NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Four, 2024

Nedgroup Investments Financials Fund

Performance to 31 December 2024	Nedgroup Investments Financials Fund[1]	Benchmark: FTSE/JSE SA Financials Index
3 Months	-0.2%	-1.1%
12 Months	21.8%	23.0%

Market Commentary

Global markets

Towards the end of last year, Cooper Burton, a researcher and writer at 538 (a US-based firm specialising in data-driven research and election forecasting), highlighted that by the close of 2024, record voter turnout was paired with over 80% of democracies seeing incumbent parties lose seats or vote share - a clear indicator of global dissatisfaction with governments. Across the globe voters are demanding change. The status quo is no longer good enough. Several commentators have summarised the results as an electorate seeking pro-growth reform to benefit citizens.

Despite major geopolitical and economic changes, markets proved resilient. Japan ended its negative interest rate policy in March and hiked again in July. In August, an unexpected interest rate hike by the Central Bank of Japan resulted in a dramatic market downturn.

In the US, the Magnificent 7 continued to outperform in 2024. The equally weighted S&P 500 delivered returns of 12.4%, substantially under-performing the market cap weighted index return of 24.5%. In recent years the market cap weighted index benefited from significant multiple expansion and rapid earnings growth. The US Fed started its cutting cycle but was far less aggressive than what had been expected at the start of the year as the US economy remained resilient and inflation more persistent.

The election of Donald Trump as president had a significant impact on equity, bond and currency markets over the three weeks that followed. Notably, the Euro declined by 15% against the US dollar, while other currencies like the Swedish krone and Japanese yen fell by 9%. Similarly, US banks jumped around 15% vs. Euro banks' fall of 7% (or -16% in US dollar). The dispersion between banks and insurers positioned for rising or falling interest rates was about 20%.

The MSCI World Index outperformed emerging markets with the index up 18.7% vs 7.5% for the MSCI Emerging Markets Index (in US dollars).

South African markets

The political landscape in South Africa saw significant changes. The ruling ANC not only lost ground, but also fell below 50% of the vote as opposition parties gained. Investor sentiment improved as the Government of National Unity provided potential for growth enhancing reform. This was a key catalyst in driving improved returns for local investors in the second half of 2024. Now we need to see growth friendly reforms and prudent macroeconomic policy that will translate into real economic growth.

The SA equity market delivered strong returns in 2024, aided by a more constructive economic backdrop and undemanding valuations. The FTSE/JSE Capped ALSI was up by 13.4%. Within the sectors, the SA Financials index was up 23%, ahead of the SA Industrial Index which rose by 18.5%. The resources index disappointed, recording a loss of 8.6%. Within the headline indices, the small cap index led the charge with a total return of 35.6%, outperforming the other indices for the fourth consecutive year. The mid cap index returned 15.4%, while the large cap index rose by 10.4%.

The SA government bond market out-performed its emerging market peers and delivered the strongest one year returns in over a decade. Over the quarter, the SA 10-year bond yield rose from 8.85% to 9.05% and the rand weakened from R17.26 to R18.85. The rand declined by 8.9% to the US dollar, which was in line with developed market and many other emerging market currencies.

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

Fund performance

The Nedgroup Investments Financials Fund (the Fund) closed marginally negative (-0.2%) over the quarter, but delivered excellent performance over the 12 months to December 2024 (21.8%). In fact, for the 3 years (16.1% annualised) and 5 years (12.3% annualised) to December, it outperformed the majority of SA general equity funds.

The SA banks took their cue from the weaker currency and took a knock - with the exception of Absa and Capitec. The Fund's 20% offshore allocation helped contain the damage.

The rand weakness vindicated our decision a few quarters ago to limit the reduction of the Fund's offshore exposure, despite the then attractive valuations of SA financials (refer our March 2024 quarterly commentary). Since the cut to 18%, the investment in the Denker Global Financial Fund has grown back to 20% by year end (through market performance and fund withdrawals.).

