NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS ENTREPRENEUR FUND

Quarter Three, 2021

Nedgroup Investments Entrepreneur Fund

Performance to 30 September 2021	Nedgroup Investments Entrepreneur Fund[1]	ASISA category average	Small Cap Index	Mid Cap Index
3 months	1.0%	5.8%	11.7%	7.2%
12 months	30.4%	47.0%	78.3%	41.1%

Market commentary

In South Africa, the positive momentum that we discussed in the Q2 report was driven by a record trade surplus on the back of high export commodity prices, recovering retail and vehicle sales, progress on corruption accountability and some movement on policy reforms (energy, partial privatisation of SAA). However, this was very effectively snuffed out by the widespread acts of vandalism and looting across KZN and parts of Gauteng that we all watched with horror on our TV screens. While the way in which communities banded together to protect and rebuild the damage caused was heartening, the limited accountability we have seen for the perpetrators is a poor indictment on the state security cluster already suffering from a public confidence deficit.

Against this backdrop, it was a dull performance from SA equities over the third quarter of 2021. The market continued its trend sideways since March and following the dramatic recovery off the Covid-19 impacted crash of Q1 2020. More important than our domestic violence events, the combination of further slowing in China's economic growth and the significant increase in regulation in the name of "Common Prosperity", lower commodity prices, fresh waves of Covid and concerns over rising inflation weighed on market sentiment throughout the quarter.

The Chinese regulatory crackdown (common prosperity drive) was a very disruptive factor to investor portfolios during the quarter. China's campaign, driven by Premier Xi Jinping, is aimed at addressing inequalities of income and wealth, and has seen regulation aimed at Chinese internet platforms, after-school private tutoring, cryptocurrencies, e-cigarettes, alcohol consumption and celebrity fan culture. The aim of this is to effectively grow the middle class in China and protect its citizens from predatory commercial interests seeking to exploit households' desire for housing, the best education for their child(ren), healthcare, financial services and entertainment.

Although admirable and conducive to long term economic growth, the draconian manner in which it has been effected in certain cases, has shocked capital markets, which have in turn de-rated many businesses as they have demanded a higher risk premium to compensate for the regulatory uncertainty. This has had a profound impact on the Chinese market with the MSCI China Index declining by -16,6% for Q3, and caused a big impact locally given the significance of Naspers / Prosus for the JSE, down 18% and 14.5% respectively.

The JSE Small Cap and Mid Cap indices weathered the above storms extremely well and continued their strong recovery off the trough lows now recorded more than a year ago. In comparison, the JSE All Share Index (ALSI) returned -0.8% for the quarter, hurt by a notable drop in September (-3.1%). At a sector level, Financials returned +12.0% in Q3, while Industrials (-4,3%) and Resources (-3,6%) lagged. The Precious metals sector (i.e. Platinum shares) had an especially challenging quarter declining -14.5%.

Portfolio Commentary

The fund has disappointingly continued to lag its peers and benchmarks over the last year and analysis shows this to be largely due to the funds relatively lower exposure to small domestic businesses that have experienced the strongest price recovery from their troughs recorded

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

immediately following the Covid-19 induced market crash at the end of Q1 2020. While we have strongly tilted the fund in this direction to try and capture this effect, and have had excellent performance out of many of our stock picks such as Reunert, Raubex, KAP Industrial, CMH, Kaap Agri, Merafe, Advtech and Hudaco, our natural conservative management style has retained a healthy exposure to larger businesses with more stable and defensive profit streams and which have not performed as strongly in the short term.

Most damagingly, our core and unique positions in Naspers / Prosus and British American Tobacco / Reinet have also lagged the high-flying recovery plays over the last year, but more about this in the section below.

Very pleasingly our core holdings in defensive businesses RMI Holdings and AVI which we commented on in the previous quarterly report, had been laggards until the end of June, but had an excellent Q3 2021 performance with both companies subject to possible corporate action. RMI have already announced their intention to unbundle (a process we have been deeply involved in pushing for over the last 2 or 3 years) and AVI which is trading under a cautionary.

Although we did take a little profit, the fund's large positions in Royal Bafokeng and Northam pulled back dramatically in the quarter as PGM prices fell from very high levels. This was sparked by the reduced demand from the automotive sector due to the global shortage of semi-conductors. We expect this bottleneck to be substantially resolved by the end of the year and that there will be a noteworthy recovery in demand for material to make up the backlog.

