PRIVATE WEALTH PROPERTY EQUITY FUND

Q2 2020

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MARKET REVIEW

The listed property sector (as measured by the All Property Index) posted a pleasing 18,73% return in the second quarter of 2020, recovering some of its losses from the beginning of the year. Property stocks that reported in the quarter continued to deliver anaemic, if any, distribution growth. Dividends also continued to be held back by boards in an attempt to preserve liquidity and to shore up balance sheets ahead of what is expected to be a protracted period of weakening sector fundamentals. Growthpoint Properties, one of the large cap stocks in the sector, is among those that reported results. It declared an interim dividend that was 0.2% higher than the comparable period. It also announced the withdrawal of its full year dividend growth guidance given the uncertainty regarding the impact of Covid-19 on the business. Post quarter-end Growthpoint provided a further update to the market indicating that based on the impact of the pandemic on the business thus far, including the effect of the rental relief that has been granted to tenants and that of the rentals that are in arrears, it expects dividends for FY20 to be at least 15% lower than in FY19. Further, Growthpoint announced that its historic policy of declaring and paying out 100% of distributable income per share is being reconsidered by the board. Vukile Property Fund also reported its FY20 results in the quarter; it achieved 3.2% growth in distributable income per share. The Vukile board decided not to provide dividend guidance for FY21 given the uncertain outlook; it did however indicate that it does not anticipate paying an interim dividend. Similar to Growthpoint, Vukile intends to adopt a variable dividend pay-out policy going forward and will no longer pay out 100% of distributable earnings. We expect other REITs to adopt similar measures as the sector prioritises balance sheet strength over the short to medium-term. The sector is also awaiting feedback from the JSE regarding possible amendments to REIT dividend payment requirements that will enable REITs to retain a greater proportion of their taxable income that is available for distribution; REITs are required currently to distribute minimum 75%. The JSE, together with the FSCA and the National Treasury, have to date announced an interim relief measure that will enable REITs, with financial years ending February 2020 to September 2020, to postpone payment of their dividends by a two-month period; current requirement is for payment to be within four months of year-end.

FUND PERFORMANCE

The All Property Index (J803) delivered an 18.73% return over the second quarter of 2020. The Nedgroup Investment Private Wealth Property Equity Fund returned 16.97% over the period, underperforming its benchmark.

The top contributors to performance over the quarter were overweight positions in Fairvest Property Holdings (+0.70%) and in Lighthouse Capital (+0.70%). The main detractors to performance were overweight positions in Octodec Investments (-1.19%) and Hospitality Property Fund (-1.11%), and the underweight position in Redefine Properties (-1.36%).

FUND POSITIONING AND OUTLOOK

While property shares look more attractively priced today than they did a year ago, we remain cautious given the persistently weak sector fundamentals that we now expect to worsen due to the pandemic. We are particularly concerned with the sector's stretched balance sheets which are as a result of aggressive offshore expansions. The fund continued to maintain large overweight positions in stocks that have relied more on fundamental drivers of income growth than on once-off gains, and to those that have healthy balance sheets. The fund manager is of the view that defensive and prudently managed SA portfolios at appropriate prices will deliver superior performance over the medium-term compared to peers that trade at similar valuations but on lower quality income streams. The fund is also well diversified, with sizeable exposures to Central and Eastern Europe, and to the UK, which will assist in limiting SA specific risks. The level of cash in the fund reduced in the second quarter as it was used to take advantage of attractive valuations; the manager will look to raise cash in the new quarter to be prudent as the outlook for the sector remains opaque.