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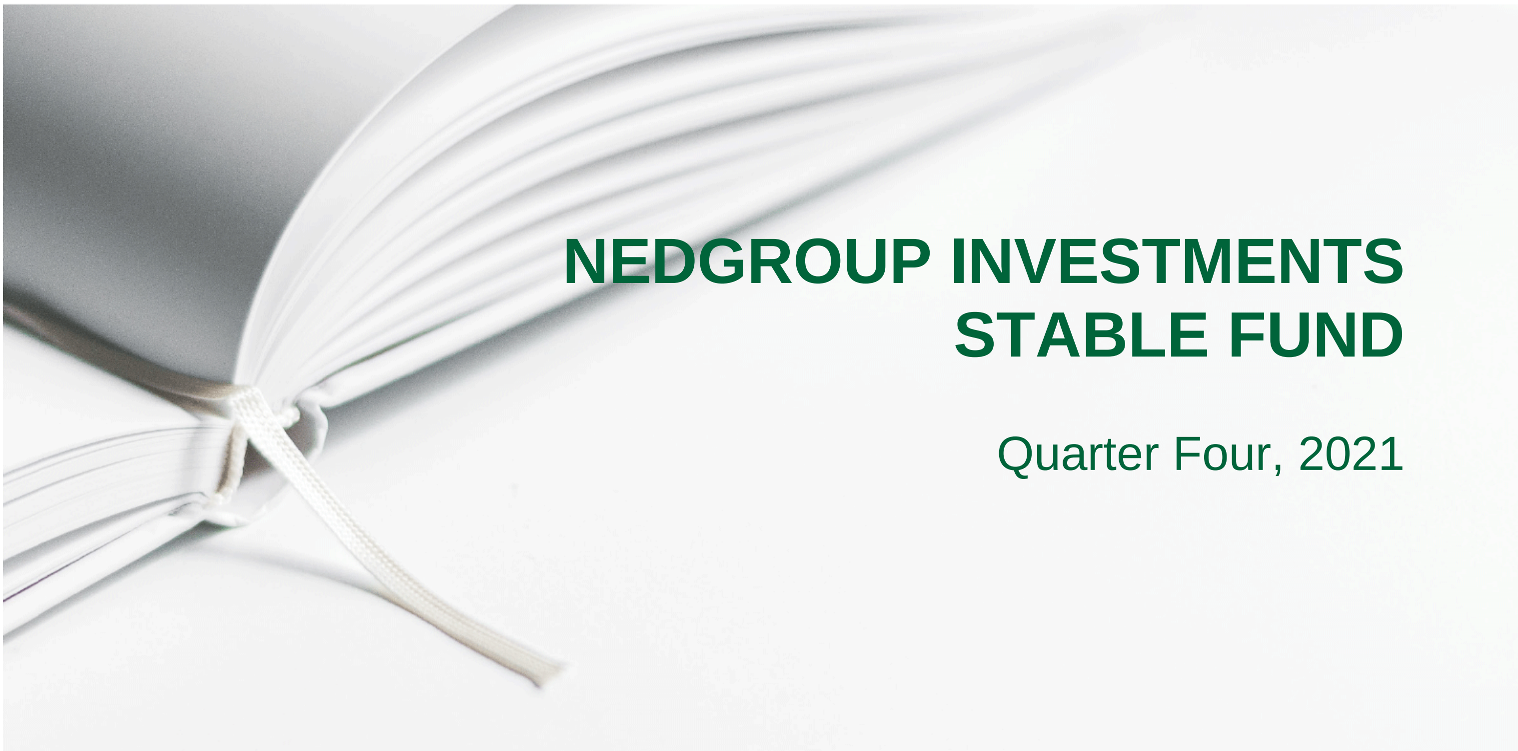

# NEDGROUP INVESTMENTS STABLE FUND

## Quarter Four, 2021

# Market Commentary

## International

The emergence of the more transmissible Omicron COVID-19 variant initially stoked fears of further supply shocks. But its trajectory, combined with high levels of vaccination and natural immunity suggests that we are heading into a post-COVID socio-political and economic realm.

Pandemic-related global economic growth uncertainties have started to fade, with markets increasingly turning to the fundamentals of the real economy. Equities continued to rally into year-end, but markets have already begun to discount the changing real economy drivers and policy backdrops. The post-COVID world should see strong demand growth in the services sector, which has lagged the recovery in capital goods, amid a tightening labour market and robust commodity prices.

