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A photograph of an open book with white pages, tied with a white string bookmark. The book is open to a blank page, and the pages are slightly curved, suggesting it is being turned or held open.

# **NEDGROUP INVESTMENTS**

## **Private Wealth Equity Fund**

Quarter Four, 2020

## Nedgroup Investments Private Wealth Equity Fund

Performance to 31 December 2020 ('R)	Fund <sup>1</sup>	Benchmark <sup>2</sup>
3 months	14.22%	8.90%
12 months	0.44%	5.90%

### Market Overview

The ALSI posted a return of 9.8% during the fourth quarter. The sectors leading the advance were Equity Investment +68.3%, Media +38.3% and Platinum +29.1%. The decliners included Gold Mining -24.8%, Tobacco -6.0% and Healthcare Equipment -4.1%. The SWIX40 returned 8.9% for the period.

2020 will likely go down in history as a remarkably challenging year for reasons that are well documented. However, from a global perspective, many records were set including the VIX reaching all-time highs, oil futures contracts going into negative territory as well as Apple becoming the first ever \$2trn market cap company. The pace of decline and recovery in equity markets during the year were also unprecedented and continues to leave some market participants perplexed.

During the fourth quarter, positive vaccine announcements resulted in strong market moves as a long-awaited rotation from so called growth to value seems to have gained some traction. In addition, strong YTD relative performance from gold miners sharply retraced during the period on the back of the vaccine updates. At the time of writing, the peak to trough drawdown in the SA gold mining index is just over 41% since July. US election uncertainty dissipated quickly after what appeared to be a consensus outcome, bar the democrat sweep that was feared going into the vote (which was subsequently confirmed in January).

In SA, many challenging issues remain, and our fiscal position remains delicate. However, some key performance indicators at a country level appear to be moving in the right direction, namely energy de-regulation, the fight against corruption etc. The current environment has made execution ever so important on some of the plans that have been announced to address the country's challenging issues.

During the period, trading updates from companies such as Shoprite and Bidvest showed the importance of scale and strong balance sheets. Our banking sector remains well capitalised, with some signs of better than expected actual bad debts relative to provisions raised earlier in the year. Overall, we continue to find pockets of value within the JSE.

### Portfolio Commentary

*"In investing, nothing is certain. The best investments we have ever made, that in retrospect seem like free money, seemed not at all that way when we made them. When the markets are dropping hard and an investment you believe is attractive, even compelling, keeps falling in price, you aren't human if you aren't scared that you have made a gigantic mistake."*

- Seth Klarman: Baupost Group, 1997 shareholder letter.

<sup>1</sup> Net return for the Nedgroup Investments Private Wealth Equity Fund, A class. Source: Morningstar (monthly data series).

<sup>2</sup> Benchmark is the SWIX40.

## Domestic

### *PSG vs Capitec*

After successfully unbundling Capitec, the PSG portfolio has become much more balanced with PSG Konsult now being the largest asset. During the period, the fund exited its direct stake in Capitec, in favour of further increasing its holding in PSG, which we believe continues to offer an attractive investment opportunity. The current discount to NAV for PSG is c.40% which we view as overly punitive.

Since unbundling at the end of August, Capitec has returned c.53%, while PSG itself has returned c.26%. Capitec management continue to execute on its runway opportunity and are constantly adding new streams of income at high rates of return. In its most recent results, we saw evidence that the business continues to benefit from strong growth in its transactional offering. It has a substantial base of 14.7m clients, which can be monetised further over the medium term. Increased client activity levels should continue to support growth in non-lending revenue.

However, we view Capitec's valuation at these levels as already discounting very high expectations which results in a limited margin of safety. PSG has retained a small stake in Capitec, but on the most recent results call management mentioned that they will look to exit at the right price which should further unlock value for shareholders. In addition, management noted the start of a share buyback programme during the last set of results which should support an increase in NAV per share over time.

### *Exited MRP, Pepkor update*

Going into the quarter, the fund was positioned in what we believe to be well-positioned clothing retailers.

Mr Price is well known for its value fashion offering, experienced management team while having financial flexibility as a result of its strong, debt free balance sheet. In its latest results, Mr Price announced that it will be expanding its offering into school, baby and novelty and gifting categories. The first two are c.R4bn markets each and present a sizable opportunity to take market share from the incumbents.

