NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS GROWTH FUND

Quarter One, 2020

Nedgroup Investments Growth Fund

Performance to 31 March 2020	Nedgroup Investments Growth Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	-32.4%	-23.0%	-21.4%
12 months	-35.1%	-21.3%	-18.4%

Market Commentary

Global financial markets

Last quarter we mentioned that the quantitative easing in developed markets post the GFC in 2008 had created a great deal of "investor complacency", with borrowers of "free capital" becoming too aggressive in their investment strategies, highlighted by an ever-increasing misallocation of investors' capital. Household balance sheets were in good health, but corporate and government balance sheets were over-indebted, and the quality of the much-increased USA and European corporate debt was very poor. We also mentioned that the USA's Federal Reserve had become very "market friendly" and Developed market equity markets were moderately over-priced.

The arrival of the COVID-19 global pandemic changed everything in the world in early 2020. This is the first global pandemic in 100 years and besides the traumatic "loss of life", the global "lockdown" has totally switched off the global economy. While we had previously forecast that a global recession was a strong possibility in mid/late 2020, it is now a confirmed deep global recession in mid-2020. In reaction, the US has cut its interest rates to zero, joining the rest of the developed markets with their long-standing zero interest rate policy.

The global developed markets and China are probably correct in "throwing" as much money as possible at the problem and ensuring there is adequate liquidity and money in financial markets, while also supporting businesses and consumers. While the US's Federal Reserve seems to have effectively "merged" with the US's fiscal authorities in "throwing" money at the problem, you cannot solve this lack of "demand" problem solely with more "supply". While inflation will not be a problem for 2020, excess liquidity and money is a problem for financial market "greed" and this huge stimulus will keep many USA & European "junk" companies afloat, while they should really be going bankrupt. It now seems highly likely that Western Europe and probably also the USA will begin to look even more similar to Japan of the past 20 years, with its low growth, low inflation, low interest rates, high government debt and an increasingly aging population.

The new reality is that we live in an un-forecastable global environment, with some form of social-distancing likely to remain in place for the balance of 2020, until we get a new vaccine, hopefully in early 2021, that can properly manage COVID-19. Due to the un-forecastability of COVID-19, economies and companies, and the big rise in unemployment, it was appropriate that global equity markets fell very sharply from mid-February to mid-March. While these equity markets have recovered strongly in the past few weeks, on the back of the unprecedented huge monetary and fiscal stimulus, as the global economic recovery is going to be very slow and off a very low 2020 base, global equity markets once again look moderately over-priced. While we must look forward for valuations, the extent of the slow recovery off a low base, means that currently, on a consensus "top-down" forecast basis, the USA's S&P 500 is trading on an expensive forward price/earnings multiple of 17x to December 2022.

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

South African markets

At the end of 2019, the South African (SA) economy was already very weak and over-indebted with government and Eskom debt and this was clearly seen in the annual Budget in February 2020. Sadly, the COVID-19 pandemic has now caused immense problems for SA. We are amid a very necessary "lockdown" period, which will be followed by a period of gradually letting companies and people get back to work, but with an ongoing and necessary form of "social-distancing" until a vaccine is available. From a healthcare perspective, this means that winter and most of 2020 will be extremely problematic to manage in SA, with our many informal settlements, large informal economy, limited public transport and high level of HIV infections.

The above problems mean that SA will now have a deep recession in 2020, followed by a very low GDP growth rate for at least 3 years. Unlike the global developed economies and China, with SA's high level of debt and a fragile currency, which has already weakened by ±30% vs the US dollar in 2020, we do not have the ability to dramatically stimulate the SA economy, even though the Reserve Bank has cut interest rates by 2% over the past month. We must now hope that the SA Government embraces the private sector and implements the required major structural changes around State-Owned Enterprises (SOEs), especially Eskom, as well as education, skills, productivity and labour flexibility. As we have for the past 2 years, once again we must stress that only if these positive structural changes occur, together with a more muted public sector wage growth rate, will it enable SA to have an economic platform where the country can have a sustainable longer-term annualised GDP growth rate of >2%.

