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NEDGROUP INVESTMENTS STABLE FUND

Quarter Four, 2020

Market commentary

International

Economic activity improved from the historic second-quarter recession as momentum built on less stringent lockdowns. However, the emergence latterly of more transmissible variants and increasingly onerous winter lockdowns suggests that economic recovery in 2021 may not be as robust as first expected. Positive vaccine trial news flow and the first UK and US inoculations supported expectations for a faster return to normal and propelled equity markets to new highs. But the time required to reach global herd immunity is uncertain given the logistical challenges of vaccinating that many people and developing countries' ability to access sufficient supply. The passage of an additional $900 billion US relief package provided further buoyancy to equity markets.

The US elections did little to settle US political uncertainty given President Trump's non-capitulation and legal challenges to Biden's electoral college and popular vote victories. Longer term, the Democratic clean sweep now makes higher US corporate taxes and increased government spending much more likely. However, the unprecedented peacetime global deficit spending that we saw in 2020 went to personal consumption and not productivity enhancing infrastructure investments, raising the spectre of higher long-term inflation as debt burdens spiral.

The major central banks (excluding China) maintained their extreme monetary policy stance with cash pouring into alternative assets and corporate credits in search of higher yields. Indeed, global corporate debt issuance in 2020 reached a record $5.4 trillion, resulting in much weaker balance sheets and sharply rising risk of corporate credit defaults should solvency ratios not improve meaningfully.

The US dollar was weaker on the sheer scale of US monetary stimulus and as the eleventh-hour Brexit trade deal buoyed the euro and pound. Dollar weakness should persist as the Democrats implement their economic agenda and investors move out of safe havens ahead of economic recovery following the vaccine roll-outs.

Industrial commodity prices surged as market sentiment for economic recovery in 2021 gained momentum. The weaker dollar should provide further support for commodity prices with growing inflation risks in the long-term expected to keep precious metals prices also well bid.

South Africa

The economy continued to recover at pace from the severe second-quarter recession but is still expected to have contracted by at least 5% in 2020. However, a sooner than expected summer second-wave infection caused by a new, more transmissible SARS-CoV-2 variant, the return to Level 3 restrictions and bungled vaccine procurement have elevated the risks to meaningful economic recovery.

The Mid-Term Budget Policy Statement ("mini-budget") in October was disappointingly vague on government's strategy for arresting the rapidly deteriorating public finances. The slim chance of meaningful public wage reductions and incomprehensible support for bankrupt SOEs does not bode well for the trajectory of the country's debt spiral.

SA equities delivered good returns with financials, resources and industrials rallying on buoyant emerging markets sentiment. Despite the weak economic outlook, select 'SA Inc.' companies are attractively valued. Resource companies, however, appear to be near the peak of their earnings and operating margins cycles.

The SA government bond yield curve moved lower and flatter as long bond yields fell on the global risk-on environment amid hopes for a faster return to normal in 2021. South African bond yields remain attractive given the benign inflationary environment. In the long-term however, inflation risks include reserve bank independence, money printing and ever-increasing bond issuances to fund the fiscal deficit.

Listed property was the best performing asset class as investors were bottom feeding the optically attractive yields. But the asset class is still down 34% for the year as property values were marked down amid recession-driven negative rent reversions. Risks to distributions persist, given weakening balance sheets, rising debt ratios and persistently difficult trading conditions.

The rand appreciated on broad-based US dollar weakness, but is at risk longer term from capital outflows despite an improved current account surplus. Notwithstanding, emerging market currencies should stay well bid while market sentiment remains positive for vaccine rollouts, allowing a return to more normal levels of economic activity.

The first, long overdue, high level corruption arrests provided much needed balm to the national psyche. But the country's fortunes remain intricately linked to internal ANC factional frictions, with the time for much needed structural economic reforms starting to run desperately short.

Performance commentary

- SA fixed interest securities contributed positively as the yield curve fell and flattened — the core holding in the medium-term R186 slightly underperformed the All Bond Index as yields at the long end fell but has strongly outperformed over the year.
- SA equities contributed most to performance with financials, industrials and resources all advancing—core holdings FirstRand, Standard Bank, Anheuser-Busch InBev and Richemont all advanced, partially offset by declining British American Tobacco.
- The global equity component continued to outperform, ending the year 8% ahead of the benchmark MSCI All Country World Index—but foreign assets in total detracted at the margin this quarter as the rand gained on dollar weakness.
- The low listed property weight detracted this quarter but protected capital over the full year with the sector down 34% in 2020—core holding in London value play Capital & Counties made a positive contribution.
- The diversifying physical gold position detracted from performance over the quarter—on a lower dollar gold price and stronger rand.

