Merchant West Sanlam Collective Investments Balanced Plus Fund
Quarterly Report
Quarter ending 31 December 2024

Fund Details

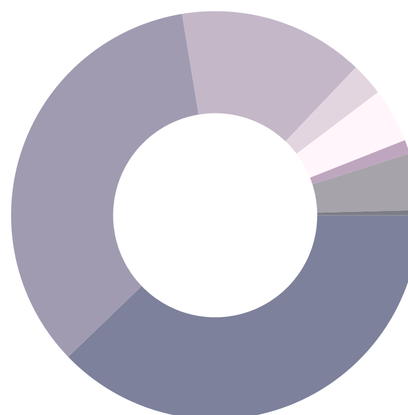
Benchmark	ASISA Category	Portfolio Managers	Suitable Investor
ASISA Category Average: SA Multi-Asset High Equity	South African Multi-Asset High Equity	Andrew Dowse Raymond Shapiro	The Merchant West Sanlam Collective Investments Balanced Plus Fund is suitable for an investor seeking long-term capital growth with a medium risk tolerance. The Fund is Regulation 28 compliant and has a maximum effective equity exposure limit of 75%. The recommended investment horizon is five years or more.

Top 10 Holdings

Top 10 Holdings	%
Merchant West Global Equity Fund USD Class A	20,3
Naspers Ltd	6,2
RSA Govt Bond R2035 8.875% 28022035	4,6
RSA Govt Bond R2040 9.0% 31012040	2,9
FirstRand Ltd	2,9
Standard Bank Group Ltd	2,7
British American Tobacco Plc	2,7
Nedbank Group Ltd	2,7
Absa Preference Shares	2,6
RSA Govt Inflation-Linked Bond R202 3.45% 07122033	2,5

Asset Allocation

Portfolio Date: 31/12/2024



Asset Allocation	%
SA Equity	37,8
Global Equity	34,6
SA Fixed Income	14,7
SA Preference Share	2,6
SA Property	4,3
SA Cash	1,1
Global Property	4,5
Global Cash	0,4
Total	**100**

Annualised Performance

Annualised Performance	Fund %	Benchmark %
3 months	5,5	1,9
1 year	23,5	8,2
3 years	11,8	6,9
5 years	12,6	5,8
10 years	11,1	6,2
Since Inception (November 2012)	9,0	6,3

Launch Date (November 2012)

Highest and Lowest Annual Returns

Highest and Lowest Annual Returns	%
Highest annual return	44,0
Lowest annual return	-10,2

Market Overview and Fund Performance Review

The first three quarters of 2024 were characterised by strong price gains in global equities, with the MSCI World Index (US$, net Total Return) gaining almost 19% and the MSCI Emerging Markets Index almost 17% over this nine-month period. The fourth quarter started off with some uncertainty surrounding the outcome of the US election held early in November. The results were conclusive and confirmed that Donald Trump had won the presidential vote and that the Republican party had secured majorities in both chambers of the US Congress. The clean sweep places Donald Trump's government in a position to quickly enact the "America First" economic policies that were key to his election campaign, including lower taxes, higher trade tariffs and government deregulation which investors hope will boost economic growth. This drove US equity markets higher in November, with the US outperforming other major regions significantly.

However, global equity markets stumbled in the last month of 2024. Comments from Federal Reserve Chair Jerome Powell in December suggested that the Fed's outlook for US inflation had become more cautious and that he saw the need for fewer interest rate cuts in 2025, triggering a sell-off in US equities. The Dow Jones Industrial Index shed 5.2% and the S&P 500 lost 2.4% in December, while the Nasdaq managed to eke out a positive return of 0.5% as the mega-cap tech stocks defied the December gloom.

