

Current context

The positive momentum equity markets enjoyed during the second quarter of the year was sustained during the third quarter. Global equities reached all-time highs during the period, ending a bear market that had, at one point, reduced the value of publicly traded companies by more than a third. This continues to be a remarkable outcome considering the deepest global recession in decades and the ongoing elevated levels of economic uncertainty in the wake of the COVID-19 pandemic. Locally, the JSE/FTSE All Share Index closely mirrors this feat by being merely a couple of percentage points shy of a positive year-to-date performance and inches away from all-time highs.

Growth and technology companies are large components of global indices and have overwhelmingly driven the strong headline recovery. However, the gains have not been evenly distributed and most global shares are still in negative territory.

Our perspective

It goes without saying that these are unprecedented times, but even more acutely so for value investors, as growth and large cap stocks continue to outperform to a remarkable degree. History suggests that over long periods of time, investors are rewarded for investing in cheaper assets, rather than expensive ones. This is especially true where there is a degree of discomfort, i.e. when investing in out-of-favour assets with above average chances of being mispriced. We are witnessing one of the most brutal value cycles on record, with the extent of the divergence in relative performance compared to growth stocks being by far the widest this century, surpassing the experience of the Great Depression and the dotcom bubble. However, we believe this creates a very interesting opportunity for the (very few) investors who are prepared to invest in what is out of favour. The current environment is presenting an abundance of such investment opportunities – a setup which we believe will generate excellent long-term returns for investors.

Considering the high expectations reflected in aggressively crowded areas of the market, as in the case of the largest constituents, we believe there has never been a more valuable juncture for a differentiated, active approach to add a tremendous benefit to client portfolios looking forward. Our sense is that there is a high degree of complacency at the index level that little can go wrong, and that past performance can be replicated with a high degree of certainty. We are not complacent in our approach, and recognise the risks of simply projecting a past experience as a given future outcome.

As tough as the environment has been, we think current market conditions are highly favourable for building well-diversified portfolios, and as such we are excited about prospects embedded in our portfolios.

Portfolio performance and positioning

Cheap stocks, particularly in emerging markets like South Africa, have under-performed significantly over the last two years. The Covid-19 pandemic exacerbated this situation, shattering an already weak domestic economy and low levels of confidence. Consequently, the fund's recent performance has been disappointing. While the future remains very uncertain, we have used market dislocations and very low prices to the benefit of our clients. This provides us with confidence that the recent drawdowns will prove to be temporary. Encouragingly, most of our actions from March onwards have delivered pleasing results to date. We have high levels of confidence that the companies our clients are invested in trade at a material discount to our assessment of worth. Our highest conviction ideas are quality businesses with inherent resilience and cash generation that support our expectation that 2020 will set a foundation for strong growth in the years ahead. Shareholder returns are underpinned by very attractive prospective 2021 shareholder payouts (dividend yields and share buybacks) for several of our larger positions: it is reasonable to expect a scramble for companies yielding 7% to -15% in a world of 3.5% domestic and 0% global interest rates. A combination of high payout yields that grow over time and a reversion in ratings to more normalised levels could result in extremely attractive investment returns for investors that can look through the current bout of elevated uncertainty and lack of confidence.

Over the quarter the PSG Equity Fund returned 5.26% versus the benchmark return of 0.67%. The contributors over this period were industrials (1.62%), foreign equities (1.40%) and resources (1.40%). The fund is suitable for investors with an investment term of 7 years and longer. Over the short-term returns can be volatile and for this reason it is important to measure fund returns over the relevant investment term. Since inception the fund has produced an annual return of 13.5% versus the benchmark return of 12.4%.

Changes in portfolio positioning

Q2 2020		Q3 2020	
Domestic equity	70.4%	Domestic equity	72.2%
Domestic cash	0.1%	Domestic cash	0.1%
Foreign equity	26.0%	Foreign equity	24.0%
Foreign property	3.4%	Foreign property	3.6%
Foreign cash	0.1%	Foreign cash	0.1%

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

Number of units as at 30 September 2020 (Class A):	41 200 873
Price (net asset value per unit) as at 30 September 2020 (Class A):	R8.21
Number of units as at 30 September 2020 (Class E):	85 629 122
Price (net asset value per unit) as at 30 September 2020 (Class E):	R8.23

All data as per Bloomberg as at 30 September 2020

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Performance

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Pricing

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Redemptions

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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

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Trustees

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

Additional information

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Current context

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Growth and technology companies are large components of global indices and have overwhelmingly driven the strong headline recovery. However, the gains have not been evenly distributed and most global shares are still in negative territory.

Our perspective

It goes without saying that these are unprecedented times, but even more acutely so for value investors, as growth and large cap stocks continue to outperform to a remarkable degree. History suggests that over long periods of time, investors are rewarded for investing in cheaper assets, rather than expensive ones. This is especially true where there is a degree of discomfort, i.e. when investing in out-of-favour assets with above average chances of being mispriced. We are witnessing one of the most brutal value cycles on record, with the extent of the divergence in relative performance compared to growth stocks being by far the widest this century, surpassing the experience of the Great Depression and the dotcom bubble. However, we believe this creates a very interesting opportunity for the (very few) investors who are prepared to invest in what is out of favour. The current environment is presenting an abundance of such investment opportunities – a setup which we believe will generate excellent long-term returns for investors.

