# Benguela South Africa Equity Commentary


Review of Q3 2020

**Portfolio:** Benguela Equity 27four Fund

**Benchmark:** FTSE/JSE Capped SWIX



## Portfolio Performance Review

For the quarter, the fund returned -1.4% (net of fees) vs the benchmark (FTSE/JSE Capped SWIX) return of 1.0%. Over 12 months, the fund returned -6.5% vs the benchmark's -5.0%.

During the 3rd quarter of 2020, the rand gained 4.2% against the US dollar and the SARB reduced interest rates by another 25bps given weak consumer sentiment and benign inflation prints. The expectation is that rates will remain at these levels for the next 12 months. Government's spending in response to the pandemic, as well as renewed commitment to SAA in the form of a restructure, has put further pressure on the fiscus. This trend has exacerbated concerns surrounding the level of government debt to GDP and its trajectory. We are not convinced by the recovery plan put forward by government to address this problem, more specifically with the actual execution of the plan. Unemployment has also been exacerbated by the lockdown, seeing over 2.2 million jobs lost over the period. Recovery efforts will depend on finding growth. Growth will depend on improving confidence, which in turn will support employment and consumption, however confidence will only return to the South African economy if policy uncertainty is removed and if there is a drive to support small business growth.

In terms of economic growth, the IMF now projects South Africa's economy to shrink by -8.0% this year, while the South African Reserve Bank recently revised their prior -7.0% expected contraction down to -8.2%.

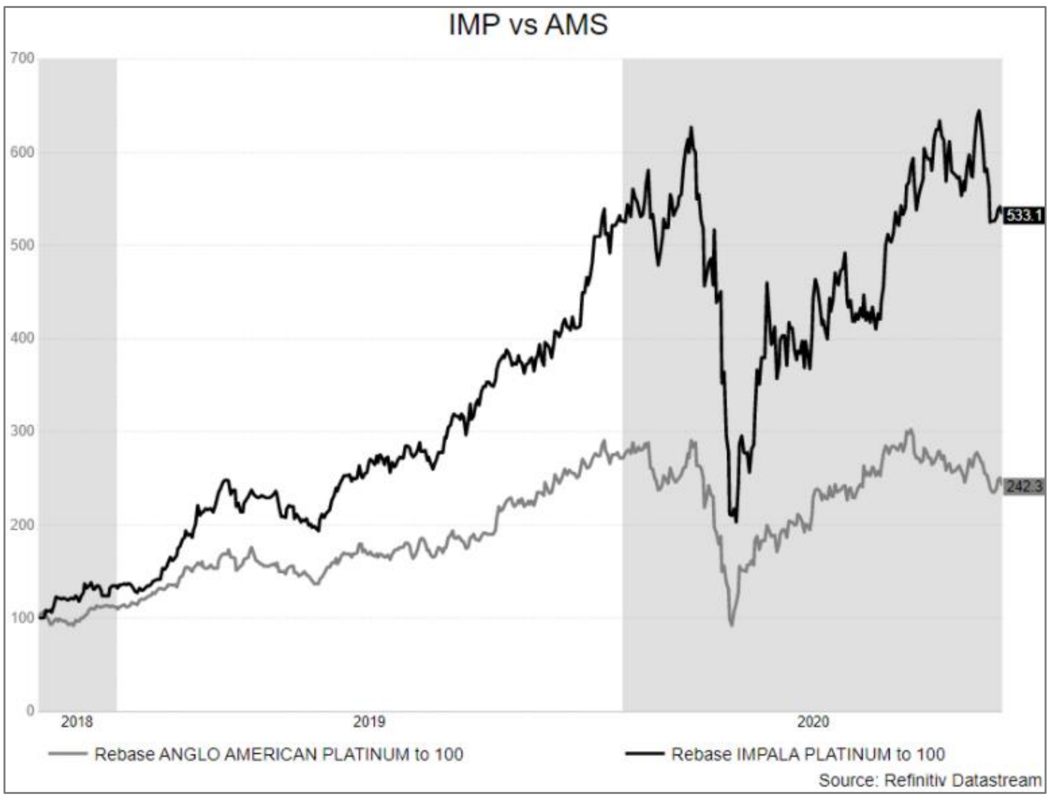
Besides a post lockdown "recovery", we generally don't see South African based industrials and financials offering much growth over the medium term and remain cautiously positioned in only the best quality SA based companies.

The fund's performance continues to be impacted by the underweight positioning in the Materials sector, specifically the Precious Metals sector (gold and PGM's). Within the Materials sector, the fund has sizeable positions in diversified international miners – BHP Billiton and Anglo American – whilst within the PGM sector the fund has, for a long time, held a large position in Anglo American Platinum, one of the lowest cost producers in the world. Low cost of production is a key competitive advantage for mining companies. These positions have certainly aided the performance of the fund over the longer term. However, as commodity prices have rallied, even the good performance of the AMS, AGL and BHP share prices have been outdone in recent months by some of the higher cost commodity producers.

