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# NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter Three, 2020

## Nedgroup Investments Opportunity Fund

| Performance to 30 September 2020 | Nedgroup Investments Opportunity Fund[1] | ASISA category average | FTSE/JSE ALSI |
|---|---|---|---|
| 3 months | 2.7% | 1.1% | 0.7% |
| 6 months | 16.9% | 12.6% | 24.0% |
| 12 months | -3.4% | 2.8% | 2.0% |

## Market commentary

The market has a lot to digest, which includes a resurgence in Covid-19 infections (2nd wave), a too-close-to-call US presidential election and an uneven uptick in growth post the second quarter collapse. Markets are also watching central banks closely – forever wanting and expecting more stimulus. It's been quite clear for a while that monetary policy has run its course and that fiscal stimulus is now required to kickstart and maintain global growth momentum.

After the sharp rebound in second quarter global asset prices, the third quarter of 2020 was more subdued. The JSE All Share Index rose +0.7% in Q3 2020 continuing the recovery from the Covid-19 induced market crash trough recorded in late March 2020 and bringing the year to date return to stand at -2.5% by the end of September. For the quarter the Resource sector (+6.0%) was again the strongest, while Financials (-1.6%) and Industrials (-2.3%) were again the weakest, driven by the Property sector (-20%) which continues to perform poorly.

Global markets continued to climb higher. For the quarter, the MSCI World index posted a US$ total return of 8.0% and has returned 2.1% year-to-date. The MSCI emerging markets index gained 9.7% over the quarter (-0.9% year-to-date).

The general stance has been that central banks and governments will do whatever it takes to get economies on a reasonable growth path and are willing to tolerate higher inflation. The Fed has taken the lead in terms of offered support, cutting rates aggressively close to 0% and engaging in QE (creating new money to purchase debt), which involves buying $1.7trn of federal debt, promising to buy up to $750bn in corporate debt and $500bn in state and local government debt. It is likely that the global investment environment will continue to be characterized by negative real interest rates, fiscal expansion, and massively growing money supply.

With South Africa in a weak fiscal position going into Covid-19, we have less room to manoeuvre than most other countries. Our debt to GDP ratio is currently 82%, more than 15% above what it was projected to be, and frustratingly almost 22% of revenue is now going purely to servicing debt. The prospects of some IMF assistance and/or debt restructuring are becoming more and more likely over the medium-term.

During the third quarter the South African repo-rate dropped to a multi-decade low of 3.5%. While we have been accustomed to positive real money market rates for many years, this seems to be something of the past for the foreseeable future. The stark day-to-day realities of Covid-19 are still with us in South Africa with a peak in infections only likely in the third quarter of 2020. The bullish trajectory of global markets feels somewhat disconnected from the harsh economic realities so many corporates and sovereigns are still experiencing because of this crisis.

[1] Net return for the Nedgroup Investments Opportunity Fund, A class. Source: Morningstar (monthly data series).

The markets, however, have reminded us that it's a mechanism that discounts expectations in future cash-flows and profits. But one does suspect the massive stimulus from central banks, low money market rates and bond yields have added fuel to the asset market fire. The IMF recently reminded us of the impact of the pandemic and now expects global gross domestic product to fall 5% this year.

## Portfolio Commentary

The fund's top five performing positions for the quarter added 4.5% to our return while the bottom five detracted 1.3%.

| Top contributors | Average weight | Performance contribution | Top detractors | Average weight | Performance contribution |
|---|---|---|---|---|---|
| Royal Bafokeng Convert | 5.5% | 2.63% | Eurostoxx note ASN 087 | 2.8% | -0.43% |
| Royal Bafokeng Ltd | 1.0% | 0.72% | Alexander Forbes | 1.7% | -0.27% |
| Naspers | 6.8% | 0.30% | Dipula A | 0.9% | -0.23% |
| Capitec | 1.0% | 0.42% | Anglogold | 1.1% | -0.20% |
| Goldfields | 0.4% | 0.40% | Prosus | 0.82 | -0.19% |
| Total | | **4.47%** | | | **-1.32%** |

The Royal Bafokeng Convertible Bond was the largest contributor to performance, on the back of a very strong run up in the rand PGM basket price. We continue to hold a 6.7% position in the Royal Bafokeng Convertibles, as it still offers material upside should the share price rally but slightly less downside than holding the shares outright. Furthermore, RBP has lagged the other platinum producers somewhat and we are hopeful that it still has some catching up to do. We have been patient investors in this firm for a long time and this is finally being rewarded as the production growth profile of this firm is more attractive than any other in the sector.