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As tough as the environment has been, we think current market conditions are highly favourable for building well-diversified portfolios, and as such we are excited about prospects embedded in our portfolios.

Portfolio performance and positioning

Cheap stocks, particularly in emerging markets like South Africa, have under-performed significantly over the last two years. The Covid-19 pandemic exacerbated this situation, increasing pressure on an already weak domestic economy and further lowering confidence levels. Consequently, the fund's recent performance has been disappointing. While the future remains very uncertain, we have used market dislocations and very low prices to the benefit of our clients. This provides us with confidence that the recent drawdowns will prove to be temporary. Encouragingly, most of our actions from March onwards have delivered pleasing results to date. We have high levels of confidence that the companies our clients are invested in trade at a material discount to our assessment of worth. Our highest conviction ideas are quality businesses with inherent resilience and cash generation that support our expectation that 2020 will set a foundation for strong growth in the years ahead. Shareholder returns are underpinned by very attractive prospective 2021 shareholder payouts (dividend yields and share buybacks) for several of our larger positions: it is reasonable to expect a scramble for companies yielding 7% to 15% in a world of 3.5% domestic and 0% global interest rates. A combination of high payout yields that grow over time and a reversion in ratings to more normalised levels could result in extremely attractive investment returns for investors that can look through the current bout of elevated uncertainty and lack of confidence.

Over the quarter the PSG Flexible Fund returned 4.61% versus the benchmark return of 3.40%. The contributors over this period were industrials (1.65%), foreign equities (1.17%) and financials (0.86%). The fund is suitable for investors with an investment term of 5 years and longer. Over the short-term returns can be volatile and for this reason it is important to measure fund returns over the relevant investment term. Since inception, the fund has produced an annual return of 12% versus benchmark return of 11.6%. The fund currently holds low levels of cash compared to the historical experience. This reflects the attractiveness of the opportunity set: we can find many good businesses on the JSE and abroad that are out-of-favour and hence trading at deep crisis levels. We sold out of domestic bonds in favour of domestic equities during the quarter. This was a result of more clarity around the emergence from severe lockdown and the favourable conditions for investing in domestic counters.

Changes in portfolio positioning

Q2 2020		Q3 2020	
Domestic equity	59.5%	Domestic equity	65.9%
Domestic cash	4.3%	Domestic cash	3.7%
Domestic gold	0.0%	Domestic gold	0.0%
Domestic bonds	3.8%	Domestic bonds	0.0%
Foreign equity	27.8%	Foreign equity	26.5%
Foreign property	3.8%	Foreign property	3.6%
Foreign cash	0.8%	Foreign cash	0.3%

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

Number of units as at 30 September 2020 (Class A):	589 600 848
Price (net asset value per unit) as at 30 September 2020 (Class A):	R4.07
Number of units as at 30 September 2020 (Class E):	995 603 429
Price (net asset value per unit) as at 30 September 2020 (Class E):	R4.07

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Performance

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Pricing

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Redemptions

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Current context

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Growth and technology companies are large components of global indices and have overwhelmingly driven the strong headline recovery. However, the gains have not been evenly distributed and most global shares are still in negative territory.

Our perspective

It goes without saying that these are unprecedented times, but even more acutely so for value investors, as growth and large cap stocks continue to outperform to a remarkable degree. History suggests that over long periods of time, investors are rewarded for investing in cheaper assets, rather than expensive ones. This is especially true where there is a degree of discomfort, i.e. when investing in out-of-favour assets with above average chances of being mispriced. We are witnessing one of the most brutal value cycles on record, with the extent of the divergence in relative performance compared to growth stocks being by far the widest this century, surpassing the experience of the Great Depression and the dotcom bubble. However, we believe this creates a very interesting opportunity for the (very few) investors who are prepared to invest in what is out of favour. The current environment is presenting an abundance of such investment opportunities – a setup which we believe will generate excellent long-term returns for investors.

Considering the high expectations reflected in aggressively crowded areas of the market, as in the case of the largest constituents, we believe there has never been a more valuable juncture for a differentiated, active approach to add a tremendous benefit to client portfolios looking forward. Our sense is that there is a high degree of complacency at the index level that little can go wrong, and that past performance can be replicated with a high degree of certainty. We are not complacent in our approach, and recognise the risks of simply projecting a past experience as a given future outcome. As tough as the environment has been, we think current market conditions are highly favourable for building well-diversified portfolios, and as such we are excited about prospects embedded in our portfolios.

