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NEDGROUP INVESTMENTS MINING & RESOURCES FUND

Quarter Three, 2019

For the period ended 30 September 2019

Performance to 30 September 2019	Nedgroup Mining & Resources Fund[1]	ASISA SA Equity Resources & Basic Industries
Q3 2019	-2.8%	9.7%
12 month	8.4%	30.4%
YTD	13.7%	27.3%

Market Commentary

A marked escalation in the US-China trade war and further deceleration in global growth, plus the additional uncertainty around the start of efforts to impeach President Trump, kept most global equity returns either flat or in the red in the third quarter of 2019 (Q3). Bond market returns were also subdued as a consequence of the US Federal Reserve's (Fed) perceived unwillingness to lower interest rates sharply – despite its 50bps of cuts during the quarter and easing measures in several other countries as well. Amid the increasingly bearish environment in July and August, investor sentiment turned even more cautious, to the benefit of safe-havens like gold and bonds (the latter to a lesser extent), while emerging markets suffered losses. Only in September was there some relief for equities, with an uptick across most markets as risk appetite improved. However, this wasn't enough to erase the quarter's losses in many markets. For South African investors, local equities posted negative returns, while bonds were only marginally positive, and the rand depreciated notably against all the major currencies for the quarter after having rallied in Q2.

The price of Brent crude oil fell during Q3, starting off July at around US$65 per barrel and ending September at around US$62 per barrel. In between, however, it weakened to near US$60 per barrel on the back of softer global growth and then spiked some 13% to over US$68 per barrel in reaction to the 17 September drone strike on Saudi Arabia's oil production facilities, which impacted over 50% of the oil giant's supply. The spike lasted only a day, as Saudi Arabia reported it would be able to recover most of its production very quickly. However, longer-term concerns remain over the protection of Saudi facilities and rising tensions between Iran and Saudi Arabia. Other commodity prices were mixed, as gold gained 5.8% (up 25% in the past year on its safe-haven status), palladium jumped 10%, platinum rose 11.7% and lead was up 8.9%. However, the prices of aluminium, copper, and zinc were all down between 4-8%.

US-China trade hostilities ramped up significantly during the quarter: from the 1st of September the US imposed new tariffs worth US$112 billion on Chinese goods including clothing, shoes and other basic commodities. China retaliated with a further US$75 billion in tariffs (including on crude oil) and a halt in buying some US agricultural goods. The Fed lowered interest rates by 25bps in both July and September, in the face of the prospective negative impacts of the trade war and slower global growth. However, it downplayed the prospect of further cuts given the still-expansionary local economy. The latest Fed inflation-rate forecasts show no rate changes for the rest of 2019 and 2020, although Fed policymakers were divided in September: 7 members wanted at least one more 25bp cut in 2019 versus 10 advocating against. US GDP growth for the second quarter of 2019 (Q2) surprised positively at 2.0% year-on-year, with wage and inflationary pressures remaining subdued. The rate cuts combined with the risk-averse sentiment and surplus global capital to send the 10-year US Treasury (UST) yield down from around 2.0% at the start of the quarter to a low of 1.5% in early September, before weakening again to around 1.7% at quarter-end.

The UK moved further into a Brexit-related crisis during Q3 as new Prime Minister Johnson's move to suspend Parliament was found to be unlawful by the UK Supreme Court, and Parliament reconvened to pass a measure preventing a no-deal Brexit. With Johnson calling for fresh elections and threatening to ignore Parliament, the

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

foundation of British democratic institutions was challenged. Amid the heightened uncertainty, the pound fell to its lowest level in 12 years against the US dollar and Q2 GDP growth slowed to 1.3% (quarter-on-quarter annualised) versus 2.1% (quarter-on-quarter annualised) in Q1.

In the 19-member Eurozone, growth slowed further as the area's Q2 GDP fell to 1.1% (quarter-on-quarter annualised) from 1.2% previously, impacted significantly by Germany's export-led economy which slumped to 0.4% growth (quarter-on-quarter annualised) versus 0.9% the previous quarter. Germany's September manufacturing PMI dropped to 41.7, its biggest contraction in 10 years. The European Central Bank (ECB) opted to cut interest rates by 10bps to -0.5% (below market expectations of a 20bp cut) and pledged to keep rates at accommodative levels. The ECB also pledged to resume its corporate bond repurchase programme to add stimulus from the first of November. Bond yields across the EU consequently fell further into negative territory. Faced with negative interest rates and relatively high budget deficits in member countries, the EU has little room to add further stimulus should growth falter further. In more positive news, Italy's politicians managed to form a coalition government, and also avoided EU budget deficit sanctions.

In China, 16 consecutive weekends of large and increasingly violent protests in central Hong Kong started to make their impact felt on the island's economy in the form of lost consumer sales and business turnover. Although the Hong Kong government eventually formally withdrew its bill easing extradition conditions to the mainland, residents' protests swelled over concerns about losing their democratic rights. At the same time, Chinese exports continued their decline, impacting China's overall Q2 GDP growth which came in at 6.2% (q/q annualised) the lowest in 27 years. However, subsequent data showed that the government's stimulus (in the form of tax cuts, infrastructure spending, and lower bank reserve requirements) had started to work, as fixed investment, industrial output, and retail sales have all risen more recently.

