



MENTENOVA

HOW INVESTMENT PHILOSOPHIES SHAPE RESPONSES TO BENCHMARK CONCENTRATION

Part 2 | Concentration Risk: Different Views, One Solution

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PART 2

HOW INVESTMENT PHILOSOPHIES SHAPE RESPONSES TO BENCHMARK CONCENTRATION

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SETTING THE SCENE

In Part 1 of this series, we examined the nature and extent of concentration risk in both domestic and global equity markets.

The data painted a clear picture: the materials sector driven predominantly by precious metals now constitutes just over a third of the Capped All Share Index, while Information Technology continues to dominate global benchmarks. Our conclusion was that concentration, while elevated, need not be feared. It must be understood, contextualised, and actively managed.

Yet structural analysis tells only half the story.

How portfolio managers *respond* to concentration ultimately determines investor outcomes.

This second instalment presents perspectives from local equity managers on the Capped ALSI's current composition, how they navigate benchmark concentration, and critically how Mentenova constructs portfolios that harness these differing views to achieve more consistent results.

Where Views Are in Alignment: The Risk Is Real

Despite differences in investment philosophy and positioning, there is clear alignment on one point: concentration in the Capped ALSI is elevated and requires deliberate attention. Precious metals have become a dominant component of the index, with gold equities accounting for approximately two thirds and platinum group metals comprising the remaining precious metal exposure. A meaningful weighting to a sector that is deemed inherently cyclical and volatile. Bearing in mind the words from Morgan Housel in his seminal book *The Psychology of Money*, "Volatility is the price of admission".

THREE KEY AREAS OF CONSENSUS EMERGE ACROSS OUR LOCAL EQUITY MANAGERS:

1

First, concentration has increased meaningfully. The sustained rally in gold equities, alongside a recovery in platinum group metals, has materially shifted index composition in recent years, though it is worth noting that elevated concentration is not a new challenge for South African equity managers. The JSE has historically been prone to single-stock and sector dominance, characteristically of a market like ours, most notably through Naspers and its subsequent unbundling, which was itself a catalyst for the development of the FTSE/JSE Capped SWIX as a preferred benchmark. The current precious metals exposure represents the latest iteration of this structural feature, rather than a departure from a previously balanced index.

2

Second, this concentration introduces important and unequal portfolio construction considerations. A large weighting in a single cyclical sector heightens sensitivity to commodity price movements and necessitates careful position sizing and risk budgeting. Critically, however, not all sector exposures carry equivalent risk, and this asymmetry matters for how managers construct portfolios. A meaningful allocation to gold or platinum group metal equities introduces commodity price risk that is exogenous, dollar-denominated, and historically volatile, quite distinct from the domestic credit and rate-cycle risk embedded in a large banking exposure. These are not interchangeable units of risk, and risk budgets must be calibrated accordingly. Managers recognise that such concentration can amplify both upside and downside outcomes, but the nature of that amplification differs materially depending on the underlying driver of each sector's returns.

3

Third, all managers are responding intentionally through ongoing monitoring, selective underweight and overweight positions where risks and opportunities are present. There is no evidence whatsoever of passive acceptance of benchmark composition. This reflects a shared understanding that concentration is not a static feature of the market, but a market dynamic that must be managed through continuous judgement.

WHERE VIEWS DIVERGE: THE BENCHMARK QUESTION

Central to this debate is a distinction that is often overlooked in practice: not all benchmark-related risk is the same, nor is it borne by the same party.

The first layer is policy risk. When a client selects a benchmark, they accept the return and risk characteristics that come with it, including sector concentrations and single-stock exposures. That is a client decision, and the outcomes that flow from it belong to the client.

