

Counterpoint SCI Cautious Fund

Quarter ending 31 December 2021

This Fund is suitable for a conservative investor seeking long term capital growth with limited exposure to higher risk assets and downside volatility. The Fund is Regulation 28 compliant and has a maximum effective equity exposure limit of 40%. The recommended investment horizon is seven years or more.

Performance Table

Annualised Performance	Fund	Benchmark
3 Months	5.5%	5.0%
1 Year	11.6%	13.4%
3 Years	7.1%	9.0%
5 Years	6.3%	8.4%
Since Inception (January 2012)	7.1%	8.7%

Fund Details

Benchmark	ASISA Category Average
ASISA Category	South African Multi Asset Low Equity
Portfolio Managers	Andrew Dowse Raymond Shapiro

Performance Review

Global markets marched higher during the last quarter of 2021. The MSCI All Country World Index rose 6.7%, taking the annual return for 2021 to 18.5% in US dollars. Strong gains in select technology stocks like Apple, Microsoft and Nvidia and Tesla in the consumer discretionary sector did the heavy lifting, but gains were also seen across the market in other sectors like healthcare where Pfizer and Unitedhealth Group rose sharply. Although a small sector contributing to the overall market in the United States, real estate also saw strong gains of around 17.6% during the 4th quarter. However, it was not simply a smooth ride up. Strong gains in October and the first half of November unravelled somewhat towards the end of November on news of a new variant of Covid-19, named Omicron by the World Health Organisation, having been identified in South Africa. Furthermore, persistently high inflation numbers in developed markets were wearing down central bank governors who had up until then dismissed inflationary pressures as temporary and transitive. The release of the Federal Reserve Committee's minutes on 24 November revealed that members of the Committee were growing increasingly anxious and resolved to taper monetary stimulus and raise interest rates earlier than had been guided in prior minutes and announcements from the Committee. Nevertheless, the market shrugged off these concerns somewhat in December as a late Christmas rally ensued at the end of the year.

Energy markets in Europe continued to be impacted by supply constraints with natural gas prices remaining elevated, albeit moderately lower off the extreme highs as supply bottlenecks ease. Oil held previous quarter gains and base metals drifted sideways to slightly lower. The shock to energy supplies as northern hemisphere countries head into their winter, has prompted a re-think about how aggressively "green" energy alternatives can displace traditional hydrocarbon energy base supply. Coal and oil have proved a point through this crisis, but that does not take away from the fact that the climate crisis needs to be addressed in a hurry.

The rand depreciated a further 5.8% against the US dollar during the quarter, following the 5.5% decline in the prior quarter, as South Africa was labelled as the origin of the Omicron variant outbreak. The United Kingdom and a host of other countries wasted no time in banning travel to or from South Africa. In time, it was shown that the origin could be traced to countries in Europe, but it was first detected in South Africa. Furthermore, South African scientists led the world in

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Top 10 Holdings (%)

Counterpoint Global Equity Fund	20.2
RSA Govt Bond R2030	11.4
RSA Govt Bond R186	8.8
Liberty Bond	4.0
FirstRand Bond	3.4
RSA Govt Bond R202	2.8
Absa	2.4
Development Bank Bond	2.4
Accelerate Property Fund FRN	2.3
Nedbank Bond	2.3
Total	60.2

Asset Allocation (%)

SA Fixed Income	45.2
Global Equity	21.0
SA Equity	15.7
SA Cash	9.2
SA Preference Share	3.9
SA Property	2.6
Global Property	2.0
Global Cash	0.4
Total	100.0

understanding that although infections of Omicron were more aggressive than other variants, it was less dangerous, and the number of hospital admissions are notably lower than during previous waves of other variants. During December many of the countries that placed travel bans on SA removed these bans after the SA government employing them to not exacerbate the economic impacts of lockdowns and travel bans. The Reserve Bank raised the benchmark repo interest rate in November by 25 basis points, bringing the prime interest rate up to 7.25% and commencing a tightening cycle. Concerns of rising inflation globally, driven by higher commodity prices and supply disruptions, is prompting most central banks to change to a hawkish tone. Developing economies have been quick to get ahead of the curve by hiking earlier. Higher interest rates are being priced in by the market at a faster pace as this rhetoric grows.

On the JSE, basic materials, consumer discretionary and the telecommunications sectors performed well, driven by rising commodity prices and good earnings updates from Richemont and MTN. Richemont, which rose 55.1% during the quarter, is riding a wave of stimulus that has landed in the hands of global travellers. In fact, their discretionary spend has been boosted even further by travel bans leaving more cash in their wallets while they sit at home. Online retail channels established by luxury retailers in recent years has helped them to still reach their customers, meeting their addiction for self-gratification during a depressing global pandemic (the lipstick effect). MTN (+20.7%) continued to show encouraging results in their major markets of Nigeria and Ghana and was granted a fintech banking licence in Nigeria, supporting its growing fintech investment portfolio. Resources broadly enjoyed strong returns with gold stocks rising around 40%, the larger platinum producers rising between 30% and 40%, and the diversified miners rising between 15% and 25%. Sasol was a laggard and fell 10% during the quarter, underperforming the rand equivalent price of oil. Sasol updated the market in mid-December on their Secunda operations and guided for lower volumes to supply constraints on feedstock. They are hoping to increase the use of coal to try and meet targets as far as possible. The Fund does not own Sasol, but rather owns oil exposure through the global integrated oil producer Exxon Mobil.

