Skyblue Fund Feedback

Dissecting September 2019

September was a less stressful month for local investors, after a tough July and August, ending the third quarter of 2019 on a slightly more positive note. Returns were still relatively muted however, with the highest barely breaking 1%, but at least all the local asset classes delivered a positive number.

Offshore markets were the place to be once again, as in July and August, with the average global flexible portfolio providing the best returns for the month. This return included significant currency volatility however, as the Rand initially strengthened from around R15.20 to under R14.60 midway through the month, before weakening back to the where it began the month. Relatively strong markets, rather than currency, therefore drove the return, with major exchanges holding up amid a string of quite negative economic data and news headlines.

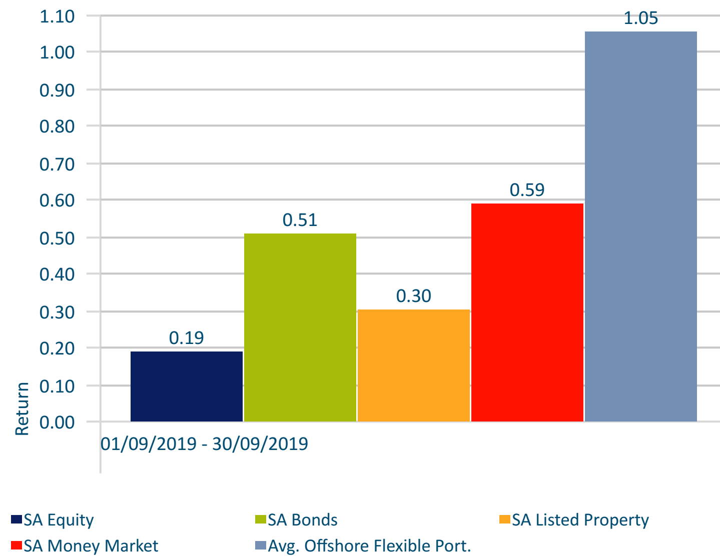
Cash was king in September, as evidenced by the muted returns of other asset classes. The return figures definitely do not show the volatility experienced however. The local equity index started the month out strong, recovering from the downturn experienced throughout August, peaking at close to 58 000 halfway through the month. The trend turned downwards hereafter, with the index ending below its starting point to post a price return of approximately -0.8%. Dividends thankfully helped to push the Total Return to positive 0.2%.

Here at home it was a chaotic month of social unrest and violence. There were what should have been some key economic events, such as strong GDP data released for the second quarter of 2019 (3.1% QoQ), the World Economic Forum in Cape Town, a massive $5bn raised in South Africa's biggest Eurobond sale to date, and the surprise release of a generally well received economic policy proposal by minister Tito Mboweni. The focus however, especially that of the media, was on the shocking violence displayed in xenophobic- and gender-based attacks, with much of this positive economic news being drowned out.

Monthly economic data released included a slight rise in inflation for the month of August, up from 4% in July to 4.3%, attributed to increases in the food and non-alcoholic beverages and housing and utilities categories. The MPC decided to leave interest rates unchanged at 6.5% and in so doing indicated the likelihood of another cut is receding over the short term.

Asset Class Returns - September

Currency: South African Rand



Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
SA Equity	1.86	5.07	5.32	11.48
SA Bonds	11.42	8.91	8.28	8.79
SA Property	-2.70	-3.51	3.24	11.21
STeFI Composite ZAR	7.34	7.41	7.15	6.53
(ASISA) Global MA Flexibl	7.37	8.01	8.73	11.47

*Annualised return is the weighted average compound growth rate over the period measured.

Some Food for Thought

We have been doing catch up's with our underlying managers regarding performance and holdings. Our property holding has experienced a tough year, so we provide below some comments from the manager regarding the state of the SA Listed Property market.

