QUARTERLY REVIEW

NEDGROUP INVESTMENTS CORE ACCELERATED FUND

as at 30 September 2019

See money differently

September provides a glimmer of hope after market weakness in July and August

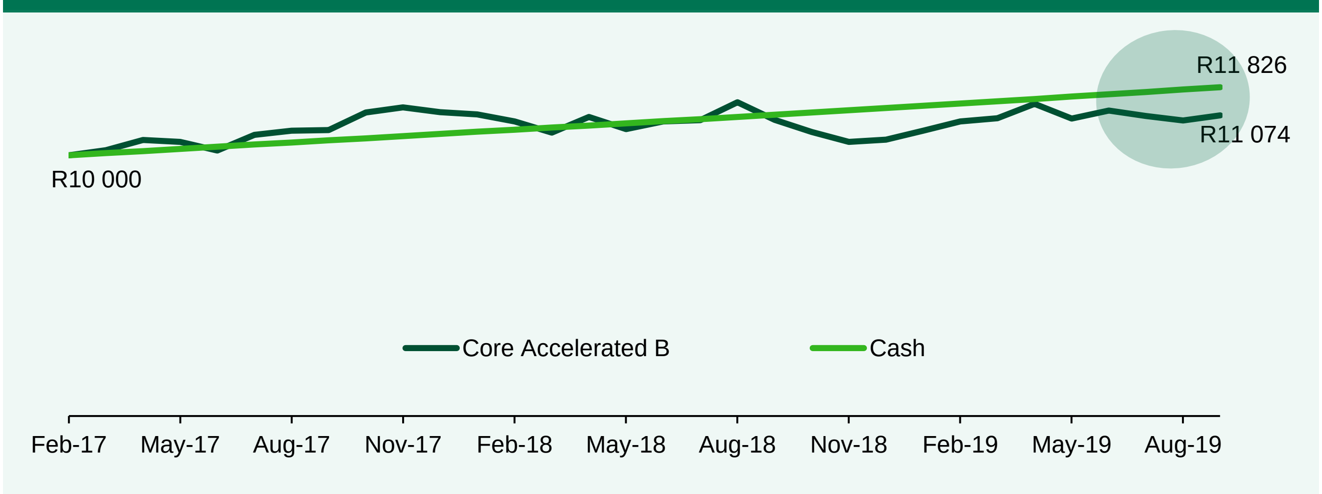
Risk assets once again took a knock this quarter, with SA equity and property yielding negative returns in July and August. However, there was a glimmer of hope, with both asset classes earning a small positive return in September. With SA equities and property down by nearly 4.5% for the quarter, your investment in the Nedgroup Investment Core Accelerated Fund declined by only -1.2% over the quarter, cushioned by positive returns in other asset classes. The Fund return this quarter was slightly negative compared to a positive return of 1.9% observed in the second quarter

The table below compares an investment in Nedgroup Investment Core Accelerated Fund to bank deposits (cash) investment over various time periods. For every R10 000 invested in the Nedgroup Investment Core Accelerated Fund at inception (28 February 2017), you would have R11 074 at the 30th of September 2019. This is a little lower than the R11 826 you would have achieved had you invested your money in bank deposits (cash) over the same period. The green circle in the chart below, highlights the recent market detraction, which helps to contextualise the returns experienced in the past few

Value of R10,000 investment in Nedgroup Investment Core Accelerated Fund versus Cash[1]

	3 Months	1 Year	3 Years	5 Years	7 Years	Inception 28 February 2017
Growth of fund (after fees) ***(Growth in %)***	R9 883 *-1.2%*	R10 109 *1.1%*	-	-	-	R11 074 *4.0% p.a.*
Growth of cash ***(Growth in %)***	R10 162 *1.6%*	R10 664 *6.6%*	R12 160 *6.7% p.a.*	R13 702 *6.5% p.a.*	R15 105 *6.1% p.a.*	R11 826 *6.7% p.a.*

Fund Return versus Cash[1] from inception ending 30 September 2019



The Nedgroup Investment Core Accelerated Fund is designed for investment periods of 7 years and longer as it has a high exposure to shares (90%). This means that it can experience significant fluctuations over shorter periods but in the long-term has a growth target of 6% above inflation (around 12% per year), as demonstrated in the chart above.

The Nedgroup Investment Core Accelerated Fund has fallen short of this target since inception. However, history[2] demonstrates that two-thirds of a fund such as the Nedgroup Investments Core Accelerated Fund would have achieved its long-term growth target of 6% above inflation (around 12% per year) over any 7-year period. In fact, as the time horizon extends, so the risk of underperforming this target decreases.

1. We used the STeFI call deposit rate for cash returns
2. Based on SA market returns from 1960 to 2018 (source Firer 2006) using the same long-term equity allocation and fees.

