Opportunity Fund

At a glance – our asset class views

Domestic asset allocation	Reason for inclusion	31-Oct-24			30-Jun-24		
		-	0	+	-	0	+
Equities	Limited domestic opportunities. We prefer SA-listed global stocks over 'SA Inc.'	●			●		
Fixed income	Real yield opportunities and portfolio construction benefits.			●			●
Cash	Default asset class. Portfolio construction and capital preservation benefits. Real return environment		●			●	
Listed property		●			●		
Global asset allocation	**Reason for inclusion**						
Equities	Plentiful real return and high-quality opportunities that reduce the risk of capital loss			●			●
Fixed income	Only short-dated bonds are attractive.	●			●		
Cash	Currency diversification and defensive benefits		●			●	
Listed property		●			●		

Views expressed for each asset class are subjective and are for the asset class as a whole. All views are as at 31 October 2024.

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The Ninety One Opportunity Fund is a multi-asset high-equity fund investing in a mix of South African equities, bonds, property and money market instruments, as well as international equities and fixed interest assets. The international exposure is limited to 45% of total assets, and the Fund may invest up to 75% in equities (local and global).

The Fund focuses on balancing capital preservation and delivering inflation-beating returns. By limiting the permanent loss of capital and consistently growing capital and income, the Fund has a proven long-term track record of outperforming CPI + 6%.

The asset allocation and stock selection decisions are bottom-up driven. They depend on the portfolio manager's ability to find individual assets that meet the criteria necessary for inclusion in the Fund — the criteria being the Fund's real return and capital preservation target objectives. As a result, we do not have specific top-down asset class views. Instead, we allocate capital based on where we see the best bottom-up opportunities while maintaining a balance of exposures that offers protection in a number of different investment scenarios.

Summary

- Global equities have continued their relentless march into the stratosphere, driven by momentum and sentiment. The market faces valuation risks at an index level, and despite the recent rally, its uncertain outlook has largely been ignored.
- Quality companies bring greater certainty. A slightly firmer economy provides a high degree of confidence in companies that are well-positioned to continue delivering growth beyond an additional boost that comes from some excitement around a single election event.
- Domestic equities, while buoyed recently, raise question marks given our concerns over the sustainability of these returns without growth. We see limited opportunity in domestic equities and tend to favour domestically listed global businesses.
- South African bonds provide investors with real return opportunities and are attractive relative to cash despite increased inflation and interest rate uncertainty globally. We argue that there is scope for further rate cuts, and cash rates will decrease accordingly.

The Fund's exposure to various asset classes is driven either by our real return objective and/or where an allocation to an asset class enhances diversification and reduces potential downside risk (portfolio construction benefits).

Equities

Global equities

With the US elections behind us, we can focus on markets and the likely impact on asset classes. From an investment perspective, the role that governments play in the economy and, ultimately, how that transmits to financial markets cannot be discounted. So, while we are bottom-up investors focused on company fundamentals and company prospects, it is important to keep an eye on political developments, especially in a world where geopolitical tensions are rising and risk is developing.

Regarding the US specifically, it is important to stress the context of where we were in the broader cycle as we went into the election. The US economy has been growing very strongly. We've had very low levels of unemployment and a very strong market. In addition, we're starting to see the first signs of a downward trajectory in interest rates, so in essence, the world is teed up for a potentially softer environment juxtaposed against potential industry support. It is important to interpret any policy changes through that lens.

It is too early to make specific comments about what could happen as the particulars of President-elect Donald Trump's policies will only be revealed throughout the next couple of months with him entering office in January. There are three key factors that we are mindful of as investors, with two positive and one negative. Trump is likely to reduce the amount of regulation sitting in the economy, which is pro-business and innovation-friendly, which is ultimately good for companies that innovate and invest in R&D. Secondly, Trump has promised lower rates of taxation, which is supportive of equities in general, but does lead to the negative point, which is that this all needs to be funded.

These policies also reinforce the idea of US exceptionalism, which, given our significant allocation to US equities, certainly benefits us from an investment perspective. Life may get more difficult for some of the trading counterparts of the US, with China in particular, Europe and emerging markets all potentially coming under pressure. However, we are not heavily invested in these areas. Investing is a complex puzzle, and this is undeniably a chunky piece in solving it.

