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NEDGROUP INVESTMENTS RAINMAKER FUND

Quarter Four, 2022

Nedgroup Investments Rainmaker Fund

Performance to 31 December 2022	Nedgroup Investments Rainmaker Fund[1]	ASISA category average	FTSE/JSE ALSI
3 months	9.6%	10.6%	15.2%
12 months	-3.3%	3.1%	3.6%

2022 was not kind to equity investors; while we expected (some) inflation, higher interest rates and slower economic growth rates after the stronger than expected 2021, in reality it all turned out much worse. The Russian invasion of Ukraine, prolonged zero-Covid policy in China and extreme weather events across the globe further fueled inflation and continued to constrain global supply chains. 2022 turned out to be far more brutal and unpredictable;

- Global inflation rose much faster (highest in 40 years), leading to much stronger monetary tightening and in most countries positive real rates. Suddenly equities were not the only investment alternative anymore and highly rated growth stocks, specifically, were severely punished.
- The uncertainty over where inflation and rates would end and whether central bank actions would help or hurt led to apparent over-analysis of every inflation linked data release, which in turn caused wild swings in sentiment and asset valuations.
- In addition, the Russian invasion of Ukraine caused much angst over food-, fertiliser- and energy supply. It also hastened the de-globalisation of supply chains and materially heightened geopolitical stress.
- While Covid did subside outside of China, the longer-term impact on global supply chains remained, exacerbating the inflationary impact. China's Zero-Covid policy caused much upheaval and was finally abandoned at year end, causing a material spike in infections, the outcome of which remains uncertain at this time.
- South Africa, despite our own political and energy turmoil, almost appeared as a haven against this backdrop (certainly amongst Emerging Markets) and materially outperformed global indices.

Global markets declined materially in 2022, notably the US (S&P 500 -19.4%) recording its worst performance since the global financial crisis in 2008. The SA equity market was resilient with the JSE All Share Index appreciating by +3.6% for 2022 after a sharp rebound in performance during the final quarter of the year (ALSI +15.2%). Even when measured in US$, South African equities (MSCI SA -7.5% in US$) outperformed MSCI Developed World (-19.5%) and Emerging Markets (-22.4%) in 2022.

The uncertainty and global angst of 2022 remain, although there are a number of green shoots in this bleak environment. Some of the drivers of the current elevated inflation have already turned down, interest rates should peak, energy prices seem to have stabilised, China is re-opening faster than expected and there seems to be far better balance sheet and cashflow discipline at corporates – a positive backdrop. However, corporate earnings growth is still weak (it seems that earnings downgrades are not done yet), and the possibility of recession (certainly in Developed Markets) has not gone away. In this scenario, South Africa, as a commodity producing emerging market, should do relatively well, especially if the USD gradually weakens as expected. The war in Ukraine remains a dark cloud on the investment horizon especially as a positive outcome seems remote.

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

Portfolio Commentary

We continued to experience significant volatility during Q4, as both local and global macroeconomic headlines impacted investor sentiment. South African equities rallied in Q4 (ALSI +15.2%) after strong returns in October (ALSI +4.9%) and November (ALSI +12.3%) but ended on a weak note with a decline in December (ALSI -2.3%). Including its offshore allocation, the Rainmaker Fund could not match the strong SA performance and delivered a net return of 9.6% for the quarter.

In Q4, the promise of China's re-opening from their zero-Covid stance boosted not only direct Chinese equities (like Tencent – Prosus/Naspers), but also the miners and luxury goods companies that sell their goods into China. Naspers and Prosus appreciated 24%, Richemont 30%, Anglo American 21%, Impala Platinum 25%, etc. Amongst the global holdings, Eagle Materials (+23%), Tractor Supply (20%) and Samsung (20%) also contributed positively as global markets in general recovered from their earlier declines.

At the other end, it was mostly our large US tech exposure that detracted in Q4. Amazon declined 25% and Alphabet 7% - both on account of investor concerns over their ability to sustain their above market growth rates in this uncertain world. We remain confident in their solid business models and significant own intellectual property – yes, growth rates will fluctuate, but their underlying business models still have the ability to outgrow the market.

For the year, SA investment returns were far more muted – so much so that cash (+5.2%) outperformed the ALSI (+3.6%). However, MSCI SA (-7.5% in US$) still trounced the offshore returns of MSCI Developed World (-19.5%) and Emerging Markets (-22.4%).

Within SA equities, the defensive British American Tobacco (+22.9%) was the best performer. Basic Materials (+6.1%) and Financials (+6.9%) also outperformed, with Industrials (-13.3%), Healthcare (-16.9%) and Telecoms (-18.7%) lagging. The fund holds large positions in BAT, miners, SA banks and the Naspers/Prosus combination, all of which contributed positively.

