Skyblue Fund Feedback

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Dissecting October 2019

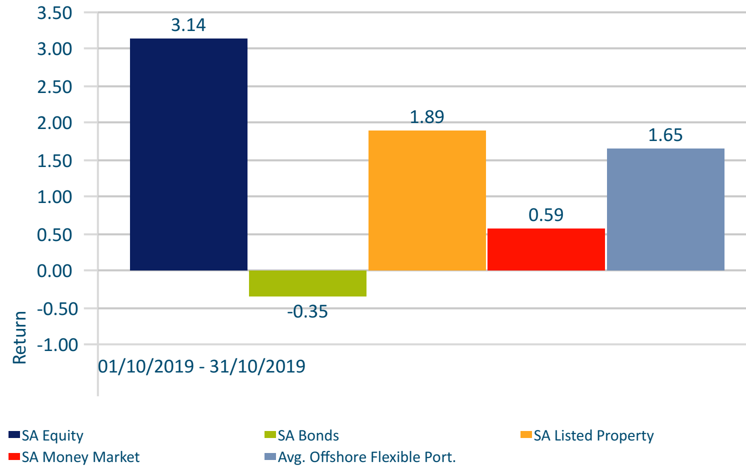
In last month's feedback we commented how September was a slightly easier, less stressful month than the few months preceding it. In October, we reverted to an uneasy and slightly nervous state, albeit more likely related to the Rugby World Cup than to financial markets. As with the risk-reward trade-off we often face in investments, we have at least been handsomely rewarded for our nerves and anxiousness, being crowned world champions and giving South Africa a much-needed feeling of unity and pride.

Much like South Africans with the rugby, the market seemed to turn increasingly optimistic as we headed towards month-end. The Rand strengthened significantly from around R15.30 on the first day of October to just under R14.60, before the relatively bleak picture painted by the Medium Term Budget Speech lead to a reversal and saw the Rand end the month back above R15 to the US Dollar. The local equity market managed to hang on to its returns however, posting 3.14%. The main drivers were the Resource counters, as the Resi 10 index delivered 7.27%, while Financials also made a significant contribution of 3.26%. Industrials were the losers however, with some of the large-caps suffering losses in excess of 10%. Local property had a relatively positive month, delivering 1.89%, while SA Bonds lost out towards month-end when bond yield spiked around 30bps on the SA 10-year.

It was a relatively busy month in terms of political and economic events, with the majority occurring towards the back end. Locally we saw the Medium Term Budget Speech announcement, the release of the special paper on Eskom, the further implosion of the official opposition party (Democratic Alliance), and the dreaded review of our credit rating by Moody's. In international markets, trade-war uncertainties continued to drive volatility, with prospects of reaching a deal becoming doubtful according to officials. The Fed decided to cut the benchmark rate, affirming their more accommodative stance, although comments from the chair suggest that the growth outlook would have to worsen further before any more easing would be considered.

Asset Class Returns - October

Currency: South African Rand



Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
SA Equity	11.49	7.06	5.76	11.18
SA Bonds	12.96	8.55	7.48	8.77
SA Property	0.84	-3.07	2.27	11.19
STeFI Composite ZAR	7.33	7.40	7.16	6.53
(ASISA) Global MA Flexible	11.43	10.07	9.76	11.28

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

Other local economic data stats were mostly negative, with the only real positive data point being a slightly lower CPI figure of 4.1% year-on-year for September (4.3% in August). Private sector credit extension remained above the 6% level, although slightly lower than the previous month, while money supply (M3) growth also eased to 6.11% from 7.45% in the previous month. Unemployment data indicated a worsening state of the labour market, as the Q3 rate came in at 29.1%. Retail sales growth eased from the 2% year-on-year growth for July to 1.1% in August, below expectations.

Some Food for Thought

Towards the end of October we had two key policy statements on South African economics occur, namely the presentation of a special paper on Eskom by Public Enterprises Minister Pravin Gordhan, and the Medium Term Budget Speech by Finance Minister Tito Mboweni. This was followed by the credit rating review by Moody's, although this review only occurred at the start of November. For this month's Food for Thought, some of the key information that was put forward in these announcements is summarised:

- **Eskom**

The special paper released presented a plan for expanding renewable energy output, greater competition, lower fuel costs, and the separation of Eskom's transmission component (by March 2020). The plan would see Eskom giving up its monopoly status, with the first step being the sale of the transmission unit. This will make it easier for private energy generators to provide to the national grid. The plan would be that this unit could buy power from Eskom as well as independent producers in order to increase competition and lead to better overall operational efficiency. The timeline of the split of the remaining units, and thus the full establishment of separate legal entities for transmission, generation and distribution, is aimed for 2021, although there are some strong headwinds in especially the distribution separation process. They are also trying to renegotiate contracts with independent suppliers of renewable energy, looking to cut their cost of coal and diesel, and get to a point where everyone profits, but at a lower price level to give some headroom. Another focus was a serious call on municipalities to pay their outstanding debts to Eskom for electricity provided, and putting an end to the culture of non-payment. These are the first steps in a restructuring process that is aimed to be completed by 2024. The new CEO announcement is also expected to be made within the coming days.

