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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Two, 2021

Nedgroup Investments Rainmaker Fund

Performance to 30 June 2021	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	-1.9%	0.5%	0.0%
12 months	13.0%	25.0%	25.1%

Market commentary

In South Africa, the near-term outlook is improving. Macro data releases have generally been better than expectations, such as the local trade surplus, retail sales, and vehicle sales. Sentiment has also been buoyed by the ANC's drive to address corruption and introduce much needed reforms, including energy production limits and the partial privatisation of SAA. Unfortunately, the frustratingly slow vaccine roll-out and 3rd Covid wave remain key threats to the economic recovery in the short term.

Against this backdrop, the JSE All Share Index (ALSI) was flat through the second quarter. The Financials sector (+7.5%) was the strongest performer driven by a recovery in property shares, where the SAPY posted a total return of +12.1%. In comparison, Industrials posted a small gain of 0.8% and Resources lost -5%.

Year-to-date, the ALSI has risen +13.2% led by the Industrials sector (+13.8%). Resources have returned +12.8% with Financials lagging at +11.7%.

Portfolio Commentary

The fund's top five performing positions for the quarter added +1.4% to our return, while the bottom five detracted -3.8%.

The fund had a disappointing quarter (-1.9%) in comparison with the performance of the JSE All Share Index. The table below details the primary contributors and detractors from performance. Disappointingly, our largest holding (Naspers) underperformed – this was driven by a weak performance from Tencent (its main underlying asset) and an ill-considered transaction with Prosus that has been badly received by the market. In addition, several of our platinum holdings performed poorly during the quarter.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
MTN Group	2.5%	0.42%	Naspers	12.3%	-2.00%
Capitec	1.6%	0.30%	Amplats	2.4%	-0.65%
Alphabet	2.0%	0.26%	Implats	4.4%	-0.63%
Bidvest	2.1%	0.23%	Northam	1.9%	-0.33%
Li Ning	0.2%	0.22%	Samsung	2.9%	-0.16%
Total		**1.43%**	**Total**		**-3.77%**

Current positioning and outlook

Since the inclusion of offshore in the Fund's mandate on 01 September 2020, we have used the ongoing Rand / US Dollar strength to steadily increase the proportion of the global component. As at

[1] Net return for the Nedgroup Investments Rainmaker Fund, A class. Source: Morningstar (monthly data series).

the time of writing, this has reached 27% and getting quite close to the maximum limit of 30%. While we acknowledge the windfall South Africa is currently experiencing caused by high commodity prices (notably iron ore and the platinum group metals), which has resulted in a substantial positive trade balance and driven the strength in the Rand, the longevity of these circumstances remains as uncertain as ever. On our research, the Rand is in expensive territory versus our trade peers. Our longer terms concerns regarding structural impediments to economic growth, constructive political and economic policy reform, the role of the private sector, and commitment of the State to stop wasteful spending remain, and consequently support our view regarding the opportunity that the fund's more flexible global mandate allows.

Despite the comments in the above paragraph, we are happy to note the undeniable constructive progress made in the last quarter regarding political accountability for corruption, economic policy progress (such as the increase in self-generation capacity maximum to 100MW), the State's attitude towards State Owned Enterprises (apparent introduction of private shareholder to SAA and relinquishment of economic control), the slow but steady rollout of the Covid-19 vaccination program, and the increase in select fixed investment spending activity (SANRAL).

For the first time in more than 7 years we are closely tracking for signs that the spark of economic activity and improved prosperity that higher commodity prices (notably iron ore and platinum group metals) and agricultural prices may ignite a broader economic recovery in SA leading to improvements in business and consumer confidence, and that will feed into investment spending and employment creation. The base is very low for many of these metrics, and while naturally sceptical, we feel the domestic economy has a better chance in 2022 and 2023 to grow faster than at any time in the last so-called "lost decade".

The fund offers material exposure to a recovering SA economy through its local financial and industrial exposure, with key picks here being Bidvest, AVI, Imperial (now the subject of a buyout offer) as well as FirstRand, Standard Bank and Sanlam in the Financial space.

The relatively large exposure to the mining space is retained because valuation is very attractive, despite the risk of a decline in iron ore and PGM commodity prices. This is because the stocks that we own have little-to-no debt and the management teams restrained by shareholders have no ambition to re-invest the current very large quantities of excess cash being generated in M&A activity or production expansion. We expect the bulk of our return from here to come in the form of dividend distributions.

Although we reduced the size of the Naspers position in Q1, it remains the single largest position in the fund. We oppose the recent Prosus cross-holding transaction that introduces increased complexity to the corporate structure, does not solve the JSE Index weighting problem management purport to be trying to address and, judging by the market's reaction, will exacerbate rather than alleviate the NAV value trap problem. The increase in governance failures at this organisation is raising our concerns, and the Board's continuing failure after many years to present a remuneration model that is acceptable to shareholders, is another. The attractive valuation of the primary asset (Tencent), combined with the record high NAV discount, do however keep us invested. While we have previously felt that our patience would ultimately be rewarded with a value unlock event, the recent corporate moves in the opposite direction are causing us to question this view.

Global portion

Global markets continued the strong start of Q1 and are now up +12.3% for the year, having added 7.4% in Q2. Contributors to the Fund's performance during the quarter were Li Ning (more about this new investment later), Alphabet (Google), Microsoft, Moncler and Amazon. Their price performance ranged from +14% to +30%. Unfortunately, there were a few detractors from this good performance, the most notable being Samsung. During the past quarter, the fund added Li Ning, Made.com and Facebook.