Top 5 contributors	Performance Contribution %	Holding Return %	Average Weight %
R186 government bond	1.0%	4.3%	24.4%
Foord Global Equity Fund	0.3%	2.0%	16.3%
FirstRand	0.3%	24.4%	1.3%
R2035 government bond	0.3%	7.9%	3.5%
Capital & Counties Properties	0.3%	19.8%	1.4%

Top 5 detractors	Performance Contribution %	Holding Return %	Average Weight %
Sasol	0.0%	14.8%	0.1%
Netcare	0.0%	-6.3%	0.2%
British American Tobacco	-0.1%	-6.0%	0.9%
Foord International Fund	-0.7%	-4.1%	15.2%
Newgold ETF	-0.7%	-12.1%	5.3%

Investment Outlook

World:

- Economic recovery to continue to be driven by the speed and efficacy of vaccine roll-outs and extent of continued hard lockdowns.
- Unprecedented monetary and fiscal support is likely to persist for the foreseeable future, raising the risks of an inflation break-out in the longer term.
- Geopolitical risks continue to rise as the US continues to push against the strategic risks of a rising China.
- Market volatility levels are expected to remain elevated.
- Higher US corporate taxes and government spending are expected in time on the back of the Democrat clean-sweep in the US elections.
- Dollar weakness is likely to persist, supporting commodity prices.

South Africa:

- The pace of economic recovery is likely to remain slow and volatile given the structural economic challenges and vaccine procurement bungles.
- Unsustainable fiscal deficits are expected to continue, increasing the risk of a full-blown debt spiral.
- Recovery in employment levels likely to be slow in the absence of meaningful reform and accelerating economic growth.
- The outlook for inflation is benign given the weak consumer demand and stronger rand.
- The rand is vulnerable to continued depreciation over time.

Conclusion

The fund's equity weight has increased as global and SA markets rallied latterly and although positive news flow should be supportive, the longer-term risks continue to rise. US market valuations are very high relative to history, only justifiable by extremely low borrowing costs. A meaningful allocation to equities is maintained but the managers are cautious given the prevailing risks. Stock selection is critical with positions focused on good quality, niche global companies at attractive valuations that are well positioned to survive further stress.

The managers opportunistically purchased some niche "SA Inc." companies but still favour JSE-listed global businesses given the higher risks in the SA economy and more attractive global opportunity set. These are well capitalised companies that should deliver hard-currency, real earnings growth through the cycle, supported by expected longer term rand weakness.

The low resources weight is retained, primarily via BHP Group, which is the highest quality diversified miner and the fund's largest single equity investment. Despite likelihood of continued momentum for the sector in the short term, the managers are concerned that current market ratings and earnings are unsustainable.

The diversifying physical gold position via the NewGold ETF is an uncorrelated asset and hedge against market dislocations and the risk of possible rampant inflation in the future.

Foreign assets were reset to the prudential maximum during the quarter, with a preference for global equities over bonds and cash with some hedges against market retracement. The fund's investments favour higher growth and better-valued emerging market businesses with structural tailwinds over more expensive US bourses.

Despite some recovery in SA retail and commercial property counters, the sector faces significant structural challenges. The managers remain focused on niche logistic and self-storage property counters and UK-listed value play Capital & Counties.

Medium-term SA government bond investments are a meaningful part of the portfolio, although we trimmed holdings at the margin during the quarter. Despite lower nominal yields, bonds still offer attractively high real return prospects given benign inflation conditions in South Africa.

Reasonably high levels of optionality and liquidity are maintained in the fund, allowing the managers to take advantage of attractively priced long-term opportunities as and when market volatility presents them.

