PSG Asset Management

ANGLES & PERSPECTIVES

FOURTH QUARTER 2020

Contents

As custodians of its clients' capital, PSG Asset Management aims to minimise risks and help its clients build wealth in the long run by investing in companies of above-average quality at below-average prices.

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.

Reassessing the risk narrative

There is always some risk to investment – that is, after all, why investors demand a return when entrusting their money to others. As custodians of our clients' capital, we aim to minimise these risks and help our clients build wealth in the long run by investing in companies of above-average quality at below-average prices. Our in-depth research process helps us identify quality companies, while our focus on a margin of safety helps us to pay less for these companies than they are inherently worth. Since an investor's view of risk can influence their investment decisions, we believe it is always advisable to check in on the assumptions on which you base your decision-making.

When we look at the story of investment risk, we have often said that the starting prices investors pay for their investments matter a great deal: the deeper the discount to intrinsic value we buy a quality company at, the surer we can be that the market will come around to our point of view in the future. But markets diverge from fair value for extended periods of time, and – in our estimation – we are currently in record territory.

Prevailing narratives favour a narrow subset of assets which are perceived as offering 'low risk' returns. However, current valuations raise several red flags to these perceptions, even as valuations in other areas are increasingly signalling value. As anomalous market conditions drag on, we ask: how are our investors compensated when we take a different perspective on risk? Our analysis shows that there are in fact rich opportunity sets available for patient investors who are willing to look beyond the short-term noise.

In the first article, our Head of Research Kevin Cousins explains why we view the current consensus 'safe' assets as actually being very risky destinations for capital. He elaborates on how applying our alternative view of risk has enabled us to identify a rich opportunity set of underpriced assets, both in South Africa and globally.

In the second article, Fund Managers John Gilchrist and Mikhail Motala explain that during the 2020 market sell-off, traditionally high dividend paying companies globally faced a particularly severe sell-off as the dividend underpin evaporated. South African smaller cap value shares, the most unloved part of an unloved market within an unloved investing style, were particularly hard hit. As we look across the opportunities expressed in our funds, a common theme of high prospective dividend yields on offer in a post-Covid-19 world emerges.

In our final article, Fund Manager Duayne Le Roux argues that the rate cuts associated with efforts to contain the economic fall-out of the Covid-19 pandemic, together with worries about South Africa's fiscal position and investor preference for low risk options, have driven distortions in the local yield curve. The current environment offers opportunities for fixed income investors to secure equity-like returns at lower risk levels, provided they are willing to look further out along the yield curve.

We trust that you will find these articles insightful, and their guidance valuable in these turbulent times.

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Our analysis shows that there are in fact rich opportunity sets available for patient investors who are willing to look beyond the short-term noise.

An alternative view of risk

Kevin Cousins

Kevin has over 25 years' experience in investment management. Kevin joined PSG Asset Management as an Investment Analyst in 2015. He was appointed Head of Research in 2017.

What is safe and what is risky?

At current multiples and yields, we believe the consensus 'safe' assets are actually very risky destinations for capital. In addition, extrapolating past economic trends may be a very poor guide to what lies ahead, especially regarding inflation, interest rates and currencies. Applying our alternative view of risk has enabled us to identify a rich opportunity set of underpriced assets, both in South Africa and globally.

What price for safety?

There is a massive bifurcation between the price levels of those assets generally perceived as being low risk and everything else. Many commentators have highlighted the extreme out-performance of the growth factor over the value factor, but this is just one of several 'themes' highlighted below.

Table 1: The matrix of conventional wisdom: circa Q3 2020

'Safe' assets	'Risky' assets
US equities	Japanese, UK and emerging market (EM) equities
Large cap equities	Mid- and small cap equities
Index funds or quasi-index funds	Actively managed funds with off-index positions
FAANG stocks	Financials, resources and other cyclical sectors
Growth and momentum factors	Value and free cash flow factors
US treasuries	SA government bonds
US dollar (USD)	SA rand and other EM currencies

Source: PSG Asset Management

Let's be clear: the popularity of the perceived 'safe' assets shown on the left above has not been easily earned. It has been built up steadily due to a long period of price appreciation and returns. For example, the table below shows the total returns of US government bonds and US large cap equities over various time frames.

Table 2: Total returns of US government bonds and US large cap equities

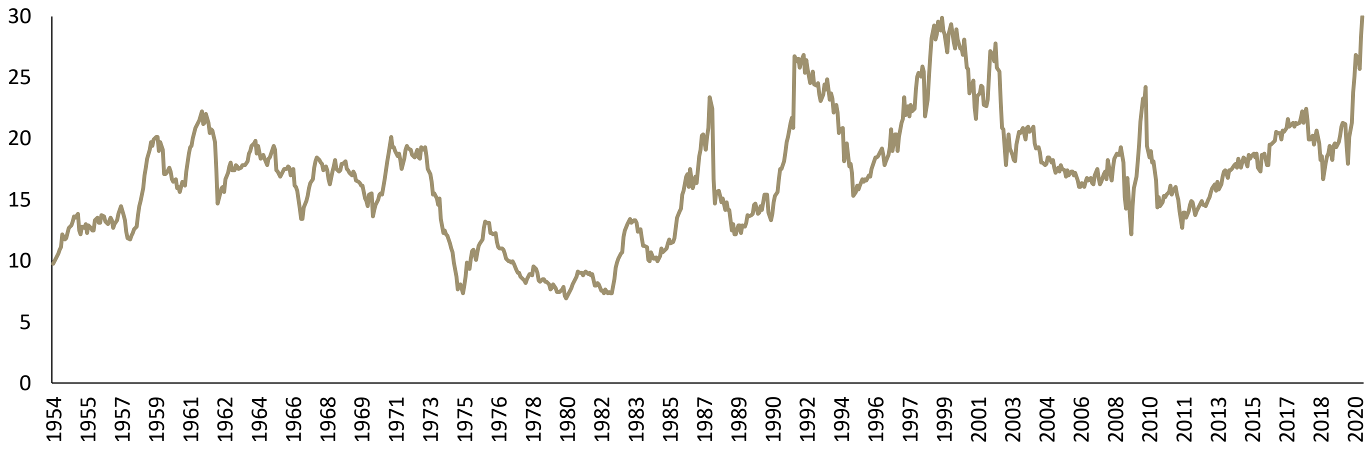
Annualised total returns in USD	2020	3 years	5 years	10 years
US treasury bonds*	10.0%	6.3%	4.4%	4.5%
US large cap equities (S&P 500 Index)	18.3%	14.1%	15.2%	13.9%
* Total return of iShares 7-10 year treasury ETF (IEF)				

Source: Bloomberg

Given this performance, it is not surprising that over the past decade substantial capital has flowed into the 'safe' assets. The excellent returns have reflexively encouraged more funds to follow. This process has continued until the perceived safe assets are the majority of positioning, with investors crowded into a handful of themes. That these themes delivered in an extraordinary year like 2020, further supports their validity.

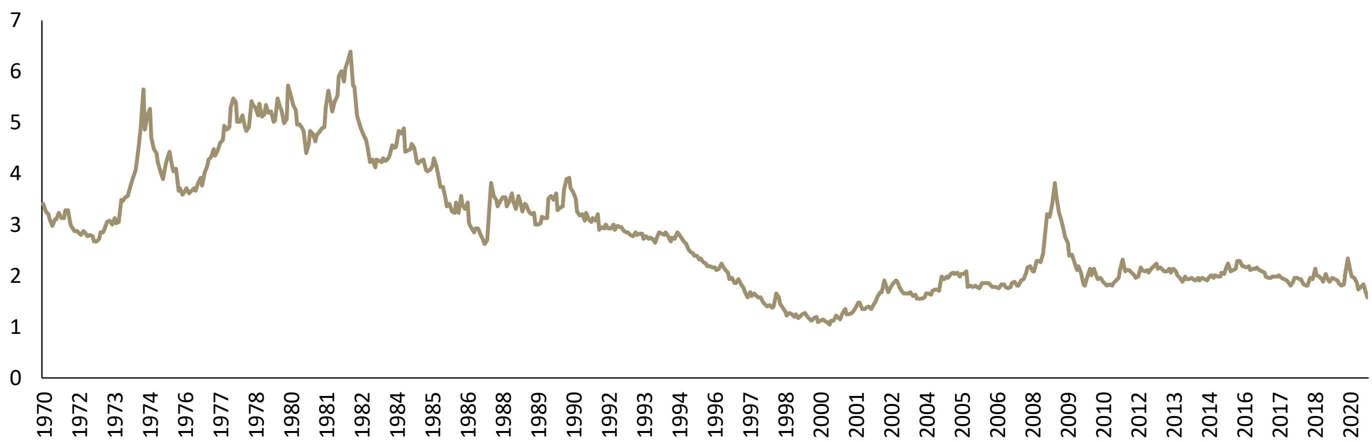
However, there is a catch. The 'low risk' assets are at extreme ratings and provide miniscule, if any, yields. The current dividend yield on the S&P 500 is 1.5% and the 10-year treasury bond yields about 1%. How does that compare to history? On the following page we show various long-term rating measures for the S&P 500 Index, based on Bloomberg data.

