NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS PROPERTY FUND

Quarter Three, 2023

Nedgroup Investments Property Fund

Performance to 30 September 2023	Fund[1]	Peer group[2]	Benchmark[3]
3 months	3.4%	-0.3%	-1.0%
12 months	7.1%	11.1%	12.9%

Market Overview

There is growing optimism that we are near the top of the interest rate hiking cycle. While inflation remains above most central bank targets, it is now trending in the right direction and there is mounting evidence that higher interest rates are finally having an impact in the United States. While the US labour market remains robust, money supply and credit extension have slowed sharply in the past quarter, suggesting a more marked slowdown in economic activity in the fourth quarter of 2023 and the first quarter of 2024. While some central bank officials are suggesting that interest rates could go higher and stay there for longer, consensus in the market is for interest rates to start falling in the second or third quarter of 2024. Heightened geopolitical tension in the Middle East and China's property market woes are also likely to contribute to a slowdown in global economic activity and prompt central bank policymakers to start cutting interest rates before inflation is within targeted ranges.

The uncertain outlook for interest rates and comments from several central bank officials that interest rates would need to stay higher for longer pushed US Treasury yields to multi-decade highs, with the 2-year Treasury yield finishing the quarter above 5%, while the 10-year Treasury yield rose 75 basis points to 4.6%. Higher debt issuance is also contributing to the spike in government bond yields, as governments have increased spending on infrastructure redevelopment and social welfare to stimulate economic growth in the face of tighter monetary policy. Against a backdrop of rising global bond yields and increased geopolitical risks, global equity markets finished the quarter lower. Chinese stocks were once again the noticeable under-performers as the Hang Seng index tumbled 5.9% in the third quarter. The tech-heavy NASDAQ index was also down sharply (-3.9%), while the Dow Jones Industrial Average was down 2.1%. The FTSE-100 index in the UK was up 1.0%, one of the very few global equity markets to register a positive return in the three months to the end of September.

Cash was once again the top performing asset class in South Africa in the third quarter, while bonds (-0.4%) and listed property (-1.0%) outperformed the broader South African equity market (-3.5%). The yields on longer-dated South African bonds tracked their global counterparts higher, creating a difficult backdrop for South Africa's listed property sector. The Monetary Policy Committee of the South African Reserve Bank kept interest rates on hold at both policy meetings held in the third quarter, suggesting that policy rates have peaked and that the next move in interest rates is likely to be lower, although the timing of that move is up for debate. A weak FY2024 outlook from sector heavyweight, Growthpoint Properties, placed further pressure on the sector towards the end of the quarter. Higher financing costs (particularly in Europe) and lower property valuations were the main reasons for Growthpoint warning that distributable income was expected to drop by between 10% and 15% in FY2024.

Delta's share price doubled during the quarter following a positive trading statement that showed the company's relationship with its major funders has improved and that longer leases with government are now being signed. Liberty Two Degrees was the other big winner during the quarter after Liberty Group offered to buy all the Liberty Two Degrees not owned by Liberty Holdings or its subsidiaries at a price of R5.55 per share, which represented a 47.6% premium to the share price on the day the announcement was made. The number of smaller REITs listed on the JSE has been shrinking following several corporate actions over the past 2 to 3 years, all of which have been done at premiums to market of around 50%.

[1] Net return for the Nedgroup Investments Property Fund, A class. Source: Morningstar (monthly data series).
[2] Peer group is the (ASISA) Real Estate General category average
[3] FTSE/JSE South African Listed Property Index

Portfolio Commentary

The Fund out-performed the peer group and the market in the third quarter of 2023. The out-performance during the quarter was driven primarily by the Fund's large overweight positions in Dipula (+15.4% in the third quarter) and Fairvest (+9.6%), as well as the Fund's small position in Delta and recently increased position in Equites (+9.10%). The Fund's large underweight position in Growthpoint (-9.5% in the third quarter) also contributed positively to the Fund's relative performance.

