Adviser Choice

Investec Equity Fund

As at 31 March 2011

Market review

Local equities mimicked global market volatility, recovering January's losses and ending the quarter marginally higher (1.1%). Resource counters performed best, with Sasol, the only oil & gas producer constituent in the index, rising 13.1%. Diversified miners closed 3.2% higher while paper stocks added 15.5% over the period. Platinum stocks lost 10.5%. Both the industrial and financial sectors underperformed the broader market, closing down 0.3% and up 0.7%, respectively. Again, there was substantial dispersion amongst the various sub-sectors, with construction (-25%), food producers (-4.3%) and pharmaceuticals (-11.5%) underperforming, while mobile telecommunication (3.9%), life insurance (6.4%) and industrial metals (14.5%) enjoyed strong returns.

Portfolio review

It seems paradoxical that amidst a sovereign debt crisis in Europe, the aftermath of an earthquake and tsunami in Japan, structurally high unemployment and a weak housing market in most developed countries, there is in fact positive global growth. The quarter continued to show signs of economic growth on a global basis, and not surprisingly the IMF has forecasted global GDP growth of 4.2% for 2011. The main risk to growth appears to be inflation. However, according to Ben Bernanke, the chairman of the US Federal Reserve, this is well in check as private incomes are growing by 5% per annum and private consumption expenditure is only increasing at 0.9% per annum, thereby creating a healthy margin in order to pay down debt. The risk of runaway inflation at this stage seems unlikely.

The risk to equity markets may come as a result of the Federal Reserve concluding its $600 billion bond buying programme in June. It is possible that once the Federal Reserve's quantitative easing programme comes to an end, equity markets might pull back and the natural recipient of the outflow could be the bond market. The G7's move to weaken the yen in the wake of Japan's earthquake has created a monster of speculation in higher yielding assets, driven by an artificially cheap currency. The market's view is that the carry trade is on, which will mean an increased purchase of higher yielding assets, emerging market equities and commodities.

In South Africa, the monetary policy committee left the repo rate unchanged at 5.5%, and revised up growth expectations to average 3.7% in 2011 and 3.9% in 2012. The Quarterly Bulletin from the South African Reserve Bank provided further assurance that the consumer recovery is now well entrenched, supporting the growth recovery in the face of global headwinds.

Over the first quarter, the Investec Equity portfolio outperformed the FTSE/JSE All Share Index and the FTSE/JSE Shareholder Weighted Index. The portfolio's holdings in Mondi, Exxaro and Sasol were the main contributors to performance. We did not hold Standard Bank, Nedbank, Truworths and Shoprite, which benefited the portfolio.

Portfolio activity

The portfolio's exposure to MTN was raised aggressively during the quarter from 6% to 10%. This was primarily due to an increase in the company's free cash flow as a result of lower projected future capital expenditure. Subsequently, the company has increased its dividend payout ratio significantly, and has indicated that this improved ratio will be maintained. The result is a current dividend yield of 5.8%, and 8.87% for 2012 and 2013 respectively.

Portfolio positioning

The portfolio remains weighted towards resource and large capitalisation industrial stocks, which are mostly global companies. Our underweight position is mainly in banking stocks, which on current valuations appear fully priced and with poor relative growth rates. That said, we have chosen to be overweight FirstRand and Rand Merchant Bank. FirstRand's exposure to the vehicle market and its increasing exposure to the unsecured lending market make it a superior growth company in an unattractive sector. The portfolio also has positions in PSG and African Bank, which exhibit similar qualities. African Bank's exposure to the unsecured lending environment and strong cash generation have resulted in an attractive dividend yield as well as continued growth potential, while PSG has offered a good entry point into quality assets such as Capitec and Paladin.

Large cap industrial companies, which make up a significant proportion of the portfolio, continue to offer exposure to a wide array of growing economies whilst allowing for preservation of capital should the rand weaken from current strong levels. Furthermore, these companies are in cash-rich positions with excellent corporate strategy and governance, which are of utmost importance during times of relative uncertainty. The portfolio's largest positions are in Sasol and MTN, representing over 20% of the portfolio. Its top ten positions comprise 64% of the overall portfolio.

Out of the Ordinary®

Investec

Asset Management