Graph 1: S&P 500 Index price/earnings ratio for the past 66 years



Source: Bloomberg

Graph 2: S&P 500 Index dividend yield for the past 50 years



Source: Bloomberg

Graph 3: S&P 500 Index price/sales ratio for the past 30 years

Source: Bloomberg

The dangers in the prevailing 'safe' asset narrative

We know that medium- and long-term subsequent returns are very dependent on the entry multiple. Asset manager GMO's latest forecast real returns for US large cap equities is -6.6% per annum for the next seven years (source: GMO). The S&P 500 is at a generational extreme rating based on the various valuation measures shown above. While on a dividend yield basis the yield was briefly lower from 1998 to 2000, an investor investing at those levels would have to wait some 13 years before seeing a capital gain, and weather two drawdowns of more than 45% in the interim.

Many investors are not deterred by these record multiples. A typical response to sky-high ratings of the popular equity assets, is that any multiple is justified with interest rates this low. Like many compelling narratives, there is a grain of truth in that, stemming from the potential to use lower discount rates in valuations. However, work done by both Goldman Sachs and Bernstein shows the equity risk premium expands during periods of very low bond yields (due to weak growth expectations) and, consequently, implied discount rates remain relatively stable. Therefore, this at best has a muted impact.

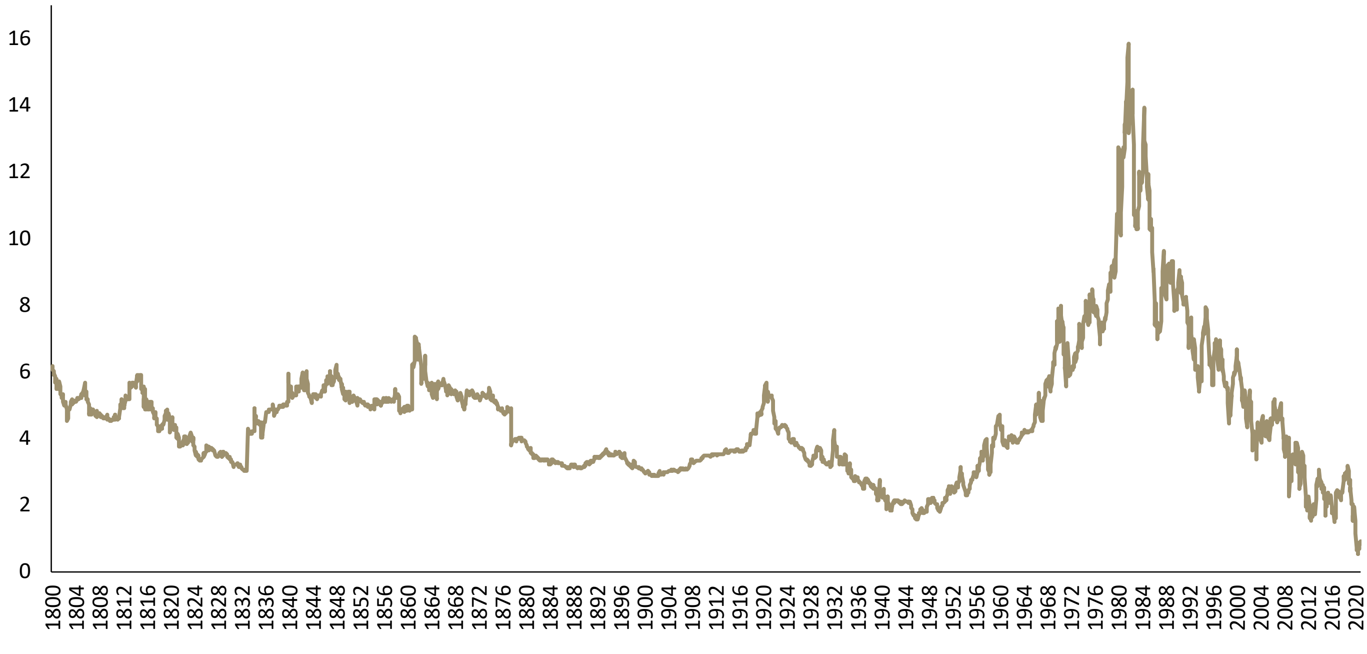
More importantly, the secondary impact of the "any multiple is justified given low rates" narrative is that all your so-called 'safe' assets become a correlated bet on future developed market bond yields. Is that appropriate positioning for a prudent manager, let alone from a 'low risk' portfolio? After 40 years of declining yields, is it reasonable for investors to extrapolate more of the same many years into the future?

Betting everything on still lower yields

The current US 10-year treasury bond yield is about 1%. Inflation is expected to be just over 2% for the next decade (per inflation-protected security or 'TIPS' pricing). The idea that a 10-year government bond yielding roughly half the inflation rate is a safe asset, is entirely based on the belief that the bonds can be sold at an even lower yield (higher price) in the future. Holding the bond to maturity is a guaranteed losing strategy. Here, a really long-term view can help to provide perspective. Bernstein has put together a time series showing US government bond yields going back an incredible 220 years.

It is very difficult to make the case for a very substantial bet on sustained lower yields from where we currently are. In fact, the chart shows that the current levels are anomalous. Given that the continued decline in bond yields is an essential backdrop to the future performance of all the so-called 'safe' assets, even an ambivalent view on future yields calls into question the consensus of what is safe and what is risky.

Graph 4: US 10-year treasury bond yield: 220 years from 1800



Sources: Bernstein and Bloomberg

Forming an alternative view of risk

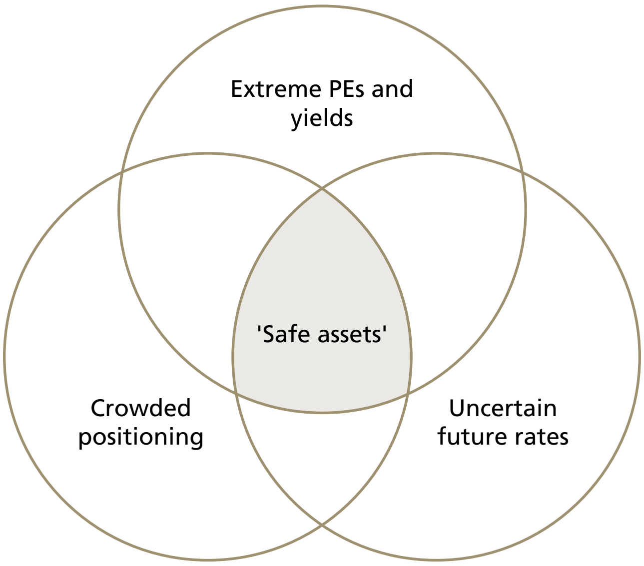
We believe investors needs to take an alternative view of risk. In this alternative view we are:

- prepared to look ahead a few years to a post-Covid-19 world
- careful not to base expectations on naive extrapolation of the past
- cognisant of where we stand with many markets at generational or all-time extremes

Most importantly, we explicitly consider the role of the price paid in the risk of permanent capital loss.

When we take this alternative view, the opportunity set changes dramatically. At current multiples and yields, the consensus safe assets, are, in our view, very risky destinations for capital. In addition, extrapolating past economic trends may be a very poor guide to what lies ahead, especially regarding inflation, interest rates and currencies. Finally, if we also consider the very crowded positioning in these so-called safe assets, in terms of our alternative view they actually represent risk for conservative portfolios focused on long-term returns.

Layered risk: An alternative view of the so-called ‘safe’ assets



Source: PSG Asset Management

Getting paid to wait: Attractive opportunities away from the consensus

Applying our alternative view of risk has enabled us to identify a rich opportunity set of under priced assets, both in South Africa and globally. Focusing our research efforts on uncrowded or unloved regions and sectors raises our odds of finding ‘quality on sale’. Being prepared to look out several years enables us to consider opportunities created by the impact of the global pandemic response on businesses and the economy.

We believe the local and global buy lists that underpin all our portfolios contain very attractive assets at substantial discounts to their intrinsic values. The forward dividend yield on our local buy list is 6.5% and our global buy list 4.0% (using the 2-year forward DY based on Bloomberg consensus or PSG research, if no coverage). John Gilchrist and Mikhail Motala elaborate further on dividend income in their article Being paid to wait.

A catalyst for performance is likely to be an inflection in the long-term interest rate cycle. In the future, when we look back, we might conclude the inflection point of the yield curve started in November 2020, but we must acknowledge we have no certainty on the timing of macroeconomic variables, and do not attempt to forecast them.

What if it takes several more years before the cycle turns?