Facebook

One might well ask, why invest now? Is FB not last year's story and the F in FAANG which is now an old theme? We were initially sceptical too, just because we are not necessarily Facebook users/fans. However, the bullets below make it clear that Facebook is a formidable force globally, at an attractive valuation and certainly better than sitting on cash. It is facing increasing regulatory/political oversight, but we believe this to be manageable. One of the equity team members pitched FB and it ranked strongly on our proprietary ranking table – a good example of how our full research team participation in the Global Equity process, combined with strong quantitative screening, help the investment process.

- **Facebook (FB) is inescapable:** Nearly half of the world's population uses one or more of Facebook's four main social media properties (platforms) - Facebook, Messenger, Instagram, and WhatsApp. The "family" of products sees approximately 2bn Daily Active Users and 3bn Monthly Active Users.
- **Most valuable digital real estate:** With the decreased importance of offline real estate, Facebook's online real estate is some of the most valuable in the world. Advertisers across the globe can reach nearly half of the world's population via Facebook and Instagram. No other digital platform can reliably deliver the same returns for advertisers that these platforms can.
- **Under-monetised opportunities** – despite their global reach, WhatsApp, Messenger, Marketplace, Shops and Reels are hardly being monetised and presents huge opportunities; not only for advertising, but for payment/fintech opportunities too. WhatsApp could easily become the world's transaction enabling messaging app (like WeChat in China).
- **Attractive economics:** Revenue growing >20%, Gross Margin >80%, EBITDA Margin >45%, Cash >US$50bn.
- **Attractive valuation:** Facebook trades at the lowest forward P/E multiple (22x) amongst peers notwithstanding the attractive economics (highest GM and EBITDA Margins) and growth outlook (second fastest YOY revenue and EPS growth behind Amazon).

Li Ning

We made an initial investment in Li Ning in early June.

- "**China's Nike**" **–** from China for China, performance athletic shoes and apparel, but also athleisure. It was founded in 1989 by Li Ning (Chinese gymnast with 6 Gold medals in the 1984 Los Angeles Olympics) and has grown strongly since.
- The company **well run**, has net cash, good margins and is improving further with more direct to consumer, fewer stock keeping units (SKU's), fewer suppliers and less discounting, all generating positive **operating leverage**. They have about 6% market share in China, lagging adidas and Nike, each with almost double Li Ning's sales. The recent Xinjiang cotton issue is positive tailwind though as Chinese consumers have turned away from foreign brands towards local offerings, of which Li Ning is the strongest. They only have about 2% of their sales outside of China and still have much room to grow in China.
- For the next 3 years, Li Ning is expected to show **compound growth** of Revenue >25% and EPS >40% CAGR
- We remain encouraged by the strong economic growth in China that must present numerous investment opportunities. China's population demographics continued urbanization and rising education levels lead to much **stronger internal consumption**. With geopolitical tensions, local brands and purchasing are even more important. In addition, there remains a global move towards more casual wear and specifically athletic wear (athleisure). Li Ning sits comfortably at the intersection of all these trends.
- However, with the rapid share price rise, it is now trading at about 60X 2022 earnings, therefore **pricing in a lot of these positive points**. Different to our normal long holding periods, we therefore very quickly crystalized some of the short-term profit and sold 1/3 of the position size already (for 28% more than what we paid in early June).

In conclusion, this remains a surreal time; global supply chains have been shocked and will not just simply snap back to "normal", there will be leads and lags; government stimuli, however well intended, will have second order impacts and, sometime in the future, the borrowed money will have to be repaid. Share prices can be expected to be quite volatile in this period, this is both an opportunity and a curse. We remain vigilant to populate the portfolio with quality businesses that will stand the test of time, whilst also looking to add good companies where this volatile market creates opportunities.

Responsible Investment

We endeavour to invest in businesses that exhibit robust corporate governance, quality management, sustainable business models, and the potential for solid growth in earnings and dividends over an extended period. To this end, ESG matters are integrated into our investment analysis to strengthen the decision-making process, better manage risk, and ensure that investments generate long-term value in an ethical manner. Our investment approach is one of full integration of ESG issues into investment decisions. We use several methods for bringing ESG considerations into our decision-making, that includes engagement with management on issues that are relevant and material.

Notable engagements during the second quarter of 2021 include:

- Standard Bank: Co-filed a non-binding resolution calling for clear Climate related targets and disclosure. In addition, engaged with executive management on the topic.
- Nedbank: Engaged with the Chairman during their annual ESG roadshow.
- FirstRand: Engagement with sustainability team regarding their Climate Policy.
- MTN: Governance call with the Chairman where ESG matters addressed.
- Naspers / Prosus: Sent a collaborative investor engagement letter to the respective boards regarding concerns with the Prosus voluntary share exchange offer for Naspers shares.

Conclusion

Many companies held in the portfolio have enjoyed a strong price recovery since the depths of the Covid crisis, but it is important to note that the companies we own remain attractively valued, highly cash generative, and are likely to grow earnings at a handsome rate over the next few years. This puts the portfolio in a good position to continue to deliver strong risk-adjusted returns in the years ahead.

The portfolio currently trades on a forward rolling Price/Earnings (P/E) ratio of 10.3x and a dividend yield of 2.8% which we believe offers attractive value.

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.

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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