Property fundamentals remain constrained due to the low economic growth in South Africa, but the price action from the negative sentiment and short-selling action has been severe. The current share price of some REITs suggests the market appears to be pricing in their bankruptcy, which in the main is unlikely. The increased M&A activity (e.g. Safari cash offer) illustrates that there is substantial value in the mid and small cap sector, which most seasoned property professionals recognise. Unfortunately, many of the large cap REITs are wary to take on additional SA risk now, and are probably being instructed by their boards and largest shareholders to focus on their existing portfolios, or look for more offshore opportunities (e.g. Growthpoint recently announced they are looking at investing into Capital & Regional). We may see more cash offers come from private equity or unlisted funds, or potentially from management buyouts. There are other candidates, similar to Safari, that have started to attract attention.

In the past, SA REIT investors and sell-side analysts have used the loan-to-value (LTV) metric as the key indicator of a REIT's capital structure. Investors have felt comfortable in the past with LTVs up to 40%, knowing that property values in SA generally increase each year due to the contractual escalations built into most leases. Investors became uncomfortable if this limit was breached and management had no clear strategy to reduce it in the short to medium term. Due to the anaemic economic growth, and growing concerns of oversupply in most property sectors / types, investors have become more concerned around the possible impact negative rental reversions could have on commercial property values in the short to medium term. There is also the risk that property valuers adjust their discount and cap rates higher if they deem the risk premium related to future cashflows has increased.

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Source: Morningstar Direct

Skyblue Fund Feedback

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Some Food for Thought (cont.)

There has been a significant decline in commercial property transactional activity over the last two years due to low levels of investor confidence, which means the reference data available to valuers has also significantly declined. Lower rentals and higher discount rates will negatively affect property values, and therefore adversely affect LTVs.

We have started to see lower valuations come through in recent results from SA REITs, but they had not been significant to date. The exception came at the end of last week. Texton Property Fund (TEX) reported their FY19 results and disclosed that their SA portfolio devalued by 18,5% on a like-for-like basis as a result of the "economic erosion and the impact of negative rental reversions". The Texton management team has seen many CEOs come and go over the last few years. The numerous management changes have probably meant that their assets have not been receiving the required attention, which has probably led to their decline and the writing down of their value. Most SA REIT management teams have remained stable and have focussed on retaining tenants, and completing defensive and accretive capex programmes to ensure that their properties remain relevant to their current and potential tenants, and at least retain their value in the short to medium term.

Most management teams hedge between 75% and 100% of their interest rate risk in the short to medium term, generally in line with their debt maturity profile, which limits their risk to short-term interest rate movements.

SA REITs have generally expanded offshore using debt due to the relatively lower cost of funding. They have achieved this through a mix of in-county debt and cross currency interest rate swaps (CCIRS). In effect they have been shifting their rand debt into offshore debt, and benefitting from the lower debt yields in those markets. This has meant most offshore investments have been made with LTVs ranging between 50% and 100% , which does put them at risk if there are any issues within the portfolios, or if interest rates in those markets increase. This risk has been highlighted by sell-side analysts and has probably contributed to the negative sentiment to the asset class more recently. We continue to be wary of the quality of some of the offshore portfolios that have been acquired by SA REITs recently, and the excessive use of debt and CCIRS to finance them.

SA REITs have experienced a significant derating since the start of 2018. Their prices have dropped significantly below their expected cashflows. We acknowledge the higher risks to the sector given the weak fundamentals, but believe they have been more than captured in current valuations. Most are trading at discounts to NAV and at forward yields in excessive of the SA long bonds (e.g. Growthpoint trading at 9.8% vs 8.9% for the R2030.)

