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Private Wealth Equity Fund
Quarter Three, 2023

Nedgroup Investments Private Wealth Equity Fund

Performance to 30 September 2023	Fund[1]	Benchmark[2]
3 months	0.2%	-5.0%
12 months	19.5%	12.4%

Market Overview

Market sentiment deteriorated against a backdrop of re-emerging risks on the energy front, stress in the Chinese property sector and a firm message from monetary policy makers that interest rates will stay at restrictive levels for as long as necessary to reach inflation targets. In addition, investors had to calibrate the risk of a US government shutdown as policy makers remained at loggerheads on funding until a last-minute deal pushed the deadline out to mid-November.

Manufacturing activity, industrial production and retail sales in China showed some improvement in August, while Chinese authorities announced further monetary measures to shore up the economy. Saudi Arabia and Russia announced an extension of oil production cuts to the end of the year. US crude inventories declined beyond expectations, with the Strategic Petroleum Reserve recording its lowest level since 1983. Combined with curtailed supply from OPEC+ members, the oil price increased by 9,7% in September, trading above $95 a barrel by month end. This brings the increase over the quarter to a hefty 27,2%, emphasising the risk of higher energy prices to the inflation outlook and driving the narrative of higher interest rates for longer.

The US Federal Reserve kept the policy rate on hold in September, with the hawkish accompanying commentary from US Fed chair Jerome Powel indicating that further hikes could be considered. The Bank of England (BOE) surprised the market by keeping interest rates on hold relative to expectations for a 25bps hike while the European Central Bank increased policy rates by 25bps.

After a positive first half, risk assets started to price for the more challenging backdrop in the third quarter. Both developed and emerging market equities suffered drawdowns in September and over the quarter as volatility picked up and investors recalibrated for restrictive conditions. The S&P 500 lost 3,3% over the third quarter, while declines across Europe and Asia were more meaningful. Domestic Chinese assets suffered noteworthy losses as investors priced lacklustre economic data and the challenges in the property sector. On a quarterly basis, the Hang Seng Index declined by 4,1%, while the MSCI Emerging Markets index traded down 2,8%.

Locally, second quarter GDP printed at 0,6%, beating market expectations. While an increase in activity on the production side was seen across industries, pressure on consumer spending was evident on the expenditure side. The current account deficit increased to 2,3%, all but reversing the improvement from the previous quarter and reaching levels last seen in 2019. Fiscal data to the end of August recorded marginally better than expected, but still paints a difficult picture for the upcoming Medium Term Budget Policy Statement in early November.

The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) kept the bank's key lending rate on hold at 8,25%, with three members voting in favour of the pause and two for a 25bps hike.

Domestic assets retreated further in September as risk off sentiment persisted. Local equity markets ended the quarter in the red, with the FTSE/JSE All Share trading down 3,5% with declines across resources (-5,4%) and industrials (-6,8%) and gains for financials (2,0%). Third quarter returns from index bellwethers, Naspers (-11,0%) and Prosus (-11,7%) mirrored losses from Chinese technology company Tencent (-7,7%), while also pricing portfolio revaluations. Despite persistent volatility, the Rand depreciated by a marginal 0,5% against the US dollar in the third quarter, bringing the decline year to date to 11,3%.

[1] Net return for the Nedgroup Investments Private Wealth Equity Fund, A class. Source: Morningstar (monthly data series).
[2] Benchmark is the Capped SWIX40

Portfolio Commentary and Activity

The fund exited its position in Glencore during the period, informed by the view of a full valuation. The proceeds were allocated to Northam, which offers attractively valued resource exposure, and also to initiating a new position in Capitec. Concerns around slowing transactional income growth and rising credit losses created an attractive entry point into Capitec during the quarter. Highlights from the most recent results of Capitec and Northam are detailed below.

The fund also took the opportunity during the quarter to trim positions in companies that have had strong performances year to date and where expected returns have become less attractive as a result. This includes positions in Alphabet – which is up more than 50% year to date on the back of the AI theme – as well as Bidcorp and FirstRand. The fund added to its positions in Anglo American and Richemont, where share prices have de-rated significantly on concerns of a flailing economic recovery in China.

The fund initiated a small position in Transaction Capital during the period. A shock profit warning early in the year and revelations of insider selling ahead of that, precipitated a steep decline in the share price. Structural changes relating to the industry that SA Taxi services have seen a significant reset in that business' earnings base. This has brought into question the viability of the business given its substantial debt commitments and funding requirements. Having assessed the investment merits and stressed the assumptions underlying the valuation, the fund has sized the position appropriately with full consideration of the inherent risks. We believe management will act rationally to preserve and restore value, given the fair value of Nutun and WeBuyCars, relative to the group's current share price.

