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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Four, 2020

Nedgroup Investments Rainmaker Fund

Performance to 31 December 2020	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	+4.7%	+9.6%	+9.8%
12 months	-7.4%	+1.9%	+7.0%

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 Rainmaker Fund, A class. Source: Morningstar.

Portfolio commentary

The fund had a disappointing quarter and year in 2020, declining by 7.4% for the year in comparison with the positive +7.0% recorded by the JSE All Share Index. The table below details the primary contributors and detractors from performance for the fourth quarter of 2020. It is interesting to note that in the first quarter since the implementation of the mandate change to allow foreign investment, we find direct foreign positions appearing on both sides of the below standard table.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Anglo American	6.42%	1.12%	AngloGold	3.12%	-0.94%
FirstRand	5.22%	1.09%	Alibaba	2.56%	-0.80%
Impala Platinum	2.86%	0.99%	British American Tobacco	7.5%	-0.50%
Samsung	2.58%	0.64%	Amazon	1.67%	-0.19%
Naspers	15.46%	0.46%	Anhui Conch	0.79%	-0.17%
Total		**4.30%**	**Total**		**-2.60%**

We would like to pause here, assure our unitholders whose patience we know we have tested in the last few years considering the fund's disappointing absolute and relative performance, that we are acutely aware of the numbers currently showing on the scoreboard.

While there is little we can do about absolute performance from year to year, considering the mandate type, our relative performance has been disappointing.

Versus the JSE All Share Index our underperformance can principally be attributed to the following factors:

1. **Underweight Basic Materials**
   While we have for several years had very large positions in Anglo American, BHP, Mondi and platinum shares, this position has not been as large as that in the benchmark and apparently our peers. While we have been positively positioned in the stocks, the absolute size of the positions has been limited by our considerations of risk in the degree of exposure we have been comfortable with. After four years of consistent annual substantial outperformance by the sector it is the single largest contributor to our under-performance.

2. **Sasol Ltd**
   We have written extensively about this position which we mis-judged.

3. **British American Tobacco**
   This position has been a huge source of frustration as it is a position in which we have retained a substantial position. This company continues to trade at multi-decade low valuation levels. This despite its very constructive progress regarding reducing its debt levels, clear progress on the investment in, 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), performance 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. Perhaps 2021 will signal some rotation from the decade long global trend of growth stocks outperforming value. We do not categorise ourselves in either of these strict baskets, preferring to build a balanced portfolio of quality assets where the current price undervalues the expected medium- and long-term profit performance.

4. **Large position in banks**
   Valuations were attractive and balance sheets strong pre-COVID, and these are being tested at the moment. But they certainly did feel substantial pain in Q2 and Q3 of 2020. Fortunately, the tide seems to be turning for their fortunes and our persistency is being rewarded (see table above for evidence).

We remain convinced that the strategic decision to allow the Rainmaker Fund to access the 30% offshore allowance was the right thing to do for unit holders long term, and the points we made in our Q3 2020 commentary supporting this logic remain as valid as ever.

While the above is true, we think the further short-term strength in the rand is being driven by a strong showing from our trade balance. While it helps, it does not however fix the problem of our severely damaged and deteriorating balance sheet.

Strategy of accessing offshore assets implemented during first quarter of mandate change

When we got the green light to access the offshore quota in September, and after a long internal debate, we elected to implement the following course of action.

Logically, accessing the offshore allowance by necessity required some selling of existing positions. With the Rand having already strengthened by 15% from its lowest point in April 2020, and with the Medium-Term Budget Policy Statement due on 28 October with our finance minister having his back against the wall, we decided we wanted to get to around 15% offshore or half the allowed allocation. Which would still be below most other general equity funds with offshore allowances.

We did this at an average exchange rate of around R16.40 to the US$ by mid-October. We have continued to 'migrate' gradually into further Rand strength with the offshore component now making up about 18% of the fund.

So how did major positions change or not?

We have remained confident of the valuation and very high current level of cash generation of the diversified miners, retaining our heavy exposure to Anglos (volume growth in Iron ore, Copper, PGM's and diamonds) as well as BHP (65% of profit from iron ore). This has worked well and remains compelling as the important commodities for both have continued to push higher.

