NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Three, 2022

Market Commentary

The Fed's continued hawkish stance (and correctly so, in our opinion) triggered a further 6.2% sell-off in world markets over the quarter. The MSCI World Financials Index (-6.1%) marginally outperformed the MSCI World Index (-6.2%), in US dollar terms. In South Africa the FTSE/JSE Capped Swix (-2.4%) however outperformed the FTSE/JSE Financial 15 (-4.6%) but both underperformed their global peers when one adds the 9.7% fall vs. the US dollar to the sector returns.

The rand continued to suffer from a strong US dollar. Most global currencies weakened along with the rand, but the rand was amongst the worst over this quarter (continued Eskom, Transnet and political uncertainty has been a big headwind for growth and a deterrent of inflows of foreign capital). The FTSE/JSE Financial 15 Index was pulled down mainly by the 21% fall in the Capitec share price as well as the ~18% falls in Old Mutual and Investec share prices.

Fund performance, contributors & detractors for past quarter

The fund outperformed both its benchmark as well as the FTSE/JSE All Share Index (+0.2% vs. -4.2% and -1.9% of the indices).

Top 5 contributors:

- **Denker Global Financial Fund**: This fund was hit hard in the Q1 'risk-off' environment. We wrote in the June quarterly *"Although the global financial sector was sold off, it sold off less than the main indices. This is because of the positive effect on profitability of higher interest rates. On the negative side however, the market fears the potential impact of bad debts resulting from a deep recession*". The same factors **again helped** the Denker Global Financial Fund outperform both the MSCI World Financial Index and the MSCI World Index whilst the 9.7% fall in the rand means the fund generated a positive return of 7.5% in rand. This compares very well against the FTSE/JSE SA Financials Index. We maintain our view that the global financial sector is at record low valuations and the market is missing the fact that the sector should come through the forthcoming recession well with a strong re-rating next year when the global recession ends. As such, we maintain our maximum possible investment in this fund.
- **Capitec:** We rate the Capitec management team and the franchise highly and our research shows that it should generate higher earnings growth than all the other large constituents of the financial index for many years to come. But the market had put it on too high a rating (P/NAV of 6.0x) vs. Absa's 1.1x for example). Hence, we only held 5% in the fund (considerably below the index) and the 21% fall in the share price was a significant contributor to the fund's outperformance this quarter. The fall has increased Capitec's attractiveness, and we are using the opportunity to add to our investment.
- **PSG Group:** During the quarter PSG unbundled PSG Konsult, Curro Holdings, Zeder and a few other small holdings**.** The unbundling unlocked the value management hoped it would by narrowing the discount. It is sad, and the end of an era. We first held Capitec and then later substituted that for PSG (when you could effectively buy Capitec at a discount via an investment in PSG) for at least 15 years and the group made a significant contribution to the outperformance of the fund over the years.
- **Discovery**: The fund has not owned Discovery for many years, mainly due to its high valuation (we think the market put too high a valuation on possible future earnings from its potentially attractive growth initiatives). It remains a very attractive franchise and we admire what they're doing but the pay-off profile of their strategies is a bit too long for us, when so many other good franchises are available at very attractive valuations.
- **Absa Group:** The disaster in 2021 when the new CEO resigned and then the spat about the new chairman made us deeply concerned about corporate governance at Absa. Whilst the CEO and his exec team manage a business, a well-functioning board is very important in guiding and correcting the CEO. In the case of Absa, CEO Arrie Rautenbach and his team have done a remarkable job in formulating and executing their post Barclays separation strategy despite the seemingly divided board. As the exec team's successes became apparent, we increased the fund's investment in Absa again - to its regulatory limit of 10% (market movement has since taken it higher). The management team's hard work has set up the bank to deliver a potential 17%+ ROE for a few years. That means that our calculations show that it's P/NAV of 1.1 is too low, making it the most attractive investment in the sector, in our opinion, and we expect Absa to continue delivering outperformance for the fund.

