PSG Asset Management

PSG Equity Fund

Quarterly portfolio commentary as at 30 June 2020
by Shaun le Roux and Gustav Schulenburg

Current context

Global stock markets staged a remarkable recovery in the second quarter. The FTSE/JSE All Share Index and the S&P 500 Index both posted moderate 3% year-to-date declines as at 30 June, after gaining 43% and 39% respectively during the second quarter. The extent of the market recovery has surprised many, as these are volatile and unpredictable times and the path to economic recovery is uncertain. However, governments and central banks have countered the sharp economic contraction with an unprecedented willingness to act boldly and swiftly to provide stimulus and liquidity which have supported the prices of financial assets.

Our perspective

The index recovery in 2020 only tells part of the story. Indices, like the Nasdaq, that are heavily exposed to technology shares have materially outperformed: the Nasdaq Composite Index has risen by 13% in 2020. The strong performance by tech counters can partly be explained by the acceleration of digitisation and e-commerce trends in a lockdown and work-from-home world. However, it can also be attributed to the support that very low global bond yields provide to secular growth stock valuations. The relative weighting of tech stocks on the S&P and JSE (Naspers/Prosus) have been very supportive of index returns, as we are witnessing a surge in the popularity of tech stocks that rivals what we saw during the dotcom era. Indeed, the securities that dominate most global portfolios today (US large caps, tech, growth and quality) also outperformed in 2020, repeating the outcome of the previous few years. We are observing extraordinary crowding into past winners and a capitulation out of strategies and investments that have not worked: cheap stocks, value funds, emerging markets and contrarian investment strategies. This reflects a high-conviction bet that the next few years will mirror the past few years. We view this outcome as unlikely given the extreme discrepancies in starting valuations and the likelihood that growth will return to unloved parts of the market once the recovery gets underway. A stimulatory environment, like the one that the COVID-19 pandemic has induced, has also typically been kind to cyclical industries, commodities and emerging markets and less favourable for developed market bonds and 'bond proxy' stocks like consumer staple and tech. There is a material complacency as far as expensive stocks are concerned.

At the same time, investors have been capitulating out of cheap under-performers where risk is perceived to be high. This fear is being most acutely felt in emerging markets like South Africa, that don't have the same capacity for stimulus as developed countries to counter the effects of the lockdown. We would argue that many securities are discounting long-term outcomes that are overly pessimistic. We view this as very fertile ground for long-term contrarian investors and have used the COVID-19 panic to increase exposure to excellent businesses that were out-of-favour at incredibly attractive prices. Long-term returns look compelling.

Portfolio positioning

The fund's largest holdings can be classified as good examples of our 3M process: stocks of superior inherent quality trading at wide margins of safety. Such opportunities arise when fear abounds and this challenging and uncertain macro environment has seen investors fleeing areas of perceived risk, like South Africa. To demonstrate, our 15 largest equity holdings have on average outperformed the market over the past twenty years, while generating materially higher than average returns on equity, yet can be bought at a 42% discount to the market rating. The fund has diversified exposure across offshore equity and property (29%), domestic economy stocks (37%) and rand hedge stocks (33%). These investments have separately been identified by our bottom-up approach as excellent opportunities. Accordingly, we do not have an all-in bet on a swift South African recovery, though we are conscious of the outsized opportunity for long-term returns from domestic stocks from these price levels.

Changes in portfolio positioning

Q1 2020		Q2 2020	
Domestic equity	65.2%	Domestic equity	70.4%
Domestic cash	2.9%	Domestic cash	0.1%
Foreign equity	28.5%	Foreign equity	26.0%
Foreign property	2.1%	Foreign property	3.4%
Foreign cash	1.3%	Foreign cash	0.1%

There may be slight differences in the totals due to rounding.

Number of units as at 30 June 2020 (Class A):	44 864 216
Price (net asset value per unit) as at 30 June 2020 (Class A):	R8.02
Number of units as at 30 June 2020 (Class E):	90 362 791
Price (net asset value per unit) as at 30 June 2020 (Class E):	R8.06

All data as per Bloomberg as at 30 June 2020

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Performance

All performance data for a lump sum, net of fees, include income and assumes reinvestment of income on a NAV to NAV basis. Annualised performances show longer term performance rescaled over a 12 month period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Performance is calculated for the portfolio and individual investor performance may differ as a result thereof. The portfolio is valued at 15h00 daily. Cut-off time is determined by the platform. Income distributions are net of any applicable taxes. Actual annual figures are available to the investor on request. Prices are published daily and available on the website www.psg.co.za/asset- management and in the daily newspapers. Figures quoted are from Morningstar Inc.

Pricing

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Redemptions

The ability of a portfolio to repurchase is dependent upon the liquidity of the securities and cash of the portfolio. To protect investors, a manager may suspend repurchases for a period, subject to regulatory approval, to await liquidity. A suspension ensures that the sale of a large number of units will not force PSG Collective Investments to sell the underlying investments at a price in the market which could have a negative impact on investors. PSG Collective Investments will keep all investors informed should a situation arise where such suspension is required.

Company details

PSG Collective Investments (RF) Limited is registered as a CIS Manager with the Financial Sector Conduct Authority, and a member of the Association of Savings and Investments South Africa (ASISA) through its holdings company PSG Konsult Limited. The management of the portfolio is delegated to PSG Asset Management (Pty) Ltd, an authorised Financial Services Provider under the Financial Advisory and Intermediary Services Act 2002, FSP no 29524. PSG Asset Management (Pty) Ltd and PSG Collective Investments (RF) Limited are subsidiaries of PSG Konsult Limited. PSG Collective Investments (RF) Limited can be contacted on +27(21) 799 8000; (toll free) 0800 600 168, via email assetmanagement@psg.co.za.

Conflict of interest disclosure

The Fund 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 reinvested in the Fund for the benefit of the investors. Neither PSG Collective Investments (RF) Limited nor PSG Asset Management (Pty) Ltd retains any portion of such discount for their own accounts. The fund manager may use the brokerage services of a related party, PSG Securities Ltd.