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Source: Morningstar Direct

Skyblue BCI Solar Flexible Fund of Funds

Global Multi Asset Flexible Allocation - More than 85% offshore

Proxy Benchmark: 60% MSCI World; 30% Barclays Global Bond Index; 10% US Cash

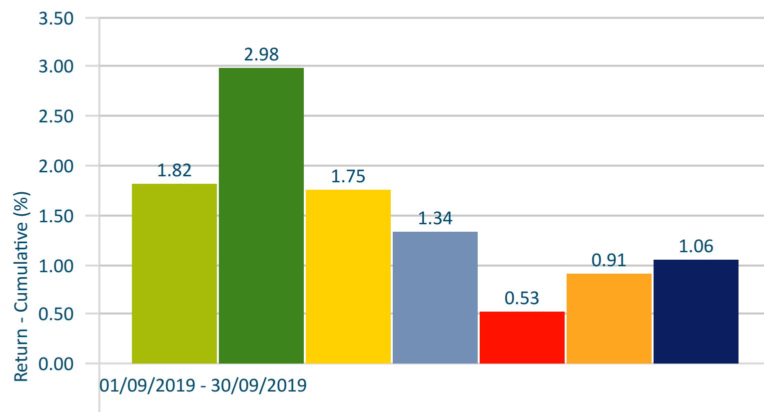
Fund Commentary

The Rand ended the month pretty much where it started against the US Dollar - but this end outcome hides a lot of volatility during the month. With developed market central banks seemingly set on keeping monetary policy loose it is somewhat surprising to not see stronger emerging market currencies, including the Rand. It is worth remembering that emerging market real yields are much higher than those on offer from developed markets. On the contrary developed markets are now predominantly offering yields below inflation i.e. negative real yields. The likelihood of a rally when the ongoing risks, trade war, Brexit et al subside is therefore worth remembering.

Solar added 2.01% over September. The best underlying fund was Orbis Global Equity, adding 2.98%, whilst the laggard was the Templeton Global Total Return fund.

We retained our focus on a diversified portfolio. Although emerging market assets look attractive, the current skittish risk on and off plays are creating havoc in the minds of market participants – evidenced by developed market bond yields trading below inflation and continuing to experience rather big movements. Market participants right now have a very short term focus!. This behaviour is to be expected when such big unknowns as the outcome of the Trade War, Brexit and China's inability to amend the Hong Kong scenario are to be confronted daily.

Underlying Holdings Return - September



Calendar Year Returns - Cumulative (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Solar Flexible FoF	5.13	24.49	54.80	168.65
(ASISA) Global MA Flexible (Sector)	7.37	25.99	51.98	196.02
Stefi + 5% (Benchmark)	12.70	43.42	80.21	206.61

Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Solar Flexible FoF	5.13	7.58	9.13	10.39
(ASISA) Global MA Flexible (Sector)	7.37	8.01	8.73	11.47
Stefi + 5% (Benchmark)	12.70	12.78	12.50	11.86

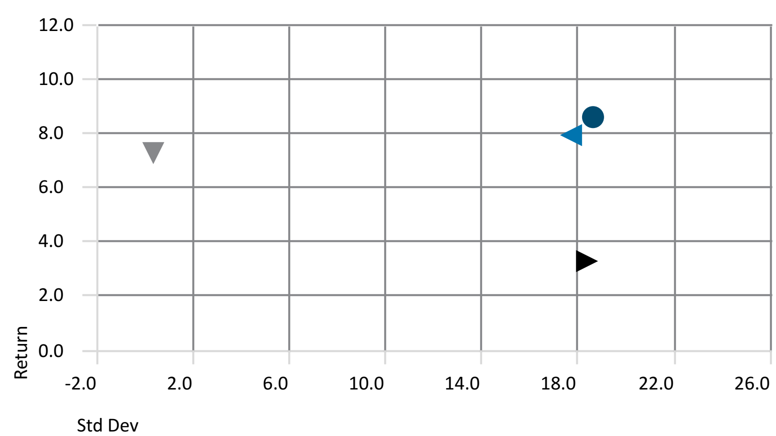
*Annualised return is the weighted average compound growth rate over the period measured.

