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NEDGROUP INVESTMENTS GLOBAL FLEXIBLE FUND

Quarter 4, 2018

For the period ended 31 December 2018

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Commentary produced in conjunction with sub-investment manager, First Pacific Advisors

USD performance to 31 December 2018	Nedgroup Investments Global Flexible[1]	S&P 500	MSCI World
3 months	-9.9%	-13.5%	-13.4%
2018 (calendar year)	-7.8%	-4.4%	-8.7%

Stock markets around the world had a dismal 2018, particularly in the fourth quarter with December delivering the brunt of the decline. December 2018 was the worst December for the S&P 500 since 1931 - and that's after bouncing back 6.6% over the last four trading days of the year.

We are disappointed as your portfolio managers that we did not cover ourselves in glory in 2018. The Nedgroup Investments Global Flexible Fund ("The Fund") declined -9.9% in the last quarter of the year and -7.8% for the full year (net of fees). In comparison, the S&P 500 and MSCI World declined -13.5% and -13.4% respectively in the fourth quarter and -4.4% and -8.7% for the full year. Global Flexible, with its global exposure and value focus, outperformed the global and value indices but lagged the U.S. market.

In the context of its global and value focus, the Fund thankfully did not wholly disappoint as shown in the following table of 2018 performance of domestic and global equity benchmarks.

2018 performance of US and global benchmarks[2]

Name	2018
S&P 500 Growth	-0.01%
S&P 500	-4.38%
MSCI ACWI Growth	-8.13%
S&P 500 Value	-8.95%
MSCI ACWI	-9.42%
MSCI ACWI Value	-10.79%

Global Flexible's performance remains consistent with its stated long-term goals. Last year, the Fund's maximum drawdown was not unreasonable in the context of the overall market's drawdown and net risk exposure – the MSCI ACWI declined more than 9%, which is far from a bear market but a bit more than general market "noise". This was especially true in light of our net risk exposure each quarter, which increased from 59% in the first quarter to 68% by the fourth, largely as a result of the greater number of bargains that developed amid December's volatility.

Nedgroup Global Flexible performance during 2018 MSCI ACWI drawdown greater than 10%[3]

	21 Sep 2018 to 25 Dec 2018
Nedgroup Global Flexible Fund	-13.5%
MSCI ACWI	-17.4%
Global Flexible Downside Capture	77.3%
Global Flexible Net Risk	66.7%

[1] Net USD return for the Nedgroup Investments Global Flexible Fund, A class. Source: Morningstar (monthly data series).
[2] Source: FPA. The table shows performance for various indices gross of fees.
[3] Source: FPA, Morningstar. The table above shows the performance of the Fund and the MSCI ACWI and is presented gross of fees.

Importantly, the Fund's 2018 drawdown was almost entirely mark-to-market; that is, the stocks we owned declined in price, but we do not believe the intrinsic value or long-term earnings power of the underlying businesses was impaired. As long as these companies deliver on earnings in the coming years, their stock prices should do just fine. We discuss specific examples in the Portfolio Commentary section.

Despite the aforementioned mediocre performance last year, the flagship Contrarian Value Strategy[4] achieved its stated goals longer term, producing equity rates of return while avoiding permanent impairment of capital. While we have been managing the Global Flexible Fund for 5 years (since mid-2013), we believe the full merit of our process can only be truly assessed through a full market cycle (which the last 5 years have not been).

We took advantage of what we believed were attractive opportunities in 2018, finding possibilities to purchase good, growing businesses (albeit cyclical in some cases) at reasonable, if not good, prices. At the same time, we sold entirely or reduced positions in many of the companies that had helped drive past returns. We focus on where a company will be over the next five to seven years, consistent with our four- year average holding period. Just because we believe in a certain outcome, however, doesn't mean Mr. Market will see it our way immediately. In fact, Mr. Market held quite a different view from our own in 2018, as on average, what we sold performed better than what we purchased.

In the fourth quarter, mark-to-market price changes in the bottom five detractors from the Fund's performance outweighed the benefit realised from the top five contributors. Other than the announcement that Transdigm plans to acquire Esterline Technologies and favourable developments in the restructuring of Puerto Rican municipal debt, there was no substantive news that drove either quarterly or annual winners and losers.

