Truffle Asset Management

Mid-Year Newsletter 2023

The Halfway Mark

Iain Power
Chief Investment Officer

Investment Review

After a difficult 2022, 2023 is proving to be a better year for global equity markets. Commodities have lost first place position for asset class performance, experiencing price declines over the year-to-date as the world adjusts to post-pandemic imbalances and a slower-than-expected China reopening. The US Fed has increased the dosage of interest rate hikes to treat rising inflation and bring down within target levels, and while CPI in the US economy has reduced, the consumer has stayed strong. At the start of the year, China looked set for a strong recovery; however, the economic recovery has lost some of its momentum in the last few months, and market sentiment has soured. Poised at the 2023 start line for a slowdown or potential recession in the US and a more exuberant China, we reached the halfway mark having experienced just the opposite.

United States

Savings & healthy balance sheets protect from interest rate hikes

The US economy should eventually succumb to the pressure of higher interest rates following a decade of "free money". However, the timing of a potential slowdown is now more likely to be 2024 and possibly at a lower intensity given cash-flush consumers and companies. Employment data has stayed strong, and the US consumer is still to drain pandemic-era savings. US equities have continued to shine, year to date, primarily led by the "magnificent 7" tech stocks. We began the year with a high conviction that US valuations had become expensive, and at elevated levels, it's difficult to build a compelling investment case to buy into this market and halfway through the year, we maintain this view. Multiples on US equities are high, and companies such as Apple, Nvidia and Microsoft are trading well in excess of one standard deviation above their 10-year median multiples. We believe longer-term investors can find superior and sustainable value elsewhere.

China

Struggling to gain momentum

While China may have temporarily lost investor support, we are still of the view that the economy can and will continue to grow, although at a slower rate. Importantly, the shape of this growth will change. Historically, fixed asset investment, particularly in the property sector, has been a large driver of Chinese growth and, in the process, has boosted commodity prices and related manufacturing sectors. However, the incremental returns on this invested capital have been declining for some time rendering this model unsustainable, with increasing risks of bad loans and impairments due to these falling returns. Today Chinese policy is more focused on "sustainable growth" driven more by consumption and services rather than the build-out of fixed assets. Government stimulus and support are increasingly targeting consumption, decarbonisation, and the high-tech sector. Once consumer confidence inevitably improves, we believe the savings pool of $2.6 trillion within a $20 trillion economy will go some way in supporting consumption and a more sustainable economic recovery. We expect the consumer and services sectors to be the biggest beneficiary of this recovery. As a result, there are significant opportunities to benefit from the continued recovery of the Chinese consumer. Companies such as Tencent, Alibaba, JD.com and Ping An have strong financial metrics with low earnings bases and are trading on valuations which are more than one standard deviation below their 10-year medians.

South Africa

Are we moving out of the darkness?

On the local front, while it's been an intensely tough start, we believe (and hope) at the 2023 halfway mark, we are now past the point of peak pessimism. As mentioned in our May economic update, consumer and business confidence reached its lowest point since 1993. The resilience of our nation is once again coming through as businesses and consumers find solutions for the loss of electricity, and those in power take some action to revive a failing electricity grid. While this is not the only challenge for the SA market – it certainly represents a significant negative impact on economic growth, consumer sentiment, and business health. SA equity valuations are now extremely low, and while we are mindful of the ongoing challenges in our economy, including looming fiscal struggles, we are starting to see green shoots and opportunities for investing. We maintain that the companies we own should have high free cash flows offering strong dividends and high yields.

As we look ahead to the rest of 2023, we believe Central Banks are likely to pause their rate hiking cycles as the inflation data continues to decline as they wait to see the effects of tighter monetary policy on inflation. The higher rates will eventually play through to the US economy, which, although still buoyant, will weaken. The adage, “the US sneezes, and the rest of the world catches a cold,” may soon come to roost. However, many countries have their own set of challenges and regions like the UK and Australia may take even more strain from higher mortgages. We are entering a period of “wait-and-see” as authorities and markets assess the real impact of rate hikes and evaluate where inflation will settle. US real yields are headwinds, and with tight monetary policy, this brings an argument for lower multiples.

Public-private partnerships bring idiosyncratic opportunities to SA while we are still aware of the macroeconomic risks, particularly as the fiscus continues to strain without support from higher commodity prices.

Importantly, we are committed to delivering consistent financial outcomes to meet our clients’ objectives, and we remain agile in our approach while steadfast in our philosophy to ensure we capture the best opportunities to grow capital while protecting against risks.

