NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter One, 2020

Nedgroup Investments Opportunity Fund

Performance to 31 March 2020	Fund Performance[1]	ASISA category average[2]	FTSE/JSE ALSI
3 months	-20.7%	-10.5%	-21.4%
12 months	-14.8%	-6.9%	-18.4%

Market Commentary

The positive start to global markets in 2020, which were buoyed by constructive US-China trade news, has collapsed sharply under the weight of the COVID-19 pandemic. Countries across the globe have taken unprecedented responses to curb the spread of the virus, with billions of people now subject to some form of lockdown. The steps taken will lead to a severe fall in economic activity in the first half of 2020. Governments and central banks have responded swiftly with significant liquidity and fiscal packages.

South Africa has suffered additional setbacks with ratings downgrades by Moody's and Fitch. The lack of a clear strategy to ensure government debt stabilisation is the key reason for the downgrade.

Against this backdrop, we have seen some extreme moves in equity markets in a short period of time. The JSE All Share fell -12.1% for March 2020 and -21.4% for the quarter. At a sector level, Industrials declined -8.4% for the quarter, while Resources and Financials posted losses of -25.3% and -39.5%.

Almost all emerging market currencies depreciated against the US dollar in the first quarter of the year with the Brazilian real (-22.4%) and the SA rand (-21.7%) being the weakest of the major global currencies.

The extent of the economic impact and disruption caused by human and goods movement restrictions and quarantines imposed on parts of the world to limit its spread remain is hard to predict. Faced with the inevitability of a deep recession, many companies are having to react quickly to preserve cash-flows. Understandably, investor focus has been on the financial resilience of companies.

The shape of a recovery remains uncertain. We are conscious of the fact that it will take some time for the full impact of this global shock to the human healthcare and economic system to be felt and analyzed, but we have seen some extreme moves in equity markets over a short period.

Portfolio Commentary

The fund's top five performing positions for the quarter added +2.6% to our return while the bottom five detracted 11.2%.

Top contributors	Avg. weight	Performance contribution	Top detractors	Avg. weight	Performance contribution
Abax Global Income	3.6%	0.6%	**Sasol**	1.7%	-6.1%
Abax Global Equity Fund	8.5%	0.5%	**Absa**	1.7%	-2.4%
MTN	0.2%	0.3%	**Std Bank**	2.6%	-1.2%
Naspers	9.1%	0.3%	**Truworths**	1.4%	-0.9%
DRD Gold	1.2%	0.2%	**Nedbank**	0.9%	-0.8%
		1.9%			**-11.4%**

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

The fund's large positions in Abax Global Income and Abax Global Equity benefitted from an appreciating US dollar, while Naspers, despite initially falling in late February, recovered and posted a positive performance for the quarter. The portfolio's holding in Sasol and banking stocks hurt performance in the short term. From having no stake in MTN, a position in MTN was initiated in mid-March at favorable levels, resulting in a positive contribution to the fund, despite the stock's negative quarterly return.

We remain cautious on domestic discretionary spend and have limited exposure to this segment of the market given the weak South African economic outlook (Truworths is the preferred holding). The virus and the subsequent government response have resulted in a reduction in consumer demand and forced store closures. While earnings and cashflows will suffer during this period; we take comfort that Truworths went into this crisis with one of the strongest balance sheets in the sector, being in a net cash position. For some time, we have avoided companies with uncomfortably high leverage such as Foschini.

It is worth noting the defensive nature of the domestic consumer exposure in the portfolio with a preference for non-discretionary local consumer stocks. During the quarter, a position in Spar was initiated. The REIT sector declined -51% in the first quarter of the year. We have used the weakness to increase our holdings in the property sector. Our main holdings are Atlantic Leaf Properties and Dipula A units.

South African Equity Case Studies

Sasol

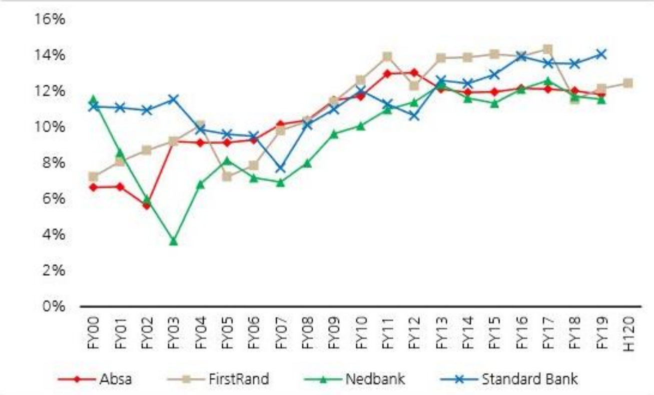
Sasol's share price performance has been a major source of disappointment for us, but we continue to hold the course. Over the past 18 months, Sasol has fallen out of favour with investors for three primary reasons: the abysmal execution of the Lake Charles Chemicals Project (LCCP), downward earnings revisions, a steadily worsening and increasingly fragile balance sheet. More recently, further events have driven the share price lower - a Moody's downgrade on their debt which will raise financing costs, and the very unexpected breakdown of talks between OPEC and its Russian counterparts, leading Saudi Arabia to announce significant price discounts on its oil for May delivery. Meanwhile, the spread of Coronavirus will reduce oil demand to multi-decade lows. This has placed Sasol in a precarious position.

