see money differently

NEDGROUP INVESTMENTS BRAVATA WORLDWIDE FLEXIBLE FUND

Quarter Two, 2019

For the period ended 30 June 2019

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MARKET OVERVIEW

Over the last few months we have had the opportunity to travel. In May we attended the annual Berkshire Hathaway AGM in Omaha where we met with fellow fund managers from across the globe and shared our thoughts on the investment markets. This was followed by a trip to New York to visit companies and fund managers. A few weeks later our team attended a consumer conference in Paris. Below are a few of the themes which may be of interest to our investors:

- It is certainly getting harder to make money out of listed stocks today than ever before. Global interest rates are again trending lower and the total amount of stocks available has halved as companies have either merged, been acquired or been taken private. Companies are spending more money on buybacks and less on productive assets. Top line growth is hard to come by and margins are at record highs.
- The concerns we expressed in the past about potential trade wars and their side effects are now becoming a reality. The political systems in the US, UK and Europe continue to create uncertainty - something markets never like.
- The risk of cyber-crime is on the rise. A major bank CFO we visited recently considered this to be the first and foremost threat to his operations. Not far behind this were concerns about the increased costs of compliance and regulation. We suspect that the increase in capital requirements mean that banks have never been safer for depositors but that the high returns on equity they achieved in the past are unlikely to be repeated.
- The US Fed has started to communicate a dovish view on rates as we head into the US elections next year. If these interest rate cuts do not materialise, equity valuations are too high.
- We see very little to provide us with comfort in the markets as we attempt to find new investments. We suspect that overall, the best opportunities lie in small caps around the world as they escape the attention of ETF's, benchmark-huggers and momentum investors. One of the few markets with low valuations is South Africa, but it remains very difficult to envisage what will restore confidence to consumers and companies allowing them to invest for the future. Pessimism is rife as the stewards of the country, mainly the South African government, appear to be unqualified and helpless to take the tough decisions to create the appropriate environment for growth in the economy.

In light of the above, our view is that the most intelligent approach is to invest in companies that have reasonable balance sheets, valuations on our side, and products and services we understand. Around the globe we will have to invest cautiously in assets we understand and that will be able to withstand any kind of shock that will be thrown at the managers of those assets.

During our annual pilgrimage to Omaha to attend the Berkshire Hathaway AGM, we were privileged to spend time with some of the most intelligent fund managers in the world. This year reinforced lessons of past AGMs:

- It is not possible to predict the future.
- Having a simple investment plan is useful and if we consistently apply it, we will do reasonably well.
- Time and time again I am pleasantly surprised at the positive feedback we get on how we do things at Aylett & Co. What we do works, the trick is to keep it that way and not to feel the short-term pressure markets place on us to change our thinking.

PORTFOLIO

The following table shows the 5 biggest contributors and detractors in the fund for the 6 months ended 30 June 2019:

31 December 2018 - 30 June 2019	
Share	**Contribution (%)***
Transaction Capital	1.0
Royal Bafokeng Platinum	0.9
Grivalia Properties	0.7
IBM	0.7
MTN Group	0.6
USD Cash	-0.1
Bowler Metcalf	-0.2
BNY Mellon	-0.3
Tsogo Sun Holdings	-0.3
Omnia Holdings	-0.5

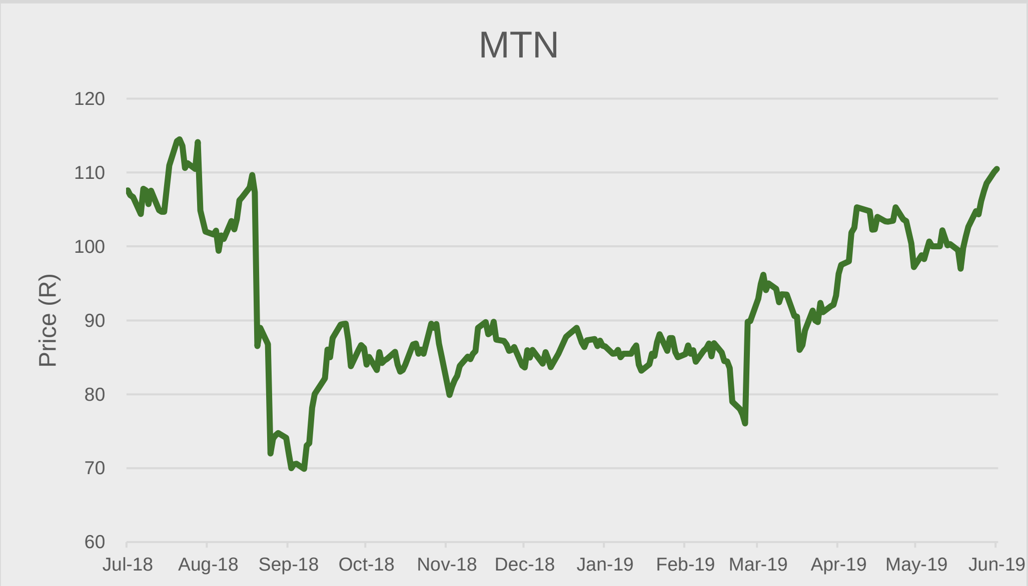
**Figures are not exact but do give good estimates of the relative contribution of the underlying securities.*
Source: *Bloomberg, 30 June 2019*

Below we share a few ideas which have worked for us. These illustrate the type of investments, and strategies, that not only fit into our thinking but protect us from the unknown. We also discuss an investment that hasn't worked for us.

