NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter One, 2022

Market Commentary

The invasion of Ukraine by Russia in late February was both unexpected and shocking and had a dramatic effect on market and commodity prices - but most of all, the loss of life and wilful destruction has and continues to be heart-breaking.

The inflationary impact of the war on gas, oil, wheat and other commodity supplies caused the US and EU five- and 10-year bond yields to race to new highs. The US 10-year bond yield reached 2.9% (at the time of writing in April). This put considerable downward pressure on markets.

For the quarter, the MSCI World Index lost 5.2% in US dollar terms, with the European region shedding 7.2%, followed by North America (-4.8%), whilst MSCI Emerging Markets fell 6.9%

The FTSE/JSE All Share Index (Alsi) (+2.4%) and rand on the other hand strengthened considerably (USD/ZAR +8.6% and EUR/ZAR +11.1%). This was due to the positive effect of higher commodity prices on SA's trade balance, tax revenues and positive impact on SA's budget deficit.

The difference of the impact of the war can be seen in the S&P banks index (-8.1%) whilst the SA banks index was up 24% (+33% in USD).

Whilst both US banks and SA banks will benefit from the impact of higher interest rates, the US and EU now face a recession risk and, hence, for the banks the risk of bad debts is higher. In South Africa that risk is considerably lower.

The short-term outlook for South Africa improved, while the longer-term growth outlook remains weak. This is due to the macroeconomic challenges the country faces.

Fund performance, contributors & detractors for the past quarter

The fund returned 9.4% for the quarter. Whilst this is a good return (the Alsi returned 2.4%), relative to its peers and benchmark the return is disappointing.

The banks showed strong gains (Absa the least with +25% and Nedbank the best with +33%). Sanlam performed well (+21%). The only other large counter in the financial index, besides the banks and Sanlam, to show a 20% plus return was Discovery (+27%).

The main reason for the fund's underperformance relative to its peers was its 19% investment in the Denker Global Financial Fund (as well as investments in Sasfin and Coronation). This is highlighted in the tables below.

<u>Top 5 contributors:</u>

The top 5 contributors were all shares in the index in which the fund has no investment (a very rare occurrence).

- Old Mutual: Despite its seemingly attractive valuation we remain unconvinced of the board and management team's track record of growing shareholder value, hence the fund does not own any Old Mutual shares.
- Quilter: This was 'too hard to call' for us in an expensive market. Hence, the fund doesn't own it.
- Growthpoint, Nepi and Sirius: Besides a small investment in Trematon the fund has no investment in the property sector. This due to the continued uncertainty about the earnings outlook for property companies in the post-Covid environment.

<u>Investments that detracted with negative or below index price performance this quarter:</u>

- The main detractor was the fund's investment in the Denker Global financial Fund. This fund was hit hard by the Russian invasion of Ukraine, mainly through its investments in Central and Eastern European banks. But the effect of Russia's invasion also increased global inflationary pressures which affected US banks negatively due to the risk of the US Fed hiking interest rates too sharply causing slower growth or possibly a recession. The fund itself declined 8% plus a further 8% fall in the rand caused the -16% unit price decline (in ZAR).
- Sasfin's illiquidity means its share price is susceptible to large swings when there is a large quantity of shares either being bought or sold. It seems this quarter there were more sellers than buyers. However, both Sasfin bank and Sasfin Wealth have come through the Covid pandemic well and have launched

initiatives that should benefit the group in 2022. At its current valuation it is very attractively priced and the share price should recover during the year.

- Standard Bank is a detractor due to the fund's investment (4.8%) being far below that of its weight in the index (11.3%). This is because we believe that Standard Bank has loaded its plate with a number of initiatives, each of which will be difficult to attain within the next three years. (Liberty Life and bank integration, building a Pan African product range and improving cost:income ratio). Hence, we prefer the other banks above Standard Bank Group. In addition, based on current valuations and potential growth rates, we believe that the investments in the Denker Global Financial Fund will outperform Standard Bank.
- Cash: Due to the 16% gain of the financials index, cash holdings detracted considerably.
- PSG: In the current uncertain environment we liked the certainty of the cash we will receive post unbundling and hence held onto the 5% position.

Top 5 Contributors	Return in Rand	Contribution
Nepi Rockcastle	-4.23%	0.62%
Quilter PLC	-5.56%	0.6%
Old Mutual Limited	-12.94%	0.49%
Sirius Real Estate Ltd	5.11%	0.39%
Redefine Properties Ltd	-19.95%	0.19%

Top 5 Detractors	Return in Rand	Contribution
PSG Group Ltd	7.19%	-0.43%
Cash	0.63%	-0.44%
Standard Bank Group Ltd	30.08%	-0.85%
Sasfin Holdings Ltd	-13.72%	-0.85%
Denker Global Financial fund	-15.61%	-5.62%

Portfolio Changes, current positioning and outlook

We continued to reduce holdings in Coronation and JSE and cut the PSG holding a bit. Coronation - due to a combination of its going through a poor performance patch (especially its emerging market fund which is represented in many of its other funds); and the JSE - due to the continued poor outlook for listings, although management have some innovative fresh ideas.

The cash generated plus new inflows were used to increase the Absa holding significantly and also increase the Investec holding a bit. Absa's new management team are gaining market share, the only pity is the boardroom problems. The 'new' Investec team is doing well, especially in the UK where they are finally gaining ground both in wealth and SME lending. Both Absa and Investec remain at very attractive valuations.

The top 5 holdings are the investment in the Denker Global Financial Fund and then FirstRand, Sanlam, Investec and Absa. Should the high commodity prices indeed persist for a while and change SA's outlook, then the 53% holding in SA banks will re-rate further.

The valuations of the holdings in the Denker Global Financial Fund are now back at April 2009 levels. Based on our research we feel the market is wrong in its assessment of a) the severity of a possible recession and b) the extent of bad debts. Both US and EU banks have been very cautious and low loan growth rates reflect this, Besides, both consumer and corporate balance sheets are generally still strong.

We feel strongly that the market has overreacted (good quality banks like ING and Swedbank were sold down >30% and the sector is now trading below 2008 P/NAV levels again).

Conclusions

Q1 2022 saw a strong re-rating of SA banks, looking forward to good loan growth and some improvement in net interest margin and the endowment effect of higher interest rates. Globally (outside of SA and other commodity producing emerging markets), banks were sold down aggressively due to fears of a US recession and quality banks like JP Morgan, ING and Swedbank are again trading at levels below previous crises. We feel strongly that these valuations are unwarranted and that the probability of a positive re-rating is high.

Both local and global financials will benefit from higher interest rates which will also boost earnings growth, overcoming the negatives of lower loan growth and possible bad debts.

Hence, based on our outlook and the valuations we remain confident that the sector will continue to generate good returns for investors.

Responsible Investment Comments

Banks and people like Warren Buffett have consistently warned about closing down 'dirty' sources of energy, before there is sufficient green energy, too soon. The Russian invasion of Ukraine has highlighted the wisdom in these warnings, when unexpected shortages of gas and fuel forced the 'E' of ESG to the background in the scramble to ensure economies have sufficient energy sources.

The most important lesson here is that one needs the largest economies (or superpowers) to agree and be responsible. As long as countries like India refuse to reduce coal fired power and Russia considers using nuclear weapons to get its political way, the world is unlikely to beat its carbon emissions target.

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

The Standard Bank of South Africa Limited is the registered 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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