



TANTALUM
CAPITAL

Straight Talking. Curved Thinking.

Market Commentary | December 2019

2019 proved to be a very strong year for equities in most markets, developed and emerging. A strong final quarter pushed returns from the MSCI World Index to over 27% for the year in US\$. The US stock market led the way, with the S&P 500 returning over 31%, reflecting the strong underlying US economy, and accommodative monetary policy in the US and across most developed economies. Bond market performance was also positive, helped by a combination of benign inflation pressures, the search for yield across the globe, and continued quantitative bond purchases by the ECB.

Throughout 2019, the economic backdrop, while seemingly strong, has kept investors on edge. This is due to both the length of this economic expansion, as well as the belief and knowledge that the expansion has been fueled by unsustainably low interest rates, amidst rising socio-political tension. Fiscal constraints imposed after the Global Financial Crisis of 2008/9 have been systematically dismantled in many key economies. Labour markets in the US and the EU showed signs of peak health, levels which usually presage inflationary wage pressures. Commodity prices have also continued their rally, which would usually raise the prices of goods and fuel the forecasts for consequent cost-push inflation. When coupled with a pending trade war between the two large economic superpowers of the US and China, where tariff imposition should also inevitably lead to greater goods price inflation, market participants have fretted all year that asset prices could and should reflect more risk. They should also derate in line with the deterioration in new growth capacity and a more hawkish monetary stance. Despite a briefly inverted US yield curve mid-year, this did not happen. Investors stayed “in the trade”, supporting the prices of known growth assets/equities, boosting cyclicals in many cases, and even supporting those stuttering economies like

South Africa, where yield remains on offer.

We have written before that economic expansions do not simply “die of old age”, but typically end suddenly due to policy mistakes and pent-up imbalances in specific areas of the global economy. In this cycle, the booming, doomed imbalances are not easily identifiable, as the known ‘suspects’ like US housing, EU/Japan sovereign debt, and Chinese bank lending appear to have found their own (domestic?) supporters and policy enablers that ‘kick the can down the road’. We have made the argument that the most significant and pressing other risk we see is not economic, but socio-political in nature, with a rapidly polarizing world order developing. Within countries, and across continents, in our judgement global political tension has not been higher since the end of the Cold War. This reality should claim some level of risk discount in asset prices, as the tension can readily manifest itself in fiscal and economic policy missteps and misallocations of capital and spending.

In South Africa, the situation remains fraught. Renewed power generation problems at Eskom in December defeated growing optimism over the appointment of a new CEO there, as well as decisive action to deal with the ailing SAA. Business and consumer confidence has been at such a low ebb, for such a long time, that the market has been looking for early signs of a turnaround in both Eskom’s and the country’s fortunes. Interestingly, the Rand has held firm all year, and rallied even more in December, as too did the price of our SA bonds. This provided another indication that the global search for yield remains high, and that the absolute interest rates on offer in Rand are attractive versus the entire EM and DM bond universe, even with the negative ratings outlook in place.

TANTALUM FUND PERFORMANCE

Tantalum funds benefited from the December rally and we saw strong performance across our funds for 2019 with positive asset class performance in all areas. The Tantalum BCI Balanced Fund ended the year up 10.4%, our local only Balanced Fund up 9.9%, Absolute Return fund up 9.4%, Equity Fund up 9.6% and our Tantalum BCI Strategic Income Fund up 7.8% The SA equity universe has been unusually skewed by large returns from the SA Resources index this year (28.7% for the year, 7% in December). This is in contrast with the SA Financials index, which has returned 0.9% this year, and which returned -0.4% in December. The SA Industrials index returned 11% for the whole of 2019, and -1% in December. We had good equity selection throughout the year on both the domestic and foreign side with our core resource and commodity positions in the likes of Northam Platinum, AngloGold, and Anglo American being strong positive contributors to returns. British American Tobacco has also recovered somewhat from a poor 2018 performance amidst greater US FDA regulatory scrutiny of vaping competitors.

Sasol has been a major detractor from returns this year as it faced further delays in commissioning its Lake Charles cracker, and additional cost over-runs. Good news arrived in December in the form of success in starting production after a new catalyst was installed. While we are hesitant to call the worst as being over given the poor management track record in communicating the status quo, we continue to see compelling value in the share itself and in the energy-price risk mitigation role that it plays in our SA portfolios. In December, a resurgent oil price provided further support to the Sasol outlook.

With the strong end to the year for global markets and a more positive backdrop emerging, we saw a rally in SA bond yields, and the ALBI returned 1.89% for the month. This move was despite the renewed electricity load shedding, a factor that remains a material downside risk to domestic growth and confidence in the coming year.

Top contributors to December performance were Sasol, British American Tobacco, AngloGold, Naspers and Northam Platinum with MTN, Blue Label, Woolworths and MPact amongst the negative performers.

Looking forward, we expect that the rising market volatility currently being experienced will continue. We would usually expect that rising volatility coupled with above-average asset prices would suppress returns from risk assets over time. In terms of global bond prices, we recognize that the process of normalizing DM central bank policy from such uniquely accommodative levels is still ahead of us. This factor should inevitably suppress cumulative prospective returns from yielding assets, specifically DM bonds. However, faced with a US election year, and such unstable global politics, we expect that key central bank actions will likely remain dovish. A significant increase in tensions between Iran and the US at the turn of this year is likely to impact SA bond yields in a number of ways: firstly via an elevated oil price which is unfavourable for the rand via a weakening in SA’s terms of trade, as well as a negative (direct and indirect) impact on domestic inflation. The second key influence is via global uncertainty and the resultant flight to safety should tensions increase further, which would be negative for emerging market risk sentiment. Near term, bond yields will be driven by the above risk factors, offset by likely positive developments in US and China trade relations, but the key domestic bond direction for the coming year is likely to be set by progress (or lack thereof) set out in the critical upcoming February budget.

Despite heightened near term risk, the SA bond curve is pricing in a significant risk premium, particularly at the longer end of the curve. Given imminent event risks, we continue to feel that nominal bonds should be held primarily with a yield objective as capital gains may be difficult without concrete signs of accelerating policy traction or union compromise. Although we have increased exposure to longer dated yields slightly into weakness in recent months, we still view duration to be conservatively positioned. Shorter dated inflation linked bonds, at real yields between 3.0%-3.5% and undemanding break even inflation rates of under 4.5%, remain attractive investments, particularly as a shock absorber against a potential protracted rise in oil prices.

We also find that many equities (foreign and local) are offering much better value than the headline indices imply. This is especially true of those SA shares exposed to the SA economy, which is at such a trough level. Many SA Inc shares are valued as if these recessionary times will continue for many years. Some imply no going concern value at all. It is at times like this that our active fund management style will be most rewarded, as our small size and proactive decision-making should allow for a higher frequency of value unlock. Of course, we do not have a crystal ball that gives us all the answers in advance, but we will continue to focus on normalized valuations, and fundamental analysis to guide our capital allocation. In this way, we expect to deliver above-average returns through the market cycle.

FUND	DEC '19 RETURN	ROLLING 12MTH RETURN
Tantalum BCI Strategic Income Fund	0.6%	7.8%
Tantalum IDS MNC Retail Hedge Fund	1.1%	7.1%
Tantalum Absolute Return Fund	2.3%	9.4%
Tantalum Balanced Fund (Local Only)	2.5%	9.9%
Tantalum BCI Balanced Fund (incl. Offshore)	0.8%	10.4%
Tantalum Equity Fund	3.3%	9.6%
PPS Stable Growth Fund	1.3%	9.7%

* All performance numbers are estimates until final approval by administrator