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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Two, 2019

For the period ended 30 June 2019

Performance to 30 June 2019	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	+0.4%	+1.6%	+3.9%
12 months	-3.6%	+1.5%	+4.4%

Market Commentary

The second quarter of 2019 proved to be volatile. Markets fell sharply in May (JSE ALSI -4.8%) as the US-China trade war escalated. However, SA equities staged a recovery in June (JSE ALSI +4.8%) given the US-China trade 'ceasefire' as well as the prospect of further stimulus by the world's primary central banks.

For the quarter, the JSE Mid Cap Index achieved a total return of +1.5% while the Small Cap Index returned 1.8%. Financials (+5.4%) was the leading sector, followed by Industrials (+4.0%) and Resources (+2.4%). Gold shares performed particularly well for the quarter (+29.6%), benefiting from a higher gold price that is being buoyed by lower global interest rates and rising geopolitical tensions (US and Iran).

The rand traded in a broad range versus the US dollar, but closed 2.5% stronger over the quarter, appreciating to R14.08 at the end of June.

Domestically, the May 8th national election was a much anticipated market event and the ANC victory with 57% of the vote is considered a market-friendly outcome, and broadly in line with analyst expectations. Much of the focus leading up to the elections was whether the result would provide Mr. Ramaphosa with a strong mandate to address corruption, state capture, and introduce structural reforms that can lift economic growth. And whether South Africans could look forward to seeing harder evidence of delivery. While we recognise that the wheels of politics move frustratingly slowly, we are underwhelmed by the lack of progress on several fronts. Recent developments including statements regarding the ownership and mandate of the SARB, questionable appointments to head portfolio committees in parliament (such as Mosebenzi Zwane and Faith Muthambi) and the Public Protector, Busisiwe Mkhwebane's priorities in relation to her investigations into the President and Minister of Public Enterprises, Pravin Gordhan. While we see no progress regarding prosecution of many other crimes that have been publicly exposed by demonstrably more corrupt members of the ANC, these are undermining any confidence in the ANC's promised turnaround.

Investors are looking for signs of policy coordination, joint purpose and a willingness to execute structural reforms. Unfortunately, for the time being, these remain absent.

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

Portfolio Commentary:

The fund's top five performing positions for the quarter added +2.25% to our return while the bottom five detracted -3.22%.

Winners	Ave.weight	Total Return	Performance contribution	Losers	Ave.weight	Total Return	Performance Contribution
FirstRand	5.7%	11.2%	0.60%	Sasol	5.5%	-22.2%	-1.33%
Std Bank	6.6%	9.1%	0.55%	BAT	6.4%	-15.8%	-1.09%
Naspers	2.0%	2.6%	0.39%	KAP	1.5%	-20.5%	-0.32%
MTN	2.0%	20.5%	0.36%	Sappi	1.5%	-17.6%	-0.28%
Richemont	2.7%	14.2%	0.35%	Netcare	0.8%	-23.0%	-0.20%
			2.25%				**-3.22%**

The fund's holdings in FirstRand (+11.2%) and Standard Bank (+9.1%) were the primary positive contributors to performance. This was offset by the fund's holdings in Sasol (-22.2%) and British American Tobacco (-15.8%).

During the quarter, Sasol announced substantial cost overruns for its Lake Charles Chemicals Project (LCCP). This update was particularly disappointing given the materiality of the overrun at a very late stage (96% practical completion) in the project. It also follows multiple earlier adjustments to the cost of delivering the project, which have reduced the markets already low opinion of Sasol management and their project delivery capability. In addition, the cost overruns and start-up delays have brought into question the firm's ability to repay the debt incurred on building the plant.

Despite the now further reduced project IRR, the LCCP will contribute meaningfully to earnings and cash flows and, based on our estimates, two-thirds of the forecast EBITDA growth at Sasol over the next five years will come from it. Although the debt will peak at an elevated level, even on reasonably pessimistic chemical and oil price forecasts, we expect this to remain manageable and that a rights offer remains a remote possibility.