MTN

During a recent due diligence on our funds, we were asked why we bothered with MTN. While not normally the type of company we would consider owning in Bravata, we felt that by the middle of last year the share price was discounting far too much pessimism. We have written in the past about MTN and our readers are encouraged to read the past commentary to provide the background to our thinking.

We took advantage of a number of buying opportunities into the falling price, capturing the fairly substantial dividend. This, together with writing several put options on the counter, was able to produce a return of 26% over 10 months.



Source: *Bloomberg, 30 June 2019*

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Although we believe there is further upside in MTN, we recently exited the position in the fund. In Bravata, which has the pick of a worldwide universe to choose from, it made sense to exit the company.

We are not great believers in trading in and out of shares, but occasionally we are able to produce profits from short-term opportunities. In this case, we were able to sell MTN and placed the proceeds into the fixed interest market, earning an additional annualised return of 8% until we can invest the proceeds into the next new idea.

Grivalia Properties and Jumbo S.A.

On numerous occasions in the past we have reported how pessimism favours the investor. With this as background, we purchased two shares on the Greek stock market that proved to be very profitable: Grivalia Properties (Greece's largest property REIT) and Jumbo S.A. (a very successful retailer of mainly toys and family products). After the GFC, Grivalia got rid of smaller assets and continued to not only purchase brand new properties at prices of 50% of replacement value, but to buy back its own shares. Jumbo on the other hand went about its business as if no crisis had occurred, with the main objective of leveraging its brand and their product offerings. Grivalia has recently been acquired and delisted by Eurobank Group, and Jumbo reached a value we felt was full and we exited the position. Both investments produced pleasing returns, but in hindsight we failed in that we did not buy enough of these companies. The total return in euros for Grivalia over the 4 years and 3 months holding period was 77% and for Jumbo over the 8-month holding period was 39%.

Below are graphs of the share prices (EUR) of the two investments:

** EuroBank Group acquired Grivalia Properties effective 20 May 2019 and as such our Grivalia shares were converted to Eurobank shares*
Source: *Bloomberg, 30 June 2019*

Source: *Bloomberg, 30 June 2019*

Omnia

From time-to-time we make mistakes, and unfortunately, we need to report back on an investment that has led to some permanent loss of capital. So, what went wrong?

Omnia is in a difficult situation and comprises 0.37% of the portfolio. It is a cyclical group with operations primarily in fertilisers and explosives. Omnia has historically managed both of these businesses very well, having grown them organically into dominant positions in their industries. However, both businesses require significant investments in working capital, requiring large amounts of cash as they grow. This, combined with two poorly timed acquisitions, raised gearing levels.

Under "normal" conditions, this gearing was not high and could have been paid back relatively quickly. However, in 2019, both fertilisers and explosives have suffered from particularly severe conditions simultaneously, resulting in an earnings meltdown with which the banks are clearly not comfortable. As a result, the funders have forced Omnia to announce a R2bn rights issue. Raising that amount of capital will destroy any hope of the share price recovering to past levels.

Unfortunately, Omnia were poor in their market communication in this regard, having first issued a SENS (market announcement) reassuring investors that they would not require a rights issue, and then shortly thereafter reversing tack and announcing a large capital raise. In addition, it is never wise to announce an intended rights issue without complete details on price, shares to be issued and underwriting terms.

Our view remains that Omnia's divisions are valuable businesses through the cycle, and clearly worth more than they are currently valued. However, this recent reminder of their earnings volatility means the market is unlikely to re-rate Omnia back to past levels.

OUTLOOK

There are similarities between our experiences in the Greek markets and what South African investors are currently going through. Pessimism abounds, and it is only the optimistic investor salivating at the low prices of local equities. Just like when we invested in Greece, we don't know what the catalyst will be to the market recognising that our shares are too cheap. We suspect that in time to come we may look back at this as an ideal opportunity to have invested in local stocks.

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

The Standard Bank of South Africa Limited is the registered trustee.
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PERFORMANCE

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Certain unit trust funds may be subject to currency fluctuations due to its international exposure. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital.

PRICING

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.

DISCLAIMER

Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Nedgroup Investments has the right to close unit trust funds to new investors in order to manage it more efficiently. For further additional information on the fund, including but not limited to, brochures, application forms and the annual report please contact Nedgroup Investments.

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