



Bateleur Flexible Prescient Fund

First half 2021 commentary

Published: 26 July 2021

Bateleur Flexible Prescient Fund – 2021 first half report back to unitholders

The fund returned 13.7% net of fees for the first half of 2021. Over the same period, the JSE All Share Index appreciated 13.2% (including dividends reinvested), SA bonds (ALBI) gained 5.0%, while cash (STeFI) returned 1.7%.

Fund attribution by strategy and the top contributors and detractors are shown below. Over the review period, JSE listed equities (+11.4%) accounted for the majority of returns. Foreign listed equities contributed 2.6% while domestic bonds were a marginal contributor.

Attribution by strategy	1H 2021	Top contributors	%	Top detractors	%
JSE listed equities	11.4%	Mpact	2.3%	TeamViewer	-0.4%
Foreign listed equities	2.6%	Royal Bafokeng Platinum	2.3%	Alibaba	-0.3%
Domestic bonds	0.5%	Hudaco	1.7%	African Rainbow Minerals	-0.2%
Costs (and other)	-0.8%	Impala Platinum	1.1%	Sony	-0.2%
Total	13.7%	Anglo American	1.0%	Spar	-0.1%

Source: Bateleur

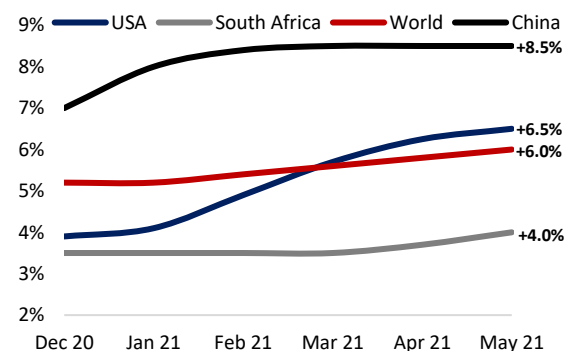
The top individual contributors YTD were the domestic mid-cap holdings of Mpact, Royal Bafokeng Platinum and Hudaco – all key fund differentiators. These companies are all operating well ahead of pre-pandemic levels, have sound prospects and trade at compelling valuations. No individual share detracted more than 0.4% from fund returns, highlighting the current favourable risk-on environment.

Current thinking - global

The unprecedented global monetary and fiscal response to the pandemic has driven a sharp V-shaped recovery with World GDP now forecast to grow 6% in 2021, up from an expected 5% at the beginning of the year (chart 1).

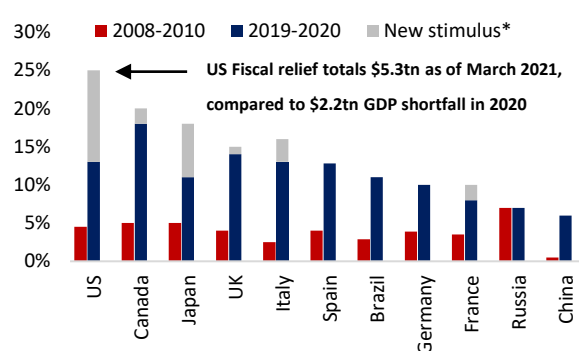
The US has dwarfed peers in the magnitude of its response, with researchers from the Brookings Institution estimating total US fiscal relief of \$5.3tn as of March 2021, far exceeding the \$2.2tn GDP shortfall caused by the pandemic (chart 2).

Chart 1: 2021 real GDP estimates (%)



Source: Bateleur, Bloomberg, BCA research *2021 announced plans

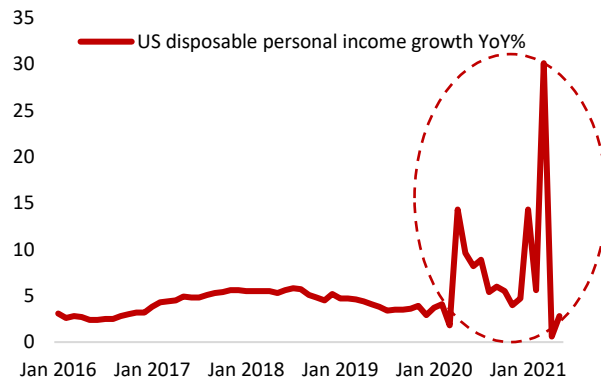
Chart 2: Record stimulus (as % of GDP)