Q4 winners and losers[5]

Winners	Performance contribution	Ave.weight (%)	Losers	Performance contribution	Ave.weight (%)
Esterline Tech.	0.28%	0.8	AIG	-0.81%	3.0
US Treasuries	0.18%	31.1	Baidu	-0.74%	2.1
Naspers	0.14%	0.5	Citigroup	-0.61%	2.0
Broadcom	0.12%	2.5	Arconic	-0.59%	2.5
Naver	0.06%	0.3	CIT Group	-0.58%	2.1
	0.78%			**-3.33%**	

2018 winners and losers[6]

Winners	Performance contribution	Ave.weight (%)	Losers	Performance contribution	Ave.weight (%)
Puerto Rico Muni's	0.54%	1.3	AIG	-1.04%	3.0
Microsoft	0.43%	2.1	Arconic	-0.92%	2.3
Esterline Tech.	0.41%	0.8	Jefferies Group	-0.77%	2.1
Cisco Systems	0.38%	1.0	Baidu	-0.72%	2.2
Broadcom	0.35%	1.3	Citigroup	-0.66%	2.1
	2.11%			**-4.11%**	

4 FPA were appointed sub-advisors of the Global Flexible Fund in 2013. The Nedgroup Investments Global Flexible Fund is modelled on FPA's Contrarian Value Strategy which has a track record going back to 1993.

5 Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the quarter. Contribution is presented gross of investment management fees, transactions costs and Fund operating expenses, which if included, would reduce the returns presented. The information provided does not reflect all positions purchased, sold or recommended by FPA during the quarter or year-to-date.

6 Reflects the top contributors and top detractors to the Fund's performance based on contribution to return for the 2018 calendar year. Contribution is presented gross of investment management fees, transactions costs and Fund operating expenses, which if included, would reduce the returns presented. The information provided does not reflect all positions purchased, sold or recommended by FPA during the quarter or year-to-date.

The price of a company's stock can perform better or worse than its underlying business, sometimes for extended periods. Such was the environment last year that the businesses of the companies we own performed on average within the range of our expectations – the companies we held for the full year actually *beat* analyst expectations. But their stock prices failed to reflect that performance.

For more than a quarter century, the strategy[7] has leaned into weakness. That is a hallmark of our past success, and we expect it to be no different in the future. We have never been able to dial in timing, however. We habitually buy and sell early which has led to fund performance untethered from the benchmarks. The most glaring example of such divergence in the CV Strategy was the 1998/1999 tech bubble, when the strategy underperformed by 59% versus the S&P 500 during those two years. Some have suggested, only partly tongue in cheek, that once we decide to make an investment, we consider waiting six months before we start to buy it!

Shares in a good, growing business purchased at a reasonable price should perform well over time. That doesn't mean they will perform well for all periods of time, and for Global Flexible's portfolio, 2018 was one such out-of-sync period. We wish we could guarantee our companies will continue to perform as expected and that the stock market will appropriately value them, but we can't. We are now midway through our third decade of operating with the same investment philosophy supported by a consistent research and portfolio management process, which should allow Global Flexible to continue to perform well *over time*, through full market cycles.

Eventually, fact trumps emotion and hope, and businesses receive a just valuation. In the interim, however, the inexplicable can frustrate and stymie both client and portfolio manager.

Given the Fund's positioning, which we discuss below, we are genuinely more encouraged than we have been in the past few years.

PORTFOLIO COMMENTARY

Last year was one of the Fund's more active periods on record. We took advantage of the inevitable return of volatility to eliminate and reduce certain positions while initiating and increasing others. We bought 19 new names and sold or reduced 27 names, some by more than half. The opportunities to put capital to work in 2018 allowed us to increase the Fund's net risk exposure from 59% to 68%.

The Fund's top 10 positions, comprising roughly one-quarter of the portfolio, have declined an average of 20% from their peaks relatively and absolutely, making them attractively priced.

We believe these businesses have increased their intrinsic value per-share over the past year, and we expect them to make further progress in the years ahead, though the rate of that improvement will depend on economic conditions and management execution. But given current valuations, which we discuss below, share prices should now at least keep up with business progress.

