see money differently

NEDGROUP INVESTMENTS STABLE FUND

Quarter Two, 2019

For the period ended 30 June 2019

NEDGROUP INVESTMENTS STABLE FUND

EXECUTIVE SUMMARY

The quarter to June saw the US economy recording its longest period of expansion since 1854 according to the US National Bureau of Economic Research. At 121 months and counting, it is now longer than the 1991–2001 golden era. Despite June's US–China trade détente at the G20 summit in Japan, concern persists that the next downturn still looms. The US Federal Reserve's abrupt January U-turn and decidedly dovish statements during the quarter under review lend support to this thesis, sending US yields sharply lower and the dollar weaker in expectations that the US interest rate hiking cycle may be over.

Safe haven bond investments gained, with more than $12 trillion in sovereign debt trading at negative yields by quarter end. Investors cheered the advent of lower rates and global developed and emerging market bourses rallied through June to recoup May's declines. Meanwhile precious and industrial metals prices gained as geopolitical tensions rose as the US faced off against Iran. But the US yield curve has been inverted for a full month, a traditional bellwether of approaching economic weakness. The portfolio thus remains conservatively positioned. with very sizeable SA cash and bond holdings yielding attractive real rates, portfolio hedges in commodity ETFs and relatively low equity weights.

The rand was buoyed by broad-based dollar weakness, offsetting gains made in the global component of the fund. But negative terms of trade from rising crude oil prices and South Africa's policy vacuum, growing fiscal deficit and looming debt trap are currency negative. We maintain a full weight to foreign assets.

Q2 2019 PERFORMANCE COMMENTS

- The allocation to SA government bonds was the largest contributor to returns whilst SA equities were also positive
- Richemont (+14.7%) and RMB Holdings (+14.0%) rose sharply whilst British American Tobacco (-15.3%) and Sasol (-22.0%) detracted
- The allocation to foreign assets detracted at the margin, mainly due to a stronger rand. Positive returns from First Majestic Silver (+20.2%), FMC Corp (+8.5%) and Allergan (+15.0%) were partially offset by the underweight US and overweight China positioning
- Property detracted at the margin with Stor-Age (+11.1%) and Fortress A (+16.8%) offset by weakness in Capital and Counties (-15.4%)
- The physical Gold (ETF) allocation also contributed positively as the gold price rose

MARKET OVERVIEW

WORLD

- Growth in the world's two largest economies slowed after a surprisingly buoyant first quarter as the US–China trade war escalated – culminating in the US branding Huawei, HIKVision and other Chinese technology businesses national security risks
- President Trump's more conciliatory tone at the G20 meeting renewed hopes of a less confrontational second half with improved growth dynamics forecast – but expectations of a speedy trade resolution should be tempered given the shift in Trump's ire towards European manufacturers
- Global equity markets rose 3.8%, led higher by developed market cyclicals after dovish ECB and Fed commentary ignited expectations of a half-point US interest rate cut this year – but falling earnings expectations amid growing uncertainty over fixed investment, slower employment gains and pedestrian wage growth may scupper appetite for equities
- Geopolitical risks rose after UK Prime Minister Theresa May resigned and Brexit hardliner Boris Johnson emerged as Tory leadership front runner – while Iran's downing of a US surveillance drone, suspected attacks on oil tankers in the Strait of Hormuz and announcement of uranium enrichment exceeding previously agreed limits tested Trump's appetite for conflict
- The Fed kept rates unchanged but signalled its propensity to lower the federal funds target rate amid growing macro risks and slower growth, with outgoing ECB President Draghi promising further policy easing if Eurozone growth falters – fed fund futures indicate a high probability of at least two quarter-point reductions this year, unless employment gains continue and global sentiment improves
- Demand for sovereign debt soared, with Austria successfully placing a 100-year bond at a 1.1% yield and an astounding $12 trillion (that's 12 followed by 12 zeros) of government debt now negative yielding – the US yield curve inverted, with 10-year yields lower than 3-month yields, which suggests a weaker growth outlook and commensurately lower policy rates

