PRIVATE WEALTH EQUITY FUND

Q3 2020

see money differently

MARKET REVIEW

The ALSI posted a return of 0.7% during the third quarter. The sectors leading the advance were Basic Materials +6%, Consumer Services +4.7% and Telecommunication +3.3%. The decliners included Healthcare -7.2%, Technology -6.1% and Financials -1.6%. The SWIX40 returned -0.49% for the period.

FUND PEFORMANCE

Nedgroup Investments Private Wealth Equity Fund

Performance to 30 September 2020 ('R)	Fund[1]	Benchmark[2]
3 months	1.08%	-0.49%
12 months	-11.83%	1.80%

Top 5 contributors and detractors for Q3 2020: Overweight positions

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Alibaba	4.3%	0.9%	**Cigna Corp**	2.3%	-0.3%
Shoprite	2.1%	0.7%	**Citigroup**	1.4%	-0.3%
PSG Group	2.5%	0.6%	**Adcorp**	0.3%	-0.2%
Altron	4.1%	0.4%	**Remgro**	0.3%	-0.2%
Comcast	2.4%	0.3%	**Mr Price**	0.8%	-0.2%
Facebook	2.2%	0.3%	**Raytheon Tech**	1.9%	-0.2%

Top 5 contributors and detractors for Q3 2020: Underweight positions

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Naspers	-21.7%	1.3%	**Impala Platinum**	-2.6%	-0.6%
Anglogold Ashanti	-3.1%	0.4%	**Gold Fields**	-2.4%	-0.5%
British American Tob	-0,3%	0.2%	**Sibanye Stillw.**	-2.5%	-0.5%
Old Mutual	-1.2%	0.2%	**Northam Plat**	-1.2%	-0.4%
Nepi Rockcastle	-0.7%	0.2%	**Discovery**	-1.0%	-0.2%
Anglo Platinum	-1.9%	0.1%	**Absa Group**	-0.9%	-0.2%

[1] Net return for the Nedgroup Investments Private Wealth Equity Fund, A class. Source: Morningstar (monthly data series).
[2] Benchmark is the SWIX40.

PORTFOLIO OVERVIEW

> *"Market inefficiencies are visible every day to practitioners. But the anomalies do not automatically close. The challenge is having the conviction and the staying power and the process to exploit them. There can be occasions when valuation anomalies persist for months or years or even decades."*
>
> 10½ Lessons from Experience: Perspectives on Fund Management: A book by Paul Marshall

International equities

The Fund's direct international exposure is predominantly to US-listed companies. We have provided a brief comment on the three biggest positions as well as a smaller position in Bed Bath & Beyond.

Alibaba: BABA becomes 9988HK

The impact of the trade war between the U.S. and China has thus far had little impact on Alibaba. The Company continues to benefit from the long-term structural upgrade of the Chinese consumer, which has experienced limited impact from global trade, as well as COVID-19. However, in recent months, the U.S.'s rebuke for China has moved beyond trade with the passage of the Holding Foreign Companies Accountable Act in the Senate. The Act aims to increase oversight of Chinese companies listed on U.S. exchanges and force these companies to comply with new regulation or face the possibility of delisting.

While Alibaba has stated that it will aim to comply with any incremental regulation, conflicting laws between China and the U.S. might make it difficult to do so. In late 2019, Alibaba completed a secondary listing in Hong Kong with the official goal of diversifying its investor base and the unofficial goal of decreasing the risk of worsening tensions between Washington and Beijing. We are of the view that deteriorating tensions can increase pressure on Alibaba's U.S. listed ADRs in the future and cause it to trade at a discount. In response the fund has switched its Alibaba ADR holding from the U.S. to Hong Kong listed shares.

