NEDGROUP INVESTMENTS

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Quarterly review

Nedgroup Investments Core Accelerated Fund

As at 31 December 2020

2020 finished in strong fashion

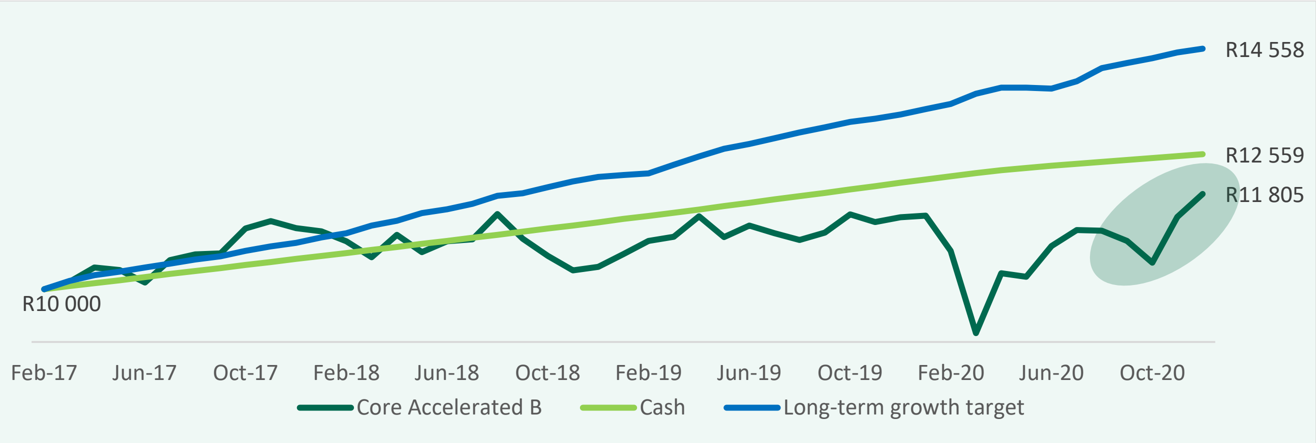
After a V-shaped recovery that started in the second quarter, global fiscal and monetary stimuli are keeping the economic recovery on track with regionally significant growth divergences. Major escalation in Covid-19 cases over the fourth quarter posed notable near-term challenges. In spite of the new outbreak, global market rallied strongly with indices like the MSCI World reaching all-time highs. Investors continue to respond positively as regulators approve new Covid-19 vaccines and governments initiate programmes to administer them. Quick implementation of the vaccines coupled with the exceptional fiscal relief provided throughout 2020 should hopefully result in a quick economic recovery in 2021 and beyond. Over the course of the quarter, the Nedgroup Investments Core Accelerated Fund grew by +6.5%.

The table below compares an investment in Nedgroup Investments Core Accelerated Fund to a bank deposit (cash) investment and its growth target over various time periods. For every R10 000 invested in the Nedgroup Investments Core Accelerated Fund at inception (28 February 2017), you would have R11 805 at the 31th of December 2020. This is a lower than the R12 559 you would have achieved had you invested your money in bank deposits (cash) over the same period. The green circle in the chart below, highlights the recent market collapse, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investment Core Accelerated Fund versus Cash[1] and the Growth target

	3 Months	1 Year	3 Years	5 Years	7 Years	Inception 28 February 2017
Growth of fund (after fees) ***(Growth in %)***	R10 816 *8.2%*	R10 387 *3.9%*	R10 581 *1.9% p.a.*	-	-	R11 805 *4.4% p.a.*
Growth of cash ***(Growth in %)***	R10 087 *0.9%*	R10 452 *4.5%*	R11 879 *5.9% p.a.*	R13 565 *6.3% p.a.*	R15 128 *6.1% p.a.*	R12 559 *6.1% p.a.*
Growth target (inflation+6%) ***(Growth in %)***	R10 191 *1.9%*	R10 938 *9.4%*	R13 385 *10.2% p.a.*	R16 780 *10.9% p.a.*	R20 888 *11.1% p.a.*	R14 558 *10.3% p.a.*

Fund Return versus Cash[1] from inception ending 31 December 2020



The Nedgroup Investment Core Accelerated Fund is designed for investment periods of 7 years and longer as it has a high exposure to shares (90%). This means that it can experience significant fluctuations over shorter periods but in the long-term has a growth target of 6% above inflation (around 12% per year), as demonstrated in the chart above.