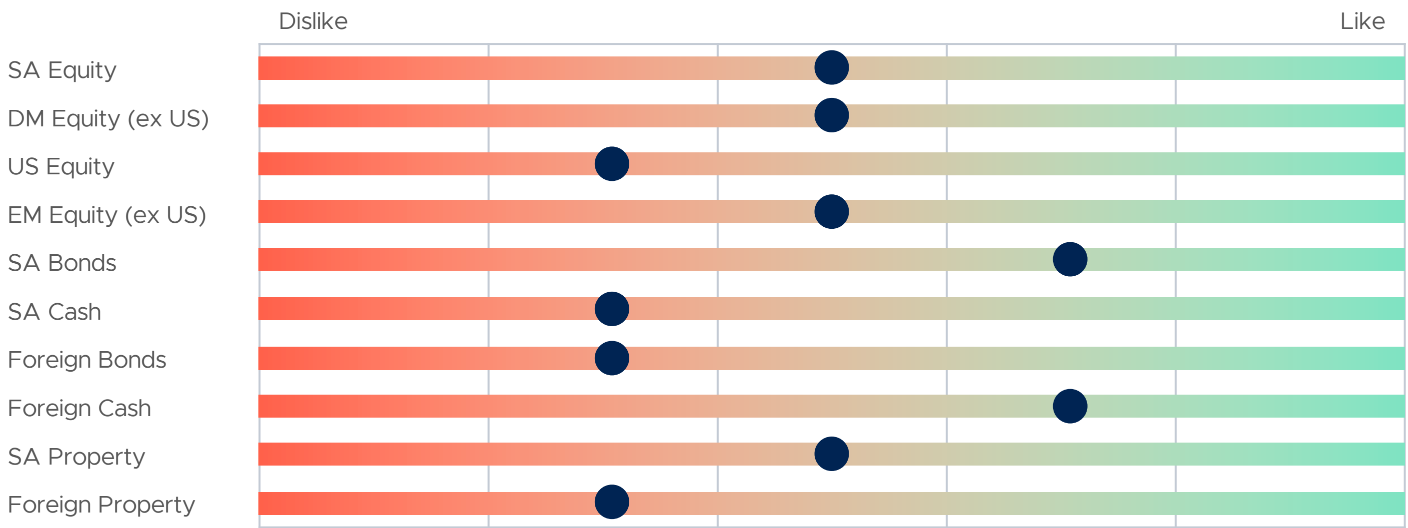
As we take on the second half of 2023, the Rugby World Cup is a seemingly well-timed and much-needed spirit lifter for all South Africans. If you’re a rugby fan, I hope you find the time to escape and enjoy the play, and if not – it wouldn’t be a bad idea to soak up some SA cheer and fly the flag for our team.

In closing, I am reminded that Truffle is now going on 15 years strong, and I congratulate everyone who is, and has been, part of the business journey. We have steadily and mindfully grown our asset and client base while retaining our open and dynamic culture in pursuit of delivering long-term financial value for our clients. This is something to be proud of as a 15-year-old!

We thank you for sharing our journey and partnering with Truffle.

All the best for the second half.

Asset class views



Equity

Our view on global equities (ex-US) is relatively neutral. Persistently high interest rates pose headwinds; however, there are specific sector and stock opportunities.

We favour companies with strong free cash flow and high dividend yields. SA valuations are compelling, but investing in SA is not without risk. Positive news on the infrastructure and power front does bode well for SA Inc., and we are evaluating related investment opportunities. We maintain our view that US valuations are elevated.

Fixed Income & Cash

South Africa and other emerging markets able to combat inflation with similar restrictive policies are now in a precarious position, given bond strength is also dependent on the weakening of the US Dollar. The US Dollar will continue to maintain its strength until the US reaches a peak in real rates. While emerging markets offer lucrative real returns, a strengthening dollar could erode those gains.

Against this backdrop, we believe that while we are close to peak rates, there is potential for one more rate hike in South Africa in 2023. We still favour floating rate instruments that offer attractive yields in relation to fixed-rate bonds for the time being; however, we are ready to pivot once expectations for rate cuts are priced into the nearer term.

Property

Our outlook for offshore property counters is stock and sector dependent. Lower inflation and a pause in the rate hiking cycle present an improved backdrop; however, a US recession remains likely into 2024. We remain comfortable that the few offshore counters we hold have low balance sheet risk, long debt maturities, and fixed interest rates. We are evaluating selective offshore shares that we believe are attractively valued after significant underperformance over the last 2 years.

Local and offshore markets are trading on high-frequency data points, e.g., a monthly inflation print. It is important that, through property stock selection, we consider both the timing and impact of a relaxation to monetary policy (or reduced tightening), balanced with a potential US recession, to ensure we gain from related benefits while protecting the portfolio from any downside risk.