In the meantime, we are ‘paid to wait’, with good yields from the assets that look attractive via our alternative risk view. Our current buy lists represent what we believe to be well-diversified and resilient portfolios for long-term investors.

Being paid to wait


John Gilchrist **Mikhail Motala**

John has 20 years' investment experience and was previously co-head of the Customised Solutions Boutique at OMIGSA. He is a CA(SA) and has an MBA from Insead in France.

Mikhail joined PSG Asset Management in 2015 and serves as an Assistant Fund Manager. He conducts research on both local and global companies across various sectors. Before joining PSG, he worked in the assurance division at Ernst & Young. Mikhail is a qualified chartered accountant.

Dividends provide an underpin for attractive future returns from unloved companies

During the 2020 market sell-off, traditionally high dividend paying companies globally faced a particularly severe sell-off as the dividend underpin evaporated. South African smaller cap value shares, the most unloved part of an unloved market within an unloved investing style, were particularly hard hit. At PSG Asset Management, we are looking beyond the short term to the attractive dividend yields we believe will be on offer in a post-Covid-19 world. Importantly, we believe these dividend yields can be achieved even if overall South African economic activity remains subdued.

2020 was characterised by disappearing dividends

In early April 2020, as the economic and financial effects of Covid-19 and the related lockdown started to take hold of the South African economy, the South African Reserve Bank (SARB), acting in its capacity as the Prudential Authority to South African banks, issued a Guidance Note recommending that banks withhold their upcoming dividend declarations. This recommendation was designed to help banks conserve their capital resources and thereby ensure they were in a position to both support the economy by advancing loans to corporations and individuals as and when required, and absorb losses stemming from potential bad debts. The regulator instructing banks not to pay a dividend to its shareholders is an extreme move and one that was unprecedented in South Africa, but it followed on the heels of global banking regulators such as the Bank of England and European Central Bank, who issued similar guidelines.

Investors in these banks, many of whom would have assumed ongoing attractive dividends, were faced with the prospect of a year of zero dividend income. Other corporates elected to suspend dividend payments over the next few months – not as a result of regulatory intervention but rather out of prudence in the wake of extreme uncertainty caused by Covid-19. Dividend expectations are often a key driver of share prices, providing an underpin for investors' valuations. Therefore, traditionally high dividend paying companies suffered a particularly severe sell-off in 2020, as the dividend underpin evaporated.

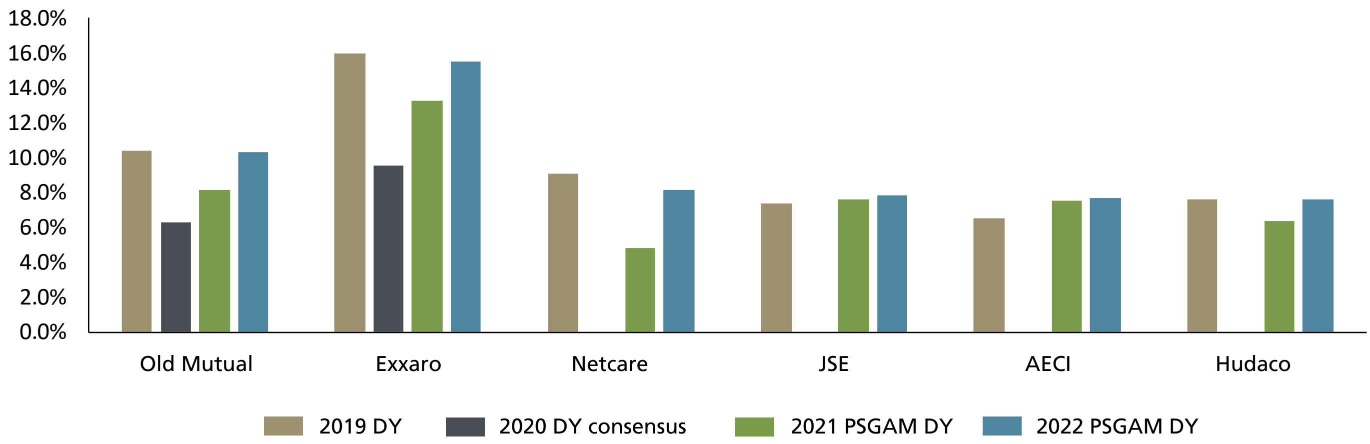
A case of investor myopia

While few South African companies are expected to pay dividends this year, dividend payments will eventually resume. Some investors can become myopic and increasingly short-term focused when faced with large market moves or higher levels of uncertainty. However, as Kevin Cousins writes in his article An alternative view of risk, for investors who have the discipline and fortitude to look further into the future, short-term setbacks can be a rich source of opportunity. We anticipate that certain companies will resume paying dividends as soon as next year and, in many cases, will return to pre-Covid-19 dividend levels the following year.

These dividend projections incorporate conservative assumptions on the recovery in revenues – they do not rely on a buoyant economic environment, significant pent-up demand or market share gains. We cannot say for sure when earnings and dividends will match pre-Covid-19 levels, and the glidepath will look very different from sector to sector and company to company. However, if you calculate a dividend yield using the dividends companies declared before any effects of Covid-19 against current share prices, you get an indication of the level of income investors could potentially expect to earn on shares once earnings and dividends return to pre-Covid-19 levels.

Notwithstanding the uncertainties that surround future dividend payments, there are many companies that have reasonable prospects of achieving close to pre-Covid-19 dividend levels in 2021. As shown in Graph 1, a number of the companies held in our portfolios have forward dividend yields of close to 8%, and in some cases in excess of 10%. Starting dividend yields of this magnitude provide very good entry points and usually correspond to attractive expected returns, both in nominal and real terms. If we consider a 10% starting yield and assume that the dividends only grow by the current inflation rate of 3.2% (SARB, November 2020), the expected annual return (without real growth or a re-rating) is an extremely attractive 13% p.a.

Graph 1: Forward dividend yields: examples from our buy list shares



Sources: PSG Asset Management and Bloomberg

Dividend yields and interest rates

Dividend yields should not only be considered in isolation, but also relative to prevailing interest rates. To highlight the importance of the relationship between dividend yields and interest rates, consider the alternatives available to income-seeking investors. The most risk averse of these investors invest in money market funds. For a number of years, inflation has been low and interest rates have been relatively high, allowing these investors to earn inflation-beating returns from money market instruments. As interest rates have been cut in response to the impact of Covid-19, that real yield (interest rate less inflation) has evaporated. Short-term rates at 3.5%, is the lowest in 55 years. High dividend yields combined with low interest rates could tempt investors earning paltry income further up the risk spectrum, thereby driving flows into undervalued, high dividend yielding equities and supporting share prices.

When dividend yields are this high relative to interest rates, they typically bode well for subsequent returns. In June 2008, dividend yields of the FTSE/JSE All Share Index were at their lowest levels relative to interest rates. The subsequent 9-month return from equities was a 31% decline. Conversely, dividend yields reached their highest levels relative to interest rates in April 2020. The subsequent rally to the end of the year was 36%. Despite this strong equity rally, dividend yields still look highly attractive relative to interest rates.

Dividend sustainability case studies

Case study 1: Old Mutual

In 2016, Old Mutual plc embarked on a capital return strategy via a break-up of the company known as 'managed separation'. The African business was listed on the JSE in 2018 as Old Mutual Limited and began its own capital return strategy immediately. That capital return via dividends and share repurchases continues to be a cornerstone of the Old Mutual investment thesis.

There is a strong chance that Old Mutual will be able to declare a dividend approximating pre-Covid-19 levels in two years' time. The primary reasons for this are:

- An incredibly high margin, cash-generative business of selling funeral policies to entry level clients.
- Significant scale in their Corporate Solutions and Investment Management businesses, which generate strong recurring revenue.

With a forward dividend yield approaching 10%, Old Mutual is very attractively valued.