Unfortunately, for the year, it was the offshore holdings that detracted the most value, with Amazon (-50%), Alphabet (-40%), Samsung (-33%), Trex (-70%) and Microsoft (-29%) – all in ZAR terms. The global rotation from growth to more defensive value did not help any of these companies and with relatively higher PE multiples to start with, they were sold down indiscriminately. It is understandable why much of the highly geared, loss-making platform companies (such as food delivery, financial services, crypto currencies, etc.) were sold down – investors realised that their business models are mostly inherently weak. In contrast we believe that the holdings in the fund mentioned above all have solid business models and healthy balance sheets.

Q4 Top contributors	Average weight	Performance contribution	Q4 Top detractors	Average weight	Performance contribution
Naspers	5.8%	1.35%	Amazon	1.7%	-0.61%
Anglo American	6.4%	1.30%	Alphabet	2.0%	-0.27%
Prosus	3.8%	0.91%	Sanlam	2.4%	-0.13%
Glencore	3.4%	0.62%	Raubex	0.4%	-0.09%
Firstrand	7.3%	0.59%	Trex Company	0.8%	-0.07%
Total		**4.77%**	Total		**-1.17%**

Current positioning and outlook

Domestic SA Equity

As discussed above, the South African equity market materially outperformed developed markets in 2022, in spite of some own goals with Eskom and political uncertainty. Whilst many of the macro drivers that caused this continue into 2023, there are a number of reasons why 2023 might be somewhat more challenging for the SA market.

The SA listed equity opportunity set is much more global than one would think; the largest companies generate almost all their revenue and profit outside of South Africa (e.g. Naspers, the miners, British American Tobacco, Richemont, Sasol, the mobile telecoms companies); about 60% of the JSE's profits originate from outside SA. This is predominantly from Tencent (which generates more than 100% of Naspers' profits), commodity and precious metal exports, tobacco (BATS), luxury goods (Richemont) and the substantial African operations of Vodacom and MTN. We are fortunate that very little of this offshore exposure is dependent on global discretionary consumer spend and should therefore be relatively resilient in the event of some developed world recession induced by monetary tightening. If anything, the re-opening of China should stimulate internal consumer demand and some normalisation of the housing market, both positive drivers for our mining exports, Tencent and Richemont. We therefore maintain strong positions in our diversified and platinum miners, Naspers/Prosus, British American Tobacco, Richemont and MTN.

We prefer the offshore Shell over Sasol on account of their more focussed business model and project delivery track record. The world has decarbonised energy supply (especially in exploration for new sources) much faster than demand. Shell is uniquely positioned with longer life resources whilst also investing in non-carbon energy. Whereas Sasol is a direct beneficiary of higher oil prices (which will be likely once China's economy recovers), they need dramatic and costly interventions in South Africa to reduce their very significant carbon footprint, whilst in the US they are at the mercy of gas prices as a raw material cost for their chemical operations – both issues make for substantial headwinds.

Within South Africa we are more concerned about weakening economic conditions; unemployment, inflation hurting the consumer and Eskom's poor performance seems set to continue into the foreseeable future – i.e. very little economic growth. In addition, the government's finances are not able to stimulate growth. As such we have limited exposure to the SA consumer, other than Shoprite and Mr Price, both examples of well managed businesses that successfully address the lower-, mid- and parts of the upper consumer market – hence being able to retain consumers in both up- and downturns in the economy.

We continue to have a large position in our banks as they are well run, well capitalised, well regulated and at attractive absolute and relative valuations to international peers (Capitec being the exception being much more expensive). Having performed very well in 2022, further upside may be limited.

Despite the bleak SA outlook, there are good locally focussed companies where entrepreneurial management deftly steer them through the turmoil. We hold positions in Bidvest, AVI, OUTsurance, KAP, Italtile and Raubex in this category.

Global Equity

With the material central bank tightening, generally high indebtedness, tight and expensive labour forces and slow growth in developed markets, it is expected that emerging markets will perform better than developed markets in the coming year(s). Global diversification in the fund should therefore not just be into the traditional “A list” of US equities, but also diversified towards some of these emerging market opportunities.

The world seems to be separating into two major trading blocs, one broadly aligned to the US, the other towards China. This is creating de-globalisation, impacting supply chains, energy diversification and independence, and new financial hubs. The US driven economic cold war against China (i.e. the ban on supplying China with high end semiconductor manufacturing equipment and forcing other supplier countries to join the US in this endeavour) could lead to a bifurcation of technology standards that further drives de-globalisation. It is interesting to note the apparent non-alignment to either from India and GCC countries (Saudi Arabia specifically following Dubai with major non-oil investment plans). In the very short term, some form of recession seems to be priced in for developed nations, although it is not expected to be severe. For the long term, these macro issues will have a material impact on the stock selection for direct offshore holdings.