In Q1 2020, the broad JSE indices followed global markets down and fell by about -25%. While we believed at end 2019 that many well-managed SA-based, mid-sized, industrial companies were offering excellent value, the COVID-19 disaster meant that the rand and SA-based companies were even harder hit than their global peers. The JSE's mid & small-cap indices fell by about -35% in Q1 2020, dramatically hurting the Nedgroup Investments Growth Fund's performance. Until the SA economy "switches on" again, it is hard to see SA-based industrial share prices outperforming, but we still believe that there are many attractively priced, and well-managed, SA mid-sized industrial companies. Based on our bottom-up aggregation of company valuations, the main JSE indices are now trading ±35% below their appropriate price levels, although on an equally weighted market-cap basis, the average company on the JSE is undervalued by double that amount. While it looks like "doom & gloom" for the SA economy and equity market, we cannot stress enough that this remains an excellent time for investing in well-managed and quality SA-based, mid-size, industrial companies.

Portfolio Commentary

In the general equity sector, the fund's performance in the past quarter was very poor in both absolute and relative terms. While we have added excess returns for investors, with best-in-class risk stats, over the past 19 years, the past quarter has negatively impacted the longer-term returns. It should be noted that Electus staff have always analysed companies and managed the fund on a very consistent basis for our unbroken 19-year track record in the Nedgroup Investments Growth Fund, including our 4-year track record as an "independent" Electus.

The top four performing positions added 1.32% to returns in Q1 2020, while the bottom five detracted 13.30%.

Top Contributors	Average weight	Performance contribution	Top Detractors	Average weight	Performance contribution
Naspers	7.96%	0.71%	Hosken (HCI)	5.96%	-4.41%
Prosus	3.08%	0.50%	Ethos Capital	5.90%	-2.85%
Reinet	5.98%	0.15%	Combined Motor Hold.	5.68%	-2.18%
Newgold ETF	0.30%	0.02%	Clientele	6.57%	-1.95%
Grindrod	0.68%	-0.06%	Texton	4.41%	-1.91%
Total:		**+1.26%**	**Total:**		**-13.30%**

Current positioning and outlook

Based on our above comments, there is very little value to be found in the US equity market, especially as over-indebted developed markets still seem very reliant on zero interest rates and ongoing huge monetary and fiscal stimulation. China is also over-indebted and dependent on monetary and fiscal stimulation. The other emerging markets are unable to stimulate their economies due to problems with either, or both, their current and fiscal accounts. With its over-indebtedness and twin deficits, SA has limited fiscal ability to stimulate and that is why it has cut interest rates by 2% in the past month. The COVID-19 pandemic has hit SA when it was already in a recession and now SA has a few very tough years ahead, with low growth and further unemployment.

However, while the SA economy is in “lockdown” and will be weak thereafter, we still believe that there are many attractively priced, and well-managed, SA mid-sized industrial companies. Based on our bottom-up aggregation of company valuations, the main JSE indices are now trading 35% below their appropriate price levels, although on an equally weighted market-cap basis, the average company on the JSE is undervalued by double that amount. The well-diversified fund currently has upside of over 100%, which suggests above average absolute and relative prospective returns.

As we wish to maintain a high level of Active Share and Tracking Error risk in the fund, we currently only hold 24 companies, with all shares having a targeted weight of >2.0%. This clear focus and positioning, with suitable diversification and strong risk management, enables us to target excess returns for clients from specific share selection and not from sector selection. The Growth Fund is currently 96% invested in South African listed equities and we always target being >98% invested.

The key changes in the Nedgroup Investments Growth Fund in Q1 2020 were the sales of Grindrod and Sasol, while with the proceeds we bought a new position in the quality global food distributor, Bidcorp.

Responsible Investing & Corporate Governance

Following the Steinhoff collapse in December 2017, the ongoing Resilient related issues and the suspension of Tongaat due to its historic financial accounting and auditing issues, the Growth Fund will not even consider investing into these shares.

Pleasingly, in Q4 2019, our ongoing collaborative approach to the JSE regarding fuller disclosure of share trading by company directors, in terms of personal shares being used as “security”, was successful. During Q4 2019 we interacted collaboratively with the JSE in attempting to get Naspers and Prosus “capped” as one combined entity in the JSE’s Capped benchmarks. Sadly, we were unsuccessful in this endeavour.

There were no major Responsible Investing & Corporate Governance engagements in Q1 2020.

Disclaimer

WHO WE ARE
Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. 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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HOW ARE OUR FUNDS PRICED
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
A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

DISCLAIMER

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. 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. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

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