Sanlam FOUR Stable Global Equity Fund

Performance Review

The fund delivered a solid return of 6.5% in USD during Q3 outperforming its CPI +6% target and the broader equity market index. Healthcare was the standout sector with all nine of the fund's holdings doing better than the wider market. Consumer discretionary and consumer staples largely disappointed.

Key Facts	
Fund AuM	$82.6m
Strategy AuM	$82.6m
Number of Holdings	29
Active Share	94.2%
Yield	2.5%
Tracking error	4.0
VaR	4.8
% in cash	1.0%

	Inception	QTR	YTD	1yr	3yrs	5yrs	Since Inception
B Accumulation USD	10/09/12	6.5	4.6	8.0	9.6	7.9	11.0
MSCI ACWI - USD		4.3	3.8	9.8	13.4	8.7	10.2
CPI +6%		2.0	6.3	8.7	7.9	7.5	7.6
A Accumulation USD	18/10/13	6.3	4.1	7.2	8.8	0.1	7.0
MSCI ACWI - USD		4.3	3.8	9.8	13.4	0.1	7.9
A Accumulation GBP	02/01/15	7.5	7.8	10.0	14.5	n/a	10.4
MSCI ACWI - GBP		5.6	7.7	12.9	19.2	n/a	13.4

Performance beyond one year is annualised

12 Months to	Sep-18	Sep-17	Sep-16	Sep-15	Sep-14
B Accumulation USD	8.0	7.8	13.2	-1.2	12.7
A Accumulation USD	7.2	7.0	12.4	-2.0	10.6
MSCI ACWI - USD	9.8	18.6	12.0	-6.7	11.3
CPI +6%	8.7	7.9	7.1	6.2	7.7
A Accumulation GBP	10.0	3.6	31.7	-	-
MSCI ACWI - GBP	12.9	14.9	30.6	-	-

Source: Sanlam FOUR, Morningstar and Lipper as at 30/09/2018.

Past performance is not an indicator of future performance.

Market Recap

Over the quarter global markets rose in the mid-single digits in USD terms, driven almost entirely by the US market. The North American economy remained strong, with healthy ISM and GDP figures, while consumer confidence reached the highest level since 2000. Even the threat of trade sanctions on China had a limited impact on equities as Beijing ruled out a currency devaluation and the US chose to implement a staggered timetable of tariffs; $200bn of targeted goods will be taxed initially at 10% before rising to 25% in 2019.

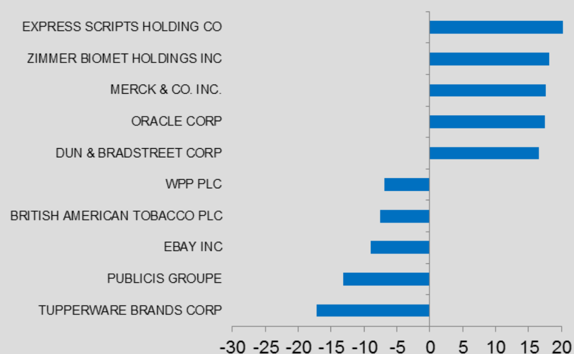
Against this background the Fed raised its benchmark rate by 25bps with short rates now surpassing inflation for the first time in this cycle. Just like the US, Europe remains committed to raising rates as inflation is rebounding and the European economies are gradually getting stronger. Germany in particular saw the IFO index and durable goods orders beat expectations, while Scandinavian countries had a strong market performance.

Conversely, southern European countries declined on the back of Italy's populist reactions to the Genova bridge disaster and the proposed budget deficit of 2.4%, a stark contrast with the EU's deficit trajectory plan. The UK was also a significant drag to equity markets as a disjointed government revealed itself incapable of guiding the country through Brexit.

Elsewhere, the Fed's monetary tightening and trade sanctions pressured emerging market currencies with the Turkish Lira, Brazilian Real and Argentinian Peso collapsing against the USD. Japan saw strong GDP growth in Q2 and the first signs of wage inflation in 20 years.

