NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter One, 2022

Nedgroup Investments Opportunity Fund

Performance to 31 March 2022	Fund Performance[1]	ASISA category average[2]	FTSE/JSE ALSI
3 months	0.4%	-1.2%	3.8%
12 months	18.1%	9.9%	18.6%

Market overview

News over the last quarter was dominated by the “un”expected invasion of Ukraine by Russia. The economic repercussions of the disruptions to the global supply chain raises the risk of supply shortages, protectionism and higher inflation. Compounding the risks to global growth is the change in tide in monetary policy with the Federal Reserve ending its quantitative easing program in March. Another breakout of Covid in China, resulting in hard lockdowns in several Chinese cities with Shanghai being the most notable, further exacerbates supply chain constraints.

Our observations on the investment implications include the following:

- Generally, these situations take longer to resolve than initially anticipated. It seems to us the opportunity for Putin to backtrack has already passed and the human and economic toll on Ukraine is now too severe for a speedy resolution.
- The Europeans have been living with a false sense of security. They have now woken up to the threat sitting on their borders (the distance between Lyiv and Berlin is less than a 1000km). This has many long-term policy implications around defense, energy security and global allegiances.
- The co-ordinated nature and scale of the sanctions levied against Russia and its leaders has been impressive and shows a unity amongst Western nations that has not been evident for a long time.
- Apart from the swift and strong sanctions, rhetoric and the supplying of arms to Ukrainians, the West has shown little appetite to become directly involved in the conflict. This will likely change if Russia expands its sights beyond Ukraine but for now also affords the opportunity for an easier resolution.
- Putin has isolated Russia for years to come and the Russian economy will not recover for a long time. Fortunately, in terms of the global impact, the Russian economy is fairly small (c. 1% of global GDP).
- The indirect impact on the global economy is, however, far more profound. Russia supplies a lot of energy to the world, mainly in the form of oil, gas and coal. These industries were already constrained given years of structural under-investment. One should expect the current high prices in these bulk consumables to remain elevated as they are difficult to substitute on short notice.
- We have seen quick action in terms of policy within Europe to wean itself off Russian energy longer term.
- This must ultimately benefit green energy and nuclear energy. Also, the German defense budget has gone through the roof literally overnight. Ukraine supplies over 10% of the world’s wheat and a number of other food products. The supply disruptions will translate to higher food prices which will further be amplified by higher transport costs. Lower LSM consumers, who spend a disproportionate amount on food and transport, will once again be the cohort that is most severely impacted.
- Russia will become more dependent on nations like China and India - both of whom have remained neutral in their stance on the invasion - as markets for its products. These three countries account for nearly 40% of the global population and it will be interesting to see if we are again moving toward an area of two super regions who are vying for global domination.

[1] Net return for the Nedgroup Investments Opportunity Fund, A class. Source: Morningstar (monthly data series).
[2] ASISA Multi-asset medium equity category.

- The decades long trend of globalisation is now past its peak and the slow reversal will be a headwind to growth and profitability.
- The direct impact on stock markets from the war may not be that profound. Of course, some sectors will benefit materially (energy, defense, select commodities), and some will be hurt (especially those that are unable to pass on the impact of higher input prices). But if history is a guide and assuming that the conflict does not escalate outside of Ukraine, markets tend to recover from these types of events in fairly short course after an initial period of shock.
- Importantly, however, the threat to the global economy and earnings currently are not limited to the war in Ukraine. Inflation globally, already on the rise, will now be higher for longer. This, coupled with higher interest rates and the drying up of quantitative easing, will provide a tough backdrop for economic activity, company earnings and valuations, especially in those markets trading on lofty valuations.

Despite the headwinds described above, the local equity market continued to reach new highs driven by strong performance from the commodity sector. Sasol (+37%) and Billiton (+40%) were some of the notable gainers on the back of a strong oil price due to Russian supply concerns. Local banks staged a strong rally as results reported by the major banks indicated a much lower bad debt experience than was feared.

Continued rising inflation coupled with a hawkish tone by the Federal Reserve resulted in the 10-year US treasury rates selling off by 0.8% over the quarter to end March at 2.33%. With inflation rearing its ugly head across the globe, the sell-off in long bonds was not contained to the US, with the UK and Europe also selling off.

In South Africa the tightening of monetary policy continued with a further 25bp repo rate hike in March. This brings the total hikes to 75bps from the 3.5% level in November last year. At least another 250bps of increases over the next two years are currently being priced in by the market.

