NEDGROUP INVESTMENTS

QUARTERLY REVIEW
NEDGROUP INVESTMENTS CORE DIVERSIFIED FUND

as at 31 March 2020

See money differently

One of the worst quarters in history

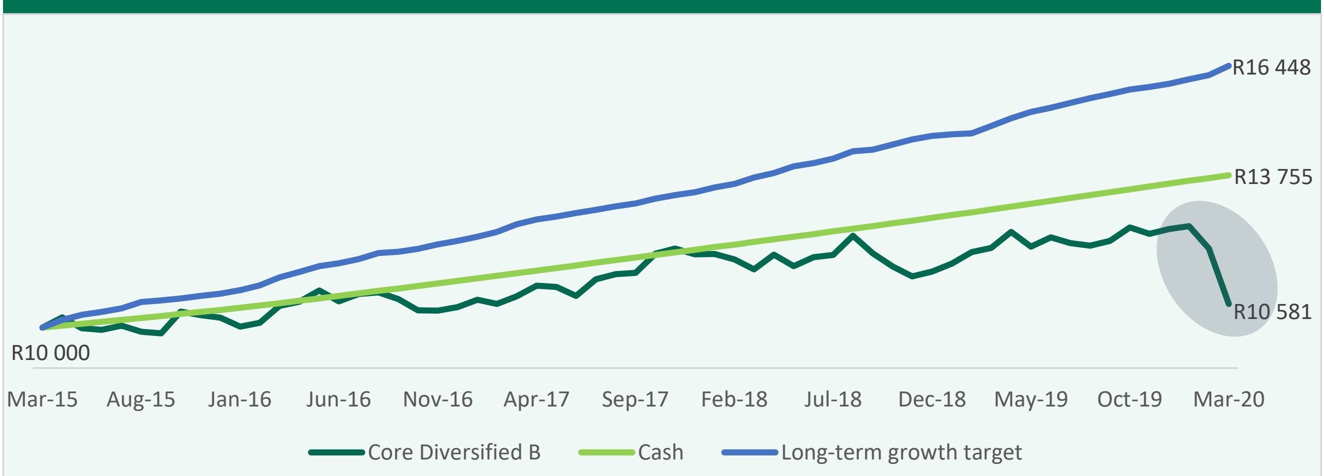
The first quarter of 2020 saw significant declines in global markets. Global equity and listed property plunged over fears of the coronavirus, resulting in the worst week for equities since the 2008 financial crises. The economic fallout intensified with the SA sovereign debt downgrade by Moody's to “junk” status and crashing oil prices due to a conflict among major oil producers. These factors resulted in the Nedgroup Investments Core Diversified Fund seeing a decline of -14.8% over the quarter.

The table below compares an investment in Nedgroup Investment Core Diversified Fund to a bank deposit (cash) investment and its growth target over various time periods. For every R10 000 invested in the Nedgroup Investment Core Diversified Fund five years ago, you would have R10 581 at the 31st of March 2020. This is a lower than the R13 755 you would have achieved had you invested your money in bank deposits (cash) over the same period. The green circle in the chart below, highlights the recent market collapse, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investment Core Diversified Fund versus Cash[1] and the Growth target

	3 Months	1 Year	3 Years	5 Years	7 Years	Inception 31 August 2009
Growth of fund (after fees) ***(Growth in %)***	R8 515 *-14.8%*	R8 845 *-11.5%*	R9 824 *-0.6% p.a.*	R10 581 *1.1% p.a.*	R14 674 *5.6% p.a.*	R23 808 *8.5% p.a.*
Growth of cash ***(Growth in %)***	R10 155 *1.6%*	R10 657 *6.6%*	R12 132 *6.7% p.a.*	R13 755 *6.6% p.a.*	R15 227 *6.2% p.a.*	R18 514 *6.0% p.a.*
Growth target (inflation+5%) ***(Growth in %)***	R10 274 *2.7%*	R10 987 *9.9%*	R13 113 *9.5% p.a.*	R16 448 *10.5% p.a.*	R19 963 *10.4% p.a.*	R28 183 *10.3% p.a.*

Fund Return versus Cash[1] and the Long-term growth target for 5 years ending 31 March 2020



The Nedgroup Investment Core Diversified Fund has a long-term growth target of 5% above inflation (around 10% per year) over 5 year periods. The Fund has provided returns closer to cash over the past 5 years. However, history[2] demonstrates that two-thirds of the time a fund such as Nedgroup Investments Core Diversified fund would have achieved or surpassed it’s long-term target. This confirms the importance of being invested for the long-term. In fact, if you increase your investment horizon, the risk of underperforming this target decreases.

1. We used the STeFI call deposit rate for cash returns
2. Based on SA market returns from 1960 to 2018 (source Firer 2006) using the same long-term equity allocation and fees.