The Fund's position in Indluplace was disposed of during the third quarter following the conclusion of the scheme of arrangement with SA Corporate. The proceeds from the sale were invested in NEPI Rockcastle, which now represents just over 9% of the value of the Fund but makes up more than 30% of the FTSE/JSE SA Listed Property index. We have become increasingly more constructive on the prospects for NEPI given its dominant position in Romania, much smaller development pipeline and limited refinancing risk in the medium-term. The valuation also looks compelling relative to European peers.

The Fund declared and paid a distribution of 0.66c for the A class and 0.77c for the A1 class, both of which were below expectations after Indluplace opted to only pay a small clean-out distribution prior to the implementation of the scheme of arrangement with SA Corporate.

Top 5 winners and losers for Q2 2023:

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Dipula	9.01%	1.31%	Accelerate	6.22%	-0.89%
Delta	1.10%	1.10%	Growthpoint	5.67%	-0.54%
Fairvest Ltd B	9.11%	0.90%	Emira	4.17%	-0.21%
Equites	5.13%	0.45%	Grit	5.15%	-0.22%
Spear	9.24%	0.42%	NEPI	6.37%	-0.17%
Total		***4.18%***			***-2.03%***

Current positioning and outlook

The Fund continues to maintain a thematic approach to portfolio construction, favouring property types and geographic locations where fundamentals remain strong or are improving. The Fund's largest single theme exposure remains to convenience and neighbourhood shopping centres in South Africa, with very little exposure to regional and super-regional shopping malls. The Fund has also maintained a high exposure to logistics properties (through Equites and Burstone Group) and self-storage properties (through Stor-Age), while the large position in Spear maintains the Fund's above-average exposure to the Western Cape as a region. The Fund has very little exposure to the UK and Western or Eastern Europe, where rising discount rates are likely to put significant downward pressure on property values over the next 12 to 18 months. The refinancing of debt in Europe is also likely to prove problematic for several property companies, given high loan-to-value ratios and the low interest rates on maturing debt. Several companies have already warned that the refinancing of their non-SA debt is likely to lead to negative dividend growth in 2024, most notably Growthpoint.

The Fund's exposure to residential property in South Africa remains high but has reduced quite sharply following the sale of the Indluplace position to SA Corporate. The Fund has maintained a high relative exposure to residential property through Octodec, as the higher costs associated with home ownership are likely to drive rental demand for well-located residential properties, reducing vacancies and driving up market rental levels in the medium-term.

The Fund's overall exposure to office remains below the market average and is expected to remain at these lower levels given declining market rentals and rising vacancies in the sector. Most of the Fund's office exposure is in the Western Cape (and Cape Town specifically) where fundamentals are far stronger than in Gauteng or KZN.

The Fund's geographic exposure remains heavily weighted towards South Africa (73%) versus the SAPY index weight of just 48%. Within South Africa, the Fund is overweight the Western Cape as well as rural areas (through convenience retail) and is underweight urban areas in Gauteng and KZN. The Fund's weight to South Africa did reduce from 78% during the quarter, following the decision to increase exposure to NEPI Rockcastle.

This approach to portfolio construction, favouring relevant themes and property fundamentals over the size and make-up of the various market benchmarks, means the Fund can and often does look very different to the market and the peer group. This differentiation has contributed to the Fund's significant outperformance since 2020 as the pandemic accelerated the rapidly emerging trends of online shopping (negative for large shopping malls but positive for logistics and self-storage properties) and changing office behaviour (work from home and hybrid models).

Based on a combination of Bloomberg, Refinitiv, IRESS and Merchant West Investments forecasts, the current one-year forward yield on the Fund is 12.3%, with growth in that income likely to approximate inflation over the medium-term following the creation of a lower income base in 2022 and the first half of 2023. Distributions are expected to decline in 2023 because of declines in the dividends paid by Dipula B and Fairvest following corporate restructurings during 2022, as well as the lower dividend from Indluplace in the first half of the year and a return of capital from NEPI instead of the payment of a dividend. The current one-year forward income yield of the SAPY index, based on the same forecasts, is 10.6% while the yield on government's benchmark R2030 bond is 10.7%.

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
The Standard Bank of South Africa Limited is the registered trustee.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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.

DISCLAIMER

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

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.

NEDGROUP INVESTMENTS CONTACT DETAILS

Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT

Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001
WRITE TO US
PO Box 1510, Cape Town, 8000