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NEDGROUP INVESTMENTS MANAGED FUND

Quarter Two, 2023

Nedgroup Investments Managed Fund

Performance to 30 June 2023	Nedgroup Investments Managed Fund A	ASISA category average
3 months	0.52%	2.98%
12 months	9.87%	14.66%

Market Overview

The broader US economy is yet to succumb to pressure from higher rates, remaining buoyant through a quarter of sustained tight monetary policy and declining inflation. US equity markets supported strong quarterly performance for developed markets, as the AI theme drove enthusiasm for technology stocks. China's economic recovery has cooled and growth from here is dependent on the level of incremental stimulus from policymakers. Globally, most major central banks raised interest rates over the quarter as core inflation remains too high vs. Central Bank target levels.

Sentiment in South Africa remained weak particularly over May when the Rand reached a low of R19.85 to the USD amidst allegations of arms supply to Russia and a potential Putin visit to SA for the BRICS conference. The economy did, however, gain some respite in June as loadshedding was reduced.

US stronger for longer

US economic resilience continued with market consensus switching to a "soft landing". Q1 GDP was revised up from a previous estimate of 1.3% to 2% due to increased consumption estimates. The US Fed may have paused interest rate hikes in June as US inflation comes down, however, the Fed is not yet convinced that further declines to inflation print over the year will be sufficient.
While signals of the increased likelihood of a potential recession in the US have been evident, there are several positive factors that lend credibility to continued economic strength for the remainder of the year. These include:

- US consumers continue to spend excess savings generated during the pandemic.
- Increasing house prices and new builds are evidenced by a strong performance from the homebuilder's index. Higher interest rates have led to supply shortages due to the long-term nature of US mortgage markets and the reluctance of existing homeowners to move and refinance at higher rates. However, this will ultimately result in headwinds for the US consumer.
- Capital expenditure intentions per Fed Surveys are reflecting improvements from current depressed levels. This indicates a potential boost to manufacturing.

The high level of wage inflation (even though marginally declining) and healthy US economy will keep policy rates elevated into 2024 and lessen the probability of a near term recession. However, with 2-year real bond rates at 2.8%, monetary policy is clearly restrictive, and the Fed rhetoric continues to be more hawkish than the sanguine bond market expectations. This is being reflected in a significantly inverted yield curve. Furthermore, tighter lending conditions will place added pressure on the economy. Given the tight monetary policy conditions and with the economy at full employment, the risk of a recession is significant, even if it might be pushed out to next year.

US valuations are stretched with the S&P 500 Price Earnings (PE) multiple at 20X. This implies an expectation of robust earnings growth going forward, of an already elevated earnings base. Even using median market PE's (as opposed to the traditional market weighted PE) which are not distorted by high tech valuations, market valuations are at elevated levels relative to history.

Chinese economy spluttering

China's economic recovery following the post pandemic reopening in the last quarter of 2022 has been mixed. Initially, consumer spending trends suggested a stronger comeback, however, recent key industrial indicators are disappointing on the downside with factory output starting to slow. The Economic Surprise indices remain negative indicating actual performance is below economists' expectations.

Stimulus measures including marginal declines to interest rates and bank required reserve ratios, and the extension of tax exemptions on electric vehicles have provided a limited positive impact on Chinese consumption to date. The Chinese Politburo is expected to announce additional measures to stimulate the sluggish economy after a July meeting, however, the nature and quantum of these measures are uncertain. Expectations are for a more balanced approach aimed to boost consumption, support investment, and preventing further deterioration in the property sectors via:

- Monetary policy: a step-up in monetary policy easing
- Fiscal policy relaxation: new tax breaks and fiscal support on large ticket item consumption
- Specific property policies: to address a) funding strains experienced by developers and b) stimulate demand.

These should go some way to restoring consumer confidence and providing some underpin to the Chinese stock market which is trading on relatively generous valuations.
Given the likely focus on consumption stimulus rather than the historically big, fixed investment rollouts, the impact on commodity prices may well be muted and unfortunate for SA in terms of trade and fiscal budget, which could do with higher commodity prices to boost revenue.

