NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS MANAGED FUND

Quarter Two, 2021

Nedgroup Investments Managed Fund

Performance to 30 June 2021	Nedgroup Investments Managed Fund A	ASISA category average
3 months	0.64%	1.84%
12 months	26.86%	17.31%

Market Overview

The carnage of the 3rd Covid-19 wave in South Africa has tragically surpassed expectations

The prevalence and severity of the disease have now left almost no South African unscathed, be it directly or via friends and family. Although the economy as a whole is on track for recovery, parts of it, especially the service sector, will once again struggle. We sincerely hope that the vaccine rollouts reach an accelerated trajectory which brings South African vaccination rates in line with the rest of the world at the very least. Current rates suggest this is now likely since vaccines to the 50–59-year age group opened. Tragically, the human cost over the next month is unlikely to be averted. We sincerely hope that you and your families are managing through these callous times.

South Africa continues on the path of economic reforms and corruption clamp downs

In a significant judgment, former president Jacob Zuma has been found guilty of being in contempt of court by the Constitutional Court and sentenced to fifteen months in jail. Several meaningful economic reforms have also occurred over the last month, with the most noteworthy being an increase in the self-generation power limit. It remains to be seen whether the Independent Power Producers (IPPs) will also be allowed to provide renewable power supply instead of it only being permissible for individual companies to self-provide. The former will be a far more efficient and wide-reaching outcome. This decision requires the approval of the Minister of Minerals and Resources. Either way, additional investment and reduced load shedding will be positive for the economy. The full details of the SAA part-privatisation and the port operation separation from Transnet are still to be disclosed, but both steps are positive.

The South African savings rate has reached an 11-year high as households and corporates have been hesitant to spend amid the uncertain environment, which should help consumption expenditure. We further anticipate that capital expenditure will pick up from current depressed levels and help drive GDP growth. This could be through government / private partnerships on infrastructure, power generation and mining capex, which we expect to rise meaningfully over the next few years. Higher commodity prices will benefit the current account deficit and the budget deficit via higher tax receipts. These factors, coupled with reasonable valuations for domestic shares compared to other regions of the world, have led us to increase our exposure to domestically exposed businesses. However, South Africa’s structural issues and an increased likelihood of entering a risk-off environment will continue to temper the extent to which we pivot our portfolios towards the domestic economy.

Commodity prices remain elevated

Speculative positioning in metals remain elevated, and most spot prices are well above the highest miners’ costs. Furthermore, most of these markets could be in oversupply in the next two years. However, the medium-to long-term dynamics are better for some metals: Copper's fundamentals remain positive as it will be required for the future build-out of renewable infrastructure. Views vary as to the extent and timing of deficits in copper, but the risks of deficits seem to increase as we look further into the future. Oil prices are far less elevated and should benefit from the continued reopening of the global economy. Palladium and Rhodium prices, although high, should find support from limited new supply and improved demand from the Automotive sector once the semiconductor chip shortage is addressed. Deficits will likely persist over the medium term.

At least to some extent, mining companies are pricing in the current elevated level of commodity prices. However, as there is a reasonably high correlation between miners' share prices and what they mine, the risk of share price underperformance, at least in the short term, is significant should commodity prices fall. As a result, we somewhat reduced our overweight exposure to the mining sector. We remain overweight, but primarily via the PGM sector, where spot valuations are the cheapest (Impala and Sibanye Stillwater trade on PEs of circa 4X), and short- to medium-term deficits are more likely than for other commodities.

US bond yields retreat on the back of more hawkish Fed guidance - we think this is temporary

The Fed governor recently suggested that rate hikes could happen sooner than guided, which caused short-dated bond yields to rise, but 10-year bond yields reduced from 1.59% to 1.47%. This move in the 10-year bond was due to now lower expected long-run inflation expectations, presumably due to the Fed's tougher stance on inflation. US bond yields are often seen as a bellwether for economic prospects, especially relative to short-term rates. Hence, the recent fall in 10-year yields, both in an absolute sense and relative to short-term rates, seems to have spooked more cyclical and 'value' type shares with the Vanguard value index underperforming the Vanguard growth index by over 7% in June.

We think this move is temporary and that bond yields should rise higher. Whilst many factors driving the short-term inflation spike of 3.8% in core CPI will be transitory (like supply chain bottlenecks and elevated commodity prices), other factors are not. The government, through stimulus, has produced an increase in savings which is likely to translate into higher demand at some stage. Budget deficits are forecast for several years, also keeping demand elevated. However, the productive capacity or the supply of goods has not meaningfully changed. Hence, economies will be closer to or above full capacity, which should heighten medium-term inflationary pressures. As a result, we think the expected inflation embedded in bond yields is more likely to widen going forward. We also believe that with growth returning to the global economy, the sizable negative real yields are not justified and should ultimately rise into positive territory. If inflation turns out to be more moderate, inflation-linked bondholders should require at least a positive real return from their bonds. Bond yields should rise via higher inflation expectations or higher real rates.