For the quarter under review, the fund outperformed its benchmark by a pleasing 5.2%. Positions in Alphabet (+9.1%), AdVtech (+14.6%) and Comcast (+6.2%) contributed positively to this relative performance. Not owning any of the gold counters was also a major contributor to outperformance over the quarter. Over a one-year period the fund's performance is ahead of both its benchmark and the peer group average by 7.1% and 7.5% respectively. Alphabet (+40.3%) and Comcast (+50.6%) have again been the major contributors to this performance as well as the overweight position in Bidvest (+43.2%). The fund's underweight across the PGM sector (Anglo Platinum -41.6%, Impala Platinum -38.3%, Sibanye -26.3%) – where Northam (-23.0%) is the only exposure – has also contributed positively to relative performance over the past year.

We turn now to discuss a select few portfolio holdings and/or related events of the quarter (results, corporate action etc).

Capitec – *Multiple growth levers*

Capitec's 1H24 results demonstrate the strength of its transactional banking franchise and the business' ability to grow despite a difficult macroeconomic environment. Revenue was up 21%, with net transaction fees and insurance revenue up 24% and 33% respectively. Capitec continues to see strong growth in its number of clients and customer activity, with the launch of various value-added services benefitting the latter during the period. Growth in costs was contained below revenue growth driving the cost-to-income ratio lower. HEPS grew by 9% as credit impairment charges increased by 62%. Capitec continues to make good progress in business banking which contributed 5% to group earnings for the period.

Deteriorating credit quality remains a concern for the banks, particularly Capitec with its narrow retail focus. While non-performing loans were higher, management did present two data points – new loans defaulting and forward roll rates – that may suggest that credit losses have peaked. Capitec has tightened credit granting and implemented collection and debt restructuring initiatives in response to the constrained consumer environment.

Capitec remains a compelling long-term growth story with scope to further grow market share in retail and business banking. Its 21m strong client base (and growing) which can be increasingly monetised through cross sell and fees differentiates Capitec from its large traditional peers. The expansion into business banking, insurance and potentially other new products and adjacencies adds impetus to this growth story. Capitec represented 2.5% of the fund at quarter end.

Northam – *Some positive developments for the investment case*

In a positive development for the Northam investment case, the group announced in July that it was abandoning its costly takeover bid for Royal Bafokeng Platinum (RBPlats), citing the adverse decline in the PGM basket price as the rationale for the cancellation. Northam accepted Impala Platinum's (Implats) mandatory offer in respect of its 34.5% stake in RBPlats for a consideration of c.R9bn and 30m Implats shares (most of which have since been sold). Management alluded to the deal strengthening Northam's financial position and the prospect of shareholder returns.

At the release of its FY23 results a few weeks later, Northam declared its first dividend in a decade and stated its intention to pay a dividend going forward at a payout ratio of 25% of headline earnings. Management also announced the approval of a R1bn share buyback programme, further confirming a change in capital allocation focus for the group. As for the financial results, an improved production performance (volumes +19%) was offset by lower PGM prices and the double digit increase in cash costs, resulting in a decline in earnings. Free cash flow was 25% higher however supporting the decrease in net debt to EBITDA from 0.97x to 0.57x. Based on production guidance, Northam remains on track to meet its medium-term target of 1m oz (FY23: 810koz).

The challenging global macroeconomic backdrop and destocking across key industries has weighed on the performance of the sector over the past year. The long-term secular headwinds faced by the industry as electric vehicle penetration increases are also a consideration. We are of the view however, that there are reasons to be constructive on the medium-term fundamentals of Northam, with its low-cost assets, robust volume outlook and improved financial position.

Sanlam – *The next phase in Africa*

Sanlam's interim results were impressive, especially given how broad-based the performance was. Pleasingly, all key lines of business delivered good y/y operational earnings performances, with the investment business being the laggard (+9%). Notwithstanding the good performance across the board, we highlight the increasing complexity of the group which introduces forecast risk. This risk is mitigated however, with appropriate disclosure.