Trustees

The Standard Bank of South Africa Limited,
The Towers, 2 Heerengracht Street,
Cnr Hertzog Boulevard,
Cape Town
8001
Tel: +27 21 401 2443
Email: Compliance-PSG@standardbank.co.za

Additional information

Additional information is available free of charge on the website www.psg.co.za/asset-management and may include publications, brochures, forms and annual reports.

by Shaun le Roux and Mikhail Motala

Current context

Global stock markets staged a remarkable recovery in the second quarter. The FTSE/JSE All Share Index and the S&P 500 Index both posted moderate 3% year-to-date declines as at 30 June, after gaining 43% and 39% respectively during the second quarter. The extent of the market recovery has surprised many, as these are volatile and unpredictable times and the path to economic recovery is uncertain. However, governments and central banks have countered the sharp economic contraction with an unprecedented willingness to act boldly and swiftly to provide stimulus and liquidity which have supported the prices of financial assets.

Our perspective

The index recovery in 2020 only tells part of the story. Indices, like the Nasdaq, that are heavily exposed to technology shares have materially outperformed: the Nasdaq Composite Index has risen by 13% in 2020. The strong performance by tech counters can partly be explained by the acceleration of digitisation and e-commerce trends in a lockdown and work-from-home world. However, it can also be attributed to the support that very low global bond yields provide to secular growth stock valuations. The relative weighting of tech stocks on the S&P and JSE (Naspers/Prosus) have been very supportive of index returns, as we are witnessing a surge in the popularity of tech stocks that rivals what we saw during the dotcom era. Indeed, the securities that dominate most global portfolios today (US large caps, tech, growth and quality) also outperformed in 2020, repeating the outcome of the previous few years. We are observing extraordinary crowding into past winners and a capitulation out of strategies and investments that have not worked: cheap stocks, value funds, emerging markets and contrarian investment strategies. This reflects a high-conviction bet that the next few years will mirror the past few years. We view this outcome as unlikely given the extreme discrepancies in starting valuations and the likelihood that growth will return to unloved parts of the market once the recovery gets underway. A stimulatory environment, like the one that the COVID-19 pandemic has induced, has also typically been kind to cyclical industries, commodities and emerging markets and less favourable for developed market bonds and 'bond proxy' stocks like consumer staple and tech. There is a material complacency as far as expensive stocks are concerned.

At the same time, investors have been capitulating out of cheap under-performers where risk is perceived to be high. This fear is being most acutely felt in emerging markets like South Africa, that don't have the same capacity for stimulus as developed countries to counter the effects of the lockdown. We would argue that many securities are discounting long-term outcomes that are overly pessimistic. We view this as very fertile ground for long-term contrarian investors and have used the COVID-19 panic to increase exposure to excellent businesses that were out-of-favour at incredibly attractive prices. Long-term returns look compelling.

Portfolio positioning

The fund's largest holdings can be classified as good examples of our 3M process: stocks of superior inherent quality trading at wide margins of safety. Such opportunities arise when fear abounds and this challenging and uncertain macro environment has seen investors fleeing areas of perceived risk, like South Africa. To demonstrate, our 15 largest equity holdings have on average outperformed the market over the past twenty years, while generating materially higher than average return on equity, yet can be bought at a 42% discount to the market rating. The fund has diversified exposure across offshore equity and property (31.6%), domestic economy stocks (32%), rand-hedge stocks (28%) and SA government bonds (4%). These investments have separately been identified by our bottom-up approach as excellent opportunities. Accordingly, we do not have an all-in bet on a swift South African recovery, though we are conscious of the outsized opportunity for long-term returns from domestic stocks from these price levels.
The residual cash holding of 5.1% is firepower to be used in the event of further market disruption, or if we see opportunities to provide capital to good businesses that require it at attractive prices in the months ahead. These cash levels are low relative to historical averages. This reflects the very wide gap between our assessment of value and prevailing share prices for a wide range of opportunities.

Changes in portfolio positioning

Q1 2020		Q2 2020	
Domestic equity	54.4%	Domestic equity	59.5%
Domestic cash	3.8%	Domestic cash	4.3%
Domestic gold	0.0%	Domestic gold	0.0%
Domestic bonds	8.1%	Domestic bonds	3.8%
Foreign equity	29.2%	Foreign equity	27.8%
Foreign property	2.9%	Foreign property	3.8%
Foreign cash	1.6%	Foreign cash	0.8%

There may be slight differences in the totals due to rounding.

Number of units as at 30 June 2020 (Class A):	639 755 654
Price (net asset value per unit) as at 30 June 2020 (Class A):	R4.01
Number of units as at 30 June 2020 (Class E):	1 060 760 173
Price (net asset value per unit) as at 30 June 2020 (Class E):	R4.02

All data as per Bloomberg as at 30 June 2020.

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Performance

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Pricing

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Redemptions

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Current context
Global stock markets staged a remarkable recovery in the second quarter. The FTSE/JSE All Share Index and the S&P 500 Index both posted moderate 3% year-to-date declines as at 30 June, after gaining 43% and 39% respectively during the second quarter. The extent of the recovery has surprised many, as these are volatile and unpredictable times and the path to economic recovery is uncertain. However, governments and central banks have countered the sharp economic contraction with an unprecedented willingness to act boldly and swiftly to provide stimulus and liquidity which have supported the prices of financial assets.

Our perspective
The index recovery in 2020 only tells part of the story. Indices, like the Nasdaq, that are heavily exposed to technology shares have materially outperformed: the Nasdaq has risen by 17% in 2020. The strong performance by tech counters can partly be explained by the acceleration of digitisation and e-commerce trends in a lockdown and work-from-home world. However, it can also be attributed to the support that very low global bond yields provide to secular growth stock valuations. The relative weighting of tech stocks on the S&P and JSE (Naspers/Prosus) have been very supportive of index returns, as we are witnessing a surge in the popularity of tech stocks that rivals what we saw during the dotcom era. Indeed, the securities that dominate most global portfolios today (US large caps, tech, growth and quality) also outperformed in 2020, repeating the outcome of the previous few years. We are observing extraordinary crowding into past winners and an abdication of strategies and investments that have not worked: cheap stocks, value funds, emerging markets and contrarian investment strategies. This reflects a high-conviction bet that the next few years will mirror the past few. We view this outcome as unlikely given the extreme discrepancies in starting valuations and the likelihood that growth will return to unloved parts of the market once the recovery gets underway. There is a material complacency as far as expensive stocks are concerned.