We invest on a bottom-up basis but find it useful to group the portfolio into similar economic categories for the purposes of discussion. Below are few of these categories.

Financials

The Fund had 16% net exposure to balance-sheet intensive Financials at year-end -- but please keep in mind that Financials as a category inadequately distinguishes between the different types of companies in it, which include traditional banks, other types of lenders, investment banks, insurance companies, service providers/middle-men, etc. Each of these have different risk characteristics. A strong balance sheet would include well-underwritten loans and insurance policies and an appropriate amount of equity to support it, and we believe the companies we own have such balance sheets, far stronger than the stock market currently appreciates. They are collectively valued at just 91% of their tangible book value and 8.4x consensus 2019 earnings. Some of our bank holdings have strong franchises and are likely to grow and earn excess returns through the cycle, for instance, Bank of America, Signature Bank and Wells Fargo. So, we primarily value these on an earnings basis. Others, like AIG, Ally Financial, CIT Group and Royal Bank of Scotland, operate less differentiated businesses or are undergoing corporate turnarounds, and in these cases, we rely more heavily on tangible book value when thinking about value. At year-end, these companies traded at an average of 73% of tangible book value.

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[7] The FPA Contrarian Value Strategy, on which the Nedgroup Investments Global Flexible Fund is modelled.

Jefferies Financial Group, our remaining balance sheet-intensive holding in this category, does not fit neatly in either group described above, though it serves as a good illustration of the type of financial investments we like. Jefferies operates a strong broker/dealer and a successful merchant bank. We like the owner/operator mindset of management, who have their money invested alongside ours. It has historically succeeded in creating value through timely investments through the merchant bank and by opportunistically repurchasing its shares at a sizeable discount to net asset value, or NAV. Last year, Jeffries met earnings expectations; enhanced NAV by reducing its stake in National Beef, and aggressively repurchased its shares at attractive prices. Despite those moves, Jefferies stock price declined 35% in the calendar year and now trades at just 65% of its tangible book value and an even larger discount to our low $30 assessment of NAV.

You should expect that we will increase our exposure to Financials in the event that their recent under-performance persists. We should note that a few of these holdings last traded at similarly discounted valuation levels in early 2016, notably AIG and Jeffries, before their stock prices soared.

Industrials & materials

The Fund has 20% of net exposure to businesses that have exposure to the industrial economy and materials. These companies range from mining to semi-conductors, and all trade at inexpensive valuations based on mid-cycle earnings. As a group, they are trading at only about 11x 2019 consensus earnings expectations, or more than a 20% discount to the U.S. stock market. We believe these companies will grow on average at least as fast as the typical public company and that their economics are less susceptible to disruption by new competitors or technology. If the global economy is larger in five to seven years, these companies should be worth appreciably more per-share, even with a recession along the way. On the downside, these companies would still be valued at slightly less than the stock market average *even* if their earnings declined by 25%, which is highly unlikely unless the rest of the companies in the stock market were to have earnings shortfalls.

Internet & related (Including cable)

In 2018, we initiated and increased stakes in a number of global internet platform companies that offered good growth prospects at attractive prices, while we reduced our stake in others that have been profitable investments but whose stock prices already reflected that success. This category represents 17% of the portfolio.

We sold down our Microsoft position, for example, which had appreciated markedly over the last eight years, and we bought a number of Asian internet platform companies at prices well below recent peaks. Our timing, though, made us look foolish over the short term. The Asian companies continued to trade poorly, declining more in the back half of the year than Microsoft. These investments still have the same growth prospects but are now at even more attractive prices. As a group, these investments trade at an average of around 16x earnings net of cash (and lower still net of non-earning assets) and are expected to grow their revenues by 18%.

Cable has had a taint to it for much of 2018 due to the twin fears of “cord cutting,” which would displace the video business, and the development of 5G, which is supposed to allow wireless to make in-roads into broadband. We do not place much stock in either view. First, we do not believe that video is as profitable as industry segment reporting suggests. Video’s free cash flow per subscriber will likely slowly erode, but we believe that will be more than offset by the latent pricing power of broadband, which is necessary for those who wish to cut the cord. Next, although 5G is something to consider, there is so far only one wireless company with any substantive investment in the technology, and it’s too early to speak to its capability. Plus, cable infrastructure will still be required for the back-haul. We believe increasing demand for faster broadband makes cable a necessary and winning asset and that well-positioned cable companies will gain subscribers and the ability to increase pricing over time. We therefore purchased Charter Communications and Comcast, two geographically diversified cable companies with less risk of overbuilding and controlled by owner operators (although we are admittedly suspect of Comcast’s purchase of Sky).

