FOREWORD

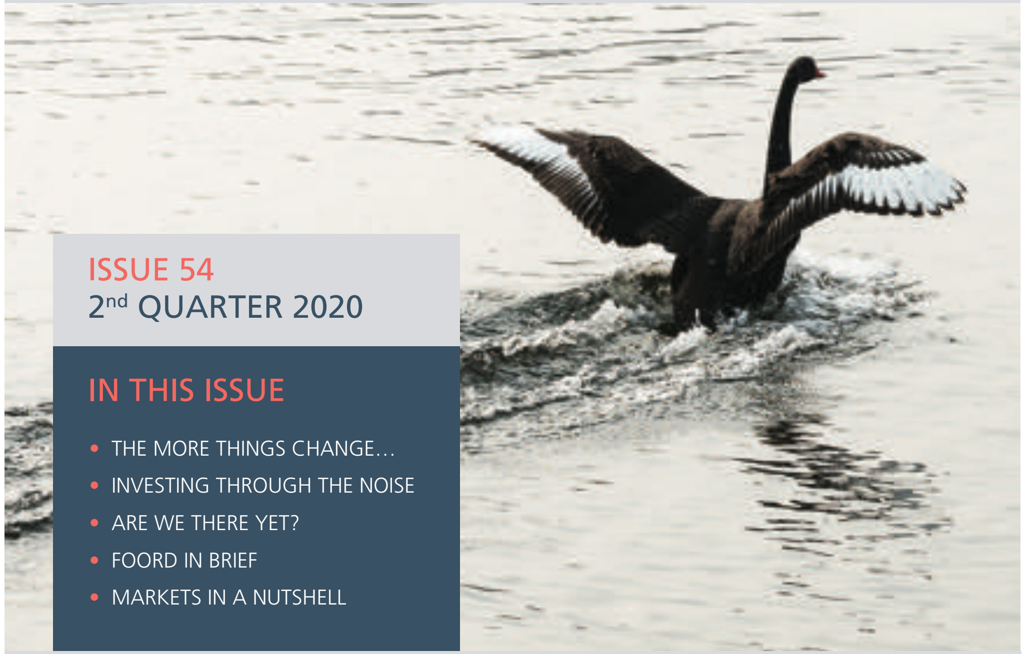
DID YOU KNOW? BLACK SWAN

Extremely rare. Severe in consequence. Hard to predict.

These are the three criteria that characterise a black swan event. Finance professor, writer and former Wall Street trader, Nassim Nicholas Taleb, first popularised the term in 2001, later authoring *The Black Swan* in 2007 — well before the Global Financial Crisis, which he considered to be a classic Black Swan (Taleb capitalises the term).

The first recorded use of the term 'black swan' was second-century Roman poet Juvenal's reference in his Satire VI to something impossibly rare, 'very much like a black swan'. At the time and for the next 1,500 years, swans were all assumed to be white, as no black swans had ever been sighted. This changed in 1697 when Dutch explorers encountered black swans in western Australia (the black swan features on the flag of Western Australia).

Taleb himself becomes irritated when the COVID-19 pandemic is referred to as a Black Swan. He says that a Black Swan was never intended to be 'a cliché for any bad thing that surprises us' and he considers the pandemic, or at least its trajectory, to have been predictable.



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THE MORE THINGS CHANGE...

JC XUE
Equity Analyst

The COVID-19 pandemic has dramatically and swiftly changed our living routines and operating habits. Future gazers have opined on how much of our daily lives will change permanently. But Foord Singapore analyst JC XUE explains what won't change and why human nature is the perennial constant.

COVID-19 lockdowns and social distancing measures have adapted us to working from home, meeting via video chat and embracing online shopping. A lot more will change and some of our habits will evolve — how much will be tied to the containment of the pandemic and timing of vaccine development.

But we should never forget that humans are social animals. We go to the office and to school for collaboration and socialisation. We need to be around people instead of staying on a perpetual social island called home.

We are also dreamers. We dream of owning a Ferrari and travelling the world. We cannot wait to board a plane to fly to our next holiday destination. We grow bored. We will always need new entertainment, be it video games, television shows or social media. We want to look good, we want convenience and we want the products that add value to our lives.

The things we want enrich the monotony of our work-sleep-work regimes. They are the constants that won't change. Much has been made about the investment winners from the post-COVID new-normal. But in my view, companies that are focused on the constants will also thrive.

