An Authorised Financial Services Provider, FSP 50733

Quarterly Commentary | March 2022

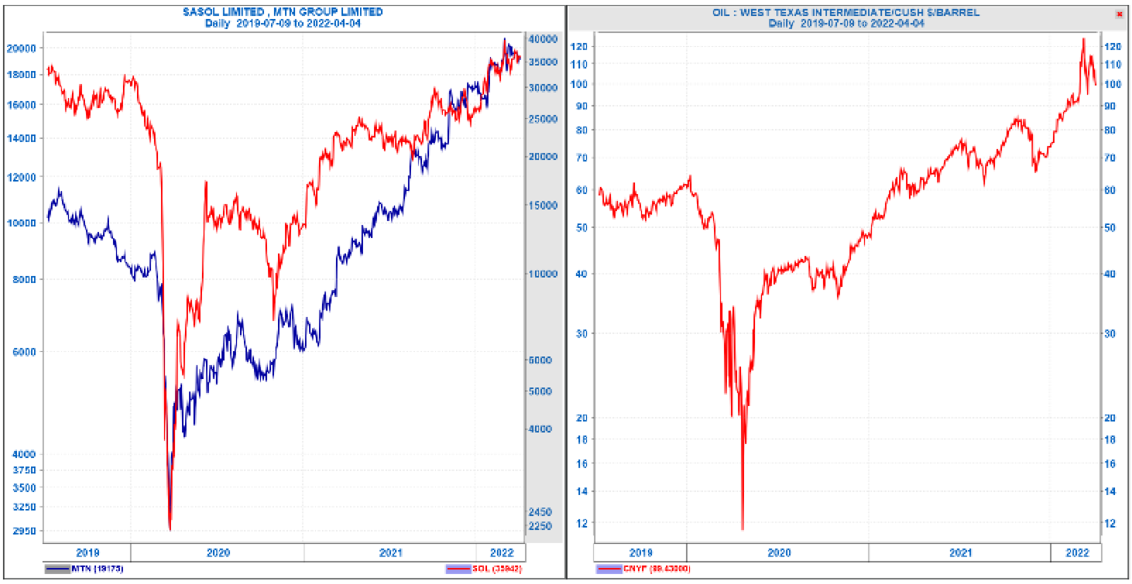
An Eventful Quarter

The 1st quarter of 2022 will forever be defined by the outbreak of War in Eastern Europe. We, like most, have been deeply disturbed by developments in Ukraine. Our thoughts and prayers extend to all those directly impacted by the war - there is no place for unilateral aggression. The Western World's response to Russia has been uniform, swift, and economically brutal.

The outbreak of war brought with it dislocation in investment markets in the first quarter. With Russia, and to a lesser extent Ukraine, being material exporters of many commodities, including Oil, Gas, Coal, PGM's and key Agricultural commodities, the global sanctions against Russia, and the disruption of export supply lines, led to a sharp increase in the spot price of many commodities.

There is growing concern around the economic consequences from these increases – the negative impact of rising gas, fuel and food prices on the global consumer economy, and the nearer term inflationary pressures that will naturally build as a consequence of the War and the imposition of sanctions. It is not for us to pontificate around the appropriateness and extent of the sanctions, but certainly the shorter term cost implications for citizens the world over are an unfortunate by-product of a political decision to "cancel" Russia from the global economy.

The Oil market is one that we find intriguing. The shorter term spike in the oil price can be seen in the chart on the right below – having reached $120, prices seem to have settled around $100 per barrel, up from below $80 at the beginning of the year. Away from the obvious adverse economic consequences of rising energy prices on the consumer economy, many South African investors were somewhat protected by the performance of companies like Sasol and MTN. As shown on the chart on the left below, the share prices of both have mirrored the underlying performance of oil. The link between Oil and Sasol is intuitive, while MTN is an indirect beneficiary by virtue of its large operations in Nigeria, an oil producing economy.