Sasol has responded with an ambitious plan to please lenders and calm the market. The share price appears cheap, although they are all earnings and cash-flow based valuations. The real concern is the balance sheet. The situation is likely to remain extremely fluid, and we will endeavor to respond as appropriate.

South African banks

Turning to our banks position; the sharp fall in bank share prices is unprecedented and appears to be pricing in the need for a recapitalisation. The SA banks would have to incur extreme losses to drive a decline in their capital ratios to regulatory minimums. Their credit losses would have to increase 8x–10x current levels or >3x that experienced in the global financial crisis (GFC) levels. On our analysis this appears unlikely. SA banks have seen significant improvements in capital ratios since the GFC. And recent regulatory intervention is also encouraging - regulators have softened their stance on loan loss accounting (banks can provision for foreseeable credit losses), as well as the size of the liquidity and capital buffers banks must hold. The combination of earnings resilience, strong starting capital position and attractive valuation is compelling as illustrated in the 2 charts below:

Figure 2: Substantial improvement in CET1 ratios since 2008



Source: Company data

Figure 4: SA banks sector P/BV trend

Source: Datastrream

Source: UBS

Current positioning and outlook

We expect the market environment to remain challenging with the fate of equities dependent on the evolution of the COVID-19 outbreak. Fortunately, the pandemic appears to be slowing, although a second wave of infections is a risk. A global recession is inevitable, but decisive intervention by central banks, governments, the IMF and World Bank and the many humanitarian assistance packages that have been launched will provide support.

There is undoubtedly enormous value (absolute and relative to EM and DM) in the SA equity market, but the full extent of the economic damage we will suffer will only be revealed in the coming months. The best local economists are projecting that the South African economy will contract by 5% in 2020 and bounce back in 2021, but the bounce only gets the economy back to a previous low base at the start of 2020.

South Africa's ability to recover given the weak (and now even weaker) starting point of the country's balance sheet, tax collection, levels of employment, consumer and business confidence is not nearly as strong as it was in early 2009 after the GFC. Prior to the Covid-19 crisis, SA's Debt/GDP was 61% and headed to 70% on a 2-year horizon, assuming a positive outcome on 2020 state wage negotiations. That already pessimistic scenario has been replaced by a looming debt crisis, with a likely 12% budget deficit pushing debt-to-GDP up to 80% on a 2-year horizon. Add a further 20% SOE debt and it will be close to 100%!

As a consequence of the starting point of the South African economy, we view any recovery as one that will (post the short-term base effect bounce-back) likely to be even slower than the pre-Covid-19 impact expectations.

There are still high levels of uncertainty in the forecast horizon. As such, we will continue to exercise caution. We believe volatility will remain the order of the day and will try and utilise our cash position (12% currently) to buy good businesses at attractive prices.

While we have been hard at work managing the fund, our thoughts are with all our clients and their families at this time where we are experiencing disruption to our daily lives which none of us have ever experienced before. It will require adaptability and perseverance but in time it will pass and we pray that you and your families will keep safe until that time.

Conclusions

We expect market conditions to remain volatile, but also expect to be through the worst of the lockdowns by the end of the next quarter. Our focus at the moment is on looking to buy or add to high quality businesses that are trading at very low valuations.

Undoubtedly there will be many tragic casualties of this human health and economic shock, and we expect that many aspects of human interaction, mobility and commercial activity are likely to be permanently altered. For the nimble, appropriately capitalized and astutely managed survival will create fresh opportunity at the expense of those who are not. This is the free market system which must be allowed to work freely while at the same time contributing to the humanitarian crisis our world is facing.

Now is the time to think carefully for the storm will pass and volatile times such as we are currently experiencing create opportunity for the long term and patient to invest.

Responsible Investment Comments

Notable engagements during the first quarter of 2019 include;

- BHP Group: Regarding Scope 3 impact on Iron ore producers and measures to alleviate the CO_2 in steel smelters. In addition, the outlook for their coal mining operations.
- Naspers: Discussion regarding remuneration and other ESG matters, such as safety of personal information.
- Anglo American: Discussion on adjusting the portfolio to “new world’ assets and the purchase of Sirius Minerals as part of this.

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
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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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