PSG Asset Management

ANGLES & PERSPECTIVES

FIRST QUARTER 2019

Contents

While we know that it may take time to realise mispriced value, we're excited by the prospects our process is uncovering. They're what we refer to as coiled springs: opportunities with the potential for significant upside. The fact that these opportunities extend across almost all asset classes is just as encouraging - and very rare. We believe that this has allowed us to build robust portfolios that are well positioned to deliver on our client mandates.

Introduction

Anet Ahern

Anet has over 30 years' experience in investment and business management. After starting her career at Allan Gray in 1986, where she fulfilled various roles in trading and investment management, she worked as a portfolio manager at Syfrets, and later BoE Asset Management, where she was CIO and CEO. She also spent six years at Sanlam, where she was the CEO of Sanlam Multi Manager International. Anet joined PSG Asset Management as CEO in 2013.

> "The bigger lesson is that once you understand a behavioral problem, you can sometimes invent a behavioral solution to it."
>
> Richard H. Thaler
> *Misbehaving: The Making of Behavioral Economics*

Market outcomes are uncertain and investors are skittish

Last year marked the FTSE/JSE All Share Index's worst year since the global financial crisis, with the overall index down in rand terms at year-end. Even more discouraging was that this signified one of the worst five-year periods the local market had seen in decades, deepening investor disillusionment. A weak economy and heightened political tension have added to the unease, while the escalating threat of international trade wars and geopolitical disruptions have caused similar scepticism towards many global markets.

It's easy to understand the temptation to disinvest

Behavioural science has shown that loss aversion – a strong preference for avoiding a loss over making an equivalent gain – and recency bias – our tendency to attach more significance to recent events than to events in the past – are inherent behavioural biases that all of us share. In combination, it's therefore easy to understand that investors may be tempted to switch out of investments that have recently performed poorly, or to exit the market completely.

Staying the course improves the odds of favourable long-term investment outcomes

However, research has also shown that most investors are notoriously bad at market timing. This means that investors who disinvest to try to *lower* their risk, run the very real risk of missing out on a potential market recovery. By selling when prices are low, investors may lock in losses, especially if they only re-enter the market once prices have already started climbing. While we know that it's incredibly difficult to act against ingrained instincts, we believe that a long-term mindset and consistent approach are critical to investors achieving their desired objectives. We recognise our responsibility both to apply these principles, and to encourage our clients to do the same.

Consistent and clear communication helps our clients understand our approach

In the opening article of this edition, a few of our investment team members respond to some of the most pressing questions our investors have been asking our client-facing team. They place the short-term underperformance of our funds in context, address perceptions around risk, and speak frankly about mistakes we have made. They also highlight the attractiveness of the current opportunities we're finding, and note that it may take time for this potential to be realised. We believe that communicating openly fosters trust. It also helps to reinforce our clients' understanding of our process, which we hope can offer some comfort in difficult times.

If you look at the world differently, panic presents opportunity

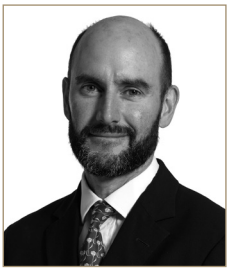
We often note that the best opportunities are found in times of fear and uncertainty. Moments of panic invariably result in the prices of quality companies and securities falling along with the rest of the market. While it may be difficult or feel uncomfortable at the time, capitalising on these low prices creates the potential for outsized returns once the panic passes. In their article, Fund Managers Dirk Jooste and Justin Floor delve deeper into the current positioning of our multi-asset funds, highlighting how rare it is to be finding such attractive opportunities across almost all asset classes. They also demonstrate how this has allowed us to construct portfolios with favourable odds of achieving their client mandates under a range of possible future outcomes – a key tenet of our investment philosophy.

Our process is designed to minimise the risk of permanent capital loss

We aim to construct robust, diversified portfolios that are not dependent on any macro forecasts (which we don't make), currency movements or specific outcomes. To do so, our fund managers rely on the consistent application of our process and the input of the broader investment team. This includes the security selections our Investment Committees approve for our buy lists, and peer assessments of each portfolio as a whole to test for unintended correlations. At an individual security level, our emphasis on avoiding permanent capital loss extends to how we evaluate each security's unique characteristics, and the price at which it is trading. In the final article of this edition, Gavin Rabbolini, one of our investment analysts, considers our funds' investments in Anglo American Platinum. It serves as a practical illustration of our preference to buy when prices are low and to remain disciplined in selling when our required margin of safety diminishes.

We hope you enjoy the read and wish you all the best for the remainder of the year.

Around the table with our investment team



Greg Hopkins

Shaun le Roux

Philipp Wörz

Greg is the Chief Investment Officer at PSG Asset Management and a fund manager on several of our funds. He has over 20 years' investment experience and is a CA(SA) as well as a CFA charterholder.

Shaun has managed the PSG Equity Fund since 2002 and the PSG Flexible Fund since 2016. He has more than two decades' investment experience and is a CA(SA) as well as a CFA charterholder.

Philipp joined PSG Asset Management in 2007 and has managed the PSG Global Equity and PSG Global Flexible sub-funds since 2015. He is a CFA charterholder and has over 10 years' investment experience.

Following a volatile start to 2019, our investment team responds to some key investor concerns

The market volatility and economic uncertainty that characterised much of 2018 continued into the new year. This has been heightened locally by intensified electioneering in the run-up to the general elections in May and the return of load shedding.

Reflecting on a difficult first quarter, our client-facing team sat down with a few members of our investment team to ask the most pressing questions currently on our investors' minds.

Q: Over the short term, your funds are underperforming. What can we read into this?

Greg:

Short-term underperformance is part and parcel of contrarian investing. To achieve superior returns over the long run, you must be able to bet away from the crowd, and to stomach the short-term drawdowns that may result. That said, we take concerns around short-term underperformance seriously and understand that it's a difficult experience for investors – we don't like it either. Looking back over the past three years, our funds have, in fact, outperformed in what was arguably one of the toughest investment environments South Africa has endured since 1994. We believe that this is largely because the quality checklists we apply as part of our investment process helped us avoid most of the corporate landmines that hit the markets in recent years. More recently, however, our funds have lagged our peers, and absolute performance is not what we'd like it to be.

It is important to understand that this is also symptomatic of our process. As we seek to identify quality companies on sale, we often buy what we believe to be good companies that are out of favour. But it's impossible to predict when the market will start to recognise mispriced quality, and we are often quite early in our positioning. We believe this is currently the case with several of our local and global holdings.

Shaun:

When our funds underperform over the short term, we always stop to ask ourselves if this is due to market timing or if we've made any mistakes. All investors make mistakes and we acknowledge that there have been instances in which we've valued companies incorrectly, either because we've subsequently been blindsided by unforeseeable events or due to flaws in our analyses. EOH serves as a recent example. But while we have had specific drags on performance recently, we need to consider how extreme the current market environment is, with poor economic conditions compounded by extremely bearish sentiment. In these environments, short-term pain is often necessary for long-term gain.

