AUTUS

wealth care specialists

QUARTERLY ECONOMIC COMMENTARY

Q3 | 2016

AUTUS OPPORTUNITY FUND

Quarterly Commentary - Autus BCI Opportunity Fund

The third quarter of 2016 was relatively less volatile than the preceding few quarters. A seemingly disproportionate amount of news coverage and market commentary was dedicated to US monetary policy uncertainty, with specific emphasis on the pace and timing of interest rate hikes by the Federal Reserve. Consensus appears to be growing that the Fed will make its next move at the December 2016 meeting. The direction of the Fed's policy is at odds with most of the policies of their developed market central bank peers, where monetary stimulus remains the weapon of choice in the fight against stagnant growth and deflation. The US presidential elections are gaining increasing media exposure as the countdown continues toward the November 8 voting day. Polls are suggesting a marginal victory for Clinton, but the outcome is by no means a given. Should this be the case, the impact on investment markets is expected, on-balance, to be positive.

The South African economy grew by 3.3% on an annualised basis in the second quarter of this year, which translated into positive momentum for the local currency in the third quarter. The rand was also propped up by renewed interest in South African bonds as investors from developed markets continued to search for higher yields in emerging markets. The political instability in Turkey counted in the rand's favour as foreign portfolio investments that were destined for Turkey were redirected to South Africa. The local government elections proceeded relatively peacefully, however the loss of support for the ANC in the country's largest metropolitan regions was a shocking outcome. Markets reacted negatively in late August to the news that Finance Minister Gordhan had been summoned to appear before the Hawks in relation to a controversial unit he had set up during his time as head of the South African Revenue Service. Violent protests over tuition fees at South African universities also weigh on sentiment for the country's financial assets. These event all contributed to a directionless market characterised by higher volatility.

The fund's return for the quarter was -1.57%, which is mostly a result of the adverse price movements in some of the underlying holdings, coupled with the effect of a stronger rand on the fund's offshore exposure. The benchmark returned 1.19% over the quarter. One of the portfolio's star performers, Brait, lost 20.4% of its value over this three-month period. This is most likely due to its geographic exposure to the United Kingdom and its exposure to Pound-denominated revenue. How Brexit will eventually pan out is still uncertain at this stage; however, we do not share the utterly gloomy post-Brexit UK view espoused by some market commentators. As long-term investors we believe that Brait is significantly undervalued at its current price. A similar story can be told of Mediclinic International, which declined by 21.6% over the quarter. Shares that were bought during the period included Mr Price and Aspen, while we have sold out of Capital & Counties, Sasol and Mondi. EOH contributed positively to the portfolio with a 20.6% increase over the quarter, and Capitec performed well with an 8% increase in its price.

The fund's equity exposure was reduced from 75.1% at the start of the quarter to 71.1% at the end of the quarter. This low level of equity exposure reflects our cautious stance and acts as a hedge against large market declines, while providing us with cash to make timely buy decisions as opportunities become available. Our allocation to bonds increased from 12.3% to 17.1% over the quarter, which reflects our view that attractive risk-adjusted returns are available at the short-duration end of the yield curve. The portfolio's offshore allocation increased from 16.2% to 18.4% during the quarter.

Our focus for the next quarter will be on Finance Minister Gordhan's medium-term budget speech, the outcome of the US elections and the decisions of the rating agencies on South Africa's sovereign credit-rating. The fund is well positioned to withstand increased market volatility and stands to gain from a weaker rand. The portfolio continues to hold the shares of companies that are attractively valued and of a high quality with an above-average prospects to deliver competitive returns over the long-term.

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