NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS MANAGED FUND

Quarter Four, 2023

Nedgroup Investments Managed Fund

Performance to 31 December 2023	Nedgroup Investments Managed Fund A	ASISA category average
3 months	4.56%	6.17%
12 months	4.56%	12.25%

Market Overview

Equity markets make a comeback

Global equity markets (except for China) made a comeback in the fourth quarter, spurred by fresh optimism of imminent US rate cuts following a two-year hiking cycle. Once again, the broader US economy failed to succumb to pressure from higher rates while China continued to disappoint.

South Africa's market performance remains sensitive to global and local economic data and news flow as investors seek positive outcomes for deep idiosyncratic challenges.

US headwinds building

The US is yet to slow down. Inflation continued to fall with buoyant but lower wage growth while employment and GDP growth stayed resilient. Pandemic savings, fiscal spending, fixed mortgages and the wealth effect benefit from higher property prices and equity markets more than offset the impact of higher rates.

The factors driving economic resilience in 2023, are likely to become headwinds into 2024. Consumers' excess savings for middle to lower income groups are now largely depleted and credit card delinquencies and defaults are accelerating. The lagged effect of a tight monetary policy may well be more extreme in the US in 2024 given the long term of their mortgage debt. US monetary policy is tight with one-year real rates at 2.8% relative to median rates of the last decade that were only marginally positive. Unless rates go back to zero real, even lower rates than today will still be a headwind as long-term debt reprices.

High levels of government spending growth in 2023 will likely detract from US GDP growth going forward. Falling job openings increases the risk of the unemployment rate rising from current low levels which will be negative for consumption.

The bond market is pricing 1.3% of rate cuts in 2024 and reaching a rate of 3.3% by the end of 2025. This implies the market is pricing in a soft landing and inflation stabilising back to a long-term trend in the low 2% range. US equity markets appear to be pricing in an optimistic outlook with Price Earnings (PE) ratios of more than 19.5 and punchy EPS growth expectations of 10% p.a. over the next 2 years.

US expected real returns are about 3.3% vs real bond returns of 1.8% meaning a paltry 1.5% equity risk premium. The S&P500 may have risen 25% in 2023 however the top 10 stocks accounted for 75% of this return and now comprise 35% of the index representing significant concentration risk. The equal weighted S&P500 is more reasonably priced but also offers a low return of 4.3% real relative to 1.8% from US bonds.

The US Fed estimates that 50% of real corporate profit growth between 1984 and 2020 was from a secular fall in interest rates and corporate tax cuts. This will not be repeated. A further long-term concern for markets is the significant level of future bond issuance which places downward pressure on yields.

China’s prospects uncertain

China stood out as the underperforming economy and market in 2023 and continues to face significant structural challenges. Geopolitics is weighing heavily, and inbound foreign direct investment is at multi-decade lows. The Chinese consumer remains depressed and saved more in the first 10 months of 2023, despite the economy opening.

Overall Fixed Asset Investment in China grew 2.5% year on year, helped by manufacturing and infrastructure. However, the key driver of metal demand historically has been China’s growth in property investment which declined 9%.

The Chinese Economic Work Conference in December recommitted to the “industrial economy”. There was emphasis on quality of growth and recognition that the property sector is a major economic and financial risk. Again, they reiterated that housing is for living and not speculation. Regulatory policy seemed to be easing although not consistently, as evidenced by a further gaming regulatory crackdown in December. Furthermore, a reduction of available economic data and concerns regarding the accuracy of GDP data adds additional risk to the Chinese investment thesis.

While the risks to investing in China remain high, Japanese equity is well positioned to benefit from structural and cyclical factors arising in Japan over 2023. Business friendly stock market reforms are supportive of unlocking value. Companies could face delisting if they do not improve capital allocation to boost valuations and returns. Unwinding of cross holdings should also be a positive catalyst. Returns on capital already appear to be improving and valuations are reasonable with PE’s trading in line with long run history.

Japanese wages reached a 26-year high in 2023 and are expected to remain above 2% over 2024. The Bank of Japan will maintain accommodative monetary policy unless wages exceed 3%. Against a backdrop of economic strength, the Japanese yen is one of the most undervalued currencies on a purchasing power of parity basis.

South Africa’s elections pivotal for growth

By the fourth quarter of 2023, South Africa’s idiosyncratic challenges including load-shedding had been well established with the focus shifting from short term crisis management to long term reform. The local equity market rallied in Q4 supported by global sentiment and prospects of lower interest rates however local economic challenges persist.

