NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS VALUE FUND

Quarter One, 2021

Market Commentary

International

The 2020 economic recession was milder than first expected given China's rapid recovery and the significant central bank monetary and government fiscal support in the developed western countries. After contracting 3.6% in 2020, the IMF has raised its forecasts for global economic growth to 6.6% for 2021, moderating to 4.4% next year. New US President Biden hammered through a massive $1.9 trillion pandemic relief bill and announced an additional $2.0 trillion infrastructure plan. Higher budget deficits and rising sovereign debt to GDP ratios should result in structurally lower economic growth as investment spending is curtailed by rising debt repayment obligations.

Developed market equities achieved all-time highs on expectations that vaccine rollouts and the massive fiscal and monetary stimulus would accelerate global growth. Aggregate equity market valuations are looking stretched with markets precariously poised should there be any negative earnings surprises.

Longer dated developed market bond yields were sharply higher. Driven by rising inflation expectations given the likely rapid economic recovery as the vaccine rollout allows economies to properly open and on the massive increases in money supply. The multi-decade epoch of falling inflation and interest rates and rising sovereign debt levels might be approaching an inflection point with meaningful consequences for normative asset class returns in the coming years.

The US dollar outpaced the majors on rising Treasury yields and expectations for faster growth while rising European coronavirus case counts weighed on the euro. Longer term risks to the dollar include deteriorating public finances, inflation and the inevitable continued re-emergence of China as a global economic superpower.

Industrial commodities oil, copper, platinum and iron ore rallied on prospects of rising economic demand, while traditional fiat currency hedges gold and silver fell on the opportunity cost of rising yields and as central banks downplayed inflation risks. The industrial commodities run up is likely behind us given the significant demand growth that is already priced in. However, rising long term inflation risks, ballooning budget deficits and rising risks of central bank policy error should provide some support to precious metals as the cycle unfolds.

South Africa

Fourth quarter GDP growth rebounded, but the SA economy contracted by a staggering 7.0% in real terms last year. The decline was reflective of the harsh lockdowns and government's inconsistent state of disaster policies. Despite a sharper recovery than expected and commodity rally driven trade surpluses, the economy still faces several structural headwinds. Hampered by policy inertia in a local government election year and a vaccine programme that has yet to commence outside of a large-scale J&J study.

The annual budget speech was more positive than previously expected with several improvements from the numbers outlined in October's Medium-Term Budget Policy Statement. But the government's ability to meet its fiscal consolidation targets relies heavily on the outcome of the politically difficult public sector wage negotiations.

The JSE outperformed emerging market peers, led higher by resources stocks on a sustained commodities rally and by industrial counters on hopes for robust 2021 growth. Resources companies are likely close to peak earnings and while there are some opportunities in select SA Inc. businesses, the JSE-listed international companies still offer the most attractive risk/reward opportunities.

In its latest unanimous decision, SARB's MPC kept the repo rate unchanged at 3.5% despite expectations for inflation to rise soon due to base effects, higher food inflation and oil prices and general insurance premium increases. These should be offset by lower medical inflation and a general lack of pricing power given weak demand in the economy.

Longer dated SA bond yields tracked global yields higher, especially in the "belly" of the curve. The current yield curve seems to be exceptionally steep given benign inflation expectations, but correctly reflects the risk of a potential fiscal cliff if expenditure cuts do not materialise.

The rand was stable against the US dollar, bucking general emerging market currency weakness on surprisingly robust recovery and improved terms of trade on the back of the commodity price rally. The currency will likely stay well bid for as long as the commodity price rally continues, but the fundamental lack of competitiveness and public sector finance stresses make longer-term weakness very likely.

Portfolio Commentary

- The allocation to the industrials/transport sector was the largest single contributor to relative performance—stock selection was good with sharp rises in mid-caps Hudaco, KAP and Value Group
- Consumer Services also contributed positively to relative performance driven by holdings in Spurcorp, Massmart, Italtile and The Foschini Group—partially offset by Rhodes Food Group which underperformed in the quarter
- Stock selection in the healthcare sector also contributed positively with both Aspen and Netcare outperforming—while core holdings in Santam and Standard Bank detracted
- The largest detractor from relative performance was the underweight allocation to commodity cyclicals and zero holding in precious metals miners—although BHP Group is the largest holding in the fund, Anglo American continued to outperform given its platinum mining exposure
- The diversifying physical gold position detracted from performance over the quarter—on a lower dollar gold price and stronger rand
- The allocation to listed property detracted at the margin—but was more than offset by good stock selection with core holding in London property company Capital & Counties outperforming

Winners	Performance Contribution %	Holding Return %	Average Weight %
BHP Group	1.2%	13.4%	8.4%
Hudaco	1.1%	25.8%	4.6%
Aspen	1.0%	15.9%	6.7%
Value Group	0.7%	46.9%	1.8%
Capital & Counties Properties	0.7%	22.0%	3.2%

Losers	Performance Contribution %	Holding Return %	Average Weight %
RFG Holdings	0.0%	-0.7%	1.1%
Standard Bank Group	0.0%	-1.1%	4.1%
Santam	0.0%	3.6%	3.2%
EOH	-0.1%	-10.6%	0.7%
Anheuser-Busch InBev	-0.4%	-10.0%	3.4%

Investment Outlook

World:

