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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Three, 2020

Nedgroup Investments Rainmaker Fund

Performance to 30 September 2020	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	-1.1%	+1.1%	+0.7%
12 months	-8.3%	-2.9%	+2.0%

Market commentary

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. The "Covid crash" is now officially on record in the history books as the fastest to reach trough as well as the fastest to record the extent of recovery that it has – so far.

For the quarter the Resource sector (+6%) was again the strongest, this time driven by platinum shares (+22%), while Financials (-2%) and Industrials (-2%) were again the weakest, driven by the Property sector (-20%) which continues to be decimated. Segments of the property sector face unresolved structural problems (retail), while others face new structural threats (office).

Year-to-date this pattern remains the same with positive market returns coming from an extremely narrow portion of the market. Resources are +12%, Industrials have eked out +4% driven by very few names (Naspers by far the biggest), while Financials -33% have been severely negatively impacted, and showed little to no recovery yet from the impact of Covid-19.

Global markets continue to climb higher. For the quarter, the MSCI World posted a US dollar total return of +8.0% and has returned +2% year-to-date. MSCI EM gained +10% over the quarter (-1% year-to-date).

Portfolio commentary

The fund's top five performing positions for the quarter added +1.9% to our return while the bottom five detracted -2.9%. The fund had a disappointing quarter declining by -1.1% in comparison with the positive +0.7% recorded by the JSE All Share Index. The table below details the primary contributors and detractors from performance. Disappointingly the success of our platinum holdings was undone by the weak performance of Naspers, AngloGold and British American Tobacco.

Top contributors	Ave. weight	Performance contribution	Top detractors	Ave. weight	Performance contribution
Royal Bafokeng Platinum	0.8%	0.5%	Naspers	15.6%	-1.0%
Northam	1.3%	0.5%	AngloGold	4.7%	-0.7%
Impala	2.1%	0.4%	British American Tobacco	7.5%	-0.6%
Firstrand	5.1%	0.4%	Sanlam	2.4%	-0.3%
Spar	1.5%	0.2%	Prosus	5.5%	-0.2%
Total		**1.9%**			**-2.9%**

Current positioning and outlook

It's difficult to compress the range of work, research and effort our team has applied over the last few months into a few bullet points, but our attention has been focused on:

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

- The extent to which the extreme monetary and fiscal interventions implemented around the world will succeed in driving an economic recovery internationally as well as here in South Africa.
- Which businesses have thrived or will emerge as survivors and which will be unable to recover or adapt to a world that will be permanently altered in certain respects.
- In the context of the above the stocks and sectors which best reflect and offer the most opportunity for recovery, while at the same time not wanting to be lured into something which may be trading at record low levels of valuation but are ultimately doomed to fail. We continue to resist any temptation to invest in the property sector which we think has many tough years still ahead of it.
- The fundamentals supporting the variety of commodity prices that drive our domestic mining stocks remain largely very supportive, especially for PGM's and Copper. Gold companies are also enjoying a rare period of super profitability (a function of the high gold price boosting revenues). We consequently have approx. 27% of the fund in Basic Materials – stocks picks are Anglos, BHP, Anglogold and all the platinum miners.
- We retain a heavy exposure to the Naspers / Prosus combination. Promisingly there are rumours of further steps to be implemented to address every investor's frustration regarding the discount. It is still all about Tencent where we remain very positive and view current valuation as attractive.
- We have select exposure to domestic SA industrials and while we note the positive recent events regarding accountability for corruption, the economic recovery plan prepared between the State, Labour and BUSA and support their stated targets, we worry it will fail at the implementation stage as all prior plans have. On selection we have a strong quality bias on firms with strong balance sheets and likely to emerge as the survivors of the future – eg Bidvest, AVI and Spar.

Mandate change

The Rainmaker Fund mandate was amended as of 1 September allowing us to invest up to 30% of the fund offshore (zero before). Whereas we are very excited about the expanded investment opportunity and the diversification benefit this brings to the fund, one can reasonably ask whether this is not too late (the JSE All Share index appreciated just 8% over the past 5 years – excluding dividends – compared to the MSCI All World Index appreciating 96% on a similar basis – both in Rand). This year's Covid-19 impact further exacerbated the SA economic, investment market and currency underperformance relative to the rest of the world. Sadly, we don't think this means SA should just "bounce back" and hence outperform; our economy was weak and challenged before the onset of Covid-19. Since then domestic economic activity has declined, unemployment increased, and our national debt levels increased significantly. On our forecasts we don't expect any of these factors dramatically improving in the short to medium term as it will require deep structural reform for which we do not perceive the political will or conviction exists. Consequently, we believe now is as good a time as ever to diversify a general equity fund to include offshore assets.

