NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS BALANCED FUND

Quarter Four, 2021

Nedgroup Investments Balanced Fund

Performance to 31 December 2021	Nedgroup Investments Balanced Fund[1]	ASISA category average
3 months	3.63%	7.29%
12 months	16.13%	20.31%

Market Overview

Omicron: Could this be the beginning of the end?

Just as the world was getting used to the new normal, another variant of the virus surfaced in November 2021. The emergence of the Omicron variant came amidst the Delta Covid wave in the Northern Hemisphere, resulting in a huge surge in infections. The good news is that whilst the Omicron strain has been more contagious, it has resulted in less severe symptoms than previous strains. Domestically and in other countries, this has been evident from higher infections but relatively lower hospital admissions and deaths. Preliminary data also suggest that exposure to Omicron confers at least partial immunity against Delta and that Omicron appears to be crowding out more dangerous strains such as Delta. Any future variant is thus likely to emanate from Omicron and odds are that it will be even milder.

Given all this, governments are typically leaning on booster rollouts and light-touch restrictions rather than resorting to more draconian restrictions on activity. There is thus a good likelihood that we shall be through the worst of the pandemic this year, at least in countries where vaccination penetration or infection rates have been high.

All eyes are still on the Fed, inflation, and the US long bond

Economic growth in the US remains buoyant and pre- Covid trend GDP growth should be achieved during 2022. The Fed expects US GDP to grow by 4% this year, with the IMF a more bullish 4.9%. PMI's and positive earnings revisions remain at high levels, and whilst they have started turning down, growth should remain solidly above trend in 2022.

Financial markets have largely taken Omicron in their stride, but they're proving sensitive to increasingly hawkish noises from the Federal Reserve. The US inflation outlook for 2022 will be dominated by two key themes. First, headline rates will fall owing to a mixture of fading re-opening inflation and base effects dropping out of the year-on-year comparison. However, wage inflation, which is close to 5%, is at risk of feeding into second round inflation and will likely remain a heightened concern.

The US unemployment rate dropped significantly in December, and with few signs of a recovery in labour supply, the continued decline in the unemployment rate and surge in wage growth looks set to be sustained over 2022. This raises the risk that the Federal Reserve will move more quickly to raise interest rates and withdraw the stimulus it put in place to support the economy at the start of the pandemic. According to interest rate projections published by the Fed following its December meeting, officials expect to raise interest rates three times in 2022, with another three moves penciled in for 2023 and two more in 2024. The risk is obviously that rates move higher and faster than the Fed and the market are expecting.

It is unclear how the bond market will react to the mix of these inflation readings. Although yields are low, they may remain volatile over the short term as the market makes up its mind about the transitory or more permanent nature of inflation. In the medium term, the extreme fiscal and monetary stimulus deployed both in the US and globally should place upward pressure on inflation, especially in an environment of above-trend growth. Furthermore, negative real bond yields should ultimately not be sustainable over the long term in a normal

[1] A-class net returns

functioning economy. They have likely driven up demand for equity, especially long-duration equity. Historical studies show that both inflation and low real yields are usually followed by poor medium-term real returns.

China's economic growth should be resilient this year

The Chinese annual Central Economic Work Conference in December struck a positive tone and prioritised economic stability, calling on all regions and departments to assume responsibility for stabilizing the macroeconomy while pursuing growth. This is in sharp contrast to the December 2020 Conference, when a regulatory reset was at the top of the agenda.

Moreover, the Chinese Communist Party will hold its 20th National Party Congress in October where President Xi Jinping will be running for an unprecedented third term. This will provide added incentive for economic stability and growth in the run-up to the Congress. China wants to curtail the excess of past property investment which implies the stimulus will probably be less than in prior downturns, and with a greater focus on infrastructure projects such as rail and green investment.

The recent energy crisis in China forced the government to instruct 170 coal mines to expand capacity, causing coal prices to temporarily plummet. Higher energy availability and increased stimulus should support Chinese industrial capacity in 2022. Over the short term, the winter Olympics in February may result in a delay before we see the full impact of infrastructure rollouts and full manufacturing capacity being reached.

China watchers typically look at the "credit impulse" -- which measures the growth in new financing as a share of gross domestic product -- as an indicator of business cycles. Chinese credit growth decelerated last year but with China's credit impulse now at a decade low of -8% after undergoing the most rapid deleveraging in history, a pause in deleveraging would also be positive for demand.