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Source: Morningstar Direct

There seems to be a clear realisation that the trend of financial support provided cannot continue. Finance Minister Tito Mboweni has commented that the problems are much deeper than just financial, and so giving more money will not save the energy provider. There were no further funding announcements made in the special paper or MTBS (last funding was R59billion lifeline spread out over two year), with the Finance Minister stating that further debt relief would only be granted once progress has been made and there has been clear commitment from the board. He also stated that new cash flow support will no longer be equity, but will be in the form of loans. There was however no clear indication of how the massive R450bil debt problem that already exists will be addressed.

- **Public Finances**

The medium term budget speech painted a far worse picture of the financial position than many people expected, with a combination of low economic growth (now only forecasted to grow at 0.5% for 2019), tax shortfall (now projected to be R52.5bil), and large SOE debt draining the budget. The budget deficit is now expected to average 6% of GDP over the next 3 years, whilst national debt has now exceeded R3trn (and is expected to rise to R4.5tril in the next three years), leading to serious deterioration in government's debt/GDP projections. Projections show the debt/GDP ratio moving from its current 61% to 71.3% by 2022/23, and 81% by 2027/2028, if nothing is done to change the trajectory.

Tax increases have clearly not been as successful, and seem to be reaching marginal rate deterioration. This is most likely due to lower economic growth, a decline in tax morality, SARS inefficiencies, job losses, lower real wages and bonuses, and low consumer spending causing lower tax revenue that could not be offset by tax increases. However, Finance Minister Tito Mboweni has indicated that tax measures could possibly be necessary to try and raise additional income over the next three years – just how the economy will enable this is yet to be debated.

Government spending is clearly a massive problem. They have been able to reduce spending slightly this year, and further spending reductions of R29bil have been identified for 2021/22, but larger scale cuts will be required. One of the key areas for this is the unsustainable public service wage bill. According to comments, for every R100 collected in taxes, R46 of this is spent on public servant salaries. In the MTBS Mboweni blamed above-inflation annual salary increases for the largest portion of this spending. Previous initiatives outlined to address this problem, induding early retirements without penalisation and lower performance bonuses, have not worked as expected. New guidelines have now been announced for members of cabinet and provincial executives. These include a cap on the cost of official cars at R700 000 (VAT inclusive), all domestic travel limited to economy class, no payment for subsistence and travel for both domestic and international trips, and a freeze on salaries with the possibility of downwards adjustments. Addressing this inefficient spending habit of government will be crucial for proper allocation of capital and fiscal discipline.

Some of the other topics included SAA, E-Tolls, the NPA, and SARS. According to the minister, SAA is unlikely to ever generate sufficient cash flows for operations in its current configuration, and mentioned that he is pleased with talks happening between SAA and potential equity partners. On E-tolls, the minister referred to the culture of non-payment, stating that drivers need to pay for the infrastructure and services, after deciding that the user-pay principle will remain intact. Additional funding of approximately R1bil has been made available to both the National Prosecuting Authority, as well as the SA Revenue Service, in order to improve operational efficiency and combat corruption.

- **Credit Rating**

Moody's, the last ratings agency that has South Africa on an Investment Grade rating, has changed the outlook from stable to negative, but has affirmed the Baa3 (one step above junk) long-term foreign currency and local currency issuer ratings. The outlook has been adjusted based on concerns around government being unsuccessful in reigning in financial expenditure. This change in outlook provides South Africa with an opportunity to speed up economic reforms **and implementation** – no more words, time for deeds, otherwise junk status beckons.

