Truffle
Asset Management



February 2024

Annual Investor Letter



Iain Power
Chief Investment Officer

A year of surprises

2023 will be remembered by all South Africans as a year of intense loadshedding. With limited warning, South Africans experienced regular stages of darkness, and by the end of 2023, daily power cuts had impacted 90% of the year. Local business and consumer sentiment dipped to the lowest level in over three decades, and by mid-year, resilience was fading. Thankfully, a Rugby World Cup win for the South African team lifted spirits. An element of hope returned by year-end as power came back onto the grid, and solutions to repair SA's failing logistics and rail network became increasingly evident. With the challenges facing our country now well established, the drive to deliver sustainable positive change is crucial. As we head into an election year, separating short-termism from long-term strategic economic upliftment will be even more critical.

For investors, 2023 will be known for unexpected global market strength. This is particularly true in the US, as the "magnificent 7" tech stocks re-rated at an alarming pace, driving a substantial portion of the S&P500's 24% return for the year. The US economy shrugged off higher interest rates, as pandemic-era savings and fixed rates on long-term funding provided a strong shield for consumers and corporates. The expected 2023 recession, or at least a slowdown in the US, never materialised, and with unemployment at record lows, resilience prevailed. US growth numbers for 2023 are estimated to be at 2,5% for the year, with Q4 coming in at triple that of economists' expectations.

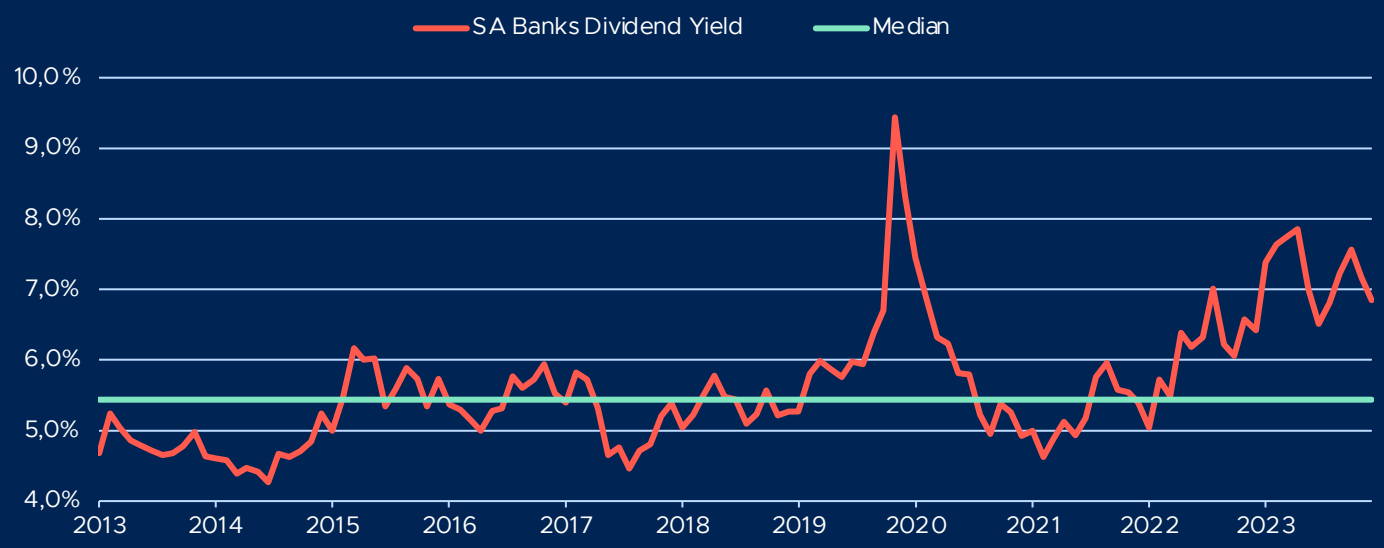
It would appear the US Fed is now comfortable that inflation is under control, and we are likely to see a series of rate cuts in the year ahead; however, both the timing and extent of cuts remain uncertain. Similarly, China's post-pandemic revival is yet to gain strength, and whether attempts to transition from a capital-intensive to a more consumption-based economy will be successful remains to be seen.

