NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS MANAGED FUND

Quarter Four, 2019

For the period ended 31 December 2019

NEDGROUP INVESTMENTS MANAGED FUND

Performance to 31 December 2019	Nedgroup Investments Managed Fund A	ASISA category average	SA inflation + 4% Geometric
3 months	+6.9%	+2.5%	+1.35%
12 months	+14.1%	+9.5%	+7.7%

The year ended on a high for the global economy

Throughout 2019 the global economy was plagued by several uncertainties, but late in the year some progress was made in resolving at least some of them. Firstly, tangible progress was made between the US and China towards reaching the first phase of a trade deal. Although the deal is yet to be signed, indications are that it should be possible and already some of the retaliatory tariffs imposed by both sides have been reduced, indicating a greater willingness to work together. Despite the consummation of this first phase deal we think the conflict between the US and China is far from over and the relationship is likely to remain volatile and confrontational.

Secondly, the Conservative Party's landslide election victory in the UK means that Brexit will likely happen. However, the form and implications of Brexit remains murky. Further, although growth has slowed, notably in Europe, job creation in the US is still strong indicating that the economy is continuing to perform well even though the cycle is mature. This year, being an election year, and a key one at that, we believe that all efforts will be directed at keeping this momentum going. Economic data seems to indicate evidence of green shoots. PMI indices and earnings revision declines have started to improve in many regions. Chinese manufacturing has now shown expansion for a second consecutive month in December.

However, the global rise in nationalism continues and it is concerning that there are too many flashpoints around the globe. In particular, tensions in the Middle East have escalated between the US and Iran. A move away from globalisation and mutual cooperation could be a harbinger of tougher times ahead into the next cycle.

In South Africa progress has been made in facing up to its challenges

2019 was not a good year for South Africa. Throughout the year growth continued to be revised downwards and it is a great concern that the economy is incapable of creating jobs on a large scale, as the unemployment rate continues to rise.

However, the good news is that there has, at last, been some visible progress in attempting to reverse the endemic corruption plaguing the nation as finally some arrests are being made. Much more needs to be done but at least a start has been made. In addition, the government is finally facing up to the challenge of rehabilitating the ailing parastatals. SAA is now in business rescue, making it easier to make the really tough decisions, and Eskom has new leadership intent on returning the utility back to sustainable health.

Regarding the economy, there has not been much good news but bright lights among the doom has been the inflation rate that has continued to surprise on the downside and the currency that has remained resilient, notwithstanding the deterioration in our sovereign ratings. But it must be said that any lasting solution to the major issues facing the country is likely to require some form of short-term austerity. Therefore, a period of disappointing growth over the next few years with a slow recovery remains a likely base case outcome. Domestic corporate profits are likely to be subdued for some time.

Global equities enjoyed a spectacular 2019

It was not surprising that with all the good news reported during the last month of the year that equity markets responded positively. The MSCI All Country World Equity Index ended the year on a very strong note, up 3.6% over the month and up a substantial 27.3% for the year. The S&P 500 index has always been a reasonable proxy for global equities and in 2019 the index tracked the World Index ending the year about 29% higher before dividends. This performance was driven, in the main, by price earnings multiple expansion from 14.5 to 18.2 (a 25% increase) rather than from earnings growth, which was negligible.

These US valuations, which are comfortably above average, are already discounting an earnings recovery. Hence, any bad news could result in underperformance. In a broader global context, although valuations in most regions are now above average post the year end global equity run, they do not appear to be excessively high.

Local equities delivered good, inflation-beating returns

Local equity markets underperformed global equity markets but comfortably outperformed inflation. The ALSI provided a 12% return and the SWIX 9.3%, bonds delivered a 10.3% return and cash provided a 7.3% return. In fact, the divergence between asset classes in 2019 was unusually low with listed property being the notable laggard, achieving only a 1.9% return over the 12 months.

There was significant return divergence across the major sectors of the JSE. Due to the strong price appreciation of the PGM basket over the year, Basic Materials enjoyed an exceptional year providing investors with a 28.7% gain over the 12 months. This performance was well ahead of the 8.9% gain from the Industrial sector and the only marginally positive gain of 0.6% from the Financial sector. It was no surprise that, given the strong performance from the PGM basket, the platinum sector was the top performing sector of the JSE for 2019.