Comcast: Peacock signs up 15 million subscribers

Comcast's diversified portfolio of businesses have helped it weather the COVID-19 storm. In a recent update to shareholders, management stated that it will add more than 500k broadband subscribers, which will be its best quarter additions yet. This helps to offset weakness in its media businesses caused by COVID-19. NBCUniversal has been affected by sub-optimal volumes at its theme parks and delaying of its blockbuster movies Fast & Furious 9 and Minions to 2021. NBCUniversal and Sky have also been impacted by the cyclical downturn in advertising, however, which has started to recover aided by strong political spending in the U.S. and the return of sport, which is especially impactful for Sky.

Management disclosed that its streaming platform, Peacock, has seen strong usage with signups reaching 15 million. Peacock which provides subscriber options from a free ad-supported subscription to a premium $10 no-ad subscription, launched to its TV and Broadband subscribers in April and nationally in July.

Cigna and the approaching US election

The political uncertainty caused by the run up to the U.S. elections and the death of Justice Ruth Bader Ginsburg, have weighed on the health insurance and administration industry, including our holding in Cigna. One health care reform proposed during election campaigning is the opening of government run healthcare plans to anyone, which may impact Cigna's strong commercial health insurance and administration business. Another is drug pricing reforms aimed at pharmaceutical companies, which can weigh on the top-line of Cigna's pharmacy benefit manager (PBM).

The death of Justice Ginsburg and the Republicans' push to add a new conservative justice to the Supreme Court has increased the risk that parts of the Affordable Care Act (Obamacare) might be repealed. This will leave millions without healthcare and impact government volumes for insurers, a sector which Cigna has relatively lower exposure to. While we see little reprieve to this uncertainty for some time, we remain confident in Cigna's ability to continue to grow its cash flow over time, with the current discounted share price providing a large margin of safety against any adverse outcomes.

Bed Bath & Beyond up 6x from the March lows as of the time of writing

The Fund purchased a small position in Bed Bath & Beyond (BBBY) towards the end of 2019. At the time, a leadership purge marked the beginning of a turnaround strategy. The disposal of non-core banners, floor space rationalisation, an improvement of the e-commerce offering, and improved merchandising were some of the low-hanging levers which the new management team set out to pursue. And then COVID-19 arrived. The pandemic saw market participants questioning the survival of retail under lockdown and beyond. Fortunately, BBBY has had a sound balance sheet to mitigate the period of business interruption risk which occurred during the peak of the lockdown.

More recent numbers from Bed Bath & Beyond for Q3 show that management has indeed started to deliver on what they had originally set out to achieve. Albeit off a relatively low base, online sales have seen significant traction and margins in the business have started to respond positively. Mr Market has responded by swinging from absolute fear to greed in a relatively short time frame. From the market lows, the counter is currently up 6x. The Fund has used this swing to more rational expectations and confidence in the turnaround plan to reduce the position size.

Domestic equities

PSG unbundling and exiting Remgro in favour of PSG

During the period under review, PSG undertook the unbundling of the majority of its stake in banking group, Capitec. The Fund held limited exposure to PSG in the past given its overriding skew to Capitec within its portfolio mix, coupled with our concerns over Capitec's stretched valuation.

Having completed the unbundling, the Fund has built up its stake in PSG into a top 10 position by exiting investment holding company sector peer, Remgro, and by switching PSG's listed holdings (Curro and Stadio) directly into PSG itself. While the investment holdco sector remains deeply discounted, our view is that PSG's no fee structure, more dynamic asset portfolio and active management team supported this move.

Exited BHP, added to Anglo American

BHP is a large-scale miner with low-cost facilities in stable jurisdictions, led by a prudent management team. Its Australian iron ore and met coal mines, along with its copper mines in South America are all tier one mining assets with structural cost benefits, generating cash flows throughout the cycle. While we remain positive on the quality aspects of BHP, its commodity basket faces downward pressure over the coming years. Iron ore, which dominates spot earnings exposure, trades well above cost support levels and is likely to pressure future earnings, even if coal, oil and copper prices continue to improve.

