



UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

see money differently

A photograph of an open book with white pages, tied with a white string bookmark. The book is open to a page that is slightly blurred, creating a sense of depth.

# NEDGROUP INVESTMENTS STABLE FUND

Quarter One, 2020

## Market Commentary

### World

- Global growth expectations plummeted as the COVID-19 virus became a global pandemic with more than 25% of the world's population in some form of lockdown – economic recession is a certainty, with only the depth and duration still debatable.
- Some countries dealt with the pandemic faster and more efficiently than others and have seemingly arrested the infection rates – but global economic activity will be slow to normalise given the risks of “second wave” infections and the likelihood of lockdowns persisting for longer than first intended.
- Global equities fell sharply on expectations for the demand shock's impact on economic activity and company earnings – market volatility should stay elevated given uncertainty of the length and degree of shutdowns needed to stabilise the pandemic.
- Developed market bond yields fell abruptly as investors fled risk assets amid a scramble for liquidity and central banks re-ignited market liquidity operations – interest rates and bond yields should stay lower for longer as economic activity takes time to normalise and monetary authorities maintain emergency policy settings.
- The oil price suffered its biggest slump in several decades as Saudi Arabia and Russia entered an all-out oil price war just as the demand shock was gathering momentum – lower fuel prices should ordinarily stimulate economic activity, but this will be offset by persistent economic shutdowns.
- Industrial commodities all fell sharply – prices should stay subdued given the likelihood of an extended retreat in economic activity and resulting surpluses, although precious metals gold and silver should find some support as alternative stores of value.
- The US dollar, US treasuries and gold initially surged as investors rushed to traditional safe havens, but eventually even gold declined as investors scrambled for liquidity – the uncertainties in the real economy and effect on financial assets, particularly in the high yield/sub-investment grade debt markets, may keep financial markets in distress for some time.
- Developed market governments and central banks launched unprecedented fiscal and monetary activities to support the real economy and ease financial market stress – the long-term efficacy of these actions is questionable given the unusual nature of this economic shock, the already extreme monetary policy positions and record indebtedness.

### South Africa

- The president announced a 21-day lockdown on 23 March to retard the COVID-19 infection rate – the economic standstill will cause a severe GDP contraction for Q2 2020 following a likely third consecutive contraction in Q1 2020.
- February's sobering budget speech highlighted distressed public finances and an economy in structural decline after years of mismanagement – the pandemic fallout will put considerable strain on an already highly stressed socio-economic dynamic, increasing the probability of IMF and/or World Bank support in the medium term.
- The JSE plunged on the global markets sell-off as companies already under severe economic pressure will struggle to withstand a lengthy economic shutdown – creating substantial near-term uncertainty about employment trends, disposable income and prospects for corporate earnings.
- The SARB cut the repo rate by a quarter-point in January to counter recessionary conditions and made an emergency 1% cut (among other technical support measures) in March as the pandemic shock reverberated across the world – further repo rate reductions are likely as the SARB moves to emergency policy settings consistent with global central bank counterparts.
- South African bond yields rose sharply as global investors sold off emerging market assets in a scramble for liquidity and Moody's finally downgraded SA debt, leaving all three major agencies' ratings on BB+ and with a negative outlook – yields should fall meaningfully in the fullness of time given prospects for further rate reductions at the short end of the curve and the disconnect between current levels and the absence of inflation risk in the medium term.

- The rand is among the weakest currencies this year given highly strained public finances and the pandemic-driven global liquidation of risky emerging market assets – the currency has probably overshoot its near-term fair value, but over time remains vulnerable given the structural economic headwinds.

