see money differently

NEDGROUP INVESTMENTS VALUE FUND

Quarter Four, 2019

For the period ended 31 December 2019

NEDGROUP INVESTMENTS VALUE FUND

MARKET OVERVIEW

WORLD

- Global growth expectations improved as the US economy started to benefit from the Federal Reserve's monetary stimulation – despite the economic expansion's late stage, growth should persist in the near term given highly supportive monetary conditions and benign inflation risks
- In the UK, the Tory electoral landslide shuttered fears of hard-left Labour economic policies and improved prospects of a decisive Brexit – notwithstanding the positive market sentiment inflection point, the EU/UK economic cluster faces significant structural economic headwinds, making sustained economic growth unlikely in the near to medium term
- Global equities rose sharply on broad-based developed market strength led by rampant US bourses – buoyed by the tech behemoths, recovering cyclical sectors and rising likelihood of a US–China "phase one" trade deal resolution
- Lower interest rates, quantitative easing and subsiding fears of a rapid slowdown rather than earnings growth (constrained to less than 5% in 2019) accounted for 2019's substantial market returns as price-earnings multiples expanded markedly – increasing market risk should underlying fundamentals falter
- Growth sensitive emerging markets also posted good gains on improved growth prospects, positive trade developments, higher industrial commodity prices and US dollar weakness – but the outlook is obscured by probable further US/China economic conflict and rising geopolitical risks
- Developed market government bond yields drifted higher as growth expectations improved – the US yield curve continued to normalise after its mid-year, panic-inducing inversion
- Interest rates are nevertheless anchored at very low levels given the absence of meaningful global inflation pressures – central bank indications are that low rates will endure through 2020
- Gold and silver were sharply higher on escalating geopolitical risks and their increasing attractiveness as portfolio diversifiers – precious metals prices should stay well bid as the effects of a decade's worth of experimental monetary policies inevitably begin to manifest

SOUTH AFRICA

- South Africa registered its second quarterly GDP contraction (Q3: -0.6%) for 2019 – prospects are bleak with business confidence near thirty-year lows and consumer confidence the lowest since Ramaphosa's December 2017 ANC presidential victory
- Unexpected and unprecedentedly severe (stage 6) power disruptions constrained fourth quarter economic activity – State Owned Entities continue to flounder, with no workable resolution to Eskom's structural financial and operational problems and SAA placed in business rescue
- Public finances deteriorated with the Medium-Term Budget Policy Statement estimating a previously unaccounted for three-year revenue collection shortfall of R252 billion – the deep expenditure cuts and meaningful reform needed to underpin higher economic growth are unlikely in the near term given the ANC's ongoing factional politics
- The rand strengthened against the US dollar on improved emerging market sentiment and attractive South African real yields – the currency remains vulnerable given the deteriorating public finances and looming Moody's credit rating decision
- SARB kept interest rates unchanged despite continued recessionary conditions and inflation again surprising to the downside – expectations are that the MPC will now cut rates in the first quarter of 2020
- The JSE was driven higher by a narrow set of precious metal miners on higher commodity prices and dollar weakness, while financials and industrials were broadly flat – commodity prices should drift lower and SA Inc. counters should remain pressured given very weak trading conditions
- South African bonds achieved good returns after yields moved lower on improved emerging market sentiment and benign inflation – the yield curve should flatten this year as rates on longer dated bonds respond to structural recessionary conditions and sovereign credit rating uncertainties pass

Q4 2019 PERFORMANCE COMMENTS

- Positions in Aspen (+38.8%), Sasol (+20.1%) and RMB Holdings (+7.5%) contributed meaningfully while the zero allocation to large index stock MTN (-15.4%) was positive
- The low allocation to the precious metals mining sector and the investment in Santam (-1.3%) were the largest detractors
- The low allocation to domestic property companies added value and the core investment in UK property company Capital & Counties (+10.2%) also contributed

Top 5 contributors (weighted contribution):

Description	Contribution (Gross) %	Holding Return (Gross) %	Average Weight %
Aspen	1.66%	39.83%	4.86%
Sasol	1.01%	20.20%	5.16%
RMB Holdings	0.57%	7.54%	7.57%
Capital & Counties Properties	0.55%	10.21%	5.49%
British American Tobacco	0.51%	10.19%	5.18%

Top 5 detractors (weighted contribution):

Description	Contribution (Gross) %	Holding Return (Gross) %	Average Weight %
Richemont	-0.08%	-1.92%	4.75%
Santam	-0.11%	-1.28%	7.87%
Standard Bank Group	-0.15%	-3.59%	4.06%
Value Group	-0.22%	-15.52%	1.36%
Anheuser-Busch InBev	-0.44%	-19.20%	2.04%

INVESTMENT OUTLOOK

World: The global economic expansion is now late stage, but dovish central banks remain supportive of risk assets. Geopolitical risks are rising, and gold should move higher on safe-haven demand. Industrial commodity prices are expected to drift lower in time.

