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NEDGROUP INVESTMENTS VALUE FUND

Quarter Three, 2019

For the period ended 30 September 2019

NEDGROUP INVESTMENTS VALUE FUND

EXECUTIVE SUMMARY

Global equities (+0.7%) advanced marginally as accommodative monetary policy helped offset the weakening trade and manufacturing environment. Emerging markets lost 4.1% over the quarter. The Federal Reserve and European Central Bank made further interest rate cuts with the ECB contentiously restarting a bond buying programme. Bond markets have already priced in another quarter point cut in the US federal funds target rate by year end.

In South Africa, The FTSE/JSE Capped All Share Index (-5.1%) fell, with Industrials (-2.5%), Financials (-6.8%) and Resources (-6.4%) all down on broad based negative sentiment. The All Bond index was virtually flat with a total return of +0.7% in the quarter. The SAPY property index (-4.4%) also finished lower as domestic property counters continued to adjust to the weak domestic environment.

Market developments continue to vindicate Foord's defensive portfolio positioning. The portfolio remains defensively positioned with a relatively high cash allocation, providing liquidity to take advantage of attractively priced long-term opportunities as and when they arise.

Q3 2019 PERFORMANCE COMMENTS

- Underweight allocation to resources added value as the sector underperformed
- Positions in RMB Holdings (-8.7%), Aspen (-14.4%) and Sasol (-27.7%) detracted but were offset by Anheuser-Busch Inbev (+15.9%), British American Tobacco (+13.3%) and Pioneer Foods (+53.3%)
- The core property allocation to UK value play, Capital & Counties (+14.2%), also contributed positively
- The cash holdings contributed positively as cash outperformed equities

Top 5 contributors (weighted contribution):

Description	Contribution (Gross) %	Holding Return (Gross) %	Average Weight %
Capital & Counties Properties	0.75%	14.31%	4.32%
British American Tobacco	0.64%	13.71%	4.82%
Pioneer Foods	0.44%	58.88%	0.73%
Anheuser-Busch InBev	0.28%	15.95%	2.03%
Spurcorp	0.25%	14.03%	1.23%

Top 5 detractors (weighted contribution):

Description	Contribution (Gross) %	Holding Return (Gross) %	Average Weight %
Hudaco	-0.64%	-12.03%	5.08%
Aspen	-0.65%	-13.83%	4.36%
EOH	-0.69%	-38.67%	1.53%
RMB Holdings	-0.72%	-7.96%	8.29%
Sasol	-1.75%	-26.99%	5.84%

MARKET OVERVIEW

WORLD

- Global growth moderated further as the ongoing US-Sino trade war accelerated the slowdown in global trade, Boris Johnson's instalment as UK prime minister raised the prospect of a hard Brexit and geopolitical risks escalated on rising Iran/Saudi Arabia tensions following a missile attack on two Saudi oil facilities – forward looking manufacturing PMIs tumbled globally and are now in contraction in the USA, Germany, Japan and China, fuelling concerns of a looming broad-based global slowdown.
- Violent protests in Hong Kong escalated despite Chief Executive Carrie Lam announcing she would formally withdraw the extradition bill which sparked the initial protests – the pro-democracy protests have hit certain sectors hard, with retail sales in Hong Kong tumbling 25% from a year earlier.
- Nancy Pelosi, the Democrat Speaker of the House, announced an impeachment enquiry against President Trump following a whistle-blower complaint alleging Trump asked the Ukrainian President to discredit Joe Biden, the front runner Democrat presidential candidate – impeachment requires two thirds of the members in the Senate to return a guilty verdict, a hurdle which has never been achieved before.
- The Federal Reserve lowered interest rates by 0.50% during the quarter and stopped rebalancing its balance sheet, while the ECB announced additional reductions in European rates and pleaded for a European fiscal expansion program – forward rate agreements place a high probability of at least one additional Fed rate cut in 2019 and an outside chance of an additional 0.25% cut before year-end.
- Global equities (+0.1%) edged higher led by the US (+1.5%) and Japan (+3.0%) while emerging markets, typically geared to growth and trade, fell 4.1% – US earnings revision ratios continue to deteriorate, with forecasts for 2020 and 2021 reflecting a big divergence between macro-economic conditions and prospects for earnings growth, with downside risk to equity markets should earnings come in lower than current market expectations.
- Developed market government bond yields continue to fall on weaker macro data and lower short term cash yields, the US 10-year falling 0.32% to 1.68% and German bonds falling another 0.27% into negative territory at -0.58% - demand for bonds remains high with asset flows into bond ETFs continuing unabated, a strategy mostly pinned on hope that central banks will be successful in averting an economic downturn by continuing to lower policy rates
- Oil prices fell 7% despite the attacks in Saudi Arabia and the short-lived 10% price spike in September, copper declined 6% and iron ore was 15% lower, but precious metals gained as investors found refuge in assets uncorrelated to equities in times of stress – the divergence between industrial commodities and safe-haven precious metals is likely to continue unless recent setbacks to global growth and rising geopolitical tensions reverse.