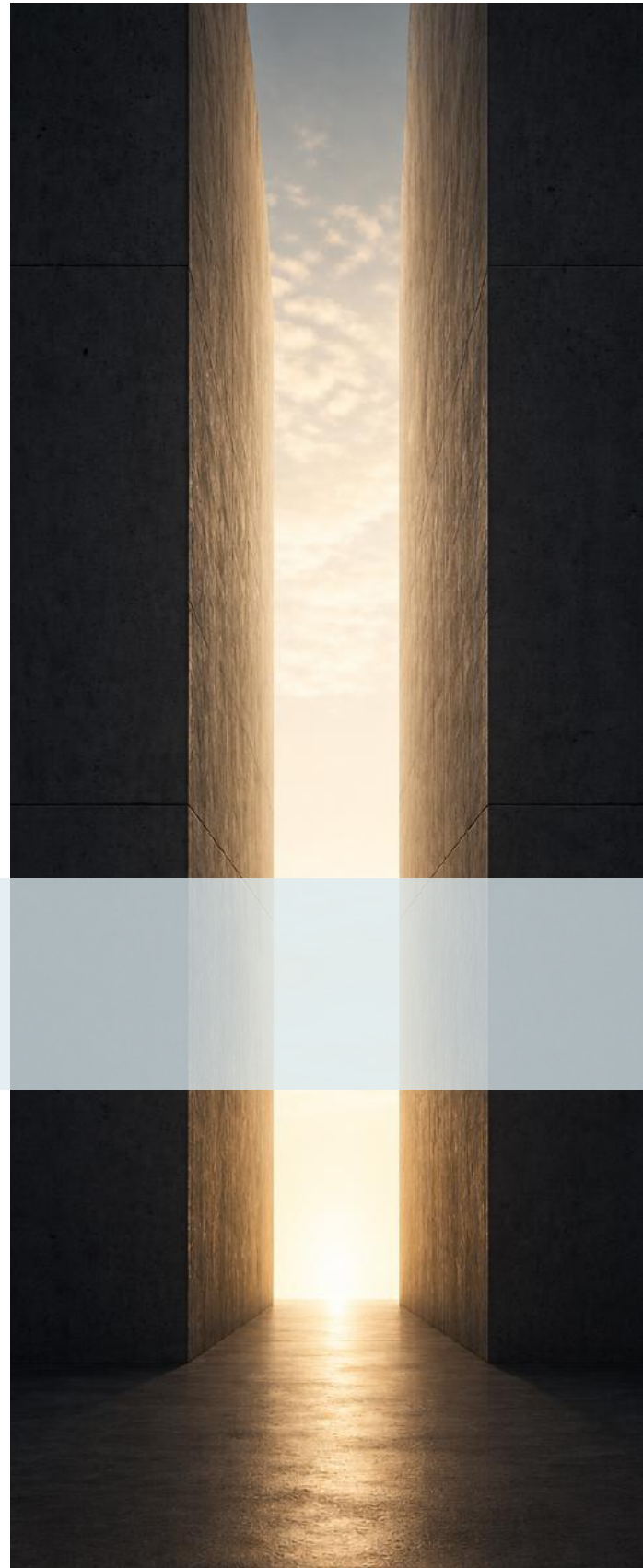
The second layer is misfit risk. Every manager has a natural investment style that will not perfectly match the client's chosen benchmark.

The gap between the two generates returns and risks that are neither the client's benchmark exposure nor the result of the manager's active decisions. They are the result of the hiring decision, and in a multi-manager setting, that accountability sits with the investment consultant.

The third layer is true active risk. This is what the manager actually controls: the deliberate positions they take relative to their own natural portfolio in pursuit of outperformance.

Conflating these three layers leads to misaligned expectations. Managers can find themselves judged against outcomes that were determined by the benchmark selection or the hiring decision, long before a single stock was bought or sold.

Keeping them separate is the foundation of a fair accountability framework.



THE DIVERGENCE CAN BE FRAMED ACROSS THREE BROAD PERSPECTIVES:



THE “STAY THE COURSE” VIEW

For some, the Capped ALSI remains an appropriate and investable representation of the local equity market, even at current concentration levels. The benchmark is seen as a reflection of the opportunity set as it exists, rather than how it should look, with sector concentration viewed as a recurring feature that has historically mean-reverted over time. Changing benchmarks in response to market conditions is therefore seen as introducing the risk of style drift and inconsistency, shifting the focus away from the primary objective, which is to outperform the benchmark as it stands. From this perspective, concentration is a portfolio management challenge, not a benchmark problem.