Portfolio positioning and performance

Economic surprises did not work in our favour in 2023. The US economy defied the pressure of high rates and inflation, and tech-heavy portfolios were rewarded despite already high valuations, given sustained exuberance for AI (artificial intelligence). We maintained our high conviction that US valuations remain elevated. Multiples on US equities reached significant highs, and companies such as Apple traded close to record multiples with expected earnings growth in single digits.

In South Africa, valuations remained compelling, and our portfolios benefitted from exposures to SA Financials, including FirstRand and Investec, with an 8% dividend yield. While ABSA did not perform in line with peers (or the previous year), we believe shares like this with high dividend and cash flow yields will deliver value to investors over the medium term.

Chart 1: Select valuations are compelling: SA Banks dividend yield tracking above median

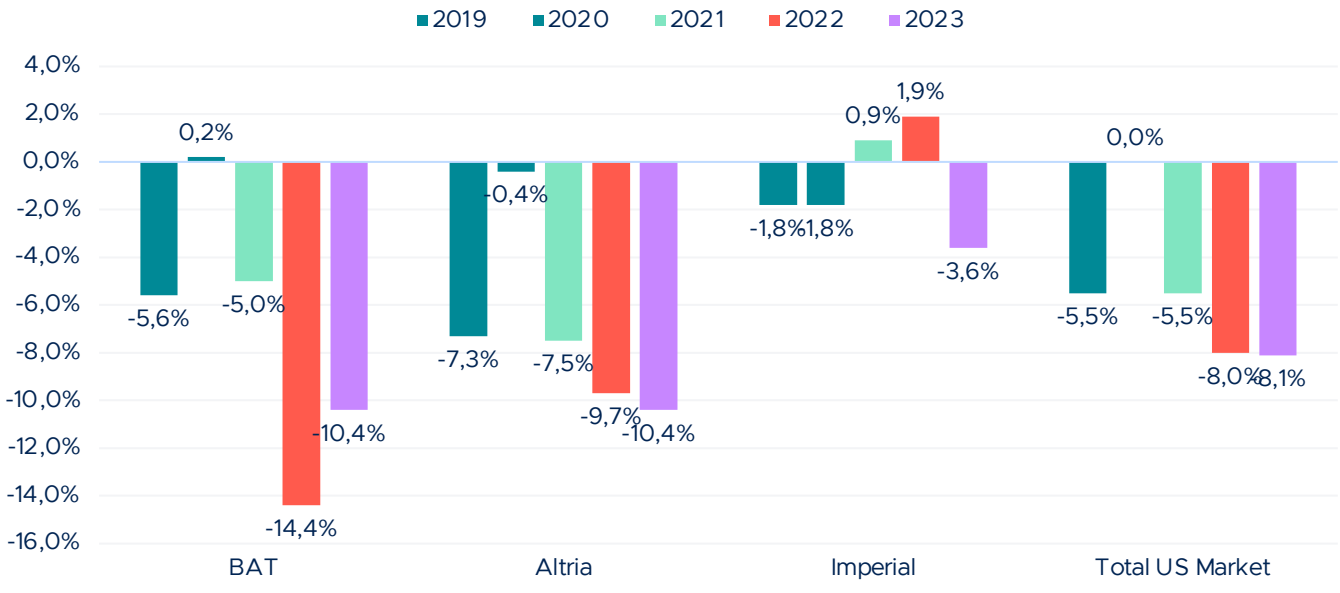


Source: Bloomberg as at 31 December 2023

The weak performance of risk assets in SA over 2023 contributed to a challenging environment for domestic stock selection, while Truffle continues to deliver steady and consistent longer-term performance, stock-specific factors detracted from the relative performance in 2023. As a well-priced oil counter, Sasol should have benefitted over the period; however, the company experienced operational issues in the first quarter. British American Tobacco (BAT) also underperformed the market.