SOUTH AFRICA

- The economy recovered from a very weak Q1 with improvements in mining activity and household consumption and a surprisingly strong growth rate in gross fixed investment by private businesses (+15.2%) - the rebound is off a low base and unlikely to indicate a permanent change in the trend, given weakening business and consumer confidence and contractions in electricity production and consumption growth.
- The current account deficit widened to 4% of GDP on weaker net exports and a persistently high services account deficit – of bigger concern is the internal deficit where government revenue collection is underperforming budget forecasts by a wide margin and expenditure growth running above expectations, trends which may necessitate a further increase in bond issuances and deeper cutbacks in much needed infrastructure investment expenditure, inhibiting future growth expectations.
- Inflation remained under control with little sign of the weaker rand impacting consumer goods prices, while services inflation has moderated following a marked reduction in household rental price growth – inflation is expected to remain contained in a low growth environment, with increases in administered price inflation and exchange rate weakness likely to be absorbed by manufacturers and retailers, not consumers, as businesses fight to retain market share.
- SARB's Monetary Policy Committee lowered the repo rate by 0.25% to 6.5% in July, believing a 2% real rate for SA is appropriate, despite near recessionary conditions across the economy – while we agree that monetary policy alone is not a panacea and that policy certainty from government is critical to encourage investment and employment, real rates are a major drag on consumption, in our opinion, and should be lowered in coming quarters.
- The rand weakened sharply against the US dollar as global investors sought out safe-haven assets at the expense of growth sensitive emerging markets – in our estimation the rand is not abnormally weak at current levels, nor is it discounting additional risks be they external via a further deterioration in global risk appetite, or internal through a potential negative credit assessment from Moody's in November.

INVESTMENT OUTLOOK

World: The global economic expansion is now very late stage. Ultra-low interest rates resulting from dovish central banks remain supportive of risk assets. But geopolitical risks are rising. Precious metals like gold will likely continue to move higher on safe-haven demand. Industrial commodity prices should drift lower in time as the economic cycle continues to age.

South Africa: Despite the positive political inflection point, many uncertainties remain, frustrating any serious policy reforms. Public finances remain strained with revenue collection underperforming budget forecasts and expenditure higher than expected, keeping the rand vulnerable. Recessionary conditions are likely to continue in the near term. The inflation outlook is favourable given low domestic demand and the absence of inflation globally. Bond yields should move lower as short-term interest rates decline and the yield curve flattens.

CONCLUSION

The resources sector weight remains low due to growing concerns of a global slowdown, likely resulting in a negative impact on bulk mineral prices at this late stage of the commodity cycle. We remain focused on investing in the highest quality diversified miner, BHP Group and rand oil price hedge, Sasol. Both companies provide protection from potential rand weakness given the negative impact of political malaise on local economic growth. Consumer sector weight is largely unchanged as we remain cautious on food and apparel retailers given the weak economic outlook, but the market did provide some opportunities to add to positions in relatively well managed, defensive companies like Spur at attractive prices.

The financial sector underweight remains given the sluggish South African economy and increasing competition from disruptive digital newcomers. We favour banks (like FirstRand, with a persistent sector leading ROE) over insurers as they should provide utility-type returns even in tough times compared to insurers that are more geared to discretionary spend and equity markets. We retain the meaningful allocation to JSE global businesses despite the deteriorating global growth and rising geopolitical uncertainties. We are confident that these specific companies will deliver real earnings growth in hard currencies aided by expected further rand weakness. We increased the relative weighting to healthcare by adding to the holding in hospital group Life Healthcare at attractive prices.

The low listed property allocation remains focused on niche UK property value play, Capital & Counties. We continue to avoid companies with office and retail exposure given the significant structural challenges facing the sector both locally and across developed markets.

The portfolio remains defensively positioned with a relatively high cash position – providing liquidity to take advantage of attractively priced long-term opportunities as and when they arise.

RESPONSIBLE INVESTMENT SUMMARY

Proxy Voting Summary Q3 2019

Resolution Type Name	Total Count	For %	Against %	Abstain %
Adopt Financials	2	100.0%	0.0%	0.0%
Auditor/Risk/Social/Ethics related	38	89.5%	10.5%	0.0%
Buy Back Shares	10	80.0%	20.0%	0.0%
Director Remuneration	38	97.4%	2.6%	0.0%
Dividend Related	1	100.0%	0.0%	0.0%
Issue Shares	10	20.0%	80.0%	0.0%
Loan / Financial Assistance	15	53.3%	46.7%	0.0%
Other	16	100.0%	0.0%	0.0%
Political Expenditure/Donation	1	0.0%	100.0%	0.0%
Re/Elect Director	69	98.6%	1.5%	0.0%
Remuneration Policy	16	0.0%	100.0%	0.0%
Shares under Director Control	4	0.0%	100.0%	0.0%
Signature of Documents	3	100.0%	0.0%	0.0%

General Comments:

- There are no abstentions. We apply our minds to every single resolution put to shareholders. When there is an abstention it would typically be intentional or for 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 were able to gain the required conviction in the specifics of the strategic rationale for such activities and could gain comfort that such activities are indeed to be used for 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.

Notable Engagements

Omnia

The effect of two large acquisitions in the previous 12 months and a high capex year (new nitrophos plant commissioned in March 2019) meant that Omnia's balance sheet was strained at September 2019 interims. A drought affected agricultural season together with poor trading in their mining division meant that results to end March were very poor which exposed the company's already stretched balance sheet. This resulted in the banks threatening to pull Omnia's credit facilities and forcing the company into a rights issue. Foord instigated a shareholder supported under-write to ensure that excessive dilution was not imposed on the company by the risk averse banks. The R2 billion rights issue has been successfully concluded with no call on the under-writers. Foord followed all their rights on behalf of our investors and remains invested in the company.

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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