In this environment industrials, healthcare and IT performed the best while materials, staples and utilities lagged the overall market. The USD continued its climb on the back of higher rates, as did the oil price which came within touching distance of $80.

Performance Attribution



Source: Bloomberg at 30/09/2018.

Despite value as a style underperforming growth, the fund achieved a satisfactory return driven primarily by healthcare. All nine of the fund's healthcare holdings outperformed the wider market with the top three holdings all coming from that sector.

Express Scripts closed towards its pending offer from Cigna as the proposed deal has made good progress with regulators. Zimmer Biomet has performed well against low expectations and showing signs of improvement within the business. Merck (US) rallied ahead of the pharmaceutical sector as new cancer blockbuster Keytruda is seeing increased adoption.

n IT, Oracle saw its share price recover after a late June sell-off as the company reduced disclosure. Microsoft continues to perform well with solid growth across the business, but especially in cloud services. HP Inc has done well achieving revenue growth in the slower growing PC and printer space via market share gains as the market consolidates around the stronger players. Elsewhere, Dun and Bradstreet agreed to a 'go-private' offer from a private equity consortium paying a 17% premium.

The consumer discretionary sector was the biggest detractor to performance. Tupperware missed earnings and lowered guidance as several important emerging markets slowed and Western Europe experienced some manufacturing disruption. Brazil has seen a notable slowdown as a 10-day truckers strike exacerbated an already tough consumer spending environment. Our two advertising agencies saw weakness over results and the stocks gave ground. Publicis highlighted disruption caused by the adoption of GDPR in Europe, whilst WPP ceded a modest amount of margin as new business pitches and co-location costs shaved the bottom line.

In consumer staples, the fund's tobacco holdings were soft as start-up JUUL has been taking the vaping market share in the US as fruit flavoured high nicotine products prove popular with younger smokers.

Market Outlook

The outlook for markets has not changed materially over the last quarter. In the near term, corporate profits (particularly in the US) look set to continue their strong growth. Third quarter earnings are forecast to grow by 20% over last year, but that number is materially boosted by corporate tax cuts and the recovery of profits in the energy sector. As these effects fade out in 2019, the outlook for earnings growth is becoming more uncertain. The list of market areas with visibly depressed profits is getting shorter whilst the list of companies with above historic profitability is lengthening. At the macro level, US profit to GDP is already comfortably above average, and appears to have already rolled over. Forecasts for economic growth remain positive (they always are!), but risks to profits from tight labour markets, rising commodity prices and interest rates are growing, not to mention the potential fall-out from a trade war.

Valuations have expanded slightly over the last three months as markets have recovered. This rise has left aggregate market valuations modestly above their long-run averages. The rise has been driven by strong gains in a handful of very large stocks. This has left the spread of valuations in the market at a wide level compared to history (not quite yet at the 1999 peaks). This is a two-edged sword to investors. On the one hand, it provides the opportunity to build a portfolio of companies at attractive discounts to market indices but makes these market favourites increasingly vulnerable to disappointments. This concentrated pattern of stock gains has been the primary driver behind the outperformance of US markets compared to the rest of the world.

Our investment process and disciplines lead us to maintain a 'belt and braces' approach to building a portfolio. Firstly, we only invest in companies with steadily growing non-cyclical earnings. This can mean we participate less in the 'peaks' of economic growth, but is intended to deliver a steady and more reliable cashflow stream over time. Secondly, we stick to a firm valuation discipline, allowing us to create a portfolio which is valued at significant discounts in terms of what we are paying for earnings, dividends or cashflows. This valuation discipline provides protection in tough market conditions, and enables a 'lower economic risk' portfolio to deliver superior real returns over time. At present, we believe the portfolio offers a compelling proposition. It continues to be valued at a significant discount to the wider equity market and yet it is composed entirely of companies with high returns and less economic risk.

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