



PEREGRINE CAPITAL



EST. 1998

TWENTY FIVE YEARS
OF PERFORMANCE

**ANNUAL INVESTOR
LETTER**

JANUARY 2023



DEAR INVESTOR,

Both our flagship funds were up double digits for 2022, with the High Growth Fund ending up 11.5% and the Pure Hedge Fund ending up 12.9% (net of all fees and expenses). Our process and investment philosophy delivered as we had planned for in 2022, leading to capital growth and outperformance in a very difficult economic and market environment. The JSE Capped All Share Index ended the year up 4%, while global markets were down almost 20% for the year.

[Source: S&P 500]

Currently, the funds remain a little more conservatively positioned than usual due to storm clouds on the horizon, both globally and in South Africa. There are meaningful lags between actions like interest rate hikes and the impact on the real economy. So while it looks like inflation has peaked, the global economy has yet to feel the full impact of the substantial rate hikes seen over the past 9 months. The key thing to watch this year will be when the aggressive rate hiking cycle starts to impact the economy, how severe that impact will be, and whether we can get through this without a potentially painful recession.

Our mission is to create wealth for our clients by delivering strong and consistent real returns over the long-run, and we are pleased that our shorter and longer-term performance reflects this goal. Our correlation with global and local markets also remains low. This means that an investment in our funds has also proved to be a great diversifier and acted as an effective shock absorber during some difficult months for the overall market during the past year.

Fund						Inception date
	Latest 1 year	Latest 3 years	Latest 5 years	Latest 10 years	Since inception	
Peregrine Capital High Growth H4 QI Hedge Fund	11.5%	13.7%	9.8%	15.5%	23.6%	Feb 2000
<i>SA Multi Asset - High Equity</i>	0.7%	8.3%	6.1%	7.6%	10.3%	Feb 2000
<i>FTSE/JSE Capped SWIX All Share</i>	4.4%	10.1%	4.9%	8.1%	12.2%	Feb 2000

Fund						Inception date
	Latest 1 year	Latest 3 years	Latest 5 years	Latest 10 years	Since inception	
Peregrine Capital Pure Hedge H4 QI Hedge Fund	12.9%	10.5%	10.0%	12.0%	19.3%	Jul 1998
<i>SA Multi Asset - Low Equity</i>	3.9%	7.3%	6.3%	7.1%	9.7%	Jul 1998
<i>CPI</i>	7.4%	5.3%	4.9%	5.2%	5.6%	Jul 1998

Our business is turning 25 years old in June. We are celebrating 25 years of performance. We are very pleased that as of the end of 2022, the High Growth Fund is up 125x and the Pure Hedge Fund is up 75x from their founding dates*. We will ensure performance in the business remains our top priority for the next 25 years, and plan to do our very best to ensure that future returns remain exceptional.

We want to thank our clients for supporting us over the past quarter of a century and at the same time, we also want to welcome the many new investors that joined us this past year. We appreciate that you've chosen to partner with us.