Share price performance is not due to significant earnings underperformance but rather a continued de-rating in the PE multiple as investors remain concerned about the higher-than-anticipated declines in US tobacco volumes and down-trading in this market. Typically, BAT would have performed well during Rand weakness, but over the most recent period, the de-rating of the stock offset the benefits of the weaker Rand exchange rates.

Chart 2: BAT combustible volumes declining more than the US market given downtrading to cheaper brands



Source: Nielsen data, BAT financial statements

Importantly, we remained committed to our investment philosophy and maintained a core focus on selective SA stocks with high free cash flow yields and attractive dividend yields, which are trading at significant discounts to their intrinsic value.

Our multi-asset funds benefitted from a relatively high exposure to fixed income assets. Within fixed income, a skew towards floating rate notes panned out well. We remain defensively positioned with a barbell strategy of exposure to fixed-rate bonds in the middle of the yield curve (R2035) and a portfolio of floating rate notes on the short end of the curve, which together give our clients a good coupon with relatively low capital risk. If local spreads blow out over the next few months due to anxiety around upcoming SA elections, we will use this opportunity to add to our fixed rate exposures.

Finding value in 2024

2024 is off to a volatile start; looking ahead, we can be certain of more uncertainty. Markets remain sensitive to significant world events, economic data releases and daily news flow. Overlay this with longer term challenges relating to the current and ongoing geopolitical tensions and the changing landscape in managing environmental challenges. Notably, 2024 is an election year in more than half the world, with four billion people expected to vote.

The US Fed has likely reached the end of the current tightening cycle. While employment data continues to support ongoing economic strength, we must brace ourselves for continued uncertainty locally and globally. The timing and impact of rate cuts remain unknown.

China stood out as the underperforming economy and market in 2023 and continues to face significant structural challenges. Geopolitics is weighing heavily, and inbound foreign direct investment is at multi-decade lows. The Chinese consumer remains depressed and continued to save in 2023 despite the opening of the economy. A China turnaround is dependent on a turnaround in Chinese consumer confidence, and it remains to be seen whether the economy can resume historical levels of fast-paced growth.

While the risks to investing in China remain high, Japanese equity is well positioned to benefit from structural and cyclical factors arising in Japan over 2023. Business-friendly stock market reforms are supportive of unlocking value, and companies could face delisting if they do not improve capital allocation to boost valuations and returns. The unwinding of cross holdings should also be a positive catalyst. Returns on capital already appear to be improving, and valuations are reasonable with PE's trading in line with long run history.

As we head into 2024, we can be certain of the challenges facing our local economy but less certain of the outcomes. The focus appears to be shifting from short-term crisis management to long-term reform.

The outcome of South Africa's 2024 elections will be important, although current polling data indicates we can expect a short-term status quo. A reduction and stabilisation of load-shedding will be beneficial for business outlook; however, consumer data remains subdued, and planning challenges weigh heavily on economic growth prospects. Transnet's turnaround efforts are positive, although complex, and will take time following years of poor management.

While the backdrop is clearly challenging, our process is not dependent on short-term economic projections, which are notoriously difficult to forecast.

Our focus into 2024 remains on finding value. Volatility brings opportunity, and it is important to identify and invest in these opportunities while protecting portfolios from downside risk. Selecting stocks where short-term prices are dislocated from the longer-term value that these companies can offer investors is key. Low valuations across both SA's equity and bond markets continue to partly take account of the above-mentioned macroeconomic risks.

Locally, we remain exposed to Financials, where we still think absolute valuations are compelling. The dividend yield of our aggregate holding is circa 8%. Domestic small and mid-cap industrials are also reflecting compelling value, with a few counters trading on PE multiples of 5-6, including Motus and Supergroup. Several high-quality, offshore exposed ALSI listed companies are also trading on generous valuations, including Bidcorp and Anheuser Busch.

