NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter One, 2019

For the period ended 31 March 2019

NEDGROUP INVESTMENTS OPPORTUNITY FUND

Performance to 31 March 2019	Nedgroup Investments Opportunity Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	8.2%	5.3%	8.0%
12 months	8.5%	6.5%	5.0%

The Nedgroup Investments Opportunity Fund produced a return of 8.2% for the quarter, in comparison to the peer-group average of 5.3%. Over one year, the fund is up 8.5% p.a. (vs. the peer-group of 6.5% p.a.) and over the past five years, the fund is 6.7% p.a. higher (vs. the peer-group of 5.7% p.a.).

Market commentary

Risk assets posted strong gains in the first quarter of 2019 after a very poor showing in 2018. The recovery was largely led by the FED abruptly changing their tone and turning dovish in the face of market weakness. It would seem that markets cannot deal with rates moving quickly higher, and that central bankers remain intent on keeping markets propped up with cheap money.

The South African equity market delivered a positive performance for the first quarter of 2019, with the JSE All Share Index rising 8%. This was driven by the Resources sector which rose by 18%. In comparison, the JSE Industrial sector returned a more measured +7%, while the JSE Financial Index was flat. Listed property stocks posted a modest 2% gain, but in the context of the strong move in risk asset prices (and last year's 25% drop), this was a relatively poor showing.

Global equity markets, as measured by the MSCI All Country World Index, moved 12% higher over the quarter.

Portfolio commentary

The fund's top five performing positions added 4.6% to returns over the quarter while the bottom five detracted 0.7%.

Winners	Ave.weight	Performance contribution	Losers	Ave.weight	Performance Contribution
Impala convertible bond	4.0%	2.2%	Sappi Ltd	1.6%	- 0.3%
Naspers	9.4%	1.1%	WBHO	0.6%	- 0.1%
British American Tobacco	2.1%	0.7%	Comair Ltd	0.8%	- 0.1%
Eurostoxx note 1	1.6%	0.3%	EPE Capital	0.8%	- 0.1%
Eurostoxx note 2	1.3%	0.3%	KAP Industrial	0.8%	- 0.1%
		4.6%			**-0.7%**

The fund benefited from its healthy allocation to risk assets. You may recall from the Q4 2018 commentary that we increased our domestic equity allocation during the course of 2018, and our global equity allocation in Q4 2018 as markets sold off aggressively. We ended 2018 with more equity than we started the year with despite markets ending lower. This aided performance as markets recovered strongly in the first quarter of 2019.

At an individual stock level, our holding in the Impala Convertible Bond was the largest contributor to performance. This bond was up 62% in the first quarter (contributing 2.2% to the fund's performance) on the back of a very strong run-up in the rand platinum price which pushed the Impala share price materially higher. We were initially attracted to the convertible securities issued by the platinum companies (specifically Impala and Royal Bafokeng) because of the asymmetry of the return profile.

[1] Net return for the Nedgroup Investments Opportunity Fund, A class. Source: Morningstar (monthly data series).

At issue, these five-year instruments paid a coupon of between 6% and 7% p.a. (not too different to cash rates) but gave us the potential to participate in any upside of the underlying companies, without the commensurate exposure to downside. Given that it is notoriously difficult to forecast the platinum price (and currency), this seemed to be the most appropriate part of the capital structure though which to invest in the company.

We continue to hold 8.6% of the fund in a combination of the Impala and Royal Bafokeng convertibles. These instruments have approximately three years to maturity. By our calculations the pay-off profile remains attractive: should the underlying share prices fall materially, we will largely break-even. But should the share prices move strongly higher, we will participate in most of the upside.

Naspers was the second largest contributor to performance for the quarter. The stock was up 30% and contributed 1.1% to the fund's performance. This was on the back of a strong recovery in Tencent's share price as concerns relating to the clamp-down on new games by the regulator started abating. We continue to be constructive on Naspers. Naspers has announced that they will be listing "Newco" (which consists of all the Naspers assets excluding Takealot and Media 24) in the Netherlands. This is expected to result in some index fund buying which could provide further support to the share price. Naspers will be a 75% shareholder in Newco, with 25% of the shares being unbundled to Naspers shareholders. Our concern is that at the Naspers level, the discount could open up even wider due to the introduction of another holding company in the company structure.

British American Tobacco was our third largest contributor to performance. The stock was up nearly 30% over the quarter and contributed 0.7% to the overall performance of the fund. This is in stark contrast to last year, where BTI was one of the larger detractors in the fund, having fallen 40% over the course of 2018.