The Nedgroup Investments Core Accelerated Fund has fallen short of this target since inception. However, history demonstrates that two-thirds of a fund such as the Nedgroup Investments Core Accelerated Fund would have achieved its long-term growth target of 6% above inflation (around 12% per year) over any 7-year period. In fact, as the time horizon extends, so the risk of underperforming this target decreases.

[1] We used the STeFI call deposit rate for cash returns

Market Review: A Tale of Two Vs – Virus vs. Vaccines

The year 2020 will go down in history as an unprecedented year for human crises - financial, medical, and social. The extensive impact of Covid-19 crisis across 200+ countries could not have been predicted. It has been a learning and testing year not only for financial market participants and observers but also for the experts across epidemiology, pharmacology, medicine and molecular biologists. The initial surge of the pandemic in February through May took the world by surprise but good policies of lockdowns, test, social distancing and preventive measures helped slow down the virus toll in the summer months. However, since September many countries are experiencing a second or third surge of virus cases with governments imposing different variations of lockdowns. The struggle between virus and vaccine will determine whether this winter brings the positive sentiment and behaviour towards normalcy. Hopes of an economic and financial recovery hinge on the successful vaccination of 70% of the population which would entail safe, effective and equitable distribution of vaccines throughout the world.

Results from vaccine trials further buoyed sentiment, supporting risk appetite and driving markets to new highs. A historic rally saw the S&P 500, gain +12.2% over the quarter, supporting a +14,0% (in dollar terms) and +0.4% (in rand terms) gain for the MSCI World Index. Emerging markets benefitted from a weaker US dollar and resilient economic data from China. Moreover, the Barclays global bond index was up roughly +3.3% (in dollar terms) but fell -9.0% (in rand terms) due to the rand appreciation over the quarter.

In the US, President Trump only recently conceded defeat in the US presidential elections, after none of his numerous attempts to overturn the results were successful. The Democrats will now control the White House, Senate and the House of Representatives when President-elect Joe Biden is inaugurated on the 20th of January. Why does this matter? Both Senate and House of Representatives typically need to pass legislation before it is signed off by the Presidency. On 24 December 2020, the UK finally agreed a deal with the European Union that will define their future relationship. China continued its impressive economic recovery, pulling much of the commodity complex along with it. Along with a weakening US dollar, these factors further stimulated market sentiment to fresh highs, with the light at the end of the Covid-19 tunnel seemingly brighter than before.

From the domestic front, South Africa's economy bounced back in the third quarter (Q3 GDP: +66.1% q/q) ahead of consensus estimates, as economic activity resumed post the second quarter national lockdowns. The surprise should hopefully result in the annual rate of contraction of South Africa's economy for calendar 2020 being slightly better than the -8.0% last forecast by the SARB in November. During the quarter, President Ramaphosa delivered the ratified Economic Reconstruction and Recovery Plan, extending the Covid-19 grant by another three months. The MTBPS outlined a 5-year consolidation plan which sees debt stabilising at 95% relative to the 87% presented at the Special Adjustment Budget in June. The SARB kept interest rates on hold with a vote of 3:2. Credit ratings agencies Moody's and Fitch downgraded South Africa's credit rating further down the sub investment grade scale, while also maintaining a negative outlook. Arguably the fiscal risks are well understood and priced to a large extent.

Local markets participated in the global risk on rally and benefitted from a weaker US dollar. The FTSE/JSE Capped SWIX Index gained +11.5% over the quarter, weighed up by Energy, Consumer Discretionary and Materials. Mid- and small caps almost doubled the return of large caps over the same period as investors rotate into more cyclical exposure. Information Technology made another valiant attempt to regain some of its losses earlier in the year but, despite a return of over 45% for the quarter, still ended down close to 18% for the year. Nominal bonds continue to outperform Inflation-Linkers, as they have done consistently over the last 10 years with the All Bond Index returned +6.7% in the fourth quarter, bringing the year to date figures to +8,7%. Property also ended the year strongly with double digit gains for December and about 20% returns for Q4. Overall though, 2020 was a year that property investors would rather forget as the sector is still down -41.1% year to date.

While transportation, storage, availability, access and funding remain only a few of the outstanding hurdles, the vast amount of progress this year still offers hope for a better 2021. While sentiment is certainly positive, the environment is not without warning signs.

What the world can expect with Biden at the helm?

The approach Trump took during his presidency couldn't be more different than what we expect to see with Biden. Trump has a direct, 'no-nonsense' approach that some considered genius and others crazy; he said what he wanted, did what he wanted and flipped foreign relationships on their head. In contrast, Biden's approach is to work together, even with his opposition, to get people on his side on key issues. His entire approach can be summarised by this statement that he made: "when you get into blood matches, nothing gets done." This is likely to mean very different international relations with the US going forward.