The outlook for commodity prices remains positive over the short term

The third quarter spike in energy prices, triggered in part by the move away from high carbon emission energy sources, brought some of the issues in the transition to renewables to the fore. Whilst the renewables transition is by now secular, it is probably fair to say that the need for the continued use of oil, gas and coal will continue at least over the medium term. ESG related costs are also likely to put upward pressure on most commodity prices going forward.

Similarly, the transition to electric vehicles may likewise take longer than forecast by the optimists. Several of the automakers, including Toyota and BMW who endorse the move to electric vehicles, think the transition will be slower as power grid emissions need to be resolved and much of the charging infrastructure still needs to be built. The uptake from lower-income economies will also be far slower than in the developed world. This should provide a medium-term underpin for PGM miners.

But secular demand for green metals including copper will result in deficits over the medium term given the current development pipeline. Copper prices should also be supported by higher tax-related costs in Peru and Chile, both significant copper miners, due to the stated policies of their newly elected governments.

China's growth-focused commitments expressed at the December Central Economic Work Conference should be supportive of commodity demand. Whilst the Chinese property collapse will weigh on iron ore and steel demand, this should at least be partially offset by the increased demand for infrastructure projects. Both property and infrastructure each account for 30% of Chinese steel and iron ore demand. Increased steel production from the low 4th quarter base of 2021 should also result in higher iron ore demand.

Valuations in the commodity sector are low relative to history based on spot prices. However, metal prices are reasonably high relative to marginal costs. Valuations, while reasonable, are less compelling on our long-term commodity price assumptions, but still reflect some upside.

South Africa begins its rate hiking cycle

The SARB raised interest rates by 25bp. The Governor was at pains to emphasise that they will not respond to first-round supply-side shocks such as food or oil prices. Their focus is rather whether there is any evidence of second-round effects, and whether inflation expectations are being affected. In essence, core inflation is on an upward trajectory and requires a gradual but clear response. As such, the SARB has followed the National Treasury and South Africa has now entered a phase of both fiscal and monetary tightening.

Whilst South Africa was unfairly vilified for being the first to identify the Omicron strain, with the new variant now prominent worldwide South Africa is now providing clues to life after Omicron. With the 4th wave having now officially peaked, excess deaths in SA were evidently ten times less than during the Delta-driven 3rd wave. Google mobility data also shows SA daily movements have not been noticeably impacted by the 4th wave: time spent in places of recreation and retail are 16% above pre-Covid levels.

Whilst SA vaccination penetration has lagged, one recent study estimated that there were antibodies in about three-quarters of blood samples taken in Gauteng as Omicron struck. This should be positive for the hospital and insurer shares which have been hard hit by fears of prolonged Covid prevalence.

Opportunities

Whilst global economic growth is intact, global equities will likely bounce between risk-off and risk-on as we navigate the rate hike cycle. We will maintain a low exposure to high duration assets given our medium to long term view but accepting these positions may only bear fruit over the medium term. We remained concerned about overvalued growth sectors including tech. We have increased our exposure to European banks which are cheap relative to history and are big beneficiaries of a rising interest rate environment.

Portfolio Positioning

We increased our exposure to local banks which sold off to very attractive levels on the back of Omicron. We increased our exposure to Mediclinic. Healthcare margins are considerably lower than their normalised history due to the lack of electives during the pandemic. As such we continue to view the healthcare stocks as very attractively priced on a medium-term basis.

We sold our holding in Spar as we are concerned about Spar losing market share. We took profits in both Aspen and Pepkor on valuation grounds as both shares had outperformed. We built a stake in Stellantis, a global motor manufacturer, given its compelling valuation. We increased our exposure to Sberbank into weakness.

Performance Commentary

Impala Platinum was our largest contributor to performance as the PGM shares rallied on the back of a higher PGM basket price. Whilst many of the SA banks declined in the face of slowing growth concerns triggered by Omicron, Investec was a standout performer, and our overweight contributed meaningfully to performance. Investec results beat expectations on the back of the UK private bank finally gaining traction, good inflows in the asset management and wealth businesses, and the non-recurrence of certain structured product losses.