Markets driven by high levels of uncertainty

Markets reflected the high levels of uncertainty locally and globally this quarter, with some months providing positive returns and others negative.

Locally, the South African business confidence index (compiled by the Bureau for Economic Research) fell to a 20-year low. Four of the five sectors in the survey showed a decline, with only the motor industry indicating a slight improvement in confidence.

Moody's credit ratings agency provided a glimmer of hope as their stable outlook on South Africa remained unchanged. They are the only credit rating agency that continues to classify South African debt as investment grade. However, they raised concerns of rising debt to GDP and no sustainable plan to tackle the burgeoning Eskom debit. It is unlikely that they will downgrade South Africa to junk status in November. Moody's are more likely to first change their outlook to negative before making any downgrade decisions. This buys South Africa time to demonstrate that we are serious about reforms and stimulating economic growth. Should Moody's downgrade South African to junk status, our government bonds will fall out of the Citigroup World Government Bond Index which can put us at risk of foreign capital outflows at a time when foreign investment is desperately needed.

Globally confidence also took a knock, with the US showing a slump in consumer confidence, a slow down in the jobs market and impending calls for Trump to be impeached. Global trade wars continue to make business planning difficult as businesses need to place orders months in advance, without knowing what tariffs they will be paying on imports.

In Europe, revised growth and inflation forecasts for 2019 and 2020 are both down from previous estimates. This together with uncertainty surrounding Brexit, led the European Central bank to cut its deposit rate by 0.10% in September and approve another round of quantitative easing. Even Germany, the powerhouse of Europe, is showing signs of stress with manufacturing activity at a 10-year low and services softening in September.

Governments mask the true state of the global economy

The last few years in South Africa have delivered cash and bond returns well above inflation and their long-term real return. This has provided investors with a safe haven from market turmoil and led to unrealistic future expectations. On the other end of the risk spectrum, South African share returns over the last 5 years have been poor, delivering lower returns than bonds and cash. However, this cannot continue forever and must at some point revert.

In contrast, global shares (in USD) have delivered higher returns than US bonds and cash, as is to be expected. Quantitative easing and extremely low (and even negative) global interest rates have provided large volumes of funding at very cheap rates to businesses. This has driven global share markets.

Most investments in the world, are priced relative to US long dated government bond yields (i.e. the interest rate you would earn on the bond if you held it to maturity). If these US yields drop then yields around the world are likely to drop. The recent US interest rates cuts and the potential for future cuts, are likely to drive global yields down. This would lead to an increase in bond prices and thus returns as bond prices move in the opposite direction to yields. For South Africa, this could mean that even if there is a widening in our credit spread due to a Moody's downgrade, that the absolute interest rate could still go down, driving bond prices and returns up. This could provide some cushion to the impact of a downgrade.

Furthermore, lower interest rates tend to lead to improved share returns as companies are able to obtain funding at lower interest rates. This should help drive share markets in the short term.

That is all very well in the short term, but all this money being pumped into economies around the world by governments is leading to burgeoning debt to GDP ratios. At some point this funding could dry up, which may have serious implications for share and bond markets around the world, leaving investors little place to hide.

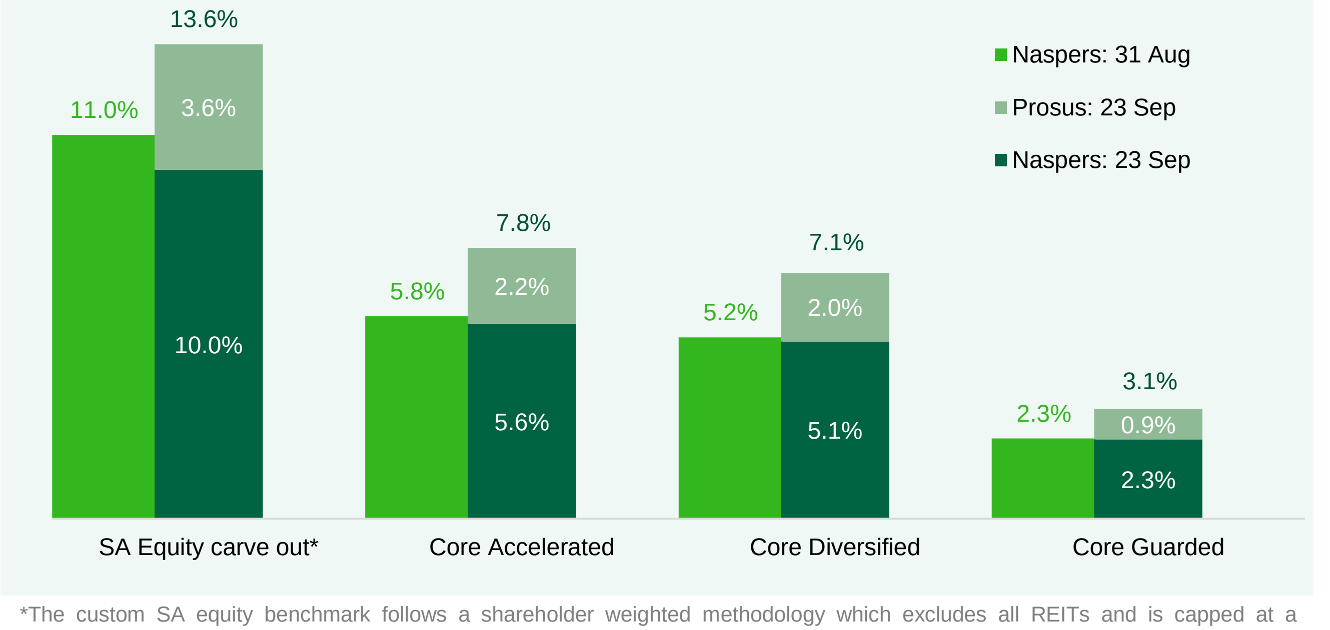
Implications of the unbundling of Naspers for the Nedgroup Investments Core Funds

