NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Four, 2023

Nedgroup Investments Financials Fund

Performance to 31 December 2023	Nedgroup Investments Financials Fund[1]	Benchmark: FTSE/JSE SA Financials Index
3 Months	10.9%	12.3%
12 Months	20.1%	20.0%

Market Commentary

Global markets

Markets shrugged off rising international and domestic political tensions to finish the year strong. Over the course of 2023 the NASDAQ and the S&P 500 gained 44.6% and 26.3%, respectively. In the final quarter, a combination of economic and employment resilience and surprisingly good inflation numbers offered investors a welcome reprieve as the market rapidly repriced the Fed's future policy trajectory. The tech heavy NASDAQ gained 13.8% in the quarter while the S&P 500 delivered 11.7% total return. The yields on bonds with 10 years to maturity declined from 4.6% to 3.9%, resulting in gains for investors.

South African markets

After avoiding a technical recession in the previous quarter, South Africa's economy showed no clear signs of any momentum in the final quarter as loadshedding returned. Every October National Treasury updates the fiscal projections in the Medium-Term Budget Policy Statement. This year's report was notable for the clear frustration with the poor state of service delivery. Operation Vulindlela's report on progress on structural interventions undertaken by the presidency to reduce growth constraints does provide some cause for hope for 2024.

The rand strengthened from R18.92 at the start of the quarter to R18.28 at year end as global interest rate declines supported riskier markets. Government bond yields declined (10-year maturity instruments saw yields decline from 10.8% to 9.8%) over the same period; the FTSE/JSE All Bond Index gained 8.1% whilst the FTSE/JSE Capped SWIX Top 40 Index gained 8.2%. The best total return performance was recorded by the FTSE/JSE SA Listed Property Index which gained 16.4% as interest rate risks declined.

Fund performance

Despite all the negativity about world markets and South Africa, the Fund has continued to generate very pleasing results. The A class returned 10.9% for the quarter and 20.1% for the year. With this, the average return over three years is now 19.4%.

The banks and insurers in the sector reported very good growth in earnings per share (16%) and shareholder value (24%) thanks to five trends:

- continued demand for credit as the bank sector provided finance for solar energy;
- the benefit from higher interest rates, both in terms of lending spreads and returns on investment assets;
- in line with the rest of the world, very low levels of bad debts in the bank sector, and
- low levels of claims in the insurance sector proving the effectiveness of the regulatory changes passed post 2008 (banks);
- and the normalisation post the high Covid claims era (insurers).

[1] Net return for the Nedgroup Investments Financials Fund, A class. Source: Morningstar (monthly data series).

In quite a few cases the share price gains were below the earnings or value growth rate, resulting in a de-rating in terms of PE (price earnings) ratio from 10.5x to 9.7x and P/NAV from 1.75x to 1.66x. In other words, despite very good financial results, the sector was cheaper at the end of the year than at the beginning of the year.

Top/bottom contributors

Top contributors	Ave. weight	Performance attribution	Top detractors	Ave. weight	Performance attribution
Investec	10.9%	0.3%	Absa Group	9.3%	-0.3%
Discovery	-	0.3%	Trematon	1.2%	-0.3%
Nedbank	1.1%	0.2%	Nepi Rockcastle	-	-0.3%
Denker Global Financial Fund*	24.9%	0.1%	FirstRand	14.8%	-0.2%
Remgro Ltd	-	0.1%	Capitec Bank	6.6%	-0.1%

*Including the Denker SCI Global Financial Feeder Fund

Source: StatPro

Top 5 contributors

- **Investec**: Investec has generated a total return of over 220% over the past three years and as such has been a strong performer for the Fund. This mainly resulted from new managements' disciplined execution of a new focused approach, especially in the UK. We believe the share remains mispriced and hence we have kept the Fund's investment in Investec unchanged.
- **Discovery**: We currently have no exposure to Discovery as we have concerns around their financial leverage and cash generation. The results published in the quarter pointed to some improvements, however, we still have doubts around their ability to scale and grow the emerging businesses and be disciplined in their approach to capital allocation.
- **Nedbank**: The fund's investment in the Nedbank group was gradually reduced during the year to the current 1.1% holding. This does not reflect a lack of confidence in the management team nor that we dispute the very attractive valuation, but simply reflects the reality that the whole sector is so mispriced that we had to make the tough choice of what to sell. However, the introduction of a new CEO (which was well handled) and its smaller size in a very competitive landscape does weigh on the share.
- **Denker Global Financial Fund**: This fund recovered very strongly post the March 2023 panic sell-off in especially US financials after Silicon Valley Bank and Credit Suisse had to be rescued. The A class of the fund generated a 20.8% return in US$ over the 12 months (29.9% in rand) and 15.1% (11.7% in rand) for the quarter and the investments inside the fund remain very attractively priced.
- **Remgro:** We admire Remgro but due to a) the large investment in the Denker Global Financial Fund and b) the attractive valuations of the SA financial sector, the Fund is not invested in Remgro.