Monetary authorities are beginning to acknowledge that the inflation spike is likely to be less ‘transitory’ than previously thought, as sharp increases in energy costs and broad-based labour disruptions compound supply-chain bottlenecks. Developed market bond yields were remarkably little changed, given the spectre of structurally higher inflation and almost universal tightening monetary policy settings.

The US dollar strengthened on the Omicron risk-off sentiment and expectations for rising US interest rates. The stronger dollar, strained global supply chains and higher energy prices buoyed commodity prices.

## South Africa

The emergence of the more transmissible Omicron COVID-19 variant in South Africa initially stoked fears of another domestic economic shock as primary tourist market countries placed SA on travel red lists. The rapid global spread of the milder variant resulted in travel resuming sooner than expected, albeit not sufficiently to restore the tourism high season to normalcy.

Notwithstanding, the economy continued to recover from the deep 2020 recession as the government followed a sensible data-driven domestic policy response to Omicron, avoiding knee-jerk restrictions.

The country’s terms of trade were buoyed by the sharp increase in commodity exports and lagging recovery in imports leading to ongoing, but gradually diminishing, trade surpluses. The unexpected spike in mining royalties and tax receipts also gave much needed support to the country’s fiscal revenues with positive near-term implications for the sovereign debt ratio.

The FTSE/JSE Capped All Share Index followed global equities higher, capping a very strong calendar-year performance. South African bonds again delivered positive returns despite the negative global emerging market sentiment and rising SA inflation and interest rates. Listed property enjoyed another very strong quarter, ending the year as the best performing asset class and well off its 2020 recession lows.

The rand weakened against the US dollar on a combination of dollar strength and negative emerging market sentiment.

## Portfolio Commentary

- Foreign assets contributed most to fund returns on higher global equity markets and rand weakness, with positive contributions from materials company Freeport-McMoran, Google parent Alphabet and US healthcare provider CVS — but risk management hedges on the S&P 500 detracted in the rising market as did some Chinese tech names on continuing regulatory pressure.

- SA equities also contributed positively, with strong returns from core holdings in luxury goods company Richemont and diversified miner BHP Group—Aspen pharmaceuticals was the only significant detractor, with the share price consolidating after several months of strong outperformance.

- The physical gold position was also positive on the higher rand gold price—the NewGold ETF serves a crucial portfolio diversification purpose as both a hedge against inflation and as an alternative store of value to fiat currency.

- SA bonds were positive at the margin as the SA yield curve flattened with long rates ticking down and short rates moving up as SARB started its interest rate tightening phase—investments in the preferred, medium-duration R186 bond gained, but underperformed longer dated securities.

- The low listed property weighting contributed to absolute returns, but the underweight position detracted in relative terms—selection was mixed with gains in Capital & Counties, Arrowhead and Stor-Age, partially offset by weakness in Fortress A.

| Top contributors | Performance Contribution % | Holding Return % | Average Weight % |
|---|---|---|---|
| Foreign Assets | 2.6% | 8.2% | 31.8% |
| Richemont | 0.6% | 56.0% | 1.3% |
| Newgold ETF | 0.4% | 9.4% | 4.5% |
| BHP Group | 0.4% | 24.4% | 1.5% |
| R186 government bond | 0.3% | 1.1% | 26.2% |

| Top detractors | Performance Contribution % | Holding Return % | Average Weight % |
|---|---|---|---|
| Standard Bank Group | 0.0% | -2.2% | 1.3% |
| FirstRand | -0.1% | -3.3% | 1.7% |
| Fortress A | -0.1% | -8.6% | 1.1% |
| Spar Group | -0.2% | -13.0% | 1.5% |
| Aspen | -0.3% | -17.1% | 1.7% |

## Investment Outlook

World:

