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NEDGROUP INVESTMENTS MINING & RESOURCES FUND

Quarter Two, 2021

Nedgroup Investments Mining & Resource Fund

Commentary produced in conjunction with sub-investment manager, Prudential Investment Managers.

Performance to 30 June 2021	Nedgroup Mining & Resources Fund *	ASISA SA Equity Resources & Basic Industries
3 Months	-5.9%	-6.2%
YTD	17.3%	13.0%
12 Months	46.2%	30.1%
3 Years	25.7%	21.5%

* Net return for the Nedgroup Investments Mining & Resource Fund, A class. Source: Morningstar

Market Commentary

During the second quarter (Q2) of 2021, more progress in vaccine rollouts worldwide, as well as upbeat corporate earnings reports and economic news, continued to lift equity returns, particularly in developed markets, even as concerns emerged over high valuations. Bonds – both government and corporate credit – also delivered solid returns, retracing some of their Q1 losses and buoyed by reassurances that Central Banks would not halt easy monetary policies any time soon.

Meanwhile, the approval of even more US government spending helped support the global growth outlook. However, emerging market equities lagged those of developed markets, and South African equities broadly underperformed their EM peers primarily due to the market's high Resources exposure, after outperforming in Q1. In contrast, South African nominal government bonds posted strong returns compared to those of many other countries over the three months.

In the US, the economy gathered speed with Q1 GDP growth at a final 6.4% (q/q annualised), and Q1 consumer spending jumped 11.1% y/y, amid a ramp-up in factory production and signs of labour shortages in some areas. Bullish sentiment was further stoked by bipartisan approval of a five-year, US$1.2trn infrastructure spending plan. At its June policy meeting, the US Federal Reserve (Fed) left interest rates unchanged, easing investor concerns over rising inflation while also signalling two 0.25% interest rate hikes by the end of 2023. Longer-dated US Treasuries rallied on the accommodative stance, helping flatten the US Treasury yield curve after its steepening trend in previous quarters. Despite headline consumer inflation of 5.0% y/y in May, its highest rate in nearly 13 years, which policymakers consider to be temporary.

In the UK, the rapid spread of the Covid-19 Delta variant, in the face of the country's successful implementation of its vaccination programme, proved to be a setback for the economy's anticipated full reopening in June, dampening market sentiment to some extent. The latest GDP figures proved equally bleak as the economy shrank by 6.1% y/y in Q1 2021. Despite this, the Bank of England upgraded its growth forecast for the year to 7.25% from 5% in February and left its key interest rate unchanged as expected, while warning against any "premature tightening" until it reached its GDP growth and inflation goals.

In the EU, Q1 GDP contracted by 1.7% y/y, disappointing most analysts on the back of slower-than-expected vaccine programme rollouts and the emergence of more contagious virus variants, which forced extended lockdown measures. On the other hand, later in the quarter, consumer and business sentiment recorded strong rebounds, albeit not yet reaching pre-Covid levels. The European Central Bank (ECB) left interest rates on hold at its June policy meeting, with President Christine Lagarde injecting some bullish sentiment by emphasising that growth in the region should pick up amid more robust global growth and consumer spending and that the central bank would continue its bond purchases and other supportive monetary measures. Unlike the US Fed, she refrained from signalling when the ECB might start to ease its accommodative policy. In May, consumer inflation in the EU rose to 2.3% y/y, mainly due to a low annual base effect.

Japan's economic contraction for Q1 2021 was revised to -3.9% y/y from a previously estimated -5.1% y/y, beating market expectations of -4.8% y/y. However, further restrictions to economic activity due to the worsening spread of the Coronavirus, particularly in the Tokyo region, have led many to expect Q2 growth to be weaker and again in negative territory. The Bank of Japan left its key short-term interest rate unchanged at -0.1% in June and also extended the deadline for its pandemic-relief programme from September 2021 to March 2022. To further boost growth, policymakers unveiled a new scheme to provide funds to financial institutions that invest or extend loans related to climate change. Japan's CPI hovered around 0%, higher than previous deflation due to the rise in global oil prices, although inflation expectations were unchanged.

In China, GDP growth slowed to 0.6% q/q in Q1 2021 from 3.2% the previous quarter. The People's Bank of China again left its lending rates on hold in June, while noting in its Q1 monetary report that it was more worried about an uneven economic recovery, weak consumer spending and lack of private business investment, than rising prices. The government continued its crackdown on local IT and fintech companies, introducing more regulations regarding financing and microlending to curb "monopolistic" practices online.

South African economic growth surprised to the upside as Q1 2021 GDP growth measured 4.6% y/y, notably higher than the 2.5% market forecast. Despite the gradual recovery, Stats SA noted that the economy's absolute size was equivalent to that last seen in Q1 2016. Covid-19 vaccine supplies continued to make their way into the country, and the government's vaccination programme made headway. Still, this progress was overshadowed in June as the third wave of Covid infections gathered pace, driven by the more transmissible Delta variant. President Cyril Ramaphosa reintroduced Level 2, and subsequently Level 4, lockdown measures, again curtailing vital economic and social activity.

