NEDGROUP INVESTMENTS

UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

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NEDGROUP INVESTMENTS VALUE FUND

Quarter Three, 2020

Market Commentary

WORLD

- Economic activity rebounded off historic second-quarter pullbacks as lockdowns eased and economies started to reopen—but recession risks persist given base effects, high unemployment, second wave fears and expiring income replacement stimulus measures
- Developed market bond yields fluctuated several minor degrees around irrational lows on unrelenting central bank stimulus—markets briefly reflected rising inflation risks after the US Federal Reserve fundamentally changed its rate setting policy to average inflation targeting
- Precious metals gold and silver rose further on US dollar weakness and continued monetary and fiscal largesse—precious metals and even cryptocurrencies should stay well bid amid expected dollar softness and growing fiat currency risks
- The vagaries of global market sentiment seesawed emerging market bourses as high yields, demographics and natural resource endowments simultaneously signaled reward and danger—but bigger risks lurk in the developed world corporate debt and alternatives markets as zero interest rates inexorably drive capital to unsustainable companies
- Geopolitical risks mounted when President Trump closed the Chinese consulate in Houston on accusations of espionage, threatened further embargoes on Chinese tech firms Huawei and TikTok and extended export restrictions to China's biggest semiconductor manufacturer, SMIC—China continues to play the long game afforded by its political system, as domestic economic activity took travel and hospitality activity back to pre-pandemic levels
- Gains in a small number of very large US technology companies pushed US equity markets to their most expensive levels since the technology bubble in 2000—the quarter was characterised by a wave of new listings and general corporate activity typically evident of investor exuberance
- Rising sovereign debt levels, pervasive experimental monetary (and now) fiscal policy continued to support financial markets—but the imminent US elections, increasing geopolitical tensions and indications of rising COVID-19 second-wave infection rates could each materially weigh on markets

SOUTH AFRICA

- The SA economy contracted a record 16% in the second quarter due to Covid-19 lockdowns—an economic recovery is already evident, but the pace of growth is insufficient for a fragile economy hamstrung by uncoordinated and inconsistent government policy responses
- Finance Minister Mboweni's supplementary budget stressed the rising risk of a full-blown debt spiral if government does not cut expenditure—given the growth vacuum and growing budgetary share of debt funding costs
- A fiscal deficit of 15% of GDP is not unreasonable for the 2020/21 fiscal year—forecast to narrow to 10% in 2022 if government stimulus ceases and the wage bill reduction is successfully implemented as currently proposed
- Unemployment rose by 2.8 million people in the second quarter as lockdown regulations led to widespread job losses—employment recovery will be slow given the dearth of fixed investment opportunities despite government commitment to fast track infrastructure projects
- The SA government bond yield curve steepened after SARB's repo rate cuts, with the longer end still availing high real yields under current inflation forecasts—but longer-term risks to the inflation outlook include reserve bank independence, money printing to fund deficits and ever increasing bond issuances
- The rand was volatile given internal and exogenous shocks but ended slightly stronger against a weaker dollar, but is at risk from continued capital outflows despite an improved current account surplus—emerging market currencies should nevertheless enjoy tailwinds from material increases in hard currency money supply and China's strong recovery
- The managers are cautious despite optically attractive South African equity and listed property valuations—yields may not be as high as they seem given non-payment (delays) of dividends and distributions on depressed revenues in addition to pay-out ratio cuts needed to strengthen balance sheets

Portfolio Commentary

- The contrarian low weight to precious metals miners was the largest performance detractor—these sectors rallied on stronger dollar commodity prices
- The allocation to financials detracted at the margin—stock selection was mixed with primary bank holding FirstRand outperforming, but offset by weakness from core holding in Santam
- The allocation to London-listed property company Capital & Counties detracted—rising second wave Covid-19 infection rates caused further disruption to retail economic activity in its core Covent Garden estate
- The holding in pharmaceutical company Aspen detracted—retracing at the margin after a strong rally over the past six months
- The overweight allocation to mid-cap companies Invicta, Italtile and Omnia added value—quality companies that are likely to deliver good real returns to investors despite the difficult economic environment

Top 5 contributors	Fund average weight (%)	CSWIX average weight (%)	Out/Under performance (%)
Naspers "N"	0.0%	10.1%	0.8%
Anglogold Ashanti	0.0%	3.2%	0.5%
Prosus "N"	0.0%	4.6%	0.3%
BHP	9.2%	2.5%	0.2%
Anheuser-Busch InBev	4.3%	0.6%	0.2%

Top 5 detractors	Fund average weight (%)	CSWIX average weight (%)	Out/Under performance (%)
Gold Fields	0.0%	2.5%	-0.5%
Implats	0.0%	2.7%	-0.6%
Santam	5.8%	0.2%	-0.6%
Aspen	5.9%	1.2%	-0.8%
Capital & Counties Properties	4.6%	0.2%	-1.1%

Investment Outlook

World: Economic recovery to be slow and volatile. Unprecedented monetary and fiscal support continues - inflation risks are mounting. Geopolitical risks continue to rise. US election could spark volatility. Weaker dollar supports higher gold price.