THE “BENCHMARK UNDER PRESSURE” VIEW

Others adopt a more cautious stance, questioning whether current levels of concentration remain consistent with the purpose of a diversified equity benchmark. A near 30 per cent exposure to a single cyclical sector introduces structural concentration risk, while historical experience, such as Naspers exceeding 30 per cent of the ALSI before a significant drawdown, highlights how extreme concentration can distort outcomes. At elevated levels, the benchmark may no longer function as a balanced proxy for the broader market, which over time strengthens the case for alternative benchmarks or structural adjustments, particularly for long-term capital. In this view, the concern is not short-term volatility, but whether the benchmark itself embeds unintended risk.



THE “PRAGMATIC MIDDLE”

A more balanced view acknowledges that while current conditions remain manageable, the trajectory is what matters most. Current levels of concentration can still be worked around through active positioning; however, further increases, particularly towards the 35 to 40 per cent range, would begin to constrain portfolio construction meaningfully. At those levels, even modest active tilts could lead to outsized and unintended exposures, making it increasingly difficult to maintain balanced portfolios. This would likely shift the discussion from portfolio management to broader industry engagement on benchmark suitability. In this way, concentration is best understood as a dynamic risk, one that is acceptable today but cannot be ignored if it continues to build.

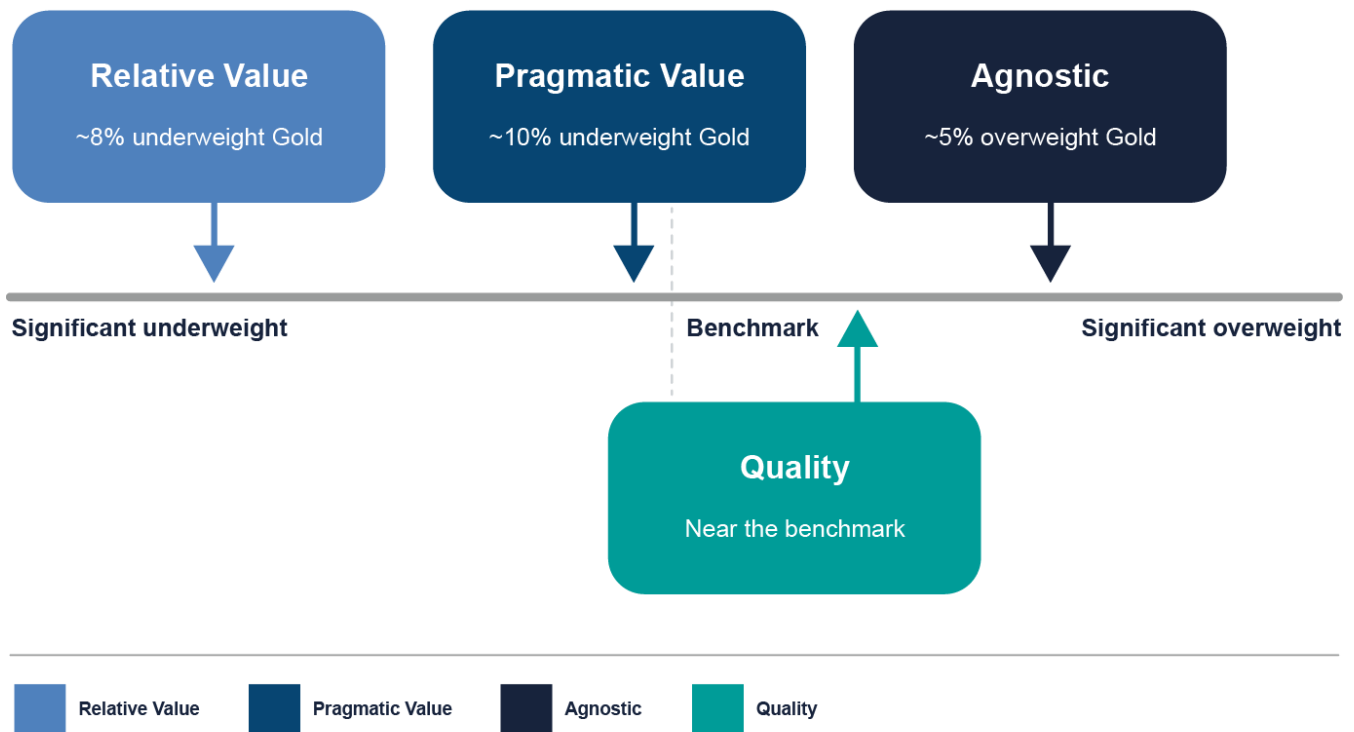
HOW PHILOSOPHIES TRANSLATE INTO POSITIONING

The practical consequence of differing investment approaches is a wide dispersion in portfolio positioning and, by extension, in performance outcomes across varying market environments. This is not a flaw in the system, but rather a reflection of it functioning as intended.

