NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS
Property Fund
Quarter Two, 2020

Nedgroup Investments Property Fund

Performance to 30 June 2020	Fund[1]	Benchmark[2]	Index[3]
3 months	19.1%	18.4%	20.4%
12 months	-40.8%	-37.2%	-40.0%

Market Overview

South Africa's listed property sector rallied 20% in the second quarter as the country moved from alert level 5 to alert level 3. This meant that most tenants that were forced to close their businesses at the start of the lockdown are now operational, generating revenues and in a position to start paying their rents again. During April and May, rent collection rates across the sector averaged between 65% and 75%, although the range across companies was quite wide. Property companies with exposure to regional and super-regional malls reported rent collection rates of below 50% in both months, while industrial and self-storage landlords reported collection rates in excess of 95%. There was a marked improvement in collection rates across the sector in June and that trend is expected to continue for the remainder of the year.

The Monetary Policy Committee of the South African Reserve Bank continued cutting official interest rates during the quarter. As a result, the repo rate is now 275 basis points lower than it was at the start of the year. This is having a positive impact on distributable earnings, although most property companies in South Africa hedge their interest rate risk by fixing rates for periods of up to five years. It is also having a positive impact on interest coverage ratios (ICRs) which are one of the debt covenants imposed on property companies by banks. In the absence of lower interest rates, ICRs are likely to fall below key thresholds, given the pressure on rental levels, increased vacancies and the concessions property companies gave tenants, while those tenants were not able to operate.

Despite returning more than 20% in the second quarter, the FTSE/JSE SA Listed Property (SAPY) index is still down more than 37% since the start of the year. There is very little institutional appetite for property given the challenges the industry faces over the next two to three years, including the growth of online retailing and more and more people working from home. Notwithstanding these concerns, the sector is offering an extremely attractive initial income yield in excess of 12% in an environment where income yields on cash and bonds are at historically low levels and are likely to remain there for some time.

Portfolio Commentary

The Nedgroup Investments Property Fund outperformed the peer group in the second quarter, but slightly underperformed the SAPY index over the same period. Since the start of the year, the fund has outperformed both the peer group (by 3.5%) and the SAPY index (by 5.8%).

During the quarter, only three positions (Octodec, Arrowhead B and Indluplace) delivered a negative contribution to the overall portfolio. The fund's performance was driven primarily by large positions in Tower, Accelerate and Fairvest, that between them contributed just under 12% of the 19% return. The relative outperformance since the start of the year can be attributed to the Fund's limited exposure to regional and super-regional malls, high exposure to convenience and neighbourhood shopping centres, and lower exposure to companies that used cross-currency interest rate swaps (CCIRs) to fund portfolio expansion outside South Africa. The sharp devaluation of the rand this year has meant that most companies using CCIRs have been forced to utilise cash resources to post margin. It is anticipated that the use of CCIRs will diminish and this is likely to have a negative impact on short-term distribution growth for those companies that have utilised them extensively.

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[1] Net return for the Nedgroup Investments Property Fund, A class. Source: Morningstar (monthly data series).
[2] (ASISA) Real Estate General category average
[3] FTSE/JSE South African Listed Property Index (J253T)

The second quarter distribution was obviously lower than previously expected as several companies in the sector delayed the payment of their interim dividends. The SAREIT Association is negotiating a relaxation of the requirement to pay out at least 75% of distributable earnings in any financial year, but several management teams have suggested that the JSE and the FSCA are unlikely to approve that relaxation. More dividends are therefore likely to be paid in the fourth quarter this year than in the same period in 2019 as companies pay both their interim and final dividends as a single payment. The JSE has allowed REITs in South Africa to delay the payment of their dividends by up to two months (i.e. six months after their year-ends).

Top 5 winners and losers for Q2 2020:

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Tower	8.10%	4.07%	**Octodec**	4.69%	-1.41%
Accelerate	5.99%	4.03%	**Arrowhead B**	7.33%	-0.72%
Fairvest	13.04%	3.78%	**Indluplace**	7.97%	-0.53%
Spear	6.57%	1.47%	**Equites**	1.10%	0.07%
Grit	12.89%	1.19%	**Vukile**	1.39%	0.10%

Current positioning and outlook

There was very little need to change the make-up of the portfolio during the second quarter, except to rebalance positions based on relative performance. Despite an expected reduction in pay-out ratios towards the minimum level of 75% of distributable earnings, the current one-year forward income yield, based on Bloomberg, FactSet and IRESS forecasts, is still well in excess of 15%. This compares very favourably with the income yields available from other asset classes in South Africa and should support valuations in the sector. As the lockdown conditions in South Africa have eased, more and more tenants have been able to resume trading and paying their rents. Unfortunately, economic activity remains weak and will take some time to return to the levels of 2019. This is likely to put pressure on market rentals and occupancy levels, but dividends from the sector are likely to accelerate in 2021 from the low point reached this year.

The fund has built up a more substantial cash position which is expected to be utilised in the coming weeks to add industrial/warehousing exposure at more attractive entry levels. Once that cash has been utilised, the fund is expected to remain fully invested to capture the expected upside in prices.

From current levels and based on historically high initial income yields, the SA listed property sector is expected to deliver above-average total returns, even in the absence of meaningful distribution growth. The income yield alone should deliver extremely attractive returns for investors and continues to provide a regular flow of cash for investors in retirement, drawing an income from a living annuity.

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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