Melville Douglas STANLIB High Alpha Fund

Minimum Disclosure Document as at 30 June 2016

Quarterly Commentary

A dramatic end closed a volatile quarter: the UK's referendum vote on the UK's continued membership of the European union went completely contrary to all market expectations, and the "Leave" outcome produced some very extreme market moves. The net result for the quarter was a near-flat JSE and a very thin 1% return in US dollars from global equity. The main victim of the UK referendum was sterling: if fell 11% against the US dollar in a day, an almost unprecedented change. Sovereign bond markets benefited as investors interpreted the economic impact as requiring stepped-up monetary stimulus in Europe and elsewhere: bond yields feel even further, or in many cases became even more deeply negative. Many governments are therefore now being paid to borrow money! The UK will have to deal with its very large current account deficit (7% of GDP), the funding of which is very dependent on foreign portfolio flows.

The impact on South Africa will be a marginal reduction in demand, making adjustment of its own current account a bit harder – but the rand had already de-preciated to account for this, and the rand appreciated an astonishing 16% against sterling in June. The reason was strong capital inflows as global investors searched for yield and concluded that the already-adjusted rand and high nominal interest rates were an attractive combination. So far, the country has successfully managed the aftermath of the finance ministry debacle last December, and thanks to very sensible policy implementation from the Reserve Bank and Treasury, the country is at least on a more even keel. More generally, on a relative basis, emerging markets look more attractive than they did.

Growth is certainly lower than historically, but still better than developed markets. Interest rates and currencies have adjusted substantially over the past three years or so, and so notwithstanding sub-stantial risks and uncertain dependencies (such as commodity producers dependent on dollar-priced resources and manufacturing hubs such as China dependent on very sluggish developed world demand), investors are beginning to shift their focus onto markets that have been out of favour for some time. This doesn't make them attractive in an absolute sense necessarily, and we remain very cautious that global financial market prices are now (and have been for some time) dependent more on developed market monetary stimulus and capital flows than on fundamentals. This is pulling currencies into very volatile territory and making cross-border investment decisions much harder. There are also a number of secular trends adding to the pressures (demographics, technology, global warming).

This means markets will very likely continue to be volatile overall, and from the fund's point of view we will continue to focus on fundamental valuation and be very wary of overpaying for assets. The portfolio positioning remains very defensive, and we continue to be cautious into the second half of 2016 given the domestic risks involved in municipal elections and another credit rating review late in the year. More work needs to be done. If volatility cre-ates opportunities, we will take prudent advantage, putting cash-generative and sustainable business models to the fore, so that fundamentals rather than speculative flows drive the longer-term returns we seek.