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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

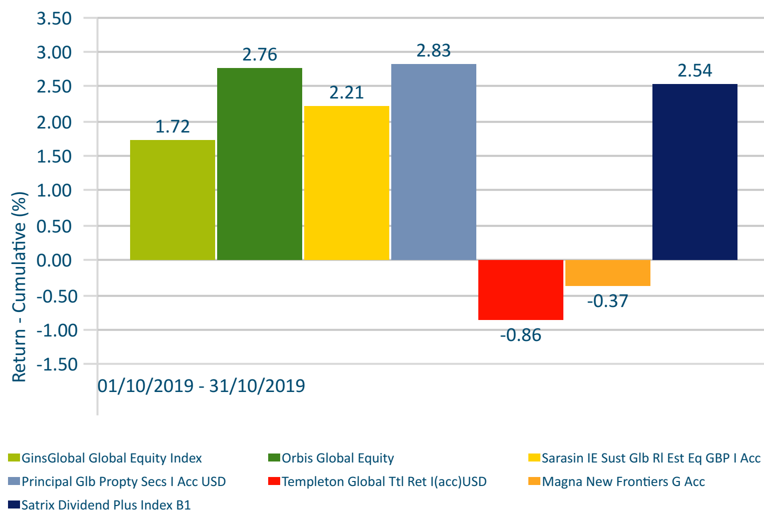
October turned out to be an exceptional month for the fund as most of the holdings delivered very pleasing returns. With the local currency showing some strength in the midst of uncertainty, not even the resultant appreciation could dampen some of the returns from offshore managers. We are still far from a state of certainty, if this ever really exists, so expect markets to remain in flux as participants try to make sense of monthly data and news flow.

Solar returned 1.09% for the month, with the best underlying performer being the Principal Global Property fund which contributed 2.83%. Templeton Global Total Return, with its fixed interest focus, was the worst performer, returning -0.86% in Rand terms.

For South African investors the mid-term budget and ratings agencies pronunciations will feature prominently in the months to come. The South African Minister of Finance did a stellar job to outline the realistic fact based picture of the dire situation in which South Africa finds itself. Hopefully this is a wakeup call for action to be taken by our political masters. Promises of policy shifts are merely all talk – right now what South Africa desperately needs is action being taken by its leaders. This is a prerequisite to keep the ratings agencies at bay. Whilst this is playing out, globally there is still much to be worked out in terms of trade agreements. World trade seems to be slowing down and, as for SA, leaders need to take proactive action so as to prevent a total melt down.

Underlying Holdings Return - October

Currency: South African Rand



Calendar Year Returns - Cumulative (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Solar Flexible FoF	7.89	27.37	57.83	162.60
(ASISA) Global MA Flexible (Sector)	11.43	33.34	59.26	191.26
Stefi + 5% (Benchmark)	12.69	43.36	80.34	206.49

Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Solar Flexible FoF	7.89	8.40	9.56	10.14
(ASISA) Global MA Flexible (Sector)	11.43	10.07	9.76	11.28
Stefi + 5% (Benchmark)	12.69	12.77	12.52	11.85

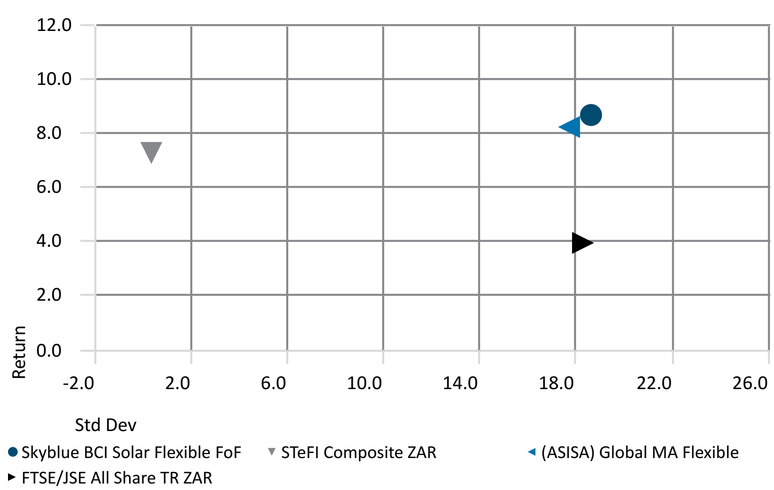
*Annualised return is the weighted average compound growth rate over the period measured.

