NEDGROUP INVESTMENTS

see money differently

Nedgroup Investments Rainmaker Fund

Quarter Two, 2022

Nedgroup Investments Rainmaker Fund

Performance to 30 June 2022	3 months	6 months
Nedgroup Investments Rainmaker Fund	-7,4%	2,8%
ASISA Category Average	-8,9%	6,6%
FTSE/JSE ALSI	-11,7%	4,7%

Source: Morningstar, Nedgroup Investments Rainmaker A-Class

Market overview

It was a harsh first half of the year for equity investors around the world.

Since our first quarter update, the global macro-economic growth outlook has deteriorated quite substantially. The war in Ukraine looks set to be protracted and Chinese economic activity remains stagnant due to strict Covid policies and on-off lockdowns. This has hampered supply chains and added to global inflationary pressure. In light of persistently higher inflation, monetary tightening around the world (with a few exceptions) has been faster than previously forecast.

The conflict in Ukraine has exacerbated rising inflation, creating more disruption especially through the energy and agriculture supply chains. While we hope that Russia and Ukraine will reach a peace agreement, this seems unlikely in the short term and so we need to adjust realistically for an extended period of sustained inflation and the likely economic impact.

The Federal Reserve in the US, after erroneously claiming that inflationary pressures would be “transitory” earlier in the year are grappling to contain it rising by +8.6% in May from a year earlier - the highest inflation reading in four decades. As a consequence, the Fed has aggressively raised their fed funds rate by +75 basis points in June (the largest hike since 1994) and indicated another likely +75 basis point hike at the end of July. Investor sentiment swiftly turned negative once it became clear the Fed would move more decisively on raising interest rates from ultra-low levels, with serious worries that these actions will induce a recession by the end of the year.

In South Africa, after recently emerging from one of the longest Covid lockdowns in the world, corporates and consumers are facing several headwinds, most notably continuous load-shedding as well as record fuel and food prices, and rising interest rates.

Against this backdrop world equities fell -16% over Q2, bringing the worst half-year returns since the GFC in 2008. SA equities fell sharply too, declining -11% in rand terms (-23% in US$). Resources and Financials ended the quarter down -21% and -15% respectively. Industrials held up better; down only 3% thanks to the last-minute strong performance from Naspers and Prosus in the final week of the quarter. The rand lost -11% against the US dollar over the quarter. There were few places to hide, with cash (+1.2%) the only domestic asset class to provide a positive total return in Q2 2022.

The fund was not immune to the abovementioned market turmoil (more below).

Portfolio commentary

After a volatile Q1 where the fund declined -2%, Q2 turned out bittersweet. While the fund’s more conservative stock selection and offshore holdings delivered outperformance against the benchmark the fund still declined -7.4%. In comparison, the JSE All Share Index declined -11.7%.

The global feel-good factor for many consumers driven by rising house prices, retail investment portfolios (think meme stock trading) and bulging crypto wallets is gone. This somber mood weighed on equity valuations (although not yet so much on actual earnings or even currently anticipated earnings) and most commodity prices.

Only a handful of stocks delivered a positive return in Q2, but the fund's allocation to a good number of these made a positive contribution. Naspers and Prosus FINALLY stood out with their +42% and +32% price appreciation after announcing a significant and open-ended share buyback (more on this later). Mediclinic (+30%) announced good operational results and is the subject of takeover interest. British American Tobacco continued its steady recovery from very oversold levels, rising +13.5%. On the global side, Li Ning, Autozone, Shell and Alibaba all delivered positive returns.

The largest drag on the domestic equity market (and the fund) came from the resource counters during Q2, with the likes of Gold Fields declining -33% as they announced their intention to acquire a Canadian gold miner on terms that make little logical commercial sense to us. MTN's share price performance (-31%) was disappointing after Q1's strong performance and with no change in the positive underlying drivers for the company. We managed to dodge several significant under-performers in lower quality businesses that we do not like or own.

The stop/start Covid lockdowns in China caused much of the resource angst as economic activity in large parts of this manufacturing engine of the world came to a complete standstill. The silver lining is an expectation of a good recovery in China in the second half on the premise that lockdowns of similar magnitude will be avoided, and that the Chinese government will stimulate to recover some of the H1 economic losses in order to work towards their goal of "common prosperity" for all Chinese citizens.