December's arrest left both developed and emerging markets equities in the red over the quarter, with the MSCI World Index showing a total return of -0.2% while the MSCI Emerging Markets Index declined by 8.0%, both in US dollar terms. Trump's election win resulted in heightened uncertainty in emerging markets, with the Chinese equity market (MSCI China: -4.4%) in particular bearing the brunt of the negative sentiment in November on concerns that an escalating trade war with the US could undermine the support measures announced by Chinese authorities earlier during the year to stimulate domestic economic growth. Chinese equities did however manage to recoup some lost ground in December as the government announced further measures aimed at boosting lackluster economic growth.

Despite the poor end to the year, 2024 was a good one for developed equity markets as the MSCI World Index produced a total return of 18.7%. The so-called "Magnificent Seven" mega-cap tech stocks ended 2024 with a gain of 48%, including a 171% year-on-year (YoY) gain by chip maker Nvidia. The MSCI Emerging Markets Index lagged somewhat with a total return of 7.5% in US dollars after Trump's election win and the prospect of increased trade tariffs.

Fed Chair Jerome Powel's cautious stance on US inflation should not come as a surprise. US inflation increased in November to 2.7% YoY from 2.6% YoY in October, in line with market forecasts.

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The Fed announced another 25 basis points cut to the federal funds rate in December, marking its third consecutive cut in 2024 and reducing the Fed's target range to 4.25% to 4.5%. Hawkish comments from Chair Powell post the meeting and a revised Fed committee dot plot indicating that policymakers now anticipate just two interest rate cuts in 2025, totalling 50 basis points, compared to 100 basis points of reductions projected in the previous quarter surprised investors. The Fed also revised its GDP growth forecasts upward for 2025 from 2.0% to 2.1% and reduced its unemployment forecast for 2025 from 4.4% to 4.3%.

The Bank of England (BoE) left its interest rate policy rate at 4.75% following its December meeting, in line with market expectations, as UK inflation (increasing for a second month to 2.6% YoY in November from 2.3% YoY in October) and some indicators of inflation expectations had risen. Governor Bailey confirmed that the BoE was adopting a more cautious approach, and that UK monetary policy would need to remain restrictive until UK inflation returned sustainably to their 2% target. The European Central Bank (ECB) cut its key interest rate for the fourth time this year by 25 basis points in December, in line with market forecasts. The inflation outlook for the region remains in line with ECB's targets and is forecast to print at 2.1% in 2025 and 1.9% in 2026.

The hawkish comments from Chair Powell around the Fed's outlook for US inflation and reduced expectations for interest rate cuts for 2025 caused a sell-off in US treasury bonds in December as bond yields moved significantly higher. The US 10-year treasury yield increased 39 basis points to 4.58%. This was nearly one percentage point higher than when the Fed began cutting US interest rates in September. This is the opposite of what the central bank would have expected as investors demand a higher risk premium on US government bonds. Bond yields also increased in the UK and Europe during December. The higher bond yields, especially in the US, left the Bloomberg Barclays Global Aggregate Treasuries Index with a total return of -6.0% in the fourth quarter, and -3.6% for the calendar year. Global listed property (GPR 250 REIT Index, US$, net) was hard hit in December (-7.5% in US dollar) after the significant increase in developed market long bond yields, resulting in a total return of -9.7% for the December quarter and just 1.6% for the calendar year.

One of the big drivers of stock market performance over the past year was investment in Artificial Intelligence (AI). While this theme is likely to continue for some time, with today's US$200 billion AI market which is forecast to reach more than $1 trillion by the end of the decade, we believe that one should approach the current exuberance cautiously. If enacted, the threat of trade tariffs by the US could hurt global economic growth and stoke inflation in the event of retaliation. Furthermore, while the US economy still appears to be in good shape, the UK and Europe as well as China appear to be struggling to revive the momentum in their economies. Perhaps more concerning, US national debt currently exceeds $36 trillion and, with an increasing interest bill, is rapidly climbing. This has prompted president elect Trump to form the Department of Government Efficiency (DOGE), headed by Elon Musk, in an effort to cut federal spending and regulations. According to Musk, DOGE will try to cut $2 trillion from federal spending but admitted that they may not reach that goal.

