REFOCUS

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This document describes our thinking behind selected recent portfolio management actions in our portfolios and provides context to their current positioning against the backdrop of their investment opportunity set. Our funds always consist of a diversified portfolio of opportunities and risks; please bear that in mind when evaluating our commentary about individual positions.

MARKET VIEW

2016 was a great year for RECM and our clients. Our equity fund outperformed the FTSE/JSE All Share Index by almost 40%, while our balanced and global funds also comfortably beat their benchmarks. To be sure, after our horrible 2015, our funds are still lagging their benchmarks over the longer term, but we are catching up fairly rapidly. And we expect this trend to continue.

At the start of every year, most market experts set out their stall with forecasts for the year. We have only one forecast to which we have an above average degree of certainty attached. It is simply that for the next few years value will continue to outperform as an investment strategy.

Our forecast is not based on crystal ball gazing, but simply recognizing that there is one fundamental law in markets: what goes up must come down. Put another way, regression to the mean in markets is an incontrovertible law. In science, and hopefully, in business, progress is linear, and sometimes even exponential. But in investing, progress is cyclical and mean-reverting. The reason for this is that the progression of business is handicapped by the market via price. Even a business with massively exponential growth can turn out to be a bad investment if its market price discounts more growth than what eventually materialises, disappointing the handicappers. And a run of the mill business could be priced to be going out of business, and if it doesn't, turns out to be a good investment as its market price rises to reflect the new reality.

So in markets, mean reversion (nearly) always works, because of the interaction of price (what the market expects) and business conditions (what is actually happening). Of course there are always exceptions, but why would you want to fish in a pond with so few fish?

For years now, value investing has been out of fashion. In fashion were concepts like "high quality", "low volatility", "yield-generating". All these concepts were effectively driven by a secular decline in interest rates to multi-generational low levels. In fact, there is a cohort of investment decision-makers out there whose investment experience includes only an environment of low inflation and low interest rates. We think the scene is set for a mean-reverting pivot away from momentum investing (which includes all the concepts mentioned above) towards value investing.

The one fly in the ointment is the move towards index investing. This move has gained ground over the past few years, and this is completely understandable. Far too many active managers have been charging active fees for merely hugging the index, and underperforming after fees. Others, mainly value investors such as RECM, have deviated substantially from the index, with, until recently, no sign of outperformance. As a result, investors have been voting with their feet.

At RECM we think indexing is useful for many investors, but we also think that active management has an important role to play. Specifically, we think value as a strategy is significantly underrepresented in most funds, and that over the next few years this will change. To the extent that the move to indexing carries on, large cap momentum stocks could continue to benefit, but value has become compelling, and this fact is in the process of being recognised by the market.

So our market view for 2017 and beyond is simple: value will come back into fashion. And RECM provides clients with a vehicle to benefit from this move.