NEDGROUP
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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Two, 2021

Performance to 30 June 2021	Nedgroup Financials Fund	ASISA SA Equity Financials
3 Months	7.9%	7.1%
12 Months	35.0%	31.2%

Market Commentary

The MSCI World Index once again delivered good performance as investors earned 6.7% for the quarter in US dollars. The yield on 10-year US bonds fell from 1.74% at the end of Q1 back to 1.43% at the end of Q2; reversing some of the first quarter's upward movements. Interestingly, inflation expectations moderated somewhat in the second quarter. However, a more detailed analysis of the options in the bond market reveals that the market is more worried about eventual higher inflation even though moderate inflation remains the most likely outcome. The FTSE/JSE All Share Index was weak (0.05%) but the rand strengthened, aided by the stronger commodity prices.

Fund performance, contributors & detractors for past quarter

Stronger GDP growth and (moderately) higher inflation in the US are positive for the US financial sector and for commodity demand, and hence good for most emerging markets.

Banks and insurers had to increase provisions substantially during the past 12 months (banks due to newly introduced IFRS9). This means that they are overcapitalised and over-reserved, so current and future results will see large reserve releases and also increased dividend payments. With this in mind, it is not surprising that globally the financial sector and the fund had another good quarter. The table (below) shows the top 5 contributors.

These were Investec, Sasfin, Capitec, Sanlam and PSG whilst Transaction Capital and Nedbank (both +22%) and Trematon (+17%) also showed good price gains.

In each case the shares were oversold and got too mispriced relative to what they should be valued at once the economy normalises. Last quarter we wrote about the risk, during market falls, of being invested in illiquid shares like Trematon and Sasfin (the risk being that the fund has to be a forced seller should investors withdraw) but that at current valuations one has to be patient.

Our patience was rewarded quicker than anticipated.

- Sasfin gained 52% during the quarter and both Sasfin and Trematon still show considerable upside even after the recent price gains (based on the Denker Capital risk adjusted forecasts).
- Investec is a share that has shown extremely good upside for a few years but it needed the effectiveness of new managements' actions to become visible to unlock the valuation gap. Despite the recent strong gains Investec continues to show considerable upside.

Five investments detracted with negative or below index price performance this quarter:

- Coronation and NinetyOne had become relatively expensive and were held back by the JSE's performance.
- JSE (the share) finds it difficult to grow in the current macro and political environment but is a good solid cash generative business and as such we've kept it in the fund as insurance against a poor Covid-19 outcome.
- Absa underperformed due to the negative news flow regarding its CEO and asset management business whilst MMI is a business being turned around that we've recently started investing in (hence the small position size).
- The investment in the Denker Global Financial Fund also underperformed, gaining 7% in US dollars this quarter but the stronger rand took some of this US dollar gain away. We must add that after the strong run, we expect the US financial sector to rest for a while whilst the world waits to see how serious the current Delta-variant wave will be.

Top 5 Contributors	Weight Mean	Return in Rand	Contribution in Rand
Investec	6.08%	26.19%	1.46%
Sasfin Holdings Ltd	2.70%	56.48%	1.25%
Capitec Bank Holdings Ltd	5.21%	20.06%	1.01%
Sanlam Ltd	11.73%	8.55%	0.93%
PSG Group Ltd	7.18%	12.64%	0.87%

Top 5 Detractors	Weight Mean	Return in Rand	Contribution in Rand
Momentum Metropolitan Holdings	0.56%	2.08%	0.01%
Cash	1.26%	0.59%	0.00%
Ninety One Limited	1.36%	-10.94%	-0.15%
JSE Ltd	5.55%	-4.80%	-0.21%
Coronation Fund Managers Ltd	3.87%	-7.13%	-0.26%

Portfolio Changes, current positioning and outlook

We made a few small changes to the portfolio during the quarter - initially reducing the fund's holding in Absa but increasing the investment in Nedbank (adding 2%), Standard Bank and MMI (a small %).

We reduced the Absa holding due to the uncertainty surrounding the changes and possible disposal of their asset management and money market fund and the departure of their CEO. However, towards the end of the quarter (and also post 30 June) we started buying back Absa and more Nedbank. Both banks are coming through the crisis well and represent excellent value. Based on our forecasts they could generate a return of 100% (including dividends paid) over the next four years.