Some of our investors will remember similar conditions at the end of 2015 and in early 2016. We experienced significant short-term pain then, but that was part of the reason our funds were subsequently able to outperform. In fact, several of the companies that have made the biggest contribution to three-year outperformance were those that underperformed in the preceding two years.

Most of our funds' current short-term underperformance can be attributed to their holdings in so-called SA Inc. companies (particularly in the mid-cap space) and unloved global sectors. Although these continue to lag, our investment case holds.

Q: You've referred to EOH as a contributor to under-performance. Can you explain what went wrong?

Shaun:

In hindsight, we got the intrinsic value and size of the position wrong. While the share performed well for our clients for several years, our research later flagged concerns about the company's balance sheet, which we didn't act on soon enough.

Q: Despite recent declines, your funds still own EOH. Why?

Shaun:

If we compare EOH now to a year-and-a-half ago, it's a very different company in several ways. Importantly, it appointed external legal counsel to conduct a thorough governance overview and has overhauled its management and governance structures. This included appointing a new CEO, CFO and head of treasury, along with new board members. The company also has a new investor relations contact, offering improved disclosure to its investor base.

While legacy issues remain a concern, the new management team is committed to rightsizing the business and attending to problem areas. There is a long way to go, but our current view is that the market is ascribing a very low likelihood of a

successful turnaround. In our view, the share therefore still offers some margin of safety and we have concluded that it is in our clients' interest to retain their investment.

Q: What risks do investors in PSG's portfolios currently face?

Greg:

Over the longer term, we believe that our portfolios can be characterised as low risk, given how low prices are. Over the short term, however, the risk of poor or volatile performance is relatively high. Many of the companies we hold are out of favour with the market in general. While this is what we believe makes them attractive, it also means that over the shorter term, they are prone to being buffeted around by sentiment. Their share price movements can be unpredictable, and prices may fall further or remain lower for longer than expected.

Q: Given how challenging market conditions are, are you still finding opportunities?

Shaun:

As we have noted for some time, there is pervasive fear in certain parts of investment markets. This is in complete contrast to other areas that are well owned and in which investors are inclined to be complacent. We're finding far more opportunities in those parts where investors are fearful. In fact, our bottom-up analysis is indicating valuations usually seen in deep bear markets.

For longer-term investors who can ride out the storm, the return profile from these low valuation levels is promising. Accordingly, we believe we should be prepared to stomach some short-term volatility in exchange for locking in longer-term returns that increase the likelihood of meeting our clients' objectives.

Greg:

We are finding significant opportunity across most asset classes, which is a rare position to be in. This has allowed us to build diversified portfolios with favourable odds of achieving their mandates under a range of possible outcomes. We are happy to sit in cash when we cannot find opportunities for our clients. The significant deployment of cash in 2018 across all of our multi-asset funds is therefore indicative of how favourably we view this opportunity set. We're excited both by the opportunities themselves, and by the balanced nature of our funds' investments. *(For more on the current opportunities in our multi-asset funds, please refer to the article by Justin Floor and Dirk Jooste on page 4 of this edition.)*

Q: Is this potential upside realistic, given some of the structural challenges in South Africa?

Shaun:

We're reading the same headlines and share the same concerns as our investors, most notably the significant challenges facing Eskom. However, at a structural level, the assessment of South Africa is more nuanced than most people give credit for – especially when emotions are heightened by economic pressures and political factors. It's important to keep in mind that governance structures (including at Eskom) have improved substantially. Furthermore, the South African Reserve Bank's credibility in inflation targeting (with the bank managing to keep inflation within its target band of 3% to 6% since adopting this mandate in 2003) acts as a long-term underpin for local assets. We believe this is far more significant than the potential short-term impact of a possible ratings downgrade that much of the market is fearing.

Greg:

If you buy good businesses on low levels of earnings and hold them for long periods, you set yourself up for above-average returns at low levels of risk. We think that the local market currently presents these kinds of opportunities. Furthermore, both corporate and consumer balance sheets are in relatively good shape, which usually offers reasonably good potential for future earnings growth. Of course, the situation at Eskom – and the risks associated with a protracted energy crisis – is troubling, and one we're monitoring closely. However, we continue to apply our checklists to determine fundamental asset values. If we can acquire assets at large enough margins of safety to compensate for structural challenges, we will continue to capitalise on these opportunities on behalf of our clients.

Q: We are 10 years into a global bull market and valuations are generally high, yet you have been deploying cash globally. Are high valuations not a concern?

Philipp:

Rising valuations globally over the past few years have indeed made us more circumspect. In fact, cash levels in the PSG Global Flexible Fund were at record levels in early 2018. However, just as in the local market, there continue to be large divergences in the valuations of well-owned, popular stocks and those that are unloved and uncrowded. Consequently, we continue to deploy capital into carefully selected companies from within these areas, which we believe the market is mispricing.

Price moves over the last 12 months have widened our opportunity set, with some high-quality businesses going on sale. We've deployed cash into these sell-offs. Importantly, the value of these opportunities may only be unlocked over several years, as sentiment towards the businesses we're buying or the sectors in which they operate (for example, global real estate and Japanese financials) is currently poor.

For more on our funds and their current positioning, please refer to the fund fact sheets on our website or the fund-specific information included at the end of this publication.

Balancing offence and defence to build all-weather portfolios

Dirk Jooste

Justin Floor

Dirk joined PSG Asset Management in August 2017 and has been managing the PSG Stable Fund since 2019. He is a CFA charterholder and has 10 years' investment experience.

Justin joined PSG Asset Management as a Fund Manager on the PSG Balanced Fund in 2019. He is a qualified actuary and a CFA charterholder, and has over 10 years' investment experience.

We are excited about the opportunity set embedded in our funds

Poor market sentiment locally and elevated economic uncertainty globally have weighed on investors in recent months. For us, the parts of the markets most clouded by fear are those that present the best opportunities. While we know that it will take time to realise mispriced value, we're excited by the prospects our process is uncovering. They're what we refer to as coiled springs: opportunities with the potential for significant upside. The fact that these opportunities extend across almost all asset classes is just as encouraging – and very rare. We believe that this has allowed us to build balanced portfolios that are well positioned to deliver on our client mandates.

We construct portfolios with our investors in mind

We build portfolios around our investors' needs, taking both return requirements and risk appetite into account. We consider the typical client a fund has been designed for and their key objectives: whether it is more important for them to grow or protect their capital, how long they are looking to invest for, and how sensitive they are likely to be to temporary dips in performance. Our aim is to maximise the number of scenarios under which we meet our investors' objectives, while remaining mindful of the client journey. This requires a balance between offence – capitalising on opportunities to enhance returns even when it might feel uncomfortable – and defence – reducing the risk of permanent capital loss by avoiding any one-way bets. While this may at times result in short-term underperformance (as we reference in the opening article of this edition on page 2), it helps us deliver the returns our clients require over mandate-appropriate periods.

Our starting point is cash, which we only allocate to individual securities that meet our criteria

Our process sees us defaulting to cash, which we will only allocate if we can identify opportunities that offer the potential for attractive risk-adjusted returns. As bottom-up managers, we do not make broad, bold asset allocation calls and then search for investments to satisfy these. Rather, we evaluate each security based on its own merits. Accordingly, our funds' cash holdings are the end result of allocations to the individual investments we identify as offering mispriced quality. Current cash exposures are low relative to history, which is indicative of the opportunities we believe markets are presenting.