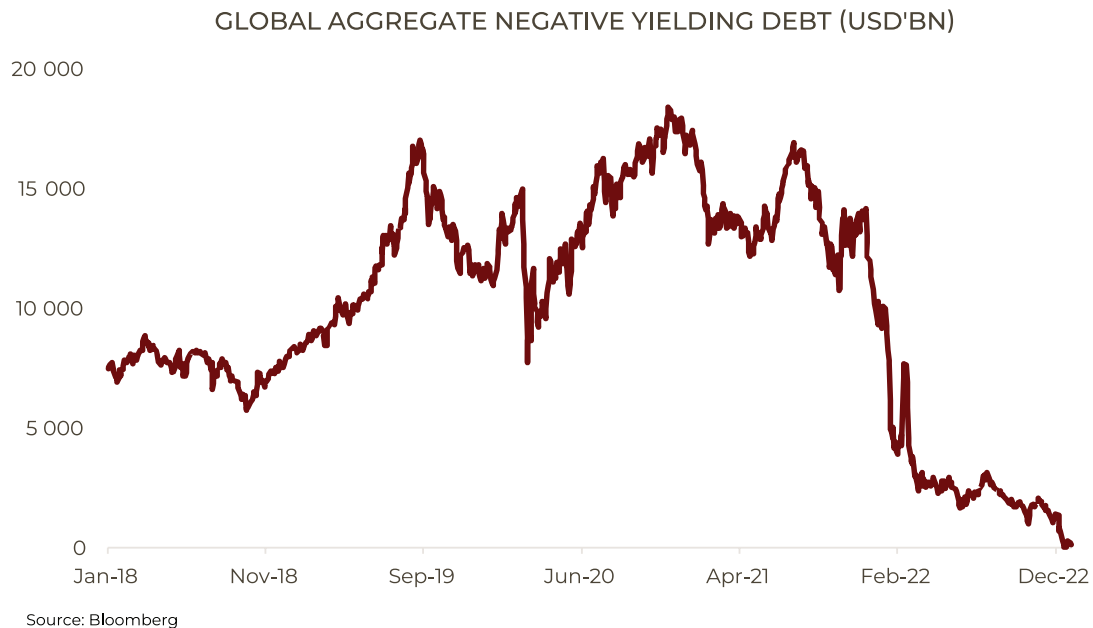


2022 IN REVIEW

Both the S&P 500 and MSCI World indices were down 18% for 2022. The decline happened mostly in the first half of the year, with both indices ending the year slightly above their June closing levels. The South African market was a stand-out performer and one of the few markets to end in the green, up 4.3% for the year, mainly supported by strong performance from resources with the FTSE/JSE Resources Index ending up 9.5% for the year.

The Barclays Global Bond Index was down 16% for the year, highlighting that bonds were not a safe place to hide as inflation surprised markets and interest rates were increased. It was the first time in 150 years that US bonds and equities were both down more than 10%.

The big story of 2022 was inflation. Inflation peaked at 9.1% in the US, at 10.6% in Europe, and 11.1% in the UK. We think it's highly likely that inflation will drift down from these very elevated levels. However, the key question is whether it will comfortably settle at previous target levels of around 2%. This seems much less clear, and it is quite possible that inflation spikes again after initially trending down. The US labour market remains very tight while there is also still supply tightness in energy markets (coal and natural gas). It is not clear whether the Federal Reserve and other central banks can break the back of inflation without causing a recession. This is likely to be the key theme that will drive markets during 2023.



This graph shows the total market capitalisation of negative yielding debt. These are bonds where you lend money to someone, and rather than the issuer paying you interest, the holder actually has to accept receiving less money back than he/she lent out (we know this sounds ridiculous, but it was a part of financial markets for more than 5 years). It was truly a crazy time to have at peak \$18 trillion of negative yielding debt in the world at the end of 2020. On 4 January 2023, the last of the bonds in this index turned positive, ridding the market (at least for now) of negative yielding debt.

The history books may struggle to understand the period from 2017-2022 in markets due to the strange occurrence of people paying others to borrow money from them for extended periods of time. This phenomenon was the result of a 40-year trend of declining interest rates in the US and developed markets and unprecedented central bank intervention in global bond markets post the Great Financial Crisis in 2008-2009, which boosted markets but ultimately peaked in 2021.

South Africa:

In South Africa, the picture looks relatively less concerning. Our inflation rate only peaked at 7.5%, due to a weaker economy and a more disciplined and rational Reserve Bank. Contrary to what most might think, conditions aren't as bad in South Africa currently. We are well positioned for a potential upswing in commodity markets, and we are far removed from the geopolitical conflict between Russia and Ukraine, and from the long-term problems brewing between China and the US.