The outcome of South Africa’s 2024 elections, likely to be held in May, will be critical. Voter turnout and the youth vote are two key unknowns and while polls are notoriously noisy, at this stage there is alignment around an ANC outcome of between 43% and 46%. Many changes are possible before election day, but it appears likely that the result will be some form of coalition government.

SA’s economic headwinds remain unchanged with tight monetary policy likely to be in place until after the election and / or when the US Fed starts cutting rates. A reduction and stabilisation of load-shedding is beneficial for business outlook however other than tourism strength over December, consumer data remains subdued and logistics challenges weigh heavily on economic growth prospects. Transnet’s turnaround efforts are positive although complex and will take time following years of poor management.

Low economic growth continues to place pressure on fiscal consolidation, and SA will need to reduce SOE debt, or grow GDP to reach a healthier sovereign balance sheet.

Low valuations across both SA’s equity and bond markets continue to partly take account of the above-mentioned macroeconomic risks. Credit spreads on SA bonds reduced over the quarter to trade in line with the median of the last 5 years. Any further strength will likely require a decline in global rates.

Portfolio Positioning

Local valuations remain low, while signs of progress in reforming the economy and solutions to power capacity allow for some optimism.

We believe the larger SA banks offer attractive valuations and relative resilience in the current environment and we continued to add to an exposure in FirstRand. We have also added exposure to Sanlam given compelling valuation metrics and outlook.

The fund continues to focus on selective SA Inc stocks with high free cash flow yields, attractive dividend yields, and which are trading at significant discounts to their intrinsic value. The fund also maintains a reasonable position in SA bonds.

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.

Summary and outlook

As interest rates peak globally, markets are optimistic around the speed and magnitude of a rate cutting cycle in 2024. However, central banks are likely to be cautious in their approach, avoiding any chance of inflation spiking once again.

Locally, we remain exposed to Financials where we still think absolute valuations are compelling. The dividend yield of our aggregate holding is circa 8%. Domestic small and mid-cap industrials are also reflecting compelling value with a few counters trading on PE multiples of 5-6 including Motus and Supergroup. Several high quality offshore exposed ALSI listed companies are also trading on generous valuations including Bidcorp and Anheuser Busch.

Performance Commentary

Q4 was a strong quarter for both global and local equity markets as market expectation of interest rate cuts in 2024 boosted sentiment. This was particularly evident in the real estate sector and SA Property (SAPY) outperformed all other asset classes for the quarter delivering a 16.4% total return. Capped SWIX rose 8.2% for the quarter mostly driven by performance from Financials. SA Bonds had a strong quarter with the ALBI up 9.7% benefitting from a softer rate environment, while cash (STEFI) delivered 2.1% for Q4.
Exposure to domestic bonds benefitted the fund as the higher yield and softer rate environment globally supported local yields.

The local banking sector remained relatively resilient over the quarter and the fund's holdings in Investec, Standard Bank and FirstRand added to performance. ABSA lost value following a trading update and an overweight to the banking group detracted. We retain a high exposure to ABSA, given the strong dividend yield and compelling valuation metrics.

Gold stocks performed well and an exposure to Goldfields contributed to fund performance over the quarter. Exposure to Anheuser Busch also contributed well to fund performance. British American Tobacco (BTI), struggled in December as the group announced weakening profitability from the tobacco sector. The fund holding in BTI therefore detracted over the quarter.

A relatively high exposure to Sasol detracted from quarterly performance as the share lost significant value in December with lower oil prices. Pick n Pay also lost value over the quarter following a poor set of results. We believe the turnaround strategy from new management should unlock value and continue to hold a relatively high exposure relative to other SA retailers.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
R2035 Govt Bond: R2035 8.875% 280235	15.87%	1.61%	Sasol Limited	2.23%	-0.85%
Anheuser-Busch Inbev SA/N.V.	5.22%	0.78%	Pick n Pay Stores Limited	0.73%	-0.44%
Firstrand Limited	3.17%	0.62%	Absa Group Limited	6.01%	-0.40%
Investec Limited	3.29%	0.58%	British American Tobacco plc	3.42%	-0.37%
Standard Bank Group Limited	3.71%	0.47%	Anglo American plc	1.92%	-0.23%

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
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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