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NEDGROUP INVESTMENTS ENTREPRENEUR FUND

Quarter Four, 2020

Nedgroup Investments Entrepreneur Fund

Performance to 31 December 2020	Nedgroup Investments Entrepreneur Fund[1]	ASISA category average	Small Cap Index	Mid Cap Index
3 months	9.5%	14.3%	21.9%	13.7%
12 months	-6.6%	-5.9%	-0.3%	-14.4%

Market commentary

It seems unlikely that many people will look back on happy memories of 2020. There is surely not a person who has not had their private or professional lives affected by the COVID-19 pandemic – for many sadly the effect has even been their loss of livelihood and for others the loss of life itself. There was much to reflect on over our traditional end of year holiday season, and with the re-imposition of a heightened level of lockdown in mid-December we entered 2021 with a nervous sense of foreboding of what the year may hold in store.

In a volatile year in which the JSE All Share Index first crashed -30%, at the height of the pandemic's global spread in late March, it subsequently staged a surprisingly steady +48% recovery from the lows and ended the year +7.0%. And closing in again on its all-time high of around 60,000 first reached in late 2017.

Most unusually and for the fourth consecutive year it was again the Basic Materials Index (largely Mining) that lead the sectoral pack with a return of 21.2%. In complete contrast, Industrials returned -20.7% and Financials were very weak at -19.7%, led by the Property sub-sector -41% (despite a strong bounce in Q4 of +19.0%). The Healthcare sector disappointingly recorded a third consecutive year of negative returns, and our local consumer stocks almost all returned negative numbers for the year. Large Cap stalwart Naspers' +32.1% return did much of the hard work combined with the Basic Materials sector to drive a positive return of the All Share Index for the year.

Despite the worryingly weak state of South Africa's balance sheet, and the unlikely prospect of a material change in that in the medium term, combined with a short-term collapse in tax revenue collections caused by the slowdown in economic activity, the rand has proven to be remarkably resilient. Having started 2020 at R14 to the US$ it weakened by 35%, to the weakest point in March touching R19, before steadily strengthening and ending the year at R14.69 – a mere 4.25% weaker from where it started the year.

This rand strength may come as something of a surprise to unit holders, we attribute it to the tremendous tailwind South Africa is currently experiencing with regards to most of our export commodities (Platinum Group Metals, Iron Ore, Gold, Manganese and Maize) which are all trading at very high levels, while our principal import – Oil – is trading at a very low level. This is having a very favourable impact on our trade balance, while at the same time we are not seeing a deterioration in our capital account flows – despite the ongoing rating downgrades (now deep into junk territory) the ratings agencies are awarding SA.

With the yield on SA government bonds now trading higher than the prime rate, it is more expensive for the SA government to borrow money from the banks than it is for the average individual mortgage bond holder. This means there is a higher demand for rands than there is supply and is driving the currency's strength. The longevity of these conditions is uncertain and means the outlook for the currency is as unclear as ever.

We are guided by the longer-term prospects of the nation's balance sheet and the States' inability to service and repay the debt already in issue, and consequently why we consider a weaker currency as the inevitable release mechanism in time.

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

Portfolio commentary

The fund had a disappointing quarter, despite returning +9.5% it failed to keep up with its peer group of funds as well as the JSE Small Cap Index. While it did well to protect value in the early phase of the pandemic inflicted market collapse, some of our larger picks did not perform or recover as strongly as we had anticipated – notably some of the domestically focused industrial stocks like Reunert, KAP and Hudaco.

A few points to note from the table below include:

- The consistent contribution from long term winner, Afrimat, buoyed by the ongoing strength of iron ore.
- The reversal of fortunes for the second largest position in the fund, Royal Bafokeng Platinum, which was a big winner in Q3, but gave some back in Q4. On a positive note, it was +11% on the first day of 2021, a day too late for the Q4 performance records.
- A disappointing end to the year from our tobacco exposure via BAT / Reinet. This position has been a huge source of frustration across our client portfolios for the last two years as this company continues to trade at multi-decade low valuation levels. This despite the company's very constructive progress regarding reducing its debt levels, clear progress on the roll out and growth in their reduced risk portfolio of products, as well as further good work on their broad ESG ambitions - where they already score very well. Operationally, the business has flourished under COVID-19 and while some of their markets were negatively affected (e.g. South Africa), growth in their most important market, the US, has been the best in the last 6 years! While the ongoing weakness has caused much internal debate and further work as well as sleepless nights, we remain confident our patience will be rewarded.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Afrox	2.11%	1.05%	RB Platinum	7.35%	-0.47%
KAP Industrial	3.70%	0.97%	BAT	3.44%	-0.24%
Afrimat	4.92%	0.96%	Reinet	3.73%	-0.22%
PSG Konsult	2.89%	0.87%	Telkom	0.69%	-0.19%
Kaap Agri	1.39%	0.69%	JSE Ltd	2.85%	-0.12%
Reunert	2.87%	0.66%	Mediclinic	1.27%	-0.10%