Skyblue BCI Solar Flexible FoF - Monthly Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2019	-1.90%	7.08%	2.75%	2.13%	-1.80%	-0.32%	1.42%	1.34%	2.01%				
2018	-0.06%	-5.20%	-0.37%	6.68%	1.01%	5.68%	-1.44%	10.03%	-2.60%	-1.49%	-5.27%	-0.41%	5.51%
2017	-0.61%	-0.14%	2.84%	0.78%	-0.60%	0.02%	2.10%	-1.31%	4.82%	5.60%	-2.87%	-7.81%	2.14%
2016	1.52%	0.44%	-6.88%	-2.94%	10.81%	-7.14%	-1.87%	4.04%	-4.78%	-1.20%	3.13%	0.22%	-5.88%
2015	0.61%	2.81%	0.04%	2.33%	1.63%	-0.72%	3.17%	2.98%	3.34%	1.43%	4.18%	7.12%	32.80%
2014	-0.52%	2.77%	1.51%	1.09%	1.17%	1.42%	0.76%	-1.07%	-0.47%	-0.85%	1.71%	0.73%	8.49%
2013	5.14%	-1.61%	1.05%	-1.94%	7.81%	-6.23%	3.45%	1.08%	3.61%	2.88%	-0.78%	2.93%	17.94%
2012	4.95%	1.59%	-0.23%	1.41%	-2.56%	-0.16%	1.81%	2.50%	1.43%	3.34%	1.54%	0.90%	17.61%
2011	-0.32%	-0.94%	0.57%	1.65%	-0.04%	-2.42%	-1.17%	-2.57%	-0.91%	6.07%	0.60%	-1.03%	-0.78%
2010	-1.74%	0.52%	4.67%	0.62%	-3.96%	-0.66%	3.38%	-2.53%	4.90%	2.95%	0.39%	2.04%	10.64%
2009	1.54%	-4.36%	3.58%	2.58%	4.89%	-1.82%	5.79%	3.92%	0.57%	3.42%	0.98%	2.18%	25.39%
2008	-3.03%	2.54%	-0.74%	0.89%	1.76%	-1.44%	-4.34%	1.73%	-5.88%	-7.37%	0.06%	0.47%	-14.82%
2007											-2.01%	-1.22%	

Risk-Reward

Time Period: 01/05/2015 to 30/09/2019



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Source: Morningstar Direct

Skyblue BCI Cumulus Moderate Fund of Funds

South Africa Multi Asset High Equity Allocation - 0% - 75% South African Equities

Benchmark: Cash (SteFi) + 3%

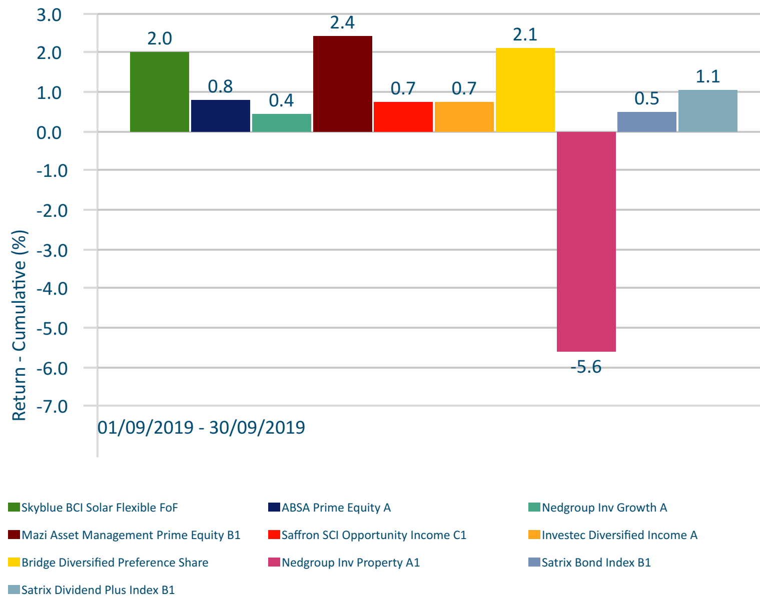
Fund Commentary

September gave some relief to what has been a tough third quarter. Cumulus posted a return of 0.62%, with almost all of the holdings adding positive value. Offshore was again the place to be, but the local market was also a contributor. The best performing holdings were Mazi AM Prime Equity which returned 2.04%, Bridge Preference Share with 2.1%, and Skyblue BCI Solar Flexible which added 2% to its value. The majority of our other holdings contributed small positives, while also managing to outperform their respective indices and benchmarks in the month. The exception was our property holding that sold off on the back of losses experienced in some of the local small/mid cap shares in the sector.