- Economic recovery to continue on unprecedented monetary and fiscal support and expected economic re-openings following the COVID-19 rollouts
- Inflation risks are mounting driven by accelerating economic growth and extreme levels of fiscal and monetary stimulus
- Geopolitical risks rise as countries seek to de-globalise and adopt more nationalist policy positions
- Equity market valuations are elevated, especially the large cap tech heavy S&P 500
- The massive fiscal stimulus in the US should result in rising budget deficits and likely higher US corporate taxes in time
- Commodity prices to remain well bid in the short-term by market expectations of rising economic demand, but the sector is approaching cyclical peak earnings

South Africa:

- The pace of economic recovery has been faster than expected as the economy re-opens post the COVD-19 second wave, but remains vulnerable given the slow pace of vaccination rollout
- Stretched public finances mean that unsustainable fiscal deficits are likely to continue, with a politically difficult wages confrontation between government and public sector workers now looking likely
- The February budget showed improved projections on several fronts compared to the MTBPS but the long-term risk of a full-blown debt spiral persists
- Recovery in employment is likely to remain slow, especially with the hospitality and tourism industries remaining under severe pressure given the lack of tourists
- Inflation outlook benign given the stronger Rand and relatively weak aggregate demand across the economy and excess capacity
- Recent Rand gains are likely overdone with structural weakness still expected over the medium to long term

Conclusion

The multiple-counsellor portfolio mix for SA equity portfolios has changed—Nancy Hossack replaced Daryll Owen who retired.

Resources weight is higher, but still well below benchmark. Principally into preferred pick BHP Group, supplemented by secondary investments in Anglo American and Sasol, which has shored up its balance sheet and taken steps on cost control.

Healthcare is a significant absolute and relative weight, evenly split between key holding Aspen Pharmacare and the hospital groups. Aspen has growth tailwinds from its stronger balance sheet and J&J vaccine deal while the hospital investments are value plays acquired after COVID-19 earnings dislocations.

Investment in JSE-listed global businesses is preferred, but the new multiple-counsellor manager has added exciting SA Inc. opportunities where the valuations are already pricing in the expected tough operating environment.

Consumer and financials increased at the margin, taking advantage of discrete opportunities on good businesses with strong underlying components where short-term fears temporarily impaired valuations.

The portfolio is in the process of transitioning to a new investment manager. Please contact us for further information.

Responsible Investment Summary

Voting Resolutions Q1 2021

Resolution Type Name	Total Count	For %	Against %	Abstain %
Adopt Financials	3	100%	0%	0%
Auditor/Risk/Social/Ethics related	47	100%	0%	0%
Buy Back Shares	16	100%	0%	0%
Director Remuneration	24	100%	0%	0%
Issue Shares	9	22%	78%	0%
Loan / Financial Assistance	11	45%	55%	0%
Other	16	81%	19%	0%
Re/Elect Director	46	100%	0%	0%
Remuneration Policy	20	45%	55%	0%
Share Option Scheme	1	0%	100%	0%
Shares under Director Control	2	0%	100%	0%
Signature of Documents	6	100%	0%	0%
	201	85%	15%	0%

Notable company engagements

Company	Topic	Company Attendees	Event Notes
Sasol	Remuneration policy	Remuneration Committee	Both Sasol's remuneration policy and implementation report received material votes against (Foord voted against all 3 Remuneration related items) and this discussion was initiated by Sasol to hear investor grievances. We expressed our concerns on 1. Excessive NED fees 2. Implementation report because of excessive severance payments to previous joint CEOs 3. Lack of clarity on proposed Rem policy. Remco took note of concerns and will attempt to incorporate them into new policies.
Oceana	Remuneration policy and BEE scheme	CEO and CFO	Engagement on structure of remuneration policy and an in-depth discussion on the new BEE scheme.
Nedbank	Auditor/Risk/Social/Ethics related	Non-Executive director	Foord concern was the amaBhungane allegations of Nedbank dealing with Regiments resulting in inflated pricing for SOEs and non-disclosure of referral fees. Board response: • Board employed external law firm to investigate allegations and found no substance to claims • Non-executive directors scrutinised issues and believe governance and compliance processes are in line with other financial services companies • Process improvements made to increase oversight on specific types of deals Foord conclusion: • No indication of systemic governance failures at Nedbank and not unique to Nedbank (all banks have had similar

			control and process failings over time) but there is possible reputational damage • Continue to monitor for signs of further governance issues and consider position size when investing.
Pepkor	Remuneration policy and votes on Social and Ethics committee	CEO and CFO	• Discussion on remuneration policy metrics • Corporate governance and inter related party relationships
Spar Group	Auditor/Risk/Social/Ethics related	CFO	Foord concern was around media reports containing allegations that: 1. CEO was an owner of an IT business providing services to Spar and this was not disclosed as related party transactions; and 2. Aggrieved former franchisees are seeking to have Spar directors declared delinquent Management response: 1. Spar have legal documentation proving that the CEO is not a shareholder of said IT company 2. There has been no development in delinquent director issue. There are no facts presented to date to Spar legal team and no court proceedings underway Foord conclusion: • Aggrieved party seems to be using media to further their agenda and there appears to be no substance or provided evidence to support their claims • Will monitor for further developments but allegations seem baseless at this time.
Quilter	Governance Roadshow	Chairman and members of the Remuneration Committee	Foord concern: Capital allocation and returns (from proceeds of QLA sale and potentially from QInt sale) and remuneration policy (adjustments which flatter earnings metrics used in incentives) Board response: • Regulator is cautious and board are assessing risks around things like share buybacks and special dividends. • Will seek shareholder feedback on capital returns (incl. any large acquisitions). Refining remuneration metrics to move to IFRS basis and looking to add relevant metrics such as flows. Foord conclusion: • No material concerns - board is cautious as it's a newly listed company and has good, proactive engagement with shareholders.

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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