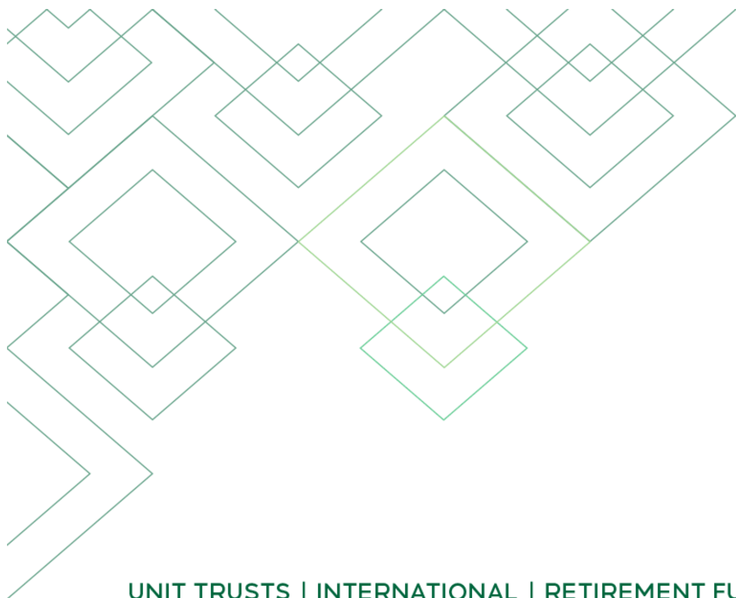

NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS BALANCED FUND

Quarter Three, 2024

Nedgroup Investments Balanced Fund

Performance to 30 September 2024	Fund[1]	ASISA Category[2]
3 months	6.04%	5.99%
12 months	14.50%	18.69%

Market Overview

The rate cutting cycle began in earnest

The US commenced their interest-rate cutting cycle with a larger than expected 0.5% cut in September. US bond yields declined, cheered on by an improved inflation outlook and more aggressive rate cut expectations. This led to a weaker dollar, which in turn benefited emerging markets, including a strengthening of the Rand. Global equity markets ended the third quarter around all-time highs, while bonds, credit and commodities managed to deliver positive returns.

The US economy, while slowing, still remains remarkably resilient as reflected in the GDPNow forecast of 2.5% growth for Q3, and continued health of the labour market. US bond yields are currently discounting a further 175bps of rate cuts over the next year and yields are therefore unlikely to compress meaningfully from here in the near term. Unlike the US, European economic growth remains depressed with PMIs in contractionary territory. This, coupled with falling inflation, has raised expectations of more aggressive European rate cuts driving European bond yields lower.

Whilst the onset of a US recession remains uncertain, the lack of structural systemic issues suggests that any potential recession will most likely be shallow. This, along with significant rate cuts and expected double-digit earnings growth, for the short term, is maintaining the high S&P 500 valuation on a PE ratio in excess of 20x. That said, medium-term concerns that could weigh on the US economy remain. Consumer savings rates are historically low and below pre-pandemic levels while government deficits are significantly higher than historic levels, and the debt-to-GDP ratio has surpassed the post-WW2 peak. Against the backdrop of a high fiscal deficit, the next governing party will have their hands tied with respect to tax cuts and spending.

China stimulates again … but is it enough?

Chinese policymakers announced a package of co-ordinated stimulus measures in late September. These were monetary, fiscal and equity market related and included the easing of monetary policy, the lowering of mortgage rates and the provision of funding to local governments to purchase property. There were also measures to support the stock market.

The Chinese equity market's positive response to the stimulus saw MSCI China's return for the quarter at 24%, bringing its PE ratio in line with its 10-year average of 11X. Commodity prices such as Iron Ore rose almost 20% post the announcement. While September's stimulus measures were more significant than those seen in the last few years, at approximately 1.5% of GDP, these are a fraction of the (successful) measures taken in previous downturns like the one in 2015. Market response therefore appears overdone.

China's depressed consumer confidence continues to weigh on spending. Encouraging banks to lend more does not solve for this. Whilst some of the policies do aim to stimulate consumer confidence, the quantum is insufficient. To date, lax monetary policy and lowering interest rates has had negligible impact. Equity market support will also be temporary unless accompanied by a change to the economic outlook.

[1] Nedgroup Investments Balanced Fund, A2-Class, net of fees.
[2] ASISA South Africa Multi Asset High Equity

In addition to what we would consider an overreaction to Chinese stimulus measures, lacklustre global industrial production remains a headwind for commodities. The JPM Global manufacturing PMI deteriorated further to 48.8 in September. However, given the collapse in refining margins which will reduce refined product supply and disappointing mine production, copper should be supported over the next year. Gold will benefit less from falling real rates and the weaker dollar (which supported gold over the last quarter) and is becoming more reliant on EM central bank purchases.