Given the stretched US equity market valuations, we remain underweight in the US equity market in our offshore positions and prefer to hold short-dated fixed income. European stock markets are trading in fair value territory while we have increased our exposure to Japan, given reasonable valuations and constructive changes to the Japanese economy.

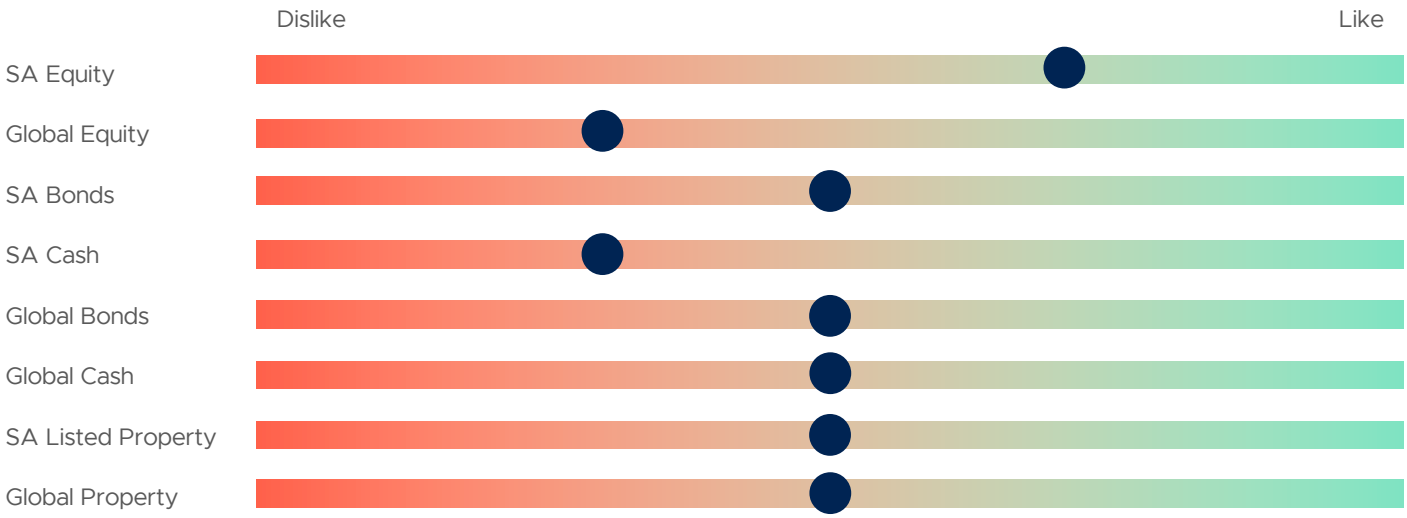
We are prepared and ready for another year of certain volatility and uncertain outcomes. South Africans are a unique nation with unwavering resilience and perseverance to stand firm in tough times and find opportunities. This year will be no different, and we look forward to finding valuable opportunities in our local markets that will enable us to deliver consistent long-term growth.

I would like to thank all our clients for your continued support through uncertain times, and I wish you a resilient and rewarding 2024.

- Iain Power, CIO

Asset class views

Q1 2024 Outlook





Saul Miller
Portfolio Manager

Equity

Our view on global equities is relatively negative, and we maintain our view that US valuations (60% of world markets) are elevated. Europe is largely trading in fair value territory, while Japan is offering value with initiatives driven by the local stock exchange that should unlock shareholder value in many stocks.

SA valuations are compelling, but investing in SA is not without risk. In 2024, major market events will continue to drive uncertainty, particularly elections and increasing geopolitical risk across the world. While the outcomes are unknown, there are investment opportunities, and it is important to focus on asset prices in relation to their value.



