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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Three, 2021

Nedgroup Investments Rainmaker Fund

Performance to 30 September 2021	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	+1.7%	+2.6%	-0.8%
12 months	+16.2%	+26.9%	23.2%

Market commentary

It was a dull performance from SA equities over the third quarter of 2021 as the market continued its trend sideways since March and following the dramatic recovery off the Covid-19 impacted crash of Q1 2020. The combination of further slowing in China's economic growth combined with the significant increase in Chinese regulation in the name of "Common Prosperity", lower commodity prices, fresh waves of Covid and concerns ever 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, cryptocurrency, 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, 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 market 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. However, given the aim of "common prosperity" to uplift another 400m Chinese further into the middle-class wealth ladder, there must be material consumer demand into the future; zero exposure to China is therefore not necessarily appropriate either.

Another event that contributed to the market volatility in the quarter was the news that Evergrande, the largest Chinese real estate developer indebted by more than $300bn, was struggling to meet interest payments. This generated fear of potential financial market contagion like the 2008 Global Financial Crisis which was sparked by a collapse in US real estate lending. So far, the worst of these fears seem to have been allayed with the Chinese State intervening aggressively to provide liquidity and to manage the situation.

Concerns over global inflation remains a prominent theme. It has been driven by a rapid recovery in the world economy causing capacity constraints along a stretched global supply chain, a shortage of labour often caused by COVID-19 induced lockdowns - all this fuelling inflation which is quite extreme in certain pockets. At the September FOMC event, the Fed signalled to the market that tapering is likely to start, even as soon as the November meeting. With the US economy having experienced a massive recovery from the lows of the COVID-19 crisis, and higher and more persistent inflation being recognized (and now an energy crisis to exacerbate this), the time to start considering monetary policy normalization is nigh. The extent of QE in the US since the onset of the Covid crisis has been an estimated $1.7 trillion in direct payments to households.

The ECB similarly announced they would start slowing the pace of their asset buying under the pandemic emergency program. Many emerging markets, because of increasing inflationary pressures, have also started tightening monetary policy, with the central banks of Brazil, Russia and Mexico all having started interest rate hiking cycles. The SARB has yet to hike rates locally, but the hawkish tone of the MPC in their September meeting has the market believing that rates will also start increasing from November. Unlike many other emerging markets, South Africa has not experienced inflationary pressures, however the effect of a rising oil price, a weakening ZAR and generally higher global inflation could mean inflation comes out higher than what was previously assessed by the SARB.

Against this backdrop, 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

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

(-3.6%) lagged. The Precious metals sector (i.e. Platinum shares) had an especially challenging quarter declining -14.5%.

Portfolio Commentary

The fund delivered a satisfactory performance relative to the ALSI for the quarter ended September 2021, delivering a return of 1.7% and outperforming the All Share Index return of -0.8%.

The fund's top five performing positions for the quarter added +3.2% to our return while the bottom five detracted -3.6%.

The fund's large exposure to banks (Firstrand and Standard Bank) enhanced performance. Our holding in MTN also contributed meaningfully. In addition, a few of the fund's core Mid-cap holdings (Imperial, RMI and AVI) are subject to corporate action which has boosted their share prices and helped the funds' performance (you will note Imperial as a top 5 contributor).

The single largest detractor was the fund's exposure to Naspers / Prosus. In line with the weak performance from the precious metals sector, the fund's platinum holdings (Implats, Royal Bafokeng and Northam) also detracted. Alibaba, the fund's only direct exposure to Chinese technology, was sold down in the regulatory "common prosperity" drive that scared investors in recent months.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Firstrand	5.8%	1.11%	Naspers	7.7%	-1.63%
MTN	3.1%	1.01%	Implats	3.7%	-0.87%
Std Bank	3.0%	0.42%	Alibaba	1.3%	-0.49%
Imperial	1.5%	0.35%	Royal Bafokeng Platinum	1.3%	-0.31%
Alphabet	2.4%	0.32%	Northam Platinum	1.4%	-0.27%
Total		**3.21%**	**Total**		**-3.57%**

Current positioning and outlook

Given the above-mentioned developments, we have executed several changes to your portfolio. The most notable changes since our mid-year report include further reducing exposure to Naspers / Prosus.

In Q1 of 2021 we had already substantially reduced our exposure to Naspers and Prosus due to concerns regarding regulatory 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 has or 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 consequently for the first time in 15 years we are underweight the combined entities' weighting in the fund's benchmark.

