

ontrack

ONTRACK INSIGHT

“May you live in interesting times”

- Ancient Chinese curse

Big data, artificial intelligence, virtual reality, the sharing economy, autonomous driving, electric vehicles and cryptocurrencies. These are just some of the global disruptors that are currently the subject of intense study and speculation, as evidenced by recent articles, books, and the themes of industry business conferences.

We live in a time characterized by rapid technology transformation and disruption. In its wake, few institutions will remain untouched and the world will experience unparalleled dislocation, upheaval, opportunity, and inequality. In light of these themes of disruption and innovation, this quarter’s OnTrack features articles on a disruptive technology, **Blockchain**, as well as **Stor-age** – the only locally listed operator in an innovate, modern real estate sector, self storage.

THE RISE OF THE BLOCKCHAIN

by Nerina de Clercq, Investment Analyst

“It’s better to make mistakes while trying something new than not try anything at all.”

- Alexandra Friedman

The Bitcoin price has increased phenomenally since 2014. It was the best performing currency in 2015 and 2016, and is well on its way to take the title for 2017.

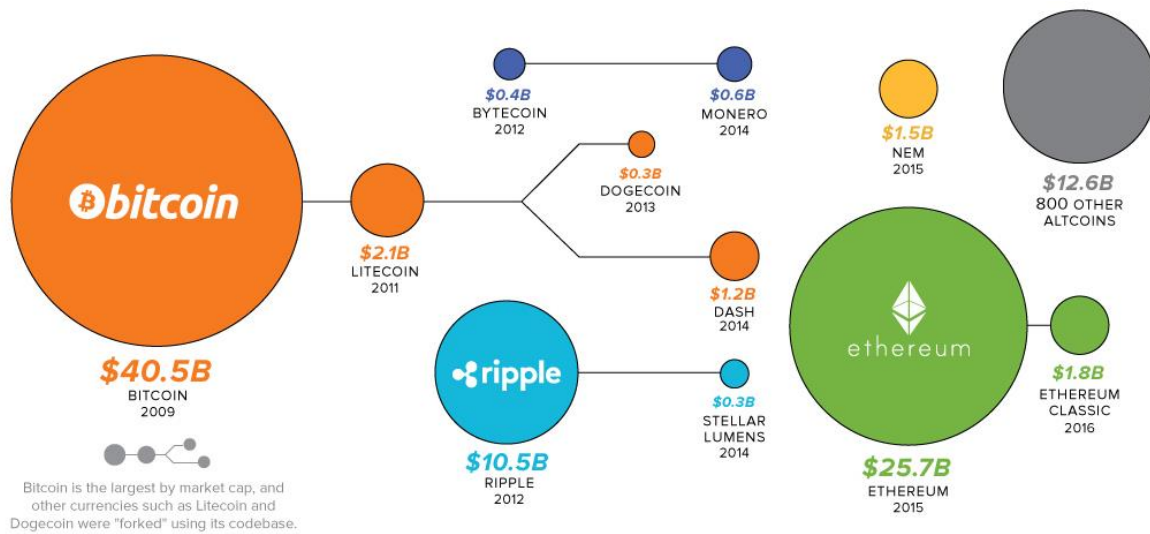
However, Bitcoin is not the only cryptocurrency in the world, with the **coin universe currently expanding on a massive scale**. Apart from Bitcoin, some other cryptocurrencies have started to gain traction, including Ethereum, Ripple, Bytecoin and NEM. The value of cryptocurrencies have increased to approximately \$83.6bn and they are now competing in market capitalization with some of the world’s largest corporations.

What is cryptocurrency?