US Fiscal relief totals \$5.3tn as of March 2021, compared to \$2.2tn GDP shortfall in 2020

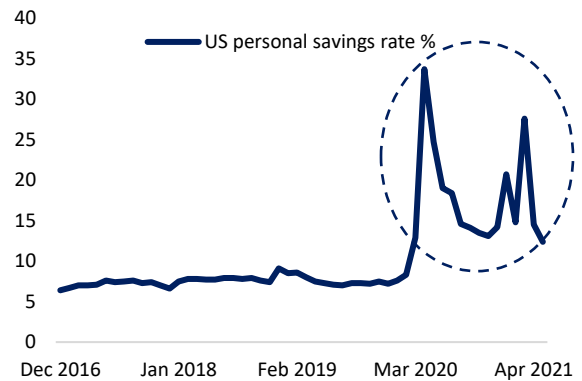
The US response has been unique in its focus on physical cheque payments to increase household incomes as opposed to backstopping pandemic impacted businesses. Chart 3 shows the significant increase in personal disposable income since the pandemic started, driven by the April 2020 CARES act and the March 2021 Biden rescue plan, both of which provided direct disbursements to households. Due to restrictions, households were able to save money they normally would have spent on fuel, clothes, entertainment, travel and other services resulting in a spike in the US personal savings rate (chart 4).

Chart 3: US disposable personal income growth (%)



Source: Bateleur, Bloomberg, FRED

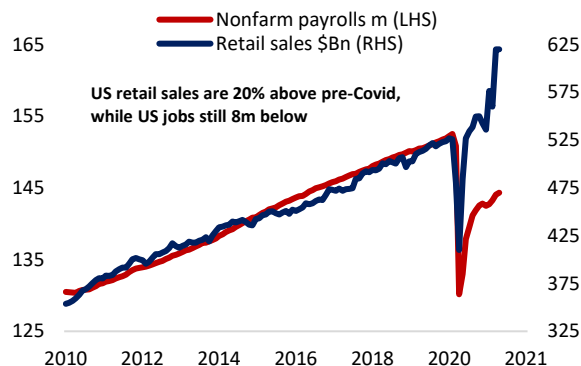
Chart 4: US personal savings rate (%)



Moody's estimates the US consumer has accumulated excess personal savings of close to \$2.6tn since the pandemic began. More recently, this has assisted consumption with US retail sales now 20% above pre-Covid levels despite US jobs remaining 8m or 5% below pre-Covid levels (chart 5).

This surge in demand for goods has come at the same time as retailer inventory levels are at record lows with supply chains heavily disrupted by Covid induced stoppages (chart 6). The net result has been a broad rise in prices in the short term – from both demand pull and cost push inflation.

Chart 5: US retail sales vs Nonfarm payrolls



Source: Bateleur, Bloomberg, BofA

Chart 6: Sharp reduction in retail inventories



Global equity market valuations remain well above trend boosted by low interest rates and elevated investor risk appetite (charts 7 and 8). Possibly the greatest risk to the current supportive backdrop is rising inflation – especially if it is more permanent in nature.

Chart 7: P/E multiples have expanded

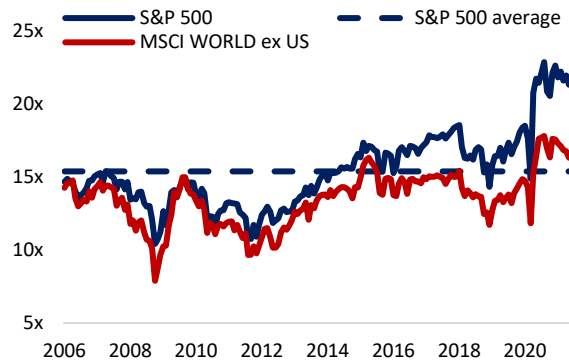
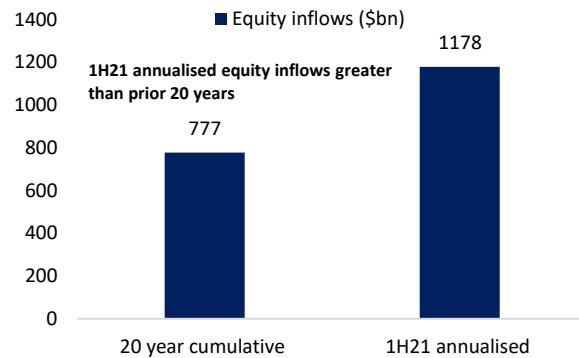


