NEDGROUP INVESTMENTS

UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

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Quarterly review

Nedgroup Investments Core Guarded Fund

As at 30 June 2021

Risk assets delivered a strong performance in second quarter

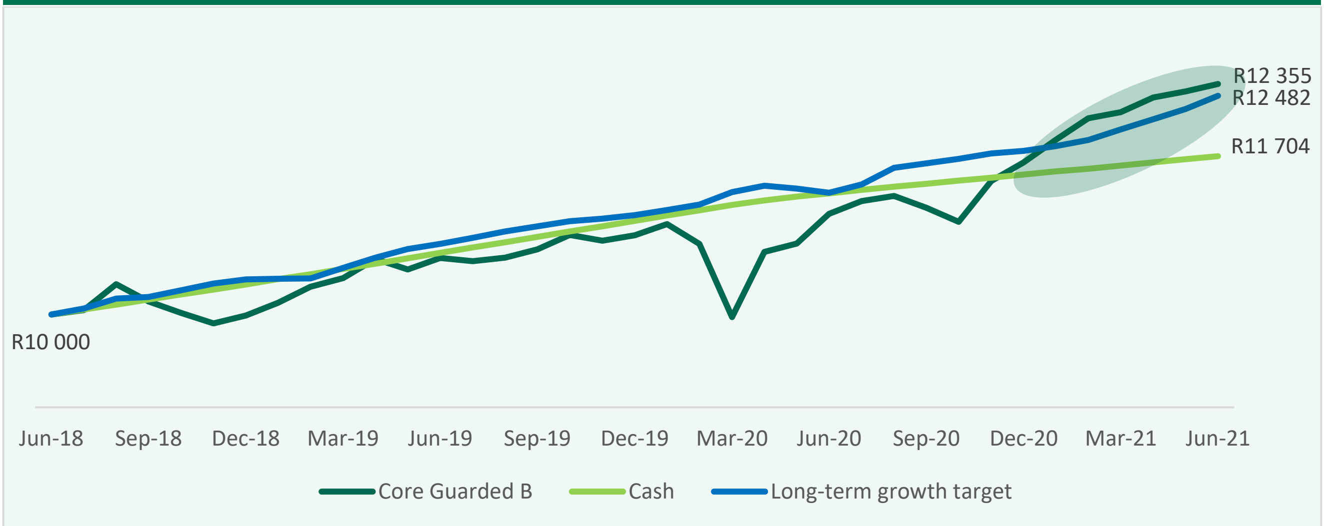
Over the quarter, global equities advanced, supported by the accelerating roll-out of Covid-19 vaccines. Growth stocks outperformed more lowly valued parts of the market. This performance was echoed by emerging market equities and property which registered a strong return over the second quarter. This was despite a sell-off in May as higher-than-expected US inflation renewed concerns over the timing of global monetary policy tightening. The rand also registered exceptional gains against the three major currencies, teetering between R13.42/$ and R14.30/$. Over the course of the quarter, the Nedgroup Investments Core Guarded Fund grew by +2.5%.

The table below compares an investment in Nedgroup Investments Core Guarded Fund to bank deposits (cash) investment over various time periods. For every R10 000 invested in the Nedgroup Investments Core Guarded Fund three years ago, you would have R12 482 at the 30th of June 2021. This is lower than the R11 704 you would have achieved had you invested your money in bank deposits (cash) over the same period. The green circle in the chart below, highlights the recent market recovery, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investment Core Guarded Fund versus Cash[1] and the Growth target

	3 Months	1 Year	3 Years	5 Years	7 Years	Inception 29 January 2010
Growth of fund (after fees) ***(Growth in %)***	R10 250 *2.5%*	R11 263 *12.6%*	R12 482 *7.7% p.a.*	R14 044 *7.0% p.a.*	R16 580 *7.5% p.a.*	R28 231 *9.5% p.a.*
Growth of cash ***(Growth in %)***	R10 086 *0.9%*	R10 354 *3.5%*	R11 704 *5.4% p.a.*	R13 361 *6.0% p.a.*	R15 004 *6.0% p.a.*	R18 867 *5.7% p.a.*
Growth target (inflation+3%) ***(Growth in %)***	R10 303 *3.0%*	R10 922 *9.2%*	R12 355 *7.3% p.a.*	R14 425 *7.6% p.a.*	R16 997 *7.9% p.a.*	R24 618 *8.2% p.a.*