Current positioning and outlook

As we consider the prospects for the fund at the start of 2021 we are not filled with optimism. Returns from the fund, the mid and small cap indices, and the market overall (with the exception of a relatively small universe of stocks concentrated in the resources space) have been poor and have not kept up with inflation which should be the bare minimum hurdle considering the higher risk associated with equity investing.

Economic growth prospects in South Africa do not look exciting and the local consumer wallet must be under tremendous pressure because of employment losses and the forced necessity of reducing the public sector wage bill. I was astonished to recently learn that the average public sector salary is >R450 000 per annum, while in the private sector that number is <R130 000!

Despite the reported success of an effective vaccine, this is not widely available, has not been proven to be universally effective and in any event, we are already learning of mutated versions of COVID-19. So, while not meaning to sound overly pessimistic, we are reluctant to conclude the worst of the COVID-19 related economic impact is behind us.

The World Bank expects the South African economy to recover by 3.3% in 2021 and return to a "near potential pace" of 1.7% in 2022, after contracting by an estimated 7.8% during COVID-19-afflicted 2020. However, it warns in its flagship Global Economic Prospects report, published on 5 January 2021, that the pandemic has precipitated a dramatic fall in per capita income, which has pushed tens of millions more people in South Africa and the rest of Sub-Saharan Africa into extreme poverty.

The resultant decline in per capita income is expected to set average living standards back by a decade or more in a quarter of Sub-Saharan African economies, with even more severe setbacks in Nigeria and South Africa – home to one-quarter of the region’s population.

The bank also notes that South Africa’s pre-existing structural constraints, such as persistent power-supply disruptions, are expected to become binding again as economic activity firms. In addition, debt sustainability concerns may require fiscal consolidation, which, if prematurely implemented, could further soften the country’s recovery. Weaker growth momentum into 2021 partly reflects the lingering impact of the pandemic, as some mitigation measures are envisioned to remain in place.

Despite this negative macro context, we note with interest that valuation levels on many of the stocks we hold are at multi-year lows. Most SA sectors are also trading at record discount valuation levels versus both Emerging Market and Developed Market peers. Many are well managed and are responding in many ways to cut costs, preserve profitability, and find new ways to drive growth in profits. Interest rates domestically and internationally are at record lows and not expected to rise, so the cost of servicing debt is actually decreasing, and this will further boost profits for companies with geared balance sheets.

Putting all the above together we believe now is not the time to reduce equity exposure, and the risk return balance favours this asset class. As at end Dec 2020 the fund traded on a weighted forward PE of 11.7X, Price to Book of 1.3X and Dividend Yield of 4.0%.

Responsible Investment

ESG factors and ongoing research are integrated into our investment analysis to strengthen the decision-making process and ensure that investments generate long-term value in an ethical manner. Notable engagements relevant to the Nedgroup Investments Entrepreneur Fund during the fourth quarter of 2020 include.

Reinet – furthered our very frustrating engagement regarding the NAV discount and suggestions to unlock the trapped value with this obstructive and poor ESG scoring company and its dismissive management.
Afrox - negotiation of terms with advisers and company management of the offer to minorities.
Pick ‘n Pay – discussions regarding food waste reduction.
Coronation – discussions regarding further disclosures made in the 2020 integrated report.
Mediclinic – review of revisions to remuneration policy.
KAP – engagement with Remuneration Committee.
Naspers – discussions with chief people officer regarding worrying associations of SA CEO.

Conclusion

As we noted in the September commentary, despite extremely negative sentiment towards SA business conditions we have already been bought out of two positions by minority offers (Assore and Peregrine) and in the fourth quarter we received an offer for our Afrox shares from the majority shareholder. This shows again that astute long-term investors see value in the space. If South Africa can just start to show slightly improving prospects off the very low base there can be substantial upside. The likelihood of that, however, remains as uncertain as ever.

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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