At the same time, investors have been capitulating out of cheap under-performers where risk is perceived to be high. This fear is being most acutely felt in emerging markets like South Africa, that don’t have the same capacity for stimulus as developed countries to counter the effects of the lockdown. We would argue that many securities are discounting long-term outcomes that are overly pessimistic. We view this as very fertile ground for long-term contrarian investors and have used the COVID-19 panic to increase exposure to excellent businesses that were out-of-favour at incredibly attractive prices. Long-term returns look compelling.

Portfolio performance and positioning
The fund’s performance over the last year has been disappointing and below what we seek to deliver for clients who have placed their valuable trust with us. While the most recent journey has been painful, it must be said that we consider the outlook to be promising. We believe the opportunity from this point is immense for disciplined investors willing to retain a long term, patient mindset and allocate capital to good, but undervalued, securities. It is rare that all components of a balanced portfolio (local and foreign equities and bonds) are simultaneously priced as attractively as they are right now.

The fund’s largest holdings can be classified as good examples of our 3M process: stocks of superior inherent quality trading at wide margins of safety. Such opportunities arise when fear abounds and this challenging and uncertain macro environment has seen investors fleeing areas of perceived risk, like South Africa. To demonstrate, our 15 largest equity holdings have on average outperformed the market over the past twenty years (while lagging more recently), while generating materially higher than average returns on equity, yet can be bought at a 42% discount to the market rating.

The fund has diversified exposure across offshore equity and property (28%), domestic economy stocks (28%), rand hedge stocks (22%), and bonds (21%). These investments have separately been identified by our bottom-up approach as excellent opportunities. Accordingly, we do not have an all-in bet on a swift South African recovery, though we are conscious of the outsized opportunity for long-term returns from domestic stocks from these price levels.

We see the fund’s residual cash holding and the liquid government bond exposure as valuable firepower to be used in the event of further market disruption, or if we see opportunity to provide capital to good businesses that require it at attractive prices in the months ahead. These cash levels are low relative to historical averages. This reflects the very wide gap between our assessment of value and prevailing share prices for a wide range of opportunities.

Changes in portfolio positioning
Total equity exposure increased from 69.2% to 72.8% as equity performance was strong over the quarter. We used the opportunity presented by an exceptionally weak rand and strength in some foreign equity holdings to optimise the composition of our equity holdings in favour of local equities.

Domestic bond exposure reduced moderately from 23.6% to 20.8% as we reduced some of the fund’s duration risk after a strong rebound in the bond market in May. We retain an exceptionally attractive exposure to government fixed and inflation-linked bonds and credit instruments at very attractive yields.

Overall property exposure increased from 2.8% to 4.8% over the quarter, attributable to market movements and incremental investments into selected local property companies.

The fund remains highly liquid with negligible exposure to illiquid credit instruments.

Q1 2020		Q2 2020	
Domestic equity	43.5%	Domestic equity	49.2%
Domestic property	0.2%	Domestic property	0.5%
Domestic cash and NCDs	3.4%	Domestic cash and NCDs	1.5%
Domestic bonds	23.6%	Domestic bonds	20.8%
Foreign equity	25.7%	Foreign equity	23.6%
Foreign cash	1.0%	Foreign cash	0.1%
Foreign property	2.6%	Foreign property	4.3%

There may be slight differences in the totals due to rounding.

Number of units as at 30 June 2020 (Class A):	58 001 200
Price (net asset value per unit) as at 30 June 2020 (Class A):	R54.91
Number of units as at 30 June 2020 (Class E):	67 155 774
Price (net asset value per unit) as at 30 June 2020 (Class E):	R54.97

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Regulation 28
The fund is managed according to Regulation 28 of the Pension Funds Act. The South African retirement fund industry is governed by the Pension Funds Act No. 24 of 1956. Regulation 28 of the Pension Funds Act prescribes the maximum limits in asset classes that an approved retirement fund may invest in. Exposures in excess of the limits will be corrected immediately, except where due to a change in the fair value or characteristic of an asset, e.g. market value fluctuations, in which case they will be corrected within a reasonable time period.

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At the same time, investors have been capitulating out of cheap under-performers where risk is perceived to be high. This fear is being most acutely felt in emerging markets like South Africa, that don't have the same capacity for stimulus as developed countries to counter the effects of the lockdown. We would argue that many securities are discounting long-term outcomes that are overly pessimistic. We view this as very fertile ground for long-term contrarian investors and have used the COVID-19 panic to increase exposure to excellent businesses that were out-of-favour at incredibly attractive prices. Long-term returns look compelling.

Portfolio positioning
The PSG Stable Fund has diversified exposure across offshore equity and property (16%), SA shares (including shares with rand-hedge characteristics, 23%), domestic bonds (49%), and cash and negotiable certificates of deposit (12%). Our bottom-up research approach continues to identify excellent investment opportunities across various asset classes. While we are conscious of the outsized opportunity for long-term returns from domestic assets at these price levels, we are also finding attractive opportunities globally.

The fund's largest equity holdings can be classified as good examples of our 3M process: stocks of superior inherent quality trading at wide margins of safety. Such opportunities arise when fear abounds and this challenging and uncertain macro environment has seen investors fleeing areas of perceived risk, like South Africa. To demonstrate, our 15 largest equity holdings have on average outperformed the market over the past twenty years, while generating materially higher than average returns on equity. Despite this, they can be bought at a 42% discount to the market rating.

Domestic bonds comprise sovereign nominal bonds (19%), sovereign inflation-linked bonds (20%), fixed-rate bonds (including government-guaranteed, 5%), and floating-rate bonds (5%). Although we took advantage of a rebound in the bond market to trim the fund duration during the quarter, the fund composition still reflects our view of the attractive asymmetry of returns available from sovereign bonds given their high nominal and real yields. Some of the proceeds were deployed into under-valued equity opportunities.

We were cautious on both credit assets and listed property and entered 2020 at the lowest allocations in these asset classes since the fund's inception. We have recently started to find selective attractive opportunities in the credit markets. Listed property as an asset class continues to face significant headwinds, but bottom up research is revealing potential opportunities.