Portfolio Commentary

The Nedgroup Investments Opportunity Fund produced a net return of 0.4% over the last quarter, which was pleasing in relative terms (peer group -1.2%). Fund performance of 18.1% over the last year compares very favorably to peers (+9.9%) as well as the market (+18.6%) when taking our lower equity exposure into account. Our investment approach of sensible asset allocation and stock selection combined with searching beyond the traditional to try and add value via a broader range of assets and strategies bore fruit over the volatile period experienced, helping us to achieve our asymmetric return objective.

Top 5 winners and losers for Q1 2022:

Top contributors	Ave. weight	Performance contribution	Top detractors	Ave. weight	Performance contribution
Thungela Resources	1.5%	1.2%	Naspers	5.5%	-2.4%
British American Tobacco	9.2%	0.9%	Abax Global Equity	4.0%	-0.7%
Merafe Resources	1.2%	0.5%	US Dollars	0.2%	-0.5%
Firstrand	1.4%	0.4%	MATLLI 1.625%	0.2%	-0.3%
Standard Bank	1.4%	0.3%	Brait convertible	1.6%	-0.2%
Total		**3.3%**			**-4.1%**

Top 5 winners and losers last 12m:

Top contributors	Ave. weight	Performance contribution	Top detractors	Ave. weight	Performance contribution
British American Tobacco	9.1%	2.1%	Naspers	5.9%	-4.2%
Royal Bafokeng Platinum	3.6%	1.7%	Balwin Properties	4.0%	-0.4%
Thungela Resources	0.5%	1.4%	MATLLI 1.625%	0.2%	-0.3%
Merafe Resources	0.9%	1.1%	IFC 0% 150229	0.1%	-0.2%
African Rainbow Capital	1.7%	1.0%	EIB 0% 050922	0.1%	-0.1%
Total		**7.3%**			**-5.2%**

- Our investment in Thungela Resources was one of the top contributors over the last 3 months as well as over the last year. They recently reported very strong results combined with a very attractive dividend. In the current high coal price environment, they are generating exceptional cashflows which are shared with shareholders through dividends. They have an un-geared balance sheet with a cash buffer of R5bn. Excess cash gets distributed to shareholders.
- British American Tobacco reported good results during the quarter with the strength in their cashflows again highlighted. Despite this strong contribution we remain extremely optimistic about their prospects as the benefit of de-gearing, growth in reduced risk products, share buybacks, a supportive dividend yield and valuation continues to support their outlook.
- Both Firstrand and Standard Bank reported results that was better than market expectations. This was mostly as a result of a more benign credit experience than expected resulting in some provision releases. A rebound in credit volumes from Covid lows also contributed.
- Naspers continues to be a major drag on performance with continued Chinese regulator intervention heightening the earnings forecast risk associated with Tencent. The severe under-performance of Naspers and Prosus was countered by the hedges we held as protection but could not fully offset the >50% decline in share-price. Post the sell-off in Tencent and Naspers, we view the risk reward outlook to be more balanced. Many of their assets have now taken major haircuts (some valued at zero) in addition to Tencent being down >60% from its high (currently trading at 12 PE), so we continue to believe that there is plenty of optionality which keeps us in the stock.

Current positioning and outlook

The Russian war, Covid supply chain concerns, rising inflation and global monetary tightening have increased the risk of asset volatility and a decline in prices. We continue to think a slightly more cautious approach is warranted at this juncture and have continued to reduce risk assets within the portfolio into market strength. The portfolio is well-diversified across a range of high-quality businesses with a more defensive bias compared to last year due to heightened global risk. Notwithstanding the recovery in local equities, we see opportunity for a further re-rating as the South African equity market continues to trade at a discount relative to its own history as well as other global markets.

Despite expectations of increasing interest rates, our local nominal bonds continue to be attractively valued, with 10-yr bonds offering a *real* return of over 5% (with inflation at c.5%) which provides a good floor to returns. The recent relaxation in exchange controls have increased our ability to substitute local businesses with global businesses of higher quality, should these opportunities present themselves. If valuations are similar, this enables us to improve the quality of the portfolio while at the same time improving the diversification of the fund.

We retain a high exposure to hybrid instruments including convertible debentures and structured notes. Our defensive portfolio is well balanced with foreign currency exposure to protect against a risk-off scenario.

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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