Investments that detracted with negative or below index price performance this quarter:

- **Attacq and Hosken:** The property sector has never been an area we place a lot of focus on, so the fund has only by exception held shares in the sector. This worked against us in the years that leverage enabled the sector to be a 'go-go' sector, and it worked for us when it subsequently collapsed. Covid-19 was a big negative for the sector, which pushed valuations down considerably. We believe the industry remains under pressure but accept that there will occasionally be individual counters that will outperform. During the quarter, Attacq and Hosken detracted from the fund's performance as measured against the benchmark (by not holding them) as they re-rated in a very negative market.
- **Curro:** The fund received Curro shares as a result of the PSG unbundling. Selling pressure caused the holding to fall and negatively affect the fund's performance. We decided to wait until the share price recovers before selling the fund's holding.
- **Remgro:** As with Attacq and Hosken the fund doesn't own Remgro, although we do own (and have been adding) three of its investments in the financial sector (FirstRand, MMI and Outsurance).
- **Investec:** Investec has been one of the fund's top performers of the past 12 months (and is the fund's third largest holding). After such a strong rally it was natural that it would first fall back a bit. Management have repositioned their UK bank franchise and it is growing its loan book at 10%+ and profitably so. At a P/NAV of 0.56 for a targeted 15% ROE, Investec is one of the most undervalued banks in South Africa. We see it as a core holding and believe it will help the fund outperform in the coming years.

Top 5 Contributors	Weight Mean	Return in Rand	Attribution
Denker Global Financial Fund	21.24%	4.39%	1.77%
Capitec Bank	5.75%	-21.60%	0.77%
PSG Group	2.57%	28.40%	0.63%
Discovery	-	-18.09%	0.56%
ABSA Group	10.63%	18.39%	0.53%

Top 5 Detractors	Weight Mean	Return in Rand	Attribution
Attacq Ltd	-	22.59%	-0.06%
Hosken Consolidated Investment	-	11.38%	-0.07%
Curro Holdings	0.17%	-5.56%	-0.12%
Remgro Ltd	-	2.19%	-0.27%
Investec Ltd	9.23%	-15.13%	-0.56%

Portfolio Changes, current positioning and outlook

We made a few small changes to the holdings, selling out of our remaining Coronation (fund managers generally are not good investments in a bear market) and adding to MMI (very mispriced and the turnaround strategy is starting to show visible fruits) as well as Sanlam and RMI (effectively now Outsurance).

The top five holdings remain the investment in the Denker Global Financial Fund, FirstRand, Investec, Absa and then Sanlam. Our view is that the probability is high that the US dollar will remain strong as long as inflationary pressures persist in the US. This, and the poor growth prospects for South Africa, means we continue to prefer holding investments that derive a large part of their earnings offshore.

As per our contributor paragraph, the shareholdings in the Denker Global Financial Fund have sold off significantly in 2022 and are back at very attractive valuation levels. There is a risk of a global recession, but global banks and insurers have come through previous recessions very well and bounced back 90%+ afterwards. Based on our research, we feel the market is wrong in its assessment of the severity of a possible recession and the extent of bad debts. Both US and EU banks have been very cautious and low loan growth rates reflect this, and both consumer and corporate balance sheets are generally still strong.

Conclusions

The global and local outlooks are deteriorating and negative. But markets have been selling off since early 2022. The sell-off has mainly been concentrated in the expensive growth stocks, whilst the financial sector has also been sold down but held up relatively well.

The fund is hence ideally placed and should benefit from a possible strong rebound in the global financial sector (we think this could be in 2023) plus the high returns on equity and high dividend yields of the South African banks and insurers it owns.

Responsible Investment Comments

The ESG scores of both the Denker Global Financial Fund and the Nedgroup Investments Financials Fund have consistently improved each quarter. This reflects that the pressure on management teams is bearing fruit, especially in tightening up governance procedures. In our interviews with management teams one can see they do take it seriously and it is challenging. For example, does one want an entrepreneurial business that grows from a small group of outside individuals to embrace diversity for the sake of it? The biggest challenge for young successful businesses is to bring in outsiders who share the same passion for (profitable) growth, and culture of rational allocation of capital and shareholder focus.

In this regard it is interesting that we find a correlation in our universe between size and ESG scores. We loathe switching holdings simply to increase the ESG scores of our funds. We rather follow the path of constructively working with management teams and sharing best practice of their peers, which we research with them.

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.

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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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