Despite a significant improvement in economic sentiment following the formation of the Government of National Unity (GNU) in June, South Africa's economy grew by just 0.3% YoY in the third quarter of 2024, below market expectations for 1.2% growth. The slower than expected growth was due to a significant slowdown in the local agricultural sector (-28.8% YoY) which was adversely affected by weak crop outcomes and lingering diseases in the livestock industry. The absence of load-shedding and improvements in Transnet's performance did support higher output from the local mining and manufacturing sectors in the third quarter of 2024.

Total new vehicle sales in South Africa increased by 8.1% YoY in November to 48.5k units.
Retail sales surged by 6.3% YoY in October, ahead of market forecasts for a 2.1% increase. SARS confirmed in November that two-pot retirement system withdrawals had reached R35 billion since its launch. The SARB expects the local economy to grow by 1.1% in 2024, 1.7% in 2025 and 1.8% in 2026.

South Africa's inflation rate increased slightly to 2.9% year-on-year (YoY) in November but came in below market forecasts of 3.0% and remains well below the SARB's midpoint target of 4.5%. Core inflation eased from 3.8% YoY in October to 3.7% in November. The South African Reserve Bank reduced its key interest rate by 25 basis points to 7.75% at its November meeting, as anticipated, bringing borrowing costs to their lowest level since April 2023. Policymakers stressed that while inflation is well-contained in the short term, the medium-term outlook carries significant uncertainties and potential for upside risks.

Despite the progress being made by the business-friendly GNU, the South African stock market could not escape the gloom in global markets and after three consecutive negative months ended the quarter with a total return of -2.1% for the FTSE/JSE All Share Index. Investors' focus appears to have shifted to global issues, including Trump's potential trade tariffs and sticky inflation. The SA Resources sector was the worst performing major index with a total return of -9.0%, with losses across the board: Industrial Metals & Mining (-7.8%), Precious Metals (-9.4%) and Chemicals (-21.1%) as metal prices fell on concerns about Chinese growth prospects, and Chemicals sector heavyweight Sasol lost more than 28%. Interest rate sensitive sectors were negatively affected by the weaker rand (which depreciated by 9.5% against a very strong US dollar over the quarter) and the uncertain inflation outlook, with SA Financials losing 1.1%. SA Industrials managed to eke out a positive return of 0.2% for the quarter as rand-hedge stocks benefitted from a weaker rand.

While SA bonds (BEASSA All Bond Index) produced a negative return of 0.3% in December as local bond yields moved higher, in line with global peers, this was not sufficient to result in a negative quarter. The All Bond Index managed a total return of 0.4% for the quarter, and a stellar 17.2% for the calendar year. South Africa's listed property market (FTSE/JSE SA Listed Property Index) ended the quarter in the red, however, with a total return of -0.8%. For the calendar year, listed property has delivered top performance with a return of 29.0%, outperforming all the major asset classes.

While we remain positive on the outlook for the South African equity market in the medium to long term, subject to the GNU holding and producing results, the challenges facing the country remain. Furthermore, uncertainty on the global economic and investment stage will continue to have a direct impact on the local economy and financial markets and will no doubt result in some volatility in the new year.

The Fund rose 1.2% in the final quarter of 2024, slightly behind the benchmark peer group (ASISA SA Multi-Asset High Equity) return of 1.5%. On a full year view, the Fund gained 14.7%, ahead of its benchmark which rose 13.5%. Like the index, the Fund's holdings in SA equities and real estate drifted lower while global equities were boosted by the over 9% weaker rand.

