NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS STABLE FUND

Quarter Four, 2022

Market Commentary

International

Sentiment was initially positive on buoyant Q3 GDP reports and expectations for slowing interest rate increases as inflation peaked, but was more sober latterly when the US Federal Reserve reiterating its hawkish posture. The Fed hiked rates in November and December by 75 basis points and 50 basis points respectively, for a cumulative 4.25% increase since March, marking one of the fastest paces of tightening in history.

Inflation prints receded from their peaks as the base effects of the Russia/Ukraine war, energy and food price shocks abate and global supply chain constraints continue to normalise.

US and European bond yields were volatile, falling initially on slowing inflation prints, but rising latterly on hawkish rhetoric from US Fed Chair Powell. Yields in the world's second largest bond market, Japan, spiked when the Bank of Japan surprised markets by "tweaking" its yield curve control policy.

China moved to quickly dismantle its zero-COVID policy after October's 20th National People's Congress, with sentiment further boosted by continued relaxation of the regulatory blitz, increased infrastructure spending and the re-opening of Macau's resorts.

Commodity prices generally weakened on economic recession risks and the lagged effect of higher interest rates and should remain under pressure. Energy prices fell as a mild European winter allowed the bloc to dodge the worst energy crunch predictions.

The US dollar retraced as the risk of economic recession continued to rise and the greenback's probable move past peak interest rate differentials strengthened alternative hard currencies.

South Africa

Q3 GDP growth was better than expected at 1.6% (quarter-on-quarter) with eight out of ten sectors contributing positively. SARB continued on its hawkish track by raising rates another 75 basis points in November, bringing the repo rate to 7% from the extraordinarily low level of 3.5% during the pandemic.

Inflation fell moderately to 7.4% but remains well above the upper end of the 3–6% monetary policy target range, with SARB forecasting a return to the 4.5% mid-range level only in late 2023.

The Eskom crisis dominated the national mood, with a record breaking 200 days of loadshedding in 2022 and little near-term prospect of any stable energy supply relief for the already stressed economy.

Terms of trade were still positive but deteriorated further on falling export commodity prices for coal and platinum group metals, offset to some extent by the lower dollar price for imported oil.

The rand strengthened on improved global risk sentiment and a generally weaker US dollar on post peak interest rate differentials.

Portfolio Commentary

- The South African equity investments were the largest contributor to returns as the local bourse tracked global equity markets higher with investments in media companies Naspers/Prosus contributing most — investments in global brewer Anheuser-Busch and luxury group Richemont and SA banks FirstRand and Standard Bank also rose sharply

- Foreign assets also contributed positively despite the stronger rand, as core China investments recovered from their recent sell-off — while investments in materials companies Freeport-McMoran and FMC rose sharply
- The investment in the Foord International Fund has meaningfully protected investor capital this year — the fund closed the year up 2.0% in US dollars against the global equity (-18.1%) and bond (-18.3%) market rout, capping the worst year for stocks and bonds combined in 150 years
- SA bonds contributed positively despite yields following global bonds higher — selection was positive with investments in the preferred medium-term "belly of the curve" outperforming the aggregate All Bond Index
- Although the allocation to the outperforming listed property was low, investments in the sector contributed positively to fund returns at the margin — the holdings in niche property counters Fortress A and NEPI Rockcastle both added meaningful value while London property value play Capital & Counties also rose
- The physical gold investment was only marginally positive with rand strength offsetting much of the higher dollar price for bullion — the NewGold ETF serves a crucial portfolio diversification purpose as both a hedge against inflation and as an alternative store of value to fiat currency

Top contributors	Performance Contribution %	Holding Return %	Average Weight %
Foord Global Equity Fund	0.7	4.9	14.9
R186 Bond	0.5	4.6	11.0
Foord International Fund	0.5	2.6	19.2
R2032 Bond	0.5	6.3	7.8
Naspers "N"	0.4	26.4	1.5