Such variation is a natural feature of active management, where distinct philosophies lead to different decisions and outcomes. While this dispersion can appear as inconsistency over shorter-time horizons, particularly when performance is assessed in isolation, it is more accurately understood as managers applying their frameworks with conviction than converging towards a consensus that offers limited differentiation.

Figure 1 below illustrates how different investment philosophies position precious metals exposure relative to benchmark weights, highlighting a spectrum from underweight to overweight positioning.

FIGURE 1:
PRECIOUS METALS POSITIONING RELATIVE TO BENCHMARK



Source: Mentenova Investment Team

HOW MANAGERS ARE POSITIONED TODAY

Philosophical views on the benchmark ultimately translate into real portfolio decisions, resulting in clear differences in positioning across managers.



The Defensive Stance

Some managers have adopted a deliberate underweight with precious metals, driven by concerns around valuation and concentration risk. Parts of the gold sector are viewed as offering limited additional upside relative to downside risk, while elevated index weights increase portfolio sensitivity to a single cyclical driver.



The Constructive Stance

Other managers remain more constructive, maintaining exposures broadly in line with or slightly above the benchmark. This reflects a supportive fundamental view, underpinned by factors such as geopolitical uncertainty and supply constraints in PGMs.

Positioning is often nuanced, with preferences within the sector rather than a broad-based overweight. However, even these managers acknowledge limits, with many indicating they would reassess exposure if concentration levels increased further.

THE PERFORMANCE ROTATION DYNAMIC

These positioning differences create meaningfully divergent performance outcomes depending on market environment.

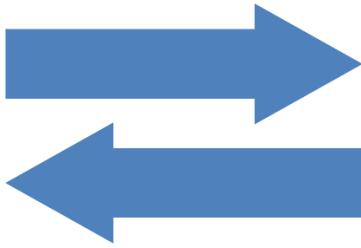
CONSIDER TWO ILLUSTRATIVE SCENARIOS:



Scenario A: Continued Gold Rally If precious metals prices advance further, driven by central bank reserve diversification and sustained geopolitical tension, the manager with 35 per cent precious metals exposure would likely outperform significantly. The defensively positioned manager with 8 per cent underweight would lag, potentially substantially.



Scenario B: Sharp Gold Correction If gold prices reverse, perhaps due to a reduced geopolitical risk premium or US dollar strength, the dynamic inverts. The concentrated positioning that amplified returns become a source of significant drawdown. The defensive manager preserves capital and likely outperforms; the constructive manager faces meaningful underperformance.



This rotation is not theoretical.

The same manager who outperforms in one environment may underperform in another.

No single approach dominates across market cycles, which explains why performance leadership among local equity managers shifts over time. Figure 2 shows that manager outperformance is highly scenario-dependent, with different styles benefiting depending on the direction of the commodity cycle.

FIGURE 2: SCENARIO ANALYSIS: PERFORMANCE ACROSS COMMODITY OUTCOME

Scenario A: A precious metals rally continues	Scenario B: Commodity cycle turns
<p>Gold and PGMs sustain elevated levels.</p> <p>Commodity cycle extends.</p> <p>Rand remains under pressure.</p> <p>Agnostic / overweight: Outperforms ↑</p> <p>Quality / pragmatic: Tracks benchmark ~</p> <p>Relative value / underweight: Underperforms ↓</p>	<p>Gold corrects from elevated levels.</p> <p>PGM recovery stalls.</p> <p>SA Inc recovery leads the index.</p> <p>Relative value / underweight: Outperforms ↑</p> <p>Quality / pragmatic: Tracks benchmark ~</p> <p>Agnostic / overweight: Underperforms ↓</p>

Source: Mentenova Investment Team

MENTENOVA'S APPROACH: THE POWER OF THE BLEND

Faced with this reality, Mentenova's portfolio construction philosophy is deliberate: we do not attempt to select the "correct" view. Instead, we intentionally combine managers with divergent perspectives, those who see concentration as risk to avoid, and those who see it as opportunity to capture.