Fund Return versus Cash[1] and the Long-term growth target for 3 years ending 30 June 2021



The Nedgroup Investment Core Guarded Fund has a growth target of 3% above inflation (around 8% per year) over 3-year periods. The Fund has almost reached its target over the last 3 years. However, history2 demonstrates that one-third of the time, a fund such as the Nedgroup Investments Core Guarded Fund, would have underperformed its long-term growth target over any 3-year period. The other two-thirds of the time it would have achieved or exceeded its long-term target.

[1] We used the STeFI call deposit rate for cash returns

Market and economic commentary

Despite the ongoing challenges and COVID-19 lockdowns around the globe, returns year-to-date to the end of June 2021 have exceeded long-term averages for most asset classes, with the only notable underperformer being global bond (in US dollars terms). The FTSE World Government Bond Index incurred a loss of 4.8% in US dollars year-to-date.

Risk assets locally and globally have delivered strong performance this quarter and year-to-date. However, with talks of central banks tapering liquidity and potentially even withdrawing liquidity, this could change the easy financial conditions that have driven risk asset returns.

Year-to-date returns to 30 June 2021

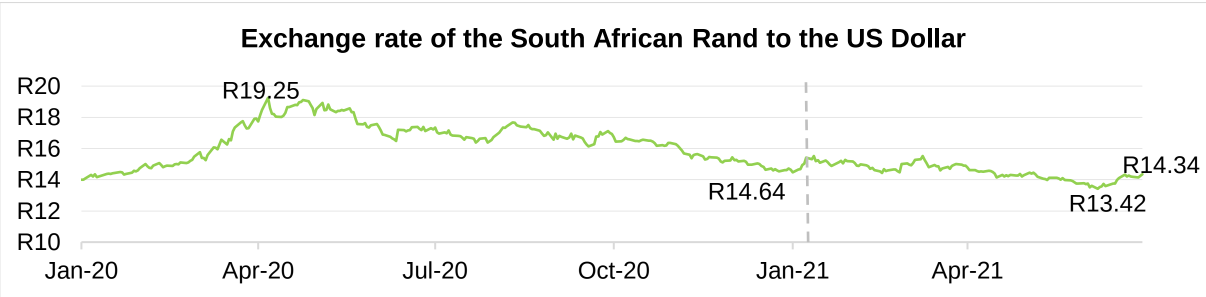
Local	**Rands**	**Global**	**US Dollar**
SA Equity	13.2%	Global Equity	12.3%
SA Property	19.3%	Global Property	16.1%
SA Bond	5.0%	Global Bond	-3.2%
SA Cash	1.7%	Global Cash	0.0%

The global property market has yielded some surprises. A Reuters poll done in May with more than 100 property market experts showed considerable upgrades to house price forecasts for the United States, Britain, Canada, Australia and Dubai, which is a noticeable change from 3 months ago, driven by a boost in confidence due to the successful vaccine roll-outs. However, the real surprise was in the change in outlook for office space. CBRE conducted research with companies regarding their expectations for the size of office space required. The latest survey showed that only 9% of large companies plan to significantly reduce their office space. This is in stark contrast to the survey done last year September where 39% of large companies planned to significantly reduce their office space. The trend has shifted to businesses holding off and waiting to see how hybrid and flexible working plays out.

Despite buoyant markets, local consumer confidence levels back pedalled in the second quarter, falling from -9% in March this year to -13%, as indicated by the FNB/BER Consumer Confidence Index. This decline was driven by a fall in durable goods, which includes items such as vehicles, furniture, and household appliances. This sentiment reflects consumer views that it is inappropriate to spend on 'unnecessary' items in times like these.