Other, including credit

The Fund continues to maintain very low exposure to high yield corporate bonds, which account for less than 3% of the portfolio. High debt levels, poor interest coverage, weak covenants, low yields, and a decade into a relatively decent economy have left us with few options that offer any reasonable margin of safety. We expect to once again be larger investors in credit when more attractive yields exist.

We recently published a white paper titled Risk is Where You're Not Looking[8] that discusses in greater detail the impending challenges likely to face the corporate debt market, which the equity markets are unlikely to exit unscathed when they emerge.

We own a number of other companies that do not fall into a neat little box, but which we believe offer attractive prospects for good returns over time. For example, Kinder Morgan, once a master limited partnership but now a corporation -- and always a pipeline transportation and energy storage company -- is a younger investment in our portfolio. Kinder has differentiated infrastructure assets; a great management team led by Richard Kinder, owner of around $4 billion of its stock, and reasonable growth prospects. It's a bit like a utility with the toll it takes on the oil and gas that flow through its pipes and reside in its storage facilities, but with better management, less regulation, good capital allocation, and a higher dividend yield.

CLOSING REMARKS

It may further an understanding of our portfolio positioning to discuss what we don't own, for example, REITS, utilities and consumer staples. Simply, we do not believe that the stock of the typical company in these sectors will offer reasonable risk-adjusted returns over the next decade, given a combination of current valuation and prospective growth.

Proctor & Gamble, or P&G, the storied consumer products company, is an example of a company we don't own. Like many consumer staples companies, its moat is still substantial but not what it once was. The result is earnings growth of less than 2% over the past seven years, but its stock inexplicably trades at 20.8x this year's consensus earnings estimates. Nonetheless, your portfolio would have been better off owning it rather than many of its existing positions last year, as P&G delivered a total return of 3.6%. Yet P&G's historic growth rate is lower than the Fund's portfolio companies, which more importantly, trade more inexpensively and offer better growth prospects. P&G is no better nor worse than a number of other consumer staples companies we could have discussed.

We find this illogical. Maybe the valuation disparity is due to expectations for a weaker economy that might allow consumer staples to outperform for a time. Or maybe it is due to passive investing, which makes indiscriminate purchases as a function of inflows. However, if the stock market didn't offer irrational moments, everyone would invest in passive vehicles, and we wouldn't be in business. We prefer our portfolio.

A stock can trade higher or lower than one might expect, but if the underlying business successfully grows over time and generates free cash flow that management then allocates intelligently, said stock should make its shareholders happy over a longer period. We are happy with what we own – happier than we have been in a number of years – and as much as we look forward to looking back, we appreciate where we are in the moment.

Although we have increased the Fund's risk exposure, we still have a lot of capital, about 30%, held in reserve to take advantage of lower prices. To put more capital to work, we require a larger margin of safety than what the market currently offers. Either:

1) the cyclical companies we would like to own must price in attractive returns based on our low case estimates of long-term earnings;
2) shares of the high-quality companies we would like to own, such as P&G, need to decline significantly in price to offer rewarding prospective returns; or,
3) the yield on high-yield bonds needs to increase from a paltry 7% to at least 9% to 10%.

When such attractive valuations might occur, alas, lies beyond our limited capabilities.

DISCLAIMER

[8] https://fpa.com/news-special-commentaries/special-commentaries/2019/01/02/risk-is-where-you're-not-looking

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UK investors should read the Appendix for UK Investors in conjunction with the Fund's Prospectus which are available from the Investment Manager. www.nedgroupinvestments.com.

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Isle of Man investors are not protected by statutory compensation arrangements in respect of the Fund.

The Prospectus of the Fund, the Supplement of its Sub-Funds and the KIIDS are available from the Investment Manager and the Distributor or from its website www.nedgroupinvestments.com

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