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NEDGROUP INVESTMENTS GROWTH FUND

Quarter Two, 2020

Nedgroup Investments Growth Fund

Performance to 30 June 2020	Nedgroup Investments Growth Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	6.9%	19.5%	23.2%
12 months	-30.8%	-7.5%	-3.3%

Market Commentary

Global financial markets

For the past year we have 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 US's Federal Reserve had become very market friendly and developed market equities 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 close to zero, joining the rest of the developed market economies 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 supply 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 US and European junk companies afloat, while they should really be going bankrupt. In developed markets we should get used to being 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/mid 2021, that can properly manage COVID-19. Due to the inability to forecast 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 2020. However, these equity markets have now surprisingly recovered extremely sharply in Q2 2020, on the back of the unprecedentedly huge monetary and fiscal stimulus. Global equity markets once again look over-priced. It seems reasonably clear that while the global economies are going to be relatively flat for a couple of years, with zero interest rate policies in developed markets, investors are now buying into equity markets as an alternative to zero yielding cash and bonds. 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 US's S&P 500 is trading on an expensive forward-price/earnings multiple of 24x to December 2020 and 18x to December 2021. In summary, in a very unpredictable world, the economies and the financial markets seem to be out of sync with each other.

[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 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 still in the midst of a necessary lockdown period, which has been "eased" over the past month, enabling 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 very deep recession in 2020, followed by a very low GDP growth rate for at least three years. With SA's high level of debt and a fragile currency, which has weakened by approximately 25% against the US dollar and euro in 2020, we do not have the ability to dramatically stimulate the SA economy. Even though the Reserve Bank has cut interest rates sharply over the past few months and the SA government has also allocated meaningful new funds to the poorest people and smaller businesses. We must now hope that the SA government embraces the private sector and implements the long-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 two 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 more than 2%.

In Q2 2020, the broad JSE indices followed the very strong positive rebound of global equity markets off a low base and rose by between 15% and 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 has meant that the Rand and SA-based companies were even harder hit than their global peers. This has badly hurt 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 on a sustainable basis, 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 approximately 25% below their appropriate price levels, although on an equally weighted market-cap basis, the average company on the JSE is undervalued by almost 70%. While it looks like doom and 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 unit trust sector, the fund's performance was extremely poor in April and May, with a decent recovery in June 2020. As shown in the table at the beginning of the commentary, the fund lagged the peer group and equity index by a significant margin in the second quarter as the mid and small cap stocks weighed on the performance of the fund. The FTSE/JSE mid and small cap indices trailed the FTSE/JSE Top 40 by 9% and 7% respectively over the three months to end June.

While we added excess returns for investors, with best-in-class risk stats, over the long time period of 2001-2018 period, the very poor past six months has negatively impacted the past 12 month returns and 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 almost five-year track record as an "independent" Electus.

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 adequately stimulate their economies due to problems with either their current and fiscal accounts, or both. With its over-indebtedness and twin deficits, SA has limited fiscal ability to provide strong stimulus to the economy, but the recent interest rate cuts and government stimulus will help a bit. 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 some form of lockdown and will be weak for a few years, 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 approximately 25% below their appropriate price levels, although on an equally weighted market-cap basis, the average company on the JSE is undervalued by almost 70%. The well-diversified fund currently has an estimated upside of 90%, which suggests above average absolute and relative prospective returns.

As we always wish to maintain a high level of Active Share and Tracking Error risk in the fund, we currently only hold 22 companies, with all shares having a targeted weight of greater than 2%. The Nedgroup Investments Growth Fund is currently 95% invested in South African listed equities and we always target being more than 98% invested.

Responsible investing and 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 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 or corporate governance engagements in Q2 2020.

Closure of Electus Fund Managers

As Electus Fund Managers closed as a business on 30 June 2020, we would like to say a very big thank you to Nedgroup Investments for backing us as the fund manager of the Nedgroup Investments Growth Fund for the past 19 years. While we had no fund manager resignations over the past 19 years, this did, however, involve us working across 4 different investment houses, showing the strength and versatility of the Nedgroup Investments fund management model. This type of loyalty is hugely appreciated by our Electus team and the extent of the loyalty is also uncommon in the SA fund management industry. While we re-paid Nedgroup Investments' faith in us during the first 18 years, delivering 14% net return per annum and more than 1% of excess return per annum versus our unit trust, general equity sector, peer group, we regret that the past year has been very disappointing.

We would also like to thank the loyalty of many long-term investors in the fund and we believe that the new manager, Laurium Capital, has a top-quality investment team and they have the capability to be very good fund managers of the Nedgroup Investments Growth Fund.

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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