Source: Iress, CGAM, April 2022

The chart below shows the Oil futures curve – the upwardly sloping orange line is the curve from 7 years ago (2015), and the green line is the April 2022 curve. In 2015 when the spot price was $60, expectations were for the longer term price of Oil to be around $75 per barrel. Without getting technical, the current curve shows the oil market in steep backwardation – the future price of oil is expected to be materially lower than spot. With spot now well over $100, the longer term expectations are still for Oil prices to settle back towards the $75 per barrel.

Source: Bloomberg; CGAM, April 2022

Whilst there are countless variables that impact the underlying price of a commodity, with shorter term supply constraints being merely one, our sense is that many commodity markets, from select metals to agricultural commodities, have similarly shaped forward curves. Elevated spot prices can distort ones thinking on Resources companies – certainly on current commodity prices, most South African listed commodity companies are trading at extremely attractive multiples – free cash flows are good, balance sheets very strong - what's not to like. But, history has taught us that extrapolating spot prices could be dangerous – just as share prices rose strongly with the spike in Oil prices, they could be vulnerable were the futures market to be correct. Whilst both the ClucasGray Equity & Equilibrium Prescient Funds had large weightings in both going into the conflict, we deemed it prudent to reduce weightings into strength.

The 3 P's and the Rand

Over the last 7 years, we have written sporadically about the Rand – it is an emotive topic, and we all know there is no place for emotion in investments. Much like commodities, there are many variables at play in the currency markets. As much as many wish it did, 3 of the P's that dominate South African conversations – Power, Politics and Potholes have over time proved to have virtually no link to currency movements. We are firmly of the view, that the other 3 P's, Purchasing Power Parity, have a far more significant longer term bearing on any currency. It is a theory we learn about in Economics 1, and one which many spend the rest of their asset management career trying to discredit. But there is a reason it is a part of the curriculum – like fundamental investing, it works - over long periods of time.

The chart below is the ClucasGray Asset Management estimate of the Rand value against the US Dollar, using Purchasing Power Parity, with 2000 as the base year. We have removed the actual currencies, as a point forecast fair value can distract from the discussion – it gets emotive! It appears to us that the Rand remains a weak currency. The red line is the fair value of the Rand according to the inflation differential – the red line has flattened over time, as the gap between South African and US Inflation continues to narrow. The blue line is the actual Rand – the deviation of the Rand from the fair value remains very wide. In other words, the Rand, in real terms, is as weak as it was during Nenegate, weaker than in the Global Financial Crisis, and whilst it has recovered from the Covid crisis lows of 2020, it has been structurally weak for 7 years.

Source: CGAM, Bloomberg, April 2022

We concede that the Rand debate is a tired one, and there are way too many vested interests and agendas in the financial services industry to get an objective view. Unfortunately it is an important variable in managing South African portfolios. We articulate the above to provide insights into how we manage the asset allocation within the ClucasGray Equilibrium Prescient Fund, our Multi Asset High Equity balanced fund. Our investment objective is to deliver a Real Rand return to our investors, with a target of Inflation plus 4% over time. Given our estimates of modest prospective Dollar returns available in many of the major global indices, the only way we believe investors can derive a real Rand return from offshore assets is for the currency to depreciate. Hence our offshore exposure remains lower than it has been for some time.

Quarterly Performance

The JSE Capped Swix gained over 6%, but it was the divergence of returns that made the 1st quarter of 2022 such a remarkable one. Some notable performances in the quarter include Exxaro, African Rainbow, Standard Bank, Absa and Grindrod all gaining over 25%. In addition, key holdings such as Anglos, Glencore, Ethos Capital and MTN all gained over 10%.

Countering the above, the JSE was impacted by the significant collapse in both Naspers & Prosus, which fell 33% & 39% respectively.

The net result of the above is that the **ClucasGray Equity Prescient Fund** gained over 7% in the quarter, ahead of the JSE Swix (5.7%) and of the peer group returns of 4.1%. Over the last 12 months, the Fund is up 31%, compared to Swix of 17% and peers of 13%. As depicted on the fact sheets, the Fund has outperformed both the JSE Swix and Peers over all periods since its inception 10½ years ago. The compound net return of 12.4% since inception is 2.6% per annum ahead of the average general equity fund, and pleasingly for investors, the Fund has outperformed inflation by over 7% per annum over this period.

