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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Three, 2019

For the period ended 30 September 2019

Performance to 30 September 2019	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	-5.2%	-3.5%	-4.6%
12 months	-6.3%	-1.6%	1.9%

Market Commentary

In the third quarter of 2019, the JSE All Share Index (ALSI) recorded a loss of -4.6%. This compares poorly to quarters one (+8.0%) and two (+3.9%) of 2019. The Industrials index shed -2.5% in the third quarter, while Financials and Resources lost -6.8% and -6.4% respectively. Of the equity sectors, Platinum (+25.8%), Tobacco (+13.7%) and Gold Mining (+12.3%) recorded the strongest returns in Q3 2019. The worst performance came from Chemicals (-25.6%), Household Goods (-24.6%) and Coal (-24.1%).

Over Q3 2019 the rand weakened by 7.5% from R14.08 to R15.14 to the US dollar.

Overall investors remain very bearish on the prospects for the South African economy given the lack of any meaningful policy direction. Policy uncertainty is weighing heavily on business confidence and manufacturing activity in South Africa, as indicated by the PMI manufacturing numbers, remaining trapped below 50 or in contraction! In fact, the ABSA PMI declined to 41.6 points in September 2019 – its worst level in 10 years. Both Consumer and Business Confidence Indices plummeted to multi-decade lows in August. In addition, according to the Reserve Bank's Quarterly Bulletin, the economy entered the 70th month of a weakening cycle in September – and remains trapped in its longest downward cycle since 1945.

In response to the economic challenges and spurred by an internally controversial document produced by National Treasury, the ANC recently announced its plans on how to revive the economy, most of which was included in the National Development Plan of 2011 – something the party has rhetorically committed to year-after-year without ever actually implementing much of. Significantly more urgency is required with the implementation of reforms to stem the economic and fiscal deterioration currently being experienced in the South African economy, however it is clear that local business is not expecting this to occur.

Globally, manufacturing survey numbers show that the trade war is starting to affect confidence. While European and Chinese manufacturing survey numbers have been weak for some time, the US joined this weakness in September. The US Institute for Supply Management (ISM) said its index of national factory activity fell to 47.8, the lowest reading since June 2009. A reading below 50 signals the domestic factory sector is contracting.

[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 +1.9% to our return while the bottom five detracted -3.3%.

Winners	Ave. weight	Total Return	Performance contribution	Losers	Ave. weight	Total Return	Performance Contribution
British American Tobacco	6.5%	13.7%	0.78%	Sasol	4.3%	-27.7%	-1.34%
Anheuser-Busch InBev	2.9%	15.9%	0.43%	Standard Bank	6.1%	-8.9%	-0.58%
Reinet	1.7%	22.3%	0.32%	Anglo American	5.3%	-8.1%	-0.55%
Bidcorp	3.0%	6.0%	0.18%	Sappi	1.1%	-31.6%	-0.40%
Mediclinic	1.4%	13.2%	0.18%	Prosus	4.9%	-8.0%	-0.39%
			1.89%				**-3.25%**

The fund’s best performers were British American Tobacco (+13.7%) and Anheuser-Busch Inbev (+15.9%). This was offset by the fund’s holdings in Sasol (-27.7%) and Standard Bank (-9.0%).

One of the most significant events in the quarter was the spin-off of Prosus from Naspers (Naspers is the largest position within the fund). The listing of all Naspers’ foreign interests and some cash via Prosus in the Netherlands and on the JSE follows the unbundling of MultiChoice earlier in 2019 and is the next step as the board (following significant pressure from shareholders) endeavors to realize the value that has been trapped in the corporate structure for many years.

Naspers trades at a discount of 30-40% to its underlying assets. The main reasons for this discount are:

- Holding companies trade at a discount because of frictional costs and potential unbundling taxes;
- Naspers has become very large in SA stock indices and local shareholders have become perpetual sellers of the share as risk and mandate limits force sales;
- Foreigners are not necessarily natural buyers of the share as they have the option of investing directly in Tencent and hence avoid any potential SA investment risk.

The Prosus transaction removes a technical overhang, lowers friction costs for investors, and the inclusion of Prosus into major developed market indices should create incremental demand from active and passive funds. Over time, the board expects this action will partially address the discount thereby creating value for shareholders. Time will tell, but initial trading in the first month has not validated the decision – which came with advisor fees of $200m!