Responsible Investment Summary

Voting resolutions for Q4 2020

Portfolio	**Total Count**	**For**	**Against**	**Abstain**
Adopt Financials	4	100%	0%	0%
Auditor/Risk/Social/Ethics related	21	100%	0%	0%
Buy Back Shares	4	100%	0%	0%
Director Remuneration	13	92%	8%	0%
Dividend Related	4	100%	0%	0%
Issue Shares	7	0%	100%	0%
Loan / Financial Assistance	4	0	100%	0%
Other	8	50%	50%	0%
Re/Elect Director	30	100%	0%	0%
Remuneration Policy	10	20%	80%	0%
Shares under Director Control	1	0%	100%	0%

Foord Global Equity Fund (Luxembourg)	**Total count**	**For**	**Against**	**Abstain**
Auditor/Risk/Social/Ethics related	2	50%	50%	0%
Issue Shares	1	100%	0%	0%
Others	1	100%	0%	0%
Re/Elect Director	19	100%	0%	0%
Remuneration Policy including directors' remuneration	6	33%	67%	0%

Foord International Fund	**Total count**	**For**	**Against**	**Abstain**
Auditor/Risk/Social/Ethics related	2	50%	50%	0%
Issue Shares	1	100%	0%	0%
Others	3	100%	0%	0%
Re/Elect Director	18	100%	0%	0%
Remuneration Policy including directors' remuneration	5	80%	20%	0%

General comments:

- There are few abstentions. We apply our minds to every single resolution put to shareholders. When there is an abstention it would typically be intentional or for strategic reasons.
- We typically vote against any resolution that could dilute the interests of existing shareholders. Examples include placing shares under the blanket control of directors, providing loans and financial assistance to associate companies or subsidiaries and blanket authority to issue shares. On the rare occasion, we have voted in favour of such resolutions, we were able to gain the required conviction in the specifics of the strategic rationale for such activities and could gain comfort that such activities are indeed to be used to the reasons stated.
- The firm also has a strong philosophy regarding management remuneration models. We believe in rewarding good managers with appropriate cash remuneration on achievement of relevant performance metrics that enhance long-term shareholder value. We are generally not in favour of share option schemes given the inherent asymmetry between risk and reward typical of such schemes. In addition, we do not believe that existing shareholders should be diluted by the issuing of new shares to management as is the case with most option schemes. We are in favour of the alignment created between management and

shareholders when management has acquired its stake in the company through open market share trading and paid for out of management's own cash earnings.

Notable company engagements

Libstar

Concerns around metrics used (operating earnings vs. reported earnings), weightings attached to the metrics and share dilution as result of new share issuances.

Spurcorp

Several engagements with the Chairman and Board Remuneration Committee non-executive members regarding remuneration and corporate governance, as well as capital allocation.

Invicta

Engagement with non-executive director on exco remuneration and general strategy for new management regarding capital allocation going forward.

Bidvest

Management wanted feedback on why we voted against remuneration policy. Our issues were primarily the share based settlement. It should be noted that the group bases returns on ROFE (excludes intangibles and goodwill). We do not believe that ROFE is an appropriate metric for a company of this nature.

Bidcorp

AGM voting and remuneration discussions. Had a discussion with the CFO on the structuring of their debt and the fact that we voted against the convertible (resolution 8.0: creation of convertible debentures). We are not in favour of obscure funding sources and the group's balance sheet is sound with ample liquidity (22% of market cap) and does not require alternative sources of debt. Essentially we voted against due to unnecessary shareholder dilution.

Richemont

AMG voting – feedback to IR on our management meeting. Remuneration policy – in our opinion the policy must be a function of earnings growth, returns and free cash flow measures to ensure that capital allocation drives both short term and long term returns. Regarding the Board of Directors, we feel that both the size of the board and total compensation is high.

MediClinic

AMG voting & rem discussions. We queried 50% of Short Term Incentive (STI) to be delivered in shares. Management confirmed that delivery is in shares and they buy back in the market, hence no existing shareholder dilution.

Disclaimer

WHO WE ARE
Nedgroup Collective Investments (RF) Proprietary Limited, is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust funds. It is a member of the Association of Savings & Investment South Africa (ASISA).

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For the Nedgroup Investments Bravata World Wide Flexible Fund it is calculated monthly as a percentage (the sharing rate) of outperformance relative to the fund's benchmark, with the high watermark principle applying. All performance fees are capped per fund over a rolling 12-month period. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

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