Our problems in South Africa are self-inflicted and continue to weigh down economic growth. We continue to suffer from the lingering effects of the State Capture era, where the criminal justice system was neutralised and criminals were unleashed to plunder our municipalities and State Owned Enterprises without fear of consequences. The current administration is finding it harder to rebuild key institutions like Eskom and Transnet than it was for their predecessors to destroy them. The performance of both entities have been horrific over the past few years, plagued by corruption, criminality and the loss of competent and experienced staff, that continues to hold them back. The frustrating thing to us is that their task is fairly basic. The world has been running trains and producing power from coal for more than 100 years. How can it be that difficult to produce consistent electricity and run trains on a schedule when people could do both of these things before we had the internet, cellular phones or airplanes?

These failures are holding South Africa back. The silver lining we take from this is that the extent of the failures has now become so glaringly obvious, that the odds of more drastic corrective action has increased. Our time in the market has taught us that a pendulum can swing to extremes. In saying that we are not saying that conditions in South Africa cannot deteriorate further but one has to be very mindful of the extreme negative sentiment surrounding our country, along with the low base that the economy is operating from. South Africa has an exceptional private sector, and the only solution we can see is more aggressive use of public private partnerships, or alternatively wholesale outsourcing to the private sector. Given the sorry state of the country's balance sheet, increased private participation is an inevitability, regardless of the political party that occupies the throne at the Union Buildings over the next decade. If this logic holds true, growth in the years ahead may steadily improve, at a time when listed company valuations are low and simply do not reflect this possibility.





PORTFOLIO UPDATE

We touched on two of our major 2022 winners during our semi-annual letter last year. Thungela Resources and OUTsurance. These were both meaningful positions, and we are very satisfied that both continued to deliver for investors during the second half:



THUNGELA RESOURCES

Thungela Resources (“Thungela”) was a standout performer for our funds in 2021 and 2022. We acquired the shares at extremely attractive levels following the unbundling by Anglo American and predictable selling by the new shareholder base. The coal market ended up playing out more favourably than we had initially forecast due to the impact of ESG on coal supply, and more significantly, the Russian/Ukrainian conflict. Looking back at this investment, there are a few key things that stand out and are worth reflecting on:

1. Be willing to work harder than anyone else. For Thungela, we did very detailed work up front when we made the initial investment, but then continued to work extremely hard to gain a thorough understanding of the global coal market, the transport issues at Transnet, and all the other variables impacting Thungela. At the price we acquired Thungela shares post the unbundling, most of the share price was under-pinned by cash. It provided us a one-sided option on the coal price moving higher.
2. Consistently update your investment thesis for new information. It would have been easy to sell our Thungela position after it had appreciated by 100% or 200% from our initial entry. But as coal prices went higher due to the Russian invasion of Ukraine, we updated our fair value consistently and realized that we should buy more rather than sell.
3. Be willing to sell even your favourite positions when they reach fair value. We have a great appreciation for the company, its management team, and the value they have brought to our investors over the past 18 months. However, as is our philosophy, we always prioritize doing what is right for our funds and investors, even when it means letting go of a stock that has reached its fair value. We have learned this lesson through experience: it is important not to get too attached to a particular stock and to be ready to sell when it reaches or exceeds our estimated value. Therefore, we sold all our Thungela shares at favourable prices in the second half of 2022.

We will continue to keep an eye on Thungela, but our focus is now on finding the next Thungela, identifying opportunities that may be overlooked by others and capitalizing on them while they are still out of favour.

To summarize, we thought we would share some levels of buying and selling on Thungela, to highlight the significant outperformance of the share over the year'. The cheapest share we acquired was R23.85 on June 9, 2022. Our highest effective sale price achieved was R341.70, which equates to a level of R419.70 if we include the R78 of dividends we received during 2022.

OUTSurance

OUTsurance was a meaningful contributor to 2022 performance for the funds. The market loves simplicity over complexity, and we were overjoyed that the RMI management team succeeded in their simplification exercise. They have sold off Hastings, unbundled Discovery and Momentum, and renamed RMI to OUTsurance.

