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NEDGROUP INVESTMENTS MANAGED FUND

Quarter Three, 2023

Nedgroup Investments Managed Fund

Performance to 30 September 2023	Nedgroup Investments Managed Fund A	ASISA category average
3 months	-1.30%	-1.53%
12 months	7.18%	13.02%

Market Overview

As we entered the third quarter of 2023, expectations were high for a softer US economy, and markets optimistic that interest rate expectations were close to a peak. Once again, the broader US economy failed to succumb to pressure from higher rates and bond yields have risen further.

China disappointed while South Africa gained a little positive sentiment (off a low base) as remedial actions to drive economic reform became more evident.

US yields accelerate higher

The US economy continues to maintain upward momentum as reflected by a low unemployment rate of 3.8% and a GDPNow forecast of 4.9% for Q3 GDP. While there are some signs of a slowing labour market in terms of lower quit rates and monthly changes in wages below 3%; the high year-on-year wage growth of more than 4%, the higher-than-expected increase in September payroll numbers coupled with a low unemployment rate has resulted in a continued hawkish stance from the US Fed. This has driven real yields on 10-year bonds to well over 2% for the first time since 2009. This has in turn placed upward pressure on the US Dollar and bond yields globally with the SA 10-year rate rising above 12%. The higher long bond rate has pushed the already paltry US equity risk premium lower to circa 0.5% (our expected return for US equities is circa 3% real), further weakening the case for US equity relative to bonds.

Many indicators of US weakness, including depressed manufacturing and a negative credit impulse from tighter lending standards have been offset by a higher government budget deficit, Covid pandemic savings that have yet to be fully spent and a mortgage market that locks in rates for 15-30 years. The latter results in consumers being less impacted by rising rates than would be the case in other countries. However, at some stage homeowners will need to sell and buyers will be forced to pay rates that are more than double those of the last decade. Corporates will also start to feel the pressure of higher finance costs as refinancing starts to pick up in 2024. There has been a shortening of outstanding terms in the high yield debt market as participants wait for rates to fall. The longer rates remain high, the more of a problem this will become. The impact of the lower credit growth from the private sector is yet to be felt and the base of government deficit is already elevated. The US economy is likely to feel pain, but the above factors mean it will be more delayed than in previous cycles.

Expensive US market valuations, especially relative to bonds, are not pricing a slowdown. Given the tight monetary policy conditions and with the economy at near full capacity with limited resources available to fuel further growth, there remains a risk of a slowdown in 2024.

China growth forecasts continue to be revised down

Growth forecasts for China in 2023 & 2024 continue to be revised down as the Chinese economy loses momentum from declining property investment and falling real estate prices. This in turn puts pressure on government revenues from lost land sales and adds to weak consumer sentiment. As a result, Chinese consumers have continued to hold back from spending some of their accumulated savings (which currently equates to approximately 40% of GDP) despite numerous government incentives to boost sentiment in the property sector, as well as cuts to income tax. While these measures are supportive, they will take time to feed through to consumer confidence. Consumers are still feeling vulnerable following the draconian actions during the pandemic years, as well as the subsequent job losses flowing from government policy actions. Other factors contributing to a low level of consumer confidence include heightened geopolitical tension which is further isolating China from the rest of the western world.

The question lingers as to what catalyst is required to shift the Chinese economy into gear with significant uncertainty over China's long-term trajectory and how the economy will continue to grow sustainably albeit at a lower growth rate.

As noted previously, a weaker China does mean commodity prices may remain muted vs. previous economic recoveries which is unfortunate for South Africa and our terms of trade and fiscal deficit.

From an investment perspective, asset prices are cheap. Companies like Tencent have implemented self-help with cost cutting initiatives and are well positioned for an earnings recovery. However, we need to tread with caution given the macro-economic uncertainty and a potential fundamental shift in the Chinese economy.

South Africa: Bottom-up progress in the face of growing global headwinds

South Africa is slowly making progress on domestic reforms. Power generation is improving driven by a combination of the private sector "making a plan" and Eskom slowly attending to operational dysfunction. Transnet, the State's ailing transport and logistics player, has recently announced structural shake-ups which may pave the way for future planned private partnerships. Naturally these reforms will take time to feed into the real economy.