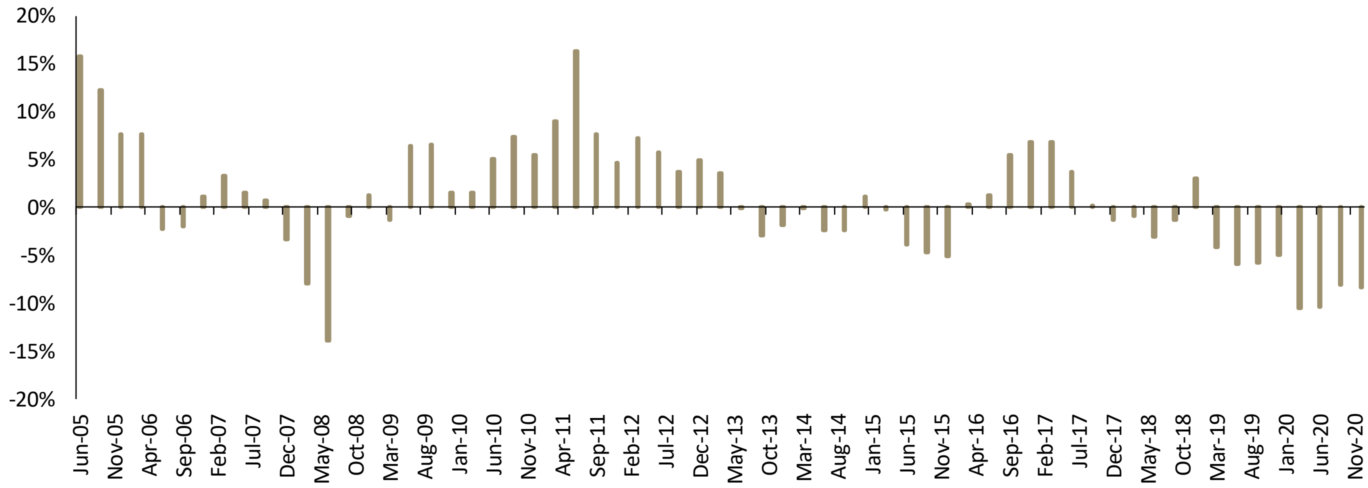
Case study 2: JSE Limited

Since listing on its own exchange in 2006, the JSE has not once reduced its distribution to shareholders. Unlike many companies that experienced pressure to preserve cash by suspending distributions in 2020, this was not the case for the JSE, which has a debt-free balance sheet. Furthermore, the JSE has a unique ability to generate countercyclical profits. Periods of heightened volatility, typically during downturns, have historically been supportive of trading activity and the JSE has demonstrated an ability to grow earnings during these downturns. Historically, the JSE has been able to generate all of its profits in free cash flow, and that looks set to continue. The combination of a strong balance sheet, resilient revenue streams and profits generated in cash, bodes very well for the sustainability of the dividend going forward. With a forward dividend yield approaching 8%, the JSE is very attractively valued.

Exploiting the opportunity in small and mid-caps

While we do not view ourselves as small cap managers, many of the opportunities meeting the attractive valuation criteria highlighted above fall within the ambit of the JSE small and mid-cap universe. As shown in Graph 2, while shares with smaller market capitalisations tend to outperform their large cap peers over the longer term, they have underperformed over the last 10 years, primarily due to substantial underperformance over the last three years.

Graph 2: Relative rolling 3-year annualised price performance of mid-caps vs Top 40 Index



Source: Bloomberg

This underperformance has been driven primarily by a relative de-rating of smaller cap shares, hence the attractive opportunities and high prospective dividend yields we are seeing in this area of the market. Potential reasons for this being such fertile ground for mispricings are:

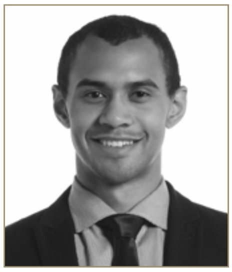
- Globally, there has been a protracted bias towards growth over value shares. In most cases, South African small and mid-cap shares are regarded as value shares, given the lack of economic growth.
- Emerging markets have been out of favour and South Africa has not been spared.
- South African small and mid-cap shares are perceived to be entirely reliant on the local economy. However, many of these companies are more diversified and resilient than perceived and often earn a significant amount of their profits in hard currency.
- There is very little broker research coverage of the small and mid-cap universe.
- Regardless how attractive the opportunity is, it cannot be exploited by many of our larger peers in the asset management industry. By way of illustration, at 31 December 2020, the PSG Balanced Fund had 9% of the fund invested in aggregate in the following four companies: JSE Limited, Imperial Logistics Limited, AECI Limited and Hudaco Industries Limited. If the three largest balanced funds in the country were to invest in these four companies with the proviso that they restrict ownership to five percent of any one of those companies, the combined position would be between 1% and 3% of the funds' assets. We see our ability to exploit these attractive opportunities in a meaningful way as a key differentiator and competitive advantage.

To put it bluntly: South African smaller cap value shares are the most unloved part of an unloved market within an unloved investing style.

Being paid to wait

As we look across the opportunities expressed in our funds, a common theme of high prospective dividend yields emerges. At PSG Asset Management, we are willing to look beyond the trials of this year, of subdued earnings and dividends, to the attractive yields we believe will be on offer in a post-Covid-19 world. It is important to note that these dividend yields can be achieved even if overall South African economic activity remains subdued. Attractive dividend yields mean that our funds will be handsomely rewarded while we wait. In addition, in a low yield world these attractive dividend yields could attract additional investment, leading to a re-rating of these shares and exceptional returns for patient investors.

Fixed income investors can benefit from South Africa's distorted and steep yield curve



Duayne Le Roux

Duayne started his career with PSG Wealth in 2015 as part of the PSG Graduate Programme. In 2016, he joined PSG Asset Management as a Graduate Trainee and subsequently became the Quantitative Analyst for the fixed income team. He was appointed as an Assistant Fund Manager in 2018 and as Fund Manager in 2021.

A distorted yield curve offers investors access to potentially equity-like returns

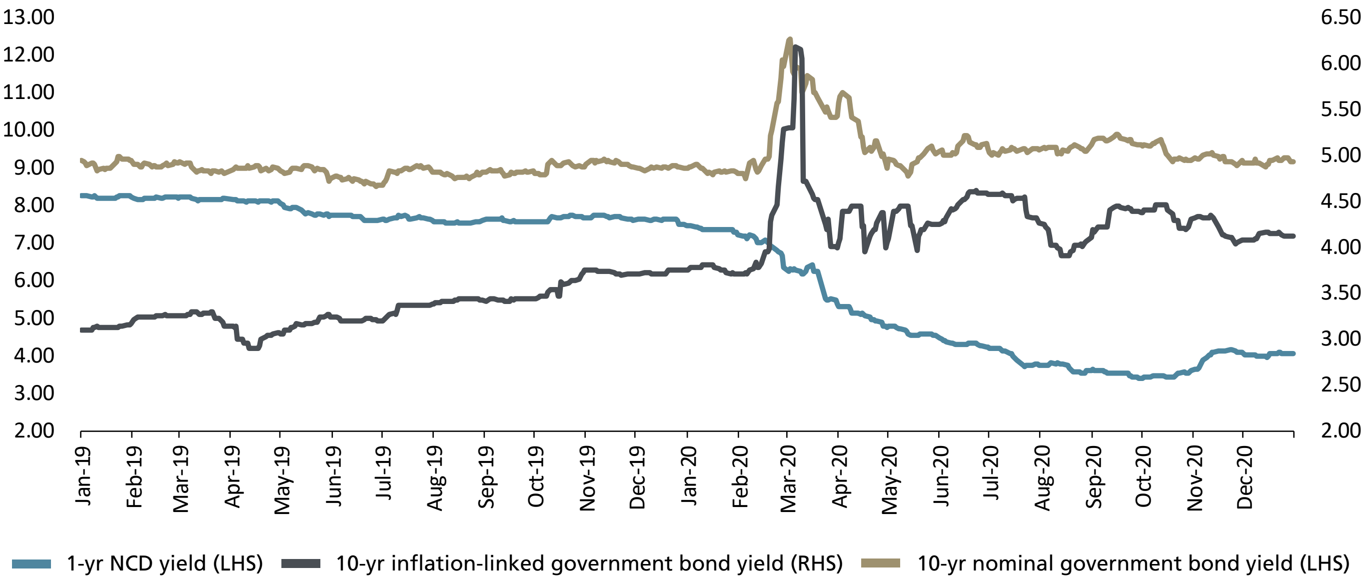
Fixed income markets have been through a tumultuous year. The rate cuts associated with efforts to contain the economic fall-out of the Covid-19 pandemic, together with worries about South Africa's fiscal position and investor preference for low risk options, have driven distortions in the local yield curve. The current environment offers opportunities for fixed income investors to secure equity-like returns at lower risk levels, provided they are willing to look further out along the yield curve.

The impact of the pandemic induced exceptional market conditions

The Covid-19 pandemic necessitated that governments take extreme actions. Entire populations were confined to their homes and people's interactions were limited to those closest to them. As a result, economic growth in South Africa came to a grinding halt. Globally, policymakers were forced to take decisions that weighed the cost of human life against that of economic progress. This was no different in South Africa, where there are significant concerns about the sustainability of government debt levels.

Additionally, the South African Reserve Bank (SARB) has cut the repo rate five times since the start of the pandemic, delivering a cumulative 3% in rate cuts. At 3.5%, the policy rate is the lowest it has been since 1965. The SARB was cutting rates even as local inflation sped to the lower bound of the SARB's target range, bottoming out at 2.1%. At the time of writing, it was still below the targeted midpoint of 4.5%. Against this backdrop, with many variables changing at the same time, we saw the 10-year government bond yield rise above 12%, something that has not happened since 2002. And the 10-year inflation-linked bond yield spiked very briefly to 6%, before settling around the 4% to 4.5% range. The repo rate cuts also helped to keep short-term rates well anchored, with 1-year negotiable certificate of deposit (NCD) rates bottoming out at 3.375%.