It's difficult to know how long the rally in some of the lower-quality parts of the market will last, and investors should ultimately focus on underwriting the earnings resilience of good businesses. Whether the current earnings outlook is still as robust in six months for these companies is unclear.

Quality companies offer a higher degree of confidence. A slightly firmer economy enhances confidence, particularly in businesses that are well-positioned to sustain growth outcomes beyond the temporary additional boost that comes from some driven by the excitement around this single-election event. Ultimately, that is what matters for quality investors. We aim to understand what will drive

long-term compounding and want to ensure that we can underwrite that with a high degree of clarity. At this point, we think many businesses have been overlooked by the market where the growth has not been appropriately rewarded and where the prospective returns are still reasonable.

Global equity remains our preferred asset class. Over the next five years, we expect global equities to be the top-performing asset class, with an annualised return of over 12% on average in rand terms. We believe that through the bottom-up analysis of our global team, we can find significant value in select, high-quality global equities, which offer diversification benefits for South African investors. We argue that there are index and valuation risks in a highly distorted and concentrated market.

Generating inflation-beating returns for our investors requires exposure to growth assets and we believe global equities remain the best risk-adjusted growth asset. The Fund, therefore, maintains a healthy offshore equity allocation of approximately 37%.

Domestic equities

From a South African perspective, it is too early to understand the long-term impact of recent global events on emerging markets generally, so the focus here is on the self-help story.

The Government of National Unity (GNU) is a potentially positive catalyst for domestic opportunities and provides hope, which has been reflected by the rally in assets linked to the domestic economy. The longer-term prospects for many 'SA Inc.' companies, however, are still dependent on the sustained recovery of the local economy, which we have seen little sustained evidence of. While we are incrementally more constructive on the backdrop, we remain conservative in our outlook and continue to hold a low overall allocation within the Fund. While we have seen renewed interest from global investors, appetite has remained poor, and we continue to see net foreign selling of domestic equities. This trend needs to slow or reverse for asset price gains to be sustainable.

We have, therefore, remained highly selective in our domestic equity holding. Our domestic equity exposure remains around 27%, of which roughly two-thirds is focused on SA-listed global equities and one-third on SA-listed local equity. Based on our scenario analysis, the range of future expectations is wide and we have a lower level of conviction here given the external risks.

Bonds

Domestic bonds

We continue to believe that the best local risk-adjusted opportunity remains government bonds. Downside risks to the fiscus and an uncertain global environment are somewhat offset by a compelling yield underpin and possible rate cuts to follow. As such, we hold ~12% in domestic government bonds in the belly of the curve.

Importantly, these assets counterbalance our global equity exposure, given its uncorrelated diversification benefits. They provide a natural hedge against the volatility of the rand and deliver stability to the portfolio, given that South African bonds and the US dollar/rand exchange rate are negatively correlated over time.

Global bonds

We are concerned about proposed policies creating more inflation. The bond market, which will ultimately serve as the arbiter of how effectively Trump can implement some of these policies, has already responded with higher yields. Given that we are in a declining interest rate environment with a softening economy, Trump's policies may alter the trajectory but not the path. Disinflation may be temporarily halted, which would feed back into the system.

Given continued uncertainty and the risk-reward dynamic currently in play, we prefer global cash on a risk-adjusted basis. We do not hold an allocation of global bonds within the portfolio.

Listed property

Global property

We believe allocations do not provide enough portfolio diversification and we can find better risk-adjusted opportunities in other asset classes. That said, property can offer diversification benefits and is not overlooked. Currently, we maintain a limited allocation to global listed property, with specific exposure to Digital Realty Trust, a geographically diverse business, specialising in data centres, Crown Castle International, and Big Yellow, the largest self-storage operation in the UK.

Domestic property

Despite better returns more recently, we have struggled to find high-quality opportunities with confidence in the sustained investment case on a medium-term view. While opportunities exist, our conviction and the certainty of outcomes remain low. We hold no

allocation within the portfolio at this stage.