## Portfolio Commentary

- Asset allocation added value with no exposure to low-quality credit securities and a material holding in physical gold, while the full weight in foreign assets benefited from extreme rand weakness.
- Hedging strategies on the S&P 500 offered some protection from the market fall as did the underweight allocation to the relatively expensive US market.
- The low weight to SA-focused companies also protected given the severe lockdown related economic effects on companies that were already distressed.
- Government bonds detracted in absolute terms, but selection was positive with the medium-term R186 core bond investment outperforming the ALBI and presented a much better outcome than SA Inc equities and listed property.
- The very low SA listed property position, despite price declines, added value relative to the benchmark as the sector capitulated.
- The largest detractor was Sasol, caught in a perfect storm of ethane-cracker balance sheet stress and a collapsing oil price on the global economic demand shock and an all-out oil price war between Saudi Arabia and Russia.

| Winners                  | Performance Contribution % | Holding Return % | Average Weight % |
|--------------------------|----------------------------|------------------|------------------|
| Foreign Assets           | 3.0%                       | 9.4%             | 33.6%            |
| NewGold ETF              | 1.4%                       | 33.6%            | 4.6%             |
| NED 9.389% (NBK001)      | 0.1%                       | 3.1%             | 2.9%             |
| British American Tobacco | 0.0%                       | 2.2%             | 1.1%             |
| R2048 Government Bond    | 0.0%                       | 8.4%             | 0.2%             |

| Losers                  | Performance Contribution % | Holding Return % | Average Weight % |
|-------------------------|----------------------------|------------------|------------------|
| R186 - RSA 10.5% (R186) | -1.5%                      | -5.7%            | 25.9%            |
| Sasol                   | -1.4%                      | -88.4%           | 1.3%             |
| Capital & Counties      | -0.7%                      | -24.5%           | 2.9%             |
| RMB Holdings            | -0.6%                      | -38.1%           | 1.5%             |
| Standard Bank Group     | -0.6%                      | -38.4%           | 1.4%             |

## Investment Outlook

*World:* Global economic recession is likely on covid-19 pandemic related shutdowns. There has been an unprecedented monetary and fiscal support response, the consequences of which remain unknown. Market volatility is likely to remain high.

Gold should move higher on continued safe-haven demand, while industrial commodity prices are expected to remain under pressure given weak global economic demand. Most government public finances are likely to deteriorate further in the long term.

*South Africa:* Economic recession will deepen on pandemic related lockdowns. There is large uncertainty on corporate earnings given the unknown extent of economic shutdowns. South Africa's already strained public finances will deteriorate further, increasing the probability of World Bank/IMF support in the medium term. Interest rates should fall substantially given the benign inflation outlook and very low aggregate demand. Bond yields should also move lower as the yield curve is expected to flatten

## Conclusion

The portfolio is still defensively positioned with the focus on capital preservation rather than growth. The managers will endeavour to take advantage of any overreaction in the market to acquire or increase our holdings of good quality companies with strong balance sheets and sustainable longer-term earnings growth prospects.

South African investments are at risk given the deteriorating global environment, weak local economy and policy uncertainty and JSE equity investments thus favour global companies that act as a hedge for rand weakness. Select defensive 'SA Inc.' companies will be held and added to where there is compelling value.

Foreign assets are at the prudential maximum with a preference for global equities over bonds and cash. Equity investment is tilted away from the more expensive US markets towards higher growth and better-valued emerging market businesses likely to benefit from long-term structural changes.

We continue to avoid SA retail and commercial property counters given the structural challenges facing the sector. The small listed property position is focused on niche logistic and storage companies and UK-listed value play Capital & Counties.

The Newgold ETF is an attractive, uncorrelated investment which should respond favourably in times of increased geopolitical risk. Gold also acts as a safe-haven asset at times of economic and market stress.

Medium-term SA government bond investments and cash are a meaningful component of the portfolio, offering abnormally high real yields.

The portfolio exhibits reasonably high levels of optionality and liquidity, allowing the managers to take advantage of attractively priced long-term opportunities.

## Responsible Investment Summary

### Proxy Voting Summary Q1 2020

| Resolution Type Name               | Total Count | For % | Against % | Abstain % |
|------------------------------------|-------------|-------|-----------|-----------|
| Adopt Financials                   | 2           | 50%   | 0%        | 50%       |
| Auditor/Risk/Social/Ethics related | 22          | 100%  | 0%        | 0%        |
| Buy Back Shares                    | 1           | 0%    | 100%      | 0%        |
| Director Remuneration              | 9           | 100%  | 0%        | 0%        |
| Issue Shares                       | 5           | 20%   | 80%       | 0%        |
| Loan / Financial Assistance        | 4           | 50%   | 50%       | 0%        |
| Other                              | 1           | 100%  | 0%        | 0%        |
| Re/Elect Director                  | 12          | 100%  | 0%        | 0%        |
| Remuneration Policy                | 6           | 50%   | 50%       | 0%        |
| Shares under Director Control      | 1           | 100%  | 0%        | 0%        |
| Signature of Documents             | 1           | 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 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 were able to 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.