We select securities from our buy lists and invest across asset classes for diversification

All our fund managers populate portfolios from the buy lists (equity, fixed income and credit) that our investment committees produce. The securities on these buy lists are those that have successfully met our 3 M (Moat, Management and Margin of Safety) criteria and reflect our team's best ideas. To make their selections, fund managers consider:

- a fund's required return hurdle, which largely determines its exposure to growth assets
- opportunities across the buy lists that could contribute sufficiently to this return to qualify for inclusion

We take a through-the-cycle view (we evaluate the potential range of outcomes over the full recommended investment horizon) and diversify across both asset classes and the individual securities on any single buy list. As a final risk overlay, we check for and address excessive correlations or unintended macro exposures to any specific variable. In combination, we believe that this allows for robust, multi-dimensional portfolios.

Both our local and foreign equity buy lists are attractive relative to history

A notable theme in our multi-asset portfolios is a sizeable weighting to neglected SA Inc. stocks, an opportunity we've highlighted for some time. Stocks exposed to the local economy remain out of favour against the backdrop of a low-growth environment and intensified political tension. However, we believe that those businesses with proven track records (in some instances spanning decades) and strong management teams have a good chance of weathering the storm – as they've done before. We've been able to acquire such businesses at low prices and on arguably low levels of earnings, which bodes well for future returns. Top 10 holdings we've previously referenced include Super Group and AECI, while the recent sell-off has allowed for new additions to our buy list, such as JSE Limited.

Globally, although valuations generally remain high, we continue to find select opportunities in less popular market segments, or those shunned by investors out of fear or uncertainty. These include investments in Japan and US real estate and, more recently, quality names such as Anheuser-Busch InBev, Asahi Holdings and Prudential plc.

South African fixed income continues to offer compelling value

We believe that long-term government bonds currently present one of the most attractive risk-adjusted opportunities in our portfolios. These instruments, which offer good liquidity and a government guarantee, are currently available at substantial real (above-inflation) yields. In fact, a recent study by Morgan Stanley shows that the real yields on South African government bonds are presently the highest among investment-grade peers.

Other opportunities our funds have taken advantage of include government-guaranteed Eskom bonds (however, as these instruments are not as liquid, positions are smaller) and inflation-linked bonds (ILBs). Both longer- and shorter-dated ILBs continue to offer notable real yields, along with an inherent buffer against upward inflationary shocks.

We are finding some good prospects in US real estate

Fears around the impact of Amazon and other online players on traditional retail outlets have presented an opportunity in US retail real estate. Some of the businesses in this sector have valuable property portfolios, which we think the market is underestimating. The shares are also currently offering high real dividend yields.

Despite a period of sustained price weakness in local listed property, the asset class does not yet present the margin of safety we require for investment. Our funds currently have no local property exposure, given the compelling alternatives available.

Credit exposures are limited

We have reduced corporate bond exposures in our multi-asset funds, as several existing investments have reached our estimates of intrinsic value. Given that these are illiquid instruments, their hurdle for inclusion in the portfolios is high. As such, we are finding few new opportunities that compare favourably enough to those in other asset classes.

Cash balances offer liquidity for counter-cyclical investing

Our process sees us defaulting to cash, which we will only allocate if we can identify opportunities that offer the potential for attractive risk-adjusted returns. We therefore view cash as valuable firepower that can be employed when we need it, which is usually in the inevitable moments of market panic when quality assets sell off. In fact, we think the value of cash is often under-appreciated.

The value we are finding across asset classes has allowed us to build diversified portfolios

The current asset allocation of the PSG Balanced Fund (as at 31 March 2019) is shown in Graph 1.

We don't take an explicit rand view and aim to build portfolios that will deliver on their mandates regardless of how the rand moves. The segments separated out in Graph 1 indicate portions of the fund that are exposed to the South African economy: SA Inc. stocks and South African government bonds. These instruments are influenced by local macroeconomic events and could respond similarly to movements in the rand. Foreign equities, foreign real estate and local equities listed offshore (shares such as Quilter plc) act as a counterweight to balance the portfolio.

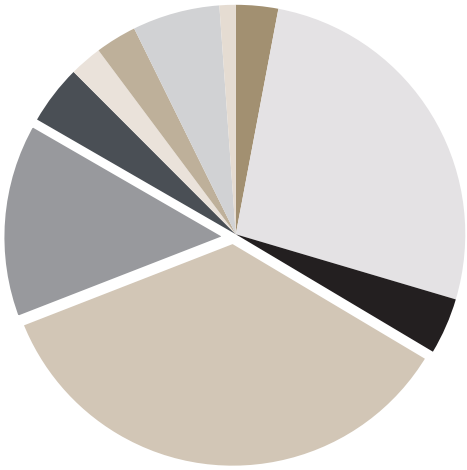
The fund's allocation to ILBs provides an additional diversification benefit, as these instruments behave very differently to others in the portfolio. While we deem it unlikely that local inflation will rise significantly, ILBs will also offer some protection if it does.

Finally, local and foreign cash holdings are not exposed to capital market risk. In addition to the attractive yields currently available on longer-dated securities in this asset class, cash holdings give us the ability to capitalise on potential equity or bond market volatility in future.

We believe that the diversified nature of our portfolios makes them more robust

Our bottom-up process results in a selection of what we deem to be the most attractive opportunities currently available, with each security included on its own merit. By reviewing the overall portfolio, we also aim to ensure that all risk factors are balanced appropriately. In combination, we believe that this enables us to build robust, all-weather portfolios with good odds of achieving the returns our investors require.

Graph 1: The PSG Balanced Fund is diversified across geographies and asset classes



Foreign real estate	3%
Foreign equities	27%
Local equities – Offshore	4%
Local equities – SA Inc.	36%
RSA government bonds*	14%
Inflation-linked bonds	4%
Fixed-rate corporate bonds	2%
Floating-rate corporate bonds	3%
Local cash	6%
Foreign cash	1%
Total	**100%**

Source: PSG Asset Management
*Includes Eskom bonds with government guarantees

Investing in resource companies: getting the odds in your favour in a high-risk, high-return sector

Gavin Rabbolini

Gavin joined PSG Asset Management in 2011 and is an Analyst in our investment team. He performs research on local and global companies across multiple sectors and is a CFA charterholder.

We are often asked on what basis we invest in resource companies

Mining shares were one of the few places to hide in 2018, offering the only double-digit returns in the FTSE/JSE Top 40 Index, which was down overall. Yet we have been reducing exposure to this sector, with mining shares now comprising less than 8% of the PSG Equity Fund compared to 14% early in 2016. Our most recent sale was Anglo American Platinum (Amplats), which we exited entirely earlier this year, having held it since 2017. It serves as a useful case study of how we think about investing in the sector.

Commodity producers are price takers, which means their profits are less predictable

Generally, companies that produce commodities have no say on the price realised for their output. Accordingly, their profits are largely dependent on global economic factors and the range of possible outcomes is wide. In terms of our 3 M (Moat, Management and Margin of Safety) analysis, these companies have narrow moats and therefore cannot be relied on to grow profits ahead of the market over long periods. We call such businesses 'mean-reverters', and our investment decisions relating to these businesses must factor in the unpredictability of future profit streams.