Portfolio performance and positioning

Over the quarter the PSG Balanced Fund returned 3.48% versus the benchmark return of 3.17%. The contributors over this period were industrials (1.82%), financials (0.81%) and resources (0.81%) while real estate detracted (-0.19%) from overall performance. The fund is suitable for investors with an investment term of 5 years and longer. Over the short-term returns can be volatile and for this reason it is important to measure fund returns over the relevant investment term. Since inception the fund has produced an annual return of 11.6% compared to a benchmark return of 10.4%.

Total equity exposure increased from 72.8% to 73.1%, largely due to market movement. We increased exposure to local shares such as Remgro, Imperial and Glencore at attractive prices. Property exposure of 4.7% is mostly attributable to a promising selection of US REITS, while we have started to selectively build a small position in South African REITS.

Domestic bond exposure reduced slightly to 19.8%. We retain an exposure to government fixed and inflation-linked bonds at very attractive yields.

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

The fund continues to seek to exploit the opportunity in selective JSE-listed equities where we think visible macro fears and investor apathy (particularly on the part of foreigners) is resulting in extreme mispricings. We are seeing many cases of prices not adequately capturing inherent qualities and defensive characteristics.

Changes in portfolio positioning

Q2 2020		Q3 2020	
Domestic equity	49.2%	Domestic equity	51.6%
Domestic property	0.5%	Domestic property	0.3%
Domestic cash and NCDs	1.5%	Domestic cash and NCDs	1.8%
Domestic bonds	20.8%	Domestic bonds	19.8%
Foreign equity	23.6%	Foreign equity	21.5%
Foreign cash	0.1%	Foreign cash	0.6%
Foreign property	4.3%	Foreign property	4.4%

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

Number of units as at 30 September 2020 (Class A):	59 651 618
Price (net asset value per unit) as at 30 September 2020 (Class A):	R54.83
Number of units as at 30 September 2020 (Class E):	63 536 127
Price (net asset value per unit) as at 30 September 2020 (Class E):	R54.82

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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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Considering the high expectations reflected in aggressively crowded areas of the market, as in the case of the largest constituents, we believe there has never been a more valuable juncture for a differentiated, active approach to add a tremendous benefit to client portfolios looking forward. Our sense is that there is a high degree of complacency at the index level that little can go wrong, and that past performance can be replicated with a high degree of certainty. We are not complacent in our approach, and recognise the risks of simply projecting a past experience as a given future outcome. As tough as the environment has been, we think current market conditions are highly favourable for building well-diversified portfolios, and as such we are excited about prospects embedded in our portfolios.

Portfolio performance and positioning

The PSG Stable Fund has diversified exposure across offshore equity and property (16%), SA shares (including shares with rand-hedge characteristics, 26%), domestic bonds (50%), and cash and negotiable certificates of deposit (8%). Domestic bonds comprise sovereign nominal bonds (16%), sovereign inflation-linked bonds (20%), fixed-rate bonds (including government guaranteed, 6%), and floating-rate bonds (6%). The fund is positioned more offensively than has been the case historically which reflects the attractiveness of the opportunity set across most asset classes – unprecedented considering the breadth and degree. Although cash exposure has declined over the quarter, we have favoured shorter-dated inflation-linked bonds which we believe offer considerably better yields at relatively low levels of risk. Domestic equity exposure has also increased slightly and we continue to balance the attractive opportunities evident in domestic assets with overall portfolio risk. Aggregate liquidity in the fund remains healthy. Cash and liquid short-dated government bonds provide ample firepower which can be used in the event of further market disruption, or if we see opportunities to deploy further into assets trading at wide margins of safety compared to their inherent quality.

Over the quarter the PSG Stable Fund returned 2.15% versus the benchmark return of 2.71%. The contributors over this period were industrials (0.88%), government bonds (0.54%), financials (0.30%) and the detractors were real estate (-0.09%). The fund is suitable for investors with an investment term of 3 years and longer. Since inception, the fund has produced annualised returns of 6.5% versus benchmark return of 8.1% per annum.

The fund's recent performance has been disappointing and this has caused some discomfort for clients. Cheap assets, particularly in South Africa, have underperformed significantly over the last two years. The Covid-19 pandemic exacerbated this situation, increasing pressure on an already weak domestic economy and further lowering confidence levels. While the future remains very uncertain, we have used market dislocations and very low prices to the benefit of our clients. This provides us with confidence that the recent drawdowns will prove to be temporary. Encouragingly, most of our actions from March onwards have delivered pleasing results to date. We have high levels of confidence that the assets our clients are invested in, trade at a material discount to our assessment of their worth.

