NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter Four, 2019

For the period ended 31 December 2019

NEDGROUP INVESTMENTS OPPORTUNITY FUND

Performance to 31 December 2019	Nedgroup Investments Opportunity Fund[1]	ASISA category average[2]	FTSE/JSE ALSI
3 months	4.2%	2.0%	4.6%
12 months	16.2%	9.5%	12.0%

Market Commentary

South African equities rebounded in December, with the JSE All Share Index (ALSI) delivering a total return of 3.3% for the month. The Resources sector gained 7.0%, followed by Industrials (+2.3%) and Financials (+0.7%).

Despite heightened geo-political tensions and concerns about slowing growth, global equity markets lifted higher over the year, boosted by the return of monetary easing from major central banks as well as progress on trade (US/China) and Brexit. In 2019, the All Share Index delivered a total return of +12.0%. The Resources sector was once again the top performer with a total return of +28.5% (2018: +15.5%). Industrials gained +8.9% (2018: -17.5%) while Financials only managed a modest gain of +0.6% (2018: -8.8%). Platinum (+203%) and Gold Mining (+108%) shares performed particularly well and were the top performing equity sectors in 2019. The Platinum sector has been driven by a dramatic rise in palladium and rhodium prices and thus a sharp improvement in sector profitability. Gold had a good year as a result of higher prices buoyed by global political uncertainty.

Despite the domestic problems of collapsing State-Owned Enterprises and low GDP growth, the Rand has remained remarkably resilient. It was the sixth best performing emerging market currency in 2019, appreciating by +2.5% against the US dollar. The rand ended 2019 at R14 to the US dollar and still 10% firmer than where it ended 2015 at the time of the Nenegate political fiasco.

Portfolio Commentary

The fund's top five performing positions for the 2019 calendar year added 13.5% to our return while the bottom five detracted -3.8% from returns.

Winners 2019	Ave.weight	Total Return	Performance contribution	Losers 2019	Ave.weight	Total Return	Performance Contribution
Impala Convertible	5.0%	230%	5.7%	Sasol	1.9%	-28%	-1.1%
Naspers	7.9%	23%	2.5%	Sappi	1.3%	-45%	-1.0%
Abax Global Equity	8.6%	22%	2.2%	KAP	1.0%	-46%	-0.7%
Eurostoxx 50 note	4.6%	29%	1.9%	Merafe	1.0%	-37%	-0.5%
Royal Bafokeng Convertible	3.2%	40%	1.2%	Prosus	0.9%	-12%	-0.5%
			13.5%				**-3.8%**

[1] Net return for the Nedgroup Investments Opportunity Fund, A class. Source: Morningstar (monthly data series).
[2] ASISA Multi-asset medium equity category

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The Nedgroup Investments Opportunity Fund produced a return of 16.2% (net of fees) for the year, in comparison to the peer-group average of 9.5%. Over three years, the fund has gained 5.2% p.a. (vs. the peer-group 5.5% p.a.) and over the past five years, the fund delivered 6.0% p.a. (vs. the peer-group of 5.1% p.a.). It is encouraging to see the negative effect of Steinhoff working out of the longer-term numbers.

Over the longer term our expectation is that the fund will produce low inflation + 5% numbers. Although this is the case in the shorter (one year) and longer term, over the medium term (three and five years) this is not so, largely because the South African equity market (as measured by the FTSE/JSE ALSI) has only managed to eke out gains of 6% p.a. over the past five years. With attractive real rates on offer for most asset classes in South Africa, balanced funds are well poised to achieve attractive returns above inflation.

2019 contributors and detractors

The fund benefitted from its healthy allocation to risk assets in 2019. We increased our domestic equity allocation during 2018. We ended 2018 with materially more equity than we started the year with despite markets ending lower. This aided performance as markets recovered in 2019.

The Impala Convertible bond was the largest contributor to performance. The bond was up 230% over the year (and contributed 5.7% to the fund's performance) on the back of a very strong run up in the rand PGM basket price. The Royal Bafokeng Convertible also made a healthy contribution to performance, given it's 40% rally over the year. We continue to hold 3.8% of the fund in the Royal Bafokeng Convertibles, as it still offers material upside should the share price rally but with very limited downside from current levels. In contrast, we have sold out of the Impala bond completely given that after such a strong run the bond now effectively acts like equity, and therefore will provide little downside protection in the event of a retracement. We were happy to lock-in our gains.

At an individual stock level, Naspers was the largest contributor to performance. The stock was up 23% over the year and contributed 2.5% to the overall performance of the fund. Despite the rally we continue to find Naspers very attractively priced at over a 40% discount to NAV underpinned by a strongly performing Tencent.

The major detractors to our performance have been our positions in Sappi and Sasol (which collectively detracted 2.1% from performance over the year). The performance of both shares has been very disappointing, and for contrasting reasons, but we believe both remain oversold at current levels.