The Chinese economy remains sluggish as evidenced by lacklustre credit and monetary aggregate growth. Weak internal demand, low consumer confidence and depressed consumer spending are at least being offset by double-digit export growth. However, risks continue to build as we see further tariffs being placed on Chinese exports and continued weakness in the property market weighing on consumer sentiment. Like the US, China's hands are somewhat tied. To make a meaningful impact on their economy, they would need to deploy a level of fiscal stimulus however, this would once again place them on a concerning Debt to GDP trajectory. Unless they can find genuine return accretive projects, this could potentially create financial instability and merely result in a once-off gain. Whilst we think there will be further stimulus measures, the likelihood of these being significant, and real economy-changing, is low.

South Africa's growth outlook improves

The outlook for SA GDP growth over the next year is finally improving. While the consumer remains under pressure, several short-term growth drivers include:

- Interest rate cuts, real wage growth and the introduction of the two-pot retirement reform (Two-pot) which will benefit near term consumer spending and savings. Two-pot, implemented in September, is expected to lift consumption given embattled consumers are opting to immediately withdraw the relevant allowance. An added benefit to tax receipts, this should also help buffer any revenue line shortfall for this fiscal year

- A decline in the oil price and import volumes will benefit GDP and the current account. The fuel price dropped to 2022 lows and will continue to ease inflation. Encouragingly, the recent CPI print came in at 4.4%, well within the target band.

- Home Affairs successfully clearing 50% of the visa backlog with a focus on critical skills and tourist visas.

- A promising increase in tourism numbers. 10% more tourists in a year could add 0.6% to GDP and needs little additional capital.

- The tailwind of reduced loadshedding.

Medium term growth should be supported by additional benefits to energy supply from the renewable pipeline, political stability from the GNU (despite some fightback at some metros in Gauteng) and SOE and structural reform. Transnet Freight Rail recently announced its official split into an infrastructure manager and an operations company, paving the way for third party participation, while the new freight tariffs for the private sector should be finalised by year end. Still to come is the separation of Eskom's transmission network.

Two years of above 2% GDP growth appears to be a reasonable outcome and could well attract foreign investors into SA equity. Furthermore, company earnings expectations do not currently reflect this level of GDP growth.

A lower cost of capital has led to higher valuations of domestically exposed shares, which have meaningfully outperformed since the elections. Domestic equities, including banks and retailers, are now trading in line with their 10-year averages. Absent a significant commodity cycle, further increases in valuations will depend on the necessary economic reform to drive economic activity and growth as noted above. Nonetheless, even at current valuations, the combination of dividends and double-digit earnings growth should deliver strong returns from the domestic equity market over the short term.

Performance Commentary

South African equities continued to benefit from positive post-election sentiment in the third quarter of 2024 (Capped ALSI: 9.6%). Property was the best performing asset class (SAPY: 18.7%) while Financials (14.3%) and Industrials (11.6%) were top sector performers as SA Inc stocks continued to re-rate. SA Resources posted a marginal 1.5% decline for the quarter as late September stimulus announcements in China supported a rebound, with many mining stocks recovering previous month losses.

SA bonds (ALBI) gained 10.6% over the quarter. After more than two years of hiking interest rates, the SARB announced its first rate cut of 25 bps, a day after the US Fed eased policy with a 50bps cut. The Rand continued to strengthen over the quarter given softening US rates and positive SA sentiment. At the end of September, the Rand was at its strongest level in 2 years, at R17.26 to US$1.

Although a quarter marked by significant volatility, global equity markets ended strongly with the MSCI World increasing 6.5% in USD (although only 0.5% in Rands). Several sectors including REITs were supported by the start of interest rate reductions. Emerging Markets outshone developed counterparts again this quarter, up 2.8% in Rands. But MSCI SA stood out for its 9.7% return for the quarter, some 16.3% in US$

Naspers and Prosus rallied hard on the back of improved Chinese sentiment post the stimulus. Both stocks contributed handsomely to performance this quarter. SA banking stocks, specifically Standard Bank, and ABSA were major contributors. Continued positive election sentiment, a softening interest rate cycle and lower inflation data supported the local banking sector and the broader SA universe of shares. The fund benefitted from exposure to SA apparel retailers, specifically Pepkor.

The SA bond market also rallied, with fixed income exposure adding to fund performance.