Given the holdings of Naspers/Prosus, the fund does not hold any Tencent directly. Direct exposure to the Chinese consumer has been through Alibaba and Li Ning. Given China's rapidly growing middle class and ferocious appetite for everything from luxury goods to base materials, the fund has much indirect exposure, something we monitor closely. The common prosperity drive also aims to move an additional 400m Chinese into the middle-class wealth ladder; this will generate significant demand for consumer goods across a wide range. We are therefore comfortable being exposed indirectly to the Chinese consumer through multi-national companies with material Chinese sales like adidas, Puma, Moncler, Richemont and Activision. We held Anhui Conch, China's largest cement producer, for exposure to the infrastructure development, but with the rapid collapse of the large real estate companies, we exited the Anhui Conch investment – it remains attractively valued with an ungeared balance sheet, but the increased risk profile is now uncomfortable.

We added to Royal Dutch Shell, in preference to Sasol. Whereas ESG and zero carbon has become rallying cries, practically it will take some time and much investment to wean the world off fossil fuels. So far, supply constraints (through integrated oil majors curtailing exploration) are exceeding demand destruction (as the world is still heavily reliant on fossil fuels whilst alternative green energy sources like wind power takes time to fully develop and settle into a dependable source). Combining this with short term climate disruptions (like the earlier cold weather, combined with less wind, as is being experienced in Europe at present) means much higher energy commodity prices. In this context Royal Dutch Shell stands out as attractively valued (on free cash flow yield) with better resource reserves, even as they too work towards becoming a green energy supplier into the zero-carbon future.

Although we have held what we consider a large exposure to Resource counters primarily through our preferred high quality diversified Mining Houses (Anglo American and BHP) as well as the platinum miners, we have been underweight the sector relative to our benchmark for several years as we have not held any positions in what we consider to be the lower quality mining firms. This has detracted from our relative performance in recent years, as the rising tide of Resources lifted all counters in the sector, while the Financial and Industrials have been left far behind. Fortunately, in Q3 this effect has partially been reversed.

Having said that, despite the substantial pullback in Q3 we have seen in many commodity prices (notably PGM's and iron ore) we retain relatively large exposure to the mining space (c.17% of the fund) because the valuation remains attractive notwithstanding the decline in commodity prices. We have added the fund's exposure to Gold (Goldfields) and Richemont.

Responsible Investment

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: Engagement with the Board regarding the NAV discount and suggested actions to unlock the discount.
- Rand Merchant Investment Holdings: Engagement with 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)*
- Anglo American Platinum: Engagement with management, focussing on social as well as environmental issues.
- Anglo American: Engagement with management regarding the coal demerger, employee safety and community impact.
- Prosus / Naspers: Engaged with the Prosus Remuneration Committee regarding their policy and its implementation.
- Multichoice: Engagement with the Board regarding the upcoming AGM resolutions.
- Impala Platinum: Engagement with management regarding spend directed to environmental improvements.
- Sasol: Participated in the capital markets day where Sasol unpacked its strategy to decarbonise its business.
- Standard Bank: Participated in the capital markets day where Standard Bank set out their ESG commitments.

Conclusion

Markets are starting to digest the consequences of a move back to “normal”. Much of the world is experiencing higher inflation and central banks globally have begun to indicate the need to start tapering asset purchases and start raising interest rates. Central banks have managed this process well, and thus far markets have come through these announcements relatively unscathed, but the process is yet to fully play out. We have no doubt, however, that the new “normal” is different, as the system is too leveraged for the old “normal” to resume. Our view is that we will likely find ourselves in a decade or so of financial repression and global deleveraging will have to continue through negative real rates for an extended period. Typically, risk assets (equities) benefit from low and falling real interest rates.

Locally, the KZN and Gauteng riots were a knock to growing consumer and corporate confidence. In addition, the recent sharp decline in several commodity prices (iron ore and the platinum basket) is an added concern that will undermine earnings, tax receipts and the trade account. It’s clear that the windfall times driven by very high PGM and Iron Ore prices are now a thing of the past.

The windfall enjoyed by our Trade Balance surplus is now substantially diminished and no longer as supportive for the Rand:US$ exchange rate as it has been for much of the past year. In this context we have raised the offshore component in Rainmaker to the mandate limit of 30%. Given heightened geopolitical tensions, rising nationalism, global minimum tax rates and China’s common prosperity drive, we are raising our confidence hurdle rate for international investments, but still find many diversification opportunities.

We take comfort that the fund continues to invest in a diversified range of high-quality businesses both locally and abroad. The portfolio currently trades on a forward rolling Price/Earnings (P/E) ratio of 10.7x and a dividend yield of 3.8% 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.

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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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