Changes in portfolio positioning

Q2 2020		Q3 2020	
Domestic equity	23.4%	Domestic equity	25.9%
Domestic property	0.2%	Domestic property	0.4%
Domestic cash and NCDs	11.9%	Domestic cash and NCDs	8.3%
Domestic bonds	48.5%	Domestic bonds	49.5%
Foreign equity	13.6%	Foreign equity	13.3%
Foreign cash	0.1%	Foreign cash	0.3%
Foreign property	2.3%	Foreign property	2.3%

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

Number of units as at 30 September 2020 (Class A):	43 237 565
Price (net asset value per unit) as at 30 September 2020 (Class A):	R1.23
Number of units as at 30 September 2020 (Class E):	369 468 046
Price (net asset value per unit) as at 30 September 2020 (Class E):	R1.23

All data as per Bloomberg as at 30 September 2020

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Regulation 28

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Performance

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Pricing

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Redemptions

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Company details

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Trustee

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Email: Compliance-PSG@standardbank.co.za

Additional information

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Current context

Fixed income market performance for the third quarter of 2020 was mixed following a very strong performance in the second quarter. This was largely due to global sentiment weakening over the period. Locally, the market was divided on the likely outcome of the interest rate decision before the Monetary Policy Committee (MPC) meeting on 18 September. In a close vote, the South African Reserve Bank (SARB) decided to maintain the repo rate unchanged at the current 3.5%, leaving markets roughly unchanged. Inflation printed at a low of 3.1% for the month of August 2020, largely in line with expectations which continue to plot a muted path for future inflation. The market is awaiting the revised budget (now expected on 28 October 2020) and the promised economic recovery plan by the President (the final version is expected mid-October) to assess whether the necessary reforms and adjustments will be made to ensure South Africa can return to a sustainable fiscal trajectory over the medium term. The narrative understandably remains fairly negative, as evidenced by the cheap valuations (high yields) we are seeing in the sovereign bond market. Importantly, the flow of liquidity we have seen introduced into the market during the year continues to provide relative yield stability, which has generally resulted in positive returns for fixed income investors over the quarter.

Nominal bonds delivered positive, cash-beating returns over the quarter. The area of the curve represented by the R186 (5 years) delivered an attractive 4.19% return. However, longer-dated nominal bonds underperformed this as the curve steepened over the period. Similarly, inflation-linked bonds delivered good performance, other than very long-dated bonds. These long-dated sovereign bonds were largely influenced by the poor global backdrop, with foreigners estimated to have sold roughly R7.7bn of bonds over the period. Cash delivered 1.16% returns for the quarter which was to be expected as rate cuts during the year begin to show in the cash market. Despite no further rate cuts, this low level of returns from cash is expected to continue, with a high likelihood of underperforming inflation and income targets. Despite the poorer fundamental backdrop, corporate bond markets saw significant tightening in spreads over the period as the excess liquidity in the market and the search for a cash-beating yields saw very high demand for these assets. As we have mentioned in previous communications, we believe this area of the market is benefiting from a search for yield and a low bar being placed on its inherent credit risk relative to that of the sovereign market. However, on a positive note, we have seen numerous corporate bond issuers returning to the market to raise funding, which is generally good for the functioning of the fixed income market. Local listed property fell further over the period by roughly 14% as uncertainty in this sector remains high.

Our perspective

The fixed income market remains characterised by diverging risk-adjusted return prospects when assessing the asset classes available to fixed income funds. We continue to believe that given the very visible bear thesis on sovereign bonds, the cheap valuations likely reflect this sentiment and therefore offer much better prospects to outperform cash and inflation over the near term. As noted, yields in non-sovereign bonds have fallen further over the period. We define risk as the risk of permanent capital loss to clients, and therefore remain cautious in areas where we believe the yields are not commensurate with the inherent risks – specifically in corporate bonds. Our funds continue to have a long-term low allocation to these assets.

We have taken advantage of the attractive inflation base effects that are due in the months ahead as inflation had reached a near-term bottom in the second quarter. Specifically, for the month of October 2020, the inflation-carry to be accrued is 1.3% (roughly an annualised 15.6% return). We have done so using the low duration R212 inflation-linked sovereign bond which has a term to maturity of 1.4 years and low credit risk. While we do not believe inflation is likely to increase sharply from these levels anytime soon, this should benefit clients significantly as we see inflation moderate to more normalised levels.

We have been attracted to the local preference share market over the period. Certain higher-quality corporates and bank preference shares have fallen roughly 25% this year and are trading at deep discounts to par value, offering yields in a range of 8.5% to 11.5%. Specifically, bank preference shares are offering yields above those of subordinated debt (bonds with similar characteristics issued by the banks) despite having better legal protections in a stress event. We are therefore looking to build a position in these assets, rather than buying into the optimism we are seeing in the corporate bond market and subordinated debt market.

Portfolio performance and positioning

Over the quarter the PSG Diversified Income Fund returned 2.40% versus the benchmark return of 2.25%. The contributors over this period were government bonds (0.85%), corporate bonds (0.39%) and local money market instruments (0.28%), while preference shares detracted slightly. Over a 1-year period the fund delivered a return of 5.91% versus the benchmark return of 4.09%, despite the tough market environment.

It remains our preference to seek out value in sovereign bonds rather than other over-bought areas of the fixed income market, as we believe doing so better positions us to achieve the fund objective at reasonable risk levels. Our buy lists continue to favour sovereign exposure as a means of increasing the odds of achieving client objectives. Due to the unique dynamic of the inflation-linked bond market, we have significantly increased our exposure in an area of the curve (1.4 years) which should outperform even long-dated bonds over the near term. Further, these bonds are very liquid and provide us with both protection against unforeseen inflation increases, as well as ammunition should we see nominal bonds weaken around the budget.