Within the **ClucasGray Equilibrium Prescient Fund**, the asset allocation decision to hold materially more in South African equities, and historically low levels in offshore equity proved to be a good one in the quarter. Aside from the currency strength, the MSCI World Index declined over 5% in Dollars, while the JSE Capped Swix gained over 6% in Rands. Over the last year, the JSE Capped Swix has returned 29% in Dollars, compared to around 7% for the MSCI World Index. The ClucasGray Asset Management asset allocation process had for some time been highlighting the relative attractiveness of local equities – notwithstanding the relative outperformance referred to above, the reality is that our assessment of prospective returns continues to favor South African equity.

The All Bond Index gained nearly 2% in the quarter – it remains an asset class that we believe offers attractive prospective returns. Over the last 12 months, the All Bond Index has gained over 12%, so our decision to have over 20% of the fund allocated to Bonds has helped the performance of the fund.

We believe the bond market holds the key to the unlocking of value in South African assets. Firstly, lower bonds yields obviously result in attractive returns from bonds, to which we are well exposed. Crucially, lower bond yields will result in a lower cost of equity for South African oriented companies – a lower cost of equity should drive a re-rating of these companies, which for too long have been held back by a cost of capital that is unjustifiably elevated, and in stark contrast to the developed world.

The net result of the above is that the **ClucasGray Equilibrium Prescient Fund** gained just over 1% in the quarter, ahead of the peer group which declined 1%. Over the last 12 months, the Fund is up 19.2%, compared to peers of 10.9%. As depicted on the fact sheets, the Fund has outperformed its peers over all periods since its inception over 7 years ago. The compound net return of 9.2% since inception is 2.8% per annum ahead of the average balanced fund, and pleasingly for investors, the Fund has outperformed inflation by 4.3% per annum over this period.

Notwithstanding a very strong recovery in the share prices of many companies since the lows of 2020, we remain of the view that a combination of a steadily improving earnings backdrop, and historically undemanding valuations will deliver attractive returns to investors. In our view, the very realistic prospect exists for both South African bonds and equities to deliver attractive prospective returns from current levels.

Please click on the links below to view our March 2022 MDDs for the **ClucasGray Equilibrium Prescient Fund** & **ClucasGray Equity Prescient Fund**.

If there is any interest to engage on a Zoom call or the like, please don't hesitate to get in touch with us.

Kind Regards

Andrew and Grant

ClucasGray Equity Prescient Fund | Net Annualised Performance Figures to 31 March 2022

	1 Year	3 Years	5 Years	10 Years	Since Inception
Fund*	31.3%	11.6%	10.0%	11.4%	12.4%
Class A2**	30.2%	10.8%	9.1%	10.5%	11.5%
SWIX TR	13.0%	10.6%	8.3%	10.7%	11.8%
SA Equity General Peer Group	17.3%	11.2%	7.6%	8.8%	9.8%

ClucasGray Equilibrium Prescient Fund | Net Annualised Performance Figures to 31 March 2022

	1 Year	3 Years	5 Years	Since Inception
Fund*	19.2%	10.1%	9.4%	9.2%
Class C**	18.6%	9.4%	8.8%	8.6%
SA Multi Asset High Equity Peer Group	10.9%	8.9%	6.9%	6.4%

* Fund performance is the net weighted average fee return for the Fund

** Highest Fee Class

Click Here to view the March 2022 ClucasGray Equilibrium Prescient Fund MDD

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Click Here to visit our Website

Our funds are available on the following platforms:

AIMS | Allan Gray | Glacier | Momentum
NinetyOne | Multilect | Old Mutual | Prescient | Prime | Stanlib

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ClucasGray Asset Management (Pty) Ltd is an independent investment management company registered in South Africa, company registration number 2019/060149/07 and authorised financial services provider under the Financial Sector Conduct Authority (FSCA) registration number 50733. The main business of ClucasGray is the provision of investment management services to private and institutional clients.

Annualised performance: Annualised performance shows longer term performance rescaled to a 1-year period. Annualised performance is the average return per year over the period. Actual annual figures are available to the investor on request

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