The residual cash holding of 12% and liquid short-dated government bonds provide firepower which can be used in the event of further market disruption, or if we see opportunities to provide capital to good businesses that require it at attractive prices in the months ahead. These cash levels are low relative to historical averages. This reflects the very wide gap between our assessment of value and the prevailing prices for a wide range of opportunities, and the low yields currently offered by cash assets. Aggregate liquidity in the fund remains healthy.

Changes in portfolio positioning

Q1 2020		Q2 2020	
Domestic equity	20.4%	Domestic equity	23.4%
Domestic property	0.1%	Domestic property	0.2%

Domestic cash and NCDs	12.4%	Domestic cash and NCDs	11.9%
Domestic bonds	52.6%	Domestic bonds	48.5%
Foreign equity	12.7%	Foreign equity	13.6%
Foreign cash	0.1%	Foreign cash	0.1%
Foreign property	1.7%	Foreign property	2.3%

There may be slight differences in the totals due to rounding.

Number of units as at 30 June 2020 (Class A): 45 015 972
Price (net asset value per unit) as at 30 June 2020 (Class A): R1.25
Number of units as at 30 June 2020 (Class E): 395 696 473
Price (net asset value per unit) as at 30 June 2020 (Class E): R1.25

All data as per Bloomberg as at 30 June 2020

Disclaimer

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Regulation 28

The fund is managed according to Regulation 28 of the Pension Funds Act. The South African retirement fund industry is governed by the Pension Funds Act No. 24 of 1956. Regulation 28 of the Pension Funds Act prescribes the maximum limits in asset classes that an approved retirement fund may invest in. Exposures in excess of the limits will be corrected immediately, except where due to a change in the fair value or characteristic of an asset, e.g. market value fluctuations, in which case they will be corrected within a reasonable time period.

Performance

All performance data for a lump sum, net of fees, include income and assumes reinvestment of income on a NAV to NAV basis. Annualised performances show longer term performance rescaled over a 12 month period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Performance is calculated for the portfolio and individual investor performance may differ as a result thereof. The portfolio is valued at 15h00 daily. Cut-off time is determined by the platform. Income distributions are net of any applicable taxes. Actual annual figures are available to the investor on request. Prices are published daily and available on the website www.psg.co.za/asset- management and in the daily newspapers. Figures quoted are from Morningstar Inc.

Pricing

Forward pricing is used. Unit trust prices are calculated on a net asset value (NAV) basis, which is the market value of all assets in the Fund including income accruals less permissible deductions divided by the number of units in issue.

Redemptions

The ability of a portfolio to repurchase is dependent upon the liquidity of the securities and cash of the portfolio. To protect investors, a manager may suspend repurchases for a period, subject to regulatory approval, to await liquidity. A suspension ensures that the sale of a large number of units will not force PSG Collective Investments to sell the underlying investments at a price in the market which could have a negative impact on investors. PSG Collective Investments will keep all investors informed should a situation arise where such suspension is required.

Company details

PSG Collective Investments (RF) Limited is registered as a CIS Manager with the Financial Sector Conduct Authority, and a member of the Association of Savings and Investments South Africa (ASISA) through its holdings company PSG Konsult Limited. The management of the portfolio is delegated to PSG Asset Management (Pty) Ltd, an authorised Financial Services Provider under the Financial Advisory and Intermediary Services Act 2002, FSP no 29524. PSG Asset Management (Pty) Ltd and PSG Collective Investments (RF) Limited are subsidiaries of PSG Konsult Limited. PSG Collective Investments (RF) Limited can be contacted on +27(21) 799 8000; (toll free) 0800 600 168, via email assetmanagement@psg.co.za.

Conflict of interest disclosure

The Fund 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 reinvested in the Fund for the benefit of the investors. Neither PSG Collective Investments (RF) Limited nor PSG Asset Management (Pty) Ltd retains any portion of such discount for their own accounts. The fund manager may use the brokerage services of a related party, PSG Securities Ltd.

Trustee

The Standard Bank of South Africa Limited,
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Cnr Hertzog Boulevard,
Cape Town, 8001
Tel: +27 21 401 2443
Email: Compliance-PSG@standardbank.co.za

Additional information

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PSG Diversified Income Fund

Quarterly portfolio commentary as at 30 June 2020
by Lyle Sankar and John Gilchrist

Current context

The fixed income market has stabilised relative to the volatility of March and April 2020. We have written extensively about the reasons for the sell-off in yields during the outset of this crisis due to a fundamental deterioration in the economic backdrop, but also the significant impact of poor market liquidity. We had performed extensive reviews of all positions held in our funds at the time, with our assessment being that the selloff had been excessive relative to our views of the fundamental risks. As a result, our process allowed us to act with conviction into this sell-off, taking advantage of the attractive yields that were presented during this period and repositioning fund to the best risk-adjusted points on the curve. Significant shifts in monetary policy had a very positive impact on local fixed income market returns over the quarter as the South African Reserve Bank (SARB) increased liquidity in the banking system, enacted sharp cuts of 2.75% to the repo rate and provided support for the bond market through nominal bond buying at the periphery.

As a result of attractive starting valuations and a stabilisation of the bond market, the market recovered from the sell-off in nominal bond yields in the first quarter to deliver positive returns for the year to June 2020. Nominal bonds delivered a phenomenal 10% return (using the All Bond Index) during the second quarter. Interestingly, being positioned in the 3- to 12-year area of the curve delivered approximately 13% returns for investors for the quarter alone. From a real yield perspective, inflation printed at 3% for April 2020 and a 15-year low of 2.1% for the month of May 2020, implying significant real returns over the quarter. Inflation-linked bonds delivered a commendable 4.7% for the second quarter of the year, however, they still have some room to recover from the sell-off in March 2020. Corporate lending (credit) continues to be an area of the market impacted by low liquidity and seeing a gradual repricing (wider spreads and lower prices) to reflect the increased risk in markets. Cash has returned roughly 3.2% for the year to date and is expected to trend lower in the second half of the year as interest rate cuts filter through to returns.