The Diversified Income Fund has built up a position in preference shares and has a diversified holding in local and offshore equity which we believe are currently not being valued appropriately by the market, and thus offers potential to the upside should sentiment turn. We have used opportunities to marginally increase our weighting to offshore cash over the period in order to create more balance against unforeseen events. We remain cautious in allocating to local listed property as the range of outcomes remain wide.

Q2 2020		Q3 2020	
Domestic equity	3.3%	Domestic equity	3.9%
Domestic preference shares	0.0%	Domestic preference shares	1.6%
Domestic property	0.1%	Domestic property	0.1%
Domestic cash and NCDs	43.0%	Domestic cash and NCDs	10.0%
Domestic bonds	50.3%	Domestic bonds	79.8%
Foreign equity	1.1%	Foreign equity	1.4%
Foreign cash	1.7%	Foreign cash	2.7%
Foreign property	0.5%	Foreign property	0.5%

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

Number of units as at 30 September 2020 (Class A):	1 053 169 231
Price (net asset value per unit) as at 30 September 2020 (Class A):	R1.21
Number of units as at 30 September 2020 (Class E):	253 642 703
Price (net asset value per unit) as at 30 September 2020 (Class E):	R1.20

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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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Current context

Fixed income market performance for the third quarter of 2020 was mixed following a very strong performance in the second quarter. This was largely due to global sentiment weakening over the period. Locally, the market was divided on the likely outcome of the interest rate decision before the Monetary Policy Committee (MPC) meeting on 18 September. In a close vote, the South African Reserve Bank (SARB) decided to maintain the repo rate unchanged at the current 3.5%, leaving markets roughly unchanged. Inflation printed at a low of 3.1% for the month of August 2020, largely in line with expectations which continue to plot a muted path for future inflation. The market is awaiting the revised budget (now expected 28 October 2020) and promised economic recovery plan by the President (the final version is expected mid-October) to assess whether the necessary reforms and adjustments will be made to ensure South Africa can return to a sustainable fiscal trajectory over the medium term. The narrative understandably remains fairly negative, as evidenced by the cheap valuations (high yields) we are seeing in the sovereign bond market. Importantly, the flow of liquidity we have seen introduced into the market during the year continues to provide relative yield stability, which has generally resulted in positive returns for fixed income investors over the quarter.

Nominal bonds delivered positive, cash-beating returns over the quarter. The area of the curve represented by the R186 (5 years) delivered an attractive 4.19% return. However, longer-dated nominal bonds underperformed this as the curve steepened over the period. Similarly, inflation-linked bonds delivered good performance, other than very long-dated bonds. These long-dated sovereign bonds were largely influenced by the poor global backdrop, with foreigners estimated to have sold roughly R7.7bn of bonds over the period. Cash delivered 1.16% returns for the quarter which was to be expected as rate cuts during the year begin to show in the cash market. Despite no further rate cuts, this low level of returns from cash is expected to continue, with a high likelihood of underperforming inflation and income targets. Corporate bond markets, despite the poorer fundamental backdrop, saw significant tightening in spreads over the period as the excess liquidity in the market and search for a cash-beating yields saw very high demand for these assets. As we have mentioned in previous communications, we believe this area of the market is benefiting from a search for yield and a low bar being placed on its inherent credit risk relative to the sovereign market. However, on a positive note, we have seen numerous corporate bond issuers returning to the market to raise funding, which is generally good for the functioning of the fixed income market.

Our perspective

The fixed income market remains characterised by diverging risk-adjusted return prospects when assessing the asset classes available to fixed income funds. We continue to believe that given the very visible bear thesis on sovereign bonds, the cheap valuations likely reflect this sentiment and therefore offer much better prospects to outperform cash and inflation over the near term. As noted, yields in non-sovereign bonds have fallen further over the period. We define risk as the risk of permanent capital loss to clients, and therefore remain cautious in areas where we believe the yields are not commensurate with the inherent risks – specifically in corporate bonds. Our funds continue to have a low long-term allocation to these assets.

We have taken advantage of the attractive inflation base effects that are due in the months ahead as inflation had reached a near-term bottom in Q2. Specifically, for the month of October 2020, the inflation-carry to be accrued is 1.3% (roughly an annualised 15.6% return). We have done so using the low duration R212 inflation-linked sovereign bond which has a term to maturity of 1.4 years and low credit risk. While we do not believe inflation is likely to increase sharply from these levels anytime soon, this should benefit clients significantly as we see inflation moderate to more normalised levels.

Portfolio performance and positioning

Over the quarter the PSG Income Fund returned 1.86% versus the benchmark return of 1.16%. The major contributor over this period was government bonds (1.03%), being positioned in the short end of the curve. Over a 1-year period the fund delivered a return of 9.73% versus the benchmark return of 6.19%.