Saul Miller
Portfolio Manager

Sophie Marie van Garderen
Portfolio Manager

Raihan Allie
Portfolio Manager
Fixed Income

Rachel Thomson
Portfolio Manager
Property

Responsible Investing

Vuyolwethu Nzube
ESG Officer

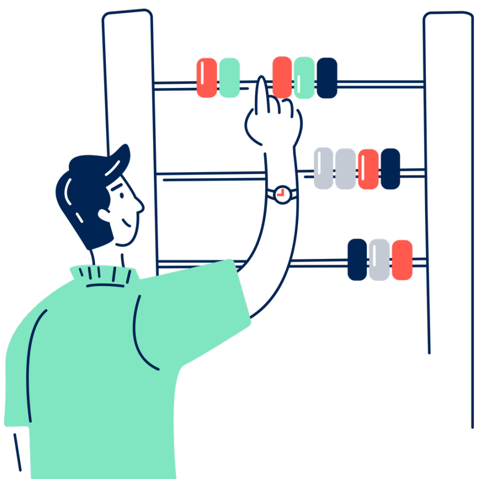
Environmental issues

Retain the spotlight in the first half of 2023

Real-life experience of extreme weather patterns is intensifying general awareness of climate-related issues and their impact on our environment and its people. As investors, we are increasingly mindful of how these changes impact potential investment risks and, in some cases, opportunities. Record temperatures in Europe this summer will likely speed up the implementation of decarbonisation initiatives at a consumer and national level. Meanwhile, soaring heat, changing rainfall patterns and an increasing incidence of wildfires place strain on sectors such as agriculture, food and beverages, retail and tourism in many countries.

The International Sustainability and Standards Board (ISSB) issued its inaugural standards on 26 June 2023. To be implemented globally in 2024, these standards aim to drive consistency of sustainability-related financial disclosures across global corporates and have already been endorsed across several jurisdictions.

The SA government, at a recent meeting of the International Partnership for Hydrogen and Fuel Cells in the Economy (IPHE), highlighted their determination for a low-carbon future by developing a hydrogen economy. Funding and skills development forms part of the programme, which is positive for a company like Sasol, intent on driving a hydrogen economy and needing related government support.



Noteworthy company updates

Naspers
Persistent engagements pay off

In 2021, as shareholders of Naspers and Prosus, we noted our concerns in a letter to management about the cross-holding transaction which had been proposed at the time. In collaboration with 10 other asset managers, we believed the transaction would not effectively unlock shareholder value, and the share would continue to trade at a discount. However, the proposed transaction was implemented, and we continued to raise concerns with Naspers management. Naspers recently addressed shareholder concerns, announcing an unwinding of the cross-holding structure.

Anheuser Busch
Sentiment on social issues mars sustained customer support

The controversy around collaboration with a transgender influencer as part of a Bud Light marketing campaign in April of 2023 led to a significant fall in market support, with US sales of the light beer dropping by approximately 25% in one month. Typically, companies experiencing a dip in sales volumes due to a once-off unexpected event of this nature would bounce back however, in this instance, Bud Light appears to have lost sustained brand support, with sales settling at a lower market share. Furthermore, sentiment has spread to other brands in the stable. We believe the related Social issue poses an earnings risk to the business, and while we don't hold any moral views on the event, we are mindful of the strong opinions around this topic within the target market. We have reduced our holding across all funds because of the uncertainty around recovery. In our multi-asset funds, we prefer Heineken, a similar business model with similar growth but lower risk.

Looking ahead

The introduction of regulation at a national level needs global support. The EU has noted the concept of carbon leakage and, in May this year, introduced a tool called the Carbon Border Adjustment Mechanism (CBAM). Recognising that stringent climate policies may drive companies to move more carbon-intensive production to other areas with less penal climate regulation (carbon leakage), the EU has introduced the CBAM to ensure their internal policies are aligned with a global solution for carbon emission reduction. The CBAM creates a fair carbon price for imported goods meaning the cost to produce in a non-EU area would end up being comparable to producing in the EU, where a more stringent climate policy applies. The CBAM is designed to be compatible with WTO rules, and the transition will begin in October 2023 with full implementation from 1 January 2026. We will continue to monitor closely the development of this and other taxations and regulations as they are introduced, particularly the resulting impact on corporate earnings and business models.

This year's COP 28 UN Summit will take place from 30 Nov to 12 Dec 2023 and will be hosted by the UAE. While several issues sit on the agenda, this year's meeting will conclude the first Global Stocktake – where for the first time, countries will formally evaluate their progress in terms of the 2015 Paris Agreement. The Agreement requires countries to limit global temperature increase to 1.5˚C above pre-industrial levels. The key question will continue around funding for developing countries to reduce emissions to reach global goals. We expect new initiatives from countries on more ambitious plans or financing arrangements before the conference.