## General comment regarding company approaches to managing pandemic related stresses

As long-term investors, we want to invest in businesses for more than just a quarter or the upcoming year. As a result, we continuously monitor whether management are making decisions that will “save” a short-term interim result or making decisions that will enhance the value of the business over the long term for **all** stakeholders (like improving employee, supplier & customer relationships).

An example that we recently discussed internally was global luxury goods manufacturer, Hermes, that sent out a letter saying:

1. they will pay all employees and will not push retrenchments (goodwill from employees)
2. they will seek no government support (goodwill from government)
3. they switched the perfume factories to manufacture sanitizer within days (goodwill from clients)

We think that is partly why when it recently re-opened the Guangzhou (China) store, it registered \$2.7m in sales in just one day.

Similarly, locally, we note the decision taken by Dischem to withhold rental payments even though they are deemed an essential service and continue to trade. This would be a negative mark against management in our view.

## Notable Engagements

*(Note: reporting at Foord Asset Management house level, specific fund might not be invested in all these companies)*

### Sasol

Engaged with Sasol's remuneration committee, who were looking for feedback on their latest remuneration report.

We stressed that incentive schemes should focus on:

- Items under management's control i.e. costs, volumes, ESG issues, through the cycle returns on capital/equity, etc.
- Should not benefit/suffer from moves in the un-controllables (e.g. oil price and currency).
- Given the latest balance sheet issues, they should consider including an item that incentivises future management to retain a strong balance sheet and/or focus on enhancing cash flow.
- Re-emphasised our opposition to any scheme that results in our investors' equity interest being diluted e.g. share options.

### Tiger Brands

Engaged with investor relations regarding new CEO appointment and the process that the Board of Directors undertook to pick the new candidate and why he was overlooked previously. (company not held in the portfolio).





## **Netcare**

Attended a two-day investor engagement session. First day was National Health Insurance (NHI) focused with the Minister of Health doing a Q&A and then Netcare discussing their preparedness.

Day 2 was a Q&A with management on COVID-19 preparedness, cost efficiency programs and discussion on management's choice of buy-backs over special dividends.

## **Bidvest**

Post results meeting in Foord's offices. Q&A around regulatory approval of Eqstra and PHS acquisitions. Discussion around the rationale & expected synergies regarding the PHS acquisition and related funding. Discussion around the price paid for the acquisition of Adcock shares and divisional restructure post consolidation.

## **Bidcorp**

Post results meeting in Foord's offices. Discussion around the impact on drought fires and Brexit on the Australian and UK businesses. Discussion around COVID-19 impact on the China/HK business and prospects for investment in both countries.

## **Life Healthcare**

Management discussion around the COVID-19 impact on the UK/Italian operations and their preparedness in SA. Q&A around their investment in LMI and the potential for future optionality.

## **Quilter**

Attended a governance meeting with Glyn Jones (chairman) to discuss AGM voting, remuneration policy and capital.

## **MultiChoice Group**

Discussed proposed changes to the remuneration policy which included minimum shareholding requirements for ExCo members, performance hurdles for Short & Long Term Incentives, vesting period and clawback clauses.







## 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.  
Contact details: Standard Bank, Po Box 54, Cape Town 8000,  
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

### 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.

### NEDGROUP INVESTMENTS CONTACT DETAILS

Tel: 0860 123 263 (RSA only)  
Tel: +27 21 416 6011 (Outside RSA)  
Email: [info@nedgroupinvestments.co.za](mailto:info@nedgroupinvestments.co.za)  
For further information on the fund please visit: [www.nedgroupinvestments.co.za](http://www.nedgroupinvestments.co.za)

### OUR OFFICES ARE LOCATED AT

Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001

### WRITE TO US

PO Box 1510, Cape Town, 8000