Raihan Allie
Portfolio Manager
Fixed Income

Fixed Income & Cash

The market appears to be pricing in a near perfect scenario in terms of imminent rate cuts, where inflation reaches target, and the probability of a recession diminishes. Increasing geopolitical tensions, do however pose an upside risk to inflation. While local bond valuations are relatively compelling, we remain defensively positioned given market uncertainties. If SA spreads blow out over the next few months due to anxiety around upcoming local elections, we will use this opportunity to add to our fixed rate exposures.



Etienne Roux
Portfolio Manager
Property

Property

Given property's significant leverage to interest rates at a peak in the rates cycle, we feel that risks to the sector are currently more skewed to the upside than the downside. The overall operational metrics for many SA property companies are all pointing in the right direction, with very resilient demand evident in occupancy levels and rental reversions. However, global macroeconomic uncertainty and local constraints pose risks.

As valuations begin to reflect the impact of higher rates on earnings, we will continue to invest in opportunities where prices appropriately value this risk and the resulting earnings implications. Our outlook for offshore property counters is stock and sector dependent.

ESG Outlook 2024



Vuyolwethu Nzube
ESG Analyst

Environmental issues and related regulation

Once again, a hot topic in 2024

The ESG landscape is fast evolving, and we experience incremental change every year. From changes in weather patterns to shifts in how companies and nations are dealing with environmental and social impact to important advances in disclosing relevant data to quantify such impact. 2023 will certainly be remembered for the launch of key landmark regulatory policies in the environmental space in developed markets. Designed to encourage businesses and consumers to limit carbon usage, both the US and EU have tabled several initiatives and subsidies – the IRA now being a well know US policy. As we head into 2024, key themes and initiatives we are following and incorporating into our investment thinking include::

- Shifts in both production and consumer demand and how traditional businesses are adapting or will need to adapt e.g.: electric vehicles.
- Cost implications of new regulation and how these may impact business models, particularly those in high carbon usage industries.
- Increased corporate disclosure and ability to measure both environmental and social impact; and increasing regulatory scrutiny around those disclosures to prevent greenwashing.
- Further development of our platform that provides relevant and meaningful ESG data for each company, enabling us to enhance our investment research.
- Enhancements to our engagement framework enabling us to drive critical conversations with company management.
- Increasing conversations and roadmaps around the Just Energy Transition.

We will be publishing our 3rd Stewardship report in Q2 of this year and look forward to sharing various statistics and case studies as well as our ongoing progress in this arena. As responsible investors, we continue to take seriously all aspects of ESG and how we enhance and refine our investment process for the benefit of our clients, while protecting the longevity of our people and planet.

Latest responsible investing insights

The Environmental Pressure Cooker

Truffle has created a glossary of terms that are now common language in the environmental space and important policies that are turning up the heat on the management of climate change worldwide.

Read now

A Force to be Reckoned With

According to the Emergency Event Database, in 2022, there were 387 natural hazards and disasters worldwide. This resulted in the loss of 30,704 lives, affecting 185 million individuals and causing economic losses of around US$ 223.8 billion. These quanta highlight the significant global impact of climate change.

Read now

Business Update

Truffle launches a new multi-asset income fund

South African investors' appetite for funds that can deliver a high-income stream while protecting capital has increased significantly over recent years.

As we have grown as a business, Truffle has had good success in the management of both our income fund and low equity multi-asset mandates. Given the increasing client preference for a multi-asset income fund, along with the strength of Truffle's investment capabilities, we have taken the decision to complement our current fund range with the **Truffle SCI* Enhanced Income Fund**.

Launched in October 2023, this fund aims to achieve attractive, consistent income with a less volatile return profile. This is a dynamically managed fund with a strong focus on capital protection.

The fund predominantly invests in a range of fixed income securities with the flexibility to invest in other asset classes such as equity and listed property. Fund managers **Hannes van der Westhuyzen**, Head of Fixed Income, and **Raihan Allie**, fixed income portfolio manager, bring significant expertise in managing interest rate risk and duration. The team adopts a flexible approach, ensuring the fund is actively managed through market cycles.