At Truffle, we have made good progress in developing and implementing a structured engagement framework which ensures added rigour and focus to our company engagements around ESG issues. In the second half of 2023, we look forward to more intensive and insightful engagements with many companies we research.

In case you missed it

In May 2023, we published our second Stewardship Report outlining our engagement statistics for the year and how we are evolving our approach to integrating ESG into our investment process and the related stewardship activities on behalf of our clients.

To download the report, click here.

Stewardship Report

Business Update

Truffle celebrates 15 years of investing in 2023! We are pleased to have successfully and steadily grown our capabilities, client base and assets under management over this time. We are also mindful of the need to develop our capabilities effectively to continue delivering our purpose and philosophy to a growing client base.

The development and addition of complementary specialist expertise, and the strengthening of our systems and infrastructure to offer excellent client service along with the best investment outcomes is critical.

In the first half of 2023, we welcomed four new members to the Truffle team.

Raihan Allie
Fixed Income Portfolio Manager

Raihan brings a depth of fixed income expertise and broad experience in the asset management industry.

Thandi Zwambila
Institutional Distribution

Thandi brings a wealth of experience and energy to the Distribution team.

Natalie Dascalu
Personal Assistant

Natalie will fulfil a much-needed role in supporting the senior investment team in Cape Town.

Thembi Hope
Distribution Analyst

Thembi joins as our newest intern within the Distribution team.

Awards

We are incredibly proud of our investment team for the nominations and wins at this year's various industry awards, a testament to their dedication and commitment to delivering consistent financial outcomes for clients. Truffle was awarded two Raging Bull and four Morningstar awards which is a remarkable achievement.

Raging Bull Awards

The 27th Edition of the Raging Bull Awards was held on the 28th of February. The trophies and certificates are based on risk-adjusted performances as measured by the *PlexCrown* rating system, provided by *ProfileData,* which considers the consistency of performance over 3- and 5-year periods.

Morningstar Awards

The Morningstar awards, announced in March, recognise those funds and asset managers that have served investors well over the long term and which Morningstar's manager research team believes will be able to deliver strong risk-adjusted returns over time.

Raging Bull Awards	Fund Nominated	Category	Trophy / Certificate
Risk-adjusted performance over 5 years	Amplify SCI Wealth Protector	Best South African M-A Equity Fund	Trophy
	Amplify SCI Wealth Protector	Best South African Low Equity Fund	Certificate

Morningstar Awards	Fund Name	Category
Category Awards	Truffle SCI Income Plus	Best Bond Fund
	Nedgroup Investments Balanced	Best Moderate Allocation Fund
	Nedgroup Investments Managed	Best Aggressive Allocation Fund
Fund House Awards	Truffle Asset Management	Smaller Fund Range

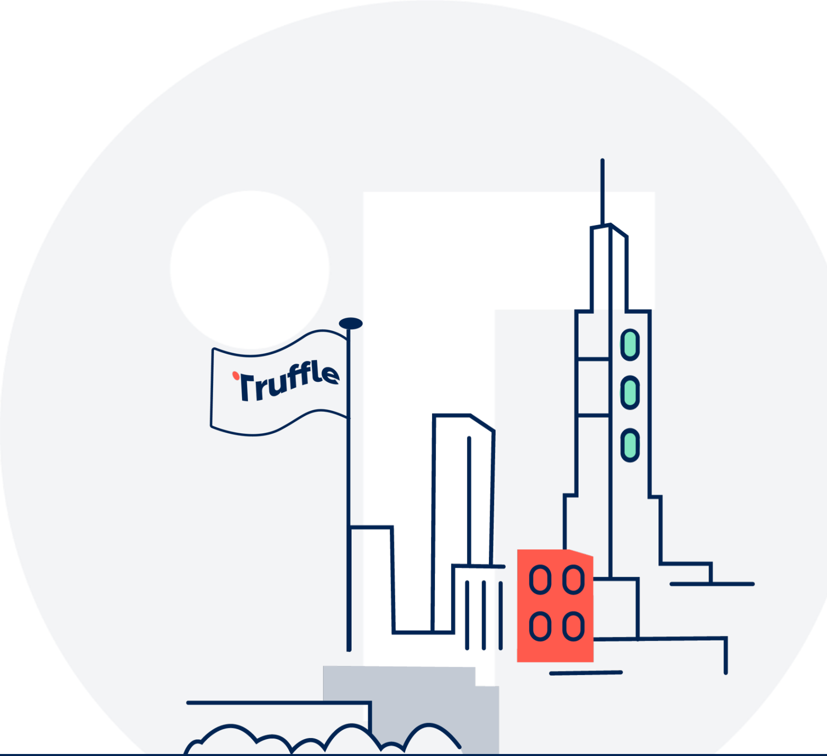
Truffle Brand

In February 2023, Truffle launched a refreshed corporate identity. Our "new look" is bolder and more contemporary and designed to signify the core principles of our business. Our signature "dot" that can be seen in the new logo represents the persistent investment track record of the Truffle funds.