This means that investors can now obtain direct exposure to one of the best businesses in South Africa for the first time. OUTsurance has most of the characteristics we look for when identifying long-term core positions for the funds:

High returns on capital. OUTsurance generates ROEs above 30% on a normalized earnings basis when adjusting for excess capital. These high returns allow OUTsurance to re-invest into their own business to grow while also paying very attractive dividends.

Strong management team. Many of the senior team members have been with OUTsurance since the early years (founded in 1998) and have played a role in building it into the largest motor insurer in South Africa. We believe they run one of the best insurance pricing engines in the world, which ensures that clients get the best price and OUTsurance makes an attractive margin. They have also been a true exception in South Africa in terms of replicating their South African success organically in another country, with YOUI being a leading motor insurer in Australia now.

Disciplined capital allocation. The company has an exceptional track record in deploying earnings generated. The single biggest success was their expansion into Australia. Their Australian business is now larger than the SA business in terms of premiums, and we believe it will also be larger in terms of profits in the next 5 years. They also tried to expand into New Zealand and showed great discipline by closing that business after they didn't gain traction within a few years. They've consistently paid out all excess capital as dividends or special dividends, and not tried to cling on to excess cash. This is exactly what we like to see.

Healthy growth prospects. It is also one of the few SA businesses with structural long-term growth prospects. The Australian business is in the midst of a period of accelerated growth (22% premium growth last year), and we see continued momentum in Australia for the next 3 years. Furthermore, they will likely enter a new market during 2023. If they manage to replicate the success that they achieved in South Africa and Australia, then this new country will likely provide growth visibility over the next 10 years.

Businesses like these are extremely scarce. OUTsurance deserves a premium valuation, and it is pleasing to see that the market is starting to agree with us.

MISTAKES

Our most significant mistake was holding onto a long position in Meta (previously called Facebook). The position had been a solid performer for the funds from 2017 to 2021. During 2022 the share price was impacted by the slowing global economy and resultant slowdown in marketing spend by companies, as well as the general de-rating that technology businesses experienced due to higher interest rates. However, the major part of the Meta decline was caused by two company specific variables: (1) Changes Apple made to the iPhone ecosystem that reduced Meta's ability to accurately target their ads and measure the click through rates, and (2) Competition from Tik-Tok.

Meta ended 2022 down more than 60% and was our biggest loser. With hindsight, there are two major lessons here.

1. Be more aggressive on selling when a share you own approaches its fair value. We should have sold more Meta / Facebook when it performed so well during 2020 and 2021. (You will notice from our Thungela section earlier that we are on our guard to try and do better with selling going forward, though it's not something one can ever get 100% right).
2. React ruthlessly and aggressively when the investment thesis changes. We pride ourselves in reacting quickly when the news flow changes. In this case, the share price moved down very rapidly post the bad news, making it harder to assess whether or not the bad news was now priced in. It has re-affirmed a long-held principle of ours: When there is a material change to an investment thesis, one should sell some or all of the position regardless of whether the share price is already down from the peak.

Getting some calls wrong unfortunately comes with the territory of managing money. Analysing our mistakes and learning the right lessons from them is a key part of what has differentiated us over the longer run and we plan to continue to do this.





LOOKING AHEAD

We still see several reasons to be cautious. There has been a one in 50-year event in bond markets, with both short and long rates increasing substantially. This has an immediate impact on liquidity in markets, but the medium-term impact on the overall economy takes time to play out and is harder to predict. The best we can do is to be mindful of the current “temperature” of the global economy and financial markets, but take into consideration that global markets have already declined by 20%. Although some of the risks and uncertainties are most certainly already reflected in valuations, the extent to which these are fully priced in remains to be seen as we navigate our way through 2023.

Our strategy at present is to actively look for unique opportunities with exceptional pay-off profiles, while at the same time carefully managing the risk we take in our overall funds. We want to protect capital if the recessionary scenario plays out, while continuing to generate strong returns even if things muddle along.