Mining company management teams have on average proven to be poor allocators of capital over the cycle

Management teams in the resource sector have generally shown a tendency to build mines and buy competitors when prices are high, and to sit on their hands when prices are low. This pro-cyclical capital allocation has tempered shareholder returns over the past decade-and-a-half – a period of booming commodity prices and rapid growth in demand from China. A canny management team can make a big difference in this sector, so we pay careful attention to the team that will be acting as fellow custodians of our clients' capital.

To make provision for these risks, we focus on ensuring a sufficient margin of safety

Given the narrow moat, we place increased emphasis on valuation (margin of safety) when we consider investing in a commodity producer. Since macroeconomic data – and particularly future demand – is unpredictable, we do not attempt to forecast commodity prices. Instead, our work is focused on the supply side of any given commodity. This entails understanding the long-term capital cycle for a commodity and what it suggests for the sustainability of prices, whether high or low.

A recent example is the collapse in commodity prices and mining shares in 2015/2016. After many years of booming capital expenditure between 2007 and 2012, prices slumped as supply flooded a market in which growth was declining from very high levels. At the peak of the 2015/2016 crash, it was evident that the prices of most commodities were well below the levels required to incentivise additional capacity. Capital expenditure plans were slashed and some mines were being mothballed. It was clear to us that prices were unsustainably low. We find it much easier to build evidence that a resource company is trading at a significant discount to our assessment of its intrinsic value (i.e. offers a margin of safety) when commodity prices are depressed. As a result, our funds invested in mining shares at the time, including Anglo American, Glencore and Merafe.

Amplats as a case study: evaluating its Moat, Management and Margin of Safety

Moat

When we analyse mining companies, we pay particular attention to their relative position on the cost curve and how this is likely to change. A low-cost producer is much more insulated in an industry that undergoes boom-bust cycles. Amplats has a significant competitive cost advantage due to best-in-class ore bodies that allow for efficient and low-risk access, mechanised extraction methods, and well-designed downstream refining assets. It is further insulated by having the most diversified basket of metals among its competitors (platinum comprises less than 50% of its production) and by the industrial-like processing agreements it recently established with its peers.

Management

A quality segmentation of the mining assets in the platinum group metals (PGM) industry reveals that the gap in profitability between the front-footed and more marginal producers is likely to continue widening. Only a few management teams – enabled by the quality of their assets – have proactively redesigned their businesses to lower risk and ensure profitability in a persistently weak metal price environment. An assessment of Amplats' management and their capital allocation decisions shows that they started taking steps to improve the quality of the company's earnings and balance sheet as far back as 2012. Though many of their decisions were unpopular at the time, they've steered the company away from exposure to narrow, steep and labour-intensive ore bodies towards higher-quality assets. In doing so, they have also reinvested in the company's moat. Completed in 2017, this shift has enabled Amplats to grow returns and maximise free cash flow in an environment where many of its competitors still face marginal returns and the prospect of restructuring.

Margin of Safety

At the time of our initial investment in the first quarter of 2017, Amplats' PGM basket price (in rands) traded at depressed levels. This was due to an oversupply in platinum, as well as poor market sentiment driven by the unsupportive economic

environment for the metal. (Concerns included European light-duty diesel vehicle market share declines, the rise of battery electric vehicles, and lacklustre Chinese jewellery demand.) Accordingly, our funds could invest in the company at a significant discount to our conservative estimate of intrinsic value (in other words, with a sufficient margin of safety).

Amplats proved to be a successful investment for our clients

The share price appreciated by 180% over the period our funds were invested (and 145% in the final year they held the share), outperforming the aggregate of its peers over this period. This was largely a function of the sharp increase in the PGM basket price (shown in Graph 1), which in turn was driven by the skyrocketing palladium price – it rose by 96% in the final year of our investment. As most market participants focused on the unsupportive environment for platinum, they overlooked the favourable outlook for palladium. A deficit in palladium had resulted from insufficient primary production and wider global enforcement of stricter emissions standards, as its primary use is in light-duty gasoline vehicles.

Our funds sold Amplats when its share price exceeded our estimate of intrinsic value

We sold our last Amplats shares at the end of January 2019. Considering the share price levels at which the company is currently trading, it looks like we sold too early. However, we prefer to follow a rigorous, repeatable process of selling mean-reverters at our assessment of conservative intrinsic value. In many cases, this means that we end up selling long before the share price peaks. This is a risk we are comfortable taking, because when the market for a commodity is very tight (as it is currently for palladium), the resultant squeeze can push prices well beyond sustainable levels. We prefer to sell into this kind of environment.

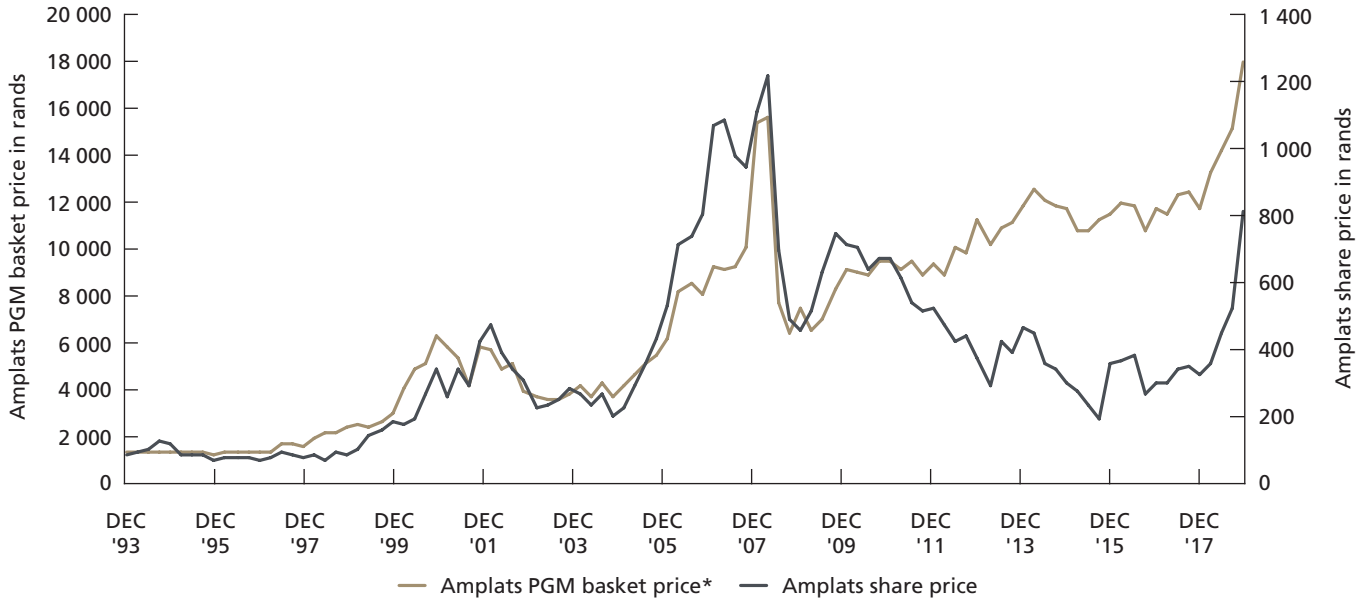
Our assessment of Amplats' current share price is that it presents increased investment risk

In isolation, we think the platinum price could be considered unsustainably low. However, the squeeze in palladium, coupled with several lifelines (attractive prices of PGM by-products and a weak dollar/rand exchange rate) means that producers are incentivised to expand PGM production, as profitability remains high at a basket level. Accordingly, platinum is likely to remain well supplied. The same can be said for palladium, given the current attractiveness of the palladium price and the surge in production of Chinese vehicles, which will provide an additional source of the metal once they age sufficiently for autocatalyst recycling. As a result, we believe that the rand price of the PGM basket is currently high, which means greater investment risk.

