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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Four, 2019

For the period ended 31 December 2019

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Performance to 31 December 2019	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	3.6%	4.4%	4.6%
12 months	3.5%	8.0%	12.0%

Market Commentary

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

Despite heightened geopolitical 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 (now four years distant) at the time of the Nenegate political fiasco.

Portfolio Commentary

The fund's top five performing positions for the quarter added +3.2% to our return while the bottom five detracted -1.4%.

Winners	Ave. weight	Total Return	Performance contribution	Losers	Ave. weight	Total Return	Performance Contribution
Sasol	4.3%	19.9%	0.81%	A-B Inbev	2.3%	-19.1%	-0.55%
Anglo American	5.9%	13.4%	0.75%	MTN	2.5%	-14.3%	-0.39%
British American Tobacco	6.3%	9.9%	0.62%	Prosus	4.5%	-4.8%	-0.23%
Impala Platinum	1.2%	50.6%	0.54%	Standard Bank	5.2%	-3.7%	-0.13%
Remgro	2.4%	21.8%	0.47%	Nedbank	2.3%	-5.5%	-0.12%
			3.19%				**-1.42%**

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

For the quarter, the fund’s holding in Sasol (+19.9%) and Anglo American (+13.4%) were the primary positive contributors to performance. This was offset by the funds’ holdings in AB Inbev (-19.1%) and MTN (-14.3%).

For the year, we acknowledge that 2019 was a disappointing year for investors and will not be happily reflected on. The primary causes for the fund’s disappointing year have been discussed in some detail in previous quarterly commentaries, but at the risk of becoming repetitive can be classified into three primary categories:

1. The fund’s limited exposure to precious metals, which performed strongly during the year as reflected by the JSE Gold Index appreciation of 108% for the year, and the JSE platinum Index which rose by 203%! This hindered the fund’s relative performance against the benchmark and peers.
2. The fund’s exposure to Sasol which had numerous challenges with its Lake Charles Chemicals Project (LCCP) and was a substantial detractor. Despite this we have worked hard on the position and concluded that despite the short-term problems associated with the completion of the project and the permanent cost overruns, at R260 per share the market was attributing an overly pessimistic value to the overall company. We added to the position at that price and are pleased to note the gradual recovery in valuation following the senior management changes and better operational performance in the completion of the project and startup of the new plant.
3. Poor share price performance from domestic orientated businesses that we considered well managed, defensive (healthy balance sheets, cash generative) and reasonably priced. The two primary examples in this category are Truworths and KAP Industrial.

We do not sit passively on these positions and continue to examine them in detail. Pleasingly, news flow pertaining to Sasol is improving – this includes higher oil prices, the successful replacement of the acetylene reactor catalyst, and the renegotiation of the debt covenant ceiling - these developments reduce the LCCP risk and bode well for improved earnings growth prospects in the period ahead. It is worth noting that Sasol was the single largest positive contributor to performance in the final quarter of the year (please refer to the performance table above).

Domestic orientated companies (such as Truworths and KAP) are at the mercy of the macro environment, and recent economic statistics continue to reflect weakness, with no sign of upward momentum. However, we regard these businesses as substantially undervalued, with their share prices providing a comfortable margin of safety.

On a more positive note, we are encouraged that underperformers of 2018 have been key positive contributors to your fund’s performance in 2019. Notable examples here are British American Tobacco (+36.2%), MediClinic (+31.5%) and Reinet (+28.7%) - vindicating our conviction in holding these positions during those testing times.

At the end of 2018 we wrote extensively about the fund’s exposure to British American Tobacco directly, as well as indirectly via Reinet, and the pain the fund had taken in Q4 2018 due to a significant de-rating those stocks underwent. Our view, at the time, was that the market had been overly punitive, and we were consequently retaining our position. We are naturally pleased to report that this diligence and patience has paid off in 2019 with these stocks recovering some of the underperformance and both making it into the top five positive contributors in 2019. We expect further positive contribution from both in 2020.

Current positioning and outlook

As we approach 2020, we find ourselves having to guard against the risk of over pessimism brought on by the endless procession, month after month of weak economic data points, very low business and consumer confidence, slow political progress, and the gridlock of contradictory economic policy within the ANC. As well as limited prosecutorial action against corrupt state employees, and of course ongoing load shedding. To many it appears there is no end in sight, if not all, to these woes. Recently, the World Bank cut its economic growth forecast for South Africa to below 1% for 2020 due to electricity supply concerns. A downgrade by Moody's Investors Service, the only major ratings company that still assesses South Africa's debt at investment grade, is almost inevitable.

The silver lining is that the government's recent moves at SAA and Prasa may indicate a more forceful attitude toward SOE reforms. Implementing greater fiscal discipline, dealing with corruption, providing a stable supply of electricity, and easing labour laws are among the major challenges South Africa must address.

While the South African economy remains challenged, the global backdrop remains supportive of equity markets. Easier monetary and fiscal policies are in motion globally. In addition, fears related to US/China trade and Brexit continue to fade.

So, as always, we will continue to examine the companies in our investable universe unemotionally within the scope of their current and historic valuation ranges and within the context of their growth prospects. While we've been let down by two or three notable disappointments (as discussed above) in the last year, we are confident the current portfolio is appropriately balanced, with position sizes governed by our level of conviction and risk. The positioning contains a combination of globally diversified companies with earnings resilience and superior dividend yields (e.g. British American Tobacco, BidCorp) together with cheaply-valued domestic-orientated companies (e.g. Std Bank, Truworths, Mr Price).

Conclusions

After a period of underperformance in 2018 and 2019, we thank investors for their patience and placing their trust in us and which we are working hard to earn.

The portfolio currently trades on a forward rolling Price/Earnings (P/E) ratio of 11.7x and a dividend yield of 4.0% which we believe offers reasonable value.

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).

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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