We have increased our PGM exposure (now about 9% of the fund) confident that the huge profits currently being earned from secondary metals (notably Rhodium) will result in large increases in profits and cash distributions.

We reduced our exposure to Gold (following conclusion of the US election as we think political tension globally is likely to ease a little) and Sasol, which has been a good short-term performer but still faces the huge uncertainty of a potential substantial rights offer and a weak outlook for oil demand growth.

With Naspers and Prosus results due at end November, and with an already announced substantial share buyback program due to commence in December, we elected to largely hold this very large position on the expectation that we would be presented with further strength in this stellar performer which would allow us to lighten. While all the events have come to pass as anticipated and we have seen some narrowing of the NAV discount, this has largely been undone by the unexpected actions of the Chinese state regarding examining what they refer to as "monopoly abuse positions".

We do not believe Tencent is at great risk from these, but it is likely to take a little while for the market to accept that what is proposed is not a direct attack on the commercial prospects of this firm. These same possible regulatory changes had an even more negative effect on one of the new shares we had acquired with the offshore funds - Alibaba - which was even forced to withdraw its imminent listing of its financial services arm

(Ant Financial) and which we had expected would drive further appreciation in Alibaba. Since the end of the year there have been further rumours of the Trump administration, in its last hours of authority, imposing limitations on US investors owning certain Chinese assets deemed to be working with the Chinese state or military. Tencent has been mentioned amongst this list. With only days remaining until the 20 January inauguration of President elect Biden, we expect substantial changes to the angle of diplomatic relations between China and the US after that date.

While some of the new global positions have performed very well in the short term – even taking the rand strength into account (e.g. Samsung, Moncler, Google and Puma), some of the new tech positions have experienced short term weakness and when translated via the short-term Rand strength have hurt even more (e.g. Alibaba and Amazon).

We of course did not want to start the off-shore expansion of the fund like this, but the timing – with hindsight – was not ideal. Unfortunately, it was not a decision that allowed selective timing given the regulatory process around the decision and its implementation. However, we remain resolute in the application of our investment process and stock selection, locally and offshore. While the short-term scorecard is against us, we remain convinced that one should own companies that grow stronger than others, whilst generating cash and without gearing up the balance sheet inappropriately.

We have retained our large banks exposure (>8% of the fund) but have consolidated it into FirstRand and Standard Bank. This has worked well, but we did dispose of the lower quality ABSA which has run just as hard.

We sold most of the very small positions (<0.4% of the fund) to raise some of the cash for the offshore component, but the timing of this has been unfortunate, as they have subsequently performed strongly during the fourth quarter. Although individually they had low weightings, most bounced very hard, such as Imperial, Motus and Sappi.

We sold our Remgro position, which as a holding company, served little portfolio purpose.

Current positioning and outlook

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 the virus. 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 million 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 December 2020, the fund traded on a weighted forward PE of 15.7X, Price to Book of 2.1X and Dividend Yield of 2.4%.

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 Rainmaker Fund during the fourth quarter of 2020 include.

Reinet - We furthered the 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.
Coronation - Discussions regarding further disclosures made in the 2020 integrated report.
Mediclinic - Review of revisions to remuneration policy.
Mr Price - Review of revisions to remuneration policy.
KAP - Engagement with Remuneration Committee.
Naspers - Discussions with chief people officer regarding worrying associations of SA CEO.
Sanlam - Engagement with the Chairman regarding various governance issues such as remuneration and conflicts of interest.
Shoprite - Engagement with Group Sustainability Manager regarding the company's approach to sustainability and key areas of focus.
Sasol - Engagement with the Chairman regarding general governance matters, with a focus on remuneration as well as sustainability targets.

Conclusion

We would like to conclude by reiterating an earlier statement that we are extremely conscious of the disappointing numbers currently showing on the Rainmaker Fund’s performance scorecard. We hope the above analysis is helpful in giving unitholders some insight into the drivers of this outcome.

As we start 2021, the fund is positioned with concentrated exposure to companies and industries where we have investment conviction, growth prospects are attractive, and most importantly valuation in the context of the growth prospects is appealing. Some of these have been held for some time and have tested our patience. Will 2021 be their year?

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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