Our increased emphasis on margin of safety helps to keep the odds in our clients' favour

When commodity producers are pricing in a scenario of sustained high prices we consider investment risk to be elevated. We prefer to buy when prices are low and to remain disciplined in selling when our required margin of safety diminishes. Although this has its price – we are likely to leave some upside on the table for investors with a higher risk appetite – we believe that it helps us to keep the odds in our clients' favour.

Graph 1: The increased PGM basket price (in rands) has rewarded investors in Amplats with significant share price appreciation



Sources: Bloomberg, Amplats financial reports
*Rand price of platinum, palladium and rhodium weighted to the ratio produced by Amplats

Notes

Notes

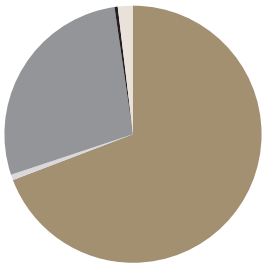
Portfolio holdings as at 31 March 2019

PSG Equity Fund

Top 10 equities

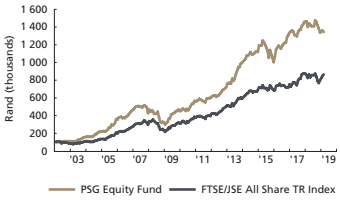
Brookfield Asset Management Inc
Old Mutual Ltd
Glencore plc
Discovery Ltd
AECI Ltd
Japan Post Insurance Co Ltd
Anheuser-Busch InBev
Super Group Ltd
Reunert Ltd
Sun International Ltd

Asset allocation



Domestic equity	69.2%
Domestic cash	0.7%
Foreign equity	27.8%
Foreign cash	0.4%
Foreign property	1.9%
Total	**100%**

Performance

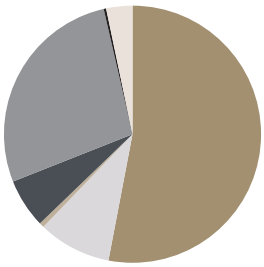


PSG Flexible Fund

Top 10 equities

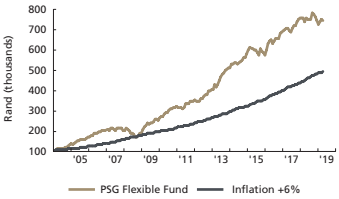
Brookfield Asset Management Inc
Old Mutual Ltd
Glencore plc
Discovery Ltd
Japan Post Insurance Co Ltd
Anheuser-Busch InBev
AECI Ltd
Super Group Ltd
L Brands Inc
Reunert Ltd

Asset allocation



Domestic equity	53.0%
Domestic cash	9.2%
Domestic gold	0.6%
Domestic bonds	6.2%
Foreign equity	27.4%
Foreign cash	0.3%
Foreign property	3.3%
Total	**100%**

Performance

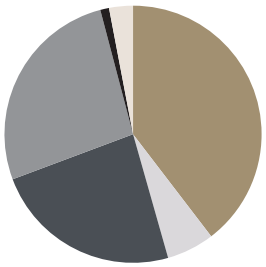


PSG Balanced Fund

Top 10 equities

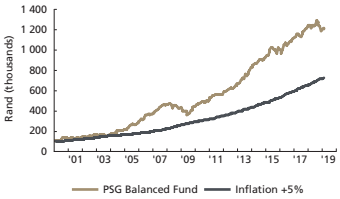
Brookfield Asset Management Inc
Japan Post Insurance Co Ltd
Discovery Ltd
Old Mutual Ltd
RMB Holdings Ltd
L Brands Inc
Anheuser-Busch InBev
AECI Ltd
Super Group Ltd
Prudential plc

Asset allocation



Domestic equity	39.6%
Domestic cash and NCDs	6.0%
Domestic bonds	23.7%
Foreign equity	26.6%
Foreign cash	1.1%
Foreign property	3.0%
Total	**100%**

Performance



PSG Stable Fund

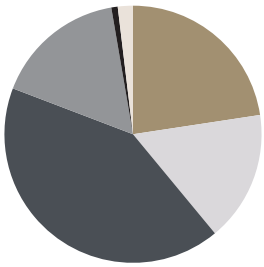
Top 5 equities

Brookfield Asset Management Inc
Japan Post Insurance Co Ltd
Discovery Ltd
Old Mutual Ltd
Anheuser-Busch InBev

Top 5 issuer exposures

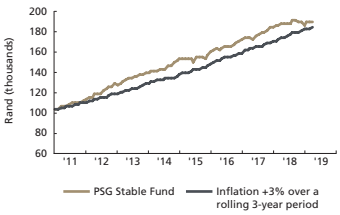
The Republic of South Africa
FirstRand Bank Ltd
Standard Bank of SA Ltd
Eskom Holdings SOC Ltd
Capitec Bank Ltd

Asset allocation



Domestic equity	22.6%
Domestic cash and NCDs	16.4%
Domestic bonds	41.8%
Foreign equity	16.5%
Foreign cash	0.8%
Foreign property	1.9%
Total	**100%**

Performance



PSG Diversified Income Fund

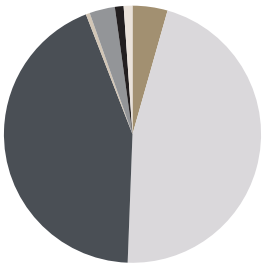
Top 5 equities

Brookfield Asset Management Inc
Washington Prime Group Inc
Old Mutual Ltd
AIA Group Ltd
Simon Property Group Inc

Top 5 issuer exposures

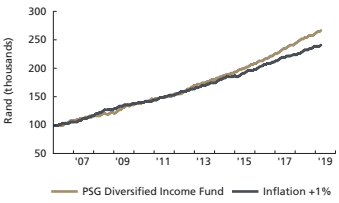
FirstRand Bank Ltd
The Republic of South Africa
Absa Bank Ltd
Standard Bank of SA Ltd
Nedbank Ltd

Asset allocation



Domestic equity	4.4%
Domestic cash and NCDs	46.3%
Domestic bonds	43.4%
Domestic preference shares	0.5%
Foreign equity	3.2%
Foreign cash	1.1%
Foreign property	1.1%
Total	**100%**

