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NEDGROUP INVESTMENTS GROWTH FUND

Quarter Four, 2020

Nedgroup Investments Growth Fund

Performance to 31 December 2020	Nedgroup Investments Growth Fund[1]	ASISA category average	FTSE/JSE CAPPED SWIX
3 months	12.3%	9.6%	11.5%
6 months	4.7%	10.9%	12.6%
12 months	-24.5%	1.9%	0.6%

Market commentary

The year 2020 will certainly go down in history books as one of the most turbulent in modern history. Laurium entered the year with a reasonable degree of optimism. As the global impact of the Covid-19 pandemic dawned upon markets, we witnessed one of the most severe drawdowns during the first quarter of the year. With governments around the world unleashing unprecedented levels of monetary and fiscal stimulus to support their Covid-19 bruised economies, we subsequently experienced one of the most aggressive recovery rallies on record.

Markets around the world are broadly above levels they were at the beginning of 2020. The MSCI World Index rose 17% and the MSCI Emerging Markets Index rose 19% for the year, whilst European markets were up around 6%. The disparity amongst economies and industries is wide, with the Nasdaq Composite (representing booming tech stocks) up 45%, whilst the Russell 1000 Value Index (which has a higher composition of "old school" industries such as financial services, healthcare, and industrials) was broadly flat. *(Returns in US dollars on a total return basis).*

In local markets, the FTSE-JSE All Share Index was up 7% for year. It is worthwhile pointing out the stark difference in performance between foreign earners and domestic companies. Domestically focussed companies such banks, retailers and real estate companies, remain 15% to 30% lower over the year, while Naspers and Prosus rallied 28% and 50%, respectively, despite lagging the spectacular 59% rally in Tencent (in Rand).

We enter 2021 with the tailwinds of monetary and fiscal support, coupled with the global rollout of vaccines, as well as the low base set by the near economic standstill induced by the initial Covid-19 extreme lockdown measures during the first half of calendar 2020.

We are cognisant that the recovery is not without risks and in positioning our portfolios, we constantly ask ourselves questions such as:

- How sustainable is the recovery and what is priced in?
- What are the risks that could derail the recovery?
- How effective will the vaccines be? Will there be severe side-effects, and will they work against mutations of the virus?
- Most importantly, what are the medium-to-longer term structural effects on economies, industries and companies?

The last question is particularly pertinent to our local economy. The pandemic has widened the gap between countries with more resources to reboot their economies, compared to those with less. The more developed economies have more resources (and substantially lower costs of debt) to support their economies and also have earlier access to vaccines, so they may recover sooner than their less developed counterparts.

The economic impact of Covid-19 will be felt for years to come. Economic growth in South Africa is generally expected to decline by around 8% during 2020, followed by a muted recovery of less than 4% in 2021 (according to Bloomberg consensus expectations). It is thus expected to take several years to recover back to 2019 levels. The weak economic environment and resultant tax revenue shortfall has worsened our fiscal position, highlighting the unsustainability of our debt trajectory, unless drastic steps are taken to avert a debt crisis.

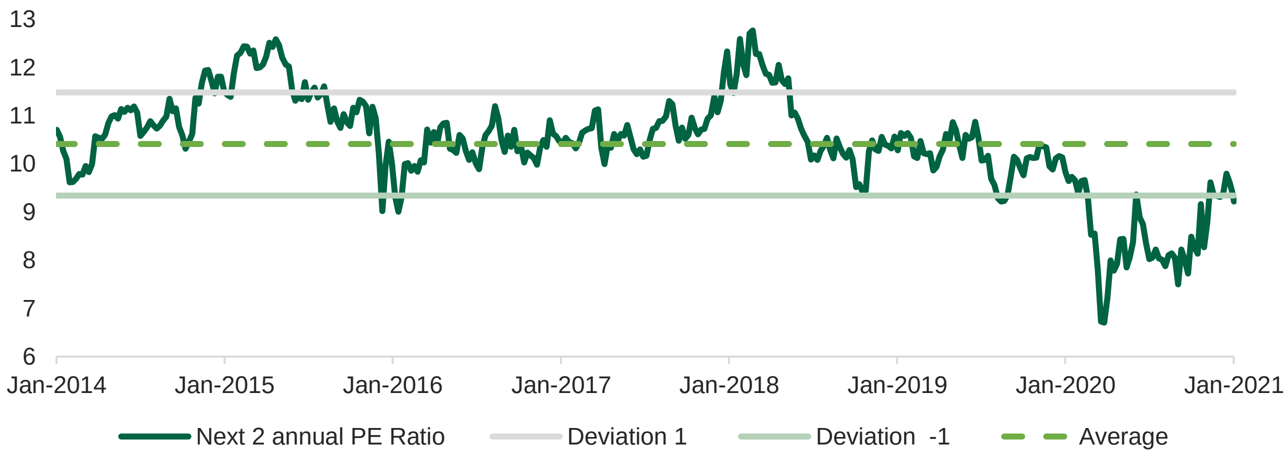
Having said this, markets tend to be forward looking and we think have largely priced in this sombre backdrop. In some domestically focused sectors, such as banks and insurers, we feel that this negative backdrop has been overly priced in and some stocks therefore offer an attractive risk-reward trade-off.