The outlook for the ALSI is best considered via its key constituents. Domestically exposed companies comprise slightly more than half the Capped Swix Index. Although many of their valuations appear reasonable, lacklustre growth prospects may limit any material re-rating of these companies. For instance, banks are offering dividend yields of between 5% and 8% but growth expectations have been continually scaled back as the economy struggles to generate credit demand. However, it should be noted that sentiment is negative and hence, improved domestic news flow, including further corruption clampdowns or an improved budget outlook could result in increased demand for domestically exposed companies. It’s also important to remember that a more buoyant global economy will offer some support to the rand and domestic-based counters.

Many dual listed shares and resource-based shares do appear to have a more promising outlook than domestically exposed companies. British American Tobacco’s outlook has improved post a clamp down on vaping in the US. Tencent, which drives the bulk of Naspers and Prosus’ value, should deliver impressive earnings growth and is reasonably priced. Deficits in rhodium and palladium should maintain a high PGM basket price. The medium-term outlook for the diversified miners is a bit more unclear. On the positive side, there is room for a potential improvement in base metals if the global economic upturn occurs, yet on the negative side the iron ore price seems over extended and could retrace.

Bonds continued to generate returns well in excess of inflation and the property sector

The ALBI generated a total return of 10.3%, broadly in line with its returns of the last few years. Relative to inflation, the domestic yields are generous considering their own history and compared to most other markets. Although the impact of a potential downgrade by Moody's in March 2020 is being partially discounted in South African bond yields, the country's precarious fiscal position remains a risk. We prefer to take our fixed income exposure via high quality credit offering similar yields without duration risk.

Property remained the poorest performing asset class with a return of 1.9% (as measured by the SAPY) over this last year. Yields remain optically cheap compared to history where they have probably been overvalued. The tough domestic economy will continue to weigh on distribution growth and in fact result in negative growth for some counters like Hyprop and Redefine. Distributions in many counters remain overly high due to financial engineering, debt, and overly high pay-outs. As distributions reach more sustainable levels or valuations improve, we will look to increase our position in this sector.

Looking forward

The valuations for most global markets do not look compelling given their re-rating over the last year. Some markets like the US look more expensive than most. Furthermore, the global geopolitical risks remain as evidenced by the recent escalation in tension between the US and Iran. However, we are still finding sufficient investment opportunities with generous risk adjusted expected returns. Hence, despite a continued murky economic and political outlook, we remain confident that Truffle will deliver inflation beating returns over the medium to long-term.

Portfolio Positioning

We recently increased our exposure to diversified miners. Their balance sheets are healthy, and they offer relatively better value over many domestic counters. Our position in British American Tobacco was increased, as the company's valuation is cheap, and is facing less pressure from vaping in the US market. We increased our position in Naspers where the discount to Tencent is significant. Tencent was also trading below its historical average valuation. We have purchased some domestically focused counters which should benefit from self-help, such as Tiger Brands and AECI.

We recently reduced our exposure to FirstRand which was trading close to fair value, while increasing our exposure to Barclays Africa Group which was cheaper. We reduced our position in Anheuser-Busch due to a revision of our expected earnings from the company. We took profits on our AngloGold Ashanti position, and trimmed our positions in the Equites Property Fund and Pepkor.

Contributors and Detractors

The platinum group metal miners were the key contributors to performance given our significant position, and the outperformance of the PGM basket over the last year driven by expected palladium and rhodium deficits. British American Tobacco performed well post the announcements of vaping flavours being outlawed in the US and an easing of regulatory pressures on the tobacco industry. Anglo American performed well on the back of the performance of some of its underlying commodities including iron ore and the PGMs. Quilter performed strongly over the quarter in line with its competitors and remains significantly cheaper than its peers.

Anheuser-Busch detracted from performance due to a poor trading update negatively impacting the share price. The Prosus share price was also under pressure due to concerns over them overpaying for a business in the food delivery space. The domestic banks came under pressure in line with other domestically exposed companies as negative earnings revisions continued.

Top contributors	Ave. weight	Performance contribution	Top detractors	Ave. weight	Performance Contribution
Impala Platinum	6.8%	2.7%	Anheuser-Busch Inbev	0.1%	-0.4%
Sibanye Gold Ltd	4.4%	2.1%	Prosus NV	4.4%	-0.2%
British American Tobacco	5.8%	0.5%	Standard Bank Ltd	2.7%	-0.1%
Northam Platinum Ltd	1.2%	0.4%	ABSA Group Ltd	2.1%	-0.1%
Sasol Ltd	2.1%	0.3%	Investec Australia Property	1.1%	-0.1%
		+5.9%			**-0.9%**

NEDGROUP INVESTMENTS

DISCLAIMER

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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).

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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.

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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
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