The risk of a 'risk-off' environment is increasing

Besides our own internal economic and political considerations, global macro considerations also influence SA share price performance. A number of potential global headwinds could lead to what is termed a 'risk-off' environment. This is when investors turn away from what is considered risky, like emerging markets of which SA is a part, favouring the US market and the dollar. Going into Covid-19, the collapse in bond yields helped markets rebound. The subsequent moderate rise in yields was offset by a rapid increase in earnings expectations, further boosting markets. Earnings expectations have risen to above pre-Covid levels in some regions like the US and may well not keep pace with interest rate increases going forward. This will put pressure on markets and investor risk appetite. Furthermore, as mentioned earlier, commodity prices are elevated. Falling commodity prices are associated with emerging market outflows.

Mitigating this somewhat is that South Africa is predominantly exposed to PGMs, iron ore and coal. Provided PGMs and coal prices remain reasonably buoyant, the fiscus and terms of trade should continue to benefit. Additionally, SA exposed companies are mostly trading in line with or below their historic valuations on single-digit and low teens PE ratios i.e., they have not benefited from the global low interest rate environment. Although domestically exposed shares may sell off in a risk-off environment, their valuations should provide protection over the medium term.

Portfolio Positioning

We increased our exposure to Glencore and Sasol. They were trading on compelling valuations, and energy pricing is not as extended as some metals like iron ore. We reduced our position in PGMs on valuation grounds and due to the PGM basket being overly extended. We increased our exposure to cheap domestically exposed companies including Bidvest, Woolworths, Standard Bank and Telkom. We reduced our exposure to a number of shares that reached fair value territory including FirstRand, Growthpoint Properties and Anheuser-Busch. We exited our notes in Prosus and Naspers where the Tencent exposure was removed. This was due to a meaningful closure of the holding company discounts in these counters. The investments in these notes were closed out at a profit. The notes were replaced with holdings in Naspers and Prosus.

Performance Commentary

A recovery in the South African economy and improved earnings from domestically exposed companies added to performance via our holdings in Pepkor, ABSA, Remgro, Vukile Property Fund and Bidvest. Bidcorp benefited from an opening of the global economy. PGM miners underperformed as the PGM basket price pulled back from fairly elevated levels and detracted from performance. The gold price came under significant pressure over the month of June and SA gold shares underperformed. Our holding in Naspers detracted from performance as Tencent came under pressure and the new proposed Naspers/Prosus structure was poorly received by the market.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Pepkor Holdings Limited	2.1%	0.4%	Naspers Limited	3.9%	-0.8%
Absa Group Limited	5.6%	0.3%	Impala Platinum	5.1%	-0.7%

Remgro Limited	3.6%	0.2%	Anglogold Ashanti	1.0%	-0.3%
Bid Corp Limited	2.9%	0.2%	British American Tobacco	6.5%	-0.2%
Growthpoint Properties	1.2%	0.2%	Sibanye Stillwater	3.4%	-0.2%

Responsible Investing

We have engaged a number of companies over the quarter:

Sasol

We engaged with the Chairman of the Remuneration Committee of the Sasol Board in September 2020 regarding the remuneration policy and incentive targets for FY21. We received a letter from the Chairman thereafter providing more detail on the FY21 STI targets, LTI targets, the peer group used to determine the remuneration, the remuneration policy design principles, and the explanations regarding the severance packages.

Impala Platinum

We wrote a letter to Impala in September 2020 to express our concern regarding the remuneration policy, specifically the weighting of variable pay that is linked to short term criteria versus the portion that is linked to long term criteria. Truffle have voted against the latest remuneration policy.

Nedbank

Truffle attended the Nedbank Annual Governance (ESG) roadshow in May 2021. Which focused on ESG during Covid-19, governance matters, social and environmental matters, and resolutions for the AGM. These roadshows assist us in understanding the company's policies and implementation of ESG as well as with the proxy voting recommendations.

Remuneration

Truffle has adopted stricter voting on remuneration and looks at each company's remuneration policy before voting. For the 2021 year we have voted NO on the remuneration policy on 40% of our proxy votes.

Engagements relating to social or environmental issues

Social

We have engaged with the various platinum companies regarding relationships with the unions and surrounding communities as this is crucial to the wellbeing of employees and reduces the probability of disruptions and damage to property.

Anglo American / BHP / ARI

We have had discussions regarding the impact of COVID-19 and its effect on the company and employees. They implemented social distancing protocols and provided screening at multiple entry points, transport to mines and onsite clinics. They are providing financial support for those families that have lost a member due to COVID-19.

Exxaro

In April 2021, we discussed the impacts of the COVID-19 response as above (with BHP/ARI), as well as their Scope 1, 2 and 3 emissions and their strategy around reducing these emissions with their Cennergi (Wind power) JV.

Kumba Iron Ore

In March 2021, we discussed and asked for clarity on the COVID-19 response as well as social engagement around their Dingleton relocation project.

Environmental

Truffle formed part of a group of asset managers who advocated to Shoprite, Massmart, PnP and Spar to accelerate the reduction or even total elimination of “single-use” plastic shopping bags in stores.

We are engaging with the mining companies, especially those in the platinum and gold sectors, on the risks of tailings dams, with specific reference to safety issues, additional capex spend that might be needed and environmental impact studies.

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.

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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