Anglo American is a more-diversified miner with attractive growth prospects. It's key differentiators from BHP, diamonds and PGMs, faced strong Covid-19 challenges but are showing meaningful signs of recovery. Its Quellaveco copper project in Peru is nearing completion and delivers low-cost growth in a future-facing commodity. Anglo American has a basket of several other initiatives in crop nutrients, PGMs and diamonds that will strengthen the company's position and advance earnings.

Reduced Shoprite

Food retailer, Shoprite, held a top 10 position in the Fund for some time. The quarter under review saw a sharp reappraisal by the market of the counter following the release of its full year 2020 trading update and subsequent results publication.

Shoprite reported a 6.2% increase in Group sales, underpinned by a strong performance from SA supermarkets. The gross margin was 50bps higher driven by a recovery in supplier allowances and supply chain gains. Operating costs grew 6.9% (+5.8% excl. covid-19 related costs) and trading profit was 10.4% higher (excl. hyperinflation) with the trading margin improving 20bps to 5.3%. Management delivered on its target to reduce inventory levels (-9.8%), contributing to the improvement in the Group's cash flow and financial position. Net debt declined by R6.1bn to R2.0bn. Management aims to reduce a substantial portion of the Group's ~R7bn of USD denominated debt by December 2020. Diluted HEPS increased by 2.5% but was 16.6% higher when excluding the impact of hyperinflation. The full year dividend of 383cps was 20.1% higher than the prior period.

Volume growth and market share gains: SA supermarkets grew sales by 8.7%; Checkers +13.5%, Shoprite +5.5% and USave +16.5%. Like-for-like sales were up 6.8% with inflation averaging 3.0% for the period, translating into impressive 3.8% volume growth. Liquor sales, which represent 5.8% of SA supermarket sales, were 3.3% lower as a result of 79 lost trading days. The SA supermarkets division reported a surprise 30bps improvement in its already industry-leading margin, to 6.6%.

A country-by-country review: The Non-SA operations continue to be challenged by currency devaluations reporting a decline in sales of 1.4%. On a constant currency basis, sales grew +6.6%; Angola -1.2%, Mozambique +3.8% and Zambia +15.7%. The trading loss narrowed slightly to R28mn from R37mn. In line with previous communication, management has taken some actions to stabilise this division including the reduction and de-dollarisation of 48 rental agreements and limiting further capital into the operations. Shoprite announced its intention to exit its Kenya (2 stores) and Nigeria (24 stores) operations, and that a country-by-country review of its non-SA operations is under way. We do not expect a wholesale exit from the rest of Africa by Shoprite given its strong position and historical success in markets such as Angola and Zambia. We would, however, view any further divestments from unprofitable and/or marginal markets as positive.

Investment view: The 2020 result, in our view, re-affirmed Shoprite's position as the best-in-class food retailer in SA as well as management's ability to deliver on its stated objectives. While we expect limited margin gains going forward, we expect Shoprite to deliver stable sales and earnings growth as it continues to defend its market position in the mass middle market and increase its penetration at the upper end via the Checkers brand. The ongoing focus on better working capital management and disciplined capital allocation should drive a sustainable improvement in cash generation and returns over the medium term.

The market was quick to reward Shoprite for this impressive performance, sending the share price more than 20% higher shortly after the release of results. The Fund took the opportunity to reduce its position in Shoprite at a level which we considered more fairly reflect its prospects.

CLOSING

The Fund ended the quarter with approximately 24% of its available 30% direct exposure to international markets. The Fund will continue to move towards the maximum 30% allocation as market conditions permit.

The Fund's performance in recent years has been hurt by its exposure to smaller market capitalisation SA Inc. stocks. The relentless de-rating of this area of the market was laid bare at the end of the quarter by the trading statement of software and digital services group, Adapt IT, for the year to 30 June 2020. Based on the guidance provided by the Company, the shares were trading on a historic PE of just 1.5x on the date of the announcement. **1.5x**, not 15x.

The macro issues in South Africa are well documented. The primary job of the investor is to distinguish between a poor outlook and negative news headlines and share prices which are discounting even more pessimistic prospects. As always, *"the challenge is having the conviction and the staying power and the process to exploit them."*