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NEDGROUP INVESTMENTS ENTREPRENEUR FUND

Quarter Three, 2022

Nedgroup Investments Entrepreneur Fund

Commentary produced in conjunction with the sub-investment manager, Abax Investments

Performance to 30 September 2022	Fund[1]	ASISA Category Average	Small Cap Index	Mid Cap Index
3 months	0.7%	1.3%	4.7%	0.7%
12 months	9.1%	3.4%	12.0%	-2.3%

Market Overview

Relentlessly rising inflation, central bank tightening of monetary policy through raising interest rates, antagonistic geopolitics and extreme weather events continue to wreak havoc on global markets.

The dominant issue remains the break-out in developed market inflation to 40-year highs and the increased signalling from the US Federal Reserve that it will determinedly raise rates into restrictive territory to tame inflation. This process runs the risk of triggering a global recession, especially when growth in the Eurozone and China is already weak.

Markets remain rivetted on the outlook for US interest rates and the next actions of the Federal Reserve and the smallest change in inflation linked data points are causing wild swings in sentiment and asset valuations. The overall trend seems to be for central banks to continue to hike aggressively to try and restrain inflation – so far their efforts do not seem to be bearing fruit, and we have experienced consequential negative impacts on equity market valuations.

As a result of these suppressing interest rates, global growth expectations have been revised down with a recession in the US now likely. Both the World Bank and International Monetary Fund (IMF) revised their forecasts for global economic growth in 2022 and 2023 down to +2.9% (from +4.1%) and +3.2% (from +3.6%) respectively. The IMF chief economist Pierre-Olivier Gourinchas said, “risks to the outlook are overwhelmingly tilted to the downside”.

The conflict in the Ukraine continues, with Vladimir Putin recently announcing a partial military mobilization that will conscript as many as 300 000 troops, together with a “referendum” to annex the four regions of Luhansk, Donetsk, Kherson and Zaporizhzhia, which represent about 15% of Ukrainian territory. Consequently, European Union member states are deliberating further sanctions against Moscow. The penalties include removing more Russian banks from the SWIFT international payment system, as well as targeting Russia's tech, cybersecurity and software industries. The most hard-hitting and controversial sanction would be to impose a price cap on Russian oil and the possibility of banning the trade in globally important commodities where Russia is a material source of supply such as nickel, palladium and copper.

As the war in the Ukraine lingers, the ramifications for those involved are having profound impacts on their economies. Europe is on the frontlines as energy is weaponized, with Russia turning off the taps of the Nord Stream 1 pipeline to Germany and beyond. Gas is widely used for residential heating and power generation for industry. Europe imported 155 billion cubic metres of gas from Russia in 2021 (40% of their total consumption), whereas the biggest LNG carriers “only” carry 266,000 cubic meters – this shows the scale of piped gas / energy that needs to be sourced from elsewhere in the worst-case scenario.

Chinese economic activity continues to slow, as the state sticks dogmatically to its zero-Covid policy which has been a drag on every aspect of economic activity and a heavy restriction on the everyday life of its citizens. However, the recent end of Hong Kong’s Covid quarantine fuels hope of looser China rules with the market broadly anticipating a relaxation to be announced at the Communist Party Congress starting on October 16th, and which will support a recovery in 2023 – if relaxation materialises.

[1] Net return for the Nedgroup Investments Entrepreneur Fund, A class. Source: Morningstar (monthly data series).

In South Africa, electricity supply deteriorated significantly over the quarter, especially during September where the country was subjected to Stage 6 power outages. While many companies have found ways to cope with load shedding, the near-term growth outlook remains at ransom to volatile and unpredictable electricity supply conditions.

With the above unpredictable and unfavourable macro backdrop, it is not surprising that equity markets behaved erratically, although the SA Rand acted as somewhat of a shock absorber. The MSCI All World Index rose as much as 10.4% in the quarter, only to drop 16% again to end the quarter down 6.8% (in USD). The Rand depreciated 11.2% against the mighty US Dollar, but substantially less so against other developed market currencies as it was more a factor of a strong US$ than necessarily a weak ZAR. As a result, the Rand returns of global markets seem less severe, but this is of little help to SA investors that are losing global purchasing power. SA cash retuned 1.3% for the quarter, SA Bonds 0.6% and SA Equities -3.8% (as measured by the FTSE/JSE All Share Index). The JSE Mid Cap Index appreciated by +0.7% and the JSE Small Cap returned +4.7% - almost all of which was delivered by the Index's large weighting in Thungela (±9% of the Index) which appreciated by 63% in the quarter!

With slowing growth and higher inflation, global risk appetite is likely to remain subdued and markets volatile.

Portfolio Commentary

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Thungela	2.1%	1.1%	Afrimat	3.6%	-0.6%
Oceana	2.8%	0.5%	Merafe	1.9%	-0.5%
Mediclinic	1.5%	0.4%	Hudaco	5.0%	-0.4%
AVI	3.4%	0.3%	PSG Konsult	3.3%	-0.3%
Telkom	1.1%	0.3%	KAP	5.2%	-0.3%
Total		**2.6%**	**Total**		**-2.1%**

In the context of the above 2 tables and broader market returns we are satisfied with the fund's performance against all its benchmarks – especially on a 1-year basis.