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%	1.09%			
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 31/10/2019



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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%

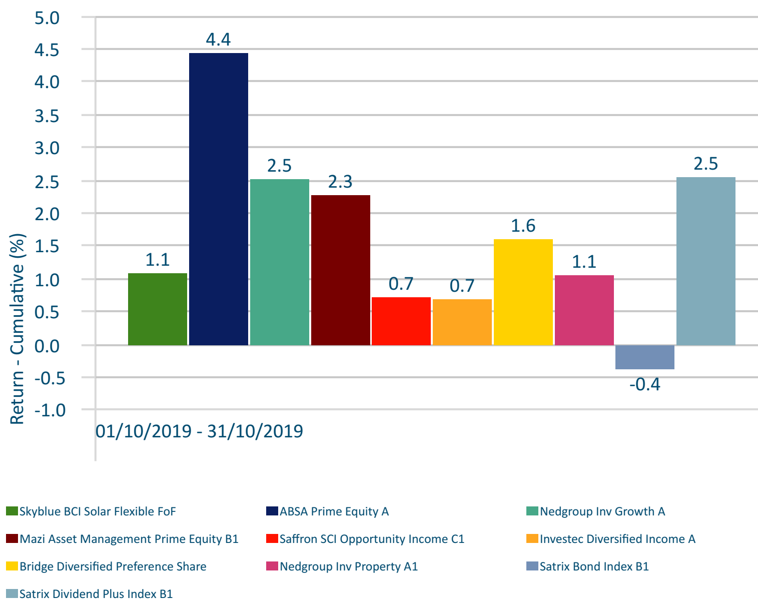
Fund Commentary

Cumulus delivered a return of 1.53% in October, with broad contribution from almost all of the exposures. The main drivers of performance came from a small overweight in equities, while the preference share, offshore, and property holdings also delivered more than 1%. The income exposures also added their reliable stable returns, while our holding in SA Bonds was the only detractor for the month, albeit relatively small.

With equities being the main driver of long term returns, it is no surprise that the best performing holdings were the equity managers this month. Managers with significant resources exposure were especially well rewarded, while those managers with predominantly large-cap industrial exposures (such as Naspers, Prosus, AB InBev, British American Tobacco) most likely underperformed as these shares came under pressure. Our underlying mix of equity managers and their diversified exposures performed well however, as ABSA Prime Equity returned 4.4%, Nedgroup Inv Growth delivered 2.5%, Satrix DIV Index added 2.5%, and Mazi Prime Equity added 2.3% to its value.

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, with the addition of BCI Income Plus to the fund as a further diversifier in our income blend. The fund is managed by Paul Crawford from Fairtree, and has an exceptional track-record of high income generation and capital stability. We have also taken further profit on our preference share holding, selling out our direct preference share fund exposure in the Bridge Preference Share fund. After our most recent Investment Committee Meeting, we have also reduced our direct property fund exposure in order to manage capital risk in the fund. We are keeping our overweight in equity, and the positive view on offshore markets is retained.

Underlying Holdings Return - October



Calendar Year Returns - Cumulative (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Cumulus Moderate FoF	1.01	7.44	22.41	115.72
(ASISA) South African MA High Equity (Sector)	7.30	16.44	28.93	125.51
Stefi + 3% (Benchmark)	10.54	35.33	63.82	152.89

Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Cumulus Moderate FoF	1.01	2.42	4.13	7.99
(ASISA) South African MA High Equity (Sector)	7.31	5.21	5.21	8.47
Stefi + 3% (Benchmark)	10.55	10.62	10.38	9.72

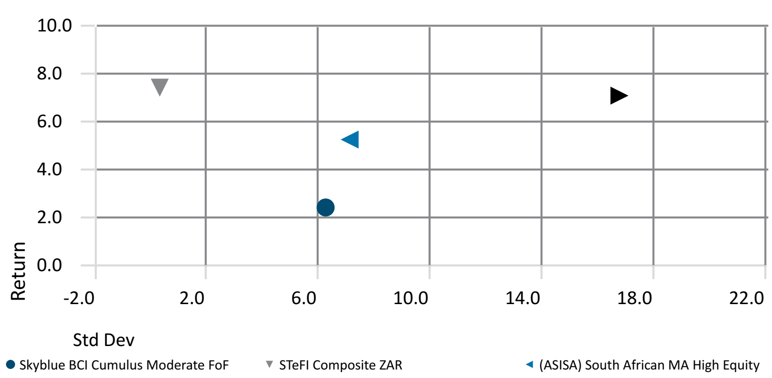
*Annualised return is the weighted average compound growth rate over the period measured.