- Global central banks are rapidly moving towards policy normalisation, with the US Fed planning to end its asset purchase program by March and hike interest rates three times in 2022. The ECB is on a similar path; the Bank of England has already started a rate hiking cycle and emerging markets (bar China) are already tightening policy.
- Fiscal stimulus should also diminish as the multitude of emergency pandemic spending programs conclude—with largely unknown consequences of the return to normal after unprecedented peacetime monetary and fiscal support of $31 trillion over the pandemic period.
- Being on the right side of the bifurcation of economic and financial asset outcomes after the decade-long 'everything rally' will be crucial. Outside of the mega-caps, long-duration speculative "growth" technology assets are already correcting, with the rotation into more reasonably valued companies likely to continue.
- Developed market bond yields should start to rise early in 2022 as the Omicron panic fades and higher longer-term inflation and interest rate expectations start to manifest.
- China looks set to ease monetary and fiscal policy as its economic growth rate fell to the lowest levels in nearly three decades on regulatory crackdowns and the faltering property development sector. Triage in these areas should see growth recovering and support for domestic services sector earnings and commodity prices generally.
- Commodity prices are likely to stay well bid near-term, given the strained global supply chains and heightened socio-political sensitivities around fossil fuel policies.
- Further dollar strength will depend on the Fed's policy tightening tenacity, with any policy U-turn likely to see the dollar weaken.

South Africa:

- The economic recovery to pre-pandemic levels in domestic consumption has largely run its course with this tailwind to growth expected to fade. However, a pick-up in domestic investment spending should provide some offset to waning export and consumption economic growth drivers.
- The benefits of the commodity exports driven positive shock to the fiscal balance are likely to be short-lived in the absence of meaningful structural economic reforms needed for more sustainable long-term public finances.
- While resources companies at peak earnings are not likely to sustain their rally, many South African companies remain on attractive valuations combined with decent earnings momentum.
- Bond yields are still reasonable (although less attractive than they were) given the higher inflation environment, more attractive JSE equity earnings yields and persistent longer term sovereign solvency risks.
- The property sector faces secular decline in rentals given weak GDP growth, high office vacancies, rising costs and unsustainable debt levels with asset values under pressure.
- The currency faces headwinds of rising global market volatility, tightening US monetary conditions and prospects of the current account balance returning to deficit in Q1 2022.

## Conclusion

Equities with pricing power are still the preferred asset class to protect investor capital from the risks posed by rising and persistent global inflation. The overall equity allocation has been retained but with some changes in sector and regional selection.

US equity market valuations are relatively high given record index levels, albeit supported by solid earnings and record corporate margins. But earnings momentum is slowing due to supply bottlenecks and wage pressures, while higher interest rates pose a risk to richly priced, longer duration technology companies.

Foreign assets remain at the prudential maximum, but with a reduced exposure to global equities through tactical short futures on the expensive US S&P 500 index in addition to trimming of select cyclical and interest rate sensitive counters.

The SA equity weight has been marginally increased through additions to JSE listed non-resources overseas companies and SA financials. Despite recent strength in the asset class, valuations are attractive, supported by good earnings momentum and high dividend yields.

The SA bond position is reduced. Real yields on SA government bonds are still attractive, but rising global bond yields, rising domestic interest rates and potentially higher and more persistent inflation reduce the attractiveness of bonds relative to select equities.

The low listed property position is unchanged. The sector's recovery from its COVID-19 lows is probably now complete, but the fundamentals for rentals and capital values in office and retail properties remain mostly unattractive.

## Responsible Investment Summary

### Voting resolutions for Q4 2021

| Portfolio | Total count | For | Against | Abstain |
|---|---|---|---|---|
| Adopt Financials | 3 | 100% | 0% | 0% |
| Auditor/Risk/Social/Ethics related | 64 | 98% | 2% | 0% |
| Buy Back Shares | 15 | 87% | 13% | 0% |
| Director Remuneration | 103 | 100% | 0% | 0% |
| Dividend Related | 3 | 100% | 0% | 0% |
| Issue Shares | 10 | 0% | 100% | 0% |
| Loan / Financial Assistance | 14 | 21% | 79% | 0% |
| Other | 12 | 83% | 17% | 0% |
| Re/Elect Director | 67 | 99% | 0% | 1% |
| Remuneration Policy | 28 | 64% | 36% | 0% |
| Share Option Scheme | 1 | 0% | 100% | 0% |
| Shares under Director Control | 5 | 0% | 100% | 0% |
| Signature of Documents | 6 | 100% | 0% | 0% |

