Adviser Choice

Investec Opportunity Fund

As at 31 December 2010

Market review

After a volatile first three quarters of 2010, risky assets responded to prospects of an improved economic outlook and ended the year firmly in positive territory. During the fourth quarter, investors switched out of bonds into equities. Global equities added 8.8% over the period, while global bonds lost 1.8% in US dollars.

Local bonds could not shrug off the global bond sell-off, ending up only 0.7% over the quarter. Cash, as measured by the STeFI, returned 1.6% for the three months to the end of December. The best performing asset class over the past year was the listed property sector. The sector continued to show strong returns, despite weak property fundamentals. Listed property gained 3.1% in the fourth quarter to rise by 29.6% for the year.

Local equities participated in the global equity rally. The FTSE/JSE All Share Index rose 9.5% in the fourth quarter on top of the 13.3% gain over the prior three months, ending the year 19% higher. Resources (16.5%) proved to be the top performing sector, with financials flat and industrials up 7.8% for the period. Amongst the resource counters, diversified and platinum miners (both up 19.2%) did best, while short-term insurers (15.4%) and some smaller industrial sectors (media and support services) beat the overall market. Stocks predominantly focused on the South African economy fared worse. Construction ended the quarter 3% higher, banks closed flat, while food and general retailers added 2.9% and 6.2% respectively.

Portfolio review

In the end, 2010 proved to be a good year for equities. The shares we selected for the Investec Opportunity portfolio generally outperformed the market, but we sacrificed some returns due to our conservative positioning. A lower exposure to equities proved to be a little early. We are not inclined to chase momentum. Unfortunately, this investment style has been the key driving force behind the local market's performance.

Our two key winning positions were the allocations to Richemont and Assore. Richemont has successfully positioned the business to sell its quality watches and jewellery to an ever-increasing Asian population, where there are many new buyers emerging. In general, though, the world's wealthy continue to raise their spending levels. Despite the fact that operating margins are at normal levels, we still see superior sales growth as the driver of investment returns going forward.

Assore continues to have the most attractive growth profile in the resource complex and has been spurred by strong prices for iron ore and manganese. The long-term commodity prices discounted by the share continue to be well below the current spot prices. The long life, low cost asset base remains attractive to us and we prefer exposure here, despite continued outperformance of both Anglo American and BHP Billiton.

The rand has been one of the strongest currencies in the world, only underperforming the Australian dollar and the Japanese yen. The local currency has been buoyed by very high export prices for gold, platinum and coal. Despite solid US dollar returns from the offshore portfolio, the gains were erased in rand terms. The only part of our offshore equity portfolio which lagged, was the holding in global pharmaceuticals. Our stocks in this sector languished, despite extremely attractive share price fundamentals.

Portfolio positioning

The decision to allocate more funds to the South African bond market late in 2009 was well timed. The additional purchase during the sell-off in November 2010 has provided a useful underpin to the overall portfolio performance. Bonds serve as insurance against a strong rand. The local currency has continued its upward trajectory, ending the year on a three-year high. Unless the rand weakens by more than 20% from current levels, there is unlikely to be any upward pressure on inflation in South Africa. Domestic bonds remain a reasonable hedge with an attractive pick-up over cash.

The surplus cash weighting in the portfolio allows us swift access to attractive opportunities that might arise. At present, many local shares do not have forward-looking return projections that exceed the returns on risk-free assets. Hence, we see no reason to add risk without a reasonable probability of a commensurate reward. The ability to increase the foreign weighting to 25% for institutional funds will allow us to allocate more funds to attractive offshore assets, which we believe offer the best forward-looking returns.

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Investec

Asset Management