The South African Reserve Bank kept its benchmark interest rate unchanged at a record low of 3.5% at its 20 May MPC meeting. It warned that slow progress on vaccinations, limited energy supply, and policy uncertainty continue to pose downside risks to the economic outlook, despite the jump in consumer inflation to 4.4% y/y in April and 5.2% in May (attributed mainly to a low base). The central bank raised its growth forecasts for 2021 from 3.8% to 4.2% but lowered its projections for 2022 and 2023 to 2.3% and 2.4%, respectively. It is projecting two 25bps interest rate hikes in 2021.

The FTSE/JSE ALSI was roughly flat for the second quarter, returning 0.05%. The standout sector was Listed Property (the All Property Index), with an 11.1% total return. Financials delivered 7.5%, and Industrials 0.8%, while the Resources Index returned -5.0%.

After gaining over 22% in the first quarter of 2021, the spot price of Brent crude oil rose another 18.2% in Q2, for a YTD increase of 45%, fuelling inflation concerns around the globe. As for commodity prices, most were higher over the quarter except platinum, which lost 7.4%. The gold price gained 4.5% for the quarter, and palladium was up 3.5%, giving it a 40% gain over the past 12 months. Industrial metals were also stronger: nickel rose 14.6%, aluminium 11% and copper 6%.

Finally, the rand appreciated against the major global currencies over the quarter, rising strongly from its oversold position in April and May before retracing some gains in June. It gained 3.3% against the US dollar, 3.1% versus the pound sterling and 2.4% against the euro over the three months.

Portfolio Commentary

As shown below, the fund's top five contributors added 1.49% to returns over the quarter, while the bottom five detractors accumulated a drag of -5.46%.

Winners	Ave.weight	Performance Contribution	Losers	Ave.weight	Performance Contribution
Exxaro Resources	7.48%	0.60%	Impala Platinum	11.61%	-1.67%
Glencore	7.22%	0.38%	Northam	7.83%	-1.45%
Pan African Resources	3.23%	0.17%	Gold Fields	3.03%	-1.13%
Mpact	0.52%	0.17%	Royal Bafokeng Platinum	10.10%	-0.76%
Omnia	1.62%	0.17%	Sappi	4.27%	-0.45%
		1.49%			**-5.46%**

Current positioning and outlook

The JSE resources sector had a more challenging quarter compared to the past 12-month performance. Medium-term headwinds offset the immense short-term profitability arising from elevated commodity prices expected in the mid-year financial results, as well as the attractive long-term potential arising from the metals intensive global energy transition away from polluting fossil fuel sources.

Medium-term risks mainly relate to policy uncertainty concerning the Covid pandemic. Most visible from tightening Chinese financial conditions and doubt on the impact of US fiscal stimulus and price elasticity of supply and demand for specific commodities off elevated levels. With iron ore and platinum group metals (PGMs) at over 150% above marginal cost support, and copper and gold also at high levels relative to cost curve support.

During the quarter, adjustments to the portfolio had a defensive tilt. We slightly raised our position in the gold sector. We backed a firm gold price and a strong ZAR within the sector by adding to Gold Fields and to a lesser extent AngloGold Ashanti, whilst cutting exposure to Harmony Gold. We view the current gold price as attractive for the miners, at a high margin, but are neutral on the valuation of the gold miners at the prevailing price.

We marginally reduced exposure to the PGM sector to reflect the reduced margin of safety in the industry, and to fund the higher gold weight, following its solid performance. We increased our position in Northam Platinum to reflect the accretive unwinding of the Zambezi BEE structure and Northam Platinum's superior medium-term growth and valuation outlook as its projects continue to ramp up into 2025. We closed the position in Anglo American Platinum after its strong performance, following the re-establishment of its processing operations and its premium rating within the sector. We also reduced our position in Sibanye Stillwater as a funder of the superior Northam Platinum growth story.

Responsible Investing

Perhaps the most exciting stock development in the sector during the quarter was the unbundling of Anglo American's South African coal assets into Thungela Resources and the subsequently announced complete exit by Anglo American from thermal coal with the sale of its Columbian joint venture stake to JV partner Glencore.

On Thungela Resources, the stock started trading in June at a very attractive estimated free cash flow yield, greater than 50%. This valuation discount is due partly to the exit of funds from the small coal exposure they inherited and the exceptional coal prices currently prevailing in the market, which are at decade highs. While coal presents an investment challenge from an environmental perspective, the shortage of finance available to the sector could create a squeeze in supply versus demand in the coming years, as the energy transition to cleaner fuels runs into obstacles associated with the supply of transition metals. Not only do we consider coal as offering a potentially attractive medium-term opportunity (high commodity price, strong Free Cash Flow, discounted equity rating), but we do see a potential benefit to society at large from seeing coal assets remaining listed and in the public domain as opposed to the alternative unintended consequences of reduced public accountability from delisting and potential state ownership.

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
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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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