Top detractors	Performance Contribution %	Holding Return %	Average Weight %
Spar Group	-0.2	-19.0	1.4
US Tips 0.125% US$ bond	-0.1	-4.4	0.6
ABSA NCD	0.0	2.9	0.2
Sasol 5.875% US$ bond	0.0	-0.4	2.1
Netcare	0.0	6.2	0.2

Investment Outlook

World:

- Risk of economic recession is rising, with the inverted US yield curve at its worst levels since 1980 while PMIs and other leading economic indicators have deteriorated
- While interest rates are likely close to their peak, the Fed's December hawkish tone indicates that rates are likely to stay higher for longer than the market is pricing in
- Market expectations for US inflation to fall back to the 2% level are still too optimistic in our view, given the breadth of price pressures and the strength of the US labour market
- While China appears to be rapidly re-opening, near-term headwinds will likely limit the economic recovery, with a strong rebound likely only in the second half of the year

- Lower commodity prices could surprise to the upside depending on China's economic recovery, the depth of the likely developed economy recession and elevated geopolitical risks
- Precious metals including gold and silver should stay well bid, driven by coincidental peaking of nominal yields and dollar weakness
- The dollar should remain under pressure in the current environment but could surprise to the upside given its safe-haven appeal

South Africa:

- Economic growth is woefully inadequate to address the country's socio-economic challenges with business and consumer confidence and other reliable leading indicators are all pointing to weak economic conditions ahead
- The market is pricing in an additional 50 basis point interest rate increase in the next 12 months, but it is increasingly probable that rates peak at current levels, given persistent weak economic conditions and consumer stress
- SARB's forecasts of a return to the 4.5% mid-range level in late 2023 are probably overly optimistic, with a medium level between 5-6% more likely in that time frame
- The energy crisis will persist near term, but President Ramaphosa's ANC's national elective conference victories could accelerate the unblocking of much needed private sector investment in renewables and industry self-generation initiatives, but grid capacity remains a major constraint
- The current account deficit should persist as the benefits of the export commodity price boom fades
- While the rand is marginally cheap at these levels, it remains vulnerable longer term given structural economic weakness, lack of global competitiveness and unsustainable public finances

Conclusion

The weight in foreign assets increased to 41% partially through an investment in a US dollar Sasol convertible bond on the attractive yield and potentially accretive conversion permutations. Foreign equities increased but remain focused on companies with pricing power which are best placed to protect investor capital from higher inflation. Portfolio hedges are retained given the downside risk to earnings from higher interest rates or economic recession. The allocation to foreign government bonds is comprised of short-duration US treasuries with a preference for inflation linked instruments, while listed property is counter-specific with an otherwise low weight given unattractive valuations.

SA equity weight reduced partially to fund the offshore Sasol convertible bond investment and to offset the higher foreign equities weight. Select quality SA companies remain attractively valued, supported by relatively defensive earnings prospects and supportive dividend yields. The weighting to SA nominal bonds is maintained with conservative positioning given the country's elevated fiscal and political risks while SA credit assets are avoided given expensive valuations. Initiated a small position in short-duration inflation linked government bonds as nominal bond inflation break-even metrics fell to more reasonable levels. Listed property is constrained to a low weighting given poor fundamentals for the asset class, despite optically attractive yields.

Physical gold ETF position is maintained on supportive fundamentals given the likely peak in nominal interest rates, a weaker US dollar and rising stagflation risks. The position provides attractive portfolio diversifying properties during periods of market stress

Responsible Investment Summary

Voting resolutions for Q4 2022

Portfolio	Total count	For	Against	Abstain
Adopt Financials	2	2	0	0
Auditor/Risk/Social/Ethics related	39	39	0	0
Buy Back Shares	9	8	1	0
Director Remuneration	47	47	0	0
Dividend Related	2	2	0	0
Issue Shares	9	0	9	0
Loan / Financial Assistance	8	1	7	0
Other	10	7	3	0
Re/Elect Director	41	40	1	0
Remuneration Policy	20	8	12	0
Share Option Scheme	5	3	2	0
Shares under Director Control	4	0	4	0
Signature of Documents	3	3	0	0
	199	160	39	0