Top 5 detractors

- **Absa:** The Absa share was a big disappointment in 2023. This was due to the unexpected loss on and write-off of their investment in Ghanaian bonds plus having to issue BEE shares at a discount during the year. The price fall in Q4 was due to the bank warning that bad debts will most probably be higher in 2024 than previously guided. This was not unexpected and already reflected in the share price trading below the forecast December 2023 book value. Post the sell-down, it trades at a December 2023 P/NAV of 0.91x. This whilst we expect a return on capital (ROE) of +/- 15% for 2024 and a +/- 7% dividend yield. We've been using this mispricing to add to the Fund's investment.

- **Trematon:** The Trematon management team continues to add value, generating cash, and the company is well positioned for increased rental demand for commercial property in the Western Cape. However, for the moment, along with other small caps in South Africa (and indeed in most developed markets), it trades at a big discount due to its illiquidity. Given these liquidity constraints, the Fund has reduced its investment.
- **Nepi Rockcastle:** Other than Trematon, the Fund does not have any investment in the REIT or property sector. The sector is undeniably cheap, but still faces headwinds. We prefer the bank sector where we have greater visibility in terms of future earnings and valuations remain extremely attractive.
- **FirstRand:** Due to it being marginally expensive, we reduced the Fund's investment in FirstRand. Although it remains our second largest holding, selling did mean the Fund was marginally underweight compared to the benchmark, explaining the fact that it detracted from the Fund's performance. In other words, had we sold Absa shares instead of FirstRand, the Fund's performance would have been even better. Our investment philosophy at Denker Capital is to invest where we get the best combination of quality and attractive valuation. In this case, our opinion is that Absa shows more upside than FirstRand.
- **Capitec:** Capitec continued to deliver good results due to the growth in particularly its business bank and continued strong growth in transaction and other fee income. The Fund used the fall in the share price in the previous quarters to gradually increase its investment but despite the purchases remained underweight. Hence, the strong share price detracted from overall performance.

Current positioning and outlook

As mentioned above, we reduced the Fund's investment in Nedbank, FirstRand and Trematon and also took some profit on Outsurance (which has done exceptionally well since its listing on the JSE) and then sold Sasfin at the end of the year. The proceeds were directly and indirectly used to increase the Fund's investment in Capitec, Ninety-One, MMI and to start buying Absa shares.

The top five investments in the Fund remain the Denker Global Financial Fund (used to take our offshore exposure), FirstRand, Sanlam, Investec and Absa.

Conclusions

Sanlam, Investec and Standard Bank all have sizeable investments outside South Africa as do Absa, FirstRand and Outsurance. Adding the 25% investment in the Denker Global Financial Fund, this means the Fund's effective look-through offshore investment exceeds 40% - positioning the Fund well for either continued low SA growth and rand weakness, but also for the possibility of stronger SA growth and subsequent re-rating of the SA financial sector.

Despite very attractive valuations and solid operational results, investors remain hesitant to invest in the financial sector, not only in the US but globally (including South Africa). Note that the Nedgroup Investments Financials Fund delivered 20.1% in 2023 despite the misgivings about the sector.

The very attractive current valuations give us the confidence to expect continued good returns from the sector and the Fund for 2024 and thereafter.

Responsible Investment Comments

The Fund's ESG score continues to improve from its already high levels as the management teams of the financial companies focus on their ESG scores. Bear in mind that low scores are often due to negative press (eg. the competition commission's investigation into price fixing in the life insurance sector) or simply reflects the long-term nature of lending eg. a bank cannot revoke commitments it made five years ago. Important to note that in all our engagements with management teams on the topic, we are impressed by the seriousness with which they approach the complex and complicated issues. This is not always reflected in the popular press.

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.
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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.

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.

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