Mr Price also announced the acquisition of Power Fashion, a value focused cash-based company that Mr Price views as aligned to its core capability. The purchase consideration will be settled via cash and represents approximately 4% of Mr Price's market capitalisation. This acquisition gives Mr Price access to the low-mid income household and geographically adds diversity through stores in high streets (i.e. away from the super-regional and regional malls).

Although these developments are positives for the investment case, we remain cognisant of valuation and used share price strength during the period to exit our holding due to more attractive opportunities elsewhere.

Pepkor operates a defensive and cash generative business offering robust and visible earnings growth. Its defensiveness is due to the attractive positioning of its two primary assets, Pep and Ackermans, which focus on delivering essentials to value conscious consumers. Pepkor in its latest set of results managed to report a 3.6% y/y increase in sales relative to the prior period. In addition, the group realised R700mn in cost savings during the period, resulting in operating costs increasing by just 3.4% y/y. PEP and Ackermans contribute c.90% of profit and managed to open 145 new stores across the two brands during the last 12 months.

Pepkor initiated a portfolio review process more than a year ago that culminated in the announcement of the disposal of the non-core Building materials business; the sale is expected to be concluded in the first half of 2021. The group also completed its exit from Zimbabwe during the period and is in the process of exiting Uganda where it currently has 13 stores. We expect further consolidation in the group's rest of Africa operations, which contribute less than 5% of profits, and further rationalisation of brands that don't align to the group's value proposition.

Pepkor will have to defend its market share against established players who are now entering some of its sub-categories. Foschini recently acquired Jet, while Mr Price's acquisition of Power Fashion and recent entry into school and baby wear may dampen some of Pepkor's prospects. At current levels, the fund retains a relatively modest position in Pepkor and we continue to monitor these key performance indicators closely.

#### *Altron Bytes Technology de-merger*

Altron has been a mid-sized position in the fund for several years now with a cost price of c.R12/share (combined entity).

During the period, Altron completed the de-merger of its Bytes Technology UK business in order to unlock value for shareholders. Prior to de-merger, Bytes UK contributed c.45% of revenue, and c.31% of EBITDA.

Bytes UK, founded in 1982, is one of the UK's leading providers of IT software offerings and solutions, with a focus on cloud and security products. In addition to creating value for shareholders, the rationale for the transaction was to provide Altron and Bytes UK the platform to pursue independent strategic initiatives, with enhanced flexibility and efficiency. The transaction will also enable the respective management teams to execute on their strategies with direct responsibility and accountability for performance and growth.

Post the de-merger, Altron "2.0" houses the SA ICT operations as well as Netstar. In our view, both Bytes and Altron find themselves in good competitive positions, alongside strong balance sheets and management teams that continue to execute. In the first few days post the demerger, we believe indiscriminate selling (as is usually the case with demergers/unbundling transactions) caused the Altron share price to trade significantly below our assessment of fair value. We therefore used the opportunity to add to our position in Altron "2.0" which we believe is a compelling three-year investment opportunity in the SA inc. part of the market.

The market viewed Bytes favourably upon listing, and quickly rerated the business well above the IPO valuation range, leaving a day one profit of just over 20%. While the prospects for Bytes remain encouraging, at the current price we believe the market is already discounting a fair amount of the runway. The fund has marginally reduced the position post IPO but continues to hold a mid-sized position.

We applaud the Altron management team for putting shareholder value creation at the top of the priority list. The transaction was well structured, swiftly executed and unlocked a significant amount of value to shareholders over the last few months.

#### International

The Fund's direct international exposure is predominantly to US-listed companies. We have provided a brief comment on changes and highlights during the period.

#### *Citibank: Value coming through*

Our investment case for Citi is largely premised on the group being well positioned to return large amounts of capital to shareholders given its strong balance sheet and large investments made in the past. Over time, this return of capital will drive book value per share and dividend growth, irrespective of top and bottom line growth. Citi's large global footprint and service offering provides shareholders with diversified earnings streams. Citi is therefore less dependent on the U.S. yield curve, relative to its peers. Citi's large network across emerging markets provides access to a source of high returns that we believe still has a large runway opportunity to capitalise on.

Accounting rules require banks to provision for all expected credit losses over the life of a loan. With businesses closing and unemployment spiking, provisions for future losses ballooned, which resulted in the industry

reporting the sharpest decline in profits for the first half of the year since the GFC. The market extrapolated these results which led to the sector underperforming, creating what we believed to be a good buying opportunity for patient long-term investors.