The strategic direction and leadership of the business remain the same, and as an independent specialist asset manager, the fresh look represents our open, dynamic culture and agile approach. We value the benefit of experience, creativity and diversity of skill across our team, coupled with healthy debate and deep fundamental research and analysis.

An important element of the brand refresh was to enhance the Truffle website allowing us to effectively communicate our business story and fund offering, share insights from our investment team and keep investors updated.

To visit our new website, visit www.truffle.co.za.



Insights from Truffle

Truffle aims to inform investors about how we think and why we make specific investment decisions. Below are our top insights shared in H1 2023.

Quarterly commentary

Developed equity markets delivered good performance for the quarter, supported by US economic resilience and a rally in tech, while in SA, the reduction of loadshedding has lifted spirits.

Read more

15 Years of Truffle

Truffle has successfully grown its capabilities, client base, and assets under management since 2008. Nicole Agar, portfolio manager, shares her insights on the successful growth to date.

Read more

A force to be reckoned with

Rising ESG regulation is set to change behaviours. Vuyolwethu Nzube, Truffle's ESG analyst explains how trends will have a financial impact on corporate.

Read more

Bonding with inflation

As the world adjusted to a post-pandemic environment, the global narrative of transitory inflation shifted to persistent with Central Banks motivating "higher-for-longer" rates.

Read more

Performance summary

	Annualised Performance								
	Inception Date	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception	Highest	Lowest
Truffle SCI* Income Plus Fund A	22 Sep 2016	9.74%	8.77%	8.53%	-	-	9.52%	12.99%	6.19%
Benchmark: STeFI Composite ZAR		6.76%	4.98%	5.81%	-	-	6.24%	-	-
Amplify SCI* Wealth Protector Fund B5	15 Aug 2016	9.65%	10.65%	10.68%	-	-	9.29%	13.04%	8.84%
Benchmark: CPI + 3% over a rolling 3-year period		8.37%	8.88%	7.85%	-	-	7.89%	-	-
Nedgroup Investments Managed Fund A	01 Nov 2003*	9.87%	15.50%	11.11%	-	-	9.35%	22.37%	0.60%
Benchmark: CPI + 4% / ASISA Category Average		9.37%	9.88%	8.85%	-	-	8.89%	-	-
Nedgroup Investments Balanced Fund A	11 Oct 2011	8.89%	11.62%	10.12%	7.61%	10.36%	11.21%	21.18%	-3.17%
Benchmark: CPI + 4% / ASISA Category Average		9.37%	9.88%	8.85%	8.85%	9.15%	9.19%	-	-
Truffle SCI* Flexible Fund A	18 Nov 2010	8.97%	12.13%	10.72%	8.29%	11.10%	12.23%	23.50%	-4.61%
Benchmark: CPI + 5%.		10.37%	10.88%	9.85%	9.85%	10.15%	10.30%	-	-
Truffle SCI* SA Equity Fund C	27 Jul 2012**	11.22%	18.27%	-	-	-	12.21%	27.07%	8.41%.
Benchmark: FTSE/JSE Capped SWIX Benchmark changed from SWIX to Capped SWIX on 13/11/2017.		13.48%	15.70%	-	-	-	6.74%	-	-
Truffle SCI* General Equity Fund A	18 Nov 2010	10.70%	17.61%	12.27%	9.24%	11.65%	11.97%	26.19%	-4.47%.
Benchmark: FTSE/JSE Capped SWIX Benchmark changed from ALSI to Capped SWIX on 01/05/2019.		13.47%	15.69%	7.23%	7.49%	9.12%	9.70%	-	-

* Truffle Asset Management has been the investment manager since December 2015.

** Fee class launch date (C class) is 01/08/2018.

Returns are annualised since inception. The inception date starts the first full month after the first 3rd party investment was received. Performance data source: © Morningstar. Returns are net of fees. Data as of 30 June 2023.

Truffle
Asset Management

info@truffle.co.za +27 11 325 0030 www.truffle.co.za

Invest in the value of experience.