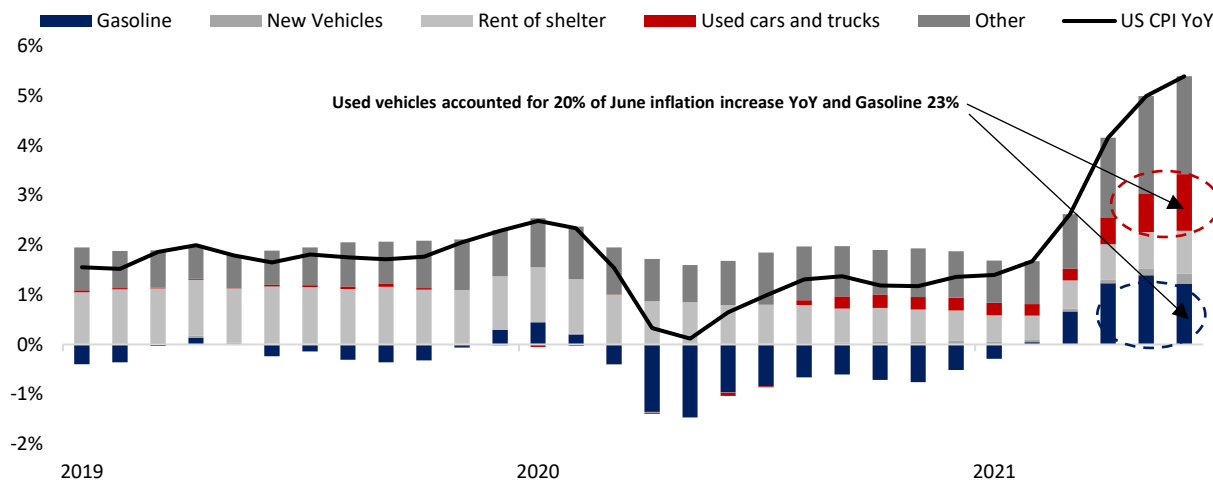
Chart 8: Global equity inflows (\$bn)



Source: Bateleur, Bloomberg, BofA

US headline inflation for June accelerated at the fastest pace in almost 15 years, rising 5.4% from a year earlier (chart 9). However, price increases are not broad based but concentrated in segments of the economy that have been heavily impacted by Covid supply chain disruptions.

Chart 9: US CPI YoY – top contributors



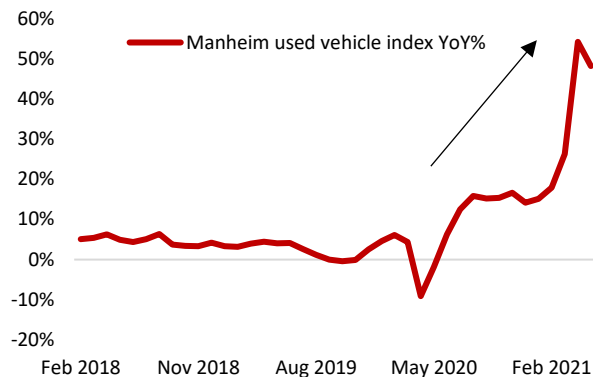
Source: Bateleur, Bloomberg

For example, used vehicle prices in the US increased 34% in June 2021 and accounted for over 20% of the rise in headline inflation year over year. Semiconductor shortages out of Taiwan has impacted lead times for new vehicles while strong consumer demand, boosted by stimulus cheques, have run down inventories, causing prices to rise. This should dissipate as new vehicle supply recovers (chart 10).

The surge in demand for goods has also impacted freight rates, with the average cost of moving a 40-foot container from Shanghai to Los Angeles up more than threefold over the past year. As port blockages and container supply improve, prices should ease (chart 11).

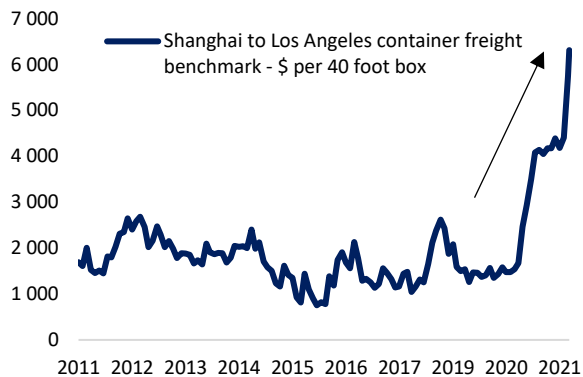
The year over year inflation figures have also shown outside gains partly because of base effects - inflation fell from March through June of last year during the pandemic lockdowns. This will moderate over the coming months as the base normalises.