We currently own a well-diversified portfolio of bottom-up ideas and are sitting on higher than usual cash balances, ready to deploy when the next opportunity comes around, or markets provide us with an attractive entry point. Last year’s volatile markets provided us with many attractive investment opportunities. We expect that the continued volatility and uncertainty in markets will be a great environment for us to continue to deploy capital and take advantage of periods of fear and panic when other investors are acting irrationally. We are on the front-foot and ready for the year.



WITH THANKS

Peregrine Capital values its clients as partners. Without your trust and support, we wouldn't have the privilege of doing the job we love every day and managing money. Many of you have been with us for a long time, and we believe that our enduring partnership has contributed to the success of our investment funds. Your confidence in us and your long-term approach to investing enables us to make the best decisions for all of us, which we believe will lead to strong, risk-adjusted returns over time. Our team is invested in the funds alongside you (collectively, we are the third largest investor) and our goals are closely aligned with yours. This alignment is unparalleled in the South African fund management industry. Our investment process has been successful through various market conditions, and we are confident in its ability to continue delivering results.

Please contact us via info@peregrine.co.za if you have any questions or comments.

David Fraser
Executive Chairman

Jacques Conradie
Chief Executive Officer

Justin Cousins
Executive Director

SHORT INTERLUDE ON ARTIFICIAL INTELLIGENCE

Something of interest we thought we'd share is the progress of AI during 2022. OpenAI launched their GPT3-chat AI during November 2022 and we think that 2022 will mark the start of the AI era.

On a personal level, AI-powered virtual assistants and chatbots will become increasingly prevalent, making it easier for individuals to accomplish tasks and access information. These assistants can help with scheduling, making phone calls, searching the internet, and even controlling home appliances. AI-powered personal health care devices and digital health technologies will also become more common, allowing people to track and manage their health with greater accuracy and convenience.

In the business world, AI is expected to have a major impact on efficiency and productivity. AI-powered automation will be used to streamline operations in a variety of industries, including manufacturing, finance, and logistics. AI will also help companies to better understand their customers through advanced analytics and prediction, improving customer experience and sales.

It can also help to improve decision-making and optimize supply chains, which could help businesses to save costs and operate more sustainably. Additionally, AI will be used to develop new products and services, such as personalized medicine, autonomous vehicles, and intelligent energy systems.

Overall, while there will certainly be challenges associated with the integration of AI into society, the benefits have the potential to be tremendous, with improvements in areas such as economic growth, productivity, and quality of life.

It might interest you to know that the previous 5 paragraphs were all written by an AI, GPT-3 chat! (We asked it how AI would impact the world over the next decade and simply inserted the answer here) If you haven't yet, we encourage you to go see for yourself, it is truly mind blowing. We are surprised that this hasn't received more mainstream media attention over the past few months. It is arguably the biggest thing that has happened in the world for a long time and the continued advancement of AI will likely be the single most important thing in the world over the next 10-20 years. You can rest assured that we are motivated as ever to stay on top of global trends. It will help us take advantage of new opportunities and also ensure that we are not missing anything that could impact the outlook for the companies we invest in.



Disclaimer:

H4 Collective Investments (RF) Proprietary Limited ("H4") is a registered and approved manager of collective investment schemes in hedge funds. Peregrine Capital Proprietary Limited ("Peregrine Capital"), is an authorised Financial Services Provider (FSP 607) under the Financial Advisory and Intermediary Services Act, No. 37 of 2002 and has been appointed by H4 as the investment manager of the portfolios. Collective investment schemes are 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. Collective investment schemes are traded at ruling prices and can engage in borrowing and scrip lending. A schedule of fees and charges and maximum commissions is available on request from H4 or Peregrine Capital. Peregrine Capital High Growth H4 QI Hedge Fund: Performance fees are payable on positive performance using a participation rate of 20%. A high watermark is applied, which ensures that performance fees will only be charged on new performance. There is no cap on the Rand amount of performance fees. Peregrine Capital Pure Hedge H4 QI Hedge Fund: Performance fees are payable on positive performance, in excess of the hurdle, using a participation rate of 20%. A high watermark is applied, which ensures that performance fees will only be charged on new performance. There is no cap on the Rand amount of performance fees. Neither H4 nor Peregrine Capital provides any guarantee with respect to the capital or return of a portfolio. H4 retains full legal responsibility for the portfolios. H4 has the right to close the portfolios to new clients to manage them more efficiently in accordance with their mandates. The performance calculated and shown is that of the portfolio. Performance has been calculated using net NAV to NAV numbers with income reinvested. The investment performance for each period shown reflects the net return for clients who have been fully invested for that period. Individual investor investment performance may differ as a result of initial fees (if applicable), the actual investment date, the date of reinvestment of distributions and/or distribution dates and dividend withholding tax. Where periods of longer than 1 year are used in calculating past performance, certain figures may be annualised. Annualised performance is the average return per year over the period. Actual annual figures and investment performance calculations are available on request. Where investment performance has been shown by way of an illustration (a) investment performance is for illustrative purposes only (b) the investment performance is calculated by taking the actual initial fees and all ongoing fees into account for the amount shown and (c) income is reinvested on the reinvestment date. The performance history is contained in the portfolios' minimum disclosure documents which are available on request from H4 or Peregrine Capital

Fund Name	Inception date	Highest annual return	Lowest annual return	Rolling 12 month return
Peregrine Capital High Growth H4 QI Hedge Fund ('High Growth Fund' above)	Feb 2000	71.6% (2001)	-16.2% (2009)	11.5%
Peregrine Capital Pure Hedge H4 QI Hedge Fund ('Pure Hedge Fund' above)	Jul 1998	133.8% (1999)	0.6% (2009)	12.9%
<i>FTSE/JSE Capped Swix All Share Index</i>	<i>Feb 2000</i>	<i>73.0% (2006)</i>	<i>-37.6% (2009)</i>	<i>4.4%</i>
<i>ASISA South Africa MA High Equity</i>	<i>Feb 2000</i>	<i>39.5% (2006)</i>	<i>-14.8% (2009)</i>	<i>0.7%</i>
<i>ASISA South Africa MA Low Equity</i>	<i>Jul 1998</i>	<i>40.6% (1999)</i>	<i>-3.3% (2020)</i>	<i>3.9%</i>
<i>Inflation (CPI)</i>	<i>Jul 1998</i>	<i>12.9% (2002)</i>	<i>0.0% (2004)</i>	<i>7.4%</i>

The calculation of all net returns from 1 February 2000 until 30 November 2016 are for the unregulated Peregrine High Growth Fund, thereafter the data relates to the regulated Peregrine Capital High Growth H4 QI Hedge Fund. The calculation of all net returns from 1 July 1998 until 30 November 2016 are for the unregulated Peregrine Pure Hedge Fund, thereafter the data relates to the regulated Peregrine Capital Pure Hedge H4 QI Hedge Fund. The 'JSE Capped Swix All Share Index' referenced is the index from December 2016 to date, before that the JSE All Share TR Index is used. The 'Cash' referenced is the STeFI Index (Stefocad) from July 2003 to date, before that the JIBAR is used.

*125X refers to the Peregrine Capital High Growth H4 QI Hedge Fund. R1m invested at inception is worth more than R100m today, SA Multi Asset - High Equity Category: R9.5m, FTSE/JSE Capped SWIX: R14.1m. High Growth Fund annualised return: 23.58% | SA Multi Asset - High Equity Category annualised return: 10.34% | FTSE/JSE Capped SWIX annualised return: 12.23%, all since inception (February 2000). 75X refers to the Peregrine Capital Pure Hedge H4 QI Hedge Fund. R1 million invested at inception is worth more than R70m today, SA Multi Asset - Low Equity Category: R9.6m, CPI: R3.8m. Pure Hedge Fund annualised return: 19.31% | SA Multi Asset - Low Equity Category annualised return: 9.69% | CPI annualised return: 5.58%, all since inception (July 1998). Data to 31 December 2022 | Source: Peregrine Capital, IRESS, Bloomberg.