From a valuation perspective, the share is cheap, pricing in record levels of skepticism about the quality of management, health of the balance sheet, long-term rand and US dollar oil prices and chemical margins. On an expected 2020 PE of 7x and EV/EBITDA of 5x, these are close to all-time lows. Sasol is also being priced at the lowest P/B (1x) multiple since the end of tariff protection. Consequently, despite it being inherently a low-quality business on our Abax analysis basis, we cannot ignore the attractiveness of the short-term valuation and thus currently have a reasonably heavy 4.3% position in the stock.

On the subject of quality, long-term investors will be aware that a cornerstone to the Abax investment philosophy and portfolio construction process is the focus on a core of high quality businesses. We define high quality as being businesses that are very cash generative, have stable to high degrees of profitability, and where these levels of profitability are defendable and preferably expandable. They have conservative degrees of gearing on their balance sheets and are governed by a shareholder centric, accountable board with experienced management who are appropriately incentivised and remunerated. We do not sit passively on these positions, but rather seek to manage them as dynamically as market conditions allow by adding when, for whatever reason, they become cheaper. While not hesitating to lighten (and even sell out completely) when they become more expensive.

In this context, the gold and platinum mining sectors, which at times combined make up material components of the JSE's mid and small market cap indices, present a challenge to us, because they fail on many of our quality criteria, including, but not limited to the following factors:

1. A primary driver of their revenue are commodity prices (gold, platinum, palladium, and few others) and currency exchange rates all of which are highly unpredictable and often volatile.
2. These businesses are constantly required to invest a significant proportion of their income in capital and exploration expenditure, simply to maintain the volumes of material available to sell. Think of it as a manufacturer constantly having to rebuild a piece of their factory EVERY year to at best produce the same volume of saleable goods.
3. Their ability to produce is conducted in inhospitable locations (deep underground), and reliant on a relatively uneducated (safety, training and negotiation problems) and unwell (HIV and occupational health) manual labour force. Labour is usually unionized with representation by militant, self-serving and politically motivated leaders.
4. The regulatory environment is private sector business unfriendly – South Africa has finally signed our 3rd mining charter in 15 years (the goalposts always move and always in the wrong direction) which inhibits exploration activity or the ability to make long term capital commitments.
5. Local communities, informed by ambitious politically motivated representatives have, and make, unreasonable demands of mining operators.

All the above factors result in the profit streams of these companies being highly volatile and unpredictable. That does not however eliminate them from our research efforts but does mean that it is unlikely that they will ever form a material proportion of our client portfolios. Currently our exposure to them is only 4.3% of the Entrepreneur Fund, while they form substantially more than that of the JSE Mid Cap Index. Typically, these shares either do very well or very badly, and the first half of 2019 has been a period where they have done very well, and thus a primary reason behind the fund's under-performance versus that index over this short-term period.

Current positioning and outlook

The second half of the year promises to be very eventful, with monetary policy a key focus area in the coming months.

In South Africa, Eskom remains a key investor concern, from the perspective of both its fiscal impact and the effect on the broader economy. Addressing Eskom's balance sheet and operational challenges is the most critical test for the new president, and the whole country is watching closely to learn if, or how, it will be addressed.

Lastly, we wanted to assure investors that we are acutely aware of the fund's mediocre performance versus benchmark and most peers, notably over the last 3 years. We appreciate the patience investors have afforded our investment team over this period but have every confidence in our team and the process that we follow, and that our investors faith will be rewarded in the medium term. As co-investors with our clients we have been frustrated and disappointed by the painful lesson we learnt from our Steinhoff exposure in December 2017. The poor short-term performance of certain core positions, which we had expected would act as stable defensive positions in our correctly anticipated weak domestic macro-economic environment (notably British American Tobacco and MediClinic), have had their valuations negatively affected by unexpected regulatory changes and / or in retrospect poor capital investment decisions.

Nonetheless the portfolio continues to be dynamically managed and reflects our strong investment preferences where conviction is high, within appropriate degrees of risk management.

The portfolio currently trades on a forward rolling Price/Earnings (P/E) ratio of 11.9x and a dividend yield of 4.1%.

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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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.

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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.

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