Abax have pressed the Board for several years to firstly acknowledge (finally achieved at the AGM in August 2018) and finally to evaluate various options to address the discount trapped in the corporate structure. There are infinite options which could be considered to unlock value, each with advantages and disadvantages. When first presented with the Prosus plan, we were highly skeptical of its likelihood of success due to the retained dominance of the Tencent asset (±85% of Net Asset Value). However, guided by an enthusiastic executive management team and board, and following detailed discussions which highlighted several favourable nuances to the transaction, we agreed to support the resolutions to create Prosus.

But investors should be under no illusion – it is still all about Tencent. In that respect, our regular readers will be familiar with the Tencent business as one of the world's largest online entertainment companies with a powerful presence spanning online games, video, music, news, cloud services and payments. It offers attractive exposure to the world's deepest social network WeChat, a platform with over 1.1bn monthly active users. Moreover, Tencent's vast investment portfolio encompasses leading companies across multiple fast-growing industries such as Supercell, Epic Games, Spotify and Tesla.

In addition to the engagement activities with Naspers (regarding Prosus), other notable ESG engagement activities in the quarter included; Sasol (regarding the enormous cost overruns, delays and lack of accountability surrounding the Lake Charles Chemical Project), Old Mutual (regarding the dismissal of Peter Moyo) and Standard Bank (regarding climate change and the need to introduce a policy on lending to coal-fired power projects and coal mining operations).

As a reminder, our investment professionals regularly meet with the management and non-executive directors of companies to discuss a range of issues relating to strategy, financial performance, governance and risk. It is normal practice for us to approach both executive and non-executive management to discuss contentious issues or material ESG matters. We believe that constructive, pre-emptive engagement results in a preferable outcome for all stakeholders and enhances long-term shareholder value.

Current positioning and outlook

South Africa is wrestling with many difficult issues at present; violence, xenophobia, corruption and economic stagnation are just some of the topics that are generating a plethora of negativity.

Much of the focus in the months ahead will fall on President Ramaphosa's capacity to deliver a bolder and more cohesive economic plan for the country. It is nearly two years since he was elected head of the ANC, and to the general public progress on matters driving the economy have been largely absent. It is time for decisive action, with Finance Minister Mboweni's economic reform plan a step toward the growth-oriented reforms needed. Internal ANC communist-minded resistance to this is disappointing.

Global event risks remain elevated, with the ongoing trade war between the US and China flagged as a key downside risk. An escalation is not in either side's best interest, with both the American and Chinese economies showing signs of strain. The ongoing trade tensions have led to slower global growth, with the IMF revising its growth forecast to a post-recession low of +3.2% for 2019. The World Bank is more bearish, with a global growth estimate of +2.6% for 2019.

For South Africa, the Medium-Term Budget Policy Statement in October is a key event, together with Moody's sovereign credit rating review (scheduled for 1 November).

Against this backdrop, domestic equity valuations are reasonably attractive - the JSE Top 100 (ex-Naspers) is now trading on a forward P/E of approximately 10x versus the long-term South African average of 14X. The combination of cheap valuations and depressed earnings expectations implies the prospect of better returns ahead - provided the economy starts to grow and provides the underlying necessary support.

We are mindful that the fund has delivered a period of average and at times poor performance since it peaked in early 2016 and expect that this will have raised concerns in the minds of our patient investors.

As co-investors in the fund, this has naturally caused some introspection and we are of course acutely aware of the specific positions and contributors to the performance that has been generated. We remain, however, committed as a stable team to our investment philosophy and process which we believe serves our clients' best interests in the long term and continue to apply it, confident of better times ahead and a return to attractive long-term returns we have produced in the past. We hope our investors will share this confidence, but welcome questions from clients with any concern you may have.

The portfolio currently trades on a forward rolling Price/Earnings (P/E) ratio of 11.0x and offers a dividend yield of 4.3%. The positioning contains a combination of globally diversified companies with earnings resilience and superior dividend yields (such as British American Tobacco and Bidcorp) together with cheaply valued domestic orientated companies (such as SA banks).

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.

For the Nedgroup Investments Bravata World Wide Flexible Fund it is calculated monthly as a percentage (the sharing rate) of outperformance relative to the fund's benchmark, with the high watermark principle applying. All performance fees are capped per fund over a rolling 12-month period. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

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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