Foord Global Equity Fund	Total count	For	Against	Abstain
Adopt financials	4	4	0	0
Auditor/risk/social/ethics related	5	5	0	0
Buy back shares	1	1	0	0
Dividend related	3	3	0	0
Issue shares	1	1	0	0
Others	1	1	0	0
Political expenditure/donation	1	1	0	0
Re/elect director or members of supervisory board	26	26	0	0
Remuneration policy including directors' remuneration	4	4	0	0
Signature of documents/ratification	5	5	0	0

Foord International Fund	Total count	For	Against	Abstain
Adopt financials	2	2	0	0
Auditor/risk/social/ethics related	5	5	0	0
Buy back shares	2	2	0	0
Dividend related	2	2	0	0
Issue shares	2	1	1	0
Others	6	5	1	0
Political expenditure/donation	1	1	0	0
Re/elect director or members of supervisory board	32	32	0	0
Remuneration policy including directors' remuneration	4	4	0	0

General comments:

- There are no abstentions. We apply our minds to every single resolution put to shareholders. When there is an abstention, it would typically be intentional or for strategic reasons

- We typically vote against any resolution that could dilute the interests of existing shareholders. Examples include placing shares under the blanket control of directors, providing loans and financial assistance to associate companies or subsidiaries and blanket authority to issue shares. On the rare occasion we have voted in favour of such resolutions, we could gain the required conviction in the specifics of the strategic rationale for such activities and could gain comfort that such activities are indeed to be used to the reasons stated

- The firm also has a strong philosophy regarding management remuneration models. We believe in rewarding good managers with appropriate cash remuneration on achievement of relevant performance metrics that enhance long-term shareholder value. We are generally not in favour of share option schemes given the inherent asymmetry between risk and reward typical of such schemes. In addition, we do not believe that existing shareholders should be diluted by the issuing of new shares to management as is the case with most option schemes. We are in favour of the alignment created between management and shareholders when management has acquired its stake in the company through open market share trading and paid for out of management's own cash earnings

Notable company engagements (Q4 2022)

Company	Topic	Company Attendees	Event Notes
The Spar Group	Corporate Governance – several meetings held through the quarter	At various meetings, engaged with the following company representatives: CEO, CFO, Chairman, Independent Director, Company Secretary, Risk Manager	**Concern:** Allegations of multiple contracts signed for the same store by Spar's CEO (Brett Botten) and a retailer in 2018. At the time Brett Botten was the MD of South Rand. **Interactions and Steps**: - Meeting with the CFO to address our issues and concerns on the allegations; - This led us to do our own analysis on the valuations paid for corporate stores; - Meeting with the Board (Chairman, Secretary, Risk Manager and Independent Board Director) and presented our analysis; - Call with Independent Retailers; - Meeting with CEO and CFO to get his views on the allegations and presented our analysis; - Met with the new Chairman on his priorities/focus points; - Emailed follow up questions to the CFO (awaiting response); - Emailed a letter to Board and management with our concerns with the full details of our analysis (in process). **Outcome:** Given the above, we have factored in more conservative assumptions for the business in general. Although the share is cheap on a base case scenario, we remain cautious given the many unresolved risks. We have therefore reduced our holding in the company. Appointment of a good external new chairman and a new board member with retail experience is a good start and will continue to be monitored closely.
Spurcorp		Chair Remuneration board sub-committee; Board Chairman; Independent director	Expressed reservations with potential for dilution on implementation of remuneration policy as it relates to settlement in shares for bonus awards and long-term Incentive programs. Discussed short-term incentives targets and potential for them to be easily achievable coming out of an economic recovery, regardless of management actions.
Bidvest	Remuneration	Remuneration Committee Chair, Investor Relations	Discussed recent remuneration changes and overall policy. Informed that Foord will vote against any policy that could lead to dilution of its investors' interests. Bidvest has bought back the required number of shares issued under their incentive schemes over the last few year's but they don't commit to do so at all times.

Disclaimer

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Nedgroup Collective Investments (RF) Proprietary Limited, is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust funds. It is a member of the Association of Savings & Investment South Africa (ASISA).

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