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%	1.53%			
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: 01/11/2016 to 31/10/2019



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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

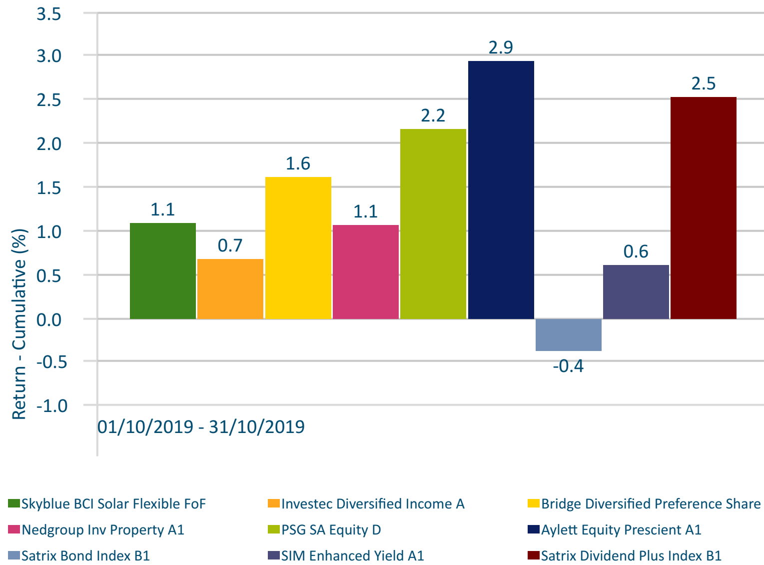
Kimberlite delivered a return of 0.92% in October, with broad contribution from almost all of the exposures. The main drivers of performance came from a small overweight in equities, while the preference share, offshore, and property holdings also delivered more than 1%. The income exposures also added their reliable stable returns, while our holding in SA Bonds was the only detractor for the month, albeit relatively small.

With equities being the main driver of long term returns, it is no surprise that the best performing holdings were the equity managers this month. Managers with significant resources exposure were especially well rewarded, while those managers with predominantly large-cap industrial exposures (such as Naspers, Prosus, AB InBev, British American Tobacco) most likely underperformed as these shares came under pressure. Our underlying mix of equity managers and their diversified exposures performed well however, as Aylett Equity returned 2.9%, Satrix Dividend Plus Index delivered 2.5%, and PSG SA Equity added 2.2% to its value.

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, with the addition of BCI Income Plus to the fund as a further diversifier in our income blend. The fund is managed by Paul Crawford from Fairtree, and has an exceptional track-record of high income generation and capital stability. We have also taken further profit on our preference share holding, selling out our direct preference share fund exposure in the Bridge Preference Share fund. After our most recent Investment Committee Meeting, we have also reduced our direct property fund exposure in order to manage capital risk in the fund. We are keeping our overweight in equity, and the positive view on offshore markets is retained.

Underlying Holdings Return - October

Currency: South African Rand



Calendar Year Returns - Cumulative (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Kimberlite Cautious FoF	-2.59	6.73	19.65	88.55
(ASISA) South African MA Low Equity (Sector)	7.64	19.70	34.71	113.08
Stefi + 1% (Benchmark)	8.40	27.61	48.52	107.87

Calendar Year Returns - Annualised (%)

	1 Year	3 Year	5 Year	10 year
Skyblue BCI Kimberlite Cautious FoF	-2.60	2.20	3.65	6.55
(ASISA) South African MA Low Equity (Sector)	7.64	6.18	6.14	7.86
Stefi + 1% (Benchmark)	8.41	8.47	8.23	7.59

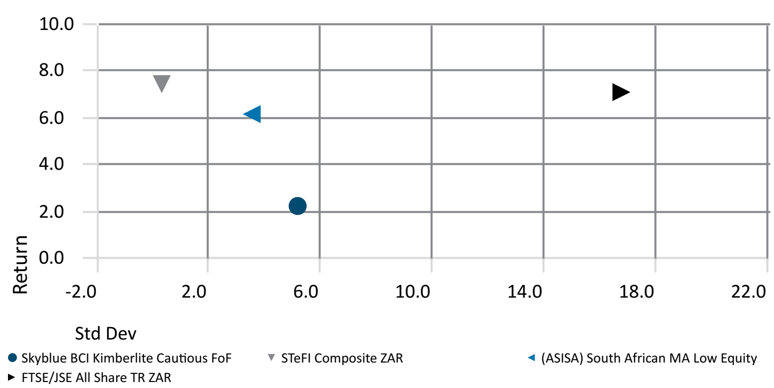
*Annualised return is the weighted average compound growth rate over the period measured.

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%	0.92%			
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: 01/11/2016 to 31/10/2019



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THE ART OF INVESTING

Source: Morningstar Direct