Capitec, one of the highest quality banks listed in South Arica was a positive contributor over the quarter. The banks are still trading close to all-time lows on various valuation metrics, with current market levels implying permanent structural damage to the banking industry. Any economic recovery will be accompanied by a strong recovery in the banking sector as lending resumes and bad debts ease from a low base leading to recovering earnings and resumption of dividends. Whilst there will be continued pressure and volatility in the short term, we believe the risks are compensated for by the attractive entry point currently.

Our largest property holding, Atlantic Leaf Properties, which operated in the UK industrial and logistics markets, was bought out by a private equity firm Apollo at a substantial premium. This highlights to us that there is great value to found amidst the property sector fall-out and that patient capital is starting to recognise it. South African Property stocks have been aggressively sold down. The SA REIT Index is down nearly 75% (excluding income) since its highs in late 2015. Despite the obvious challenges, we are now finding compelling opportunities in some of the higher quality, more prudently managed businesses. At quarter end we had a 4.6% allocation to some of the better quality REITS, which our analysis suggests should provide shareholders with highly attractive sustainable income yields (well into the teens at a portfolio level). We continue to add selectively to those counters with clear strategies, better balance sheets and sensible management. For the most part we continue to avoid the large retail and office REITS.

Despite selling some Naspers it remains a top10 position in the fund at 1.9%. The investment merits for this counter in our view remain exclusively driven by the prospects for the primary asset which dominates the portfolio – Tencent, on whose prospects we remain very positive. There is tremendous value in the share, with Naspers trading at close to 50% discount to the sum of its parts.

## Current positioning and outlook

We believe that in the longer term, with global interest rates likely to remain at extremely low levels, it is appropriate to have a high allocation to real assets, such as equity and property, which are currently priced very favourably. These 'real' assets will also fare better should all the global stimulus measures ultimately lead to some inflationary pressure.

For the most part, the portfolio consists of high quality, well capitalised business franchises that we are confident will survive the current turmoil. We understand that in the short term it can be difficult to see through to the recovery, but there is no doubt that the portfolio currently offers compelling value and that returns in the medium term should be very good by historical standards.

We have maintained our full allowable exposure to offshore assets, although we hedged some of our currency exposure at weaker levels to lock-in some of the weakness and partially protect us from some ZAR strength without giving away any immediate upside. This hedge expired in September and we now have full exposure to any currency weakness from here.

## Conclusion

The recovery in asset prices since the March crisis lows has been sharp in both scale and speed. Fiscal and monetary stimulus play a large role in this resilience. While global equity markets are now positive for the year; we remain in extremely uncertain times and we are certainly not complacently concluding that the worst is behind us. The disruptive effect of the virus on the global economy will continue until an effective vaccine is deployed.

Globally, the pending US presidential election in November is the most significant political event. The road to the White House is anticipated to be volatile. A Biden victory is expected to be supportive for emerging markets.

In South Africa, signs of government progress on the policy front as well as their anti-corruption efforts bode well for now. Last week key anti-corruption institutions made a series of arrests of public and private sector officials implicated in investigations into corruption, fraud and other related infringements. We eagerly await the outcome of the impending MTBPS. There has never been greater urgency to enact long-delayed reforms to reverse state decline and up-end the gross mismanagement that has epitomised the country's governance in the past decade (the 2010s were the worst growth decade since WW2).

Despite the recent positive developments, we still face much uncertainty regarding the future path of our economy. For example, availability of electricity remains a big risk – it is a binding constraint that continues to hold back productivity and investment growth. Without it, the country's growth potential will remain stuck at around 1%, even if progress is made in other areas.

## Responsible Investment Comments

ESG represents a theme of growing importance and focus. ESG factors are integrated into our investment analysis to strengthen the decision-making process and ensure that investments generate long-term value in an ethical manner. Our approach and commitment to ESG also enhances our value proposition to our clients.

Notable engagements during the third quarter of 2020 include:

- Sasol: Discussion regarding their ESG roadmap beyond 2025.
- BHP Group: Engagement regarding the sale of certain coal assets, Scope 3 impact and options to address this.
- Reinet: Engagement regarding the NAV discount and suggestions to unlock the trapped value.
- JSE: Engagement with the Chairman of the Board regarding remuneration and other business matters.
- Investec: Discussion regarding various governance matters, with a focus on remuneration.
- Exxaro: Engagement regarding their coal exposure as well as opportunities to offset this through green energy (wind farms).

# 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
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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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