We also sold a third of the fund's Sasfin holding after the strong price gain to maintain its position size at 2.8% (as part of our risk procedures to prevent illiquid shares from being too big a holding in the fund).

Whilst the global outlook is slowly improving, the recent unrest and looting have done significant harm to South Africa's growth prospects. It highlights the problem of an extremely high youth unemployment rate. And worse, after years of neglect the future work force is poorly educated and, due to the stranglehold of unions, SA's labour force is one of the oldest in the world whilst our labour participation rate is amongst the lowest. These factors make it very difficult for South Africa to grow and compete - both in terms of imports and exports whilst government policies continue to chase away expertise that could create jobs. We can but only hope that the current events cause the ANC to seriously rethink its economic ideology.

Conclusions

Last quarter we wrote that we believe *"that South Africa's growth rate in 2021 and most probably in 2022 will surpass expectations. The wild card in South Africa is the uncertainty brought about by ANC infighting, besides low growth (one of the lowest post-pandemic-growth-rebounds in the world) places a discount on our valuations".* The faction fighting and looting is seriously damaging those growth prospects and continue to place a discount on our valuations.

Whilst the bank sector presents excellent value (Absa and Nedbank trading below P/NAV and as said above, showing potentially 100% upside over the next four years), for that upside to be realized we need government to address the currently exposed weaknesses and restore investor confidence with policies that free up the private sector to create jobs.

Responsible Investment Comments

It is worth noting the increasing importance investee companies are placing on ESG issues (e.g. banks pledging to reduce lending to environmentally sensitive practices) as shareholders and various other activists hold management teams more and more accountable. We are encouraged by this and have observed improving ESG scores across our portfolio along with increased efforts by these companies to comply with various regulations and disclose more information (see examples below) for us to make better investment decisions. Efforts in this regard are an ongoing practice and we remain committed given our position as a signatory to the UNPRI.

South Africa's lenders (amongst the biggest banks on the continent) are facing pressure from environmental groups to stop funding fossil-fuel power projects that are seen as a major risk to global plans to tackle climate change. Resulting from this pressure the banks have made a number of announcements:

- **Absa** will become the first bank in Africa to extend loans for biomass and other renewable projects under a new sustainable financing programme based on "green loan principles" using money from the World Bank.
- *"The deal will see the* ***International Finance Corporation (IFC****) — a division of the World Bank focused on the private sector in emerging markets — extending the group a loan of up to $150m (about R2.1bn) for exclusive use in predefined green projects."* (from *RMBMS What is making the news today*)
- **Nedbank is** to stop funding new thermal coal mines from 2025 and cut direct funding of new oil and gas exploration projects with immediate effect. Of the four large SA banks, Nedbank has made the strongest commitments so far to curb its lending to the coal, oil, and gas sectors. *"Nedbank's energy policy serves to guide the bank's transition away from fossil fuels while still providing appropriate support to existing energy requirements*" said Nedbank chief financial officer Mike Davis. Nedbank also said it aimed to finance local small-scale renewable power generation to the tune of R2 billion ($141 million) above its R50 billion commitment to the country's renewable energy tendering process.

Whereas in South Africa the focus has been on fossil fuel lending, in other emerging markets the banks focus more on their own footprint.

- HDFC Bank (India) has set targets to reduce total energy consumption by 3% and energy intensity by 5%. Overall, it is aiming to become carbon neutral by FY31-32.
- Similarly, TCS (Russia) and TBC (Georgia) have received numerous awards and TBC received accreditation by the Green Climate Fund (GCF). It is among ten companies worldwide that have acquired this prestigious status from GCF this year, making it the first commercial bank in the Caucasus region to receive the accreditation.

The important point is that managements of these institutions have to grapple daily with a rapidly changing environment. Our investment process ensures we focus on those managements with long-term track records of creating shareholder value. The market's focus is often short-term, hence it is important to bear in mind that the fund is invested in businesses with good management teams with long track records and that at the moment, in our opinion, these businesses are trading at attractive valuations.

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.

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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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