Performance

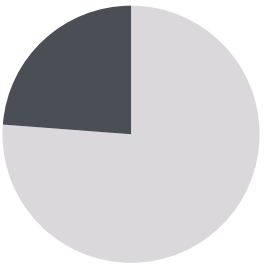


PSG Income Fund

Top 10 issuer exposures

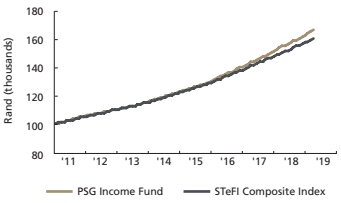
Absa Bank Ltd
Nedbank Ltd
Standard Bank of SA Ltd
FirstRand Bank Ltd
PSG Money Market Fund
Land and Agricultural Development Bank of SA
Capitec Bank Ltd
Bidvest Group Ltd
Eskom Holdings SOC Ltd
MMI Group Ltd

Asset allocation



Domestic cash and NCDs	76.2%
Domestic bonds	23.8%
Total	**100%**

Performance

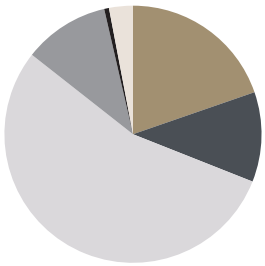


PSG Money Market Fund

Issuer exposures

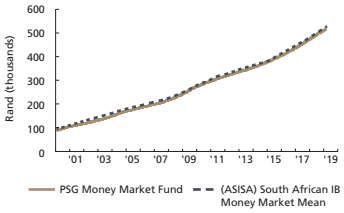
Standard Bank of SA Ltd
FirstRand Bank Ltd
Nedbank Ltd
Absa Bank Ltd
The Republic of South Africa
Investec Bank Ltd
Land and Agricultural Development Bank of SA
Capitec Bank Ltd

Asset allocation



Linked NCDs/Floating-rate notes	19.7%
Step-rate notes	11.3%
NCDs	54.6%
Treasury Bill	10.8%
Corporate bonds	0.6%
Call	3.0%
Total	**100%**

Performance

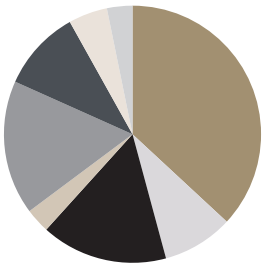


PSG Global Equity Sub-Fund

Top 10 equities

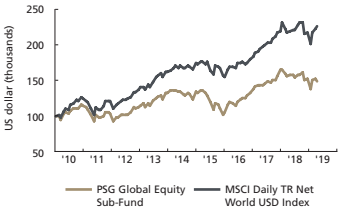
Brookfield Asset Management Inc
Japan Post Insurance Co Ltd
L Brands Inc
Liberty Global Inc
The Mosaic Co
Asahi Group Holdings Ltd
Washington Prime Group Inc
Prudential plc
Glencore plc
Babcock International Group plc

Regional allocation



US	36.9%
Europe	8.9%
UK	15.9%
Asia ex Japan	3.1%
Japan	16.9%
Canada	10.2%
Africa	4.9%
Cash	3.2%
Total	**100%**

Performance

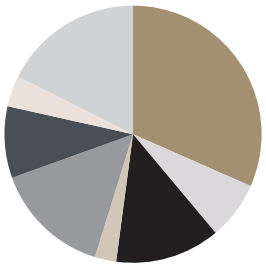


PSG Global Flexible Sub-Fund

Top 10 equities

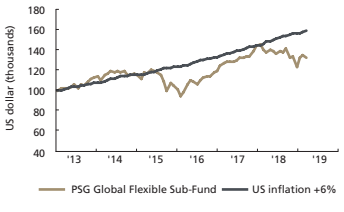
Brookfield Asset Management Inc
Japan Post Insurance Co Ltd
L Brands Inc
Liberty Global Inc
The Mosaic Co
AIA Group Ltd
Babcock International Group plc
Simon Property Group Inc
Colfax Corp
Washington Prime Group Inc

Regional allocation



US	31.6%
Europe	7.3%
UK	13.2%
Asia ex Japan	2.7%
Japan	14.7%
Canada	9.0%
Africa	3.9%
Cash	17.6%
Total	**100%**

Performance



Percentage annualised performance to 31 March 2019 (net of fees)

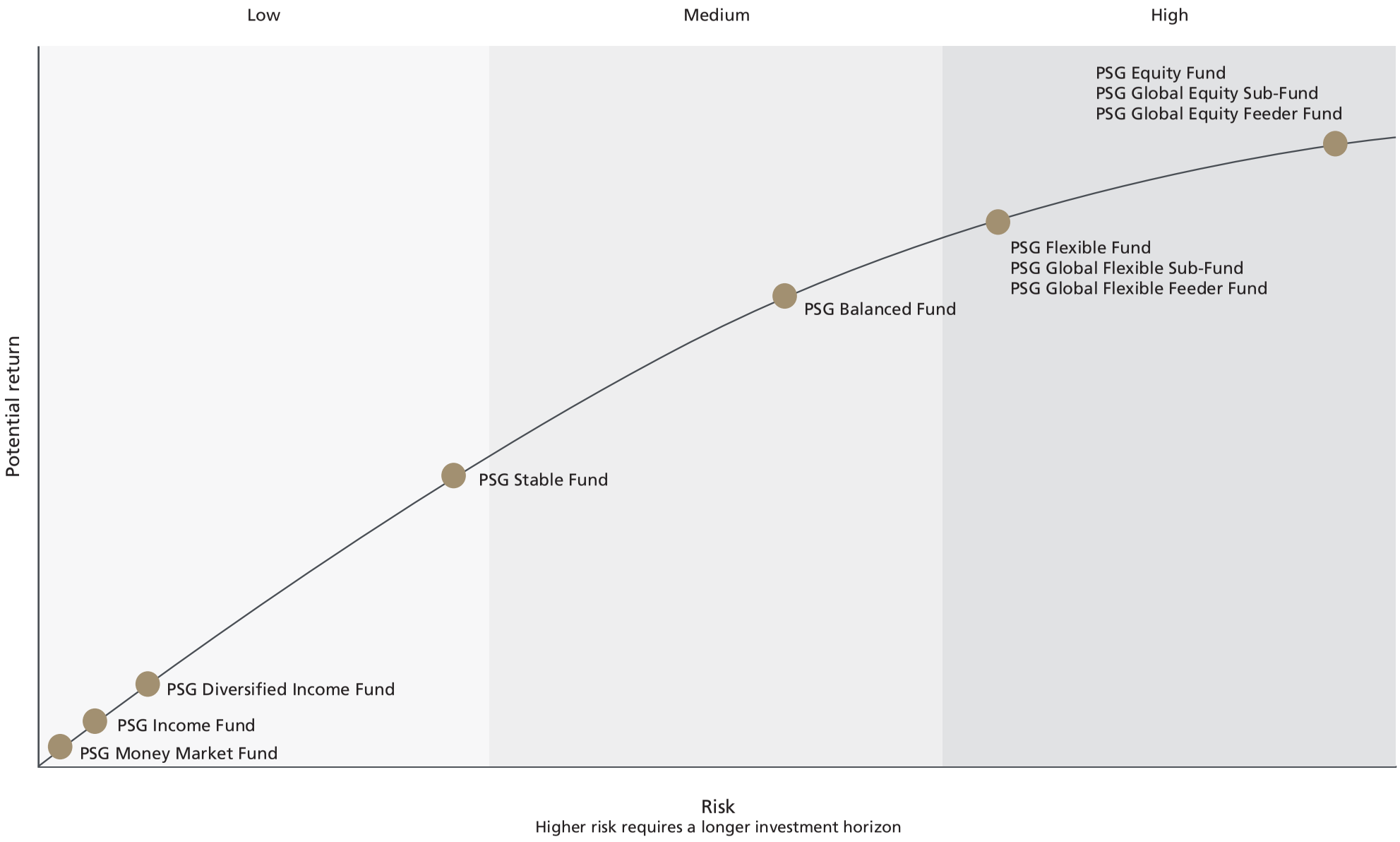
Local funds	1 Year	3 Years	5 Years	10 Years	Inception	Fund inception date
PSG Equity Fund A	-4.26	5.36	5.20	15.63	16.44*	31/12/1997
FTSE/JSE All Share Total Return Index	5.04	5.69	6.50	13.98	13.50	
PSG Flexible Fund A	0.52	5.58	7.71	16.05	14.95**	02/11/1998
Inflation +6%	9.99	10.78	11.04	11.25	11.73	
PSG Balanced Fund A	-0.99	4.79	6.70	12.54	13.35	01/06/1999
Inflation +5%	9.07	9.80	10.06	10.25	10.50	
PSG Stable Fund A	2.31	6.13	6.91		8.77	13/09/2011
Inflation +3% over a rolling 3-year period	7.07	7.80	8.06	8.25	8.29	
PSG Diversified Income Fund A	6.23	7.77	7.66	7.96	7.84	10/04/2006
Inflation +1%	5.07	5.80	6.06	6.25	6.97	
PSG Income Fund A	7.93	8.46	7.80		6.98	01/09/2011
STeFI Composite Index	7.27	7.43	7.01		6.46	
PSG Money Market Fund A	7.27	7.45	7.02	6.52	8.47	19/10/1998
South African Interest Bearing Money Market Mean	7.45	7.61	7.09	6.59	8.54	
PSG Global Equity Feeder Fund A	16.77	7.66	8.52		12.56	03/05/2011
MSCI Daily Total Return Net World USD Index (in ZAR)	26.62	9.97	13.74		18.83	
PSG Global Flexible Feeder Fund A	17.08	6.17	8.78		12.47	11/04/2013
US inflation +6% (in ZAR)	30.86	7.45	14.49		16.55	