Foord Global Equity Fund investee Tencent has focused on keeping consumers from boredom. It invests in an ecosystem of entertainment products from video games to music and streaming video content. It fostered social connection across its gaming ecosystem by encouraging friends to play together through sharing via WeChat and its other social media applications. These created a positive reinforcement cycle. Another investee, JD.com, is the second largest e-commerce platform in China. It has focused on consumers' constant need for authentic products, at the best price, delivered fastest. Both companies have performed superbly during the crisis.

"But we should never forget that humans are social animals."

The pandemic has undeniably affected the fortunes of companies focused on servicing our dreams. Lockdowns and stay-at-home orders have hit the travel and luxury goods industries hard. But I believe that we will continue to dream and that long-term demand for these products will endure. Airbus will still develop increasingly efficient planes to sustain our dreams to travel the world. And Moncler will capitalise on its 65-year heritage to expand its luxury, down-jacket brand to more aspirational consumers.

Uncertainty breeds opportunity. To focus on what is constant rather than on what is changing is to focus on things that are more knowable. This reduces the risk of investment loss. Patient investors could use this strategy during the crisis to buy great businesses at attractive valuations such as we have done at the margin with Airbus and Moncler.

INVESTING THROUGH THE NOISE

NICK BALKIN
Portfolio Manager

Uncertainty levels always feel sky-high when financial markets suffer bouts of extreme stress. It is natural for people to lose confidence in their understanding of how things should work when paradigm shifts occur. Portfolio manager NICK BALKIN presents five investment strategies for dealing with risk and uncertainty.

The understanding and management of risk is core to the Foord investment philosophy. Our favourite definition of risk is Elroy Dimson's: *'More things can happen than will happen.'* It most certainly is not *'what has happened'*. We therefore take a forward-looking approach and make investment decisions today that aim to protect investor capital across an array of future possible outcomes, knowing that most of those possible outcomes won't happen.

Because we are dealing with potentially many futures, we cannot build a portfolio for only one possible outcome. This applies whatever our conviction of that outcome's probability of occurring. We will also often be wrong in our views and forecasts. We must therefore have balancing positions that we think, on average, will achieve the investment objective, regardless of how the future transpires.

In dealing with uncertainty, we find it useful to map out scenarios and assign probabilities. We try to be flexible enough to change our views as new information becomes available. But there is a lot of noise — most new information is a red herring. Instead, we rely heavily on the facts as we see them while paying special attention to critical secular trends such as demographics and the internet-of-things.

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Here are five strategies that help to sift through market noise and segment the risks and opportunities for portfolio construction:

1. BEWARE THE DINOSAURS

Dinosaurs are companies compromised by flawed business models or industries in structural decline, also known as sunset industries. They become easily recognisable if you take an appropriately long-term view. Examples include the paper industry as the world goes digital; office space with falling demand as people work increasingly in virtual spaces; and the platinum sector as fossil fuel burning internal combustion engines increasingly make way for greener electric vehicles.

2. RIDE SECULAR TRENDS

Invest in segments of the market that are riding structural tailwinds. These are companies and industries supported by long-term secular themes that might accelerate because of the global pandemic shock. Examples include accelerating insurance sales in underpenetrated, fast-growing markets (Asia Pacific) as the dangers of being uninsured stay fresh in peoples' minds and companies in the broad internet sector that have benefited from "lockdown era" changes in consumer behaviour.

3. SHORT-TERM PAIN, LONG-TERM GAIN OPPORTUNITIES

These are opportunities where companies suffer short-term dislocations but their medium to long-term prognosis is unchanged. This is where the long-term investor's time advantage becomes acute. Most market participants want instant gratification and will sell on bad news and come back when the news changes. That strategy carries price risk and will underperform one that stays invested.

We love these opportunities, but they are not risk free. The balance sheet must be sufficiently robust to endure short-term stress. Examples include a few quality names in the beverage, restaurant and hospitality industries.

4. SUPPORT PERCEPTIVE MANAGEMENT TEAMS

No one has a crystal ball, but there are some secret weapons that can help long-term investors manage uncertainty — management, diversification and time. Good leaders will make strategic business decisions and implement them well as market dynamics change. Original investors in Naspers bought into a newspaper business. If they didn't sell, they became owners of an excellent SA pay-TV business. These investors have now become owners of a global internet giant.

5. MANAGE THE KNOWN UNKNOWNS

Known unknowns include a series of emerging trends and behaviour shifts that can profoundly affect societies and economies in the long term. These risks are identifiable today, but difficult to predict with certainty. Examples include potential unwinding of the globalisation trend of recent decades; changing consumer behaviour patterns affecting the way people live, work and play; the human employment consequences of accelerating trends in use of intelligent technology and machines; and socio-political shifts like increased radicalisation. Dynamic scenario analysis and probabilistic thinking are critical in managing these risks.