It remains our preference to seek out value in sovereign bonds rather than other over-bought areas of the fixed income market, as we believe doing so better positions us to achieve the fund objective at reasonable risk levels. Our buy lists continue to favour sovereign exposure as a means of increasing the odds of achieving client objectives. Due to the unique dynamic of the inflation-linked bond market, we have significantly increased our exposure in an area of the curve (1.4 years) which should outperform even long-dated bonds over the near term. Further, these bonds are very liquid and provide us with both protection against unforeseen inflation increases, as well as ammunition should we see nominal bonds weaken around the budget.

The Income Fund has slightly increased its duration as a result. Importantly, the duration composition of the fund remains concentrated in the shorter-dated areas of the curve with the average term of nominal bond and inflation-linked bond exposure of roughly 5.5 years and 1.5 years respectively. We believe this is a sensible use of duration at a point in the rates cycle where duration risk is preferred over credit risk.

Changes in portfolio positioning

	Q2 2020	Q3 2020
Domestic bonds	43.2%	72.2%
Domestic cash and NCDs	56.8%	27.8%

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

Number of units as at 30 September 2020 (Class A):	195 064 265
Price (net asset value per unit) as at 30 September 2020 (Class A):	R1.06
Number of units as at 30 September 2020 (Class E):	700 609 227
Price (net asset value per unit) as at 30 September 2020 (Class E):	R1.06

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Yield

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Performance

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Nominal bonds delivered positive, cash-beating returns over the quarter. The area of the curve represented by the R186 (5 years) delivered an attractive 4.19% return. However, longer-dated nominal bonds underperformed this as the curve steepened over the period. Similarly, inflation-linked bonds delivered good performance, other than very long-dated bonds. These long-dated sovereign bonds were largely influenced by the poor global backdrop, with foreigners estimated to have sold roughly R7.7bn of bonds over the period. Cash delivered 1.16% returns for the quarter which was to be expected as rate cuts during the year begin to show in the cash market. Despite no further rate cuts, this low level of returns from cash is expected to continue, with a high likelihood of underperforming inflation and income targets. Corporate bond markets, despite the poorer fundamental backdrop, saw significant tightening in spreads over the period as the excess liquidity in the market and search for a cash-beating yields saw very high demand for these assets. As we have mentioned in previous communications, we believe this area of the market is benefiting from a search for yield and a low bar being placed on its inherent credit risk relative to the sovereign market. However, on a positive note, we have seen numerous corporate bond issuers returning to the market to raise funding, which is generally good for the functioning of the fixed income market.

Our perspective

In an environment where cash rates are near all time lows given significant rate cuts by the SARB, the PSG Money Market Fund continues to prioritise a high-level liquidity and capital preservation. Cash curves currently offer little to no compensation for taking on term risk, as a result the fund is allocating to shorter-dated instruments and holding higher levels of cash. Specifically, the fund is building a book of shorter-dated treasury bills, (current yields on offer are higher than yields on the bank funding curves), while maintaining lower credit risk. As the low rate environment continues to persist, we expect the fund's yield to increasingly reflect this, however, the fund should outperform cash accounts over the near term.

Portfolio performance and positioning

Over the quarter the PSG Money Market Fund returned 1.00% versus the benchmark return of 1.14%. The fund is suitable for investors who need an interim investment vehicle or 'parking bay' for surplus money and a short-term investment horizon.

The fund's exposure to bank NCDs has declined from the previous quarter. This is due to the fund's book of NCDs gradually maturing and being deployed into buying Treasury bills and SARB Debentures. The Treasury bills are of a short maturity, offering an adequate level of liquidity as well as a yield pickup to the bank NCD curve. The debentures also offer an added yield to the bank NCD curve and are bought with a very short term to maturity. With the higher Treasury bill and SARB Debenture exposure relative to historic corporate and bank exposure, the fund's overall credit risk is significantly reduced compared to the previous quarter.

Changes in portfolio positioning

Q2 2020		Q3 2020	
Linked NCDs/ Floating-rate notes	17.7%	Linked NCDs/Floating-rate notes	18.0%
Step rate notes	12.3%	Step rate notes	12.5%
NCDs	54.1%	NCDs	28.0%
Treasury bills	7.9%	Treasury bills	21.0%
Call deposits	7.7%	Call deposits	9.8%
Corporate bonds	0.3%	Corporate bonds	0.0%
Debenture	0.0%	Debenture	10.7%

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

Number of units as at 30 September 2020 (Class A):	753 981 273
Price (net asset value per unit) as at 30 September 2020 (Class A):	R1.00
Number of units as at 30 September 2020 (Class F):	396 831 653
Price (net asset value per unit) as at 30 September 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.

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Company details

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Conflict of Interest Disclosure

The fund manager may use the brokerage services of a related party, PSG Securities Ltd.

Trustees

The Standard Bank of South Africa Limited,
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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.

