NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Three, 2020

Performance to 30 September 2020	Nedgroup Financials Fund R	ASISA SA Equity Financials
Q3 2020	-1.5%	-0.7%
12 Month	-26.4%	-29.0%

Market Commentary

After bottoming on 23 March, markets continued their good performance until the end of August when the US yield curve started steepening. This led to a fall in tech/growth stocks with the financial sector rallying on this. However, the second Covid-19 wave ended this and caused financials in Europe, the US and the UK to retreat - giving up all their gains and falling by around 8% in September.

Due to the rand strengthening (+3.7% vs. the US dollar) and further easing of Covid-19 lockdown regulations, South African banks finally started recovering and did not follow the international downward trend in September. FirstRand and Absa gained 8% and 6%, whilst Nedcor and Standard Bank were essentially flat.

The insurance sector continued to fare poorly with Old Mutual, MMI and Liberty falling sharply by 12% to 14% whilst Sanlam fell 9%.

Fund performance, contributors & detractors for past quarter

Top 5 Contributors	Weight Mean	Return in Rand	Contribution in Rand
FirstRand Group Ltd*	14.8%	12.4%	1.2%
PSG Group Ltd*	6.2%	7.2%	0.9%
Transaction Capital Ltd	2.1%	6.2%	0.3%
Trematon Capital Investment Ltd	1.4%	4.2%	0.3%
Capitec Bank Holdings Ltd*	1.6%	3.9%	0.4%

Top 5 Detractors	Weight Mean	Return in Rand	Contribution in Rand
Investec*	6.1%	-10.1%	-0.6%
Santam Ltd	4.0%	-9.5%	-0.4%
Sanlam Ltd	13.2%	-7.8%	-1.7%
Sasfin Holdings Ltd	2.5%	-7.3%	-0.3%
Denker Global Financial Fund	20.3%	-4.5%	-0.5%

**Returns and contribution are distorted due to unbundling actions (Firstrand/RMI; PSG/Capitec; and Investec/NinteyOne)*

The fund had a negative quarter, returning -1.5% (vs. the FTSE/JSE All Share Index's 0.7% return) and bringing the total fall for the year-to-date to 27.1%.

During the quarter the fund's performance was helped by the largest local investment (FirstRand) gaining 8% versus a flat financial index. However, the other two large investments (Sanlam and the Denker Global Financial Fund) detracted, in line with the other insurers and the MSCI World Financials Index.

Portfolio Changes, current positioning and outlook

Only two changes were made during the quarter. We increased our holding in PSG before the unbundling of Capitec (to benefit from the discount unlock and the low Capitec price at the time) and funded the purchase by reducing our holding in Santam.

With the fund's combined PSG/Capitec holding increasing from 7% to above 9%, effectively we also obtained Curro, Stadia and Zeder at very attractive multiples along with Capitec which is trading at a February 2021 FP/NAV of 4.7x (the lowest in the past six years). However, it must be noted that Capitec's February 2021 ROE (return on equity or capital) should be about a third lower than this year (18% vs. 26%). So relative to its past it shows less upside but management have demonstrated their quality and the quality of the franchise during the Covid-19 recession, and this should translate into outperforming growth (in both loans and profit) in the upswing.

Santam is one of the best managed insurers in the world, but will be affected in the short term by the legal battle over whether Covid-19 induced business interruption losses should be covered by their policies or not. At this stage Santam seems to have made sufficient provisions but both the uncertainty and the reduced demand for insurance in a downsized South African economy will depress earnings. Capitec on the other hand can still grow its market share even in a smaller economy by offering better services at a lower price than its competitors.

As we noted in the previous quarter's commentary, unless the economy deteriorates further the banks' provisions will prove to have been sufficient for the bad debts that will follow. At the same time the combination of good rainfall (agriculture exports and food prices) and the strong positive trade balance should keep the rand stronger for a while and allow the SARB to keep interest rates lower than anticipated. This and the improving political mood (after the recent spate of corruption related arrests) will help confidence, meaning the economic recovery might initially surprise positively and bring about stronger demand for credit than currently anticipated.

We expect banks globally to re-rate over the next 12 months as the global economy continues to recover, the US yield curve steepens, and the financial sector increases dividend payments and is allowed to buy back shares again.

Whether the SA banks re-rate in line with that global re-rating will depend on the ability of the local economy to overcome the structural problems we now face, but the banks should generate good ROEs which eventually should lead to some re-rating and satisfactory investment returns.

Conclusions

The financial sector is trading at record low valuations. On a P/NAV basis the last time they traded where they are now was in the mid-1980s after President PW Botha's Rubicon speech which led to capital flight and introduction of capital controls. History shows that investing when sentiment is negative at depressed valuations generally leads to subsequent excessive investment returns. On that basis, I believe investors should seriously be considering increasing exposure at these valuations.

Responsible Investment Comments

Covid-19 has had the short-term effect of re-ordering priorities. Whilst ESG considerations have played a role in long-term plans, in the short term managements' priorities have been to get through the pandemic with minimal disruption and loss and in fact in some cases to simply survive.

Our investment philosophy includes investing in companies that rank ESG highly on their strategic agenda and visibly pursue a sustainable strategy in this regard. It is frustrating, however, that the providers of corporate ESG scores seem to be battling with scoring the financial sector. So it is difficult to measure whether the companies in our portfolio have indeed on aggregate improved their score. However, on an individual company basis one can see how the industry is changing:

- Santam (a holding in the fund) ranks well and recent updates from the company show tangible evidence of its commitment to ESG through its key role in helping build resilient societies and running a responsible business (as noted in their latest annual report). Examples of this include CSI spend in core focus areas such as risk awareness and disaster response and relief. Santam has also made an impact via its Resilient Investment Fund which has built houses, created employment and supplied homes with green energy. Finally, Santam has also flagged climate-related risks as core to sustainability. In this regard, the group has shown progress in improving the group's CDP Score (an industry body which scores companies globally based on their journey through disclosure and towards environmental leadership) with the Sanlam (and Santam) group score improving to a B. This is higher than the African average of B- and higher than the financial services sector score of C.
- Similarly in Europe, ING (one of our largest offshore investments) '*has sharply cut the carbon emissions linked to its lending to the power industry over the past year after reducing funding to coal-fired power plants and boosting financing for renewable energy, ING is part of a small group of banks seeking to lead the way in aligning a combined 2.4 trillion euros in lending with the 2015 Paris climate agreement, aiming to keep global warming well below 2 degrees Celsius above pre-industrial norms by 2050.' (Reuters, 9 October 2020)*
- Jamie Dimon (CEO of JP Morgan, our largest investment in the Denker Global Financial Fund) has committed $5bn to providing opportunities to underserved communities. In a separate action he is also penalising bonuses of managers who have low scores on promoting diversification.

In the meantime, President Trump is doing his best to fight ESG. Earlier this year the Trump administration said it would take a serious look at the decisions by major US banks not to finance drilling projects in the Arctic to see if those moves violate federal law.

As with everything else, it is the largest companies that have resources available and the business momentum to make an impact. We notice a high correlation between market cap size and ESG score. Smaller companies often simply don't have the resources in their early years or the size to implement diversity, community and other ESG impact programs. Yet it is a fact that smaller companies play the largest role in an economy in terms of creating employment and have the highest potential to generate high investment returns.

The fund's track record has been built on our team's ability to find and invest in smaller companies (e.g. Capitec, Coronation, PSG and, many years before that, Investec). So it is a real challenge to improve the fund's ESG score whilst not ignoring smaller future winners.

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.

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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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