The team at Abax Investments has been managing offshore assets for more than 7 years, some in a UCITS registered fund domiciled in Ireland and others as underlying, direct investments in mandates that did allow offshore exposure. The Abax Global Equity fund (a listed Irish UCIT) has delivered top quantile performance over all periods, relative to international global equity peers (as per Morningstar). Since inception on 22 October 2015, the fund appreciated 98% in ZAR and 59% in USD, well ahead of the MSCI All World Index's 89% in ZAR and 52% in USD. The whole investment team contributes to the investment process, and we no longer differentiate between local and foreign specialists, with each member of the team having both local and global responsibilities. Given the track record we have delivered and the reasonable amount of time we have been doing this work (>7 years) we are confident that we have the breadth of experience and depth of team to successfully continue to manage offshore assets – but now of greater scale.

The SA investment opportunity set available to larger funds is limited to about 110 large and liquid enough companies. Naspers makes up about 30% of the Shareholder Weighted Index, the larger miners 20%, and the larger banks and insurers another 15%. This makes real diversification in terms of underlying business drivers relatively difficult. Diversifying up to 30% of the fund into foreign positions as a result of the mandate change means that one can dial back the above concentration to 70%. It also opens up the fund to a range of differentiated and hence diversified business models to invest in.

Below is a short summary of what else investors are now already getting exposure to in the Rainmaker fund:

- Chinese consumer growth and the very rapid adoption of e-everything in China; whereas the fund has always had exposure to this via Naspers/Tencent, it now adds Alibaba, the world's largest ecommerce business that transacted over $1trillion in gross merchandise value over the past 12 months across its eco-system. And Anhui Conch, China's largest cement producer with an ungeared balance sheet and good growth from the infrastructure stimulus, trading at a very attractive valuation.

- Global growth in ecommerce, fintech, social media, gaming and streaming via investments in VISA, Amazon, Google and Activision Blizzard (and still Tencent via Naspers / Prosus).
- The rapid adoption of cloud services across the world. The investments in Microsoft, Tencent, Alibaba and Amazon covers more than 80% of global cloud services.
- Strong US consumer that is demanding more DIY and "home-steading" options which have become even more appealing in a Covid-19 world as they move to the suburbs and invest in rural lifestyles. We access this trend via investments in Tractor Supply (peri-urban lifestyle products – think Agrimark on steroids), Trex (largest US composite decking manufacturer) and Autozone (aftermarket automotive service components).
- The European (and global) demand for athleisure and luxury goods are accessed via adidas (footwear and athleisure with exceptional growth in China) and Moncler (small, fast growing and innovative luxury clothing company).
- Global healthcare providers are obviously showing strong demand, but how to pick the potential vaccine winner? We rather invested in Thermo Fisher who provide the necessary laboratory equipment and diagnostic machinery to all players.

From the above it should be clear that these exciting investment opportunities are simply not available in the South African equity market. Not only do Rainmaker investors now have access to these diversified business models, but also to the currency hedging that it provides.

Lastly, a few comments on the progress in this transition that we have made to date. Although we have the latitude to hold up to 30% offshore we did not feel the necessity to complete this in the first month. We did however want to make a reasonable start and by early October the fund has 15% in foreign equity – some of the names are discussed above. All of this was achieved at a rand/dollar exchange rate of about 16.60 – which although 25% weaker than where it was at the start of the year, is also 14% stronger than its weakest point in late April.

In addition, while as discussed above, we have little confidence in the political competence or conviction to implement the structural changes that are well understood and widely accepted as necessary to kickstart South Africa's economy and rectify the many structural problems that exist. There has recently been encouraging progress on the fronts of prosecuting corruption as well as a few small wins regarding economic policy. We also have the impending MTBPS (Medium Term Budget Policy Speech) on 28 October where our Finance Minister (who fully understands what needs to be done and is one of the few politicians with the courage of his convictions), fortified with the necessity to take drastic action caused by the economic impact of Covid-19, may well announce measures we have previously only dreamed of. Depending on how these delicately balanced events and patterns play out over the rest of this year, we will use the opportunities presented to slow or accelerate the transition in the Rainmaker Fund.

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 complacent in 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 upend 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.

The portfolio currently trades on a forward rolling Price/Earnings (P/E) ratio of 11.2x and a dividend yield of 3.1% which we believe offers reasonable value.

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.
- Naspers: Participation in the AGM.
- 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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