Prosus and Naspers, the largest index constituent in the SA market (as it is the same company) has been frustrating us for some time - their unnecessarily complex corporate structuring and exceedingly large investments in lossmaking ventures across the world (many in industries of dubious long-term profitability such as fast food delivery) resulted in an ever-increasing discount to the underlying asset value (peaking at over 60% earlier in the year). In addition, the fashionable part of the investment world has rapidly moved on from backing "profitless tech" where management teams were doling out relatively free cash (low interest rates and high equity values with supportive shareholders) to build "scale" with the hope of eventually earning profits once the business achieves full scale. At the end of the quarter, Prosus/Naspers management announced an open-ended share buy-back, funded by the matching open-ended sale of Tencent shares. Whereas Tencent's share price has also fallen significantly (it has halved since early 2021), it still represents more than 80% of Prosus' net asset value (and 125% of Prosus' market price). Selling Tencent then to fund Prosus share buybacks makes mathematical sense. The announcement alone caused a significant positive market reaction. It has, unfortunately but predictably put a dampener on the Tencent price, which has lagged the recent recovery in Chinese technology shares. Prosus management also disappointingly affirmed their determination to continue to invest capital in the rump of their assets - from food and grocery delivery in Brazil to selling secondhand cars in the US and offering Buy-Now, Pay-Later financial products in India – all loss making currently). Their track record in this respect is mediocre at best and consequently why, despite the unlimited buyback program, we feel a discount to NAV is likely to persist.

Top contributors	Average weight (%)	Performance contribution (%)	Top detractors	Average weight (%)	Performance contribution (%)
Naspers Ltd	4,2%	1,9%	Anglo American	7,1%	-1,9%
Prosus	3,2%	1,1%	FirstRand	7,5%	-1,6%
British American Tobacco	7,5%	0,9%	MTN	4,2%	-1,4%
Mediclinic	1,7%	0,5%	Anglo Platinum	2,2%	-0,7%
Autozone	1,7%	0,3%	Sanlam	2,8%	-0,7%
		4,6%			**-6,3%**

Currently positioning and outlook

Domestic SA equity

During the quarter the fund took profit across several of our positions in the mining space reducing exposure to Anglo American (but which remains our largest and core mining position) as well as Gold Fields and Sibanye

Stillwater. The proceeds of the Gold Fields sale were invested in Anglogold (a notable laggard in the gold space) as well as increasing our Glencore position.

Although BAT remains a core position which we think still has substantial upside, it's strong performance so far this year has re-rated the stock and we have taken some profits, switching the proceeds into Richemont which de-rated to 16X earnings and back into attractive territory. We added to the large Naspers position at what proved to be very attractive levels.

We disposed of small positions in Coronation, and Telkom and continue to sell out of Reinet which despite the cavernous discount to NAV at which it trades we have lost all confidence in the management team constructively addressing this issue. It is quite remarkable that the matter is once again not raised at all in their 2022 integrated report.

We have started building a portfolio of small positions in autocalls with a spread of underlying equities as the underlying assets. These are unique instruments that offer very attractive risk adjusted exposure to positions we often hold direct exposure to, such as British American Tobacco. We expect they are likely to become a permanent feature in the fund.

Global equity

The allocation to offshore equities was boosted by the 11% devaluation of the Rand versus the US Dollar during Q2, reversing the 8% strengthening in Q1. This helped offshore indices like the MSCI All World Index, the S&P500 and the Chinese Hang Seng Index to deliver -6.8%, -7.3% and +10.2% in Rand, well ahead of the SA market.

The diverse holdings – from regional exposure to underlying business models – limited the fund's downside to the general sell-off. The holdings in Li Ning, Autozone, Shell and Alibaba were amongst the best contributors to outperformance, as well as the only holdings that had a positive price return in the quarter. These companies all have attractive, fundamental business prospects, yet are very diverse and have uncorrelated business drivers. The fund also held a little more offshore cash than usual as well as about 0.4% in Activision Blizzard which is in the regulatory approval process of being taken over by Microsoft and hence performs as pseudo-cash (the share trades at a discount to the offer price as the take-over is not 100% certain – as a result we have swapped some of the holding into real cash).

Unfortunately, some of the fund's previous strong contributors detracted in the quarter as the more risk averse nature of the market derated most companies. Amazon declined -34% after admitting to sitting with too much inventory and warehouse space after last year's significant expansion. Samsung disappointingly declined -23% on generally poor market sentiment. It shows attractive value trading on less than 9X forward price earnings, with 1/3 of the market capitalization in cash on hand and this week mass producing the first 3nm chip sets, ahead of market leader TSMC. Google and Microsoft declined -22% and -16% respectively, despite continued strong underlying business performance. Both traded on relatively high PE multiples (mid 20's) and were derated as a result. But, as Samsung showed, even a low PE does not necessarily provide protection.