International funds	1 Year	3 Years	5 Years	10 Years	Inception	Fund inception date
PSG Global Equity Sub-Fund A	-4.28	8.78	2.36		4.60	23/07/2010
MSCI Daily Total Return Net World USD Index (in USD)	4.02	10.69	6.78		9.78	
PSG Global Flexible Sub-Fund A	-4.21	7.27	2.46		4.48	02/01/2013
US inflation +6% (in USD)	7.50	8.16	7.49		7.52	

* Fund manager inception date 01/03/2002
** Current benchmark inception date 01/11/2004

Annualised performances show longer-term performance rescaled over a 12-month period.
Annualised performance is the average return per year over the period.
Past performance is not necessarily a guide to future performance.

Risk/reward profile



Unit trust summary

	South African portfolios							Rand-denominated offshore	
	PSG Equity Fund	PSG Flexible Fund	PSG Balanced Fund	PSG Stable Fund	PSG Diversified Income Fund	PSG Income Fund	PSG Money Market Fund	PSG Global Equity Feeder Fund	PSG Global Flexible Feeder Fund
Fund category (ASISA classification)	South African - Equity - General	South African - Multi Asset - Flexible	South African - Multi Asset - High Equity	South African - Multi Asset - Low Equity	South African - Multi Asset - Income	South African - Interest Bearing - Short-term	South African - Interest Bearing - Money Market	Global - Equity - General	Global - Multi Asset - Flexible
Investment objective	Aims to offer investors long-term capital growth without assuming a greater risk, and earn a higher rate of return than that of the South African equity market as presented by the FTSE/JSE All Share Index (including income).	Aims to achieve superior medium- to long-term capital growth by investing in selected sectors of the equity, gilt and money markets, both locally and abroad. The fund has a flexible asset allocation mandate and equity exposure will vary based on opportunity.	Aims to achieve long-term capital growth and a reasonable level of income for investors. The investment policy provides for the active management of the portfolio assets that include equities, bonds, property and cash, both domestically and in foreign markets.	Aims to achieve capital appreciation and generate a return of CPI+3% over a rolling three-year period with low volatility and low correlation to equity markets through all market cycles.	Aims to preserve capital while maximising income returns for investors. The portfolio comprises of a mix of high-yielding securities, property, bonds, preference shares and assets in liquid form (both local and foreign).	Aims to maximise income while achieving as much long-term capital appreciation as interest rate cycles allow.	Aims to provide capital security, a steady income and easy access to your money.	Aims to achieve capital growth over the long term with the generation of income not being the main objective of the portfolio. It is a rand-denominated equity feeder fund whose investment policy provides for it to invest solely in the PSG Global Equity Sub-Fund.	Aims to achieve superior medium- to long-term capital growth through exposure to selected sectors of the global equity, bond and money markets. It is a rand-denominated feeder fund whose investment policy provides for it to invest solely in the PSG Global Flexible Sub-Fund.
Benchmark	FTSE/JSE All Share Total Return Index	Inflation +6%	Inflation +5%	Inflation +3% over a rolling 3-year period	Inflation +1%	STeFI Composite Index	South African - Interest Bearing - Money Market Mean	MSCI Daily Total Return Net World USD Index (in ZAR)	US inflation +6% (in ZAR)
Risk rating	High	Moderate - High	Moderate - High	Moderate	Low - Moderate	Low - Moderate	Low	High	Moderate - High
Time horizon	7 years and longer	5 years and longer	5 years and longer	3 years and longer	2 years and longer	1 year and longer	Minimum of 1 day	7 years and longer	5 years and longer
The fund is suitable for investors who:	• want an equity focused portfolio that should produce high real returns above inflation and capital appreciation over the long term • are comfortable with significant stock market fluctuations • are willing to accept potential capital loss • have a long-term investment horizon of seven years and longer	• want exposure to the equity market, but with managed risk levels • aim to build wealth • are willing to accept potential capital loss • have a medium- to long-term investment horizon of five years and longer	• aim to build wealth with a balanced portfolio that diversifies the risk over the various asset classes • are comfortable with market fluctuation risk • are willing to accept potential capital loss • would prefer the fund manager to make the asset allocation decisions • have an investment horizon of five years and longer	• have a low risk appetite but require capital growth in real terms • have a medium-term investment horizon of three years and longer	• have a low risk appetite • want to earn an income, but need to try and beat inflation • have a short- to medium-term investment horizon of two years and longer	• have a low risk appetite • require an income • have an investment horizon of one year and longer	• seek capital stability, interest income and easy access to their money through a low risk investment • need an interim investment vehicle or 'parking bay' for surplus money • have a short-term investment horizon	• want exposure to global equities without personally expatriating rands • are comfortable with international equity market and currency fluctuations • have a long-term investment horizon of seven years and longer	• want exposure to global equities without personally expatriating rands • are comfortable with international equity market and currency fluctuations • have a long-term investment horizon of five years and longer
Net equity exposure	80% - 100%	0% - 100%	0% - 75%	0% - 40%	0% - 10%	0%	0%	80% - 100%	0% - 100%
Income distribution	Bi-annually	Bi-annually	Bi-annually	Bi-annually	Quarterly	Quarterly	Monthly	Annually	Annually
Minimum investment	As per the platform minimum	As per the platform minimum	As per the platform minimum	As per the platform minimum	As per the platform minimum	As per the platform minimum	R25 000 lump sum	As per the platform minimum	As per the platform minimum
Fees (excl. VAT)	Annual management fee: Class A: 1.50%	Annual management fee: Class A: 1.00% + 7.00% of outperformance of high watermark	Annual management fee: Class A: 1.50%	Annual management fee: Class A: 1.50%	Annual management fee: Class A: 1.00%	Annual management fee: Class A: 0.65%	Annual management fee: Class A: 0.50%	Annual management fee: Class A: 0.75%	Annual management fee: Class A: 0.75%
Compliance with Prudential Investment Guidelines (Regulation 28)	No	No	Yes	Yes	Yes	No	Yes	No	No