We discussed these stocks last quarter, but echo some of the comments again. In Sasol's case, the mis-steps have been internal, with continual upward revisions to the Lake Charles Chemicals Project (LCCP) capital cost estimates and commissioning delays clouding the investment case just as oil prices came under increased pressure. We continue to think the LCCP is worth almost half the current value of Sasol - its commissioning is underway, and it will eventually contribute around a quarter of total Sasol profits. In the meantime, at record lows relative to the rand price of oil and long run P/E and P/B multiples, the shares are attracting a substantial credibility discount. In contrast, Sappi's performance relates to external macro factors outside of its control. As a result of US-China tariffs and concerns about trade wars, China has not been buying paper pulp (for graphic paper and packaging) or dissolving wood pulp (for viscose and textile production) at the same rate it did previously. This has impacted trade flows around the world and acted as a real drag on pricing. We don't expect much downside from current levels as we believe valuations already discount recessionary conditions for the company. On a medium-term view, we think Sappi shares offer material upside.

We used market weakness to add to both Sasol and Sappi during the year, although we achieved this by using derivative structures that afforded us the opportunity to only commit to buying the stocks at lower levels than they were trading at the time, but that would still provide us with meaningful exposure to any recovery.

Current positioning and outlook

The South African equity market is currently valued to produce above average returns, as are Emerging Markets generally. It is interesting that South Africa's rating relative to Emerging Markets is as low as it has been for many years on the back of continued under-performance of SA equities. The forward P/E multiple of the South African market (adjusted for Naspers) is now lower than that of the EM peer-group.

Although we locked in some profits toward the end of 2019, we continue to hold a meaningful exposure to risk assets. Our risk exposure has slowly been rotating from the stronger performing and highly priced markets (e.g. US) to poorer performing regions (UK, Europe, Japan, South Africa) and at the same time there has been a gradual (and so far, quite small) shift to businesses that are more cyclical in nature, and have been ignored by the market. We also retain exposure to several higher quality mid-cap stocks that we believe will out-perform the general market over a full cycle.

We increased our allocation to listed property over the year, despite us remaining negative on the sector overall, as the volatility in the broader sector has thrown up some interesting specific opportunities. Our interest lies more in certain specialized names – typically of smaller size - that we feel have good prospects or are particularly mispriced for very specific reasons. An example would be Atlantic Leaf Properties (ALP), a company that owns logistics properties in the UK. This is an area of the UK market that has held up relatively well. Interestingly, although a UK REIT, ALP is not listed in the UK, and is relatively small, so price discovery is weak. We managed to acquire a decent stake when a large local pension fund decided to reduce its stake materially. The share was bought on a GBP distribution yield of 12%, and we expect distributions could grow by 1-3% p.a. Another holding is the Dipula-A units, which we bought on a yield of 11% and where we enjoy preferential rights to the distributable income of the company (the B units get whatever is leftover) and guaranteed distribution growth of the lesser of inflation and 5% p.a.

We continue to find many interesting opportunities in certain hybrid and high yielding instruments that are not as well researched and generally fall outside of the ambit of most mandates. We believe that many of these instruments should provide us close to equity like returns over their lifetimes, but with lower risk of loss. We currently have a 22% allocation to what we consider 'hybrids', made up as follows:

- 4% in Convertible Bonds (RBP)
- 6% in Preference Shares yielding 10.5%
- 3% in SA corporate inflation-linked bonds with an average duration of 2.5 years and an average real yield of 5.3%.
- 9% in Structured notes on offshore markets that provide geared upside with limited downside risk

The overall yield of the fund is close to 5%, which should provide a useful underpin to returns, and is attractive if one accounts for the fact that we currently have a relatively high allocation to equities.

Responsible Investment Comments

We were kept busy in this important aspect of the work we do over the last quarter. The main objectives of engagement are to enhance long-term shareholder value and benefit broader society. Notable engagements during the fourth quarter of 2019 include:

- **Naspers / Prosus:** Attended the Capital Markets Day in Amsterdam and have been engaging extensively with the company and industry in researching the On-line Food Delivery businesses. From an ESG perspective we are concerned that there seems to be little understanding or concern for the safety, welfare and risk their delivery operators in the field face (whether directly or indirectly employed).
- **Reinet:** Continue to engage with management regarding the firm's structure and deep discount to NAV as well as their poor governance score, limited shareholder engagement and unsatisfactory fee arrangement.
- Steinhoff: Engaged with enforcement authorities regarding Steinhoff.
- **FirstRand:** Regarding climate change and the need to introduce a policy on lending to coal-fired power projects and coal mining operations.
- **Sasol:** Regarding their response to climate change and minimising the environmental impact of their operations.
- **Oceana Fishing:** Independent research commissioned regarding environmental conduct. For example, assessing the impact of reduced access to food stocks for seabirds – notably the African Penguin.
- **Sappi:** Independent research commissioned to examine operating practices regarding environmental conduct.

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).

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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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