| Foord Global Equity Fund | Total count | For | Against | Abstain |
|---|---|---|---|---|
| Auditor/risk/social/ethics related | 2 | 50% | 50% | 0% |
| Issue shares | 1 | 100% | 0% | 0% |
| Others | 1 | 100% | 0% | 0% |
| Re/elect director or members of supervisory board | 19 | 100% | 0% | 0% |
| Remuneration policy including directors’ remuneration | 6 | 33% | 67% | 0% |

| Foord International Fund | Total count | For | Against | Abstain |
|---|---|---|---|---|
| Auditor/risk/social/ethics related | 2 | 50% | 50% | 0% |
| Issue shares | 1 | 100% | 0% | 0% |
| Others | 3 | 100% | 0% | 0% |
| Re/elect director or members of supervisory board | 18 | 100% | 0% | 0% |
| Remuneration policy including directors’ remuneration | 5 | 80% | 20% | 0% |

General comments:

- There are no abstentions. We apply our minds to every single resolution put to shareholders. When there is an abstention it would typically be intentional or for strategic reasons

- We typically vote against any resolution that could dilute the interests of existing shareholders. Examples include placing shares under the blanket control of directors, providing loans and financial assistance to associate companies or subsidiaries and blanket authority to issue shares. On the rare occasion we have voted in favour of such resolutions, we could gain the required conviction in the specifics of the strategic rationale for such activities and could gain comfort that such activities are indeed to be used to the reasons stated

- The firm also has a strong philosophy regarding management remuneration models. We believe in rewarding good managers with appropriate cash remuneration on achievement of relevant performance metrics that enhance long-term shareholder value. We are generally not in favour of share option schemes given the inherent asymmetry between risk and reward typical of such schemes. In addition, we do not believe that existing shareholders should be diluted by the issuing of new shares to management as is the case with most option schemes. We are in favour of the alignment created between management and shareholders when management has acquired its stake in the company through open market share trading and paid for out of management’s own cash earnings

## Notable company engagements (Q4 2021)

| Company | Topic | Company Attendees | Event Notes |
|---|---|---|---|
| **BHP Group** | Unification of Plc and Ltd entities | David Lamont, Chief Financial Officer | Discussed issues pertaining to BHP's unification - shareholders to vote in January 2022 |
| **Mediclinic** | New Directors and general update | Chairman, Non-Executive Director, Investor Relations | The Chairperson seems to be taking a more active approach and creating new metrics and KPIs to monitor performance and hold management more accountable to the strategy with more oversight.<br><br>It feels like the expansion into new streams has been slow and injecting more pace (which was a culture change) has been received well. |
| **Netcare** | Remuneration policy | Chief Financial Officer, Investor Relations and Human Resources | Discussed the new remuneration policy of a single incentive scheme but did not disclose the specific metrics or targets. However, it will not be dilutive to existing shareholders because they will be buying shares in the market to fund scheme.<br><br>Some metrics will be long term in nature, but we feel cash flow conversion is an easy metric to achieve and should be changed given that there are no NWC (net working capital) issues generally in hospitals. |
| **Shoprite** | Food Safety concerns | Investor Relations | Engaged the company on our concerns of growing food safety risks given growth in private label.<br><br>Shoprite's response was:<br><br>1) global benchmarking of risk;<br>2) certification of supplier and onboarding to national standard and global best practice;<br>3) audited and annually reviewed;<br>4) on-shelf specifications;<br>5) work closely with buyers;<br>6) testing in private lab and auditing in store which is reported to risk forum;<br>7) audit 4 times a year,<br>8) collect data, report on it and monitor on an ongoing basis.<br><br>Foord believes that the measures (as described) are adequate if properly implemented. |
| **Sasol** | Remuneration policy | Remuneration committee Chairman, Human Resources director | Discussed new policy, peer group for TSR, LTI, etc. |
| **Invicta** | Dartcom acquisition | Chief Executive Officer, Chief Operating Officer | Provided feedback to management on governance concerns around Dartcom and its management. This prompted Invicta management into additional due diligence processes. |

## Disclaimer

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Nedgroup Collective Investments (RF) Proprietary Limited, is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust funds. It is a member of the Association of Savings & Investment South Africa (ASISA).

OUR TRUSTEE
The Standard Bank of South Africa Limited is the registered trustee.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT
Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001

WRITE TO US
PO Box 1510, Cape Town, 8000