Mining stocks continued to underperform over the quarter given lower metal prices and a stronger Rand. An overweight position in diversified miner Glencore detracted from quarterly performance. We have held the share given a constructive medium-term view on copper. While Chinese stimulus announcements led to a re-rating in September, the commodities outlook remains uncertain given a weak global manufacturing cycle. An exposure to Aspen detracted from performance as the market has been frustrated by the lack of profit visibility on their newly announced contracts.

Foreign equity exposure was negatively impacted by Rand strength. Samsung was the largest detractor from performance for the quarter, primarily due to weaker than expected prices for legacy memory chips. Prices for newer memory chips remain strong on the back of AI demand and we have maintained our holding.

Portfolio Movements

During the third quarter we maintained exposure to the larger SA banks within the SA equity allocation given strong free cash flow and compelling dividend yields as well as a supportive macro-economic environment with the softening interest rate cycle. We further increased exposure to selected SA-centric shares which was financed by reductions in our positions in BTI and Bidcorp as well as some of our offshore equity.

From a fixed income perspective, the fund has benefitted from exposure to duration. The reduction in yield was driven by a contraction in the sovereign credit spread and a fall in US bond yields. We think these have limited room to fall from current levels.

Global equity markets continued to deliver strong returns in the third quarter, as the interest rate cutting cycle commenced. We maintain an underweight in the US equity market in our offshore positions on valuation grounds and continue to focus on select exposure to European stocks which are trading in fair value territory.

South Africa’s economic growth outlook continues to improve given political stability following the election and continued evidence of reform to infrastructure, specifically Eskom and Transnet. While many SA Inc stocks have re-rated and are closer to fair value, we maintain an overweight position in domestically focused companies with strong free cash flow and compelling dividend yields.

Responsible Investing

An important development for Truffle over the quarter was becoming a signatory to the UN endorsed Principles of Responsible Investing (PRI) in August 2024.

Tiger Brands

"Listeriosis tragedy 'breakthrough' evidence makes 'overwhelming' case Tiger Brands was responsible."

Following an update on the class action lawsuit we analysed the financial impact for Tiger. The payout would range between R100,000 and R2 million per claimant. Given there are approximately 1,060 claimants, this means the total impact is between R106 million and R2.1 billion. Tiger Brands is insured for up to R1 billion. The max payment should insurance not cover would represent 4.5% of Tiger's market cap. The main issue is the reputational damage given the outcome and the length of time to finalise the lawsuit.
Positively, hasn't had any product recalls since 2021.

Truffle engaged Tiger's Board on the matter on 2 October to ensure the risk is being well managed. The Risk Committee has been bolstered since the incident and appears to be managing this effectively and are committed to the right resolution.

Glencore

A fine was announced relating to the last investigations Swiss and Dutch investigations Glencore have been facing. Glencore will pay a fine of CHF2 million and a compensation claim of US$ 150million.

We still have comfort that, as agreed with the DOJ in 2023, Glencore has monitors in place for 3 years, to ensure that processes are implemented to avoid further illegal activities.

Increased focus on social issues

- Nigeria more than doubled their minimum wage, although only 8% of the population is impacted.
- Japan proposed the highest increase in their minimum wage of 5% (targeted minimum wage).
- SA Company's Act proposed amendment to disclose the highest vs lowest earner. We are generally supportive of this stance on inequality and have seen some large companies pledge to increase their lowest salaries as a result.
- Taskforce on Inequality and Social-related financial disclosures is in the initial steps – similar to TCFD and TNFD to eventually become a large driver of company reporting.

Truffle is committed to engaging more on social issues going forward. Having engaged companies on human rights violations in supply chains in Q2, we aim to follow up on this issue in Q4.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Naspers Ltd	2.93%	0.71%	Samsung Electronics Co Ltd	2.08%	-0.58%
Pepkor Holdings Ltd	2.36%	0.62%	PDD Holdings Inc	1.75%	-0.28%
R2035 8.875% 280235	5.37%	0.61%	Aspen Pharmacare Ltd	2.41%	-0.22%
Prosus Nv	3.01%	0.52%	Heineken NV	0.65%	-0.17%
Standard Bank Group Ltd	2.91%	0.49%	Babcock International	1.48%	-0.14%

Asset Allocation	Domestic	Foreign	Total
Equity	55.51%	15.17%	70.67%
Fixed Income	9.11%	9.89%	19.01%
Property	2.42%	1.25%	3.68%
Cash	2.08%	3.30%	5.37%
Equity Derivatives	-	1.27%	1.27%
Total	69.12%	30.88%	100%

Source: Truffle, as at 30 September 24

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)..

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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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