In the Q1 commentary, we mentioned the new investments in L'Oreal, Garmin and Align. L'Oreal has delivered on its investment thesis, being more defensive, in spite an elevated PE ratio relative to some other holdings. They presented very good financial results in the quarter and continue to grow globally. On top of their innovations and cutting-edge technology skin care product ranges, at the very basic level, they are benefitting from the well-known "lipstick effect" in these tough consumer times. Regrettably, Align is not as defensive and the stock fell -48% in Q2 as consumers deferred expensive dental realignment (mostly cosmetic) or simply could not get to the dentist (as with the strict lockdowns in China, the largest non-US region for Align). As a result, the growth in new cases/treatments slowed down relative to earlier expectations. We remain comfortable with the investment case as they remain the market leader and will grow again (from both taking market share from traditional braces and expanded markets like the middle-aged customer base).

A frequent question being asked at present is “when do you buy the dip?”, i.e. when has the market fallen too much and offer a great entry point again? The more recent reversal in globalization to more nationalist sympathies and onshoring of production (breaking efficient, low cost, global supply chains) will certainly be inflationary, on top of the war/energy induced inflation we are seeing already. Combined with already lower markets and higher interest rates, consumer confidence has weakened. Whereas staple producers usually offered some safety in a tough market, they are under pressure from much higher input costs and a diminished ability to pass on price increases to a stretched consumer. Against this gloomy backdrop, it is surprising to see that the general earnings growth expectation for US companies (using them as a proxy for the global market) have not been reduced. We think this is inevitable and the market moves of the last quarter are certainly discounting it. But, the S&P500 earnings growth for 2022 has been revised UP by 3.5% during the first half of 2022 and by 3% for 2023. We expect this to roll over once the Q2 results are announced in the next couple of months and that a good number of companies will also retract or reduce their full year guidance. That could provide another leg down in the market and start offering some investment opportunities.

Responsible Investing

ESG thinking is embedded in our business and investment process. We carefully assess the ESG attributes of each company before deciding whether to add it to our portfolios and monitor our existing holdings for changes in their ESG profiles. We believe that high-quality companies with solid fundamentals and good valuations can offer compelling long-term investment opportunities, and that incorporating ESG research into the decision-making process improves both investment and societal outcomes.

Our investment professionals regularly meet with the management and non-executive directors of companies to discuss a range of issues relating to strategy, financial performance, governance, environmental and social topics. The main objectives of engagement are to enhance long-term shareholder value, meet our fiduciary responsibilities to our clients and benefit broader society.

Notable engagements during the second quarter of 2022 include.

- Oceana: Multiple engagements with management covering numerous issues including the recent whistleblower incident/accounting shortcomings, external auditor reappointment, remuneration, board independence/rotation and environmental impact of operations (more specifically, the effective communication of the company's actions in this regard).
- Nedbank: General engagement with several board members including the Chairman and Lead Independent on environmental, social and governance matters.
- Absa: General engagement with several board members including the Chairman and Head of Remuneration on environmental, social and governance matters.
- FirstRand: Engagement with the Group Chief Risk Officer and FirstRand Bank’s treasurer covering climate change topics including progress against FirstRand’s disclosed roadmap from both a risk and business strategy perspective as well as understanding the “economics of energy transition”.
- MTN: Engagement with the Chairman of the board covering a range of aspects across ESG, with specific focus on executive remuneration and governance related to risk management.
- JSE: Participated in the JSE's Sustainability and Climate Change Disclosure Guidance launch.
- World Biodiversity Forum: Abax was a speaker at the World Biodiversity Forum hosted in Davos; addressing the influence of ESG issues on investment decisions.

Conclusion

After a volatile and eventful 1st half of 2022 global investors are more risk averse and circumspect of how they allocate funds. Risks associated with the FEDs rate policy, geopolitics, inflation and global growth remain top of mind and are likely to extend the volatility we have experienced in asset prices.

The South African equity market continues to offer COMPELLING absolute and relative value when compared to elsewhere in the world. Whilst the government is moving ahead (albeit at a glacial pace) with some muchneeded structural reforms, the return of rolling power cuts is harming corporate and consumer confidence. We remain wary of being too complacent about South Africa's economic growth prospects in the long run and maintain the belief that we should diversify the ever-narrowing set of SA equities with direct global investments. The fund holds just less than 30% direct offshore equities, and we continue to evaluate their prospects relative to SA listed companies.

The fund is appropriately diversified, containing businesses with attractive growth profiles and reasonable valuations. In addition, we continue to prefer companies with pricing power that are well placed to deal with cost inflation.

Despite the volatile market condition of the last quarter and negative returns we are more positive than we have been in a long time about the fund's prospects from these levels.

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.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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.

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
DATE OF ISSUE
16 October 2019