Graph 1: Fixed income yields



Sources: PSG Asset Management and Bloomberg

Investors reacted to market developments

A dynamic that played out last year was the flow of money from higher- to lower-risk funds. In total, 2020 saw R145 billion in outflows from balanced and high-equity funds, while income funds received R249 billion in inflows throughout the year. This flow of money from higher-risk funds to lower-risk funds also implies a movement from investments further up yield curves positioned in longer-maturity instruments to lower-risk investments positioned in shorter-maturity instruments.

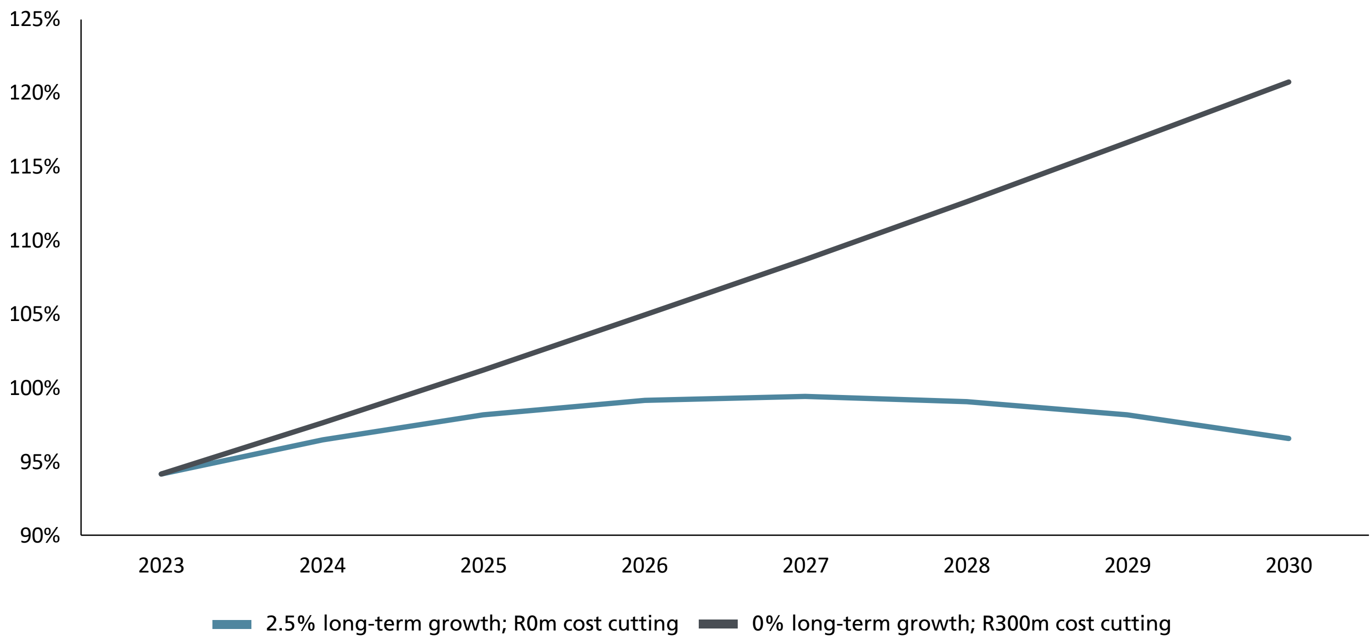
With concerns around a possible sovereign debt crisis building and investor preference for shorter-dated instruments increasing, there was a very sharp sell-off in longer-term instruments. Consequently, multiple distortions arose: a sharp divergence between short- and long-term yields (the difference in yield offered by various points on the same yield curve became exaggerated) and a sudden increase in the yields of long bonds.

Putting fears around Government's fiscal position in perspective

Before being able to make any decisions in these kinds of conditions, critical questions needed to be answered. Government's fiscal position is a relevant concern – and one that bears closer scrutiny. Therefore, we investigated whether it would be possible for a country in a vulnerable fiscal position, like South Africa, to return to a sustainable position.

Our research shows that a recovery is possible. Government's chosen path of budget cuts and spending reallocation would be the first of many steps needed to head in the right direction. These measures would not be enough on their own, however, and would need to coincide with a revival in economic growth prospects, for which private sector participation would be key. As growth starts to increase, tax receipts will rise and Government's borrowing requirements will decline. Simultaneously, GDP will increase, resulting in the debt-to-GDP ratio potentially declining fairly rapidly.

Graph 2: South African debt/GDP scenarios



Source: PSG Asset Management

The safety in high starting yields on steep curves

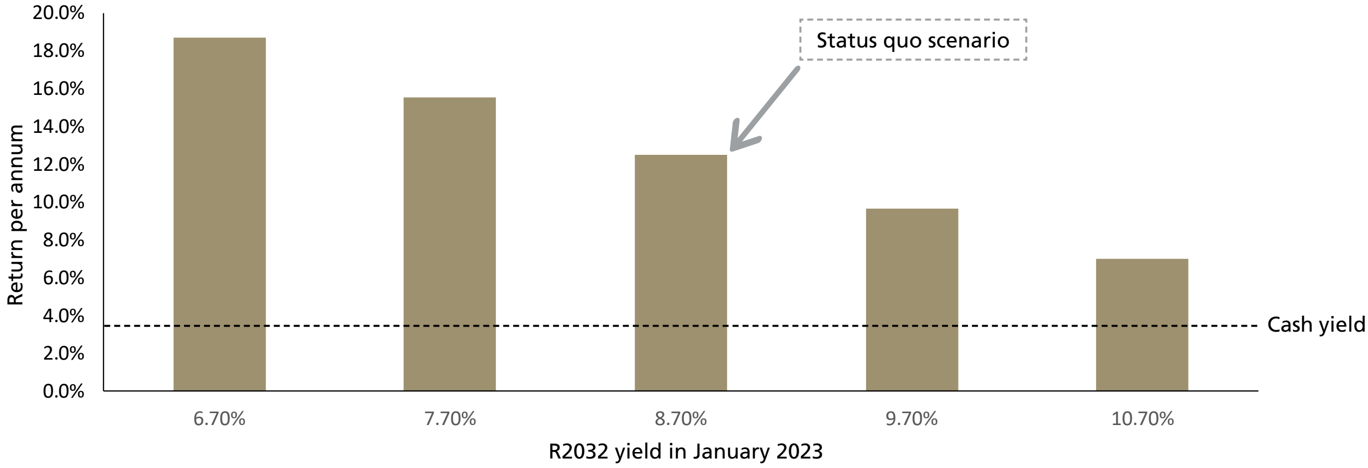
High starting yields are incredibly powerful from the perspective of buying with a margin of safety. By locking in a high starting yield, investors are less exposed to changes in yields moving against them, while earning a higher yield. When high yields are combined with steep yield curves, as is currently the case in South Africa, the risk-return trade-off becomes extremely compelling. Under this scenario, if nothing changes, returns from bonds are boosted by a decline in yield as the term of the bond reduces.

The effect of the 10-year bond 'rolling down the curve' to 9% would be a return of 16.63% in one year. In their article Being paid to wait John Gilchrist and Mikhail Motala explain that highly attractive dividend yields are also set to reward patient investors in equity markets.

Case studies on the impact of high yields and roll-down potential

The benefits of both high yield and roll-down potential are best illustrated with a real-life example currently held in our fixed income funds. The R2032, a government bond maturing in 2032, currently trades at a 9.7% yield. If nothing changes over the next two years (which we believe is plausible), this bond will deliver 12.5% comprised of the yield plus the benefits from the roll-down. The attractive risk-return trade-off available from these instruments is evident from the pay-off profile below, which shows the annual return over the next two years, under various assumptions.

Graph 3: R2023 potential 2-year return (per annum)



Sources: PSG Asset Management and Bloomberg. Returns comprise coupons plus yield roll-down given current yield curve.

To illustrate further how high yields can attract investment and in so doing drive returns, we look to a position held in our funds this year. The R186 government bond started the year as a 7-year bond yielding 8.2%. Following the bond sell-off in March, yields subsequently spiked briefly above 11%. This is a very attractive and high starting yield, especially when combined with a very steep yield curve. Throughout the year, as opportunities at the short end of the yield curve became crowded out, more money started to flow further up the yield curve. This caused the yield curve to flatten and the bond's yield to decline 1.5%, and led to the R186 generating a return of 15.4% for the year. This was comfortably ahead of both the JSE All Share Index and cash, which returned 7% and 5.4% respectively over a comparative period – a very good outcome for fixed income clients.