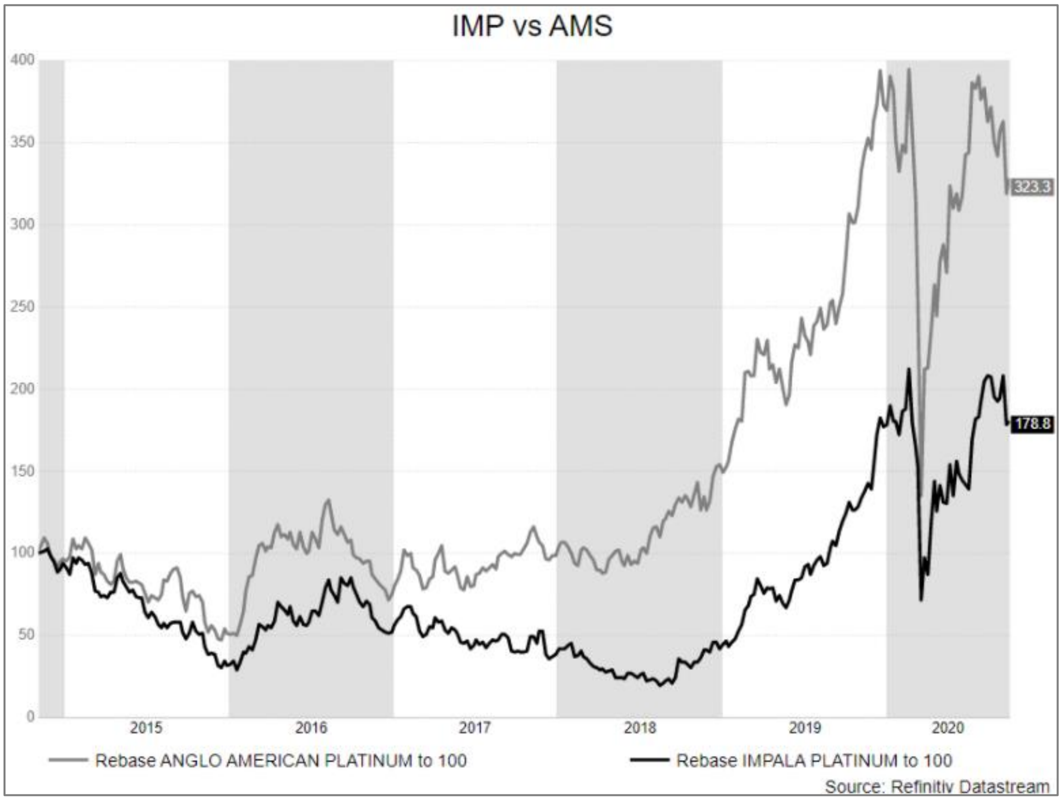
As the PGM basket price increased in recent years, the higher cost producers experienced an amplified improvement in profits due to the operating leverage and hence, a more dramatic improvement in share price.

Impala Platinum has certainly performed better over a shorter period (2 years), and as a result, is one of the major detractors of performance. However, despite this impressive short-term performance, Amplats has performed significantly better over the longer term (6 years).

Over 2 years, Impala Platinum has performed very well on the back of the increasing PGM basket price:




Over the longer term, Amplats has been more dependable:




Another aspect not often appreciated is Amplats' ability to grow organically by expanding Mogalakwena as opposed to having to look for expensive deals to buy rivals or invest in high cost deep level mines. This ability to grow its low-cost production organically reduces its risk of poor capital allocation in the future – an especially important long-term reason to hold Amplats over its peers.



Top contributors and detractors for the quarter were as follows:

| Top Contributors | Q3 Active Weight | Top Detractors | Q3 Active Weight |
|---|---|---|---|
| Aspen | U/W | Goldfields | U/W |
| NEPI Rockcastle | U/W | Impala Platinum | U/W |
| Mondi | O/W | Northam | U/W |
| Redefine | U/W | Naspers | O/W |
| Massmart | O/W | British American Tobacco | O/W |

## Outlook and Positioning

With little activity, our top active bets remained largely the same as last quarter (Prosus, BTI, Mr Price and Amplats). We remain underweight the Materials sector primarily a result of our gold sector underweight which is driven by our quality concerns for the sector. The South African economy remains under pressure, with limited levers available for stimulus given the constrained budget. Our view remains that the cheapest form of stimulus is confidence. There are a number of areas where government can remove policy uncertainty, which will go a long way to instil confidence. The portfolio remains underweight Real Estate, however our team is actively looking for opportunities within this sector.

| Issue Name | Portfolio Weight | Benchmark Weight | Weight Difference |
|---|---|---|---|
| | | | |
| Consumer Staples | 18.93% | 13.06% | 5.88% |
| Consumer Discretionary | 25.88% | 21.06% | 4.81% |
| Cash & Equivalents | 1.64% | | 1.64% |
| Health Care | 3.62% | 2.84% | 0.78% |
| Industrials | 3.24% | 2.81% | 0.43% |
| Utilities | | 0.08% | -0.08% |
| Information Technology | | 0.15% | -0.15% |
| Energy | | 0.78% | -0.78% |
| Financials | 19.62% | 21.37% | -1.82% |
| Communication Services | 3.77% | 5.59% | -1.82% |
| Real Estate | 1.80% | 4.31% | -2.52% |
| Materials | 21.51% | 27.97% | -6.46% |

Whilst Q3 performance was disappointing due to the continued detraction of the gold sector, we are confident that over the longer term, higher quality will prevail. Just as we have shown in the Amplats vs Implats example, there may be short-term underperformance during times where lower quality rallies, however over the long term, the focus on high quality has proven to be dependable.

The last quarter of 2020 will be a volatile quarter, with the highly charged US elections in November, and a second wave of Covid-19 infections in Europe. We, however, remain committed to managing the fund with a large focus on managing risk.



Kind regards,

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