ALLAN GRAY

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Understanding the impact of the Ukraine crisis on your investments

Like everyone else, we have been watching with dismay as the war in Ukraine unfolds. While in this piece we address some of the economic and investment questions we have been receiving, our hearts are with those who are in harm's way and who face much more than a financial loss.

Investment impact

The direct impact on our offshore partner Orbis' funds stemming from exposure to Russian equities has been small. As at 31 January 2022, the Orbis Global Equity Fund had a 1.7% exposure to Russian shares, around two-thirds of which came from Sberbank and the balance from internet company Yandex. This exposure was just above 4% as at 31 October 2021, but Orbis trimmed the positions late last year and early this year, given the increased tail risk resulting from the build-up of Russian troops on the border with Ukraine and other rising tensions. The Orbis portfolios have benefited from exposure to gold and energy stocks.

For investors in the Allan Gray Equity, Balanced, and Stable funds, the direct exposure to Russian equities (via Orbis) was less than 0.5% at the end of January.

The only JSE-listed stock in our portfolios with material exposure to Russia is Mondi, which has a paper mill in Russia that accounts for 18% of earnings before interest and taxes. The Allan Gray Equity and Balanced funds have a 0.7% and 0.6% exposure to Mondi respectively; Stable has no exposure. The share price of Mondi has fallen 30% from its recent high point in February.

British American Tobacco (BAT), our largest share, is the number two cigarette player in the Russian market, which accounts for an estimated 2-3% of BAT's profits.

While some of our other holdings, such as Glencore and AB InBev, have Russian interests, these are very small within the context of their overall businesses.

The prices of Naspers and Prosus have declined by 35% since the start of February. This group has a small direct exposure to Russia – a classifieds business and a social media business – which accounted for 2-3% of overall value.

The large drop in the share price could be because of fears that the world is becoming increasingly divided which, in turn, has led to renewed concerns about the long-term value of Tencent. Also, the sentiment towards some of the speculative technology sectors in which Naspers has been investing, like food delivery, has turned from extreme optimism to something more realistic. We are underweight Naspers/Prosus compared to the index, but it still comprised 7.3%, 5.6% and 2.2% of the Allan Gray Equity, Balanced and Stable funds (respectively) at the start of February, when accounting for both Allan Gray and Orbis exposure. We prefer not to comment on current trading activities, but, as always, we seek to balance attractive opportunities with our internal risk limits.

Russia is the second-largest producer of oil. Our portfolios have benefited from the higher oil price because of our holding in Sasol. However, a higher oil price presents a risk for our economy: It is bad for SA's finances, places further pressure on consumers, and it can cause inflation.

Our portfolios have also benefited from the higher gold and platinum group metal (PGM) prices. Gold has gone up slightly because of its traditional safe-haven status, while South Africa and Russia are the two big global suppliers of PGMs.

Focused on identifying long-term opportunities

It is amazing how the world has changed in less than a month. Again. It's only a slight exaggeration to say that every Russian stock has gone to zero. It is not surprising that this has caused investors to panic. As investment managers with your best long-term interests at heart, pandemic or endemic, war or peace, we continue to do what we have always done: We try to value companies based on their long-term, through-the-cycle earnings power and invest when we believe they are underpriced. Our valuations are informed by long-term business fundamentals, not by sentiment.

There is no such thing as a risk-free investment, but we believe that a diversified portfolio of undervalued shares and bonds will preserve clients' funds over the long term.

Commentary contributed by Jacques Plaut, portfolio manager, Allan Gray