The news that South Africa's Q2 2019 GDP growth came in at a stronger-than-expected 3.1% quarter-on-quarter (or 0.9% quarter-on-quarter annualised) was widely welcomed, avoiding a technical recession after the first quarter's 3.2% contraction. This helped to lift market sentiment somewhat, but the very low absolute level remained a serious concern. Business confidence fell to a record low of 21 and manufacturing production contracted 1.1% year-on-year in July, down from +3.6% in June. Besides local issues, the economy reflected the deteriorating global conditions, which were negative for emerging markets in general.

Worries about potential further credit rating downgrades and the rising national budget deficit continued to weigh on the local market as well, as the financing requirements for Eskom and other SOEs mounted. Rating agency Fitch downgraded its outlook for South Africa's sovereign rating from stable to negative, while Moody's commented that Eskom's capital structure was "unsustainable". However, Moody's also said there was a "low likelihood" of it downgrading the country at its next review on the first of November, but as analysts pointed out, this was likely due to the stable, rather than negative, outlook it currently has for South Africa's rating.

Among positive developments, Finance Minister Tito Mboweni unveiled a 77-page economic strategy blueprint in August aimed at reversing the country's fall in growth and competitiveness. It was met with generally positive reviews, although many suggested reforms drew on earlier proposals. President Cyril Ramaphosa also appointed an 18-member Economic Advisory Council (EAC) comprised of both local and foreign well-known experts to help develop reform policies, and he reappointed Lesetja Kaganyago to a second five-year term as SARB governor, helping avoid any investor concerns over central bank policy continuity and expertise.

Portfolio Commentary

The fund's top five performing positions added 8.0% to returns over the second quarter while the bottom five detracted 9.7%.

Winners	Ave.weight	Performance contribution	Losers	Ave.weight	Performance Contribution
Impala Platinum	14.0%	4.6%	Sasol	10.7%	-3.4%
Sibanye Gold	5.3%	1.2%	Anglo American	20.6%	-2.4%
Africa Rhodium Debentures	1.5%	0.8%	Exxaro Resources	6.9%	-2.0%
AngloGold Ashanti	5.9%	0.7%	BHP Group	11.7%	-1.0%
Northam	1.7%	0.5%	Sappi	2.5%	-1.0%
		8.0%			-9.7%

Current positioning and outlook

Precious metals have been the outperforming commodities in 2019 and this continued in Q3. The drivers of gold and the platinum group metals are, however, quite different.

Gold is fundamentally a "macro" call, and while there are times to own gold and times to not own gold, the rand-denominated gold price has been a relatively good performer through time for South African investors. Broadly factors that drive outperformance of gold can be characterised as geopolitical (e.g. wars), macroeconomic (stagflation) and financial contagion (e.g. collapse of Lehman Brothers), and the current environment of excessive levels of uncertainty on these fronts is conducive for a position in gold. The window of opportunity for outperformance in gold equities is both narrower but also more substantial than gold bullion; through time gold equities have not been compounders of value as poor capital allocation has led to a de-rating, while production has fallen, costs have risen, and equity dilution has occurred. While the preference and focus of our investment process is to pick stocks on bottom-up analysis, we have responded to the current environment that is conducive for gold, by increasing the exposure to gold equities by switching out of NewGold into Gold Fields and adding to the Pan African Resources position.

In contrast to gold, the platinum group metals have largely responded to a fundamental tightening of the supply and demand, particularly of palladium and rhodium, as mine supply constraints start to take hold after years of weak prices and low investment, and as demand from increased loadings on vehicle emission catalysts ratchets up price inelastic demand. We have added to more geared exposure to the metals by closing the Anglo American Platinum position and trimming the AfricaRhodium ETF and adding to Northam Platinum, Royal Bafokeng Platinum, and Sibanye Gold.

We have also trimmed positions in the general (industrial) mining stocks (African Rainbow Minerals, BHP Group, Glencore, and closing Merafe Resources) to fund the increased position in the precious metals stocks. With the continued lacklustre growth environment, the investment environment remains beholden to policy (trade, fed policy, Brexit), calling for a more balanced position between sectors that respond to global growth vs sectors that serve to protect wealth (safe-havens).

Responsible Investing

During the quarter we continued to engage with Sasol, specifically following a difficult time for the company, with further uncertainties around the execution of the Lake Charles Cracker project. The company has initiated a third party internal review, that looks to shed light on the failure of control processes in the delivery of the project, and also postponed the publishing of its 2019 financial results. While the poor share price performance creates attractive value in the stock, despite material disappointment in the cracker execution, the near-term outlook is weighed down by elevated debt and weak chemical markets; the 2020 financial year will be a critical period.

DISCLAIMER

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