Opportunities for fixed income investors

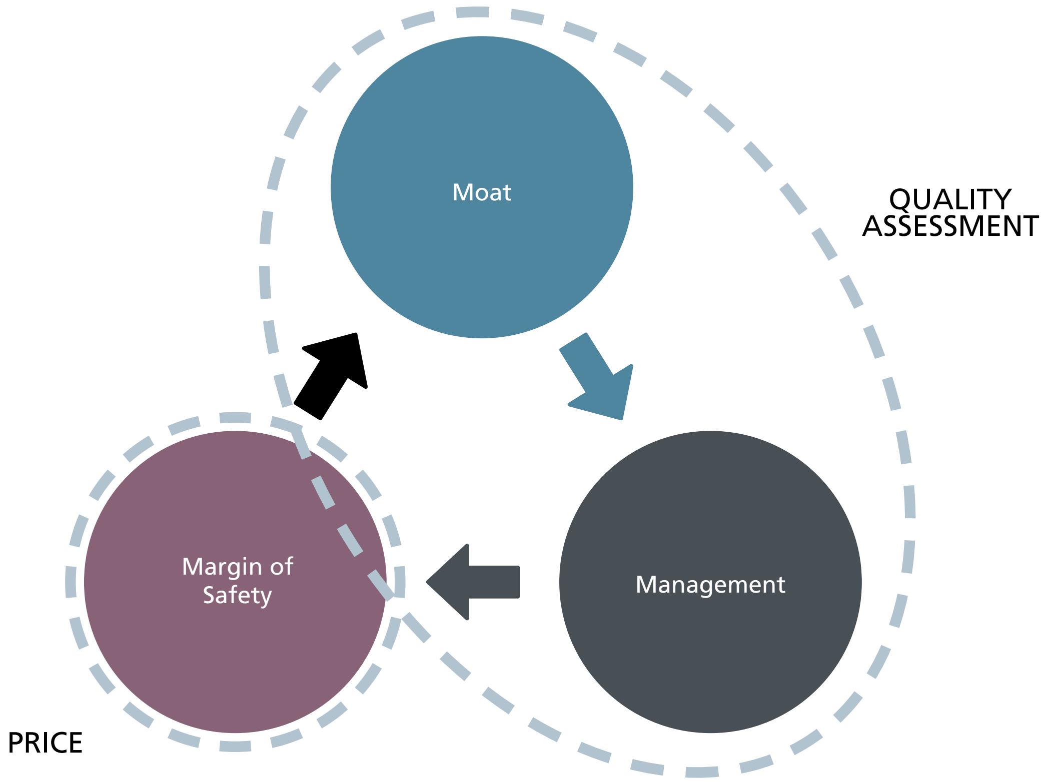
2020 saw market dynamics drive distortions across yield curves and offer fixed income investors a unique set of opportunities. There were very real risks that needed to be assessed and we continue to monitor them on an ongoing basis. However, we believe these conditions have offered opportunities to invest with a high margin of safety. In addition, steep curves have meant that if market dynamics result in flatter curves, there is the added possibility of significant capital gains. We have positioned our funds to take advantage of this, and anticipate our investors will be handsomely rewarded in the future.

A quick reminder of our 3M process

As investment professionals, we seek to generate consistent long-term returns for our clients. A robust and proven investment process is at the heart of our ability to do so consistently over time, even as market cycles come and go and stocks fall in and out of favour. We understand that generating strong long-term returns for our clients rests on the ability to buy low, invest for the long run and sell high.

To find the most attractive opportunities, we look in the uncrowded areas of the market that offer the best chance of mispricing (generally those characterised by fear, uncertainty or neglect). We further improve our chances of success by applying our 3M process.

The first two M's help us evaluate the quality of companies. These are the strength of **'management'** and evidence of a competitive advantage that serves as a **'moat'**, setting the company apart from its peers. Our third M is the **'margin of safety'**, reflected in how far a security is trading from its fair value (or, viewed differently, whether its current price is setting us up to 'buy low'). Essentially, we are looking for some inherent quality that the market might be missing. As a result, we tend to invest in companies that are as good as the market or better, but trading at a discount. We believe that if we apply this methodology consistently, we will tend to buy quality companies at affordable valuations, helping our clients in growing their investments over time.



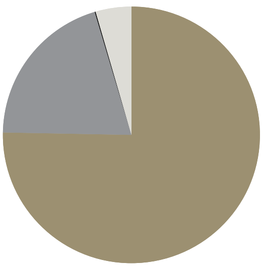
Portfolio holdings as at 31 December 2020

PSG Equity Fund

Top 10 equities

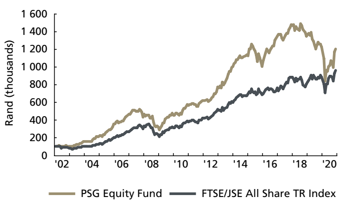
Glencore plc
Anheuser-Busch InBev
Remgro Ltd
Discovery Ltd
Imperial Logistics Ltd
AECI Ltd
Prudential plc
Super Group Ltd
The Mosaic Co
Old Mutual Ltd

Asset allocation



Domestic equity	75.3%
Foreign equity	20.1%
Foreign cash	0.1%
Foreign property	4.5%
Total	**100%**

Performance

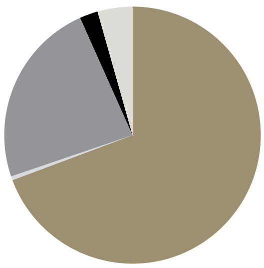


PSG Flexible Fund

Top 10 equities

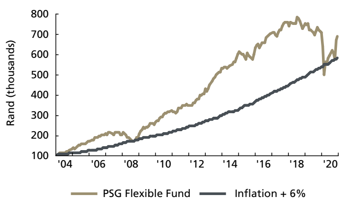
Anheuser-Busch InBev
Glencore plc
Remgro Ltd
Discovery Ltd
Prudential plc
AECI Ltd
Super Group Ltd
JSE Ltd
Imperial Logistics Ltd
Old Mutual Ltd

Asset allocation



Domestic equity	69.3%
Domestic cash	0.5%
Foreign equity	23.5%
Foreign cash	2.3%
Foreign property	4.4%
Total	**100%**

Performance

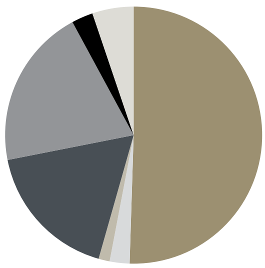


PSG Balanced Fund

Top 10 equities

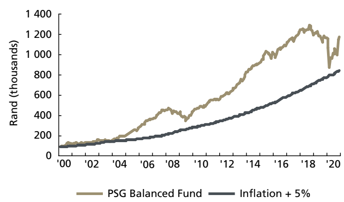
Discovery Ltd
Glencore plc
Anheuser-Busch InBev
Prudential plc
Tanger Factory Outlet Centers Inc
JSE Ltd
Remgro Ltd
Liberty Global Inc
The Mosaic Co
Imperial Logistics Ltd

Asset allocation



Domestic equity	50.5%
Domestic cash and NCDs	2.5%
Domestic property	1.4%
Domestic bonds	17.5%
Foreign equity	20.2%
Foreign cash	2.7%
Foreign property	5.2%
Total	**100%**

Performance

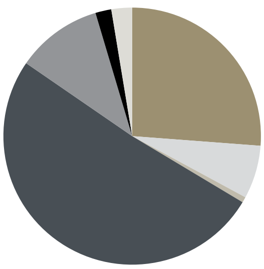


PSG Stable Fund

Top 5 equities
Anheuser-Busch InBev
Discovery Ltd
Remgro Ltd
Prudential plc
Simon Property Group Inc

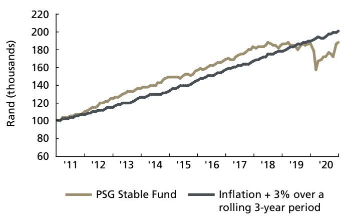
Top 5 issuer exposures
The Republic of South Africa
FirstRand Bank Ltd
Eskom Holdings SOC Ltd
Standard Bank of SA Ltd
Nedbank Ltd

Asset allocation



Domestic equity	26.2%
Domestic cash and NCDs	6.7%
Domestic property	0.7%
Domestic bonds	51.0%
Foreign equity	10.8%
Foreign cash	2.0%
Foreign property	2.6%
Total	**100%**

Performance

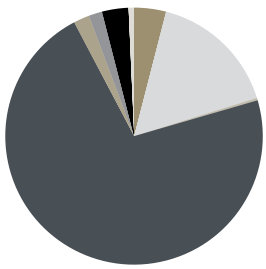


PSG Diversified Income Fund

Top 5 equities
Absa Bank Ltd preference shares
Standard Bank Group preference shares
JSE Ltd
Remgro Ltd
Tanger Factory Outlet Centers Inc

