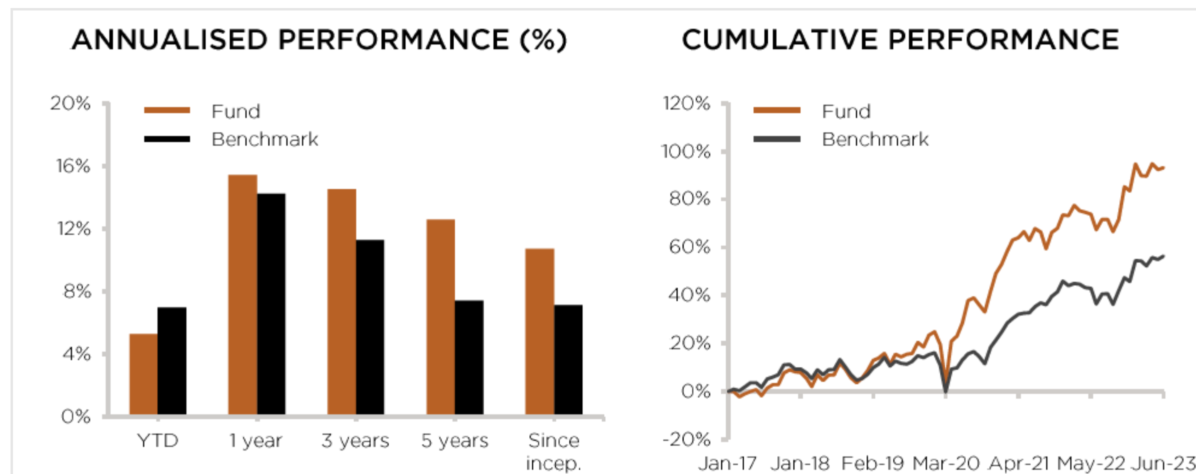
Fairtree Balanced Prescient Fund Quarterly Update Q2 2023



*Net of fees
Source: Prescient, 30 June 2023. Fund inception: January 2017
Benchmark: SA – Multi Asset – High Equity Category Average

The Early Recession Phase

The fund returned 1.82% over Q2-2023, 5.27% year to date and 15.43% over the last 12 months. The fund underperformed its peer group during the second quarter of the year but remains ranked amongst the top quartile over the last 12 months.

Fund Highest rolling 1 year period: 57.79% (Benchmark: 30.65%), Fund Lowest rolling 1 year period: -9.29% (Benchmark: -10.47%).
Benchmark Q2 2023: 2.61%. Benchmark YTD: 6.97%. Benchmark 12-Month: 14.24%
Data as of 30 June 2023

We remain defensively positioned and are increasingly focussed on the preservation of capital. Global growth continues to soften at a slow pace while inflation remains uncomfortably high and sticky despite falling. Central banks remain committed to rein in inflation and are set to hike rates further into restrictive territory. As monetary policy impacts the economy with long and variable lags, we believe the full impact of the most aggressive hiking cycle in 50 years has not been felt yet. The buffer from pandemic related excess savings is fading and global manufacturing is already in recession. We expect financial stability risk to increase and geo-political risk to continue to weigh on investor sentiment.

We are approaching the early recession phase and prefer to allocate capital to defensive opportunities across asset classes rather than aggressively increasing cash. Overall, the US consumer is in a far better position than during the prior economic

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cycles which will guide the economy to a shallow and potentially short-lived recession rather than a deep prolonged downturn.

Macro Overview

Global growth has been slowing for the last few quarters. Contrary to our expectations of a sharper slowdown in the US and stronger recovery in China, economic data suggested that the US household consumption has remained resilient on the back of a strong and tight labour market and still large amounts of excess savings available to spend. China data on the other hand has been disappointing suggesting the business and consumer confidence remains very weak despite the full re-opening of the economy.

We continue to expect a mild recession in the US over coming quarters. The buffers that protected consumption are fading and we see early signs of labour market weakness. The full impact of earlier rate hikes has not been felt yet. The more cyclical manufacturing side of the economy has been in recession the last few quarters as spending patterns has shifted from goods to services. Inventory levels of manufactured goods are high, and destocking is required before manufacturing will rebound. This trend can be seen globally, not just in the US and is largely also responsible for weak China manufacturing and trade data. China's recovery has been tepid and risk a deflationary cycle unless policy makers respond more aggressively to shore up growth. We expect more China policy stimulus over coming months.

