AYLETT EQUITY PRESCIENT FUND
Q4 2023 COMMENTARY

FUND MANAGER COMMENTARY

MARKET REVIEW
2023 saw strong positive returns from developed market equities despite war in Europe and in the Middle East and the greater confrontation between the US and China. The most anticipated recession in history is still nowhere to be seen. Our market, as measured by the ALSI, returned a respectable 9.25%. Investors, regardless of location, appear to have lost confidence in China, with Chinese indices reaching multiyear lows during the year.

FUND PERFORMANCE
Over the last 12 months, the A1 class of the fund returned 9.05% (including fees, fund expenses, and assuming all distributions reinvested), narrowly underperforming the benchmark (the ALSI with dividends reinvested), which returned 9.25% over the same period. Our peers, as defined by ASISA, returned 7.04%.

Over time, you should expect us to beat our benchmarks and peers[1]. The table below shows how the fund has done against these requirements:

Cumulative Returns (%)	1 Year	3 Years	5 Years	7 Years	10 Years	15 Years	Inception
Aylett Equity Prescient Fund	9	70	82	102	168	559	736
JSE All Share TRI*	9	46	75	94	132	476	521
ASISA SA Equity General Category Average	7	39	53	57	81	303	347

**Total Return Index assumes dividends and distributions are reinvested. Past performance is not indicative of future performance.*
***Source:** Bloomberg, Morningstar 31 December 2023*

CONTRIBUTORS
Reinet is the fund's largest holding and appears as the top contributor for a second year in a row (here's hoping for a hat-trick!). Reinet is a holding company trading at a substantial discount to net asset value. Its biggest asset is its investment in Pension Insurance Corporation, which we mentioned last year had a long runway for growth as a result of the increase in the number of defined benefit funds in a position to be bought out. In 2023, that proved to be the case, with Pension Corp executing on the opportunity and the market starting to reward them for it. Reinets' strong performance was achieved despite its investment in British American Tobacco. Notwithstanding British American Tobacco's robust and growing free cash flow generation, the share derated during the year. Challenges in the U.S. combustible market and execution missteps on the next-generation nicotine portfolio hurt investor sentiment and sent the shares to new lows. BAT is being valued like a business that will cease to exist over the next decade - an outcome we deem very unlikely. In addition to the exposure we get through our holding in Reinet, we also own BAT directly in the funds and believe the share price is well below a very conservative estimate of fair value.

Jumbo, an Athens-based retailer of everything from bath toys to ballpoint pens, experienced an outstanding year. The company demonstrated significant revenue growth in its existing stores and expanded by opening

[1] *A word of caution: The fund is materially different to its benchmark, so you should expect material differences in returns. We expect, and so should you, that there will be (hopefully brief) periods where we underperform our benchmark.*

new stores in new geographies. Jumbo's retail strategy resonates well with its customers, resulting in a year of impressive results and a swift increase in its share price.

Other contributors to performance were investments in the **Aylett Global Fund**, **Standard Bank** and **BHP**.

DETRACTORS

Transaction Capital had a terrible year, with its share price declining 89% from peak to trough. The sell-off was driven mainly by poor performance from its taxi financing and refurbishment company, SA Taxi. A combination of bad luck, a weak economy, COVID-19, and management errors resulted in the business performing very poorly. Nutun and We Buy Cars, the other assets in the group, are performing much closer to our expectations.

While the decline in the value of SA Taxi means that we think the value of the group is unlikely to recover to the price at which it started the year, we think the market's reaction to the events over the past year is overdone. A conservative estimate of the value of the group, excluding SA Taxi, generates a fair value higher than the current share price.

While we may be optimistic about the business's prospects from this point forward, the decline in intrinsic value at SA Taxi means that we have marked down our assessment of the group's fair value materially from what we thought it was this time last year. This is a painful admission to make as we work hard to avoid permanent capital loss. We have spent time analysing the investment process relating to Transaction Capital, learning a number of lessons from the experience.

2023 was a tough year for **Impala** and the PGM miners generally. The platinum group metals basket price declined from a high of over R36 000 per PGM ounce to R22 000 per PGM ounce at one point, weighing on earnings and share prices. The PGM basket price is now well into the cost curve, a situation that can't last forever. Either the metal prices recover, or supply is cut, or both. South African PGM miners were slow to cut supply in the last down cycle, and it remains to be seen how fast that happens this time. Amplats, Impala, and Northam (three of the four biggest producers) all have strong balance sheets after the last upcycle. This gives them the ability to suffer, so it may be a while before they are forced to cut supply - the industry may be in for a prolonged period of pain. We note that recent electric vehicle demand has surprised analysts and car manufacturers on the downside, which means internal combustion engine demand may well surprise on the upside, driving PGM demand.

In contrast to the good performance of BHP during the year, the **Anglo American** share price did poorly. The investor update in December was below expectations, with volume guidance being cut in many of their key commodities, most notably copper. Copper miners have been the flavour of the month, so the reduction in volumes was disappointing. While short-term volume guidance has declined, Anglo still owns a collection of world-class orebodies containing commodities the world will need for many years to come. We believe the current production issues mask a valuable underlying portfolio.