Chart 10: US used vehicle prices YoY %



Source: Bateleur, Bloomberg

Chart 11: Freight rates remain elevated



US Federal Reserve (Fed) chair, Jerome Powell recently commented *“We think it is unlikely that they (covid price anomalies) would materially affect the underlying inflationary momentum that the economy has had for a quarter century. The underlying forces that created this dynamic are intact.”* Powell is referring to structural deflationary forces such as globalization, aging populations and technology adoption; all which remain firmly in place.

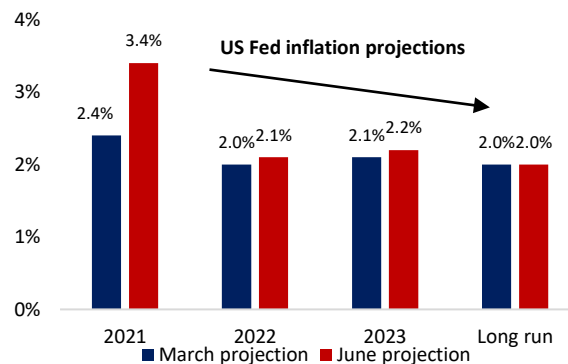
With long term inflation expectations largely aligned with Fed goals (stable inflation over time that averages 2%) and the recent pullback in longer dated bond yields, the market seems to agree with the assessment that the current bout of inflation is temporary in nature (charts 12 and 13). In combination with a robust global growth outlook and loose monetary policy[^] - this provides a favourable backdrop for risk assets – notably equities.

Chart 12: US inflation expectations (%)



Source: Bateleur, Bloomberg

Chart 13: US Fed inflation projections

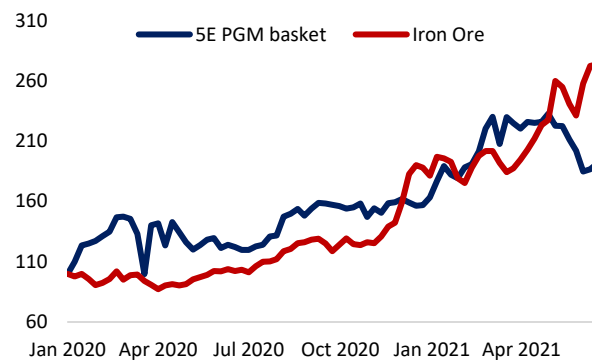


Fed Powell's comments made on 16 June 2021 post FOMC meeting. [^] Fed currently guiding to interest rate increasing from late 2023.

Current thinking – SA

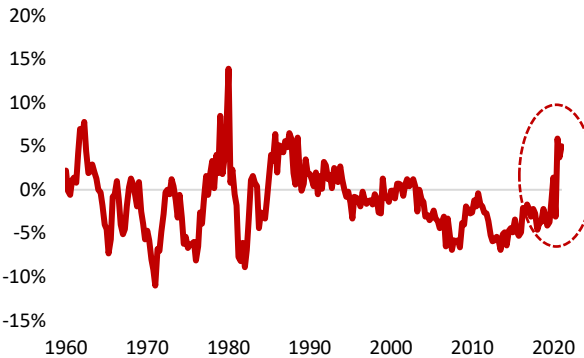
The SA economy continues to be a benefactor of external commodity tailwinds. Prices for the key export commodities of iron ore and platinum group metals (PGM's) are up strongly YTD (chart 14) resulting in SA's trade balance sharply improving. YTD, South Africa has recorded a net trade surplus of R209bn versus R18bn this time last year, the most significant since the 1990's (chart 15).