This blending serves multiple purposes. It reduces portfolio-level exposure to any single sector or trend. It ensures that when market leadership rotates, some component of the portfolio is positioned to benefit. Most importantly, it produces more consistent, less volatile outcomes over time than any single manager approach could achieve alone.

Our global equity building block employs similar principles. Where the benchmark has increased technology allocation, we have strategically moderated exposure. The portfolio's style exposure tilts toward Value, High Yield, and Quality positioning that benefits from current style rotation away from pure growth while providing resilience during volatility.

THE CASE FOR BLENDING

Mentenova's portfolio construction philosophy recognises that investment skill takes different forms.

Rather than relying on a single approach, the focus is on combining complementary styles to build a more resilient portfolio.

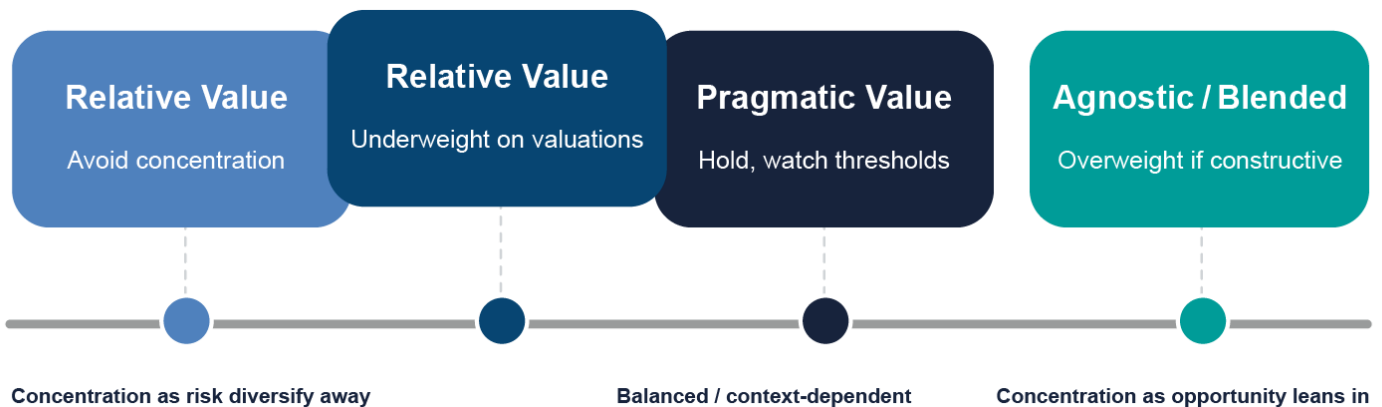
In the current environment, this translates into a deliberate balance of positioning:

- Defensive managers help reduce downside risk if the precious metals rally moderates.
- More constructive managers ensure participation if the rally continues.
- Quality-focused managers provide a stable core through fundamentally sound businesses.
- Flexible approaches allow the portfolio to adapt as conditions evolve.

The result is a portfolio that is intentionally balanced, not positioned for a single outcome, but designed to navigate a range of market scenarios.

Figure 3 below maps manager philosophies along a spectrum, from avoiding concentration risk to actively embracing it as an opportunity and shows typical positioning in the current environment.

FIGURE 3:
MANAGER PHILOSOPHY SPECTRUM:
CONCENTRATION AS RISK VS OPPORTUNITY



Source: Mentenova Investment Team

CONCLUSION: Balance, Not Avoidance

Concentration risk is neither inherently good nor bad.

It is a structural feature of markets that creates both opportunity and risk. The divergence in views is therefore not something to resolve, but a reflection of different philosophies, risk tolerances, and market interpretations.

What matters is not which view being “right”, but rather how these views are combined.

By blending managers who respond differently to concentration, Mentenova constructs portfolios that are not reliant on a single outcome but are positioned to navigate a range of market environments.

Each approach has merit and will perform at different points in the cycle. Our role is not to choose between them, but to combine them in a way that enhances overall portfolio resilience and consistency.

Concentration is not the enemy.

A single, undiversified response to it is.



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