Our Strategic Asset Allocation models are still pointing to a risk on allocation environment, with valuations in the equity market favouring those over bond markets at current levels. Tactically our allocations have moved even more overweight to high yielding fixed income instruments, an overweight in equity is being maintained, and the positive view on offshore markets is retained. We do not however favour USD over ZAR at current levels, and therefore will hold offshore exposure at current levels and look to take profit and bring some assets back if the Rand continues to weaken.

As mentioned in the previous months' commentary, we are reviewing various holdings, making sure managers are sticking to their strategies, and looking at ways to optimise the portfolios. This process is ongoing and will likely result in some changes being made. Our aim is to reduce the capital at risk and make sure the correct positioning to reach our benchmarks over the coming periods is put in place.

Underlying Holdings Return - September



Calendar Year Returns - Cumulative (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Cumulus Moderate FoF	-3.77	4.17	20.27	118.05
(ASISA) South African MA High Equity (Sector)	2.03	11.60	26.57	127.00
Stefi + 3% (Benchmark)	10.55	35.39	63.70	152.98

Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Cumulus Moderate FoF	-3.77	1.37	3.76	8.11
(ASISA) South African MA High Equity (Sector)	2.03	3.73	4.83	8.54
Stefi + 3% (Benchmark)	10.56	10.63	10.36	9.73

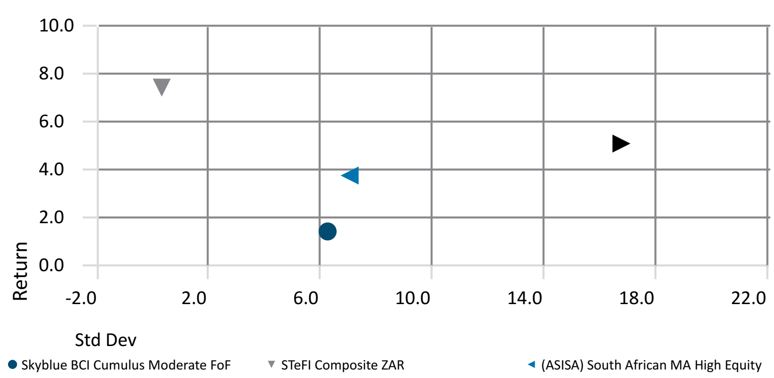
*Annualised return is the weighted average compound growth rate over the period measured.

Skyblue BCI Cumulus Moderate FoF - Monthly Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2019	1.93%	1.22%	1.14%	2.16%	-2.32%	0.70%	-0.93%	-2.92%	0.62%				
2018	0.32%	-0.62%	-1.78%	2.90%	-1.12%	1.27%	0.33%	3.55%	-2.67%	-3.28%	-2.73%	0.78%	-3.25%
2017	1.50%	-0.74%	1.53%	1.05%	0.06%	-2.42%	2.82%	0.64%	0.34%	3.48%	-0.51%	-2.45%	5.24%
2016	-1.36%	0.35%	1.78%	0.84%	2.87%	-2.07%	0.38%	1.41%	-0.69%	-1.55%	1.58%	0.82%	4.31%
2015	1.62%	2.23%	0.44%	1.48%	-0.46%	-0.56%	0.86%	-0.35%	0.22%	2.58%	-0.12%	0.94%	9.19%
2014	-0.26%	1.52%	1.46%	1.40%	0.84%	1.29%	0.47%	-0.99%	0.39%	-0.25%	1.32%	1.12%	8.59%
2013	5.39%	-0.30%	2.00%	-0.36%	6.83%	-3.87%	2.79%	1.47%	3.08%	2.05%	-0.52%	2.36%	22.51%
2012	2.87%	0.71%	0.45%	0.93%	-1.25%	0.65%	1.94%	2.87%	0.64%	2.47%	2.23%	1.01%	16.58%
2011	0.45%	0.19%	-0.22%	0.54%	1.07%	-1.03%	-0.52%	0.19%	0.34%	3.95%	0.79%	0.19%	6.05%
2010	0.28%	1.39%	1.56%	0.83%	-1.44%	-0.12%	1.74%	-0.33%	1.78%	1.26%	0.25%	1.25%	8.75%
2009	1.03%	-1.81%	2.41%	1.20%	1.22%	-0.46%	3.63%	2.00%	0.05%	2.63%	-0.32%	1.26%	13.48%
2008	-1.28%	2.27%	0.01%	0.22%	0.52%	-1.02%	-1.36%	2.04%	-1.54%	-2.51%	1.04%	0.22%	-1.50%
2007											-0.75%	-0.92%	