Citigroup's Q3 results showed early signs that the market had indeed overreacted, with little incremental provisions for future losses. The unprecedented amount of stimulus showed its worth, with actual consumer and corporate credit losses seeing no deterioration from pre-COVID levels. With bank profits recovering and capital piling up on balance sheets, the prospect of share buybacks returning has increased. Share buybacks, the primary form of Citi's capital return will be especially accretive to shareholders at its current discount to tangible book value. While it will take some time to improve returns to pre-COVID levels, as a result of the current low interest rate environment, Citigroup is well positioned to return capital to shareholders and continue to compound shareholder value over time.

The fund holds a mid-sized position to Citi, as we believe the current discount still provides a reasonable margin of safety against any short-term adverse events.

#### *Brookfield Asset Management: Investor day*

Brookfield Asset Management is an alternative asset manager with a strong track record in operating real assets on a global scale. Assets under management totalled \$575 billion at the end of September 2020, diversified across infrastructure, real estate, renewable energy, private equity and credit. Brookfield manages \$290 billion worth of fee-bearing assets across a range of private funds and listed vehicles, and has its own capital invested in several of these managed entities to create strong alignment of interests. Brookfield's global reach, experience as an owner-operator and track record in areas such as infrastructure and power generation set it apart from alternative asset management peers.

Brookfield hosted an investor day towards the end of September 2020, during which management communicated its ambition to grow fee-bearing capital to over \$500 billion and invested capital to more than \$75 billion in the next five years (currently ~\$290 billion and ~\$52 billion, respectively). The Group continues to experience strong demand for its offerings, as low interest rates drive demand for alternative assets that are able to produce stable and growing cash flows. Brookfield is aiming to raise \$100 billion in assets during its next round of flagship fundraising, which it hopes to conclude over the next two to three years. The Group is also exploring various new strategies that can add to assets under management longer term. This includes Impact funds (under the stewardship of Mark Carney, former Governor of both the Bank of England and Bank of Canada), Secondary funds, Technology funds and Insurance.

The 2019 investment in Oaktree has significantly bolstered Brookfield's credit capabilities, which places the Group in a strong position to enter the reinsurance industry. The Group has consequently established Brookfield Reinsurance Partners, of which shares will be distributed to existing Brookfield Asset Management shareholders during the first half of 2021. As a start, Brookfield has inked a deal with American Equity Investment Life under which Brookfield will reinsure up to \$10 billion worth of annuity policies. Management thinks there is scope to grow assets under management from this business to well over \$100 billion longer term.

We believe Brookfield has the right recipe to compound shareholder value for many years. In addition, the strong alignment of interest between management and BAM shareholders adds to the appeal of the investment case. BAM currently occupies a mid-sized position in the fund.

During the period, two significant items developed which negatively affected the fund's holding in Alibaba.

In November, the \$35bn IPO of Ant Group, planned to be the biggest share offering in history (expected market cap \$320bn), was dramatically suspended just two days before the planned IPO in Shanghai and Hong Kong. The move came a day after the company's top executives including its founder, Jack Ma, were summoned to meet Chinese regulators regarding Ant's activities. China's central bank also issued new draft rules for online micro-lending that raised the amount of cash lenders were required to hold as capital. Ant Group owns Alipay, one of the dominant payment companies in China with over 710m monthly active users, alongside other subsidiaries including businesses which we believe are well-positioned in the fast growing InsureTech, InvestmentTech and CreditTech markets where it partners with over 2,000 financial institutions. Ant group is c.33% owned by Alibaba, which sold off aggressively on the day of the news flow as well as over the course of the days that followed.

Then in December, China's State Administration for Market Regulation (SAMR) announced that it was investigating Alibaba for suspected monopolistic practices. The investigation into monopolistic behaviour centres on the so-called "choosing one from two" practice. This requires merchants (sellers) to sign exclusive co-operation pacts with platforms such as Alibaba's Taobao, preventing them from offering products on rival platforms. This investigation is therefore more geared towards Alibaba's core e-commerce business which contributes the vast majority of group profits. As an aside, on November 11<sup>th</sup>, the infamous "singles day" event in China, Alibaba managed to rake in a whopping \$75bn of sales, comfortably surpassing the record from the previous year. For perspective, this is just shy of 10% of South Africa's GDP in 2019.