Our perspective

In managing clients' capital, we apply a countercyclical approach (buy when others are selling and selling when optimism is excessive). We focus on areas where pessimism creates mispricing and high real yields. Through cycles, this helps to identify where the best risk-adjusted opportunities are available, and where clients will be best rewarded for the risks. In application, the approach allows us to use interest rate risk (duration) when interest rate cycles allow for attractive returns, but further, allows us to avoid areas where we believe risk is not being compensated sufficiently. The significant cuts to the repo rate during the short space of six months implies that fixed income assets tethered to the repo rate are likely to produce significantly lower returns in the period ahead. Cash is now likely to return below inflation over the coming year, and similarly, money market instruments (NCDs) are no longer presenting attractive real yields for new client capital. Corporate lending, typically offering a yield (spread) above 3-month Jibar, will equally generate significantly lower income yields. These spreads, being compensation for lending to corporates, have not adjusted higher despite the increased risks due to low liquidity and trading in the market. Conversely, nominal and inflation- linked sovereign bonds (higher duration assets) continue to offer very high real yields and compensation for the heightened visible fiscal constraints South Africa is facing. We believe, therefore, that it remains appropriate to favour duration assets in allocating to fixed income, as opposed to corporate credit where risk-adjusted returns are significantly lower. Consistent with being countercyclical, our exposure to credit remains at all-time lows.

Portfolio positioning

The fund continues to favour sovereign nominal bonds as one of the best risk-adjusted opportunities available. As such, our exposure to these bonds has gradually increased over the quarter as we bought into weakness. The fund used the volatility of March and April 2020 to reposition towards the 3- to 12-year area of the curve where we believed the curve was extremely steep, amidst the sharp cuts in the repo rate. This benefited the fund as this area of the curve produced compelling returns over the quarter. The fund continues to hold shorter dated inflation-linked bonds, with additional allocation to this area of the curve over the period. The near-term outlook for inflation remains low, however, the income from these instruments should improve as we see inflation base effects. The fund continues to maintain a holding in domestic and offshore equities, reflecting the higher conviction 3M ideas of our equity investment process where we are seeing very attractive valuations. Given the volatility that the market could present ahead, we maintain adequate liquidity and flexibility with low credit exposure in the fund.

Changes in portfolio positioning

Q1 2020		Q2 2020	
Domestic equity	3.6%	Domestic equity	3.3%
Domestic preference shares	0.0%	Domestic preference shares	0.0%
Domestic property	0.1%	Domestic property	0.1%
Domestic cash and NCDs	51.6%	Domestic cash and NCDs	43.0%
Domestic bonds	41.3%	Domestic bonds	50.3%
Foreign equity	1.6%	Foreign equity	1.1%
Foreign cash	1.4%	Foreign cash	1.7%
Foreign property	0.4%	Foreign property	0.5%

There may be slight differences in the totals due to rounding.

Number of units as at 30 June 2020 (Class A):	1 005 964 215
Price (net asset value per unit) as at 30 June 2020 (Class A):	R1.20
Number of units as at 30 June 2020 (Class E):	254 189 675
Price (net asset value per unit) as at 30 June 2020 (Class E):	R1.19

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Pricing
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Redemptions
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Yield
The yield for the portion attributable to fixed income instruments is calculated daily on an annualised basis and is based on the historic yield of the fixed income instruments. The fund returns include returns from property and equity instruments.

Company details
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PSG Income Fund

Quarterly portfolio commentary as at 30 June 2020

by Lyle Sankar and Duayne Le Roux

Current context

The fixed income market has stabilised relative to the volatility of March and April 2020. We have written extensively about the reasons for the sell-off in yields during the outset of this crisis due to a fundamental deterioration in the economic backdrop, but also the significant impact of poor market liquidity. We had performed extensive reviews of all positions held in our funds at the time, with our assessment being that the sell-off had been excessive relative to our views of the fundamental risks. As a result, our process allowed us to act with conviction into this sell-off, taking advantage of the attractive yields that were presented during this period and repositioning the fund to the best risk-adjusted points on the curve. Significant shifts in monetary policy had a very positive impact on local fixed income market returns over the quarter as the South African Reserve Bank (SARB) increased liquidity in the banking system, enacted sharp cuts of 2.75% to the repo rate and provided support for the bond market through nominal bond buying at the periphery.

As a result of attractive starting valuations and a stabilisation of the bond market, the market recovered from the sell-off in nominal bond yields in the first quarter to deliver positive returns for the year to June 2020. Nominal bonds delivered a phenomenal 10% return (using the All Bond Index) during the second quarter. Interestingly, being positioned in the 3- to 12-year area of the curve delivered approximately 13% returns for investors for the quarter alone. From a real yield perspective, inflation printed at 3% for April 2020 and a 15-year low of 2.1% for the month of May 2020, implying significant real returns over the quarter. Inflation-linked bonds delivered a commendable 4.7% for the second quarter of the year, however, they still have some room to recover from the sell-off in March 2020. Corporate lending (credit) continues to be an area of the market impacted by low liquidity and seeing a gradual repricing (wider spreads and lower prices) to reflect the increased risk in markets. Cash has returned roughly 3.2% for the year to date and is expected to trend lower in the second half of the year as interest rate cuts filter through to returns.

Our perspective

In managing clients' capital, we apply a countercyclical approach (buy when others are selling and selling when optimism is excessive). We focus on areas where pessimism creates mispricing and high real yields. Through cycles, this helps to identify where the best risk-adjusted opportunities are available, and where clients will be best rewarded for the risks. In application, the approach allows us to use interest rate risk (duration) when interest rate cycles allow for attractive returns, but further, allows us to avoid areas where we believe risk is not being compensated sufficiently.

The significant cuts to the repo rate during the short space of six months implies that fixed income assets tethered to the repo rate are likely to produce significantly lower returns in the period ahead. Cash is now likely to return below inflation over the coming year, and similarly, money market instruments (NCDs) are no longer presenting attractive real yields for new client capital. Corporate lending, typically offering a yield (spread) above 3-month Jibar, will equally generate significantly lower income yields. These spreads, being compensation for lending to corporates, have not adjusted higher despite the increased risks due to low liquidity and trading in the market. Conversely, nominal and inflation-linked sovereign bonds (higher duration assets) continue to offer very high real yields and compensation for the heightened visible fiscal constraints South Africa is facing. We believe, therefore, that it remains appropriate to favour duration assets in allocating to fixed income, as opposed to corporate credit where risk-adjusted returns are significantly lower. Consistent with being countercyclical, our exposure to credit remains at all-time lows.