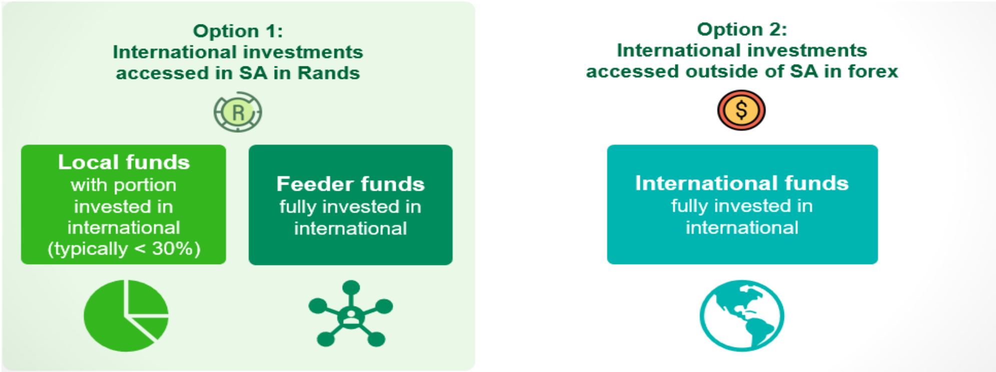
In contrast local and global manufacturing has been booming, as indicated by the manufacturing purchasing managers' index. A level of 50 indicates no change in the amount of activity since the last quarter, and values above 50 indicate increased activity. The JPMorgan global manufacturing purchasing managers' index was 55.5 and the local Absa manufacturing purchasing managers' index was 57.4 index points in June 2021 so both indicate increased activity.

Coming closer to home, the rand has significantly recovered from its high of R19.25 last year. This trend of rand appreciation has been consistent over the last 14 months, reaching a low of R13.42 in early June; a level last seen more two years ago in February 2019. Since early June, this trend has reversed somewhat, with the rand depreciating back to R14.34 as at 30 June 2021.

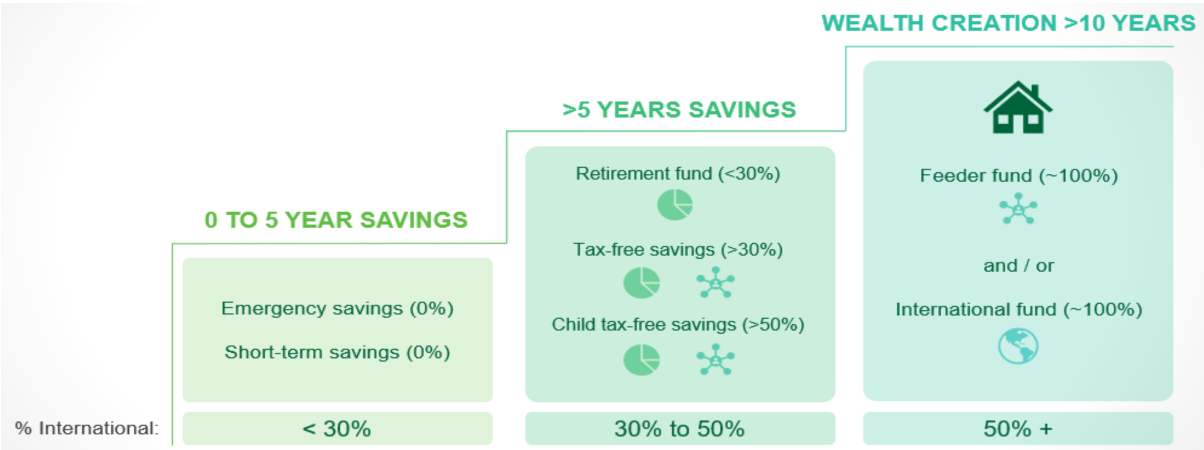


How to incorporate international investments into your savings plan

In the previous quarterly review, we covered international investing in 3 easy steps, including the types of funds that provide international exposure. Below is a recap of the funds that can be used to gain international exposure.