Cryptocurrencies are digital methods of exchange that use complex algorithms that encrypt sensitive data, in order to **regulate units of currency** and **verify any transfer of funds**. It may function like any other method of payment,

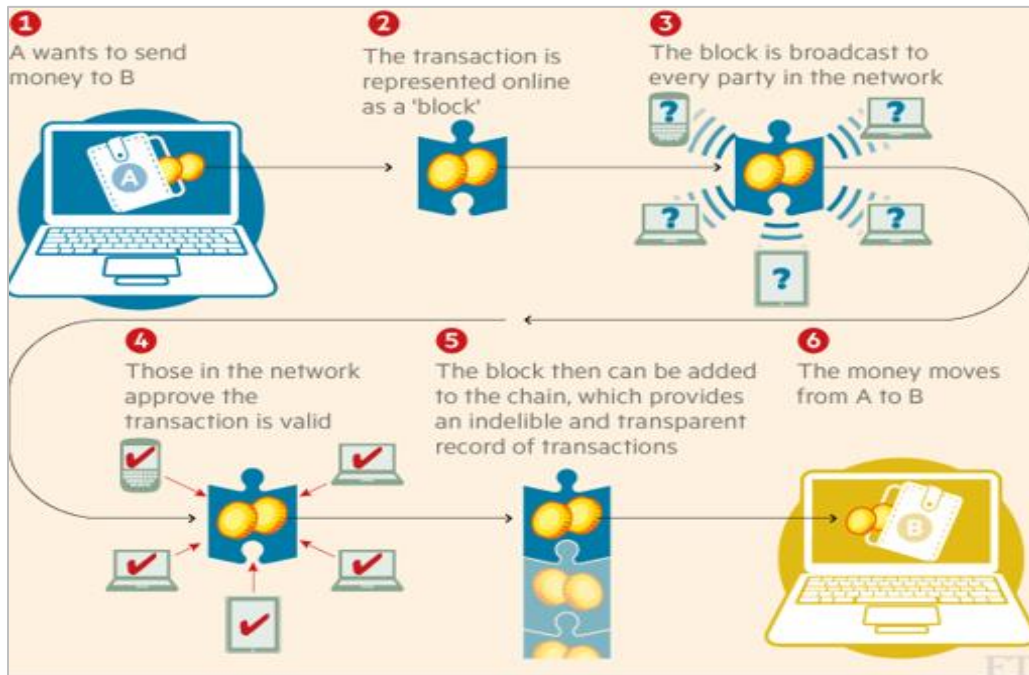
but its main advantage is that it is **decentralized**. As with Bitcoin, it means that nobody owns the network and that more than one machine in the blockchain must verify the transaction – leading to cheaper, faster and safer transactions.

THE CRYPTOCURRENCY UNIVERSE



Source: Visual Capitalist

HOW A BLOCKCHAIN WORKS



Source: Financial Times

The future of blockchain

Blockchain’s use extends far beyond just digital currencies such as Bitcoin. **It is a way of validating and sharing almost any kind of transaction that involves some form of value**, whether it is contracts, music, money, or even votes.

A prime example is how it can be used by artists to sell their music directly to fans, thereby allowing the artist to fully eliminate the middle man, protect their music and secure royalties. Furthermore, it can be used to secure voting in elections, where it is able to verify both the voter and their vote.

Blockchain is expected to be the next great disruptor by **revolutionising the way business is done**. Companies at the forefront of technological advancement, like Amazon and Microsoft, are already exploring its use to differentiate their products.

Locally, the South African Financial Blockchain Consortium (SAFBC), comprising of 22 industry leaders, as well as the SARB and FSB, are exploring blockchain as a means to make the current system more efficient and increase cost savings.

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Blockchain may still be in its infancy, but it has significant potential as a disruptive technology. Industries will see more and more investigation and education around it and in order to stay ahead of the game, it will be vital for businesses to evolve with it.