In conclusion, uncertainty has always been central to the investment management landscape. We must avoid extrapolating into the future the things we are feeling and thinking in today's seeming chaos. While market inflection points kick up many risks, they also provide the best long-term opportunities for those who can best navigate the noise while dealing with uncertainty.

ARE WE THERE YET?

On Foord International Fund's 20th anniversary three years ago, portfolio manager BRIAN ARCESE analysed the fund's performance across full market cycles. At the time of writing the prevailing market cycle was eight years long — incomplete but in its ninth innings. Where are we now?

The Foord International Fund aims to achieve meaningful, inflation-beating US dollar returns over rolling five-year periods with limited investment risk. It has a flexible but conservative investment policy. In the race between the tortoise and the hare it is without doubt the tortoise. Never fast out of the blocks, it wins in the spirit of 'to finish first, first you must finish'.

The business or economic cycle typically lasts six years and has four broad phases: expansion, peak, contraction and trough. My piece three years ago showed that **the Foord International Fund typically lags during the expansionary and peak phases, but outperforms during the contractionary and trough phases to cross the cycle's finish line first.**

The US business cycle expanded for a record 11 years until it hit the COVID-19 speedbump in February 2020. Opinion is divided on whether the pandemic constitutes a black swan event (see *Did You Know?*). Its impact was undoubtedly material and it caught the world by surprise. US markets recorded their fastest-ever bear market correction and global economies will contract heavily this year.

Foord International Fund performed admirably through the market correction. But share markets have mostly recovered to pre-pandemic levels on massive monetary and fiscal stimulus and hopes for a coronavirus vaccine this year. What then, if anything, could finally end the current investment cycle?

There are quite a few headwinds that could cause a(nother) significant market drawdown. First, COVID-19 is not under control in several large, important economies, including the United States. Failure to successfully manage the pandemic would weigh on growth more than markets are now pricing into global equities.

Second, if the US presidential election was held today, the Democrats through Vice President Biden would probably record a clean sweep, winning the White House and the Senate. This would usher in higher corporate and individual income tax rates and taxes on capital gains and dividends. S&P 500 index earnings would decline by 12% to 20%, with valuations falling accordingly.

Finally, US sovereign and corporate indebtedness is nearing all-time highs. Up to one-fifth of US corporates could effectively be insolvent. While the US Federal Reserve can address short-term liquidity crises, it is much less suited to solving solvency issues. Even in the absence of large-scale corporate defaults, this debt overhang could subdue economic growth for years.

Given these risks, Foord International Fund remains cautiously positioned and balanced, with returns not reliant on any one market outcome. The managers still hold hedged equity positions to mitigate market losses if some or more of these risks eventuate. We are keeping the liquidity powder dry to exploit these and future dislocations.

FOORD IN BRIEF

INDEPENDENT DIRECTOR RETIRES

ADAM COWELL joined the Foord Unit Trusts board of directors in October 2006 as an independent, non-executive director. During his tenure, he also chaired the board's Audit & Risk Committee. As the name suggests, this committee assists the board in matters of internal and external audit, risk management, compliance management, adequacy of internal controls and financial reporting.

The audit industry has come under intense scrutiny following several high-profile audit scandals amongst the 'big four' audit firms globally and in South Africa. In this country the issue was exacerbated by the question of whether audit firms willingly or unwillingly facilitated state capture and corruption. This placed huge pressure on audit committee chairs and Adam's leadership in guiding the committee to avoid making rash decisions will be forever appreciated.

Adam intends to spend more time in his adoptive country of Australia where his adult children now reside. He will resign formally when the unit trust regulator approves Prakash Desai's appointment to replace him. We wish him the very best and thank him for his contribution these past 14 years. We will miss his calm, assuring presence at meetings and his genuine interest in the wellbeing of all things Foord, notably staff.

DEPUTY CIO TO RETIRE IN 2021

Portfolio manager and deputy-CIO DARYLL OWEN some time ago announced his intention to immigrate to his wife's ancestral home, Portugal. Daryll's tenure at Foord was his second career, having spent decades at BoE and Nedgroup, most recently as chief investment officer at Nedgroup Private Clients. Having joined Foord in 2013, we knew he was on limited 'theta' — as we refer to time in the investment world. Daryll will only be emigrating in the second quarter of 2021 and so we look forward to his continued contribution until then.