Current context

The positive momentum equity markets enjoyed during the second quarter of the year was sustained during the quarter ending 30 September. Global equities reached all-time highs in early September, ending a bear market that had, at one point, reduced the value of publicly traded companies by more than a third. This continues to be a remarkable outcome considering the deepest global recession in decades and the ongoing elevated levels of economic uncertainty in the wake of the COVID-19 pandemic.

Growth and technology companies are large components of global indices and have overwhelmingly driven the strong headline recovery. However, the gains have not been evenly distributed and most global shares are still in negative territory. Year to date the MSCI World Index delivered a total return of 2.1%, with the MSCI World Growth index +19.2% and the MSCI World Value Index losing 14%.

Our perspective

It goes without saying that these are unprecedented times, but even more acutely so for value investors, as growth and large cap stocks continue to outperform to a remarkable degree. History suggests that over long periods of time, investors are rewarded for investing in cheaper assets, rather than expensive ones. This is especially true where there is a degree of discomfort, i.e. when investing in out-of-favour assets with above average chances of being mispriced. We are witnessing one of the most brutal value cycles on record, with the extent of the divergence in relative performance compared to growth stocks being by far the widest this century, surpassing the experience of the Great Depression and the dotcom bubble. However, we believe this creates a very interesting opportunity for the (very few) investors who are prepared to invest in what is out of favour. The current environment is presenting an abundance of such investment opportunities – a setup which we believe will generate excellent long-term returns for investors.

Considering the high expectations reflected in aggressively crowded areas of the market, as in the case of the largest constituents, we believe there has never been a more valuable juncture for a differentiated, active approach to add a tremendous benefit to client portfolios looking forward. Our sense is that there is a high degree of complacency at the index level that little can go wrong, and that past performance can be replicated with a high degree of certainty. We are not complacent in our approach, and recognise the risks of simply projecting a past experience as a given future outcome.

As tough as the environment has been, we think current market conditions are highly favourable for building well-diversified portfolios, and as such we are excited about prospects embedded in our portfolios.

Portfolio performance and positioning

Cheap stocks have under-performed significantly over the last two years with the Covid-19 pandemic exacerbating this situation and accelerating several multi-year trends. Consequently, the fund's recent performance has been disappointing. While the future remains uncertain, we have used market dislocations and very low prices to the benefit of our clients. This provides us with confidence that the recent drawdowns will prove to be temporary. Encouragingly, most of our actions from March onwards have delivered pleasing results to date. We have high levels of confidence that the companies our clients are invested in trade at a material discount to our assessment of their worth. Our highest conviction ideas are quality businesses with inherent resilience and cash generation that support our expectation that 2020 will set a foundation for strong growth in the years ahead.

During the quarter the fund materially increased its exposure to select counters at favourable prices while reducing its holdings in areas where strong share price performance resulted in a lower margin of safety.

Material purchases during the quarter were Berkshire Hathaway, Asahi Group, Exor NV, Nordstrom and Amadeus IT Group. Strong share price performances and narrower margins of safety resulted in a reduction in holdings such as Brookfield Asset Management, Wheaton Precious Metals, Pandora A/S and, after a roughly 400% rally off the March lows, a complete exit of London-listed Premier Foods.

The PSG Global Equity Sub-Fund has diversified exposure across sectors, currencies and geographies. The largest regional exposures are the United States (accounting for 39.8% of fund value), followed by the United Kingdom (20%), Europe (18.2%) and Japan (13.7%).

Over the quarter the PSG Global Equity Feeder Fund returned 0.95% versus the benchmark return of 3.61%. The contributors over this period were industrials (2.16%), financials (1.64%) and consumer staples (1.08%) and the detractors were communications (-0.32%) and energy (-0.73%). The fund is suitable for investors with an investment term of 5 years and longer. Over the short-term returns can be volatile and for this reason it is important to measure fund returns over the relevant investment term. Since inception the fund produced an annual return of 8.97% versus the benchmark return of 19.15%.

Changes in portfolio positioning

Q2 2020		Q3 2020	
Equities	98.4%	Equities	98.7%
Cash	1.6%	Cash	1.3%

Q2 2020		Q3 2020	
US	37.1%	US	39.8%
Europe	16.7%	Europe	18.2%
UK	23.3%	UK	20.0%
Asia ex Japan	0.0%	Asia ex Japan	0.4%
Japan	12.9%	Japan	13.7%
Canada	4.7%	Canada	3.0%
Africa	3.7%	Africa	3.6%
Cash	1.6%	Cash	1.3%

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 September 2020 (Class A):	5 259 313
Price (net asset value per unit) as at 30 September 2020 (Class A):	R2.25
Number of units as at 30 September 2020 (Class E):	29 217 392
Price (net asset value per unit) as at 30 September 2020 (Class E):	R2.31

All data as per Bloomberg as at 30 September 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

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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,
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Tel: +27 21 401 2443
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Current context

The positive momentum equity markets enjoyed during the second quarter of the year was sustained during the quarter ending 30 September. Global equities reached all-time highs in early September, ending a bear market that had, at one point, reduced the value of publicly traded companies by more than a third. This continues to be a remarkable outcome considering the deepest global recession in decades and the ongoing elevated levels of economic uncertainty in the wake of the COVID-19 pandemic.