While interest rates are clearly in restrictive territory, inflation data has not softened sufficiently. Central banks in Europe and UK are further behind the curve than the US and will need to do more tightening over coming months. We expect the US rates to peak potentially as soon as the July meeting. Scope for cuts remains limited. While we do see inflation softening from current levels, we doubt that core inflation will fall back to target anytime soon. Our longer-term outlook of structural high inflation implies that interest rates will also remain higher for longer. Emerging markets does not face the same inflation pressures as the developed world and are better placed to ease policy as headline inflation comes down faster. We expect economic growth in emerging markets to improve with further China stimulus, higher commodity prices and a weaker US dollar.

Our weaker US dollar view stems from peak Fed rates, softer growth in the US, improved growth outside US and still hawkish central banks in Europe. Portfolio outflows from the US combined with an increasing US trade and fiscal deficit will put further pressure on the US dollar over the long term. Although the US dollar will not lose its reserve currency status for many years or decades, the de-dollarisation themes has gained some momentum.

Geopolitically the fragmentation between the US and China has deepened. The risk of confrontation and increased decoupling between these nations weighs on Chinese assets. Russia's war in Ukraine continues to pose upside risk to energy prices as does Iran's gradual progress towards its nuclear ability.

South Africa's economy is in a dark place. Risks around energy availability, western sanctions, high interest rates, high inflation, weak state-owned enterprises, fiscal slippage, and political instability abound. Valuations reflects a large degree of these weaknesses and appears attractive against other emerging markets. We are gradually turning more optimistic on the outlook. We acknowledge the risk for further downside but believe pockets of deep value may be present already. We are encouraged by the outlook for increased renewable energy supply and improved ESKOM energy availability factor over a 6 to 12 months horizon. With inflation falling, the scope for rate cuts over the next 6-12months is rising. We do not expect Putin to be able to visit South Africa later this quarter. The risk of western sanctions on South Africa remains low.

Macro Review

Global equities rose 6.8% in dollars and 13.2% in rand over the last quarter. This rally was driven by a narrow set of consumer technology stocks and led by US stocks. Stocks aligned with progress on artificial intelligence has outperformed while the rest of the market was supported by lower inflation and decent economic data. Emerging markets underperformed and was largely flat over the quarter with China down almost -10% on growth and geopolitical concerns. Assets linked to China has underperformed including South Africa whose local equity market was up only 1.2% over the quarter. Resources underperformed largely due to PGM miners, but local banks and retailers had a positive quarter along with Naspers. During the quarter, the South Africa All Bond index dropped 1.5%, dragged down by concerns about growth, potential sanctions, and fiscal slippage. Foreign investors sold local bonds. Cash returned 1.9%.

The Bloomberg Barclays Global Aggregate Bond Index dropped 1.5% over the quarter. US 10-year bond yields rose towards 4% as inflation remain sticky and data printed on the stronger side of expectations. The US yield curve remains deeply inverted, signaling tight financial conditions. US and European high yield credit spreads narrowed over the quarter.

Commodity prices fell over the quarter. On the industrial side, Iron Ore fell 10.2%, Brent Crude oil decreased by 5.6%, and Copper decreased by 7.6%. Gold dropped 2.5% as real rates rose and the US dollar strengthened. Platinum was down by 8.9% while Palladium decreased by 15.9%.

Portfolio Performance

The fund returned 1.82% over Q2-2023 and 15.43% over the last 12 months (benchmark[1]: 2.61% Q2 2023 and 14.24% over the last 12 months). The fund underperformed its peer group over the quarter but remains ranked amongst the top quartile over the last 12 months.

The fund underperformed relative to its internal index as security selection detracted from excess returns while the asset allocation impact was neutral over the quarter.