SA: Mounting fiscal pressure

South Africa continued to face significant headwinds through the quarter reaching a high point of pessimism amongst market players in May when the Rand lost almost 10% of value in just one month.
Consumer confidence remained low through Q2 slumping to the second lowest level on record since 1994 (Bureau of Economic Research). The post-Covid labour market recovery remains sluggish with non-farm employment still 3% below pre-pandemic levels.

Positively, loadshedding reduced significantly in June as the energy availability factor edged back to 60% on reduced unplanned outages and lower maintenance. If this is sustained it could lead to a near-term upside in the economy.

SA's inflation rate declined over the quarter with CPI prints slowing from 6.8% in April to 6.3% in May. The trajectory is likely to be lower from here, driven by lower fuel and food inflation. Despite the promising trajectory, the Reserve Bank has signaled that rates will likely remain elevated for longer given their determination to get inflation well inside the 3-6% target range. We are hopefully closer to the end of the hiking cycle.

Growing twin deficits weighing on the rand and SA Bonds

South Africa's fiscal position remains tenuous. The outlook for both SA's trade and budget deficits is worsening with lower commodity prices (especially rhodium and palladium) negatively impacting exports and tax revenue. A higher-than-expected rise in the public-sector wage bill, extension of Covid grants, and further SOE funding also pose an increased risk of expenditure overshoots.

A higher budget deficit will result in a higher bond issuance in 2024 restricting yield compression despite reasonably generous valuations while the higher trade deficit will likely keep the Rand at depressed levels relative to fair value.

Meaningful Chinese stimulus in sectors requiring SA commodities would improve the outlook for SA bonds and currency. Stimulus measures have traditionally involved significant property investment (supportive of commodities) however as noted above, the nature of any stimulus measures remains unclear.

SA equity markets are trading on low valuations

Domestically exposed equities are trading on depressed valuations relative to history. Some of which are justified given the concerns highlighted above. In addition, there are risks associated with the outcomes of the upcoming 2024 election which will also weigh on markets.

However, we think there are enough companies trading on suitably cheap valuations that reflect the tough economic environment and which should provide reasonable double-digit returns going forward.

Outlook: in summary

Several global and local risks continue to weigh on the South African market. A US economic downturn remains likely but may only happen next year. China should introduce further stimulus but the quantum and nature of this remains uncertain.

The SA equity market could benefit from this via China exposed shares and possibly through some of its miners. Locally, small wins such as reduced load-shedding and a respite from political uncertainty should benefit, however, SA's worsening fiscal position poses a risk.

Portfolio Positioning

We maintained exposure to domestic equity and fixed income over global asset classes given many SA shares still offer meaningful value while the 10-year bond still offers a compelling real yield.

During the quarter we added to our positions in Nedbank and FirstRand given compelling valuation metrics for these banking stocks. We retain our overweight position in ABSA as we continue to see value in the share.

The earnings outlook for Aspen has improved and we maintain our position in this counter. We added to Pepkor given the valuation metrics and resilience of the business model.

We continued to reduce positions in PGM counters given the weakening outlook for PGM prices.

Performance Commentary

SA equity markets delivered a positive although weak quarterly performance with the JSE All Share (ALSI) rising 0.7%, ahead of SA Bonds (ALBI) at -1,5%. Strong performance from SA Bonds of 4.6% in June was not sufficient to deliver a positive return for the quarter. SA Cash (STEFI) outperformed other asset classes at 1.9%.

The local banking sector delivered a strong performance, especially in June and the fund's holdings in Nedbank and Investec added to performance. However, exposure to Absa Group detracted from performance. Lower rates gearing, (in a higher-than-expected interest rate environment) plus fears around Absa's exposure to countries under fiscal pressure including Ghana and Kenya drove market sentiment weaker. Despite this, we believe the shares are trading on a particularly depressed valuation.

The fund's exposure to gold miners contributed to its performance. We reduced holdings prior to sector weakness. The PGM sector and diversified miners came under pressure following a decline in commodity prices. Naspers and Prosus exposures added to quarterly performance following an announcement in June to simplify the corporate structure. An overweight to Sirius Real Estate was also added given a good trading update in April and the benefit of the Rand's weakness.