In terms of international relations, many criticised Trump for building relationships with countries that have blatant human rights violations. In the run up to the elections Biden made the following comment about Trump: "This president embraces all the thugs in the world. I mean he's best friends with the leader of North Korea…He doesn't take on Putin in any way". Given this stance, under Biden's administration we can expect that the support and good relationships between the US and such countries will fall away.

In terms of other relations, Russia's foreign minister said that the relationship with the US has gotten worse and they have no intention of contacting Biden's transitional team.

On the flip side of the coin, analysts expect the relationships between the US and Europe to improve, with one of the high priority items on Biden's agenda being the Paris accord and climate change. In fact, he plans to re-join the Paris climate accord on day one. Of course, a focus on climate change might mean the potential demise or at least a reduction in profits of fossil fuel companies. Biden has also asked the EU to hold off on talks with China until they can come to a common approach. At this stage, it is uncertain what US-UK relationship will be in a post-Brexit world.

In Latin America, we are likely to see a reset back to the days of Barack Obama with a return to a more holistic approach including corruption, immigration, drug trafficking and organised crime. Immigration laws are expected to be relaxed somewhat but with a phase approach to implementation to avoid a flood of people coming in to the US at once.

The world, and especially Africa are hoping for more healthcare funding from the US after this dried up during Trump's tenure. Unfortunately for Africa, funding for healthcare is heavily influenced by US politics with most republican presidents deciding to enact the 'global gag rule' and most democrats deciding to rescind it. In short, the 'global gag rule' prevents funding to NGOs who provide abortions or referrals for abortions. Under the Trump administration, he took this policy a step further and expanded this to further restrict global healthcare funding from the US. Biden is expected to address this as a priority, making US funding for global healthcare more readily available thereby providing support for many healthcare NGOs around the world.

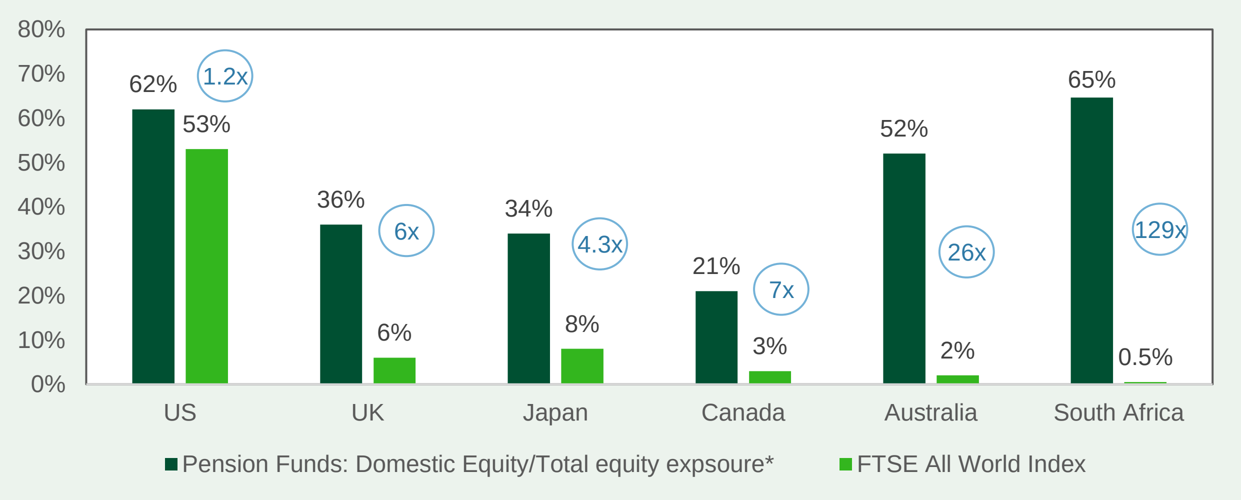
On the whole, under Biden we can expect better global trade opportunities and partnerships and stronger global business activity. However, he will face significant challenges with his term beginning with the double threat of a global pandemic and an economic crisis, that is sure to draw a substantial amount of his attention.

Home biases and changes to the Core Accelerated Fund's asset allocations

In most countries around the world, investors have an overweight to their domestic market's equities and bonds. This overweight is described as having a *home bias*. Over the past few decades the case for a home bias has become less convincing, especially from an, accessibility, diversification and investor behaviour perspective.