But global risks loom. SA as both an emerging market and commodity-based economy would suffer in the event of a potential US hard landing or with the continuation of a floundering Chinese economy. Whilst certain SA sectors and shares do look attractive and are trading at depressed valuations relative to history, we remain fairly defensively positioned and are building in a high margin of safety given the global uncertainty.

The impact of higher US yields on the SA bond market pushed 10-year yields above 12% and resulted in further rand weakness. With sovereign spreads at reasonable levels and US rates, hopefully, close to peak levels, SA yields should not weaken from current levels.

Outlook: in summary

The Chinese rebound has slowed while the US economy has maintained strength for longer than markets anticipated despite a relatively aggressive rate hiking cycle. The US consumer has been resilient due to mortgage rates being fixed at low levels and having excess savings.
US valuations remain elevated. The strength of the US consumer and an AI theme has driven a re-rating in tech stocks over the year although tempered in the last two months. A combination of stretched valuations and risks to US earnings mean we continue to avoid high allocations to US stocks. We expect that the interest rate hikes seen over the last 18 months will impact the US economy in 2024.

Incremental improvements in the SA economy could have a meaningful impact on growth going forward despite a weakened fiscus. Unfortunately, these wins are counterbalanced by mounting global economic risk and uncertainty. While Chinese growth remains lackluster and economic activity weak, the modest level of consumer demand and less draconian stance adopted by Chinese regulators in 2023 should be supportive. But China's shift in gear is difficult to forecast while growth across developed markets will likely be subdued particularly in regions where household debt is relatively high, and economies are sensitive to extended periods of higher rates.

Our portfolios are defensively positioned with investment in select businesses that display higher margins of safety and strong cashflow yields during uncertain times.

Portfolio Positioning

By the end of Q3, SA equity markets had lost some of the gains made through the year with the Capped SWIX delivering a loss of -3.1% for the quarter, bringing the year-to-date return to just 2.2%. This tracks a similar theme across global equity markets with MSCI World down 3.4% over the quarter. Mining stocks, particularly platinum miners, dragged on overall SA equity performance with the SA Resources index down 4.3% while Industrials were down 6.2% over the quarter. SA Bonds (ALBI) lost 0.4% over the quarter, mostly driven by weakness in September. SA property declined 1.0%.

The local banking sector remained relatively resilient over the quarter and the fund's holdings in ABSA and Investec added to performance. We retain a high exposure to ABSA, given the banking group's strong dividend yield and compelling valuation metrics.

A relatively high exposure to Sasol also added to performance as oil and energy prices gained value over the quarter.

The fund's holding in Naspers and Prosus detracted over the quarter as the shares lost value when Chinese data weakened. Tencent's outlook remains promising, however, given the tough macro-economic environment and uncertainty in respect of Chinese markets, we have purchased downside protection through derivatives. This would have offset some of the weaker performance over the quarter.

Exposure to domestic medium-term duration bonds detracted from quarterly returns as SA bond markets lost value when US longer term yields tracked higher. Valuations do, however, remain compelling.

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
Absa Group Limited	6.27%	0.49%	Naspers & Prosus	10,45%	-0,97%
Sasol Limited	2.91%	0.47%	Gold Fields Limited	2.34%	-0.51%
Investec Limited	2.83%	0.21%	Anglogold Ashanti Limited	1.03%	-0.33%
Glencore plc	1.83%	0.20%	Impala Platinum Holdings Limited	1.10%	-0.33%
Truworths International Limited	0.38%	0.14%	Compagnie Financière Richemont SA	1.00%	-0.30%

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.

Property Sector

One upcoming environmental risk for South African property companies is the Energy Performance Certificate (EPC) Ratings. To better understand how companies are dealing with this risk, we engaged with a few property companies.

Our engagement with Vukile in August 2021 gave us some comfort that even though shopping malls are exempt from the certification deadline of December 2022, they were still considering this risk. Truffle also engaged with Attacq in September 2021 to obtain more information around their thoughts on EPC ratings, how much it would cost them to upgrade their buildings, how this aligns with global standards around energy efficiency and green buildings, as well as how they think about improving the energy efficiency of their buildings.

In trying to get a better understanding of how property companies think about social risk, we engaged with Vukile in August 2021 on their thoughts on social spending and their impact on the community. They see the benefits as hard to quantify, but see the spend as a part of doing business and gaining the trust/loyalty of the communities they operate in

Disclaimer

WHO WE ARE
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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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