BAOBAB
INVESTMENT MANAGEMENT
AFRICAN ROOTS | GLOBAL PERSPECTIVE

Annual Partners Report

As we enter 2024 investors around the world are focused on a number of macro variables that are likely to move markets this year. These include the outlook for interest rates, geopolitical concerns and the potential impact of looming elections. We think about these factors and acknowledge their potential short-term impact on global markets, but our primary focus remains on the long-term outlook and return potential for the companies that we own. Despite the many challenges, both here and abroad, we remain very enthusiastic about the group of companies that will drive our returns in the years ahead.

"Large amounts of money aren't made by buying what everybody likes – they're made by buying what everybody underestimates."

Howard Marks

As a small, value-orientated manager, we tend to avoid popular areas of the market that everybody likes and that dominate passive indices and the portfolios of most asset gatherers. Our value proposition and edge lies in our ability and willingness to invest in hidden gems that are underestimated and off the radar screens of larger, more institutional managers. Given how much money is crowded into what everybody likes, the opportunity set in other areas is significant, providing a very compelling multi-year outlook for those prepared to venture off the beaten path. The South African market is a perfect example of this, unliked by most and understandably perceived as uninvestable by many.

South Africa – equity and bond flows

Cumulative non-resident flows in domestic equity and bond markets

A few years ago I suggested that the valuations in small South African listed companies were so depressed that we only needed things to get “less bad” for us to generate reasonable returns. Since then things have only deteriorated in South Africa, yet our local portfolios have produced very strong returns on the back of outsized appreciation in many of these severely mispriced securities. Local companies we have owned like HCI, Santova, Grindrod, Afrimat, CMH, Massmart, Distell and CA Sales Holdings have produced exceptional gains despite the ongoing domestic tailwinds. In most cases the companies have executed well operationally, but in all cases their share prices were just too cheap. Despite the strong gains already achieved, I remain optimistic about the return potential of a carefully selected portfolio of South African companies. The fact that local assets are cheap and out of favour is undeniable, but what I think most investors underestimate is the quality of many small domestic businesses and the resilience, drive and competence of the people running them. These factors allow us to continue to invest in individual companies with conviction, despite the ongoing challenges that we face as a country.

While investing against the grain in select local small capitalization shares has worked very well in recent years, the global experience has not been as fruitful. Most of our core global holdings remain undiscovered and global equity returns in 2023 were driven by a small group of companies that everybody likes and owns. The fact that we don’t own these shares has not helped in the short-term, but will not change how we invest. The popularity of these widely held shares is well understood, but what I think is underestimated is the risk attached to investing in them at current prices. I wrote about this towards the end of last year – click on the link below to read the note, together with an update on our core global holdings.

The Global Opportunity Set - November 2023

If you think that Howard Marks is on to something in his quote, you will understand my enthusiasm for the current market set up given how skewed most portfolios are towards what is universally liked. Our portfolios look very different to the index and most other investment managers, not because we are trying to be different, but because we are trying to produce superior returns. Passive investing makes sense and continues to grow in size and popularity, leading many managers to become less active/quasi-passive and settle for average returns by hugging the index. As a result our belief in the opportunity for small, focused boutique managers such as ourselves has only grown. To this end we have launched what we think is a very unique vehicle that combines the best investment ideas of two focused boutique managers, Baobab together with Andrew Vintcent of ClucasGray Asset Management. The Baobab Equity Actively Managed Certificate provides a compelling solution that compliments a traditional, index-focused equity portfolio and can be purchased as easily as a share on the JSE. Have a look at the link below.

Baobab Equity Actively Managed Certificate

Performance

Individual share portfolio returns varied somewhat in 2023, depending on when they were taken on, flows etc. Local portfolios produced above average returns (± 10%) that were marginally ahead of the index. Global portfolio returns were reasonable (±11%) in absolute terms, but below average and the index during 2023. The Baobab SCI Flexible Fund, which is a reflection of our best investment ideas, continued to do well and returned 12.6% during 2023.

Baobab SCI Flexible Fund

Summary and outlook

I am optimistic as we enter 2024, not because the world is a happy place or because I'm optimistic about the global economy, but because I like what we own. Together, we are part owners of an idiosyncratic group of companies that should thrive in the years ahead. Our portfolios are full of good companies with strong balance sheets, low valuations, strong management with high levels of insider ownership, many of whom are executing ongoing share buybacks.

The fact that they are not the same companies that everybody else likes and owns only enhances my conviction in the long-term opportunity.

Your investment partner

Sandy Le Roux

Note: The performance figures quoted are for a fully discretionary managed client and are net of fees. For domestic portfolios, asset swap is used for the offshore holdings. Because we construct each portfolio individually based on the opportunities available in the market, there will be some variation in returns across our accounts, particularly for newer accounts and those where we have inherited positions. While this can make communication about our portfolio difficult in the short-term, we believe that building portfolios in a bespoke and considered manner is in the best interests of our clients and a key differentiator of our offering. All periods longer than a year are annualized. Inception 1 January 2016.