The Fund rose 5.5% in the fourth quarter, slightly ahead of the benchmark peer group which rose 5.0%. On a stock level, the main positive contributors for the Fund were PSG Konsult, driving strong results in the financials sector; and Anglo American PLC, BHP Group PLC, Glencore PLC, AngloGold Ashanti and Gold Fields riding the strong resources rally to add some more alpha for the Fund. The abandoned talks between Mondelez and AVI Limited and the surprise capex requirement for an IT SAP implementation announced in Spar's results detracted from the Fund's performance during the quarter. On a relative basis, underweight allocations to platinum mining stocks, as well as Richemont and MTN, all detracted as these counters rose strongly offsetting most of the gains made elsewhere.

The offshore allocation tracked the MSCI World Index despite global technology stocks having produced another stellar quarter. Big names like Apple, Microsoft, Nvidia and Tesla all added strongly to the benchmark. The Counterpoint Global Equity Fund countered this with great returns from Freeport McMoran, Brookfield Asset Management, Berkshire Hathaway and Nestle. In rand terms, the offshore allocation grew 15% which contributed materially to the Fund's overall return.

The fixed income allocation slightly underperformed (+2.3% vs 3.2%) due to corporate paper lagging a long-duration rally in government bonds. However, the preference share allocation boosted returns to more than offset this, contributing nearly 0.4% to the Fund's return on the back of news of buy-backs by Nedbank and Investec Bank (INLP). Stock selection in real estate performed well with the Fund's sector allocation rising 23.4% versus the benchmark's sector rising just 8.3%. Spear REIT was a standout performer (+29.1%) after good results released in December, while Stor-Age also performed well, rising 9.9%.

Portfolio Actions

Strong performances in mining stocks, tobacco, and the food producer AVI Limited during speculation of an acquisition by Mondelez gave the Fund an opportunity to harvest some of the profits by trimming these holdings. Later in the quarter, the talks between AVI Limited and Mondelez dissolved, and the share price subsequently declined. These cash proceeds from

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the sales were used to acquire positions in Avalonbay Communities, Public Storage, Healthcare Realty (all global real estate), Exxon Mobil, (direct global equity), Absa, Standard Bank FirstRand and Investec preference shares. The Fund also reduced its exposure to the R2030 bond with the view to deploy this cash in longer dated bonds when the appropriate opportunities present themselves.

Portfolio Strategy

The Fund's objective is to outperform the average fund in the same category (South Africa – Multi Asset – Low Equity) over a full market cycle (trough to trough or peak to peak).

The Fund seeks to achieve its objective by applying asset allocation and stock selection views to the current context across domestic and global markets. For the most part, the Fund is unlikely to deviate significantly from prevailing trends. Occasionally, if faced with extreme market conditions, the judgment of the portfolio manager could result in positioning that deviates significantly from that of the average fund.

Current market conditions remain extreme by a number of measures. We observe signs of irrationality in market prices relative to their intrinsic valuations and a worrying disparity between relative asset class relationships. Easy monetary and fiscal conditions continue to provide a false sense of security and we remain concerned about a variety of tail risks that could lead to a market shock in stocks that exhibit extreme valuations. For this reason, we hold a combination of reasonably priced assets that can provide participation in the liquidity driven rally of equity markets, together with sufficient assets that provide protection if a catalyst causes reason to reprice these extreme securities. Exposure to uncorrelated assets (like bonds and gold) supports the portfolio construction process currently.

Not having exposure to assets that are enjoying the tailwinds of easy money would risk missing an earnings recovery that might negate the need for a rerating. For this reason, we look to allocate a relatively full equity weight and hold it through the cycle. Other asset classes (like bonds, property, gold or cash) that possess the right uncorrelated characteristics for the appropriate time are used to gain protection. Within asset classes, we look for companies that possess valuations that are attractive for their given quality attributes of the company as well as adequate growth opportunities.

In that context, the Fund has the following positioning relative to the average fund in its category:

- An elevated equity weighting close to 40% with an increasing tilt towards growth.
- A significant underweight to the luxury goods sector which is coming off a high earnings base.
- An overweight to SA financials where there is tremendous value in some stocks like banks and growth opportunities in underappreciated names which are followed less by the broader market.
- An overweight in SA bonds, with a tilt to longer-dated government bonds where presently there is an attractive opportunity due to the roll-down effect driven by a steep yield curve.

The Fund is positioned to benefit from continuing momentum in equities due to its intention to be fully exposed to growth assets through the cycle. However, it also has a large allocation to uncorrelated bond assets that can offer protection in a pull-back. The potential threat of reflation (that prices of goods and services may rise due to excess liquidity and stimulus that has been injected into economies around the world without a commensurate response by central banks hiking interest rates) presents a latent peril to low yielding developed market bonds. Reflation is where central banks cannot counter rising inflation by raising interest rates due to the size of the debt burden that countries are now carrying, which could risk governments to default on their loans. The Fund will not own assets in these developed market bonds until their debt levels are reduced substantially. We do not expect this to happen anytime in the near term. Similarly, company share prices that have risen sharply and stretched their valuations due to extreme suppression of macroeconomic interest rates rather than due to fundamental growth in earnings streams, are actively being avoided. This may lead to some near term underperformance if momentum in these stocks continue, however the longer-term

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outlook is far more encouraging and will likely deliver material outperformance driven by sustained earnings growth purchased at reasonable prices.

Andrew Dowse
Portfolio Manager

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