5	7.0
FTSE/JSE All Share TR	7.0		11.1	100.0	100.0	1.0	0.0
(ASISA) South African EQ General	3.8		9.3	88.3	76.5	0.8	3.1

SOURCE: MORNINGSTAR

REZCO STABLE FUND: PERFORMANCE AND POSITIONING

The Rezco Stable Fund is not managed purely as a rebalanced version of the higher risk funds in the multi-asset category. There will be times when it is very similar to a reweighted version of the higher risk funds, but we use the flexibility to manage risk more conservatively when tail risks are seen as elevated, especially if the tail risks relate to the SA environment. The Fund has benefitted from the stock picks in the higher quality mid cap space, trading SA duration well, and close to maximum offshore exposure (mostly USD cash).

Given our cautious view, with elevated tail risks regarding US/China, the weak SA balance sheet and lack of structural reform and growth, the Fund is currently positioned predominantly in SA and USD cash, as well as precious metal mining and commodity exposure. This has supported recent returns, but we do not expect cash to always outperform and are therefore actively looking for high quality investment opportunities. Being benchmark agnostic means that if we cannot find these opportunities, we will invest in cash.

REZCO VALUE TREND FUND: THE COST OF AVOIDING RISK

The long-term track record of the Rezco Value Trend speaks for itself, but the Fund has lagged the ALSI post January 2016. It has been a long time since the Global Financial Crisis (GFC), and memories of the ANC elective conference may even be fading. The global risks that emerged in 2016 and 2017 were washed over by further monetary stimulus. It is easy to forget the value of avoiding risks as time passes, but it is worth noting that there have been some major risks post the GFC that had significant downside potential, but did not materialise. We do not expect to operate with certainty, but do expect that risk-adjusted return probabilities, when accurate, do play out over multiple iterations. Every time the Fund has avoided a risk that does not materialise, such as through the South African political risk of 2016/2017, this has cost performance. Our conviction in this part of our investment style – preserving capital – is core to how we manage money. The marginal cost of lost alpha in the events of 2016 and 2017 is ultimately compensated for when a major risk materialises.

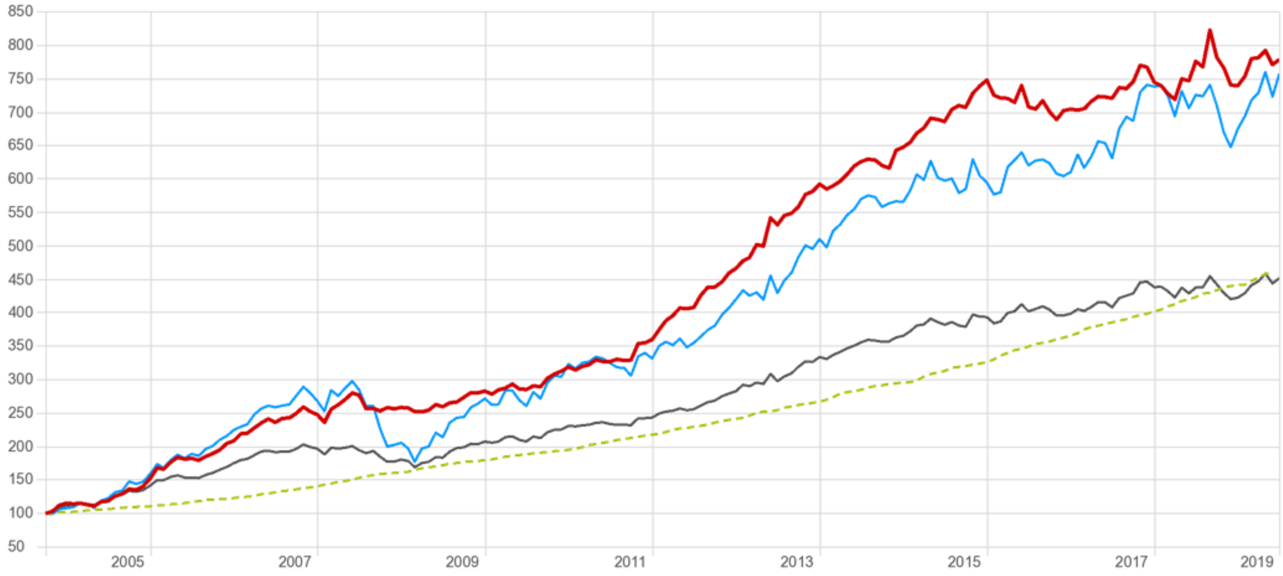
REZCO VALUE TREND FUND

SINCE INCEPTION

CUMULATIVE RETURNS

Time Period: Since Common Inception (2004/10/01) to 2019/06/30

Currency: South African Rand   Source Data: Total Return



Rezco Value Trend A	779.1	Inflation + 5%	461.3	FTSE/JSE All Share TR ZAR	758.1
ASISA SA MA High Equity	452.1				

SOURCE: MORNINGSTAR

CONCLUSION AND GRATITUDE

We remain focused on preserving capital in risky times, and creating wealth when high quality risk-adjusted opportunities are available. At the time, 2016 and 2017 were periods for preserving capital, 2018 and the first half of 2019 brought stock picking and trading opportunities, but the second half of 2019 is looking shaky. There is a risk of a significant market correction off a high base that has been built on monetary stimulus. The funds are positioned cautiously with high exposure to cash and precious metals.

The core of our business is to deliver risk-adjusted returns to our investors. It is what drives us as a business and is what we are personally passionate about. We therefore take this opportunity to once again thank you for your continued support of Rezco. We hope that over time we will deliver returns that support your personal wealth creation, whether for a comfortable retirement or to meet personal savings objectives.

ROB SPANJAARD

Chief Investment Officer

SIMON SYLVESTER

Co-Portfolio Manager