Telecoms contributed positively to performance as both MTN and Telkom rose over 20%. MTN delivered strong quarterly numbers and announced the award of a mobile money licence in Nigeria. Telkom rose in anticipation of a partial value unlock from an eventual listing of its towers. Some of the compelling valuation within British American Tobacco was unlocked, with the share price increasing 13% this quarter, contributing significantly to performance.

Insurance shares underperformed, given concerns around Omicron. The large retail banks also declined on the back of Omicron-induced growth concerns. Our positions in MMI and Standard Bank thus also detracted from performance. Sasol detracted from performance on the back of a weak trading update. On the international front the biggest detractor from performance was also from the banks, largely on Omicron-induced growth fears. Sberbank was weak due to geopolitical tensions.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Impala Platinum Ltd	3.15%	0.75%	Sasol Ltd	0.59%	-0.28%
Telkom SA SOC Ltd	2.70%	0.52%	Sibanye Stillwater	1.26%	-0.25%
British American Tobacco	4.65%	0.47%	MMI Holdings	1.27%	-0.16%
MTN Group Ltd	1.86%	0.34%	Standard Bank	2.98%	-0.15%
Prosus NV	4.62%	0.31%	Woolworths	1.03%	-0.14%
		2.39%			**-0.98%**

Responsible Investing

Responsible Investing Engagements:

Environmental

Mining companies' environmental impact
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.

In 2020, we engaged with Anglo American Platinum and discussed their specific plans and progress in reducing their carbon footprint. They will switch out of their diesel trucks (one of the biggest emitters of $CO2$ on the mines) for hydrogen trucks. These trucks will be rolled out to the rest of their mines. We also engaged with Exxaro on their Scope 1, 2 and 3 emissions and their strategy around reducing these emissions with their Cennergi (Wind power) JV.
Outcome achieved: engagement ongoing, but companies are making plans to reduce their emissions

Sasol emissions reduction
Sasol Climate Change Report 2019 – Poor Carbon footprint disclosure
Truffle met with various Sasol executives in 2019 to discuss their carbon footprint and how they could reduce their carbon footprint given their specific chemical processes. The meeting also covered how they could improve on their carbon disclosure vs. global peers. Sasol undertook to provide a more comprehensive report on their impact on climate change by 2020. They also undertook to improve their carbon footprint disclosure. Truffle has also attended multiple decarbonisation conferences globally which we use to benchmark Sasol and provide feedback to the company in this regard.

Sasol Climate Change Report 2020 – Improvement in targets, but more ambition is required.
Following that meeting in 2019, we went through their 2020 Climate Change report and attended a group ESG meeting in June 2021 to discuss the level of ambition in that report. Sasol stated that they were aware that their

commitment of reducing GHG emissions by 10% to 2030 might fall short of expectations. They were in the process of revising these targets and would give further detail at the Capital Markets Day later in the year.

Post Sasol Capital Markets' Day 2021 engagement – increased ambition noted, questions remain around remuneration

We noted the increased ambition in Sasol's Capital Markets' Day – from 10% emissions reduction by 2030 to 30% reduction. Truffle engaged with them in October 2021 on a number of climate-related topics. Sasol were planning to table their own climate change resolution and explained the main driver behind the increase in ambition. We had some concerns around how their more ambitious climate targets would come through in remuneration, and whether the right people were being incentivised in the right way. To get more clarity on that, we have set up a follow-up call with them on remuneration only.

Outcome achieved: engagement ongoing, company increased ambition in emission reduction. Give the ESG concerns facing fossil fuel producers, we have set internal limits as to our maximum active position we would take in Sasol in the portfolios. These limits are set at a much lower levels than we would have been the case historically.

Environmental risk in property companies

One upcoming environmental risk for South African property companies is the Energy Performance Certificate (EPC) Ratings. To better understand how companies are dealing with this risk, we engaged with a few property companies.

Our engagement with Vukile in August 2021 gave us some comfort that even though shopping malls are exempt from the certification deadline of December 2022, they were still considering this risk. Truffle also engaged with Attacq in September 2021 to obtain more information around their thoughts on EPC ratings, how much it would cost them to upgrade their buildings, how this aligns with global standards around energy efficiency and green buildings, as well as how they think about improving the energy efficiency of their buildings.

Outcome: engagement ongoing with the sector, but this helped us obtain more information about how this risk might be incorporated into valuations.

