Merchant West SCI Global Equity Feeder Fund

Quarterly Report
Quarter ending 31 March 2023

Fund Details

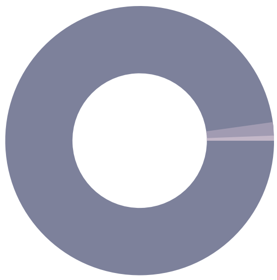
Benchmark	ASISA Category	Portfolio Managers	Suitable Investor
MSCI World Index (USD)	Global Equity General	Raymond Shapiro Andrew Dowse	The Merchant West Global Equity Fund is suitable for investors seeking long-term capital growth from a diversified portfolio of global equities. It seeks to outperform world equity markets without greater risk of loss. The recommended investment horizon is seven years or more.

Top 10 Holdings

Top 10 Holdings	%
Berkshire Hathaway	6,6
Alphabet Inc	4,3
Nestlé SA	4,0
Booking Holdings Inc	3,8
Novo Nordisk A/S	3,6
Brookfield Corporation	3,3
Microsoft Corporation	3,1
SAP SE	2,6
Hess Corporation	2,5
TJX Companies Inc	2,5

Asset Allocation

Portfolio date: 31/03/2023



Asset Allocation	%
Global Equity	97,8
Global Cash	1,6
SA Cash	0,6
Total	**100**

Annualised Performance

Annualised Performance	Fund %	Benchmark %
3 months	9,1	12,3
1 year	15,1	13,5
3 years	12,6	16,7
5 years	10,2	17,7
Since Inception	4,8	12,9

Launch date (December 2015)

Annual Returns

Annual Returns	%
Highest Annual %	35,7
Lowest Annual %	-15,1

Market Overview and Fund Performance Review

To slow the pace of rapidly rising consumer prices, central banks throughout the world started raising interest rates at the beginning of 2022. A combination of supply chain bottlenecks, increased geopolitical tensions and an energy crisis in Europe pushed global consumer price inflation to multi-decade highs, forcing central banks to respond. The US Federal Reserve has been very aggressive in its efforts to curb inflation, raising official interest rates by 425 basis points in 2022.

In the fourth quarter, the Federal Open Market Committee met twice to set policy rates, raising the Federal Funds rate by 75 basis points following the conclusion of their November meeting, before slowing the pace of rate hikes to 50 basis points at their December meeting. Interest rates are expected to rise further although there is growing evidence that consumer inflation has peaked and is expected to fall towards 3% by the end of 2023.

The likelihood of a recession in the US remains high, given the sharp rise in short-term interest rates and the prognosis is no different for the UK and Europe. China's economy is likely to buck the global trend and grow faster in 2023 as the country emerges from very strict COVID-19 restrictions which hampered growth in both 2021 and 2022.

Harmony (+38.2%), Hammerson (+36.3%) and AngloGold (+31.9%) completed the list of top five gainers during the quarter. Telkom (-35.3%) was a big loser in the fourth quarter after MTN terminated discussions, while Spar (-19.3%) also fell sharply following the publication of an article in the financial press alleging unethical business practices by certain executives including former CEO, Graham O'Connor and current CEO, Brett Botten.

The Fund gained 7.1% in the fourth quarter of 2022, beating the benchmark peer group (ASISA SA Multi-Asset High Equity) return of 6.9%. On a sector level, the Fund outperformed in Basic Materials driven by strong performances from large cap diversified miners, platinum stocks and Kumba Iron Ore, largely following substantial relaxation of COVID-19 restrictions in China synchronised with government stimulus to promote real estate investment.

Market Overview and Fund Performance Review

Their real estate sector had recently been in distress due to some businesses running into financial trouble that prompted anxiety and fear of a global contagion if not managed and supported. Adding to the outperformance was the Fund's avoidance of Sasol (-5.7%) as an oil play and rather choosing to own an overweight exposure to oil through a global major being Exxon Mobil (+20.6%).

Over the year, this decision resulted in a gain of 99.8% (in rands) from Exxon while Sasol rose a measly 9.0%. The Fund carries a small overweight position in the Energy sector through the coal exporter Thungela Resources which performed disappointingly, falling 14.0% following an exceptional run over the course of the year. Still, the gain on this stock for 2022 was remarkable (+334.7%). An underweight exposure to gold stocks (which performed well as fears of recession grew) did detract somewhat, but not enough to offset the gains in the materials sector. Other sectors performed similarly to the benchmark index, except for disappointments in Consumer Discretionary and Financials.

The Fund did not own any Richemont (+30.4%) which is expected to enjoy benefits from China which is emerging from hard COVID-19 lockdowns, and an overweight holding in Foschini (-14.1%) which could no longer maintain its premium rating over its peers – the most painful points for the Fund and both in Consumer Discretionary.

Banking stocks performed well, notably Investec as mentioned above, Capitec (+20.6%) and Standard Bank (+16.5%) but the Fund's underweight position to banks in favour of diversified financials did shave off some relative performance too. Real Estate was a strong asset class in the quarter, rising 19.2%, however largely driven by the larger cap stocks while the Fund is positioned in mid- and smaller cap stocks that have not yet experienced the same level of gains. The Fund's offshore allocation is primarily accessed through the US dollar-denominated Merchant West Global Equity Fund which had a strong performance in the quarter, rising 13.6% in USD and despite the rand strengthening by nearly 6% this investment contributed around 7.2% in rands. By contrast, the MSCI World Index rose 9.8% in USD and just 3.5% in rands, helping the Fund to outperform headline benchmarks and most of its peers.

For the 2022 calendar year, the Fund delivered a slightly disappointing result, rising only 4.4%, but it was a pleasing relative result compared with peers that on average declined marginally (-0.2%) according to Morningstar ASISA category averages.

Portfolio Actions

It was a quiet quarter for the Fund with reference to trading activity. We did however make some relatively minor adjustments with one new addition and one exit. In the real estate sector, we added Equites Property Fund which had declined from higher levels to a level we felt was a decent entry point given the growth prospects and the defensiveness of the logistics sector. We also managed to collect the dividend soon after adding the stock to the Fund, racking up the 5% semi-annual dividend yield. We sold out of Spar following a litigation claim against directors for inappropriate behaviour in lending practices to some of its retail operators. This alone was not the only factor, but a combination of implementation risks around its SAP rollout and execution in its investments in Poland has culminated in us seeing more risk than reward here for the moment and therefore we can find better uses for this capital investment. Other actions were trimming slightly on Ninety One PLC, Netcare and Thungela.

Portfolio Strategy

The Fund's objective is to outperform the average fund in its category (SA Multi-Asset High 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 have become volatile by several measures. We observe signs of irrationality in market prices relative to intrinsic valuations and a worrying disparity between relative asset class relationships. Easy monetary and fiscal conditions have provided 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, preference shares and gold) supports the portfolio construction process.

Not having exposure to assets that enjoy the tailwinds of easy money would risk missing an earnings recovery that might negate the need for a re-rating. 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 as well as adequate growth opportunities.

Portfolio Strategy

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

- An elevated equity weighting close to 75% 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 outlook is far more encouraging and will likely deliver material outperformance driven by sustained earnings growth purchased at reasonable prices.

Raymond Shapiro
Portfolio Manager