Risk-Reward

Time Period: 01/10/2016 to 30/09/2019



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Source: Morningstar Direct

Skyblue BCI Kimberlite Cautious Fund of Funds

South Africa Multi Asset Low Equity Allocation - 0% - 40% South African Equities

Benchmark: Cash (SteFi) + 1%

Fund Commentary

September gave some relief to what has been a tough third quarter Kimberlite posted a return of 0.36%, with almost all of the holdings adding positive value. Offshore was again the place to be, but the local market was also a contributor. The best performing holdings were PSG SA Equity which returned 3.1%, Skyblue BCI Solar Flexible with 2%, and Aylett Equity which added 1.6% to its value. The majority of our other holdings contributed small positives, while also managing to outperform their respective indices and benchmarks in the month. The exception was our property holding that sold off on the back of losses experienced in some of the local small/mid cap shares in the sector.

Our Strategic Asset Allocation models are still pointing to a risk on allocation environment, with valuations in the equity market favouring those over bond markets at current levels. Tactically our allocations have moved even more overweight to high yielding fixed income instruments, an overweight in equity is being maintained, and the positive view on offshore markets is retained. We do not however favour USD over ZAR at current levels, and therefore will hold offshore exposure at current levels and look to take profit and bring some assets back if the Rand continues to weaken.

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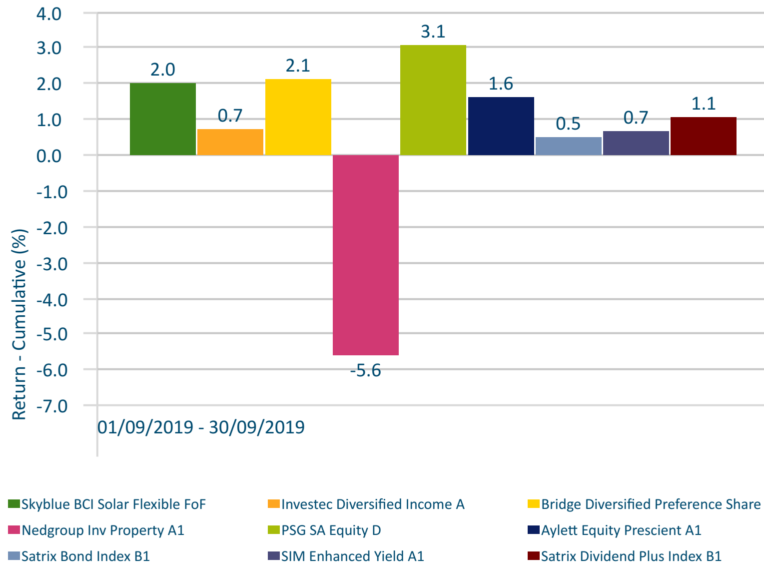
Underlying Holdings Return - September