Our security selection within SA & Global Equity detracted. SA Equity returned -1.1% underperforming the local equity index while Global Equity returned a positive 9.8% but also underperformed its index. Security selection within SA Equity detracted due to our overweight exposures to resources, especially PGM miners. Our exposure to gold miners contributed to returns along with Naspers and some local financial names. On the global side our selection within the consumer discretionary and underweight to information technology detracted from returns but more than offset the positive contribution from our name selection in energy, financials and overweight to communication services. Within Bonds our increased exposure to belly bonds contributed to returns.

Within asset allocation, our underweight allocation to Global Equities worked against us, but were offset by our overweight allocations to Global government bonds and underweight to SA Equity.

Portfolio Positioning

We remain defensively positioned for a global environment of; slower growth, high inflation, increased geo-political and financial stability risk.

As a result, we remain close to neutral on SA Equities and underweight Global Equities with a bias towards Emerging Markets. We remain overweight both SA and Global Fixed Income and are overweight Commodities. We are underweight SA Property and Global Real Estate. We are overweight cash with a bias towards SA Cash.

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[1] SA – Multi Asset – High Equity Category Average

We have a close-to-neutral position on South African equity and maintain a more defensive stance against global growth and rand weakness through global defensive industrial and global consumer exposures. Together with resources, these positions provide us with ample rand hedge exposure. We believe energy and diversified miners will benefit from increased EM demand and tight supply factors. Geopolitical tensions and scope for lower real rates will support gold and platinum. We trimmed our PGM miner exposure and increased exposure to SA Inc as local valuations are attractive.

We have trimmed but kept our SA property underweight as weak growth, high cost, and oversupply continue to weigh on the sector.

We are underweight on global equities, with our exposure split between emerging and developed markets. Valuations in the US remain elevated relative to history, and earnings estimates remain too high relative to our outlook for a recession. We believe profit margins will continue to contract as wage inflation remains sticky while nominal earnings come under pressure. On the other hand, valuations outside the US and across emerging markets appears cheap to fair. Equity markets outside the US may benefit from a weaker US dollar, low energy prices, and EM recovery. We have trimmed our cyclical bias in favour of defensive and consumer technology sectors within global equities.

We maintain our overweight positions in energy, materials, gold, and consumer discretionary sectors. We are underweight on the US, where policy is tightening, and overweight on China, where policy is loosening. Within Emerging Markets, we are overweight energy and financials and underweight information technology. We prefer commodity producers, including South Africa and Brazil, and are underweight Asia and commodity consumers. We remain neutral to underweight global property.

We have trimmed but continue to maintain our overweight exposure to physical commodities, including Gold and PGMs, which will benefit from inflation, high geopolitical tension, and the recovery in global vehicle production. Our total global exposure is in line with our Strategic Asset Allocation exposure. We believe US treasuries may provide a hedge against recession risk.

We are overweight on SA Fixed Income, given the attractive yields in real terms. We believe the SARB is nearing the end of its hiking cycle, and inflation will fall below 5% over the coming quarters. We have trimmed exposure to the long end and increased exposure to the belly of the curve.

Our portfolio is well diversified and defensively positioned to weather potential policy and geopolitical volatility, with high dispersion amongst sectors providing opportunities. We believe that growth will slow below trend as we enter a potential recessionary environment. Emerging markets may surprise to the upside but the risks around China have also increased. We continue to monitor macro indicators and will

adjust the portfolio as necessary, with a preference for diversification and investment in the liquid portions of the market for easy adjustment to changing.

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Highest rolling one-year return 57.79% (Benchmark 30.56%) and lowest rolling one-year return -9.29% (Benchmark: -10.47%) information to 30 June 2023. The fund has returned an annualised return of 10.72% since inception (Benchmark: 7.11%). The fund's annualised performance over 1-year is 15.43% (Benchmark: 14.24%). The fund's annualised performance over 3-year is 14.53% (Benchmark: 11.28%). Fund returns disclosed are annualised returns net of investment management fees and performance fees. Annualised return is weighted average compound growth rate over the period measured. Fund investment risk indicator level: conservative. Full performance calculations are available from the manager on request. 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. Highest & Lowest return: The highest and lowest returns for any 1 year over the period since inception have been shown. NAV: The net asset value represents the assets of a Fund less its liabilities.

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