Cash

Domestic cash

Headline figures have eased, now tracking closer to the lower end of the inflation target bands, providing impetus for rate cuts. The South African Reserve Bank (SARB) cut rates in September by 0.25%, in line with global central bank moves. Cash rates are now at 8.0%, and we expect a further 0.25% decrease when our central bank meets later this month. The direction of travel for 2025 will be heavily influenced by the global rates cycle, which is now less clear.

Current cash rates imply a real return for investors and less of a drag on our return target. We hold an allocation of ~13% within the portfolio.

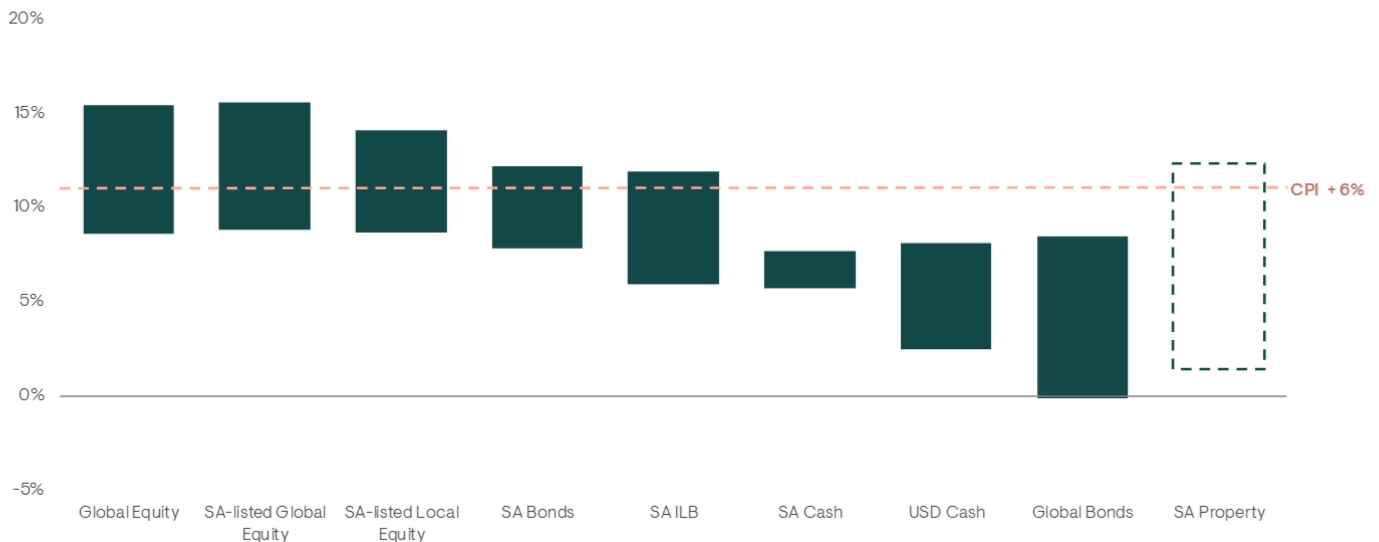
Global cash

While the US Federal Reserve has cut rates by 0.75% and real rates have decreased, global cash still provides a defensive ballast amid continued uncertainty, and will benefit the portfolio should the rand devalue. We hold an allocation of ~3%, and patiently await more attractive opportunities.

Return outlook

Looking ahead, we believe investors will be rewarded for holding appropriate risk assets, despite potential short-term volatility, which should be viewed as a natural and healthy aspect of investing. Given the outlook, we believe our inflation-plus targets are achievable based on the available opportunity set. Importantly, the expected range of returns outlined below does not reflect return expectations for broad asset classes as a whole, but rather the assets we own, which we argue provide greater certainty of outcome. The midpoint of each bar represents the most likely outcome, and the height of each bar represents the variability (or risk) attached to each.

Expected 5-year returns



Source: Ninety One – November 2024. Forecasts are based on disclosed reasonable assumptions and are not a reliable indicator of future results.

In our view, we are well positioned to provide dependable, meaningful inflation-beating returns over the medium term, blending the best of growth assets with the income on offer from defensive assets.

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