"And if this is the long haul,
How'd we get here so soon?" *Taylor Swift, Coney Island*

Welcoming the *winds* of fortune

In the Cape we have experienced one of the windiest summers in recorded history. While this has spelled misfortune for beachgoers, the winds of fortune have been favourable for the share prices of several of the companies held in our funds. This was on top of already good returns earned before the arrival of summer and has resulted in very strong 12-month returns for our clients. More importantly, this is a continuation in the construction of longer-term track records. The cumulative returns of the Granate BCI Balanced Fund and the Granate BCI Flexible Fund since their inception (they will be four years old next month) are 79% and 83% respectively.

by Paul Bosman

These returns bring us joy, partly because we are investors in these funds ourselves but especially because we are delivering for our clients. At Granate, we don't see 'our clients' as a generic term; we see faces. Some we know very well (and spent the windy holidays with on the beach) and some we know less well, but these are the faces that drive us to leave no stone unturned in our hunt for good investment opportunities.

However, we would like to caution as we often do, that our funds will not always generate the short-term returns our clients have experienced over the past 12 months. In fact, it is possible that there will be times when our funds will generate negative returns over these shorter periods. Share prices can be dragged down significantly by broad panic. Measured over long periods we hope to deliver at least our benchmark returns, but all journeys have good and bad weather along the way. Being aware of this is especially important on investment journeys as the weather can swing violently, which could tempt you to make short-term decisions based on current conditions.

We don't spend too much time watching the weather vane

A different question would be whether such strong 12-month returns are likely to be followed by weaker or negative short-term returns. Should we be expecting a change in weather? We certainly do not have the answer to this. We will always ask you to focus entirely on our long-term returns, which will largely be driven by the profits of the companies we own. They will also partially be driven by the extent to which the companies we own re-rate from undervalued to more fairly valued. We remain excited about the prospects of many of the companies we own and believe that there are many different opportunity sets in the funds. I have highlighted some of these below.

1. **The strong economics of a few companies in the semiconductor industry**

   Global processing capacity is very likely to grow rapidly for a long time and there are several companies that have strong competitive advantages within this industry. This makes it unlikely for new entrants to enter their specific area of expertise. Companies operating in the semiconductor industry currently make up 14.0% and 14.4% of the Granate BCI Balanced Fund and the Granate BCI Flexible Fund respectively. These companies have generated good returns for our clients and especially so over the last 15 months. For example, Lam Research Inc has more than doubled since mid-October 2022. There was a dramatic industry-wide sell-off early in the first quarter of 2022, which we used to increase our exposure significantly. Although such high returns are unlikely to continue, we believe that profit growth will continue to drive share prices higher over time.

2. **Listed property**

   This is an opportunity we have written about before. Share prices have started to move up for some of the companies we own – especially so in the case of Unibail-Rodamco-Westfield SE, which is up 43% over the last quarter. However, this price remains way below what we believe the company to be worth. This is also the case for the other property companies we own, as they continue to trade far below their net asset values. Importantly, property companies will be challenged by the rising cost of debt. We only own companies where we have conviction in their ability to absorb a higher interest bill. Property companies currently comprise 18.7% and 16.1% of the Granate BCI Balanced Fund and the Granate BCI Flexible Fund respectively.