Market panic from the COVID-19 pandemic

Amidst the fear and panic from the announcement by the World Health Organisation in March that the COVID-19 outbreak is a pandemic, the extreme market events in the wake of the disease went almost without notice. News and social media were flooded with COVID-19 breaking updates with the market chaos that accompanied it barely receiving a mention.

As the weeks passed, the world became more aware of the devastating impact of this virus and the resulting lockdowns on economic growth and markets. This is especially true of retirees who have limited ability to increase their savings and have to ensure that their money lasts throughout their retirement. Small business owners, those who are self-employed and companies with high debt levels are especially struggling with limited ability to earn an income but with little to no relief on their expenses. Some companies were able to pivot to provide essential goods and services in order to continue operating during lockdown. One such example is an alcoholic beverage producer that changed their production to manufacture hand sanitiser.

However, overall the impact has been devastating. The JSE Shareholders Weighted Total Return Index (SWIX), which can be used as a proxy of the South African share market, fell 36% in just over 2 months this year with unprecedented daily market movements. This move is not far off the fallout in the 2008/2009 financial crisis, where the SWIX fell by 41% in just under 10 months. Although, the decline this year happened in a matter of 2 months.

Globally, markets have also experienced significant volatility and losses. The MSCI All Country World Index (ACWI), which represents stock markets globally, fell 34% in US Dollars terms this year over a period of less than 2 months.

All is not lost, the SWIX has recovered somewhat from its low on 23 March this year, to provide a loss of only 14% year to date (to 14 April 2020). Similarly, global markets have also recovered a fair portion of the losses incurred this year with a loss of only 15% year to date in US Dollar terms (to 14 April 2020).

Countries worldwide are forecasting lower economic growth, with a number of countries responding by implementing significant interest rate cuts in an attempt to stimulate the economy. Despite this stimulus, there is still much uncertainty in terms of the time markets and economies will take to recover. The more likely scenario is that that recovery will be slow and economic growth subdued for some time. The exact impact will of course depend on how long the lockdowns in South African and worldwide remain in place and the measures governments take in response to the pandemic.

How liquidity can help you stay the course

The ability to access savings or investments to carry one through difficult times is one of the most important risk management tools; for individuals and businesses. A “rainy day” fund can make a material difference when money is tight, especially if you are still servicing debt. In times like these the last thing you want is to be forced to sell out of less liquid savings such as a pension fund or an investment property which may be significantly down in value due to the tough market conditions.

For this reason, you should aim to have at least 3 times your monthly salary set aside for emergencies. If your earning is based on commissions, you may need 6 times to make sure you can cover your costs. These savings should ideally be easily accessible and provide you with some form of a return over the periods when you don’t need it.

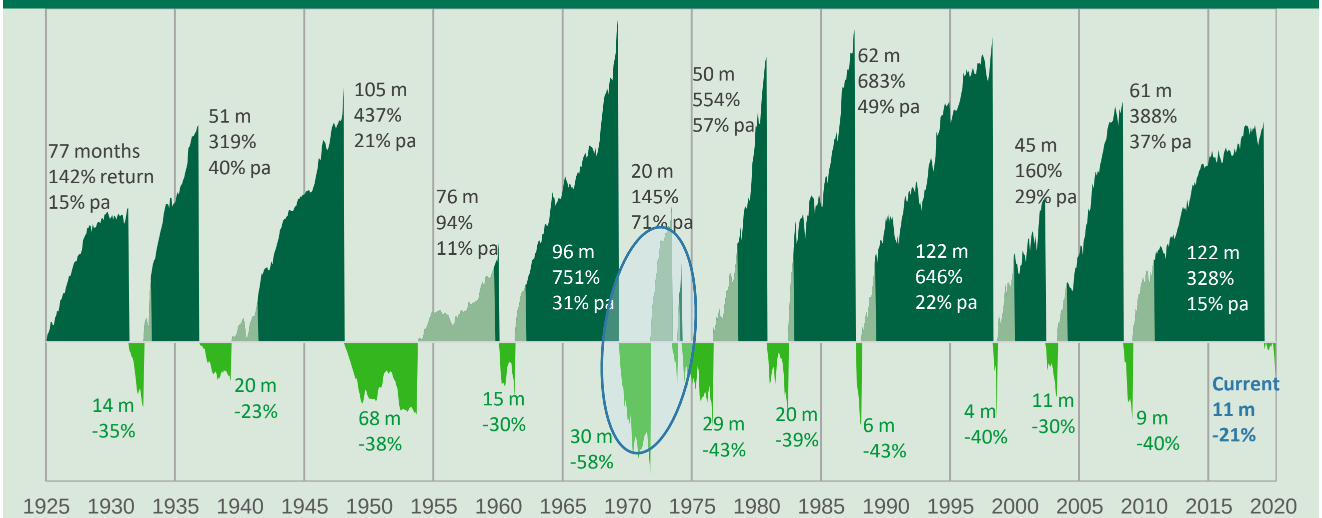
It is also important to ensure that you have sufficient liquidity in your estate on death. On death your estate is faced with various liabilities (i.e. estate duty, executors fees, funeral costs, cash bequests, capital gains tax, outstanding loans). In order to settle these liabilities your executor requires cash and often the majority of assets in the estate cannot easily be reduced to cash. This may result in the executor having to sell assets within a short space of time which often results in the deceased estate receiving far below the market value for these assets. In order to guard against this, it is advisable to ensure that some of the assets in your estate is liquid.