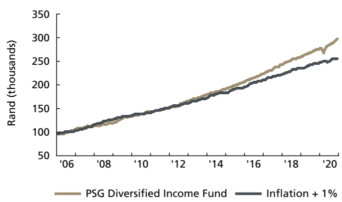
Top 5 issuer exposures
The Republic of South Africa
FirstRand Bank Ltd
PSG Money Market Fund
Standard Bank of SA Ltd
Eskom Holdings SOC Ltd

Asset allocation



Domestic equity	4.0%
Domestic cash and NCDs	16.2%
Domestic property	0.3%
Domestic bonds	71.8%
Preference shares	2.0%
Foreign equity	1.7%
Foreign cash	3.3%
Foreign property	0.7%
Total	**100%**

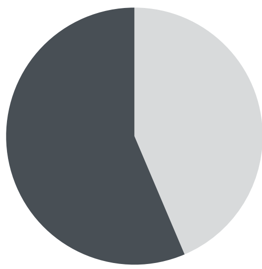
Performance



PSG Income Fund

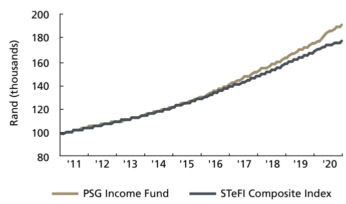
Top 10 issuer exposures
The Republic of South Africa
PSG Money Market Fund
The South African Reserve Bank
Standard Bank of SA Ltd
FirstRand Bank Ltd
Absa Bank Ltd
Nedbank Ltd
Capitec Bank Ltd
Eskom Holdings SOC Ltd
Old Mutual Ltd

Asset allocation



Domestic cash and NCDs	43.6%
Domestic bonds	56.4%
Total	**100%**

Performance

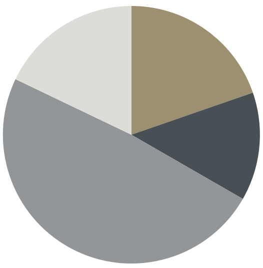


PSG Money Market Fund

Issuer exposures

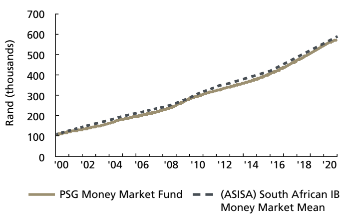
The Republic of South Africa
Nedbank Ltd
FirstRand Bank Ltd
Standard Bank of SA Ltd
Absa Bank Ltd
Investec Bank Ltd

Asset allocation



Linked NCDs/Floating rate notes	19.7%
Step rate notes	13.6%
Treasury bills	48.8%
Call	17.9%
Total	**100%**

Performance

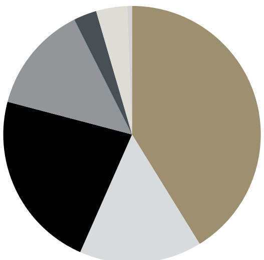


PSG Global Equity Sub-Fund

Top 10 equities

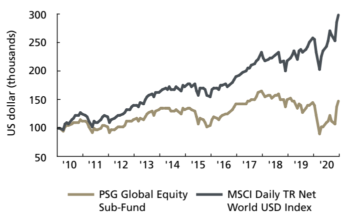
Prudential plc
Anheuser-Busch InBev
Liberty Global Inc
Glencore plc
Asahi Group Holdings Ltd
The Mosaic Co
Japan Post Insurance Co Ltd
Simon Property Group Inc
Nordstrom Inc
Resona Holdings Inc

Regional allocation



US	41.2%
Europe	15.4%
UK	22.5%
Japan	13.5%
Canada	2.9%
Africa	3.9%
Cash	0.6%
Total	**100%**

Performance

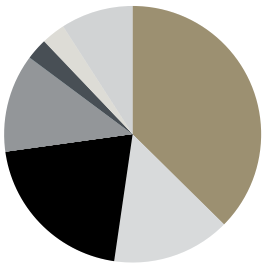


PSG Global Flexible Sub-Fund

Top 10 equities

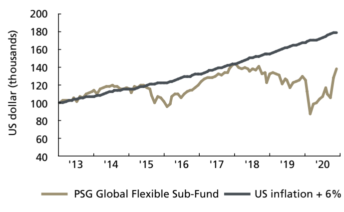
Prudential plc
Anheuser-Busch InBev
Liberty Global Inc
The Mosaic Co
Asahi Group Holdings Ltd
Glencore plc
Simon Property Group Inc
Japan Post Insurance Co Ltd
Nordstrom Inc
Resona Holdings Inc

Regional allocation



US	37.4%
Europe	14.9%
UK	20.5%
Japan	12.4%
Canada	2.7%
Africa	3.0%
Cash and bonds	9.1%
Total	**100%**

Performance



Percentage annualised performance to 31 December 2020 (net of fees)

Local funds						
	1 Year	3 Years	5 Years	10 Years	Inception	Fund inception date
PSG Equity Fund A	-3.72	-6.46	2.62	7.75	14.11 *	31/12/1997
FTSE/JSE All Share Total Return Index	6.98	3.12	6.36	9.61	12.79	
PSG Flexible Fund A	-4.12	-3.28	3.20	8.58	12.66**	02/11/1998
SA Inflation + 6%	9.16	9.94	10.60	11.07	11.49	
PSG Balanced Fund A	0.66	-1.92	3.35	7.89	12.05	01/06/1999
SA Inflation + 5%	8.16	8.97	9.62	10.08	10.35	
PSG Stable Fund A	1.37	1.47	4.54		7.22	13/09/2011
SA Inflation + 3% over a rolling 3-year period	6.16	6.97	7.62		7.96	
PSG Diversified Income Fund A	8.16	7.08	7.67	7.51	7.78	07/04/2006
SA Inflation + 1%	4.16	4.97	5.62	6.07	6.68	
PSG Income Fund A	9.50	8.60	8.62		7.33	01/09/2011
STeFI Composite Index	5.38	6.64	6.97		6.41	
PSG Money Market Fund A	4.99	6.50	6.89	6.25	8.27	19/10/1998
South African - Interest Bearing - Money Market Mean	5.42	6.76	7.11	6.38	8.36	
PSG Global Equity Feeder Fund A ^	6.51	2.33	4.08		10.22	03/05/2011
MSCI Daily Total Return Net World USD Index (in ZAR)	21.70	17.02	11.00		18.65	
PSG Global Flexible Feeder Fund A ^^	12.87	5.11	4.65		10.50	11/04/2013
US inflation + 6% (in ZAR)	12.56	14.12	6.71		14.74	

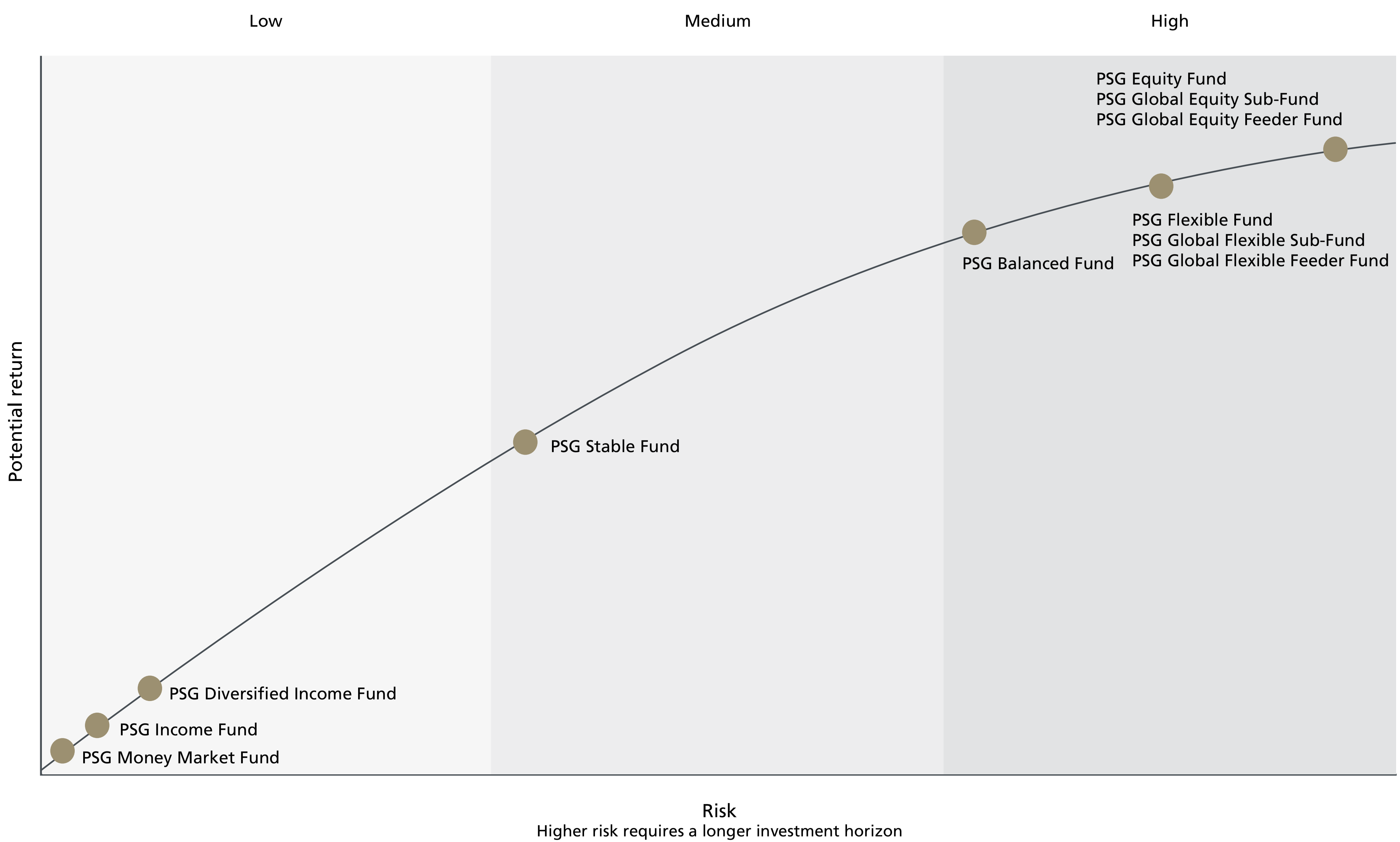
International funds						
	1 Year	3 Years	5 Years	10 Years	Inception	Fund inception date
PSG Global Equity Sub-Fund A	1.63	-3.26	5.95	3.24	3.76	23/07/2010
MSCI Daily Total Return Net World USD Index (in USD)	15.87	10.54	12.19	9.87	10.95	
PSG Global Flexible Sub-Fund A	6.22	-1.19	6.29		4.07	02/01/2013
US inflation + 6% (in USD)	7.16	7.80	7.86		7.55	