For full disclosure on all risks, costs and fees, as well as performance fees FAQ, refer to the fund fact sheets on our website: www.psg.co.za/asset-management

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Trustee: The Standard Bank of South Africa Limited, Main Tower, Standard Bank Centre, 2 Hertzog Boulevard, Cape Town, 8001. Tel: +27 (21) 401 2443. Email: compliance-PSG@standardbank.co.za. **Conflict of Interest Disclosure:** The funds may from time to time invest in a portfolio managed by a related party. PSG Collective Investments (RF) Limited or the Fund Manager may negotiate a discount in fees charged by the underlying portfolio. All discounts negotiated are re-invested in the fund for the benefit of the investor. Neither PSG Collective Investments (RF) Limited nor PSG Asset Management (Pty) Limited retains any portion of such discount for their own accounts. The Fund Manager may use the brokerage services of a related party, PSG Securities Limited.

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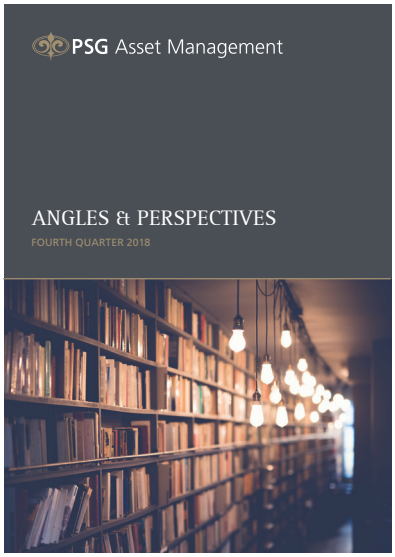
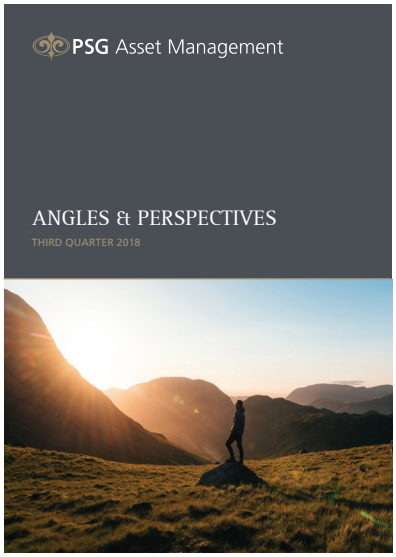
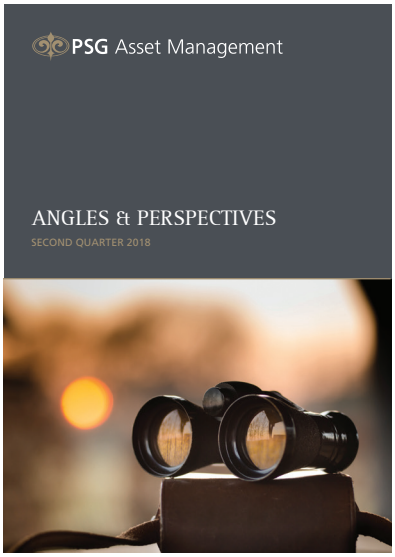


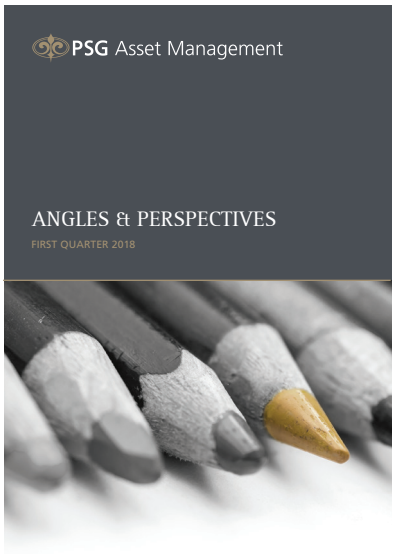
Fourth quarter 2018



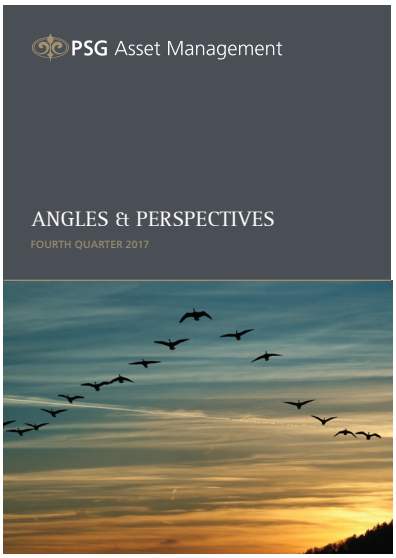
Third quarter 2018



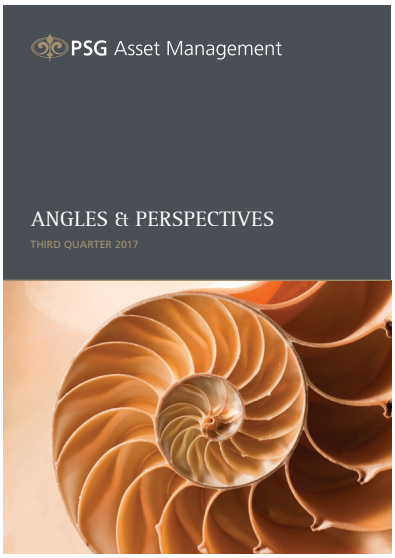
Second quarter 2018



First quarter 2018



Fourth quarter 2017



Third quarter 2017

PSG Asset Management