In communication with clients on our fixed income views, we have emphasized, for some time, the importance of critically understanding the underlying positioning of your allocations to income funds and fixed income assets. Income funds typically generate returns in a fairly predictable range above cash rates through cycles, but the risks taken on to achieve these returns can differ widely. Our approach to managing fixed income assets has always been to offer a risk-adjusted income return, limiting the potential for permanent capital loss. The impact of COVID-19 has highlighted the importance of this, as evidenced by divergence in performance across funds in the market. Further, critically analysing the current market opportunity set indicates that this type of divergence can continue.

Portfolio positioning

The fund has performed very well during and after the difficult periods of March and April – much of which we attribute to our investment approach of targeting real yields and buying with a margin of safety. We also believe navigating early out of credit has been beneficial to the fund in both increasing the risk-adjusted return prospects and ensuring the fund is flexible and liquid. We continue to hold a significant allocation to sovereign nominal bonds in the attractive 7- to 12-year area of the curve. We are also building exposure to very short dated inflation-linked bonds with very attractive real yields with protection against any inflation. We are pleased with the performance of our fixed income allocations, and believe despite the lower rate environment, the fund can deliver attractive returns above money market rates, without taking significantly higher risk.

Changes in portfolio positioning

	Q1 2020	Q2 2020
Domestic bonds	26.4%	43.2%
Domestic cash and NCDs	73.6%	56.8%

There may be slight differences in the totals due to rounding.

Number of units as at 30 June 2020 (Class A):	26 031 840
Price (net asset value per unit) as at 30 June 2020 (Class A):	R1.05
Number of units as at 30 June 2020 (Class E):	335 423 909
Price (net asset value per unit) as at 30 June 2020 (Class E):	R1.05

All data as per Bloomberg as at 30 June 2020

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Yield

The yield is calculated daily on an annualised basis. The calculation is based on the historic yield of fixed income instruments.

Performance

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Pricing

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Redemptions

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PSG Money Market Fund

Quarterly portfolio commentary as at 30 June 2020

by Lyle Sankar and Duayne le Roux

Current context

The fixed income market has stabilised relative to the volatility of March and April 2020. We have written extensively about the reasons for the sell-off in yields during the outset of this crisis due to a fundamental deterioration in the economic backdrop, but also the significant impact of poor market liquidity. We had performed extensive reviews of all positions held in our funds at the time, with our assessment being that the sell-off had been excessive relative to our views of the fundamental risks. As a result, our process allowed us to act with conviction into this sell-off, taking advantage of the attractive yields that were presented during this period and repositioning the fund to the best risk-adjusted points on the curve. Significant shifts in monetary policy had a very positive impact on local fixed income market returns over the quarter as the South Africa Reserve Bank (SARB) increased liquidity in the banking system, enacted sharp cuts of 2.75% to the repo rate and provided support for the bond market through nominal bond buying at the periphery.

As a result of attractive starting valuations and a stabilisation of the bond market, the market recovered from the sell-off in nominal bond yields in the first quarter to deliver positive returns for the year to June 2020. Nominal bonds delivered a phenomenal 10% return (using the All Bond Index) during the second quarter. Interestingly, being positioned in the 3- to 12-year area of the curve delivered approximately 13% returns for investors for the quarter alone. From a real yield perspective, inflation printed at 3% for April 2020 and a 15-year low of 2.1% for the month of May 2020, implying significant real returns over the quarter. Inflation linked bonds delivered a commendable 4.7% for the second quarter of the year, however, still have some room to recover from the sell-off in March 2020. Corporate lending (credit) continues to be an area of the market impacted by low liquidity and seeing gradual repricing (wider spreads and lower prices) to reflect the increased risk in markets. Cash has returned roughly 3.2% for the year to date and is expected to trend lower in the second half of the year as interest rate cuts filter through to returns.

Our perspective

Our approach to managing the fund continues to focus on risk-adjusted yields, limiting the potential for permanent capital loss and, importantly, maintaining high levels of liquidity in the fund. Our allocation in the fund continues to focus on a healthy diversified exposure to fixed- and floating-rate bank NCDs, with relatively high liquidity and attractive real yields in line with our views of lower inflation. Our holdings in corporate credit are at long-term lows in the fund and we are exercising patience with regards to this market, applying a high bar for allocating client capital.

The significant cuts to the repo rate during the short space of six months implies that fixed income assets tethered to the repo rate are likely to produce significantly lower returns in the period ahead. Cash is now likely to offer returns below inflation over the coming year, and similarly, money market instruments (NCDs) are no longer presenting the attractive real yields we have seen in recent years. Corporate lending, typically offering a yield (spread) above 3-month Jibar, will equally generate significantly lower income yields. These spreads, being compensation for lending to corporates, have not adjusted higher despite the increased risks due to low liquidity and trading in the market, justifying a low allocation to these instruments. While we believe inflation will remain anchored over the coming year, we are cognisant that the environment is fluid and the fund needs to avoid buying fixed-rate instruments where the margin of safety is not adequate, should rates reverse direction and trend higher again.

Portfolio positioning

The fund continues to hold a diversified book of bank NCDs earning yields above the cash rates offered by the banks, as well as above the near-term expected inflation rate. We are however allocating to shorter-dated instruments as money market curves are currently not rewarding investors for buying at the longer end. We are slowly allocating more cash to treasury bills, which offer lower credit risk but higher yields than the prevailing bank money market curves. We continue to emphasize that the role of this fund is to ensure clients earn an appropriate yield and maintain high capital preservation − but importantly during this period − maintain high liquidity. As such, we hold a higher cash allocation than in a normal cycle. We expect that the fall in rates will gradually translate into lower income distributions for clients. Importantly, we are comfortable that the risk of default is low.