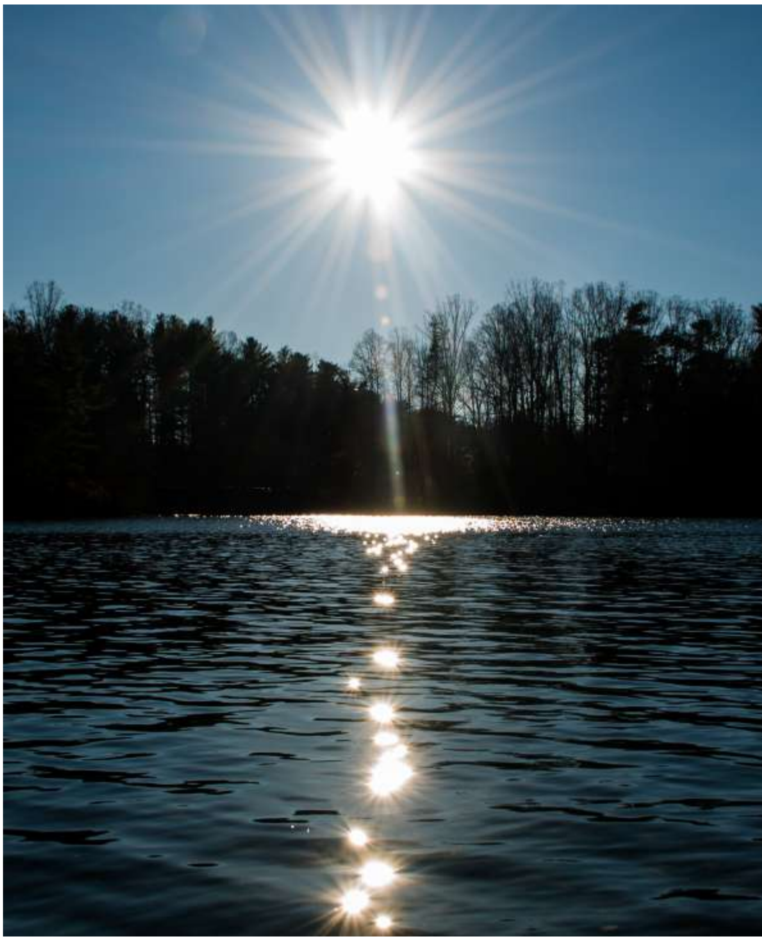
3. **Companies that have built a strong platform in growth markets**

   We expect the revenue of the companies we own in this category to grow both from market growth and market share growth. In our view, these companies are well positioned to take market share because they are offering a superior product or service without charging more than competitors. Our holdings include Microsoft, Capitec Bank, Outsurance and the Shoprite Group. Their share prices are generally deemed expensive, but companies that can generate consistently high returns on capital should be more expensive. We rate the management teams at these businesses very highly, but also remind ourselves not to fall in love with companies. We continue to scrutinise their actions and those of their competitors. These four companies collectively make up 13.3% and 13.9% of the Granate BCI Balanced Fund and the Granate BCI Flexible Fund respectively.

4. **Investment companies**

   These are companies that own several different businesses, partially or entirely. Here we believe that we are partnering with good allocators of capital. Although we look through to the underlying companies to build comfort with the basket, we also place value on the fact that we are partnering with individuals who have track records of making good investment decisions. In all cases these individuals have meaningful holdings in their own companies. In this category we include Afrimat, Exor (holders of Ferrari, Juventus Football Club, The Economist and CNH, who make New Holland tractors) and Berkshire Hathaway. These three companies collectively make up 7.3% and 8.9% of the Granate BCI Balanced Fund and the Granate BCI Flexible Fund respectively.

5. **The JSE as an unloved market**
Foreigners have been selling JSE-listed companies, and domestic managers are investing progressively larger portions of their funds offshore. This has resulted in high-quality companies trading at very attractive levels. Even if these companies don't re-rate (i.e., remain under appreciated), we are happy to look through to their earnings and dividend growth. The local companies we own include Sun International, Hudaco (importers and distributors of industrial, automotive and electronic products), KAL (previously Kaap Agri), Nedbank and CA Sales (a fast-moving consumer goods logistics company). These five companies collectively make up 14.9% and 17.5% of the Granate BCI Balanced Fund and the Granate BCI Flexible Fund respectively.



It is important to note that these opportunity sets are not all mutually exclusive. For example, we believe that the management at KAL, Shoprite and Hudaco are also very good capital allocators.

Then there are various idiosyncratic opportunities like EOG (a US listed oil and gas company, which provides some protection against rising oil prices) and AIA, a Hong Kong-based insurer that offers some exposure to the rapidly growing insurance and investment markets in Asia.

The long haul

Although we are very pleased with the fund returns since inception, we also know that the investment horizon of these funds – the duration of our partnership with our clients – is much longer. There will be good and bad weather along the way, but we trust that our relentless search for opportunities that match our investment criteria will generate the returns our clients need, also over the long haul.

Granate is a people business.

We are committed to creating a rich and rewarding culture through our shared values. Granate is configured thoughtfully and intentionally so that our team can thrive for the benefit of our clients. We care about the same things you do and are *relentlessly* **committed to protect and grow your savings**.