Growth and technology companies are large components of global indices and have overwhelmingly driven the strong headline recovery. However, the gains have not been evenly distributed and most global shares are still in negative territory. Year to date the MSCI World Index delivered a total return of 2.1%, with the MSCI World Growth index +19.2% and the MSCI World Value Index losing 14%.

Our perspective

It goes without saying that these are unprecedented times, but even more acutely so for value investors, as growth and large cap stocks continue to outperform to a remarkable degree. History suggests that over long periods of time, investors are rewarded for investing in cheaper assets, rather than expensive ones. This is especially true where there is a degree of discomfort, i.e. when investing in out-of-favour assets with above average chances of being mispriced. We are witnessing one of the most brutal value cycles on record, with the extent of the divergence in relative performance compared to growth stocks being by far the widest this century, surpassing the experience of the Great Depression and the dotcom bubble. However, we believe this creates a very interesting opportunity for the (very few) investors who are prepared to invest in what is out of favour. The current environment is presenting an abundance of such investment opportunities – a setup which we believe will generate excellent long-term returns for investors.

Considering the high expectations reflected in aggressively crowded areas of the market, as in the case of the largest constituents, we believe there has never been a more valuable juncture for a differentiated, active approach to add a tremendous benefit to client portfolios looking forward. Our sense is that there is a high degree of complacency at the index level that little can go wrong, and that past performance can be replicated with a high degree of certainty. We are not complacent in our approach, and recognise the risks of simply projecting a past experience as a given future outcome.

As tough as the environment has been, we think current market conditions are highly favourable for building well-diversified portfolios, and as such we are excited about prospects embedded in our portfolios.

Portfolio performance and positioning

Cheap stocks have under-performed significantly over the last two years with the Covid-19 pandemic exacerbating this situation and accelerating several multi-year trends. Consequently, the fund's recent performance has been disappointing. While the future remains uncertain, we have used market dislocations and very low prices to the benefit of our clients. This provides us with confidence that the recent drawdowns will prove to be temporary. Encouragingly, most of our actions from March onwards have delivered pleasing results to date. We have high levels of confidence that the companies our clients are invested in trade at a material discount to our assessment of their worth. Our highest conviction ideas are quality businesses with inherent resilience and cash generation that support our expectation that 2020 will set a foundation for strong growth in the years ahead.

During the quarter the fund materially increased its exposure to select counters at favourable prices while reducing its holdings in areas where strong share price performance resulted in a lower margin of safety.

Material purchases during the quarter were Berkshire Hathaway, Asahi Group, Exor NV, Nordstrom and Amadeus IT Group. Strong share price performances and narrower margins of safety resulted in a reduction of holdings such as Brookfield Asset Management, Wheaton Precious Metals, Pandora A/S and after a roughly 400% rally off the March lows, a complete exit of London-listed Premier Foods.

The PSG Global Flexible Sub-Fund has diversified exposure across sectors, currencies and geographies. The largest regional exposures are the United States (accounting for 33.9% of fund value), followed by the United Kingdom (16.8%), Europe (15.8%) and Japan (13.2%). The fund holds below-average levels of cash from a historical perspective. While parts of the market are trading at elevated levels, it reflects the attractiveness of the opportunity set: we can find many good businesses that are out-of-favour and hence trading at deep crisis price levels. The current cash and bond holding of 14.5% of portfolio value still provides valuable firepower as opportunities that meet our criteria for investment become available.

Over the quarter the PSG Global Flexible Feeder Fund returned 1.4% versus the benchmark return of -1.3 %. The contributors over this period were industrials (1.95%), financials (1.33%), consumer staples (1.00%) and the detractors were communication (-0.29%) and energy (-0.48%). The fund is suitable for investors with an investment term of 5 years and longer. Over the short-term returns can be volatile and for this reason it is important to measure fund returns against the relevant investment term. Since inception the fund produced an annual return of 9.4% versus the benchmark return of 17.0%.

Changes in portfolio positioning

Q2 2020		Q3 2020	
Equities	81.7%	Equities	85.5%
Bonds	0.9%	Bonds	0.9%
Cash	17.4%	Cash	13.6%

Q2 2020		Q3 2020	
US	29.8%	US	33.9%
Europe	13.8%	Europe	15.8%
UK	19.7%	UK	16.8%
Asia ex Japan	0.0%	Asia ex Japan	0.4%
Japan	12.2%	Japan	13.2%
Canada	3.8%	Canada	2.7%
Africa	2.4%	Africa	2.7%
Cash and Bonds	18.3%	Cash and Bonds	14.5%

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Number of units as at 30 September 2020 (Class A):	19 086 991
Price (net asset value per unit) as at 30 September 2020 (Class A):	R1.95
Number of units as at 30 September 2020 (Class B):	140 920 879
Price (net asset value per unit) as at 30 September 2020 (Class B):	R2.02

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