Chart 14: Commodity prices (indexed)



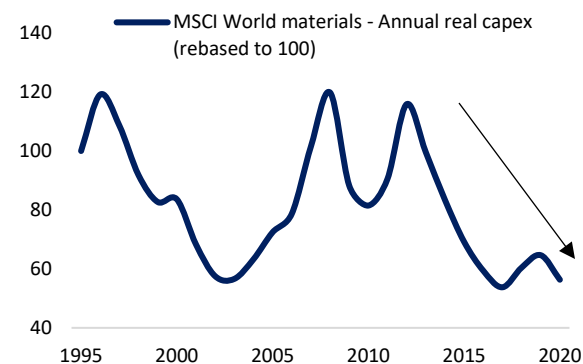
Source: Bateleur, Bloomberg

Chart 15: SA current account as % of GDP



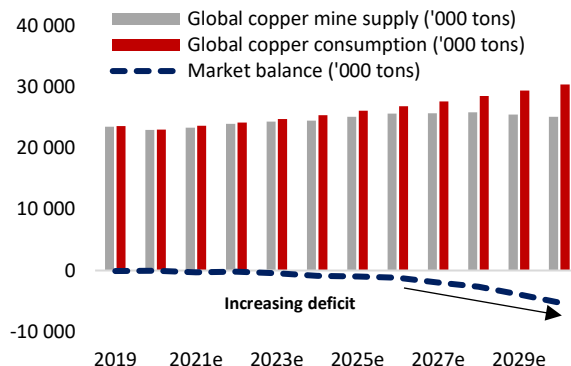
It is expected that this commodity up-cycle will be supported by persistent supply deficits (driven by record low real mining capex – chart 16) and increasing demand globally from government fiscal stimulus and decarbonisation policies (chart 17). A decade of underinvestment cannot be quickly remedied and even today there are little signs of large-scale growth capex across the mining sector.

Chart 16: Commodity sector capital expenditure



Source: Bateleur, Bloomberg, Glencore, Jefferies

Chart 17: Decarbonisation = metal intensive

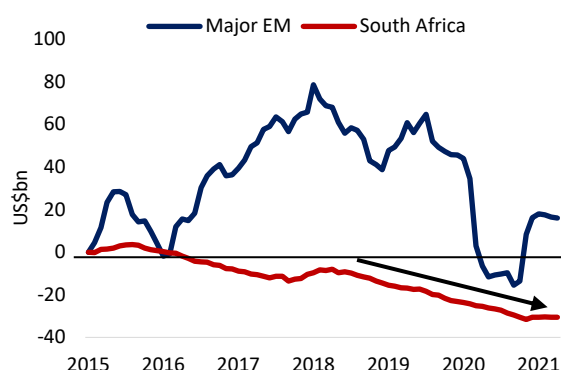


Firm commodity prices improve the country's trade balance, but there are additional positives via an increase in corporate taxes from the mining companies and future capital expenditure. We are already seeing the trickle-down impact where capital expenditure from the SA listed miners is expected to grow 60% this year from \$4.1bn to \$6.6bn. Fund holdings AECL and Hudaco should benefit from this increased mining capital expenditure.

Despite the supportive fiscal backdrop and encouraging signs of selective political and economic reform (Magashule suspended from ANC, Zuma arrest & imprisonment and the removal of self-power generation caps) there remains an overhang of slow structural reforms, high unemployment, low economic growth and what appears to be deep factionalism within the ruling ANC party – no doubt magnified by the current spate of civil unrest.

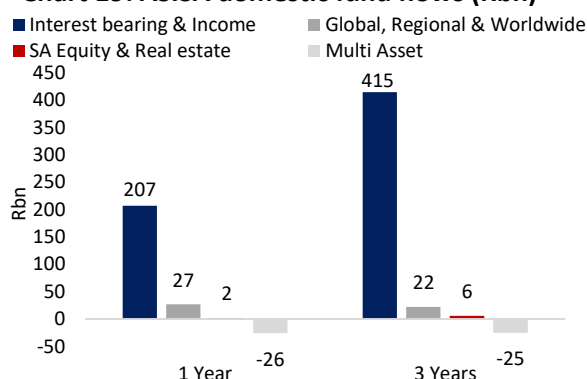
This challenging backdrop has manifested in sustained poor investor sentiment to SA risk assets. Foreigners remain net sellers of SA equities YTD, (chart 18) continuing a six-year negative trend. Similarly, ASISA data shows limited net inflows into equities, with local investors favouring interest bearing and income funds (chart 19).