Unit trusts make ideal investment vehicles for liquidity requirements as they can be access within a day or two. They also cater for different investment horizons and risk appetites. For example for shorter term emergencies, unit trusts such as the Nedgroup Investments Money Market Fund or Nedgroup investments Core Income Fund are ideal as they pay interest but is not exposed to the equity markets.

We've been here before: Market crashes and recovery

Global markets have been in decline since the end of February as the coronavirus COVID-19 pandemic became a worldwide phenomenon. This is not the first, nor will it be the last time markets have responded negatively to global events. The chart below illustrates this by showing the bull and bear markets in South African equities over the period 1 January 1925 to 31 March 2020. Over this long period there were thirteen periods, including the present, where the market value of SA equities dropped by more than 20%. The biggest drop in SA markets occurred between 1969 and 1971 when it was down by whopping 58%!

Bull and bear markets of South African equities – 1925 to 2020



A **Bull market** starts at the lowest point reached after the market has fallen by more than 20% or more, and ends when it reaches a new high

A **Bear market** is a period over which the market falls by 20% and more from its previous high to its next low

A **Recovery Period** starts at the lowest point reached after the market has fallen by 20% or more, and ends when it attains its previous high

Source monthly data:

1. Firer, C. and McLeod, H., 1999. Equities, Bonds, Cash and Inflation: Historical performance in South Africa, 1925 - 1998. Investment Analysts Journal, 50, 7-28. This study used monthly equity data going back to 1925, but mainly included commercial and industrial shares prior to 1960.
2. Morningstar for recent monthly returns of the All Share Index (J203T).

There is a saying "this too shall pass" which is applicable to most market corrections. Sometime markets can rebound within a short period and deliver staggering returns such as in the 20-month period after 1971 when markets delivered a total return of 145% (or 71% per annum!).

While we have no idea when this crisis will be over, we can apply what we have learned from history. Markets do recover at some point and so for long term investments such as retirement savings it pays to stay invested. It is also important to invest across different asset classes and regions of the world to reduce some of the impact of a market pull back and poor economic conditions.

Battle of the oil giants

During early March, oil prices had one of the biggest falls in history, taking the price of Brent crude to around $22 a barrel by the end of the month. This was the lowest price since January 1991 at the start of the gulf war. At the beginning of March, OPEC+ held several meetings, where it was expected that further production cuts would be agreed to. This occurred after the release of a report by the International Energy Agency (IEA) indicating that global oil demand is expected to contract for the first time since 2009 due to the containment measures applied in more than 187 countries. Despite this fact, Russia refused to agree with Saudi Arabia for deeper production cuts to counter the effects of the spread of Covid-19 on demand. The outcome of these meetings meant an effective collapse of an agreement between Russia and OPEC+, resulting in Saudi Arabia declaring an oil price war. the Kingdom indicated that it would put another 2.6million barrels per day in the oil market, in an apparent attempt to punish Russia. The supply shocks caused oil futures prices to fall by 40% in March. This is first time since the 1930s that we saw a severe demand shock now combined with a supply shock.

What now? There is a lot of uncertainty around how long the price war will last. However, the short-term outlook for oil prices is likely to be volatile, given the changing sentiments surrounding major oil producing nations, the cost pressure across the industry and the uncertainty surrounding the extent of the Covid-19 pandemic. Major oil companies are preparing for prolonged periods of low oil prices, for example Occidental Petroleum in the US has cut its dividend by almost 90%.

With the oil price sitting around $26 a barrel, the immediate impact has been damaging for oil companies. In our universe Sasol's balance sheet took a hit as a result of the oil price war. Since the start of the year, the share price of Sasol plummeted by nearly 87% by end of March. The company has also suffered several setbacks over the past year putting the business under pressure. The Sasol weightings across the Core funds as at the end of December 2019 and March 2020 were as follows:

Sasol weighting:	31 December 2019	31 March 2020
NGI Core Accelerated Fund	1.97%	0.35%
NGI Core Diversified Fund	1.77%	0.33%
NGI Core Guarded Fund	0.78%	0.16%

The rules-based nature of the Core portfolios mean that we will be holding the share at its benchmark weighting.

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