- Iron ore prices rose sharply on supply concerns given low inventory levels and new incremental ore volumes slow to respond with Brazilian mines out of commission, but oil retreated on rising inventory levels despite supply responses from US shale producers – the longer-term outlook for commodity prices is skewed to the downside given expectations for weaker global growth, although US dollar weakness may support commodities in the short term
- The gold price rose sharply, responding to lower interest rate expectations and major central bank balance sheet support of developed economies– near-term inflation risks are skewed to the downside, but any central bank policy missteps this late in the cycle may trigger rapidly rising inflation which should continue to support bullion prices

SOUTH AFRICA

- First-quarter GDP growth (-3.2%) contracted the most in a decade as severe electricity load shedding constrained mining and manufacturing output – second-quarter growth should improve but will remain well below levels required to improve revenue collection and government's balance sheet, despite optimistic Treasury forecasts to the contrary
- The rand breached R15/$ on ANC infighting regarding the South African Reserve Bank's independence and the rogue proposal for "quantity easing" (sic) to alleviate government's debt burden, but rallied latterly on broad-based US dollar weakness – poor SA economic growth prospects, rising debt burden and fiscal deficit exceeding 5% for the foreseeable future bodes ill for the rand
- The FTSE/JSE Capped All Share Index rose 4.0%, led higher by financials and industrials, while resources lagged following Sasol's stunning 22% price fall, despite stellar returns from gold and platinum miners and Kumba – interest rate sensitive shares benefitted from falling bond yields, but UK-focused property companies continued to slide amid falling property valuations and high gearing
- The All Bond Index advanced 6.1% (and 9.8% year to date) as government bond yields fell across all maturities, with the R186 gaining most – yet prospects of bond prices rising more is increasingly assured given expectations that SARB will lower the repo rate as soon as July, although MPC hawks will likely veto a deep rate reduction cycle
- Inflation should rise at the margin in the coming months as petrol, water and electricity prices accelerate – however, poor consumption expenditure by households and increasing competition by retailers for consumers' wallets should constrain inflation to the midpoint of the 3-6% inflation target, leaving further scope for future rate cuts

INVESTMENT OUTLOOK

World: Global economic expansion is now late stage with the US economy reaching its longest expansion since 1854. Low interest rates as a result of dovish central banks should be supportive of risk assets. However, geopolitical risks continue to rise and gold could move higher on safe-haven demand. Industrial commodity prices are likely to drift lower in time as the expansion cycle continues to age.

South Africa: Despite a solid election result, the new ANC government's reform momentum appears to be waning. The highly strained public finances keep the rand vulnerable in the medium term. Recessionary economic conditions are likely to continue near term. The inflation outlook is favourable given low domestic demand conditions. Bond yields should move lower as the market anticipates near term repo rate reductions.

CONCLUSION

The fund has an unchanged focus on capital preservation. The late stages of economic cycles are fraught with risk as cyclical companies produce unexpected windfalls, with the illusion of cheap valuations given peak earnings and margins. Falling global interest rates may prolong the equity bull market despite high P:E ratios, given negative real yields on developed market bonds and cash. We therefore retain a balanced weight to equities, with the focus on companies with strong balance sheets and more certain earnings growth prospects.

Within the SA component, the portfolio is conservatively positioned given the weak domestic economy and struggling consumer and the historically-low JSE equity weight thus favours global businesses. This is balanced by a healthy weight in select SA Inc. financial, consumer services and industrial counters, often in niche sectors with greater earnings certainty given the low growth outlook.

Foreign assets are at the prudential maximum with a preference for global equities over bonds and cash – earnings prospects of some global companies offer greater certainty given their supporting long-term structural tailwinds. We continue to avoid SA retail and commercial property counters in the main given the structural challenges facing the sector. The small listed property position is mostly in Capital & Counties and niche counters less correlated to major economic drivers.

The Newgold ETF is an attractive, uncorrelated investment. The risk of central bank policy missteps is increasing as rates are lowered while growth (albeit slower than before) is still positive with employment creation and wage growth relatively stable. The bond allocation has been diversified into slightly longer duration 2030 and 2032 bonds where yields well exceed cash and inflation and lower SA cash rates should flatten the yield curve to the greater benefit of longer duration bonds. The cash allocation is lower due to bond purchases at the margin.