The fund’s US exposure remains in the likes of Visa, Thermo Fisher, Microsoft, Amazon, Alphabet (all global leaders with solid fundamentals and financials), Tractor Supply and Autozone (US specialised retailers with solid growth) and Martin Marietta and Eagle Materials (aggregate and cement producers – very localised businesses feeding into the US’s need to rebuild their aging infrastructure).

China’s economy has been beset by several problems: the disruptive impact of a zero-tolerance Covid policy, the worst fall in real estate activity on record, weakening export growth and sluggish consumer demand. The mounting cost of restrictive Covid management and property instability prompted important policy initiatives in November 2022 and the effective end of zero-Covid policy. There is now a real prospect that China’s economic performance can at last begin to recover, despite continued challenges and uncertainties. This will be positive for consumption and commodity demand. Our resource holdings (Anglos, Glencore) should continue to benefit from the China re-opening trade, underpinned further by low metal inventories and strong balance sheets. A rebound in household consumption will benefit our holdings in Alibaba, Li Ning, Tencent and Richemont and Moncler in the luxury goods space. The approval of new video games will also support the earnings outlook of Tencent (Naspers/Prosus).

In addition, the fund diversified into Shell (global energy supply), Samsung (important semi-conductor alternative to the at risk Taiwanese producers and with 1/3 of the market capitalisation in cash on the balance sheet), L’Oreal (best in class global cosmetics business), Moncler (small, growing luxury clothing business out of Italy) and Puma (niche version of Nike and adidas).

Responsible Investment

The U.N. Climate Change Conference (COP27) occurred during the quarter, with many of the parties looking for concrete pledges to combat the damaging effects of climate change. Despite many summits and conferences, limited progress has been seen since the 2015 Paris Agreement to curb warming at 1.5 degrees Celsius above pre-industrial levels. After a dip in 2020 owing to the Covid pandemic, global carbon emissions have rebounded with global carbon dioxide emissions from fossil fuels projected to increase by 1% in 2022, hitting a new record of 37.5bn tonnes. COP27 President Sameh Shoukry emphasised, “Moving from negotiations and pledges to an era of implementation is a priority”.

Abax actively and consistently engages with companies and other stakeholders to address ESG issues, including the importance of climate change. 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.

Notable engagements during the fourth quarter of 2022 include:

- Shoprite: Engagement with the Board ahead of their AGM. The main topics addressed included remuneration, diversity, and board composition.
- Sasol: Engagement regarding Sasol's decarbonisation targets and progress towards 2030 goals.
- Absa: Participated in an independent stakeholder engagement survey.
- PRI: Participated in a PRI workshop to discuss, amongst others, the role for investors to play in advancing the global responsible investment agenda.

Conclusion

The path from here remains opaque as markets are engaged in several key debates, most notably global economic strength (possible US recession), China's reopening, earnings sustainability, the path for inflation and interest rates as well as geopolitics. In the US, monetary policy has already reached tight territory, which has typically acted as a catalyst for a recession (economists expect a mild one in contrast to the last two severe contractions). Countering this, we expect Chinese policymakers to ease policies in 2023 to support the economy, but it remains unclear whether these policies will merely stabilize economic activity or whether they will cause a significant acceleration in growth. In addition, the geopolitical conflicts that erupted in 2022 do not have clear, verifiable resolutions in the works and remain a source of risk. All things considered, 2023 looks likely to be a challenging year for the major developed markets, all of which look set to enter recessions under the weight of higher interest rates and energy prices (Europe in particular).

Despite the above-mentioned realities, South African corporates have shown resilience in the toughest of times, they are sitting on very healthy balance sheets and from a valuation point of view continue to trade cheap relative to history. MSCI SA is currently trading at a c20% discount to MSCI EM on a 12-month forward basis, its cheapest level since the Asian Crisis in 1999, providing a massive valuation cushion.

To conclude, we will continue to invest in quality businesses that are well managed, well capitalised and attractively valued – our selection of higher quality companies typically outperform and emerge stronger in times of crisis. The composition of your portfolio is balanced and should prove resilient given the various scenarios that could emerge over the medium term; containing exposure to globally diversified businesses (British American Tobacco, Richemont, Bid Corp), miners (which will benefit from China's reopening) and high-quality domestic shares should the domestic backdrop prove better than what market participants fear.

We continue to believe that South Africa is likely to outperform other emerging markets in 2023 given superior earnings growth and cheap valuations, with much bad news priced in regarding electricity and pedestrian growth. Importantly, many JSE listed companies generate revenue outside SA, thus not solely tied to the soft SA growth backdrop.

Disclaimer

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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.

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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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