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NEDGROUP INVESTMENTS PRIVATE WEALTH EQUITY FUND

First Quarter, 2020

For the period ended 31 March 2020

1. Market overview

What a quarter! Markets worldwide experienced some of the most bone-jarring volatility on record during Q1.

The quarter started without the slightest tell of what the market had in-store. For many market participants, the risk register for the year ahead might have included a few well-documented concerns. Locally; more load-shedding courtesy of Eskom and the February Budget delivered in typical flamboyant style by Minister of Finance, Mr Tito Mboweni. If that wasn't going to be enough, a possible downgrade by Moody's was also on the cards. Internationally, US elections later this year may have featured on the radar.

Then, bang! What Warren Buffett has since described as a "one-two punch", COVID-19 arrived and was promptly followed by an oil price war in response to OPEC talks between Russia and Saudi Arabia breaking down. Wikipedia elaborates as follows: "*In boxing, the 'one-two punch combo' is the name given to the combination consisting of two common punches, a jab (thrown with the lead hand) followed by the cross (thrown with the back hand). When this combination lands successfully, the boxer's jab is used to lift their opponent's head in order to expose their chin for their cross."* Mr Market took both blows and promptly went down for the count.

The quarter moved along quickly with other events including the much-anticipated Moody's downgrade, the Reserve Bank cutting interest rates and providing liquidity adjustments, and President Ramaphosa announcing a State of National Disaster coupled with a nationwide lockdown. At the time of writing, this lockdown has been extended by a further two weeks. Against this backdrop, the rand was put to the sword, blowing out to record levels against the dollar.

The 2020 Budget revealed challenging fiscal metrics, pressure from SOEs and a lack of debt consolidation. Even this is contingent on the ability to decrease expenditure via public sector wage negotiations. This, in addition to the impact from the coronavirus crisis, prompted credit ratings agencies Moody's and Fitch to downgrade the credit rating of the sovereign further and retain a negative outlook.

The SA Reserve Bank cut interest rates by 25bps in January and 100bps in March. The unanimous vote acknowledges a modest inflation environment and a lack lustre economy that would benefit from any marginal support.

JSE (SWIX40) posted a first quarter return of -20.8% and the ALSI was 21.4% lower. During the quarter, the top performing sectors were Technology (+11.9%), Gold mining (+4.6%) and Tobacco (+2.3%). On the downside, the decliners were led by Chemicals (-81.7%), Travel & Leisure (-64.4%) and Industrial Engineering (-64.4%).

2. Fund performance – Q1 2020

The Fund returned -24.60% for the quarter, underperforming its SWIX40 benchmark by 3.80% over this period.

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Stocks held which contributed to Q1 performance included Alibaba (+1.37%), Reinet (+1.23%) and Brookfield Asset Management (+1.21%), as well as an underweight position in Sasol (+1.16%). Underweight positions in Standard Bank (+0.57%) and not holding FirstRand (+0.68%) also added to relative performance.

Stocks held which detracted from Q1 performance included Adapt IT (-1.38%), Adcorp (-1.33%) and Prosus (-1.33%). Not holding Anglogold Ashanti (-0.91%) and Sibanye Gold (-0.81%) detracted from relative performance. The Fund's underweight position in Naspers detracted 4.32% from the quarter.

A recap of first principles

Valuation-driven

We believe investment returns are a function of what you get (value), for the price you pay, adjusted for risk. Our investment philosophy is active and valuation-driven, and can be summarised as "**well-considered, long-term investing"**.

Diversification

We diversify in case things go wrong (they always do at some point) and in case we get things wrong (we sometimes do). We recognise the benefits of diversifying across countries, currencies and business sectors to ensure that we make the most of your wealth at the lowest risk throughout market cycles.

Long term

We recognise that investing in financial markets offers the best results over the long term. Although there are many variables that affect your wealth in the shorter term, focusing on quality investments at a fair price, and the power of compounding will give you the best chance of achieving your objectives.

Portfolio overview

The Fund started its ~15th year with approximately 5% in USD cash given our view that markets were at elevated levels in the US. This cash has proven invaluable as market conditions quickly deteriorated. The Fund has continued to slowly build-out its allocation to US equities, more recently adding positions in Citi, Facebook and Accenture. The Fund is now approaching ~25% in direct offshore equities and USD cash, with room to increase further up to the maximum allowable 30%. In response to the prospect of a global economic slowdown, we identified the balance sheets of companies held by the Fund which may come under pressure and reduced these positions in favour of other higher quality opportunities as part of an overall risk management trade. The Fund continues to be well diversified by industry and geography subject to the constraints imposed by our mandate. We are also diversified across holdings, arguably more broadly than we would typically be in a more stable economic environment.

In respect of PGMs, the Fund has benefited from its underweight positioning going into 2020. We have maintained the view that PGM prices have been stretched for some time and we were well placed as PGM-related counters snapped back sharply. The quarter also saw the start of an oil price war. The Fund held a position of ~2% in Sasol prior to the announcement by the Saudis that pricing would be cut dramatically. The Fund has been underweight Sasol in the run-up to the LCCP challenges incurred by Sasol as well as being underweight other oil-related plays, notably MTN.

Another underweight position which has benefited the Fund during the quarter is foodservices business, BidCorp. Our large underweight during 2019 was premised on valuation and the retracement seen in this counter has been exacerbated by the start of the COVID-19 chapter which is likely to negatively impact out-of-home consumer behaviour in 2020.

The Fund's exposure to SA small and mid-caps has continued to detract from performance. Names like Curro, ADvTECH and Stadio have endured relentless pressure, and the arrival of COVID-19 has further damaged short-term sentiment, despite the businesses performing relatively well under extreme macro-conditions.