The chart below shows the home biases within pension funds from different countries across the world. Australia has one of the biggest home biases at 26 times its FTSE All World Index weighting. South Africa, on the other hands is 129 times its index weighting! This clearly poses significant concentration risks relative to investors from other countries.

Home biases in pension funds across the world



Source: FTSE Russell and Willis Towers Watson

In South Africa we have already seen a big move towards offshore investing in the discretionary space as accessibility has become easier through direct UCITS funds, local and offshore platforms and offshore rand denominated feeder funds. We have also seen increased usage of offshore feeder funds in living annuities which don't have to comply with the offshore limits of Regulation 28.

If we see further relaxations of exchange controls over the next decade this trend will likely include a much broader spectrum of South African investors, not just High Net Worth (HNW) individuals. It will also have an impact on how financial planning is done from cradle-to-grave and how global investing is introduced into an investor's portfolio. These changes will also have an impact on risk profiles multi-asset unit trusts that generally comply with Regulation 28 and which caters for compulsory and discretionary investments.

In order to deal with the home bias dilemma, we have modelled multi-asset funds with different home biases - ranging from a 70% home bias (regulation 28 portfolios) to no home bias (Nedgroup Investments Core Global Feeder Fund). This allowed us to study the trade-offs between broader diversification and increased volatility due to the rand exchange rates. We also studied the tax benefits within compulsory and tax-free investment structures for funds with different home biases.

This research indicated that if legislation allows for higher offshore allocations that one could easily reduce the home bias to 50% or even 35% and still have portfolios that have reasonable range of returns over rolling 5-year periods and longer.

The implication for the Nedgroup Investments Core Accelerated Fund is that, if allowed, we would take the offshore to at least 50%, as at that level we would be able to cater for most investor's needs. Under the current dispensation we have increased the offshore allocations to the maximum weighting of 30%. The fund can however be combined with the Nedgroup Investments Core Global Feeder Fund to reduce the overall home bias to any level the investor desires while still being able to target a similar real return over the appropriate investment horizon.

Progress in South Africa?

2020 has certainly been one for the history books, in many respects. The South African economy, on an annualised basis, contracted by 51% in Q2 due to decreased economic activity during lock down, only to rebound by 66% in Q3 off the low base of the previous quarter. Despite the rebound, overall, consensus is that the economy will be down by about 8% in 2020.

Looking ahead, the question on everyone's mind is whether Covid-19 has given the government the much-needed opportunity to implement the desperately needed structural reforms, or if this has further derailed progress. There are mixed emotions but on the whole, decisions taken by President Ramaphosa indicate that there is political will to undertake the necessary structural reforms and progress is being made.

In October, Ramaphosa released the Economic Reconstruction and Recover plan. The plan sounded all too familiar, but the president was quick to point out that there was renewed determination and that the plan was supported by important social partners. While some areas of the plan may be tough to bring to fruition, such as infrastructure development which heavily relies on the private sector, other areas are achievable.

One important aspect of the plan is employment stimulus, with the plan being to create about a million jobs a year primarily via community-based job creation programmes. This is targeted at rural communities and the poor. In addition to public sector jobs, the proposed energy reforms should help boost private-sector employment.

We have already seen decisive actions taken to address the energy crisis, with Eskom beginning the planned maintenance to its plants, emergency power has been secured and the process to procure renewable energy is well on its way. Although this is no quick fix, we are moving in the right direction to stabilise the power grid, which is so desperately needed for economic growth.

Other positive progress includes the plans to increase spectrum in South Africa. Simply put, this should translate to more accessible, faster and cheaper internet access. Studies by the world bank indicate that increasing the spectrum in a country can lead to an increase in GDP. Moreover, this also means more money in government coffers from spectrum licenses.

On the flip side of the coin, what does the government bailout of SAA indicate? Although this was not a great decision, from a budget perspective, this money was taken from other departments as opposed to simply adding to our debt burden. This of course is not net neutral as it means that other departments bore the brand of the decision. That said, it is important to view the SAA bailout in light of the bigger picture, that is, it was a bad decision against a backdrop of many other good decisions and indications of progress, so one must be careful not to throw the baby out with the bath water.

And so, as 2020 comes to an end, we hope for a better 2021. The OECD forecasts GDP to grow by 3.1% in 2021. This is a similar figure to the consensus amongst economists. In fact, the OECD mentioned that it views the auction of spectrum and the procurement for renewable energy as positive signals. If the world has got their predictions right, we can look forward to a better year ahead.

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