We commented in the previous quarterly report that we believed the negative sentiment around tobacco stocks was overdone. Although nothing really changed in Q1 (except perhaps for the unexpected resignation of the vocal Scott Gottlieb, the FDA Tobacco Commissioner, who seemed intent on quashing the growth of vaping and eradicating the use of menthol in cigarettes); the degree of negativity waned somewhat as BTI reported steady results and Consumer Staple companies benefited from falling US rates.

Our view remains that for the foreseeable future, this business will continue to grow its hard currency earnings in the mid to high single digits (with a fairly high level of predictability) and will successfully navigate the regulatory headwinds and declining cigarette volumes just as it has done in the past. At the current valuations it remains one of the most attractively priced securities in our universe and we retain a net position of 1.3% (including the impact of options) in the fund. We did, however use the strong bounce in share price to reduce our position in the stock by quarter end.

The largest detractors from performance over Q1 were Sappi (-18%), Wilson Bayly (-14%) and Comair (-12%). In total these three stocks detracted 0.5% from the performance of the fund. Over the quarter our contributors added 9.8% to the funds' performance whilst the detractors detracted only 1.2% in total.

Current positioning and outlook

We believe that despite the recent pick-up in markets, pockets of attractively priced risk assets remain. South African equity is currently valued to produce above average returns, as are Emerging Markets generally. From a purely bottom-up basis, it we aggregate our expected two-year IRR's for all the companies on the JSE we research, our expected returns for the market overall is in the region of 15% p.a. for the next two years.

It is interesting that South Africa's rating relative to Emerging Markets (EM's) is as low as it has been for many years on the back of continued under-performance of South African equities. The forward PE multiple of the South African market (adjusted for Naspers) is now in line with that of the EM peer-group. This is despite the fact that South African-listed companies have less leverage (lower risk) and higher margins than their EM counterparts. Another interesting observation is that SA is the most under-owned emerging market by EM fund managers. This should bode well for future returns should a favourable election outcome be achieved in May.

Developed market equities are somewhat expensive, but we still expect them to deliver positive returns over the next few years.

We currently retain a relatively full equity allocation in the fund but do have a few single-stock and index hedges in place to try and mitigate some of the downside risk.

We continue to find value in certain hybrid and high yielding instruments. A full 10% of the fund is allocated to such instruments, which have a weighted average yield of 11% p.a. With just a modest re-rating, these holdings afford us the possibility of earning equity-like returns but with substantially lower risk due to our preferential position within the capital structure. Examples include the PSG Preference Shares (11% yield) and Zambezi Preference Shares (13% yield).

We have a fairly low allocation to domestic-listed property as we remain concerned about the fundamentals of this asset class. There remains an over-supply of both office and retail property, and demand looks set to wane further as Edgars reduces their footprint, banks look to reduce their branch networks, and foreign retailers consolidate their offerings. Furthermore, the inexorable rise of on-line shopping is likely to hurt landlords, just as it has in the developed world. Generally, SA listed property companies have high levels of debt, and have been synthetically increasing their yields by disproportionately gearing their offshore properties and under-gearing their local properties. This allows them to pass on the lower cost of funding in the form of apparently higher dividends, but this will ultimately be at the expense of lower growth and higher balance sheet risk.

We view the rand as being broadly fair value. That said, the currency has been volatile which provided us with an opportunity to hedge some of our exposure at higher levels. Our exposure to the basket of Eurostoxx notes provides a very attractive asymmetric risk return pay-off profile should global markets continue to rally. The basket is not trading far above the capital protection levels which should cushion some of the downside should markets turn around.

We believe that although the portfolio has a high allocation to equity and other risk assets, it is sensibly constructed and well diversified. The portfolio is designed to perform reasonably in most foreseeable scenarios rather than spectacularly under certain conditions and dismally under others. There are a broad range of diversified risk premia that are influenced by different factors, which should provide some implicit protection. Our explicit hedges should also help reduce some of the downside should that scenario eventuate.

We thank investors for their continued support.

DISCLAIMER

WHO WE ARE
Nedgroup Collective Investments (RF) Proprietary Limited, is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust funds. It is a member of the Association of Savings & Investment South Africa (ASISA).

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Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

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For the Nedgroup Investments Bravata World Wide Flexible Fund it is calculated monthly as a percentage (the sharing rate) of outperformance relative to the fund's benchmark, with the high watermark principle applying. All performance fees are capped per fund over a rolling 12-month period. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

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