NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Four, 2022

Market Commentary

Higher interest rates have a profound effect on economies, dampening growth and lowering market valuations. Hence the significant market weakness in Q2 and Q3 of 2022 should not have been a surprise. However, as the quarter progressed the view increased that US inflation had peaked and that US interest rates were close to their peak. This caused investors to start bottom-fishing, resulting in a very strong quarter. In addition, the US dollar started weakening against most currencies and the rand gained 6.3%.

The strong market gains for the quarter can be seen in the index movements (the following returns are in rand terms): FTSE/JSE All Share Index (15.2%), MSCI World (3.9%) and the Denker Global Financial Fund A (12.8%). One can see that the financial sector was a major beneficiary of the belief that the global interest rate cycle was close to peaking and that the likelihood of a shallow recession increased. The re-rating was supported by the attractive valuations and good results.

Fund performance, contributors & detractors for past quarter

Over the three months to December 2022 the fund underperformed its benchmark (11.8% vs. 12.9%) but for the 12-month period it outperformed both its benchmark as well as the FTSE/JSE All Share Index (7.5% vs. 6.9% and 3.6%). The fund benefitted from the significant mispricing of Investec and Absa. It is seldom that the market presents such opportunities, but this is what has helped the fund to outperform over the past 20 years: Using our experience and research base to spot such opportunities and making big investments.

Top 5 contributors:

- **Investec**: Fani Titi (Investec CEO since March 2020, joint CEO from October 2018) has built on the platform left by predecessors Stephen Koseff and Bernard Kantor, but with the initial focus of improving the bank's cost:income ratio. This and subsequent growth initiatives have increased the reported and possible future ROE to +12%. It took the market some time to believe management and we used this period to significantly increase our holding and were rewarded with Investec being a strong outperformer for the full 12 months, but specifically over the last three months. We believe it remains mispriced and did not reduce the fund's holdings as at end of December 2022.
- **Denker Global Financial Fund:** As fears of a global recession receded, markets started re-rating global financials - especially European banks (benefit from increasing interest rates, low bad debts and excess capital returned to shareholders via dividends and share buy-backs). The fund gained 19.1% in US dollars but ended -11.0% for the 12 months (after the heavy losses when Russia invaded Ukraine in February 2022). Shareholder value of the shares in the portfolio grew by 12% whilst their share prices declined by 10%. This implies that the invested companies are on average 22% better value than at the beginning of the year. It seems investors are missing the important point that banks (and insurers) in 2022 differ from banks in 2008. The ROEs are lower than pre 2008, but the balance sheets are strong and loan books low risk. Our research shows that the sector should generate shareholder value growth of 10% per annum and should re-rate by 30%+.
- **RMI/Outsurance:** RMI added significant value to the portfolio via the sale of Hastings (UK) to Sampo and its unbundling of MMI and Discovery. But we think the real value add will be over the next few years due to Outsurance now being a listed entity (without the overhang of the non-core holdings). We used the cash received via the unbundling (along with cash from PSG unbundlings) to increase the fund's holding in Outsurance.
- **Underweights Old Mutual and Remgro (quarter) and Capitec (12 months):** The fund's underweight positions in Old Mutual and Capitec contributed to outperformance in the quarter and for the 12 months, and the underweight in Capitec (was too expensive at the beginning of the year) contributed positively.
- **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) and this was a significant outperformer (and contributor to outperformance for the 12-month period).

Top 5 Contributors	Weight mean	Return in Rand	Attribution
Investec Ltd & PLC	10.2%	52.9%	1.7%
Remgro Ltd	-	3.0%	0.4%
Old Mutual Limited	-	7.0%	0.2%
Denker Global Financial Fund*	22.0%	14.0%	0.2%
Outsurance Group Limited	0.8%	0.0%	0.1%

*Including the Denker SCI Global Financial Feeder Fund

Top 5 Detractors	Weight mean	Return in Rand	Attribution
Transaction Capital	2.3%	-9.1%	-0.3%
Standard Bank Group Ltd	5.1%	16.7%	-0.3%
NEPI Rockcastle PLC	-	27.2%	-0.3%
Growthpoint Prop Ltd	-	29.8%	-0.4%
Sanlam Ltd	8.4%	-5.8%	-0.7%

Source: StatPro

Portfolio Changes, current positioning, and outlook

We made very few changes to the portfolio. We sold the holdings received from the PSG delisting and used the cash to increase Outsurance. It is expensive but we think the valuation doesn't accurately reflect its growth potential (which justifies the price). MMI is the opposite: little near-term growth but presents significant opportunity for value unlock.

The funds top five holdings remain unchanged: The investment in the Denker Global Financial Fund, FirstRand, Investec, Absa and then Sanlam. The US dollar will most probably continue to weaken which implies a stronger rand. However, the inability of the ANC led government to resolve the electricity problem and its continued ideology that the state must create jobs rather than create an environment that facilitates growth that creates jobs, means that SA's growth rate is likely to remain sub-par - particularly when compared to other attractive investment destinations. Despite that, South Africa regularly produces outstanding companies like Investec, Capitec, Transaction Capital and now Outsurance. In fact, the history of the fund (outperforming both the JSE and MSCI World over the past 20 years for a compound return of 15.5%) shows that we have world class managements and banks and insurers like FirstRand, Absa, Standard Bank, Santam and Sanlam have been world class at capital allocation and growing shareholder value.

Conclusions

The global and local outlook are uncertain. But markets have been selling off since late 2021 and the financial sector especially is very attractively in terms of its valuation.

The 20-year track record of the fund and current very attractive valuations give us the confidence to expect continued good returns from the sector and the fund for 2023 and into the future.

Responsible Investment Comments

The ESG scores of both the Denker Global Financial Fund and the Nedgroup Investments Financials Fund have again improved this quarter. This reflects that the pressure on management teams is bearing fruit, especially in tightening up governance procedures. In our interviews with managements one can see they do take it seriously and it is challenging. Yet, one must be careful of 'throwing the baby out with the bath water'. In the formative years of businesses, one needs smaller cohesive (entrepreneurial) management teams. The score of one large holding in the Nedgroup Investments Financial Fund did fall (Sanlam). This was due to the investigations into the industry by the competition commission. The investigations are about long-standing practices initiated by the insurance regulator and hence should not have a significant impact on the group.

Remgro chair Johann Rupert has been critical of the way ESG scores are measured, and this (Sanlam being negatively penalised due to an investigation which might be spurious) does prove that point. Rupert also warned that alternate energy cannot efficiently build South African industry and address its urgent electricity needs. South Africa will need to make choices. The fact that Asia's greenhouse gas emissions are ten times that of Africa's highlights this point.

An interesting point on executive compensation is Christiano Ronaldo's wages of $200m per week. We think both CEOs of listed companies and Ronaldo get overpaid. The question must be asked why workers and supporters don't complain about Ronaldo's income being so out of line. A question that does need to be thought about.

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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