On a recurring note in the negative column is the Fund's underweight positions in Naspers/Prosus relative to the Swix40. At a combined 11.1%, we deem our exposure to be adequate from a risk management perspective but the drag on relative performance continues to be painful.

3. Portfolio changes

International equities

During the quarter, new positions in Citi, Facebook and Accenture were started. Not all of the businesses we own in the Fund will escape the short-term impact of the COVID-19 environment. For example, beauty retailer Ulta Beauty has had to temporarily close stores in the US and furlough staff. In addition, Comcast, through its subsidiary NBCUniversal, has theme parks and resort properties which are likely to be adversely affected. Even Facebook has already reported sharply lower advertising revenues as a consequence of the sharp contraction in economic activity.

We take comfort from the fact that, for the most part, the businesses we own have solid balance sheets, are diversified either geographically or horizontally and they typically have multiple channels to market. Furthermore, other than Naspers/Prosus, we do not hold any outsized positions which would hurt the Fund should the COVID-19 era take longer than expected to resolve.

Citigroup (Citi)

During the quarter the Fund initiated a new position in Citi. The financial industry has significantly underperformed the overall market, creating a buying opportunity.

The large four U.S. banks have experienced share price declines not seen since the Great Financial Crisis (GFC). The COVID-19 crisis presents new and unchartered risks for the banks. However, regulatory changes since the GFC like the Volcker rule and Dodd-Frank, have significantly reduced the risk banks can take, as well as increased the amount of capital reserves they must carry.

Our preferred pick during the recent weakness has been Citi. Our view is based on relative valuation and both business and geographic diversification. Citi, at its lows in March, traded at a discount to tangible book value of more than 50%. The market priced in a significant loss of capital and impairment of future operations, which we believe is unwarranted. Citigroup is well diversified across consumer and commercial banking. It has the largest geographical footprint amongst its peers, reducing specific country risk. Relative to its peers, Citi is the least reliant on the U.S. yield curve which is attractive with the Federal Funds rate back at the zero bound.

United Technologies (UTX)
UTX started the year as an industrial holding company which owned several high-quality businesses. These businesses included: (i) Otis – the world's largest elevator and escalator company; (ii) Carrier – a global provider of commercial and residential heating, ventilation and air-conditioning (HVAC) services as well as fire & security products and services; (iii) Pratt & Whitney – a leading supplier of aircraft engines and aftermarket services for commercial, military and business aircrafts; (iv) Collins Aerospace – a leading supplier of a range of interior products, advanced technological equipment and avionics located on aircrafts for the aerospace and defence industry.

During 2019, UTX undertook a large-scale restructuring to create three separately listed Companies, namely: Otis Worldwide, Carrier Global and Raytheon Technologies. The latter is a merger of Pratt & Whitney and Collins Aerospace with Raytheon, a leading defence contractor. The goal was to create shareholder value by eliminating its conglomerate discount. On the 3rd of March, UTX shareholders received one Raytheon Technologies (RTX), one Carrier Global (CARR) and a half OTIS Worldwide (OTIS) share for each UTX share previously owned.

The more focused companies post separation has also meant that exposure to the COVID-19 crisis has different implications for each entity. The defensiveness of elevator servicing (majority of profit) means that **Otis** listed near its fair value. **Carrier**, which is more reliant on equipment sales, listed significantly below our estimation of fair value. Large parts of the world are still in lockdown, limiting both the production as well as the demand for the equipment Carrier sells. **Raytheon Technologies** (RTX) exposure to the commercial aerospace industry weighed on the its valuation. The Company is the largest supplier of equipment and services to the commercial aerospace industry, which has been impacted by the severe stress within the airline industry around the world. The merger of UTX RemainCo with Raytheon reduced risk by increasing the contribution to earnings from the defence industry as well as reducing the gearing on the new RTX balance sheet.

<u>Domestic equities – Position sizes reduced</u>

During the period and with the onset of COVID-19, we undertook a review of the weakest balance sheets of firms held by the Fund. With risk management in mind, we modestly reduced our positions in **Aspen, Mediclinic** and **AB InBev**.

In a prior factsheet, we noted that in our view, **AB Inbev** is a high quality, globally diversified, defensive business, led by able and aligned management. Its balance sheet is geared however, which makes it exposed to the vagaries of the current COVID-19 environment. The interruption of its organic cash generation to further deleverage the balance sheet as the premiumisation and portfolio expansion strategies are executed, made it a candidate for portfolio action.

<u>Domestic equities – Position sizes increased</u>

The Fund has been underweight local banks during 2019 and into 2020. We had remained cautious of the exposure banks faced to a weak local economy and consumer. The extent of the sell-off in banks has provided the Fund with the opportunity to close this large underweight, although at the time of writing we still remain marginally underweight the sector.

Company specific commentary – FSR/ RMH/ REM

The Fund has been a long-standing owner of RMH, as a discounted entry point to FirstRand. During the period, RMH announced a restructure of its portfolio, following an internal review.

We expect an update from RMH regarding the unbundling imminently. Remgro has since indicated that while it remains its intention to unbundle its RMH stake, the Group will now be retaining its interest in FirstRand.

4. Closing

Volatility during Q1 was arguably unprecedented as the market attempted to weigh a wide range of outcomes emanating from the initial shock of the one-two punch. To the long-term investor, volatility should be seen as a source of opportunity rather than risk. Opportunity aside, remaining invested during turbulent markets is key to protecting capital, notwithstanding that it may feel extremely uncomfortable at the time. We look forward to seeing how the rest of the year unfolds and we thank you for your courage under fire.

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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