Chart 18: Cumulative foreign equity flows into EM



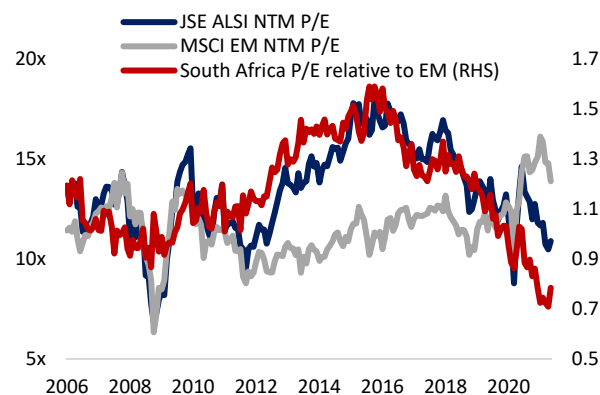
Source: Bateleur, Bloomberg, ASISA, SGB securities

Chart 19: ASISA domestic fund flows (Rbn)



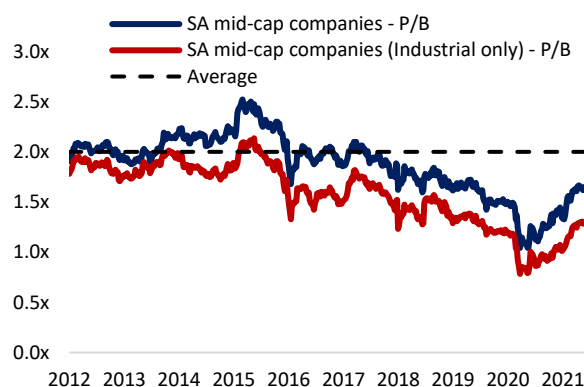
Unsurprisingly, SA equities continue to trade well below their long-term P/E multiple averages and at a record discount to emerging market peers (chart 20). Within domestic equities, mid-cap companies remain attractively valued despite a sharp share price recovery YTD (chart 21).

Chart 20: JSE ALSI forward P/E – below average



Source: Bateleur, Bloomberg, MS

Chart 21: SA Midcap holdings remain attractive



Current fund positioning

Positioning by asset class has not changed materially YTD. In the current low global interest rate environment, the fund retains a strong equity bias. However, we remain alert to rising global inflation expectations that if sustained could temper the attractiveness of equities. A clearer picture of the sustainability of higher inflation should emerge by September, once the Covid base effects dissipate.

The fund continues to hold close to the maximum 30% in global equities allowed by its mandate. This is an important diversifier from SA and reflective of the wider opportunity set available offshore. These holdings are stock specific, of high quality, trade at reasonable valuations relative to free cash flow prospects and, for the most part, have been held in the fund for a lengthy period.

The global portfolio includes select technology (Alphabet, Amazon, Sony, Microsoft) and defensive names (Johnson & Johnson, Nestle, Merck, Dollar General and Comcast). Exposure to global cyclical/value stocks is limited. Many of these value companies have questionable business models with poor earnings quality and weak balance sheets. They may experience strong share price gains in the short term, but over the longer term are likely to remain poor businesses and poor investments.

SA listed equity exposure at 58% is in line with the start of the year. Of this, 25% display Rand hedge attributes with 33% purely domestic focused. As alluded earlier, despite a weak and uncertain economic backdrop, SA equities are cheap relative to history, offer attractive dividend yields relative to money market rates, and trade at a record discount to emerging market peers.

Domestic holdings are largely stock specific incorporating select mid-caps, healthy weightings in RMI and Remgro and select quality defensives such as Shoprite and Spar. From a top-down perspective, the fund is constructively positioned for a continuation of the firm commodity price environment. Resource holdings include Anglo American, BHP, African Rainbow Minerals, Impala Platinum and RB Platinum.

The fund's exposure to longer dated SA government bonds ('SAGB') increased further in the review period to 9.7%, largely funded from domestic money market holdings. The 2030 maturing SAGB offers a current annual yield of 9.0%, a substantial 5.5% premium to short term money market rates.

Current fund positioning by strategy	%
JSE listed equities	58.0%
Domestic facing holdings	33.0%
Dual listed/Rand hedge	25.0%
Foreign listed equities	28.6%
Total equity exposure	86.6%
SA government bond (10 yr.)	9.7%
Cash & money market	3.7%
Total	100.0%

Sincerely



Kevin Williams

Bateleur Capital (Pty) Ltd

Authorised financial services provider

FSP no 18123

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SG109 Ground Floor, South Wing

Great Westerford Building

240 Main Road, Rondebosch

7735

—

T +27 (0)21 681 5060

F +27 86 649 1794

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E funds@bateleurcapital.com

W bateleurcapital.com

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