Changes in portfolio positioning

Q1 2020		Q2 2020	
Linked NCDs/ Floating-rate notes	18.9%	Linked NCDs/Floating-rate notes	17.7%
Step rate notes	22.0%	Step rate notes	12.3%
NCDs	23.7%	NCDs	54.1%
Treasury bills	10.8%	Treasury bills	7.9%
Call deposits	16.3%	Call deposits	7.7%
Corporate bonds	8.3%	Corporate bonds	0.3%

There may be slight differences in the totals due to rounding.

Number of units as at 30 June 2020 (Class A):	821 533 912
Price (net asset value per unit) as at 30 June 2020 (Class A):	R1.00
Number of units as at 30 June 2020 (Class F):	379 735 337
Price (net asset value per unit) as at 30 June 2020 (Class F):	R1.00

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Money Market
The PSG Money Market Fund maintains a constant price and is targeted at a constant value. The quoted yield is calculated by annualizing the average 7 day yield. A money market portfolio is not a bank deposit account. Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and in such circumstances a process of ring-fencing of withdrawal instructions and managed payouts over time may be followed. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument. In most cases the return will merely have the effect of increasing or decreasing the daily yield but in the case of abnormal losses it can have the effect of reducing the capital value of the portfolio.

Regulation 28
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Conflict of Interest Disclosure
The fund manager may use the brokerage services of a related party, PSG Securities Ltd.

Trustees
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Additional information
Additional information is available free of charge on the website www.psg.co.za/asset-management and may include publications, brochures, forms and annual reports.

by Greg Hopkins, Philipp Wörz and Justin Floor

Current context

Global stock markets staged a remarkable recovery in the second quarter. The MSCI World Index and the S&P 500 Index both posted moderate year-to-date declines as at 30 June, returning -5.5% and -3.1% respectively, after gaining 19.5% and 20.5% during the second quarter.

After a disappointing first quarter, the PSG Global Equity Fund returned 20.9% during the quarter ending 30 June 2020.

The extent of the market's recovery has surprised many, as these are volatile and unpredictable times and the path to economic recovery is uncertain. However, governments and central banks have countered the sharp economic contraction with an unprecedented willingness to act boldly and swiftly to provide stimulus and liquidity which have supported the prices of financial assets.

Our perspective

The index recovery in 2020 only tells part of the story. Indices, like the Nasdaq, that are heavily exposed to technology shares have materially outperformed: the Nasdaq Composite Index has risen by 13% in 2020. The strong performance by tech counters can partly be explained by the acceleration of digitisation and e-commerce trends in a lockdown and work-from-home world. However, it can also be attributed to the support that very low global bond yields provide to secular growth stock valuations. The relative weighting of tech stocks on the S&P have been very supportive of index returns, as we are witnessing a surge in the popularity of tech stocks that rivals what we saw during the dotcom era. Indeed, the securities that dominate most global portfolios today (US large caps, tech, growth and quality) also outperformed in 2020, repeating the outcome of the previous few years. We are observing extraordinary crowding into past winners and an abdication of strategies and investments that have not worked: cheap stocks, value funds, emerging markets and contrarian investment strategies. This reflects a high-conviction bet that the next few years will mirror the past few years. We view this outcome as unlikely given the extreme discrepancies in starting valuations and the likelihood that growth will return to unloved parts of the market once the recovery gets underway. A stimulatory environment, like the one that the COVID-19 pandemic has induced, has also typically been kind to cyclical industries, commodities and emerging markets and less favourable for bonds and 'bond proxy' stocks like consumer staples and tech. There is a material complacency as far as expensive stocks are concerned.

At the same time, investors have been capitulating out of cheap under-performers where risk is perceived to be high. This fear is being most acutely felt in the cyclical sectors most impacted by COVID-19 and in many emerging markets that are still experiencing an acceleration of COVID-19 infections and that don't have the same capacity for stimulus as developed countries to counter the effects of the lockdown. We would argue that many securities are discounting long-term outcomes that are overly pessimistic. We view this as very fertile ground for long-term contrarian investors and have used the COVID-19 panic to increase exposure to excellent businesses that were out-of-favour at incredibly attractive prices. Long-term returns look compelling.

Portfolio positioning

The fund's largest holdings can be classified as good examples of our 3M process: stocks of superior inherent quality trading at wide margins of safety. Such opportunities arise when fear abounds and this challenging and uncertain macro environment has seen investors fleeing areas of perceived risk.

Many of the fund's largest holdings have on average outperformed the market over long time periods while generating materially higher than average returns on equity, yet they are significantly cheaper than the rest of the market.

The fund has diversified exposure across sectors and geographies, albeit having limited exposure to technology shares, as our bottom-up work identified few mispriced securities in this area.

New positions introduced in the quarter included Philip Morris International, Compass Group, Berkshire Hathaway and Exor N.V, all acquired at attractive prices.

The investment environment has been difficult for valuation-disciplined investors like us over the past two years. We, however, hold strong conviction that the fund's holdings are deeply undervalued, offering strong embedded returns going forward.

Changes in portfolio positioning

Q1 2020		Q2 2020	
Equities	98.1%	Equities	98.4%
Cash	1.9%	Cash	1.6%

Q1 2020		Q2 2020	
US	36.0%	US	37.1%
Europe	15.5%	Europe	16.7%
UK	21.9%	UK	23.3%
Asia ex Japan	0.0%	Asia ex Japan	0.0%
Japan	17.0%	Japan	12.9%
Canada	4.4%	Canada	4.7%
Africa	3.3%	Africa	3.7%
Cash	1.9%	Cash	1.6%

There may be slight differences in the totals due to rounding.

Please note that the above commentary and portfolio positioning is for the US dollar-denominated PSG Global Equity Sub-Fund. The PSG Global Equity Feeder Fund is 100% invested in the underlying US dollar fund. However, there may be small short-term valuation, trading and translation differences between the two funds.

Number of units as at 30 June 2020 (Class A):	5 455 285
Price (net asset value per unit) as at 30 June 2020 (Class A):	R2.22
Number of units as at 30 June 2020 (Class E):	33 126 886
Price (net asset value per unit) as at 30 June 2020 (Class E):	R2.29

All data as per Bloomberg as at 30 June 2020.

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Feeder Funds

A Feeder Fund is a portfolio which, apart from assets in liquid form, invests in a single portfolio of a collective investment scheme, which levies its own charges and which could result in a higher fee structure for the feeder fund.

