NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS VALUE 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 overshot its near-term fair value, but over time remains vulnerable given the structural economic headwinds.

Portfolio Commentary

- The high cash weight protected investor capital, as did the lower allocation in banks.
- The low allocation to the resources sector was positive, but offset by Sasol, which was the largest detractor at a stock level.
- Within financials, stock selection added value with core holding in insurer Santam protecting capital and higher quality RMB Holdings selling off less than Absa (not held) and Nedbank (underweight allocation).
- The low allocation to telecommunications also added value with portfolio holding Vodacom contributing positively and no holding in large benchmark stock MTN which underperformed materially.
- The holding in Capital & Counties detracted in absolute terms, but fell much less than the broader SA-focused property companies where the fund was not invested.

Winners	Performance Contribution %	Holding Return %	Average Weight %
Cash	0.1%	1.6%	6.7%
British American Tobacco	0.1%	2.1%	4.9%
Vodacom	0.1%	1.8%	2.6%
Anheuser-Busch InBev	-0.2%	-17.6%	2.2%
Santam	-0.2%	-5.6%	7.8%

Losers	Performance Contribution %	Holding Return %	Average Weight %
Capital & Counties Properties	-1.4%	-24.5%	5.7%
Hudaco	-1.6%	-30.7%	4.9%
Standard Bank Group	-1.7%	-39.0%	4.1%
RMB Holdings	-3.0%	-38.2%	7.4%
Sasol	-5.4%	-88.5%	5.1%

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

Resources weight reduced on Sasol's share price collapse and covid-19 shutdown effects on commodity prices. The managers continue to avoid precious metals miners with significant SA-specific headwinds. The core resources allocation is in the highest quality diversified miner BHP Group with a low cost, defensive asset base.

The allocation to well managed companies in the healthcare sector was increased, primarily via Aspen as one of its key drugs is used to treat covid-19 ICU patients. The managers also used recent share price weakness to add selectively to hospital businesses with strong long-term positioning.

The low weight to growth-sensitive bank shares is maintained given the base case of persistent SA recessionary conditions and near-term earnings headwinds. Core financials holdings are in high quality insurer Santam and RMB Holdings (FirstRand Bank holding company), which is the highest quality SA bank.

The bias to JSE-listed global businesses remains in place given the higher risks in the SA economy and larger global economic opportunity set – well capitalised companies that should deliver hard-currency real earnings growth through the cycle, supported by expected rand weakness.

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 portfolio is well-diversified and defensively positioned given the global economic contraction and distressed SA economy. High levels of cash and liquid holdings afford the managers excellent optionality to exploit long-term value opportunities.

Responsible Investment Summary

Proxy Voting Summary Q1 2020

Resolution Type Name	Total Count	For %	Against %	Abstain %
Adopt Financials	1	0%	0%	100%
Auditor/Risk/Social/Ethics related	39	100%	0%	0%
Buy Back Shares	4	100%	0%	0%
Director Remuneration	10	100%	0%	0%
Dividend Related	1	0%	100%	0%
Issue Shares	11	45%	55%	0%
Loan / Financial Assistance	2	100%	0%	0%
Other	29	97%	3%	0%
Re/Elect Director	12	67%	33%	0%
Remuneration Policy	3	67%	33%	0%
Shares under Director Control	1	0%	100%	0%
Signature of Documents	3	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 re 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.

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