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# NEDGROUP INVESTMENTS RAINMAKER FUND

## Quarter One, 2019

For the period ended 31 March 2019

| Performance to 31 March 2019 | Nedgroup Investments Rainmaker Fund[1] | ASISA category average | FTSE/JSE ALSI |
|---|---|---|---|
| 3 months | +5.1% | +5.8% | +8.0% |
| 12 months | -4.5% | +1.0% | +5.0% |

**Market commentary**

After a challenging 2018, the first quarter of 2019 has brought some reprieve for emerging markets, including South Africa. This has been driven by a softening Fed stance, a possible US-China trade truce, and the reducing likelihood of a no-deal Brexit.

The South African equity market delivered a positive performance for the first quarter of 2019, with the JSE All Share Index rising by +8.0%. This was underpinned by the Resources sector which rose by +17.8%, driven hardest by the Platinum Sector (+49.7%) as palladium rocketed from $1250 to $1600 an ounce. The rise was further supported by Industrial Metals as Iron Ore (US$65 to US$85 per ton) was boosted by the regulatory closure of several mines in Brazil following a tragic tailings dam breach which claimed nearly 300 lives. In comparison, the JSE Industrial sector returned a much more measured +7.4%, while the JSE Financial Index declined by -0.4%.

In comparison the Nedgroup Investments Rainmaker Fund returned +5.1% for the quarter.

**Portfolio commentary**

As represented in the table below, the fund's top five performing positions for the quarter added +6.7% to our return, while the bottom five detracted -1.8%.

| Winners | Ave.weight | Total Return | Performance contribution | Losers | Ave.weight | Total Return | Performance Contribution |
|---|---|---|---|---|---|---|---|
| Naspers | 14.3% | 18.8% | 2.55% | Truworths | 2.1% | -18.5% | -0.44% |
| BAT | 6.4% | 29.5% | 1.79% | Vodacom | 2.3% | -15.6% | -0.39% |
| BHP Group | 4.8% | 22.9% | 1.01% | Mr Price | 1.3% | -23.0% | -0.36% |
| Anglos | 4.5% | 22.1% | 0.95% | Sappi | 1.8% | -15.9% | -0.32% |
| Sasol | 6.0% | 7.4% | 0.42% | AVI | 2.5% | -11.2% | -0.31% |
| | | | **6.72 %** | | | | **-1.81%** |

Naspers and British American Tobacco (BAT) were the strongest contributors to performance in the first quarter of 2019. This marks a pleasing reversal of fortunes following a difficult Q4 2018 for both shares.

In the fourth quarter of 2018 report we commented extensively on the fund's exposure to British American Tobacco, the negative impact caused by exposure to the stock during that quarter, as well as our investment assessment of the company. In the first quarter of 2019, the BAT share price bounced back strongly from an extremely under-valued position as the market's extremely negative view on a variety of issues was moderated by a variety of new data points; which included:

- The company reported financial results to end December 2018 which beat the market's expectations for growth and demonstrated their ability and commitment to the pay down of their debt levels from the current elevated post-Reynolds minority take-out position.
- At an Investor Day held in London in mid-March 2019 (also attended by Abax Investments) the company showcased its broad-based approach to the provision of nicotine delivery to consumers regardless of their preferred conduit, and agnostic of the demographic and cultural preference which vary widely around the world. In addition, the

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

successor CEO and CFO conveyed a very confident message of the firm's ability to continue to grow despite the well-known headwinds facing elements of their business and meet their debt repayment obligations.

- The FDA Tobacco Commissioner in the US (Scott Gottlieb) who had conducted an extremely public and vociferous campaign against the growth of vapour use amongst American youth in the last two years, as well as more recently and controversially started to mount a campaign against the use of menthol in traditional cigarettes, resigned suddenly and unexpectedly. It is expected that his successor is unlikely to adopt as aggressively confrontational an approach.

- The rapid growth of a competitor's vapour product in the US was curtailed in part by the actions taken by the FDA in the fourth quarter of 2018, but also through the acceleration in sales of BAT's newly launched competitor vapour product – Alto.

While the bounce in the first quarter has come as a welcome relief, we acknowledge that many of the concerns that came to the fore in 2018 are still relevant. We will manage this position actively in client portfolios and have adjusted some of our valuation metrics to take these issues into account.

The fund's exposure to Naspers was the single largest contributor to performance in the quarter as its primary asset (Tencent) recovered from the weakness it experienced in the fourth quarter of 2018 because of Chinese regulatory pressure on their gaming business and the markets concerns about the impact that would have on the firm's future growth prospects. Although volatile, the rand ended the quarter in a similar position to where it started, so the currency did not have any impact.