Mediclinic rose 10% as a take-out offer by shareholder Remgro and a private company (MSC) became more of a certainty as they lifted their offer price. Contrary to other corporate actions where the target company's share price remains well below the offer price, indicating shareholder scepticism that the deal will be concluded, Mediclinic traded at or about the offer price immediately following the announcement. As we concurred with the Mediclinic Board that the offered price represented a fair and reasonable valuation of the company we sold our entire holding, locking in the corporate action price uplift.

Our limited Resource exposure had a weak month with Afrimat declining on a falling iron ore price and Merafe too on general weaker commodities. Merafe is currently on a PE of 1.5X and we could get all our capital back via dividends alone in 2 years. The price is certainly discounting a complete collapse in Ferrochrome.

Current positioning and outlook

During the 3rd quarter of 2022 the fund continued to implement some trading decisions discussed in Q2, which included reducing Reinet and Telkom and used the short-term uplift in Mediclinic as a result of corporate action to sell out of the position completely. We continued to add to various core positions which have been short term laggards, and these include Italtile, KAP Industrial, Kaap Agri and Adcock Ingram.

We also elected to offer more Alexander Forbes shares into the offer made to shareholders at 505c as we have concerns regarding the substantial reduction in liquidity post the implementation of the transaction. These were accepted and we have sold out of the position entirely.

Sun International is a position we added to the fund earlier in the year for the first time in many years and have been accumulating a position and which currently is a ±2.0% position in the fund. This is a company that for a long time we did not like at all for the following reasons, and then an update of how that has changed in the last year or so.

1. Concerns over the longevity of traditional gambling at casinos – isn't this yesterday's form of entertainment? While we do still have some concerns in this respect, we note the company's development of now legal on-line gambling offering which is already a small but also material component of the profits but also the resilience of the physical gambling business which can clearly be seen in the rate of profit recovery at their casinos post the Covid collapse during restricted access periods. We expect this to continue as especially corporate activity continues to recover.
2. Overly complex corporate structure with too much debt. Despite being a highly cash generative, high profit margin business with the ability to carry a reasonably heavy debt burden this was too large in Sun International. However, the disposal of their Latin American business (for cash – some of which is pending certain conditions awaiting payment) which had had a mixed performance over the years as well as a successful rights offer has substantially improved the health of the balance sheet and reduced the complexity of the business.

These changes and further management actions prompted Abax to reconsider our view on the stock and we have accumulated a position in it. We expect further substantial growth in profits. After a 6-year absence the company is back in a position to pay a dividend!

Responsible Investment

The global covid pandemic revealed and magnified a range of social issues (inequality, unemployment), while the threat of climate change is escalating. These have profound implications for investors. Investors need to consider how well their portfolios are prepared to navigate climate-related risks (including regulatory changes, supply chain disruptions, as well as political and social backlash). Investors should also prepare for opportunities that arise.

Our approach to the integration of sustainability and ESG is pragmatic and is constantly evolving. We aim to invest in companies that are well positioned to provide sustainable returns into the future and that consider their impact on all stakeholders.

Abax actively and consistently engages with companies and other stakeholders to address ESG issues. Notable engagements during the third quarter of 2022 include;

- Mr Price: Engagement with the Board ahead of their AGM. The main topics addressed included remuneration, audit committee independence and initiatives to improve transparency of their supply chain.
- Woolworths: Participated in qualitative research conducted by the company assessing Woolworths' governance, environmental and social standards.
- JSE: Engagement on a variety of ESG initiatives including enhancements to ESG indices and data, as well as encouraging JSE listed companies to improve their ESG disclosure.

Conclusion

The global economic growth environment is expected to deteriorate further. The slowdown is likely to intensify as persistent inflationary pressures and rising interest rates hurt household incomes, while sluggish growth and rising costs (energy, wages) will erode company profit margins. Furthermore, when the next recession arrives, we expect the monetary and fiscal responses to be more reserved than in the past when inflation was not a concern and when government debt levels and central bank balance sheets were less bloated.

Investors will have to navigate a volatile and challenging path over the next year as disruption and uncertainty are likely to persist. This reinforces the case for active management with a thoughtful long-term focus.

In summary, we will continue to perform bottom up, fundamental research, and invest rationally where market prices deviate from fundamental value. Now is the time to own strong businesses, with quality characteristics that are attractively valued, and we are confident with our selection.

It is our strong view that SA equities are very cheap on both an absolute and relative basis, and we remain confident that over the medium term the companies we own will deliver attractive returns for investors. Despite the volatile market condition of the last quarter and negative returns we are more positive than we have been in many, many years about the Fund's prospects from these levels. However, given the flow of funds headwinds peculiar to South Africa and bearish global equity sentiment more patience seems likely to be required.

Anthony Sedgwick
Abax Investments, October 2022

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)..

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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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DATE OF ISSUE
16 October 2019