South Africa: Slow pace of economic recovery. Unsustainable fiscal deficits to continue leading to a rising risk of a full-blown debt spiral. Employment levels likely to recover very slowly. Inflation outlook remains benign.

Conclusion

Retain contrarian position of low resources weight on concern that market ratings and earnings are unsustainable. BHP Group is the highest quality diversified miner and is the fund's largest single position. The managers will not speculate investor capital in the precious metals mining sector given prevailing risks.

Upweighted select consumer-facing holdings notwithstanding wariness of the long-term trajectory of the South African economy. These are unique value investment opportunities into great companies with strong, sustainable franchises that sold off on near-term earnings downgrades.

Diversified industrial stocks weight was also increased via mid-cap acquisitions where corporate prospects are secure even through the pandemic-induced disruption. The fund maintains a significant healthcare position in a basket of hospital counters and largest sector holding, Aspen Pharmacare, which was further de-risked following the sale of its European thrombosis business. We expect these sector stocks to be more robust as longer-term earnings are less geared to the economic cycle.

The fund retains a meaningful allocation to JSE-listed global businesses given the higher risks in the SA economy and larger global economic opportunity set. These are well capitalised companies that should deliver hard-currency, real earnings growth through the cycle, supported by expected rand weakness.

The managers have a low property exposure via niche storage and logistics counters and UK-based Capital & Counties. While Capco's substantial restaurant-linked trade was impacted by Covid-19, it still has significant financial flexibility to add to its Covent Garden estate as owners are forced to sell for liquidity reasons.

Cash levels lower on select buying and net redemptions — the portfolio remains well diversified and defensively positioned given the global economic contraction and distressed SA economy.

Responsible Investment Summary

Proxy Voting Summary Q3 2020

Resolution Type Name	Total Count	For %	Against %	Abstain %
Adopt Financials	6	100%	0%	0%
Auditor/Risk/Social/Ethics related	62	89%	11%	0%
Buy Back Shares	11	82%	18%	0%
Director Remuneration	68	97%	3%	0%
Dividend Related	2	0%	100%	0%
Issue Shares	12	0%	100%	0%
Loan / Financial Assistance	21	43%	57%	0%
Other	19	84%	16%	0%
Political Expenditure/Donation	1	0%	100%	0%
Re/Elect Director	96	100%	0%	0%
Remuneration Policy	30	17%	83%	0%
Shares under Director Control	1	100%	0%	0%
Signature of Documents	3	0%	100%	0%

General Comments:

- There are no abstentions. We apply our minds to every single resolution put to shareholders. When there is an abstention it would typically be intentional or strategic reasons.
- We typically vote against any resolution that could dilute the interests of existing shareholders. Examples include placing shares under the blanket control of Directors, providing loans and financial assistance to associate companies or subsidiaries and blanket authority to issue shares. On the rare occasion, we have voted in favour of such resolutions, we could gain the required conviction in the specifics of the strategic rationale for such activities and could gain comfort that such activities are indeed to be used to the reasons stated.
- The firm also has a strong philosophy regarding management remuneration models. We believe in rewarding good managers with appropriate cash remuneration on achievement of relevant performance metrics that enhance long-term shareholder value. We are generally not in favour of share option schemes given the inherent asymmetry between risk and reward typical of such schemes. In addition, we do not believe that existing shareholders should be diluted by the issuing of new shares to management as is the case with most option schemes. We are in favour of the alignment created between management and shareholders when management has acquired its stake in the company through open market share trading and paid for out of management's own cash earnings.

Notable Engagements

(Note: reporting at Foord investment house level, specific fund might not be invested in all these companies)

Capital and Counties

Discussion with remuneration committee regarding 2020 Financial Year executive remuneration

Spur

Engaged with Spur chairman, head of remuneration committee on remuneration policy, strategy, board appointments and succession as well as capital allocation generally.

Metair

Engaged with head of remuneration committee and chairman on executive management succession, 360-degree review for the Finance Director as well as Chairman succession plans. Separately engaged a board member on capital allocation/structure.

Invicta

Engagement with board members on capital structure/capital allocation and executive management remuneration.

Aspen

Engagement on auditor appointment and new audit rotation engagement process.

Mediclinic

Discussion with management on AGM voting and remuneration policy

Life Healthcare

Met with Chairman and lead independent director on remuneration policy

Richemont

Discussion with management about AGM voting

Bidcorp

Discussion on appropriateness and of the return and growth targets in the remuneration policy

Bidvest

Discussion on appropriateness and of the return and growth targets in the remuneration policy

The Foschini Group

Engagement ahead of finalisation of new Long-term Incentive plans

Italtile

Engagement regarding internal succession plans

Disclaimer

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For the Nedgroup Investments Bravata World Wide Flexible Fund it is calculated monthly as a percentage (the sharing rate) of outperformance relative to the fund's benchmark, with the high watermark principle applying. All performance fees are capped per fund over a rolling 12-month period. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

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