NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS PROPERTY FUND

Quarter Two, 2019

For the period ended 30 June 2019

NEDGROUP INVESTMENTS PROPERTY FUND

Performance to 30 June 2019	Nedgroup Investments Property Fund[1]	ASISA category average	SAPY
3 months	-2.5%	2.3%	4.5%
12 months	-23.9%	-1.9%	0.8%

Market Commentary

During the second quarter of 2019, South Africa's listed property sector drifted higher as investors digested the outcome of South Africa's national elections and the appointment of President Cyril Ramaphosa's first cabinet. While both outcomes were viewed as positive, they were overshadowed by the release of South Africa's first quarter GDP numbers, which printed significantly below market expectations. The impact of regular stage 4 load-shedding and low levels of business and consumer confidence contributed to the 3.2% decline in South Africa's GDP (quarter-on-quarter, seasonally-adjusted and annualised).

Against this backdrop of a contracting economy and record low levels of business and investor confidence, several listed property companies reported results below market expectations or warned that property fundamentals had continued to deteriorate (higher vacancy rates and lower market rentals) and near-term distribution growth rates were likely to be lower than current consensus estimates. On a weighted-average basis, distribution growth for South Africa's REITs slowed to 1.7% in the second quarter, the lowest level of growth since the second quarter of 2004.

During the quarter, both Delta Property Fund and Rebosis Property Fund retained earnings (and lowered their dividends) to shore up their balance sheets and have cash on hand to fund the tenant installation (TI) allowances that will arise when their government leases are renewed. Given the recent changes at the Department of Public Works (DPW), including the appointment of Patricia de Lille as Minister of the department, both companies anticipate that all outstanding government leases will be renewed in the short term.

Portfolio Commentary

The Nedgroup Investments Property Fund underperformed the FTSE/JSE SA Listed Property (SAPY) Index in the second quarter as investors continued to reduce exposure to the listed property sector generally and to those companies with predominantly South African exposure specifically. While trading volumes have been below average, there has been persistent selling of several of the smaller and medium-sized property companies, despite their high initial income yields and deep discounts to net asset value.

Delta's share price registered strong gains during the quarter after the company announced that 37 of the 59 leases that form part of the bulk renewal process with DPW have been signed for periods of between three years and five years, with average escalations of 6.5% per annum. Of the remaining 22 leases still under negotiation, 4 leases total 96,500m^2 and management remain confident those leases will be signed before the end of July. Following the signing of these leases, Delta's longer weighted average lease expiry profile will allow the company to re-negotiate its loan facilities and reduce its cost of debt.

Rebosis' share price continued to tumble, despite the company announcing the sale of three retail properties to Vukile Property Fund for approximately R1.8 billion. Rebosis is also expected to announce the sale of a further two retail centres for R3.2 billion. The sales, if concluded, would substantially reduce the company's gearing and restore investor confidence.

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

The second quarter distribution was lower than expected after both Delta and Rebosis reduced their dividends during the quarter. For the year, distributions are forecast to reduce by between 15% and 20%, with the lower dividends from Delta and Rebosis primarily responsible for the revised forecast. The repositioning of the portfolio into property companies with stronger fundamentals, like Spear and Stor-Age, has also contributed to the lower guidance. These businesses are currently trading on forward income yields substantially below the sector average but offer the prospect of higher distribution growth over the medium-term. In line with the fund's objectives of providing a high level of initial income (the one-year forward yield is still in excess of 13%) and inflation-beating distribution growth, the short-term dilution will lead to higher distributions and distribution growth in future years.

Top 5 winners and losers for Q2 2019:

Winners	Ave.weight	Performance contribution	Losers	Ave.weight	Performance Contribution
Accelerate	9.3%	1.08%	Rebosis	2.2%	-2.14%
Delta	5.3%	1.02%	Indluplace	7.2%	-1.84%
Stor-Age	8.3%	0.88%	Dipula-B	7.1%	-0.85%
Spear	3.6%	0.35%	Safari	5.5%	-0.57%
Equites	2.4%	0.31%	GRIT	6.3%	-0.48%
		3.64%			**-5.88%**

Current positioning and outlook

Although the fund's positioning has changed somewhat over the past nine months, with the introduction of Spear and Stor-Age and significantly upweighted positions in Fairvest and Vukile, it is still dominated by smaller and medium-sized listed property companies that trade on extremely attractive forward income yields and steep discounts to net asset value. The share prices of these companies are likely to benefit from easier monetary policy and some sector consolidation.

Economists currently forecast a 25-basis point cut in official interest rates in South Africa in July, with two more cuts forecast over the next 12 months. The South African listed property sector has always responded to a change in the direction of official interest rates, rising substantially over the next three months when interest rates are cut for the first time following a period of interest rate hikes.

Sector consolidation is likely to gather momentum following several announcements in the second quarter. Farivest and Safari and Arrowhead and Gemgrow have announced potential mergers, while Emira said it had sent an offer to the board of SA Corporate at a 25% premium to SA Corporate's share price. Sector consolidation typically occurs when prices in the sector trough and investor sentiment is at its lowest point.

Property fundamentals are expected to remain weak throughout 2019 and at least the first half of 2020, but these weak fundamentals are fully captured in current prices, which have fallen well below the value of the property portfolios they represent. At the same time, the sector has begun to address the governance shortcomings that have weighed on investor perceptions and which were exposed at the Resilient group of companies at the start of last year. Balance sheets, where possible, are being strengthened and most companies have stopped distributing once-off and non-sustainable income, preferring instead to invest those cash flows back into their portfolios for future rental growth.

Based on a combination of forecasts from IRESS, FactSet, Bloomberg and Bridge Fund Managers, and considering the lower dividends from Delta and Rebosis, the current one-year forward income yield on the portfolio is 13.5%. The manager's view is that investors are therefore being fully compensated for the risks in the South African property market which have been exacerbated by the slowdown in economic activity and the resulting deterioration in investor, business and consumer confidence. After falling in 2019, distributions are now expected to grow by between 3% and 5% per annum in both 2020 and 2021, with growth expected to accelerate above inflation beyond 2021. Investors in the und can therefore enjoy an extremely high initial income yield, with the prospect of inflation-beating growth in that income stream over the medium and long term.

The fund is therefore ideally suited to investors drawing an income in retirement and wanting that income to maintain its purchasing power (i.e. grow at or above inflation) throughout their retirement, irrespective of the number of years they spend in retirement. Importantly, the fund is also suited to investors looking to maximise the income-producing potential of their retirement savings in the years leading up to retirement. South African REITs are exempted from all forms of taxation, with the tax burden borne by the REIT's shareholders. If the shareholder is also exempted from all forms of taxation, like a provident fund, preservation fund, retirement annuity or tax-free savings plan, then the shareholder is able to maximise the impact of compounding a high and growing income stream through time.

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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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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