South Africa: Political uncertainties within the ruling party remain in place. Strained public finances are keeping the rand vulnerable. Recessionary conditions are likely to continue near term with the inflation outlook looking favourable given low aggregate demand across the economy. Bond yields should move lower on falling short term interest rates with the yield flattening in time.

CONCLUSION

The low weight to resources is maintained given the late stage of the global economic cycle, with investments in the highest quality diversified miner BHP Group and rand oil price hedge Sasol. Higher commodity prices should support sector cash flows near term but should drift lower in time as the commodity cycle rolls over. We also avoid precious metals miners with significant South African-specific headwinds, despite the recent run up in the platinum group metals and gold prices.

The managers maintain a low weight to food and apparel retailers given the cash strapped consumer and adverse trading conditions. In addition, there is a moderate weight to growth sensitive financial shares given our base case of persistent recessionary conditions in South Africa. We reduced RMB Holdings (FirstRand bank holding company) at the margin on the ten percent value unlock after the holding company structure unbundling announcement.

The portfolio maintains a high absolute and relative weighting to JSE-listed global businesses given the weak South African economy and greater certainty of global economic growth. We are confident that these companies will deliver real earnings growth in hard currencies through the cycle, aided by expected rand weakness. The listed property weight is focused on niche UK property counter Capital & Counties as we continue to avoid companies with office and retail exposure given the significant structural challenges facing these sectors in South Africa.

The portfolio is well diversified and defensively positioned given the late stage of the global economic cycle and distressed South African economy. High levels of cash and liquid holdings afford the managers excellent optionality to exploit long-term value opportunities as and when they arise.

RESPONSIBLE INVESTMENT SUMMARY

Proxy Voting Summary Q4 2019

Resolution Type Name	Total Count	For %	Against %	Abstain %
Adopt Financials	3	100%	0%	0%
Auditor/Risk/Social/Ethics related	52	96%	4%	0%
Buy Back Shares	10	100%	0%	0%
Director Remuneration	36	97%	3%	0%
Dividend Related	3	100%	0%	0%
Issue Shares	12	8%	92%	0%
Loan / Financial Assistance	11	27%	73%	0%
Other	19	84%	16%	0%
Re/Elect Director	60	98%	2%	0%
Remuneration Policy	19	26%	74%	0%
Shares under Director Control	6	33%	67%	0%
Signature of Documents	4	100%	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 could 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 to 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
(Note: reporting at investment house level, specific fund might not be invested in all these companies)

Sasol
We held a face to face ESG specific meeting with the new CEO. Main ESG risks center around pollution as Sasol's Secunda plant is a major source of carbon emissions. Sasol acknowledges the scientific evidence for climate change and has, for many years, been trying to mitigate its impact on the environment. It produces a comprehensive sustainability report and incorporates its progress on set criteria when reporting to shareholders to ensure long term value is not compromised. The introduction of a carbon tax in South Africa could result in a 5% knock to earnings so, as shareholders, it is essential that we engage with management to ensure the impact to their bottom line is limited. Although exposure to Eskom has been reduced with self-provision, major Eskom blackouts would impact production facilities.

In addition, the board has also not necessarily been strengthened by recent appointments and we are flagging the effectiveness of the proposed new chairman. Longer serving, more experienced board members will have to take leadership in guiding the executive team.

Against this, Sasol remains an uncorrelated source of return in our investor's portfolios and a good hedge against the rand fuel price and therefore inflation. In addition, given the relatively narrow investment opportunity set in South Africa, the investment case for including it in our investors' portfolios remains. Our approach is to manage the various risks cited through position size and ongoing constructive engagement with the company, rather than outright exclusion.

FirstRand (Invested indirectly via RMB Holdings)
Voted "For" on two special resolutions relating to climate change risk:

- We are in favour of increased disclosure that is deemed to provide greater insight into business, social and environmental risks pertaining to the group.
- Management has shown a clear understanding and active approach towards mitigation of ESG risks.

Aspen
Engaged with Ben Kruger (board member) on general corporate governance issues, the structure and conduct of board meetings, interactions and conduct of the executive.

Stor-age
Interaction with Graham Blackshaw (new Chairman) on executive related party transactions.

Spur
Interaction with Mike Bosman (Chairman) on remuneration, related party transactions, board conduct and interactions.

Invicta
Engaged with Christo Wiese (Chairman) regarding general corporate governance and executive management.

Metair
Interaction with Sam Sithole (board member) on strategy, corporate governance, executive remuneration and board meeting conduct.

Italtile
Engaged Susan Du Toit (lead independent non-executive director) over the remuneration policy and share incentive scheme.

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

The Standard Bank of South Africa Limited is the registered 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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