NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS MANAGED FUND

Quarter Three, 2020

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Performance to 30 September 2020	Nedgroup Investments Managed Fund A	ASISA category average	SA CPI plus 4%
3 months	1.1%	1.3%	3.0%
Year-to-date	-3.1%	-0.6%	3.2%
12 months	3.6%	1.8%	7.2%

Source: Morningstar

Overview

Low interest rates, subdued inflation and significant stimulus continue to buoy global markets

The MSCI World and the MSCI Emerging market indices posted returns of 8.0% and 9.7% over the quarter. Globally, economic data surprises to the upside have been significant, supporting the V-shaped recovery driven by stimulus and record budget deficits. High personal savings rates should help sustain spending going forward. US, Euro and Japanese 10-year real bond yields are negative, helping to prop up equity valuations.

The Fed's new Monetary Policy Framework is more accommodative and only targets average inflation of 2%, while allowing for temporary overshoots of this level. Despite extremely accommodative monetary and fiscal stimulus, inflation expectations remain muted. US breakeven inflation, the expected inflation implied by the difference in index-linked and nominal bond yields, has fallen from a peak of 1.8% to 1.6% indicating the market's scepticism of the Fed reaching its 2% target rate. Hence, in the short-term, interest rates should remain low.

The near-term market risks including the resurgence of Covid-19 infections and the US stimulus package negotiations should be manageable. It is in both Democrat and Republican interests to get a stimulus package passed. With mortality rates faring better than infections and the likelihood of a vaccine on the horizon, the impact of Covid-19 will hopefully not result in a significant adverse market impact.

With the gap between US rates and other developed economy rates having been largely closed and given the overvaluation of the dollar relative to most currencies (through a purchasing power parity lens) a weaker dollar seems likely. This together with fiscal stimulus especially from China should be positive for commodities given their significant proportion of total demand.

Low interest rates are a boon for the short term but a problem for the long term

The 40-year bull market in bonds has been a tailwind for equities. Negative real yields should not be sustainable over time. Although the bull market may have ended, rates could remain depressed for an extended period. Record levels of government spending on top of elevated levels of debt financed at a cost below inflation should be a recipe for inflation. Unless central banks can carefully balance inflation at a level close to the target, bonds and consequently equity markets would likely be adversely impacted. This is a key risk faced by financial markets over the next few years.

However, not all sectors have benefited from the fall in interest rates. The value segment has underperformed the growth segment for approximately 20 years and is trading at the deepest discount on record. Prior to this, value outperformed growth as investors had historically been overly optimistic on earnings forecasts for growth companies. This has not been the case with the FAANGs where superior earnings growth has been delivered for a number of years now. Notwithstanding this, ratings for some of the large-cap tech companies do appear to be stretched and have run ahead of earnings growth. This can be at least partially explained by the fact that high growth companies are more geared to long term interest rates and due to the FAANGs being more of a beneficiary of the pandemic than other sectors.

Banks, which are a meaningful portion of the value segment, have been negatively impacted by lower rates as they are forced to reduce the cost of lending while their funding costs remain at zero i.e. their margins get squeezed. Hence, although markets could come under pressure when rates rise, some sectors which are not on pricy valuations should still deliver reasonable returns provided they generate reasonable earnings growth.

Are we seeing green shoots in South Africa?

There have been a number of positive developments over the last month. The wheels of justice finally seem to be turning with some individuals being sentenced for corruption. NERSA has approved a plan to tender 12GW of power generation capacity. ICASA (Independent Communications Authority of South Africa) has released the tender for broadband spectrum which will raise R15bn for the fiscus.

Unfortunately, Treasury's sourcing of an additional R10.4bn to support SAA's rescue process was disappointing in so far as it speaks to their general commitment to fiscal consolidation. The medium-term budget in October will hopefully address this as well as providing more clarity on their commitment to the R233bn of expenditure savings mentioned in the June budget. We still await sign off on much-needed infrastructure projects that will help drive employment and economic growth.

Falling Covid-19 case numbers and significantly lower interest rates are raising economic activity from trough levels. Spending from mid-level consumers has started to pick up as evidenced by housing activity and retail spend. The positive trade account coupled with an improvement in global growth has been supportive of the rand.

Equity positioning and outlook

Domestically exposed companies are trading at low levels relative to their history and other emerging markets. The outlook for South Africa has improved recently but remains highly uncertain. We have moderately increased our exposure to domestic companies where valuations are not discounting a recovery in growth to pre Covid-19 levels and where balance sheets are healthy.