Anheuser detracted from performance this quarter given a surprise share price fall following the BudLight marketing campaign which saw the brand losing significant market share in May.

Exposure to domestic medium-term duration bonds detracted from returns over the quarter as SA bond markets experienced negative sentiment, especially in May. Valuations do however remain compelling.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Nedbank Group Limited	2.78%	0.28%	Impala Platinum Holdings Limited	1.86%	-0.46%
Glencore plc	2.66%	0.27%	Anheuser-Busch Inbev SA/N.V.	3.05%	-0.43%
Naspers Limited	8.70%	0.23%	Anglo American plc	2.14%	-0.26%
Investec Limited	2.67%	0.19%	Absa Group Limited	5.35%	-0.20%
Sirius Real Estate Limited	0.88%	0.18%	Metair Investments Limited	0.51%	-0.16%

Responsible Investing:

Mining and Resources

We are engaging with the mining companies, especially those in the platinum and gold sectors, on the risks of tailings dams, with specific reference to safety issues, additional capex spend that might be needed and environmental impact studies.

In 2020, we engaged with Anglo American Platinum and discussed their specific plans and progress in reducing their carbon footprint. They will switch out of their diesel trucks (one of the biggest emitters of CO2 on the mines) for hydrogen trucks. These trucks will be rolled out to the rest of their mines. We also engaged with Exxaro on their Scope 1, 2 and 3 emissions and their strategy around reducing these emissions with their Cennergi (Wind power) JV.

Sasol

We met with various Sasol executives in 2019 to discuss their carbon footprint and how they could reduce their carbon footprint given their specific chemical processes. The meeting also covered how they could improve on their carbon disclosure vs. global peers. Sasol undertook to provide a more comprehensive report on their impact on climate change by 2020. They also undertook to improve their carbon footprint disclosure. Truffle has also attended multiple decarbonisation conferences globally which we use to benchmark Sasol and provide feedback to the company in this regard.

Following that meeting in 2019, we went through their 2020 Climate Change report and attended a group ESG meeting in June 2021 to discuss the level of ambition in that report. Sasol stated that they were aware that their commitment of reducing GHG emissions by 10% to 2030 might fall short of expectations. They were in the process of revising these targets and would give further detail at the Capital Markets Day later in the year.

We noted the increased ambition in Sasol's Capital Markets' Day – from 10% emissions reduction by 2030 to 30% reduction. Truffle engaged with them in October 2021 on a number of climate-related topics. Sasol were planning to table their own climate change resolution and explained the main driver behind the increase in ambition. We had some concerns around how their more ambitious climate targets would come through in remuneration, and whether the right people were being incentivised in the right way. To get more clarity on that, we have set up a follow-up call with them on remuneration only.

Given the ESG concerns facing fossil fuel producers, we have set internal limits as to our maximum active position we would take in Sasol in the portfolios. These limits are set at a much lower levels than we would have been the case historically

Naspers

Over many years we have engaged with management and industry specialists on many of the issues around the control structure of Naspers and its low voting N shares. This means that shareholders have little sway over effecting the necessary changes within the business. We also raised concern around the re-election of BJ van der Ross, MF Phaswana and RCC Jafta as their years of service have now rendered them non-independent.

We have consistently voted against endorsing the Naspers remuneration policy, as well as amendments to any of the share incentive schemes. Many of these concerns raised are not new and have been part of the broader Naspers governance debate for quite some time. Other issues raised were around the MultiChoice matter and ANN7 probe. We engaged extensively with management around the MultiChoice corruption charges.

In June 2021, Truffle teamed up with 35 other managers to question the complex shareholding structure and lack of management alignment in new Naspers, Prosus deal. We found several aspects of the proposed transaction problematic. We were of the view that it introduces elements which serve to increase complexity in the overall company structures, thereby reducing the likelihood of further value unlock, whether immediate or longer-term. The collaborative engagement was a way to escalate our commonly held concerns directly with the non-executive directors of NPN and PRX.

In addition to those core matters, we also had concerns over the more commercially based aspects of the proposed transaction, including the exchange ratio in respect of the NPN share offer and the future potential tax liabilities. The engagement was unsuccessful since the transaction went through, but we managed our risk through the portfolio construction process.

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
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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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