In addition, as the firm's management continue to evaluate the overall corporate structure as part of their ongoing management of the portfolio of media and on-line assets that the firm owns, their South African and African pay television business – Multichoice – was unbundled to Naspers shareholders. We support this decision and are confident that the direct exposure will drive better financial performance from this asset, and we are especially excited about the prospects should the African business be able to return to the levels of profitability it has been able to report in the past. This substantial part of the business is currently loss-making due to the investments being made in adding subscribers and subsidisation of content, but we believe will provide a material boost to profits should management be able to deliver on their planned strategies to restore profitability. We will be following their progress closely.

In late March 2019, the firm also announced its intention to create and list a new company, which will own 75% of its interests in its non-South African online assets (as well as the balance of the cash proceeds of the Tencent shares sold in 2018), on both the JSE and Amsterdam stock exchanges. While we applaud management's commitment to review the firm's structure and active engagement to address the huge value trapped in the firm's corporate structure, we have little confidence that the proposed action will address this and are concerned that it may in fact exacerbate the problem. We have not had the opportunity to discuss the proposal with the management team yet but will be doing so shortly. The proposal will in any case require shareholder approval.

**Environmental, Social and Governance (ESG)**

As custodians of our clients' capital, we are focused on the long-term growth prospects of the assets in which we invest. We endeavor to invest in businesses that exhibit robust corporate governance, quality management, sustainable business models, and the potential for solid growth in earnings and dividends over an extended period. To this end, ESG matters are integrated into our investment analysis to strengthen the decision-making process, better manage risk and ensure that investments generate long-term value in an ethical manner.

It is normal practice for us to approach both executive and non-executive management to discuss contentious issues or material ESG matters. This was no different in the first quarter of 2019, where we had robust engagements with several corporates including Sasol, Nedbank, BHP Group and FirstRand. We often own large stakes in investee companies (on behalf of our clients) and it is of the utmost importance that we vote on these stakes with the aim to influence management. We view proxy voting as an integral part of the investment process because the way we exercise our rights can strengthen corporate governance significantly and enhance shareholder value.

**Current positioning and outlook**

Twenty-five years into democracy, our country is faltering economically under the weight of corruption and institutional failure.

While the citizens of South Africa daily learn (through the various current commissions of inquiry) of fresh acts of corruption and theft inflicted on tax payers by our elected politicians and their deployed cadres in the state institutions, municipalities, and state-owned enterprises, the May 8th election date draws inexorably closer. The political alternatives presented on the ballot papers are an unappealing collection of self-serving unfulfillable promise-mongers, and we consider it naïve to expect



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a dramatic reversal in economic fortunes for the country post the inevitable ANC victory. Despite the very supportive effect on the economy of strong commodity prices, business and consumer confidence languish at decade low levels, and state expenditure remains directed at consumption and salary expenditure rather than capital investment. Cyril Ramaphosa's executive authority appears curtailed by the divisions within the ANC where the corruption agenda seems to still enjoy a considerable support base. We expect to see some improvement through a reduced and reallocated spread of ministerial responsibilities post the election, but also expect the disappointment of the inevitable political compromise.

Inconsistent power supply (load-shedding) is exacerbating the challenging political backdrop and lackluster economic environment. The risk of repeated and prolonged electricity supply disruptions represents a key downside risk to South Africa's growth outlook.

Despite the adverse context, Moody's, the only major rating agency that still awards South Africa an investment grade rating, has kept the country's credit rating and outlook unchanged. South Africa's sovereign credit rating remains important for the country, and if a downgrade were to materialise we anticipate capital outflows as well as pressure on the rand.

In the context of the above, an optimistic forecast would be a gradual and faltering economic recovery as institutional capacity is slowly rebuilt, South Africa's balance sheet starts to mend, and as consumer and business confidence improves. In this scenario, the portfolio remains defensively positioned with a preference for larger businesses that can withstand the low growth operating environment. Naspers, British American Tobacco and FirstRand are good examples, and these businesses remain core holdings within the fund. We also remain alert for opportunities and attuned to changing conditions. In this context, we have used recent share price weakness to add to our financials exposure given extremely attractive valuations (dividend yields >5%).

The portfolio currently trades on a forward rolling Price/Earnings (P/E) ratio of 12.2x and a dividend yield of 4.2%.

## 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).

OUR TRUSTEE
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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.

FEES
Certain Nedgroup Investments unit trust funds apply a performance fee. For the Nedgroup Investments Flexible Income Fund and Nedgroup Investments Stable Fund, it is calculated daily as a percentage (the sharing rate) of total positive performance, with the high watermark principle applying.

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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