Growth in global economies and increased stimulus from China should be positive for commodities and global cyclical shares. Our commodity exposure remains primarily through the platinum group metal mining sector where free cash flow yields remain generous. We maintain a meaningful exposure to Naspers. Tencent, Naspers' major holding, is trading in line with its historic valuation levels unlike US large capitalisation tech companies that are on stretched valuations. Furthermore, Naspers is trading at a discount of over 50% to Tencent and its other holdings.

Property remains optically cheap

Property valuations remain optically cheap. We selectively purchased some domestically exposed counters where the balance sheets are sufficiently well capitalised to withstand lower rental and property valuation levels. Our overall property exposure remains conservative.

Long term interest rates remain elevated despite the fall in short term rates

The yield curve in South Africa is extremely steep post the recent rate cuts. The real yield on SA long bonds has become more generous as inflation has reduced. However, domestically exposed equities are also offering decent value. Hence, we have not increased our exposure to long-duration bonds. We have reduced our exposure to short duration bonds where yields have fallen and deployed the proceeds into equity.

Portfolio positioning

Over the quarter we reduced our net exposure to the diversified, PGM and gold mining sectors. We continue to maintain a significant exposure to the PGM sector. We also reduced our exposure to Sasol post its recovery. We increased our exposure to Richemont, MTN and Anheuser-Busch. We increased our exposure to domestically focused companies with compelling valuations, such as Standard Bank, Hyprop, Motus, Pepkor, Old Mutual and Bidvest.

Performance Commentary

Our position in the PGM miners was a net contributor to performance. An increase in the PGM basket price helped drive the PGM miners higher. African Rainbow Minerals performed strongly over the quarter helped by a buoyant iron ore price and an increase in the PGM basket price. Positions in FirstRand, Capitec and Cashbuild contributed to performance. Increased activity in the home renovations market helped the prospects for Cashbuild.

Naspers underperformed over the quarter as its discount to its underlying holdings widened to over 50%. Sasol and Glencore underperformed over the quarter. Our purchases of Hyprop and Vukile Property fund detracted from performance as they underperformed despite their low valuations. British American Tobacco underperformed due to concerns of a Biden win in the US potentially placing more regulatory pressure on the tobacco industry.

Contribution over a one-year period as at 30 September 2020:

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Naspers Ltd	6.0%	5.0%	Absa Group Ltd	1.7%	-2.0%
Sibanye Stillwater Ltd	3.8%	2.3%	RECM and Calibre Ltd	1.6%	-1.4%
British American Tobacco plc	6.2%	2.2%	R2030 SA Govt. Bond	0.8%	-1.2%
Sasol Ltd	1.6%	0.9%	Netcare Ltd	1.3%	-0.7%
African Rainbow Minerals	1.7%	0.9%	Anglogold Ashanti Ltd	1.0%	-0.7%

RESPONSIBLE INVESTING

Company / issuer engagements

SASOL

We engaged with the Chairman of the Remuneration Committee of the Sasol Board in September 2020 regarding the remuneration policy and incentive targets for FY21. We received a letter from the Chairman thereafter providing more detail about the FY21 STI targets, LTI targets, the peer group used to determine the remuneration, the remuneration policy design principles, and the explanations on the severance packages.

SIBANYE

We engaged with Sibanye Investor Relations team on the purchase of a small corporate finance business and the conflict of interest regarding the owner of the business. The conflict of interest was not related to the purchase of the corporate finance business as Sibanye had previously worked with the company before.

IMPALA

We wrote a letter to Impala in September 2019 to express our concern around the remuneration policy, specifically the weighting of variable pay that is linked to short term criteria versus the portion that is linked to long term criteria and Truffle have voted against the remuneration policy.

NEBDANK

Truffle attended the Nedbank Annual Governance (ESG) roadshow in May 2020. Which focused on ESG during Covid-19, governance matters, social and environmental matters, and resolutions for the AGM. These roadshows assist us in understanding the company's policy's and implementation of ESG as well as with proxy voting recommendations.

SOCIAL

We have engaged with the various platinum companies regarding relationships with the unions and surrounding communities as this is crucial to ensure minimum operational disruptions and damage to property.

ENVIRONMENTAL

Truffle formed part of a group of asset managers who advocated to Shoprite, Massmart, PnP and Spar to accelerate the reduction or even total elimination of "single-use" plastic shopping bags in stores.

We are engaging with the mining companies, especially those in the platinum and gold sectors, about the risks surrounding tailings dams, with specific reference to safety issues, additional capex spend that might be needed and environmental impact studies.

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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