At this stage, we believe there is too little information (and also too much noise) to assess the true impact on the intrinsic value of the business from the above-mentioned issues. Both Alibaba and Ant group have publicly stated that they will comply with the requests of the regulator and are open to engaging on any concerns. From a portfolio perspective, we have kept our Alibaba positioned unchanged but will closely monitor the developments and adjust our estimates of intrinsic value and our resulting position size, when the updated facts emerge.

#### *Compounder with runway - Stryker*

Stryker engages in providing medical technology products and services. It operates through four segments: **Orthopaedics** products consist primarily of implants used in hip and knee joint replacements and trauma and extremities surgeries. **MedSurg** products include surgical equipment and surgical navigation systems, endoscopic and communications systems, patient handling, emergency medical equipment and intensive care disposable products, reprocessed and remanufactured medical devices used in a variety of medical specialties. **Neurotechnology** and **Spine** products include neurosurgical, neurovascular and spinal implant devices. The Company was founded by H Stryker in 1941 and is headquartered in Kalamazoo, Michigan, in the US. The Stryker family remains invested in the Group.

Our investment case for Stryker is premised on the group having an established track record of double-digit returns on capital which speaks to the competitively advantaged nature of the business. Stryker's return profile is built on being a brand that surgeons trust in managing their own career risk. The industry which Stryker serves has a large runway opportunity ahead of it due to; (i) increasing global healthcare demand, (ii) increases in life expectancy and, (iii) new product development resulting from the advancement in robot-assisted surgery and technological advancements. Less invasive surgeries lead to more procedures and therefore more equipment sold, as equipment will need to be replaced more frequently. The firm has a history of augmenting its R&D-enhanced organic opportunity set with a gap-fill M&A strategy. This strategy focuses on; (a) smaller targets to mitigate risk, (b) emerging technologies that complement the existing Stryker product set and, (c) supply agreements with hospitals. Furthermore, Stryker's opportunity outside of the US remains largely underpenetrated.

During November, Stryker completed its acquisition of Wright Medical after receiving final regulatory approvals for the acquisition earlier in the month. Wright Medical is a global medical devices business which will enhance Stryker's global position in the trauma and extremities categories. Shortly after the transaction, the group priced a \$600 million senior notes offering at 0.6%, making use of extraordinary low interest rates. Going forward, as management continue to execute on the runway opportunity, we will remain cognisant of valuation in order to distinguish between a great business and a good investment.

#### Top 5 contributors and detractors for Q4 2020: Overweight positions

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Adapt IT	2.3%	1.8%	Alibaba	4.6%	-1.9%
PSG Group	5.2%	1.2%	Altron	3.7%	-1.3%
African Rainbow Cap.	1.0%	0.6%	Unilever	1.4%	-0.4%
EOH	0.9%	0.5%	Facebook	1.8%	-0.3%
Citigroup	1.9%	0.4%	Mediclinic	1.7%	-0.3%

#### Top 5 contributors and detractors for Q4 2020: Underweight positions

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Naspers	-20.8%	1.3%	Impala Platinum	-2.9%	-0.8%
Gold fields	-2.0%	1.0%	Sibanye Stillw.	-2.7%	-0.5%
Anglogold	-2.3%	0.8%	Capitec	-2.1%	-0.5%
Sasol	-0.5%	0.2%	ABSA Group	-1.7%	-0.4%
Mondi	-1.0%	0.2%	Multichoice	-1.3%	-0.3%

#### Current positioning and outlook

The fund ended the quarter with approximately 25% of its available 30% direct exposure to international markets. The fund will continue to move towards the maximum 30% allocation as market conditions permit.

The relative performance of the fund over the last six months has shown material signs of improvement both against the peer group (1<sup>st</sup> quartile) as well as against the indices. For the 2020 year, the fund placed in the middle of the third quartile amongst peers.

On a see-through basis, the exposure remains geographically balanced, with sizeable exposure to high quality rand hedge businesses, complemented by what we believe are good businesses that are well positioned in the SA environment.

We continue to diligently apply our investment philosophy of “*Long-term, well considered*”, and we look forward to 2021 as a year of recovery from a low base. We thank all our unit holders for entrusting us with their capital and for their patience in what has been unprecedented times.

## 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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