Truffle is excited to be offering our clients a multi-asset income fund that leverages the expertise and experience of our fixed income and multi-asset capabilities.

Click here to find out more about the fund.

Fund Brochure

Developing young people in asset management

Truffle continues to grow our capabilities, client base, and assets under management successfully and steadily. We reiterate our message from last year that while our purpose or philosophy has not changed; we are mindful of the need to develop our capabilities effectively to deliver the same purpose to a growing client base. Developing and adding complementary specialist expertise and strengthening our systems and infrastructure to offer excellent client service along with the best investment outcomes remains critical.

Importantly, we recognise that our culture is what makes Truffle, and our people define who we are. We are committed to maintaining an open, dynamic environment across two locations. A key element of Truffle's culture is how we support and develop young people in the local asset management industry and provide valuable learning opportunities for aspiring professionals. Our internship programme is now well-established, giving young SA graduates hands-on experience and an opportunity to develop essential asset management skills. Where possible, we aim to promote Truffle interns into permanent roles.

Blessing Khanyile started his career with Truffle in our internship programme in January 2022, and his enthusiasm and capability quickly led him to a Distribution Analyst role. At the end of 2023, Blessing has been moved into a role with our investment team as a Fixed Income analyst. This is an opportunity to extend his quantitative skill and passion for investments, supporting our Head of Fixed Income, **Hannes van der Westhuyzen** and Portfolio Manager, **Raihan Allie**, in managing our fixed income funds.

We have also welcomed a new intern at the start of 2024. **Namhla Faku** joined our portfolio administration team and is already learning critical operational tasks in managing client portfolios. We welcome Namhla to the Truffle team and look forward to her fresh perspectives and energy.



Blessing Khanyile
Fixed Income Analyst



Namhla Faku
Portfolio Administration

At the end of 2023, we unfortunately bid farewell to equity analyst Rachel Thomson, who emigrated with her young family to Australia. This is a reminder that while war is tragically dividing certain regions, we do live in an increasingly globalised environment, and career opportunities span many countries. We thank Rachel for her valuable input into our investment decisions and her ongoing dedication to sharing deep and thorough research in her nearly 5 years at Truffle. We wish her well on a new adventure.

Insights from Truffle

Below are some recent articles from 2023

Economic themes of 2023 have carried into 2024

The economic themes of 2023 have carried into 2024 with the US economy remaining strong and China's outlook still uncertain. US markets gained in January on positive sentiment with the S&P 500 reaching record highs while China's weak equity market performance dragged on Emerging Market returns.

Read more

Making light of a dark situation

In the face of adversity, South Africans have shown their resilience and "made a plan". Adapting to persistent loadshedding in 2023 means efforts to combat loadshedding have gained, and continue to gain, traction.

Read more

Equity markets make a comeback

Global equity markets (except for China) made a comeback in the fourth quarter, spurred by fresh optimism of imminent US rate cuts following a two-year hiking cycle. Once again, the broader US economy failed to succumb to pressure from higher rates while China continued to disappoint.

Read more

Celebrating 15 years of Truffle

Truffle Asset Management was founded in April 2008 by Louis van der Merwe and Hannes van der Westhuyzen. The business has successfully grown its capabilities, client base and assets under management over the past 15 years.