ECONOMIC DATA

CPI: May ('17)	5.40%	PPI: May ('17)	4.80%
Unemployment (Q1 '17)	27.70%	Repo Rate	7.00%
Prime rate	10.50%	GDP (Q1 '17)	-0.70% q/q

SOURCE: STATS SA, SARB

STOCK OF THE MONTH

by Wim Prinsloo, Portfolio Manager



Storage hitting its stride on the JSE

Listed property – one of the best performing sectors on the JSE during the past 10 years – has started to lose its lustre... In fact, it is stuck in a rut. We are nonetheless witnessing an increase in listings of Specialist Real Estate Investment Trusts (“REITS”) which are at the forefront of growing, secular real estate trends.

A prime example of a successful listing in the property space is the self-storage specialist **STOR-AGE**.

The STOR-AGE story

STOR-AGE opened their very first self-storage facility in Edgemoed, Cape Town back in 2006. Soon after, management embarked on an international research tour – gaining valuable market insights from top self-storage operators such as US-listed Public Storage and UK-listed Big Yellow.

Realising that the South African market was suitable for the storage business model, they set forth on a journey to become a highly specialised, niche self-storage property fund with prime storage assets throughout the major metropolitan cities.

Stor-age’s properties are of significantly higher quality than your average mom ‘n pop storage facilities



What is driving the demand for self-storage in SA?

The self-storage industry is undoubtedly benefitting from the ongoing urbanization of SA’s population and the resultant densification of its cities. Space in cities is becoming scarce as more and more people flock to major metros for job opportunities. The consequence is that the urban population is settling into smaller living spaces - driving the demand for storage space.

Self storage is also used for business purposes where customers require storage as a short-term measure when growing or scaling down, or longer term for convenient, secure and flexible storage of inventory and archives.

TOP MODERN TRENDS BENEFITTING THE SELF STORAGE INDUSTRY:

- a shift to apartment living (increase of mixed-use developments - “live, work and play”) with a resulting reduction in household storage space
- shifting social preferences among ‘Millennials’ who are deferring marriage and traditional family in favour of maintenance-free lifestyles
- increased population mobility and urban density
- increased number of online retailers which require flexible storage space

A new era of specialist REITs

REITs that specialise in self-storage, student accommodation, communication towers and data centres have listed their stock on global markets in recent years. **STOR-AGE is a first-of-kind in SA and part of this new era of innovative and increasingly tech-savvy REITs that are at the forefront of modern property trends.**

The company’s stock has returned 28% (incl. dividends) since its listing, but the one metric demonstrating that it is in a better “space” than its more traditional peers is the 10% increase in rentals achieved (on a like-for-like basis) in its most recent financial year. To put this into context, larger landlords in the office and retail sectors are struggling to achieve even positive increases on lease renewals at the moment.

This shows the self-storage industry in SA is growing despite the tough economy – a sharp contrast the lackluster fundamentals at play in most of SA’s commercial property markets.

FUND COMMENTARY FOR Q2 OF 2017

TRUE NORTH IP FLEXIBLE EQUITY FUND

True North IP Flexible Equity (TNFE) returned +2.09% in 2Q17 – a strong result given that its benchmark declined by 0.39% during the quarter.

TNFE’s 2Q17 return was achieved against a backdrop of a local economy technically in recession for the first time since 2009. It’s fair to say that both consumer and business confidence turned decidedly negative after the cabinet reshuffle in late-March and the subsequent downgrades of South Africa’s credit rating.

Given the abovementioned political-economic risks to the local economy, we have retained a large offshore exposure in the fund through rand hedges and offshore listings.

However, the depressed local environment also provides the opportunity to invest in well-run local businesses that are overlooked by investors who are simply ignoring companies linked to the local economy.

CMH: Our top performer YTD



Our holding in **Combined Motor Holdings (CMH)** is a prime example of the excellent opportunities available to investors willing to *dig deeper* than the negative news headlines prevalent in SA. CMH returned a magnificent +22% in 2Q17 despite the overhang of lacklustre local vehicle market.

