

## Melville Douglas

### High Alpha Fund

#### Quarterly Commentary

---

The quarter was a strong one for equity. The JSE more than recovered from the June quarter's rout which followed the cabinet "reshuffle". Over the quarter, the fund underperformed the market, mainly because it was underweight basic materials (though the holdings did very well) and Naspers, and had some poor performers in IT and an overweight position in healthcare. Our Billiton and Anglo American holdings delivered a return of 22% and 42% respectively. Naspers, Anheuser Busche, Richemont and the banking exposures through Firststrand and Standard Bank all contributed positively to the absolute performance. The holding in EOH was down 24% for the quarter. We have had numerous meetings, both internal and with management. At this stage, we believe the company is offering good value.

The year has been remarkably good to investors. That is thanks to the favourable global backdrop: strong economic growth, accommodative central banks, sustained recovery in corporate earnings and continued low interest rates. South Africa has had astonishing challenges, mainly political, but because markets had already adjusted for the deterioration last year, returns have been satisfactory, even if they have not kept up with other emerging markets, which have been the star performers so far this year. The economy should be performing much better in this global environment, and even though Q2 GDP growth rebounded from recession, it was narrowly based (agricultural recovery mainly) and the transmission from strong global demand to domestic demand is not working because household and business confidence have been badly undermined. Globally, the central bank debate has moved on from "whatever it takes" determination to create growth, to worrying about the emergence of inflation and the need for a gradual change in policy to avoid disruptive changes later. This means the world will be different in 2018, and there may be higher volatility as the impact of central bank action becomes less certain. At home, South Africa's governance challenges have become all too clear, among them the financial weakness of state-owned enterprises, which now threatens the sovereign credit rating. The latest bailout of the national airline is obviously damaging, but in the short run it is the only answer, given the threat that default would pose. The presentation of the Medium Term Budget in October will be important for what it reveals regarding government's commitment to fiscal stability and plans to return floundering state-owned entities to financial viability, but the challenges are substantial: tax revenues are under severe pressure. Late in the year there are the challenges of the ANC's elective conference and scheduled reviews from credit rating agencies. The fact that the domestic economy should by now be responding very healthily to the strong global environment, but remains stuck, is purely down to the impact of politics on interest rates and confidence. The Reserve Bank is forced to keep real interest rates high to maintain stability. Household and corporate finances are in a healthy state and the banking system could easily fund a cyclical upswing, but demand will stay weak until confidence returns, which requires a sensible political outcome. The rest of the year and 2018 may prove somewhat more volatile than 2017 so far. Valuation and diversification are paramount.

#### Melville Douglas

Melville Douglas Investment Management (Pty) Ltd is a subsidiary of Standard Bank Group Limited.  
Melville Douglas Investment Management (Pty) Ltd (Reg. No. 1962/000738/06) is an Authorised Financial Services Provider. (FSP number 595)

#### Disclaimer

This summary brochure has been prepared for information purposes only and is not an offer (or solicitation of an offer) to buy or sell the product.

This document and the information in it may not be reproduced in whole or in part for any purpose without the express consent of Melville Douglas.

All information in this document is subject to change after publication without notice. While every care has been taken in preparing this document, no representation, warranty or undertaking, express or implied, is given and no responsibility or liability is accepted by Melville Douglas as to the accuracy or completeness of the information or representations in this document. Melville Douglas is not liable for any claims, liability, damages (whether direct or indirect, actual or consequential), loss, penalty, expense or cost of any nature, which you may incur as a result of your entering into any proposed transaction/s or acting on any information set out in this document.

Some transactions described in this document may give rise to substantial risk and are not suitable for all investors and may not be suitable in jurisdictions outside the Republic of South Africa. You should contact Melville Douglas before acting on any information in this document, as Melville Douglas makes no representation or warranty about the suitability of a product for a particular client or circumstance. You should take particular care to consider the implications of entering into any transaction, including tax implications, either on your own or with the assistance of an investment professional and should consider having a financial needs analysis done to assess the appropriateness of the product, investment or structure to your particular circumstances. Past performance is not an indicator of future performance.