Despite the pullback in PGM prices these companies have de-geared their balance sheets and will generate significant cash, the majority of which we expect to see returned to shareholders. We have consequently retained large holdings in these two stocks.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
KAP Industrial	4.6%	0.9%	Royal Bafokeng Pt	7.4%	-1.9%
Merafe	1.9%	0.8%	Naspers	5.2%	-1.2%
RMI Holdings	3.2%	0.6%	Afrimat	4.8%	-0.9%
Advtech	3.4%	0.6%	Prosus	2.7%	-0.4%
Ninety One	2.6%	0.5%	Northam	3.1%	-0.4%
Total		**4.5%**	**Total**		**-4.8%**

Current positioning and outlook

Despite the violent events of Q3, we are retaining our bullish view on a gradual continuing economic recovery in SA. With the 3rd Covid-19 wave behind us, increasing rates of vaccination, a return of international travellers, and an extension of the Covid 19 social grants we look forward to a reasonable festive season trading period.

Although we reduced the size of the Naspers / Prosus combination position in Q1, it remains the single largest position in the fund as we are limited by the fund mandate to trade this unique investment opportunity. In Q1 of 2021 we had already substantially reduced our exposure to Naspers and Prosus due regulatory concerns and other actions taken by the Chinese government. Our previous long held view that the Chinese state would be unlikely to pursue actions to materially undermine the commercial success of Tencent – one of their national technology champions - has been eliminated through the actions taken against the private after-school education sector (essentially expropriating it without compensation) as well as the fines imposed on other technology businesses – all in the pursuit of what Xi Jinping (China's Premier for Life) describes as Common Prosperity.

While we acknowledge that Tencent is trading at extremely attractive valuation levels and that the NAV discount still trapped in the Naspers and Prosus corporate structures are at record high levels, we feel the ratings of all Chinese companies are likely to be permanently impaired by the State's actions over the last three quarters. The way the Prosus / Naspers cross holding corporate action was forced on shareholders by the Naspers Board, and which makes no logical sense to us nor is likely to have any impact on reducing the NAV discount, leaves us very disappointed shareholders in this otherwise very attractive business.

While it remains a large position in the fund and valuation is at multi-year lows, our concern levels have never been higher, and despite the undeniable exceptional long-term value our position is the smallest it has been in many years.

Responsible Investing

We are acutely aware that ESG issues have a direct impact on the companies that we may invest in and as such, can affect the performance of our investment portfolios. Our integrated approach focuses on the issues that are, or will, likely become material for businesses. We use several methods for bringing ESG considerations into our decision-making, including engagement with management on issues that are relevant.

Notable engagements during the third quarter of 2021 include;

- Reinet Investments: We engagemed with the Board regarding the NAV discount and suggested actions to unlock the discount.
- Rand Merchant Investment Holdings: We engaged with the CEO regarding the NAV discount and suggested actions to unlock the discount. *(It is encouraging to note that our numerous engagements on this matter have borne fruit, with the company recently announcing a corporate restructuring that has already unlocked value for minority shareholders)*
- Prosus / Naspers: We engaged with the Prosus Remuneration Committee regarding their policy and its implementation.

Conclusion

Although we worry that the SA economy may be doomed to remain trapped in a low growth scenario, and the political will to embrace market friendly economic policy simply does not exist, we also know that the economy remains boosted in the short-term by higher commodity prices, recovering consumer demand (arguably artificially boosted), and the potential recovery in international tourist traffic. These factors combined with the undeniable value at which the JSE is trading versus history, and given record low interest rates, leaves us cautiously concluding that a healthy exposure to equity is appropriate.

We are very comfortable with the balance in the fund and the high-quality bias in our stock selection. With its bias towards domestic stocks we feel it is likely to continue to prosper.

We do also acknowledge the recent sharp decline in several commodity prices (notably iron ore and the platinum basket) that is dampening the windfall benefit registered through our trade balance surplus earlier this year, and which is now substantially less supportive for the Rand/US$ exchange rate. The attractively valued Rand hedge stocks held in the fund make up 31% and are an appropriate hedge in the portfolio's construction. As at the end of September 2021, the fund traded on a forward PE of 9.3X, Dividend Yield of 4.2% and Price to Book of 1.5X.

Anthony Sedgwick
Abax Investments
July 2021

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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