RESPONSIBLE INVESTMENT SUMMARY

Proxy Voting Summary Q2 2019

Resolution Type Name	Total Count	For %	Against %	Abstain %
Adopt Financials	4	100%	0%	0%
Auditor/Risk/Social/Ethics related	8	100%	0%	0%
Buy Back Shares	4	100%	0%	0%
Director Remuneration	5	60%	40%	0%
Dividend Related	1	100%	0%	0%
Issue Shares	1	0%	100%	0%
Loan / Financial Assistance	1	0%	100%	0%
Other	9	89%	11%	0%
Political Expenditure/Donation	1	0%	100%	0%
Re/Elect Director	31	100%	0%	0%
Remuneration Policy	3	67%	33%	0%
Share Option Scheme	1	0%	100%	0%
Shares under Director Control	3	0%	100%	0%

General Comments:

- There are very few abstentions. We apply our minds to every single resolution put to shareholders. When there is an abstention it would typically be intentional or strategic reasons.

- We typically vote against any resolution that could dilute the interests of existing shareholders. Examples include placing shares under the blanket control of Directors, providing loans and financial assistance to associate companies or subsidiaries and blanket authority to issue shares. On the rare occasion, we have voted in favour of such resolutions, we have been able to gain the required conviction in the specifics of the strategic rationale for such activities and have been able to gain comfort that such activities are indeed to be used to the reasons stated.

- The firm also has a strong philosophy regarding management remuneration models. We believe in rewarding good managers with appropriate cash remuneration on achievement of relevant performance metrics that enhance long-term shareholder value. We are generally not in favour of share option schemes given the inherent asymmetry between risk and reward typical of such schemes. In addition, we do not believe that existing shareholders should be diluted by the issuing of new shares to management as is the case with most option schemes. We are in favour of the alignment created between management and shareholders when management has acquired its stake in the company through open market share trading and paid for out of management's own cash earnings.

Standard Bank Climate Change related resolutions:

During Q2 2019, there were two climate change related resolutions put to shareholders for voting at the Standard Bank AGM, which was a first in South Africa. The resolutions were as follows:

1. To report to shareholders on the company's assessment of greenhouse gas emissions resulting from its financing portfolio, and
2. To adopt and publicly disclose a policy on lending to coal-fired power projects and coal mining operations.

A summary of our positioning on this as follows:

- Climate change is a material long-term risk factor that must be considered in a long-term investment management context
- Whilst climate change risk is not explicitly mentioned in the current Regulation 28, PF130 or other directives, the existing broad ambit regarding ESG considerations, provides ample space (indeed compulsion) for asset owners and investment managers to be appropriately seized with the matter.
- Over time, there are likely to be continued regulatory interventions (already emerging globally) as the climate change risk issue specifically continues to become more politically relevant and broadly accepted in the mainstream. As such, the proactive and relatively advanced ESG ecosystem in the South African retirement funding system is well placed and we are fully supportive of its further development.
- We also note however that the issue of investment choice is salient. Pension funds in the developed economies with their much larger investment opportunity sets can afford to be more resolute on applying ESG factors than South African investors, given the country's historic reliance on commodity exports. Exchange control constraints also mean that we must make do with a tiny subset of viable long-term investments.
- We therefore have a pragmatic approach whereby we can still invest in companies that score poorly in terms of environmental impact, but as owners will exert influence over these investee companies' ESG policies and look to see ongoing incremental improvements.
- Regarding the recent Standard Bank climate change related resolutions, we voted in favour of both. Quite simply, from an investor perspective more information enables better investment decision making. Therefore, whilst we might not necessarily proactively propose such a resolution, we will in most instances, vote in favour of one that does. In Standard Bank's case, meaningful lending exposure to companies facing ethical headwinds and potential liabilities and additional regulation does pose incremental business risk, which albeit relatively small, needs to be understood and quantified to the extent possible. Lastly, from an ethical perspective it is positive for investors to demand greater transparency regarding all market players involved in areas which raise environmental concerns.

Notable engagements – Q2 2019

- Mediclinic – The analyst met with the Chair of the Board Remuneration committee to explain the rationale we apply when voting on remuneration schemes in general. In their particular case, the remuneration model relies on EBITDA measures, which we feel is not appropriate in a capital-intensive business.

- Omnia – Met with management regarding the pending capital raising requirement as well as the bank's bridging finance facility. Ongoing discussions are taking place until finalisation of the rights issue.

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
The Standard Bank of South Africa Limited is the registered trustee.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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.

NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT
Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001

WRITE TO US
PO Box 1510, Cape Town, 8000