Other detractors to performance include **British American Tobacco** and **Melco International**.

ASSET ALLOCATION

At year-end, the fund was 95% invested in equity, 31% of which was equity listed offshore. We calculate that just less than a third of the fund is invested in companies directly exposed to South Africa.

NOTABLE ADDITIONS TO THE FUND

During the final quarter of the year, we added a position in **Famous Brands**, owner of well-loved South African brands like Steers, Wimpy, Mugg & Bean, and Debonairs. We like the franchise business model; we

think the business trades at a significant discount to its fair value, and management is focused on the core domestic business and seems suitably chastened from past capital allocation mistakes.

Mondi's share price came under pressure as global paper prices normalised after COVID and after its decision to exit its Russian business as a result of Russia's invasion of Ukraine, giving us another opportunity to add the name to the portfolio. Mondi is a conservatively managed, well-run business and is the dominant European player in the niche paper grades they produce, with a high-quality asset base in the right places in Central Eastern Europe.

St. James's Place presented an attractive investment opportunity following a period of sluggish inflows and a share price drop. We initiated a position which, with hindsight, proved premature. Major adjustments to their complex fee structure further pressured the share price. However, these changes simplified the fee structure and maintained SJP's position as the leading wealth management firm with the largest UK advisory force. Despite current headwinds from the post-pandemic slowdown and cost-of-living crisis, the UK savings market remains a compelling long-term growth story. SJP's strong advisory network and simplified fee structure position them to capitalise on this structural potential when market conditions improve.

Totalenergies and **Shell** are two other new positions in the fund. Long-term readers will remember our preference for US-listed oil and gas producers. This changed during the year as the difference in valuation between the US and European oil companies diverged. In addition to being considerably cheaper than the US alternatives, Shell and Total also have two of the best gas portfolios available. They also have attractive mobility businesses (petrol stations), assets that set them apart from their US competitors. We note that management's capital allocation thinking has improved for the better, too!

NOTABLE EXITS

Despite our admiration for **Booking Holdings** strengthened business model and their impressive post-pandemic recovery, we sold our position in 2023. While leisure travel, Booking's core strength, enjoyed a significant resurgence, exceeding pre-pandemic levels, this robust performance was already fully reflected in the company's valuation. We felt limited upside potential at the share price, considering the potential for travel trends to normalise and the increasingly competitive landscape.

Grupo Aeroportuario Centro Norte, a Mexican airport operator, performed tremendously post-pandemic, mirroring Booking's rebound. Passenger growth, revenue, and margins soared, prompting a significant share price revaluation. However, we exited our position due to concerns about a limited margin of safety. Airports remain a regulated asset in Mexico, a country where political leadership had previously made worrisome statements about similar industries. Our concerns proved prescient post-sale as regulatory changes were announced, leading to substantial share price declines.

We sold our remaining holding in **Woolworths** during the year as the share had appreciated to our assessment of full value.

Sonic Automotive, a major US auto dealer that thrived during the pandemic's supply crunch, was sold as its share price approached our fair value estimate. While the company continued to perform well, its post-pandemic normalisation wasn't fully reflected in the stock price, prompting our exit.

OUTLOOK

We continue to believe the market underestimates the normalised level of inflation in the developed world. Recency bias leads many to assume long-run inflation will go back to below 2% in the short term. We said last year that we thought inflation might prove to be harder to tame than expected, and that has proven to be

the case. We would reiterate this view again this year. A cocktail of higher inflation and higher interest rates, combined with high wage demands and a year full of geopolitical risk, means we aren't banking on high returns from developed equity markets in 2024.

Closer to home, South Africa's upcoming national election will add uncertainty to the already subdued sentiment. Less loadshedding should be a tailwind to productivity and earnings this year. Unfortunately, it looks like some of these gains will be offset by continued poor performance from other state-owned entities, principally Transnet.

Many of the "SA Inc." listed companies we own are cheap in absolute terms, cheap relative to comparable companies elsewhere in the world and very cheap compared to their own history. It isn't going to take much in the way of good news to see the share prices of many of our local listed companies rerate. Said another way, we think there is a lot of bad news in current prices in South Africa.

The fund is closer to fully invested than for much of its history, which should give the reader an indication of our return expectations over the next three to five years. The fund is well placed: the portfolio is full of good businesses, most of whom we have owned for many years, run by competent management and priced below our conservative estimate of what they're worth.

BEFORE WE GO

The end of the year is a good chance to reflect on how we think about investing and an opportunity to remind our investors of some of the important investing principles in which we believe:

- Don't lose money. We focus on the downside and let the upside take care of itself. We don't like missing investments, but it is much more important to avoid owning businesses that lose permanent value.
- We aim to buy good businesses at reasonable prices, in that order. We will consider "paying up" for good businesses.
- What makes up the benchmark has no influence on how we build the portfolio.
- We don't profess to know everything about every company. We stick to companies we think we can understand that are run by management we think we can trust.

As always, we thank you for the trust you place in us.

31 December 2023