Performance

All performance data for a lump sum, net of fees, include income and assumes reinvestment of income on a NAV to NAV basis. Annualised performances show longer term performance rescaled over a 12 month period. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Performance is calculated for the portfolio and individual investor performance may differ as a result thereof. The portfolio is valued at 15h00 daily. Cut-off time is determined by the platform. Income distributions are net of any applicable taxes. Actual annual figures are available to the investor on request. Prices are published daily and available on the website www.psg.co.za/asset- management and in the daily newspapers. Figures quoted are from Morningstar Inc.

Pricing

Forward pricing is used. Unit trust prices are calculated on a net asset value (NAV) basis, which is the market value of all assets in the Fund including income accruals less permissible deductions divided by the number of units in issue.

Redemptions

The ability of a portfolio to repurchase is dependent upon the liquidity of the securities and cash of the portfolio. To protect investors, a manager may suspend repurchases for a period, subject to regulatory approval, to await liquidity. A suspension ensures that the sale of a large number of units will not force PSG Collective Investments to sell the underlying investments at a price in the market which could have a negative impact on investors. PSG Collective Investments will keep all investors informed should a situation arise where such suspension is required.

Company details

PSG Collective Investments (RF) Limited is registered as a CIS Manager with the Financial Sector Conduct Authority, and a member of the Association of Savings and Investments South Africa (ASISA) through its holdings company PSG Konsult Limited. The management of the portfolio is delegated to PSG Asset Management (Pty) Ltd, an authorised Financial Services Provider under the Financial Advisory and Intermediary Services Act 2002, FSP no 29524. PSG Asset Management (Pty) Ltd and PSG Collective Investments (RF) Limited are subsidiaries of PSG Konsult Limited. PSG Collective Investments (RF) Limited can be contacted on +27(21) 799 8000; (toll free) 0800 600 168, via email assetmanagement@psg.co.za.

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The Fund 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 reinvested in the Fund for the benefit of the investors. Neither PSG Collective Investments (RF) Limited nor PSG Asset Management (Pty) Ltd retains any portion of such discount for their own accounts. The fund manager may use the brokerage services of a related party, PSG Securities Ltd.

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After a disappointing first quarter, the PSG Global Flexible Fund returned 18.5% during the quarter ending 30 June 2020.

The extent of the market's recovery has surprised many, as these are volatile and unpredictable times and the path to economic recovery is uncertain. However, governments and central banks have countered the sharp economic contraction with an unprecedented willingness to act boldly and swiftly to provide stimulus and liquidity which have supported the prices of financial assets.

Our perspective

The index recovery in 2020 only tells part of the story. Indices, like the Nasdaq, that are heavily exposed to technology shares have materially outperformed: the Nasdaq Composite Index has risen by 13% in 2020. The strong performance by tech counters can partly be explained by the acceleration of digitisation and e-commerce trends in a lockdown and work-from-home world. However, it can also be attributed to the support that very low global bond yields provide to secular growth stock valuations. The relative weighting of tech stocks on the S&P have been very supportive of index returns, as we are witnessing a surge in the popularity of tech stocks that rivals what we saw during the dotcom era. Indeed, the securities that dominate most global portfolios today (US large caps, tech, growth and quality) also outperformed in 2020, repeating the outcome of the previous few years. We are observing extraordinary crowding into past winners and an abdication of strategies and investments that have not worked: cheap stocks, value funds, emerging markets and contrarian investment strategies. This reflects a high-conviction bet that the next few years will mirror the past few years. We view this outcome as unlikely given the extreme discrepancies in starting valuations and the likelihood that growth will return to unloved parts of the market once the recovery gets underway. A stimulatory environment, like the one that the COVID-19 pandemic has induced, has also typically been kind to cyclical industries, commodities and emerging markets and less favourable for bonds and 'bond proxy' stocks like consumer staples and tech. There is a material complacency as far as expensive stocks are concerned.

At the same time, investors have been capitulating out of cheap under-performers where risk is perceived to be high. This fear is being most acutely felt in the cyclical sectors most impacted by COVID-19 and in many emerging markets that are still experiencing an acceleration of COVID-19 infections and that don't have the same capacity for stimulus as developed countries to counter the effects of the lockdown. We would argue that many securities are discounting long-term outcomes that are overly pessimistic. We view this as very fertile ground for long-term contrarian investors and have used the COVID-19 panic to increase exposure to excellent businesses that were out-of-favour at incredibly attractive prices. Long-term returns look compelling.

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Many of the fund's largest holdings have on average outperformed the market over long time periods while generating materially higher than average returns on equity, yet they are significantly cheaper than the rest of the market.

The fund has diversified exposure across sectors and geographies, albeit having limited exposure to technology shares, as our bottom-up work identified few mispriced securities in this area.

New positions introduced in the quarter included Philip Morris International, Compass Group, Berkshire Hathaway and Exor N.V, all acquired at attractive prices.

Cash and bonds at 18.3% at the end of June should provide valuable firepower to be used in the event of further market disruption, or if we see opportunity to provide capital to good businesses at attractive prices in the months ahead.

The investment environment has been difficult for valuation-disciplined investors like us over the past two years. We, however, hold strong conviction that the fund's holdings are deeply undervalued, offering strong embedded returns going forward.

Changes in portfolio positioning

Q1 2020		Q2 2020	
Equities	81.1%	Equities	81.7%
Bonds	0.9%	Bonds	0.9%
Cash	18.0%	Cash	17.4%

Q1 2020		Q2 2020	
US	28.9%	US	29.8%
Europe	12.5%	Europe	13.8%
UK	18.5%	UK	19.7%
Asia ex Japan	0.0%	Asia ex Japan	0.0%
Japan	15.2%	Japan	12.2%
Canada	3.8%	Canada	3.8%
Africa	2.2%	Africa	2.4%
Cash and Bonds	18.9%	Cash and Bonds	18.3%

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Number of units as at 30 June 2020 (Class A): 21 934 502
Price (net asset value per unit) as at 30 June 2020 (Class A): R1.92
Number of units as at 30 June 2020 (Class B): 160 984 301
Price (net asset value per unit) as at 30 June 2020 (Class B): R1.99

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