The past month has seen one of the largest South African Media group (Naspers) unbundled its international online assets, housing these assets in a new company called Prosus. Naspers owns 73% of Prosus, and only around a quarter of its shares are available on the open market. On the 16th of September, Prosus was listed primarily on Euronext in Amsterdam, with a secondary JSE-inward listing to allow SA investors to participate. The primary reason for lifting and shifting Naspers international assets from the JSE to the Euronext exchange was to unlock value by reducing its outsized weight in South African indices which has contributed towards it trading at large discounts. Another reason was the recognition that, Naspers' sprawling group structure, regardless of good disclosure, is likely to drive a large discount.

As an investor in one of the Nedgroup Investments Core Funds, the unbundling did not trigger a taxable event. Capital Gains Tax (CGT) will only be triggered when investors sell their units.

The chart below illustrates the weights in Naspers prior to the unbundling on 31 August 2019 and after the unbundling and quarterly index rebalance on 23 September 2019. As at the 31st of August 2019, the weight of Naspers in each fund was 5.8%, 5.2% and 2.3% in the Core Accelerated, Core Diversified and Core Guarded Funds, respectively. After the index rebalance on the 23rd of September 2019, the Funds had an increased allocation to the Naspers group (Naspers plus Prosus).

Naspers and Prosus weights prior to and after the unbundling in 2019



*The custom SA equity benchmark follows a shareholder weighted methodology which excludes all REITs and is capped at a maximum of 10% per share and rebalanced quarterly

Although Naspers and Prosus are different businesses, they could be viewed as one business from a risk perspective as the Prosus board and governance structure mirrors those of Naspers and Naspers owns a significant stake in Prosus.

In order to mitigate risk, the South African equity indices used in the Nedgroup Investments Core Funds cap the weight of any single stock at 10% at the time of rebalance. Since the combined weight of Naspers and Prosus was expected to exceed 10% in the SA Equity carve out after rebalancing, we reviewed the capping methodology. At this time, we have decided to leave the capping methodology unchanged. However, we will closely monitor the combined weight and if this increases notably, pushing up the risk level, we will revisit the capping methodology.

Celebrating 10 years of market-leading rules-based investing

The Nedgroup Investments Core Diversified Fund celebrated its 10th anniversary on the 31st of August 2019. It was the first multi-asset rules-based (passive) unit trust fund launched in South Africa and set the course for the Nedgroup Investments Core Guarded, Nedgroup Investments Core Global (UCITS), Nedgroup Investments Core Global Feeder and Nedgroup Investments Core Accelerated Funds that were launched over the following years.

The Nedgroup Investments Core Diversified Fund built up an enviable track record over the past 10 years and received the 2015 Morningstar award for the best risk-adjusted performance in the Aggressive Allocation category. It was also the runner up in 2018, illustrating the consistency of the fund's performance. During August 2018 it became the largest rules-based fund in South Africa when it crossed the R10 billion mark. Currently, the fund size is nearly R15 billion making it the 10th largest balanced fund (SA Multi-Asset High Equity category) in South Africa.

The Nedgroup Investments Core Diversified Fund is not the only fund that has enjoyed success in the Core Range. The Nedgroup Investments Core Guarded Fund will reach its 10-year milestone in January 2020 and with over R6 billion in assets making it the 9th largest conservative balanced fund (SA Multi-Asset Low Equity category) in South Africa.

The combined Assets Under Management (AUM) of the Core range reached R32 billion during September, which is around 13 times higher than 5 years ago! This stellar growth would not have been possible without the broad support from clients and partners. There are currently over 2000 financial advisors and over 100 participating employers using the Core Range as investment solutions for their clients/members.

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