Social

Social risk in property companies

In trying to get a better understanding of how property companies think about social risk, we engaged with Vukile in August 2021 on their thoughts on social spending and their impact on the community. They see the benefits as hard to quantify, but see the spend as a part of doing business and gaining the trust/loyalty of the communities they operate in.

Outcome achieved: engagement ongoing

Governance

Naspers

General concerns – control structure, lack of independence of certain directors, and a remuneration policy that we did not think incentivised the right behaviour

Over many years we have engaged with management and industry specialists on many of the issues around the control structure of Naspers and its low voting N shares. This means that shareholders have little sway over effecting the necessary changes within the business. We also raised concern around the re-election of BJ van der Ross, MF Phaswana and RCC Jafta as their years of service have now rendered them non-independent.

We have consistently voted against endorsing the Naspers remuneration policy, as well as amendments to any of the share incentive schemes. Many of these concerns raised are not new and have been part of the broader Naspers governance debate for quite some time. Other issues raised were around the MultiChoice matter and ANN7 probe. We engaged extensively with management around the MultiChoice corruption charges.

June 2021 proposed Naspers/Prosus transaction
In June 2021, Truffle teamed up with 35 other managers to question the complex shareholding structure and lack of management alignment in new Naspers, Prosus deal. We found several aspects of the proposed transaction problematic. We were of the view that it introduces elements which serve to increase complexity in the overall company structures, thereby reducing the likelihood of further value unlock, whether immediate or longer-term. The collaborative engagement was a way to escalate our commonly held concerns directly with the non-executive directors of NPN and PRX.

Our main concerns were:

- Complexity and cross-shareholding:
  - The proposed transaction increases the complexity within the PRX/NPN overall structure in its execution and its outcome, and in our view appears unlikely to address the net asset value (NAV) discounts that such complexity invokes in the longer term.
  - There is a lack of visibility over what the next steps flowing from this transaction might be that could potentially trigger further value unlock. We believe that the weak share price reaction and widening of the NAV discounts of both companies subsequent to the announcement of the proposed transaction reflect this most disappointing reality.
  - As a matter of principle, we were of the view and experience that the introduction of cross-shareholdings between two companies inhibits subsequent corporate restructuring and defers the potential unlock of trapped value. It would be unique for this instance to result in the opposite.

- Management alignment:
  - We were concerned about possible misalignment in management incentives that could result in the discount between NPN and PRX widening further given the fact that, pursuant to this transaction, it appears management's incentives are now more aligned with PRX than NPN.
  - Our previous concerns still stood, that the management incentives in PRX are dominated by the performance of Tencent and are not sufficiently connected to the unlisted companies within PRX. This reduces alignment between management's decisions in respect of the unlisted components and how their own capital allocation decisions are ultimately accounted for and assessed. We believe that this misalignment was not addressed in this proposed transaction and therefore continues to contribute in part to the lack of value attributed by the market to these unlisted investments.

In addition to those core matters, we also had concerns over the more commercially based aspects of the proposed transaction, including the exchange ratio in respect of the NPN share offer and the future potential tax liabilities.
Outcome achieved: the engagement was unsuccessful since the transaction went through, but we managed our risk through the portfolio construction process.

Sasol
Remuneration Policy 2021 – Remuneration policy not aligned with shareholder interests.
In late 2020 Truffle once again engaged with the Chairman of the board, regarding issues with their 2021 remuneration policy and incentive targets. The Chairman responded to us in writing that our concerns were noted and that they would provide more forward-looking information on the 2021 policy and target considerations than what was disclosed in the annual report.

Outcome achieved: subsequent to the above, Truffle was invited to meet with the Chairman of Sasol to discuss the new draft 2021 policy outlining the changes and how the policy is more aligned to shareholders' interests taking into account many of Truffle's concerns. We will be engaging with them again in October 2021 on their remuneration policy.

Fortress

In October 2021, we engaged with a member of the remuneration committee on their plans to unwind legacy staff schemes, the one-off retention award and their plans for their conditional share plan.

Outcome achieved: engagement ongoing

Vukile

In August 2021, we engaged on certain elements of their remuneration that we were concerned about, namely the metrics used in the past saw a very big focus on DPS growth, and not a more balanced approach.

Outcome achieved: we gained some clarity on it, but their policy will be updated in the next year – they will come back to us once that has been finalised to get a sense for our thoughts.

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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