Commodities struggled in the volatile 4th quarter of 2024. Assets exposed to China and emerging markets trended downwards amidst fears of a Trump disruption when he takes office. Tariffs are likely to be directed strongly at China, a country already battling to meet targeted GDP growth with internal demand slowing. Diversified miners like BHP (-14.0%) and Glencore (-15.5%), together with Kumba (-18.6%), dragged the Fund's allocation to the sector lower as these are businesses mostly exposed to China. Sasol (-28.3%) disappointed the market while the Fund's choice to own Exxon (+1.4% in ZAR) paid off again. Another energy related business that the Fund owns, Thungela, rose 21.8%, beating all its peers. Retailers performed well, and the Fund selected positively through Mr Price (+10.4%), Foschini (+8.6%), British American Tobacco (+9.6%) and AVI (+6.1%). Banks struggled and were down between 5% and 8%, but the Fund offset the weakness in Financials with strong performances from Discovery (+14.4%) and OutSurance (+17.5%) and picked positively offshore through JP Morgan (+25.3% in ZAR) that enjoyed the positive sentiment following the Trump election victory. The Fund's holdings in industrials also struggled but Hudaco (+11.3%), and Honeywell (+20.3% in ZAR) were shining lights against this backdrop. US Technology firms rallied, seeing Alphabet (+25.2% in ZAR), Nvidia (+21.2% in ZAR) and Microsoft (+7.5% in ZAR) rise generously. Other assets like preference shares and bonds were mostly stable and rose modestly through the quarter.

Portfolio Actions

In the fourth quarter of 2024, the Fund made one new addition, Octodec, an attractively valued real estate business focused on Gauteng. There are some self-help options available to Octodec that could bring down vacancies and boost rentals. Furthermore, the announcement of its likely inclusion into certain headline property indices will likely improve demand for these shares.

To fund the acquisition above, we sold out of Equites Property Fund, a logistics and warehousing real estate company that has performed well recently. Our optimism for this business has reduced lately given the current valuation and some macro headwinds brewing in the UK where the business has material exposure. In December, we sold another real estate business, Fairvest. This business rallied sharply from R4.51 per share in the middle of November and we felt the valuation no longer justified the opportunity. We exited at R5.03 per share. Lastly, we sold our remaining position in Absa Group. We had been trimming this holding as the optimism of a GNU played out. A decent trading update in the first week of December saw significant catchup in the share after it had lagged other banks through the GNU rally. As the market becomes more volatile leading up to the inauguration of President-elect Donald Trump, we may see our trading activity increase as we find opportunities to both realise gains and enter new positions at attractive valuations.

Portfolio Strategy

The Fund's objective is to outperform the average fund in its category (SA Multi-Asset High Equity) over a full market cycle (trough to trough or peak to peak).

The Fund seeks to achieve its objective by applying asset allocation and stock selection views to the current context across domestic and global markets. For the most part, the Fund is unlikely to deviate significantly from prevailing trends. Occasionally, if faced with extreme market conditions, the judgment of the portfolio manager could result in positioning that deviates significantly from that of the average fund.

Current market conditions remain volatile by several measures. We observe signs of irrationality in market prices relative to intrinsic valuations and a worrying disparity between relative asset class relationships. Easy monetary and fiscal conditions have provided a false sense of security, and we remain concerned about a variety of tail risks that could lead to a market shock in stocks that exhibit extreme valuations. For this reason, we hold a combination of reasonably priced assets that can provide participation in the liquidity driven rally of equity markets, together with sufficient assets that provide protection if a catalyst causes reason to reprice these extreme securities. Exposure to uncorrelated assets (like bonds, preference shares and gold) supports the portfolio construction process.

Not having exposure to assets that enjoy the tailwinds of easy money would risk missing an earnings recovery that might negate the need for a re-rating. For this reason, we look to allocate a relatively full equity weight and hold it through the cycle. Other asset classes (like bonds, property, gold, or cash) that possess the right uncorrelated characteristics for the appropriate time are used to gain protection. Within asset classes, we look for companies that possess valuations that are attractive for their given quality attributes as well as adequate growth opportunities.

Andrew Dowse
Portfolio Manager

Raymond Shapiro
Portfolio Manager

Disclaimer

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