Our investment in this company has been **successful on two fronts**. Firstly, we made our initial investment back in November 2016 when the company was trading at an **extremely attractive valuation** (i.e. dividend yield of 7%). This provided us with a margin of safety and limited our risk of losing capital.

Furthermore, upon thorough analysis we established that CMH had **excellent management** in place (CEO Jebb Macintosh has served on the board since 1976) and that the business is **strategically diversified** across several brands and segments such as 2nd hand car sales, parts and car rental services.

New passenger vehicle sales have declined for three years in a row, however CMH has managed to continuously grow its profits and dividends at a very healthy rate. *Uncovering a great investment opportunity like CMH is truly a very rewarding endeavor.*

TRUE NORTH IP ENHANCED PROPERTY FUND

In line with the good performance of our equity fund, True North IP Enhanced Property (TNEP) also had a solid 2Q17 as it **returned +2.23% compared to its benchmark's +0.91% return**.

Listed Property is an asset class that is prone to suffer when a country's credit rating gets downgraded. However, the **SA Listed Property Index has been resilient since Gordhan-gate** and the subsequent downgrades to SA's credit ratings. A key reason for the listed property market's resilience is the large portion (~40%) of offshore property assets listed on the JSE, which are unaffected by the local political-economic climate.

Nevertheless, operating conditions for local landlords are slowly turning negative. This is perhaps best exemplified by the **oversupply of retail large properties**, which used to be the most defensive local property sector.

Fortunately, TNCM has been able to invest in niche locations and sectors which still offer strong growth opportunities. As seen in the table below, the performance of **Stor-age REIT** (covered earlier in the report) and **Equites Property Fund** are good examples of the outsized returns that can be achieved by investing in property companies that are **specialists** in growing sectors of the local property market.

Company	Sector	YTD Return
Stor-age	Self storage	+9.3%
Equites Property Fund	Logistics	+11.9%
SA Listed Property Index		+2.3%

For more details on holdings and performances, please view the Minimum Disclosure Documents which can be downloaded from our website: www.tncm.co.za.

**Sources-THE RISE OF THE BLOCKCHAIN:*

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Disclosure

Collective Investment Schemes are generally medium to long term investments. The value of participatory interests or the investment may go down as well as up. Past performance is not necessarily a guide to future performance. The performance is calculated for the portfolio. The individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Collective investment schemes are traded at ruling prices and can engage in borrowing and scrip lending. The fund is invested in a portfolio of collective investment schemes that levy their own charges, which could result in a higher fee structure for the fund of funds. A schedule of fees and charges and maximum commissions is available on request from the manager. The Manager does not provide any guarantee either with respect to the capital or the return of a portfolio. The Manager retains full legal responsibility for the Fund, regardless of Co-Naming arrangements. Transaction cut off time is 14:30 daily. Valuation time is 15:00 (17h00 at quarter end). Prices are published daily and available newspapers countrywide, as well as on request from the Manager. IP Management Company (RF) Pty Ltd is the authorised Manager of the Scheme – contact 021 673 1340 or clientservices@ipmc.co.za. Standard Bank is the trustee / custodian – contact compliance-IP@standardbank.co.za. Additional information including application forms, the annual report of the Manager and detailed holdings of the portfolio as at the last quarter end are available, free of charge, from clientservices@ipmc.co.za. IP Management Company is a member of ASISA. Financial Advisor fees as agreed between the Investor and the Advisor may apply and payment to the Advisor will be facilitated on behalf of the Investor. A statement of changes in the composition of the portfolio during the reporting period is available on request.

The portfolio may include foreign investments and the following additional risks may apply: liquidity constraints when selling foreign investments and risk of non-settlement of trades; macroeconomic and political risks associated with the country in which the investment is made; risk of loss on foreign exchange transactions and investment valuation due to fluctuating exchange rates; risk of foreign tax being applicable; potential limitations on availability of market information which could affect the valuation and liquidity of an investment. All of these risks could affect the valuation of an investment in the fund.

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