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

^ The PSG Global Equity Feeder Fund feeds into the PSG Global Equity Sub-Fund
^^ The PSG Global Flexible Feeder Fund feeds into the PSG Global Flexible Sub-Fund

Source: 2020 Morningstar Inc. All rights reserved as at end of December 2020.
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 to 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 to 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 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	SA CPI + 6%	SA CPI + 5%	SA CPI + 3% over a rolling 3-year period	SA CPI + 1%	STeFI Composite Index	South African - Interest-bearing - Money Market Mean	MSCI Daily Total Return Net World USD Index (in ZAR)	US CPI + 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 moderate risk appetite but require capital growth in real terms • have a medium-term investment horizon of three years and longer • are comfortable with fluctuations in markets	• 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% Class E: 0.75% + 20.00% performance fee on outperformance of the benchmark	Annual management fee: Class A: 1.00% + 7.00% performance fee on outperformance of the high-water mark Class E: 0.75% + 7.00% performance fee on outperformance of the high-water mark	Annual management fee: Class A: 1.50% Class E: 1.00%	Annual management fee: Class A: 1.50% Class E: 1.00%	Annual management fee: Class A: 1.00% Class E: 0.60%	Annual management fee: Class A: 0.65% Class E: 0.40%	Annual management fee: Class A: 0.50% Class F: 0.30%	Annual management fee: Class A: 0.75% Class E: 0.25%	Annual management fee: Class A: 0.75% Class B: 0.25%
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. The A classes have been closed to new investors.

Contact information

Local unit trusts
0800 600 168
local.instructions@psgadmin.co.za

Offshore unit trusts
0800 600 168
offshore.instructions@psgadmin.co.za

General enquiries
+27 (21) 799 8000
assetmanagement@psg.co.za

Websites
www.psg.co.za/asset-management
www.psgkglobal.com

Cape Town office

Physical address
First Floor, PSG House
Alphen Park
Constantia Main Road
Constantia
Western Cape
7806

Postal address
Private Bag X3
Constantia
7848

Switchboard
+27 (21) 799 8000

Guernsey office

Address
11 New Street
St Peter Port
Guernsey
GY1 2PF

Switchboard
+44 (1481) 726034

Malta office

Address
Unit G02
Ground floor
SmartCity Malta
SCM 01
Ricasoli
Kalkara
SCM 1001

Switchboard
+356 (2180) 7586

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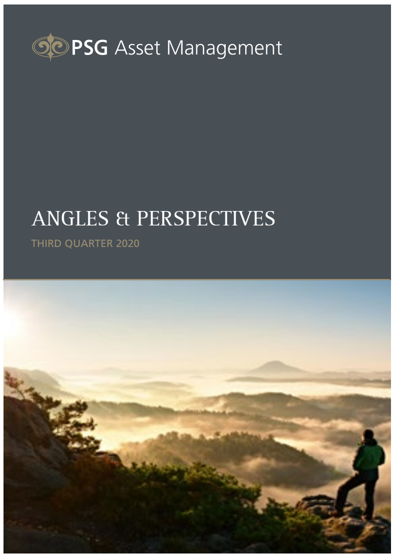
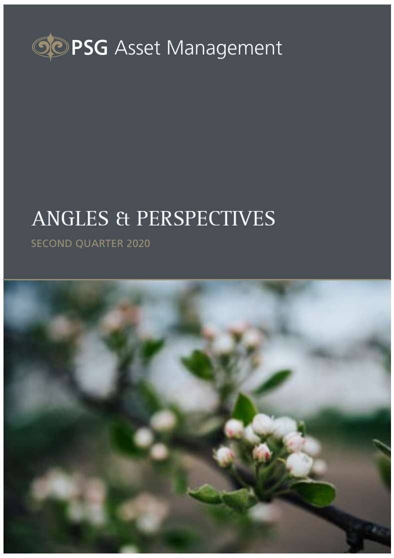
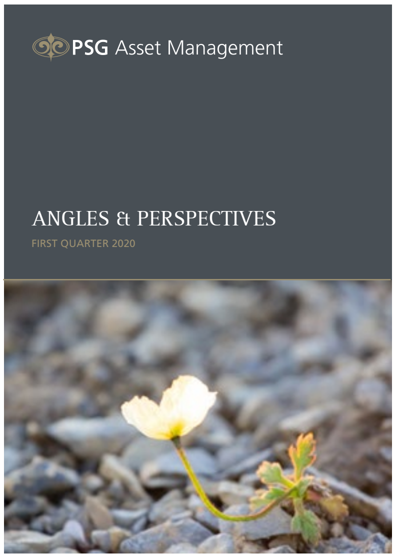


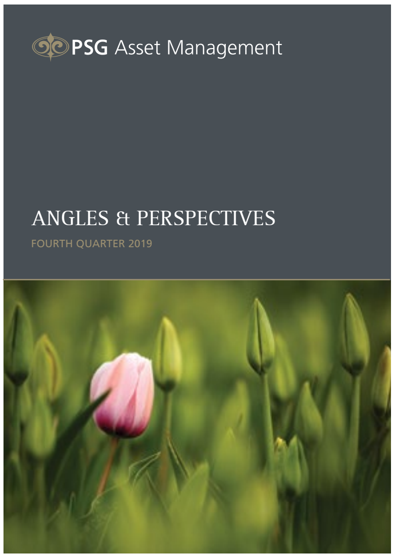
Third quarter 2020



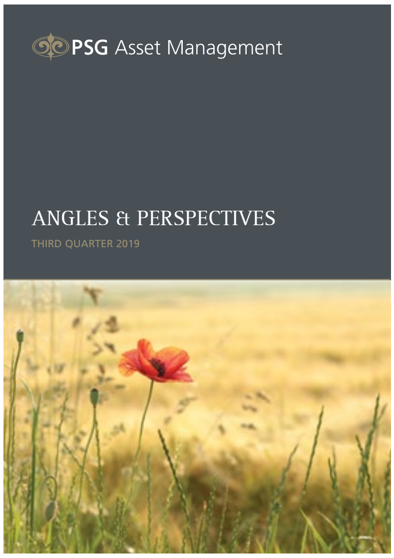
Second quarter 2020



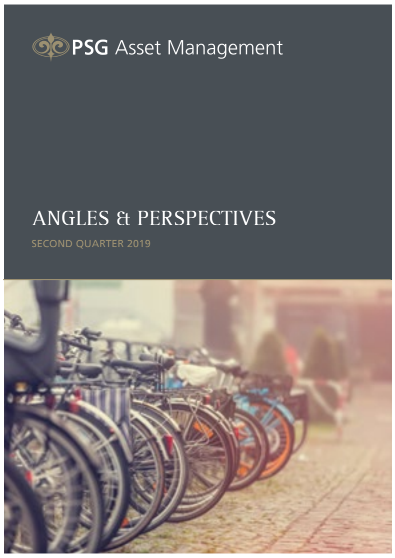
First quarter 2020



Fourth quarter 2019



Third quarter 2019



Second quarter 2019

PSG Asset Management