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

Whilst it is still early days, anecdotal feedback from several South African corporate management teams is that the recovery has generally been faster than they had anticipated, especially relative to the extremely cautious environment they had planned for.

We have created a simple index of the companies that are most exposed to South Africa (SA Inc.) and we have used this index over time as a gauge of how cheap or expensive South Africa is. On this basis, there are companies that are trading at valuations that have not been seen in generations, and others not since the 2008 global financial crisis.

Figure1: Laurium Capital Domestic South Africa forward P/E multiple 2 years out



Source: Laurium Capital, Bloomberg

Based on the above, we feel that there are several factors which could see the local SA market outperforming from current levels:

- Despite the rally off March lows, the FTSE-JSE All Share Index is only up 7% for the year and has lagged global markets which using the MSCI World as a base is up 16.5%.
- Emerging markets have broadly lagged and may benefit from rotational inflows (out of developed markets and into emerging markets), some of which may flow into SA.
- Given signs of froth appearing in certain sectors of developed markets, such as extreme tech company valuations and rapid post-listing gains in IPO's, we believe that more "value" real-economy companies should outperform were some of this to unwind. Many of the domestically orientated sectors, such as banks and insurers, would benefit from continued value outperformance.
- Although the outlook for the SA economy is certainly not rosy, we feel that pessimism may have been overly priced in and SA corporates may surprise on the upside in 2021, given:
    - Balance sheets are generally healthy, supported by strong working capital management and aggressive cost cutting initiatives.
    - Economic pain has been disproportionately felt by SME's, with less access to bank support to survive the crisis. On this basis, larger listed corporates have possibly gained market share, and their recovery back to 2019 levels of earnings may arrive sooner than generally expected.

Figure2: Portfolio Commentary Q4 2020

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
TEXTON PROPERTY FUND	2.7%	1.8%	ANGLOGOLD ASHANTI	1.8%	-0.5%
ANGLO AMERICAN	5.9%	1.1%	BRITISH AMERICAN TOBACCO	5.7%	-0.5%
COMBINED MOTOR HOLDINGS	2.4%	1.0%	CLIENTELE LIFE ASSURANCE CO	7.7%	-0.3%
IMPALA PLATINUM	2.9%	0.9%	MEDICLINIC INTERNATIONAL	1.7%	-0.1%
MUSTEK	4.1%	0.8%	REINET INVESTMENTS	1.9%	-0.1%

We continue to transition the portfolio to what we view as the optimal portfolio but continue to do so only when the market offers appropriate value for our clients. The Nedgroup Investments Growth Fund outperformed the index over the quarter, ending up 12.4% on the quarter, compared to the FTSE/JSE Capped SWIX performance of +11.5%. Texton, Anglo American and CMH were the main positive contributors to the fund, while Anglo Gold, British American Tobacco and Clientele were the main detractors. While the majority of the portfolio has been transitioned, we continue to hold the view that there is a large amount of value in the remaining legacy positions in the portfolio and remain confident that we will be able to realise this value over time.

Current positioning and outlook

In line with our view discussed above we have positioned the portfolio to have reasonable exposure to South African focussed companies (SA Inc). Our positioning within SA Inc has been predominantly taken through banks and insurers, where we feel that too much pessimism is priced in. We have rigorously stress-tested our assumptions on banks' expected credit losses and capital buffers, and based on our assessment, we feel that banks offer attractive upside.

The largest position in the fund remains Naspers and Prosus. Tencent, which is the largest underlying investment in Naspers and Prosus, is reasonably valued, with structural growth vectors, and is attractive relative to global tech companies in particular relative to the FANG's (Facebook, Amazon, Netflix and Google (Alphabet)), whilst Naspers and Prosus' management remain committed to unlocking the inherent discount to its underlying investments.

British American Tobacco (BAT) is another large position in the fund. Despite the headwinds faced by tobacco companies, we feel that BAT's valuation is exceptionally compelling trading at a forward PE of 8X, whilst offering an 8% dividend yield in sterling, which offers a strong valuation underpin in a low yield environment. We expect BAT to continue to grow earnings at high single digit levels, whilst generating robust cash flows, thereby de-gearing its balance sheet.

The fund has reasonable exposure to resources counters such as Anglo American, BHP, Impala Platinum and Sibanye Stillwater. The global macro backdrop is supportive of commodity prices, whilst strong cash generation and ungeared balance sheets support shareholder returns, and valuations remain attractive.

The fund also has exposure to hospital stocks, such as Netcare and Mediclinic, which are we think are substantially undervalued. As the post Covid-19 world recovers, and elective surgeries and hospital occupancies recover, we believe that these hospital stocks offer substantial upside.

Conclusion

We believe the fund is well positioned, appropriately diversified, and currently offers attractive upside when weighing up the inherent risks. As we enter 2021 with an optimistic view on the market, we continue to endeavour to transition the fund to what we view as the optimal portfolio in the shortest possible time period, while ensuring that we extract the maximum value for our clients from legacy positions.

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
The Standard Bank of South Africa Limited is the registered 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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