In the Life Insurance business, both key contributors (SA & Pan-Africa), delivered solid performances. Risk experience was positive overall which speaks to appropriate underwriting and conservative assumptions. New business volumes were 4% higher, while value of new business was up 21%. Margins on new business also continue to improve. In the General Insurance business, Santam reported a recovery from a low base period which was dominated by unusually large claims such as the KZN floods. New business was up 10%, with premiums 7% higher in SA, while Pan- Africa showed pleasing premium growth of 16%. Operating profit was up 38%, with the combined India and Pan-Africa segments eclipsing the contribution from Santam.

The Investment Management business reported AuM of R924bn in Sanlam Investments as at June 2023, up from R763bn in December 2022 (now including ABSA's Asset Management business of R131bn). The retail arm of Sanlam Investments showed positive flows (R2.3bn), while ABSA's Asset Management operation reported R2bn of outflows. The wealth management business recovered off a low base (+45%), due to non-recurring IT expenditure and now manages R124bn of AuM. The Credit and Structuring business showed solid growth of 36% and contributed 16% to group operational earnings during the period. The star performer in this cluster was the Indian operations (Shriram Finance), which reported 65% y/y growth on the back of a larger loan book (now R384bn gross), improving collections, and synergies post the merger of the two credit businesses in December last year.

Regarding capital allocation, the previously announced transactions (Afrocentric, Brightrock and Capital Legacy), which are now all effective, consumed ~R2.4bn of discretionary capital. Sanlam also announced the

R2.4bn purchase of preference shares from Standard Bank, issued by the SPV that was set up for the BB-BEE deal executed in 2019. The group's balance sheet remains strong, with a solvency level of 167%. Management alluded to issuing R2bn in subordinated debt in October, to restore discretionary capital back to its minimum level.

Our investment case for owning Sanlam is premised on the group continuing to transform from a largely SA based, LT insurance focused business, to a more diversified group, across geographies & segments. Underpinned by a high return SA life business which continues to generate free cash flow to support the group strategy. The group aims to leverage its expertise into Emerging Markets, where management are taking a long-term view in growing underpenetrated markets such as India, Malaysia and Pan-Africa. The Sanlam Allianz joint venture, which became effective 4 September, is in line with this strategy. Sanlam, which represented 3.4% of the fund at quarter end, has been one of the best performing local shares year to date, which has benefited the fund.

Detailed fund attribution: Q3 2023

Top 5 contributors and detractors for Q3 2023: Overweight positions

Top contributors	Average relative weight	Performance contribution	Top detractors	Average relative weight	Performance contribution
Alphabet	4.0%	0.5%	**Prosus**	2.6%	-0.2%
Advtech	2.0%	0.4%	**Transaction Cap**	0.4%	-0.1%
Comcast	2.6%	0.3%	**Nedbank**	2.0%	-0.1%
Bidvest	2.0%	0.2%			
Alibaba	2.1%	0.2%			

Top 5 contributors and detractors for Q3 2023: Underweight positions

Top contributors	Average relative weight	Performance contribution	Top detractors	Average relative weight	Performance contribution
Gold Fields	-4.6%	0.8%	**Shoprite**	-2.5%	-0.3%
Anglogold	-3.0%	0.6%	**Glencore**	-1.5%	-0.2%
Richemont	-2.1%	0.5%	**Mondi**	-1.3%	-0.2%
Impala	-1.9%	0.3%	**Capitec**	-1.1%	-0.2%
Naspers	-4.0%	0.3%	**Exxaro**	-0.8%	-0.2%

Current positioning and outlook

The "higher for longer" interest rate narrative came to the fore over the quarter and is likely to continue to dominate markets over the next few months. The prospects of the Chinese economy and recent escalations in geo-political conflicts add to the fragile global outlook. Locally, the increasingly precarious fiscal position and ongoing challenges in strategic sectors such as energy and logistics are ongoing concerns. On the energy front however, progress on the return of key generation units at Kusile and the significant and ongoing private sector investment in the sector provide reason for optimism.

The fund's diversified holdings across businesses and industries, and meaningful exposure to offshore earnings streams – direct and indirect - has proved beneficial through the volatility of the past quarter. The fund ended the quarter with ~23% direct exposure to international markets. The fund's SA inc. exposure is concentrated in businesses we think will continue to prove resilient, despite the constrained economic environment. The top 10 positions in the fund account for ~44% of the capital, with a total of 32 holdings.

We have again over this past quarter taken advantage of the opportunities presented by prevailing market conditions, to strengthen the expected return profile of the fund. We continue to do this within the context of a prudent risk management approach. While the recent performance of the fund is encouraging, our focus remains on the long-term compounding of the fund's capital.

Disclaimer

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