FOORD INTERNATIONAL FEE REDUCTION

Foord reduced the fixed management fee on its flagship global fund, the Guernsey-domiciled Foord International Trust, from 1.35% per annum to 1.0% per annum last quarter. The underlying fees of the rand-priced Foord International Feeder Fund are now also 0.35% per annum lower. Both funds feed into the Foord International Fund, the UCITS master fund domiciled in Luxembourg. Direct investors into the master fund will receive the fee reduction when its regulatory filing finally receives approval from the COVID-delayed regulator in Luxembourg.

MARKETS IN A NUTSHELL

EQUITIES

World: Equity markets rallied strongly on massive global stimulus and easing of lockdowns — emerging markets matched developed markets in the magnitude of the recovery

South Africa: The JSE rallied with global markets, led by surging resource stocks — financial counters were laggards, weighed down by the banking sector on prospects for lower interest margins and higher impairments

BONDS

World: Most developed market government bond yields fell marginally despite new stimulus — while high-yield corporate and sovereign bonds largely recovered from the March sell-off

South Africa: SA government bond yields fell on improving global risk appetite and sharp repo rate cuts — the very steep yield curve reflects market anxiety for higher inflation and risk of default in the long term

CURRENCIES

World: The US dollar was weaker — the ballooning US Federal Reserve balance sheet and surge in money supply is negative for the US dollar vs other hard currencies

South Africa: The rand retraced some of its first quarter losses — improved terms of trade contributed to SA's first quarterly current account surplus since 2002

COMMODITIES

Industrial metals bounced, gold rallied and WTI oil doubled — on the improved macro outlook and US dollar weakness

ECONOMY

World: COVID-19 lockdowns plunged the global economy into the deepest recession since the 1929 Great Depression — unemployment spiked and household savings rates soared on curtailed discretionary spending

South Africa: The beleaguered SA economy contracted for the third successive quarter to end March — even before the brunt of COVID-19 lockdowns which are estimated to cause another 25% contraction (annualised) in the second quarter

MONETARY AND FISCAL POLICY

World: Nations across the globe unleashed unprecedented monetary and fiscal stimulus to support failing economic activity — the resultant debt bloat should impair potential global output for many years

South Africa: Government unveiled a massive fiscal relief package exceeding R500 billion to support the pandemic ravaged economy — while low inflation prompted SARB to heavily cut interest rates

FUND RANGE

BEST INVESTMENT VIEW FUNDS

FOORD FLEXIBLE

Exploiting the benefits of global diversification, the fund aims to provide investors with an after-fee return of 5% per annum above the South African inflation rate.

FOR INVESTORS

- With a moderate risk profile
- Seeking long-term inflation-beating returns over periods exceeding five years
- Requiring a balanced exposure to South African and global investments.

FOORD INTERNATIONAL (US$)

The fund aims to achieve meaningful inflation-beating US$ returns over rolling five-year periods from a conservatively managed portfolio of global investments reflecting Foord's prevailing best investment view.

FOR INVESTORS

- With a moderate risk profile
- Requiring diversification through investments not available in South Africa
- Seeking to hedge rand depreciation.

REGULATION 28 FUNDS

FOORD BALANCED

Managed to comply with the statutory investment limits set for retirement funds in South Africa, the fund aims to grow retirement savings by meaningful, inflation-beating returns over the long term.

FOR INVESTORS

- With a moderate risk profile
- Seeking long-term, inflation-beating returns over periods exceeding five years
- From an SA retirement fund investment product (Reg 28).

FOORD CONSERVATIVE

Managed to comply with the statutory investment limits set for retirement funds in South Africa, the fund aims to provide conservative, medium-term investors with inflation-beating returns over rolling three-year periods.

FOR INVESTORS

- With a conservative risk profile
- Close to or in retirement
- Seeking medium-term, inflation-beating returns over periods of three to five years
- From an SA retirement fund investment product (Reg 28).

SPECIALIST EQUITY FUNDS

FOORD EQUITY

The fund aims to outperform the FTSE/JSE Capped All Share Index over the long term, with lower risk of loss.

FOR INVESTORS

- With a higher risk profile
- Seeking long-term growth over periods exceeding five years
- From a portfolio of JSE-listed equity, commodity and property stocks
- And able to withstand investment volatility in the short to medium term.

FOORD GLOBAL EQUITY (US$)

The fund aims to outperform the MSCI All Country World Net Total Return Index from an actively managed portfolio of global equities, without assuming greater risk.

FOR INVESTORS

- With a higher risk profile
- Requiring diversification through investments not available in South Africa
- Seeking to hedge rand depreciation
- And able to withstand investment volatility in the short to medium term.

 PLEASE REFER TO THE FACT SHEETS CARRIED ON WWW.FOORD.CO.ZA FOR MORE DETAILED INFORMATION.

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