The infographic below is an example of how a South African individual could incorporate international investments into their overall savings plan. The local fund, feeder fund and international funds in the infographic are represented by their icons depicted above. The percentage in brackets represents the portion invested in international.



Note: The above information does not constitute advice and the details relate to the example discussed

Let's call the South African individual in this example, Thabo. Thabo plans to stay in South African and doesn't have any explicit expenses in foreign currency, such as a child planning to study abroad.

Thabo's investments can broadly be divided into three buckets:

1. **Short-term savings** of less than 5 years – this would include money set aside for emergencies and other short-term goals e.g. saving for a house deposit.
2. **Medium-term savings** of more than 5 years – this would include saving for retirement, tax-free savings accounts and savings for Thabo's children's education.
3. **Wealth creation** and legacy savings – these are very long-term savings without any particular objective other than to grow wealth or leave a legacy.

Thabo's short-terms savings, illustrated in the first step of the infographic, would typically have very little to no international exposure. The reason for this is that foreign investments can be very volatile over short time periods due to currency fluctuations.

The next step is medium-term savings, which lends itself to including more international investments than short-term savings. Thabo could consider having 30% to 50% exposure to international investments in this bucket.

Retirement funds are restricted to having a maximum of 30% in international. In contrast, a tax-free savings account has more flexibility and international exposure can be obtained via local funds and/or feeder funds. Since there is a lifetime limit of the amount someone can contribute to a tax-free savings account and that there is no replacement of the lifetime limit, it lends itself to having money invested for as long as possible with few withdrawals. It is this long-term nature that makes it well-suited to a relatively high percentage in international. Furthermore, Thabo could also open a tax-free savings account for his children. Given that his children are young, he can invest a relatively high portion in international as they will only need the money at age 18 or later.

The final step is wealth creation and building a legacy. These investments are very long-term in nature with no specific goal. Therefore, this bucket is suited to having the highest portion in international investments. Depending on the reason that Thabo wants exposure to international investments, he could either obtain this exposure via a feeder fund which is accessible in South Africa in rands and/or an international fund priced in foreign currency. When considering this bucket, it is important for Thabo to view all his investments holistically. For example, Thabo may have a house and rent out another property, which increases his exposure to South African investments. He needs to keep this in mind as it gives him more scope to invest in international funds in this bucket to improve the diversification of his investments.

To summarise, the principle is that the longer the savings term, the greater the exposure can be to international investments as there is time to ride out volatility while still enjoying the benefits of diversification.

Incorporating sustainability objectives into passive investments is no easy task

There has been an increase awareness of sustainability in investments over the past few years, with some funds focussing on Environmental, Social and Governance (ESG) considerations. The Environmental component includes considerations such as climate change, pollution and waste. The Social component includes skills development, employee wellbeing, labour relations and client – and stakeholder relationships while Governance looks at corporate governance and behaviour.

Over the past two years funds that incorporate sustainability criteria into their investment strategies have made headlines for outperforming traditional strategies. However, longer-term studies[2] show that this 'outperformance' is mainly due to over weights in certain sectors such as technology and certain portfolio tilts towards known drivers of higher risk-returns factors such as quality. This poses challenges for incorporating sustainability criteria into passive or rules-based strategies as it introduces unintended bets. This in turn leads to a deviation from pure benchmark exposure which introduces relative performance risks.

'Greenwashing' is another challenge for incorporating sustainability considerations into passive investment strategies. This entails strategies that claims but does not actually achieve better sustainability outcomes for investors.

It is important that any sustainability criteria which gets integrated into an investment strategy needs to be supported by robust research with proper qualification and use of sustainability data and which sends clear signals to the corporates which it will invest into. Investor must also understand that sustainable investment strategies is not about achieving outperformance but rather about aligning values, having a positive long-term impact and mitigating risks.

[2] Scientific Beta Publication — "Honey, I Shrunk the ESG Alpha": Risk-Adjusting ESG Portfolio Returns — April 2021.

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