Read more

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Performance summary

* Sanlam Collective Investments

	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	11.12%	8.70%	8.58%	9.59%	-	9.64%	12.99%	6.19%
Benchmark: STeFI Composite ZAR		8.06%	5.68%	5.94%	6.35%	-	6.41%	-	-
Amplify SCI* Wealth Protector Fund B5	15 Aug 2016	6.94%	10.18%	10.72%	9.47%	-	9.13%	13.04%	4.06%
Benchmark: CPI + 3% over a rolling 3-year period		8.41%	9.18%	8.11%	7.92%	-	7.89%	-	-
Nedgroup Investments Managed Fund A	01 Nov 2003**	4.56%	12.14%	11.69%	9.07%	-	9.15%	22.37%	0.60%
Benchmark: CPI + 4% / ASISA Category Avg		12.25%	10.48%	9.20%	7.38%	-	7.39%	-	-
Nedgroup Investments Balanced Fund A2	11 Oct 2011	4.80%	9.38%	11.16%	8.72%	9.08%	11.11%	21.18%	-3.17%
Benchmark: CPI + 4% / ASISA Category Avg		12.25%	10.48%	9.20%	7.38%	6.99%	8.53%	-	-
Truffle SCI* Flexible Fund A	18 Nov 2010	4.69%	9.51%	11.51%	9.32%	9.55%	11.85%	23.50%	-4.61%
Benchmark: CPI + 5%.		10.41%	11.17%	10.11%	9.92%	10.20%	10.32%	-	-
Truffle SCI* SA Equity Fund C	27 Jul 2012***	3.61%	12.60%	13.11%	-	-	11.30%	27.07%	3.61%.
Benchmark: FTSE/JSE Capped SWIX Benchmark changed from SWIX to Capped SWIX on 13/11/2017.		7.87%	12.70%	8.97%	-	-	6.88%	-	-
Truffle SCI* General Equity Fund A	18 Nov 2010	3.18%	12.08%	13.11%	10.24%	9.57%	11.41%	26.19%	-4.47%.
Benchmark: FTSE/JSE Capped SWIX Benchmark changed from ALSI to Capped SWIX on 01/05/2019.		7.87%	12.70%	9.66%	8.36%	7.70%	9.77%	-	-

** 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 31 Dec 2023.

Invest in the value of experience.

*SCI acronym stands for Sanlam Collective Investments. Sanlam Collective Investments (RF)(Pty) Ltd is a registered and approved Manager in terms of the Collective Investment Schemes Control Act. Collective investment schemes are generally medium-to long-term investments. Past performances are not necessarily a guide to future performance, and the value of unit trusts may go down as well as up. A schedule of fees and charges and maximum commissions can be obtained from the Manager. Collective investments are traded as ruling prices and can engage in borrowing and scrip lending. Forward pricing is used. Annualised return is the weighted average compound growth rate over the period measured. All annualised returns are since inception to 31 December 2023.

The Manager does not provide any guarantee either with respect to the capital or the return of a portfolio. The performance of the portfolio depends on the underlying assets and variable market factors. Performance is based on NAV-to-NAV calculations with income reinvestments done on the ex-div date. Performance is calculated for the portfolio and the individual investor performance may differ as a result of initial fees, actual investment date, date of reinvestment and dividend withholding tax. Lump sum investment performances are being quoted.

The funds may from time to time invest in foreign countries and therefore it may have risks such as potential constraints on liquidity and repatriation of funds, macroeconomic risk, political risk, foreign exchange risk, tax risk, settlement risk as well as potential limitations on the availability of market information.

Income funds derive their income primarily from interest bearing instruments. The yield is current and is calculated daily. The manager has the right to close the portfolio to new investors in order to manager it more efficiently in accordance with its mandate. Sanlam Collective Investments retains full legal responsibility for the Sanlam Investments co-branded portfolios. The portfolio management of the funds is outsourced to Truffle Asset Management (Pty) Ltd (FSP no.36584), an Authorised Financial Services Provider in terms of the Financial Advisory and Intermediary Service Act, 2002.

The Nedgroup Investments collective investment schemes are administered by Nedgroup Collective Investments (RF) Proprietary Limited, a registered and approved Manager in terms of the Collective Investment Schemes Control Act. Time period for highest and lowest annual returns is since inception to 31 December 2023.

The full registered names of the funds are as follows: Truffle Sanlam Collective Investments Income Plus Fund, Amplify Sanlam Collective Investments Wealth Protector Fund, Truffle Sanlam Collective Investments Flexible Fund, Truffle Sanlam Collective Investments SA Equity Fund, Truffle Sanlam Collective Investments General Equity Fund and Truffle Sanlam Collective Investments Enhanced Income Fund.

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