Currency: South African Rand



Calendar Year Returns - Cumulative (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Kimberlite Cautious FoF	-4.90	4.76	17.80	91.22
(ASISA) South African MA Low Equity (Sector)	5.03	17.16	33.86	114.33
Stefi + 1% (Benchmark)	8.41	27.66	48.41	107.95

Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Kimberlite Cautious FoF	-4.90	1.56	3.33	6.70
(ASISA) South African MA Low Equity (Sector)	5.04	5.42	6.01	7.92
Stefi + 1% (Benchmark)	8.41	8.49	8.22	7.60

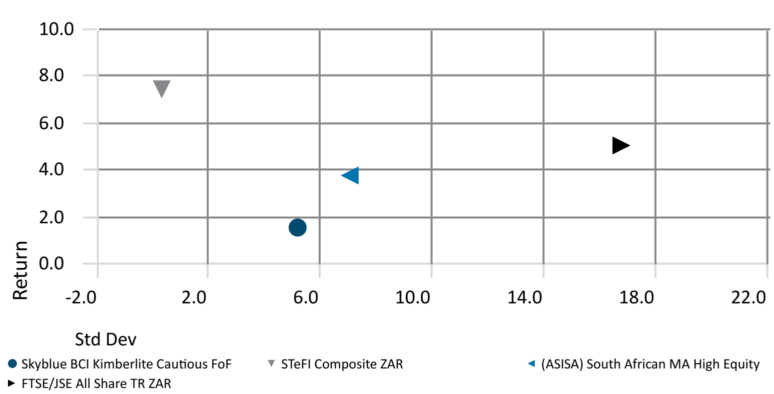
*Annualised return is the weighted average compound growth rate over the period measured.

Skyblue BCI Kimberlite Cautious FoF - Monthly Returns

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year
2019	1.50%	-0.10%	0.38%	1.49%	-1.42%	-0.20%	-0.31%	-2.53%	0.36%				
2018	0.63%	0.01%	-1.03%	2.04%	-0.72%	0.82%	0.46%	2.98%	-1.82%	-1.47%	-2.78%	0.17%	-0.85%
2017	0.93%	-0.20%	1.15%	0.46%	-0.27%	-1.30%	1.96%	0.45%	0.99%	2.37%	-0.57%	-1.12%	4.86%
2016	-0.61%	0.49%	1.74%	0.99%	1.84%	-0.99%	0.61%	1.10%	-0.14%	-0.94%	1.73%	0.89%	6.85%
2015	0.78%	1.26%	0.01%	1.10%	-0.27%	-0.68%	0.71%	-0.64%	-0.07%	2.08%	-0.24%	0.98%	5.11%
2014	0.34%	0.15%	1.18%	1.33%	0.48%	1.12%	0.43%	-0.80%	-0.23%	-0.64%	1.02%	1.42%	5.94%
2013	3.70%	0.64%	1.96%	1.05%	1.89%	-1.47%	1.06%	-0.05%	2.03%	1.09%	-0.13%	1.74%	14.28%
2012	1.51%	0.55%	0.87%	0.66%	-0.14%	0.72%	1.76%	2.42%	0.04%	1.28%	1.81%	1.10%	13.31%
2011	0.33%	0.09%	0.01%	1.13%	0.95%	-0.56%	-0.21%	0.62%	1.34%	2.24%	1.14%	0.18%	7.49%
2010	1.10%	1.26%	1.15%	0.77%	-1.55%	0.28%	2.00%	-0.29%	1.91%	0.88%	0.21%	1.11%	9.15%
2009	0.91%	-1.30%	2.50%	1.33%	0.83%	-0.68%	2.99%	0.93%	-0.41%	2.34%	-0.75%	1.08%	10.11%
2008	0.22%	1.81%	0.72%	-0.47%	0.32%	-0.31%	0.57%	2.02%	-0.38%	-1.50%	1.82%	0.18%	5.05%
2007											-0.21%	-0.26%	

Risk-Reward

Time Period: 01/10/2016 to 30/09/2019



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