Top/bottom contributors

Top contributors	Ave. weight	Performance attribution	Top detractors	Ave. weight	Performance attribution
Denker Global Financial Fund	19.2%	1.7%	Capitec Bank	9.9%	-0.1%
Standard Bank	8.9%	0.4%	PSG Konsult	0.0%	-0.1%
Momentum	5.8%	0.2%	Quilter plc	0.0%	-0.2%
Nepi Rockcastle	0.0%	0.2%	Absa Group	4.4%	-0.2%
Reinet Investments	0.0%	0.2%	Discovery	0.0%	-0.6%

Source: StatPro. Average weights in the fund are for the 3 month period.

Top 5 contributors

- **Denker Global Financial Fund:** the global financial sector had a volatile and contrasting reaction to the US presidential election outcome: US banks geared to higher interest rates and stronger growth gained strongly, but the rest (especially European and emerging market banks) sold off sharply. Against this backdrop the Denker Financial fund declined by 2.0% while the MSCI World Financials Index delivered 4.0%, the MSCI Emerging Markets Index -8.0% and the MSCI Europe Index -2.6%.
  Price moves towards the end of December (continuing in January) showed that both the sell-off and strong upward moves were overdone, and the fund has started recapturing its lost performance. Relative to SA financials, the Denker Global Financial Fund created positive contribution.
- **Standard Bank:** Standard Bank fell 8.6% (in line with the other large South African banks). Because the Fund had a lower weight in the bank when compared to the benchmark's weight (8.9% vs. 13.7% respectively), the position helped the Fund outperform its benchmark. It's important to note that, as with the other global bank indices, this was purely a knee-jerk reaction to Donald Trump's election, which was seen as increasing the probability of higher US interest rates due to inflationary pressures. This, in turn, was expected to lead to a stronger US dollar, resulting in higher interest rates and lower growth in SA.
- **Momentum Group:** Based on a number of meetings with the management team over the past few years, we increased the Fund's holding in Momentum considerably in 2023. The decision has been vindicated, with the group reporting very good financial results. The group remains undervalued in our opinion and should re-rate further. It remains a core holding.
- **Nepi Rockcastle:** The listed property sector performed strongly over 2024, coming off a very low and undervalued base. As reported in previous quarterly commentaries, the Fund has no exposure to the sector as we prefer the more liquid, and safer, banks.

- **Reinet Investments:** Similarly, the Fund has no exposure to either Reinet or Remgro, often used by other investors to gain offshore exposure. This is due to the Fund's 20% investment in the Denker Global Financial Fund.

Top 5 detractors

- **Capitec:** Capitec was one of the few SA financials that that delivered positive performance over the quarter (+2.0%). However, it detracted from relative performance, as the Fund's investment of 9.9% was lower than the benchmark's 11.9%. We rate management very highly but, at Capitec's current strong valuation, we will wait for weakness in the share price before adding to this investment.
- **Absa:** Absa remains one of the most undervalued shares in the financial sector, trading at below its book value whilst forecast to generate a return on equity (ROE) of 15%. However, the board's track record of CEO appointments over the past 10+ years and the current vacancy does concern us in terms of Absa's continued ability to generate a high ROE. Hence, the Fund only has a 4.3% investment relative to the benchmark's 6.3%.
  However, the price jumped sharply in December when Absa reported provisional results that exceeded expectations. This is value investing 101: Shares that are undervalued reflect low expectations than can lead to a sharp re-rating when a company reports better-than-expected results. But it also brings with it the risk of continued disappointment. For the moment we will remain underweight and reassess the size of the investment after the next round of results and meetings with the management team.
- **Discovery Holdings**: As per our comments in past quarterlies, we rate the management team's ability to build businesses highly but feel that it has tackled too many projects at the same time - which increases financial risk. Hence, the Fund does not have an investment in Discovery Holdings. In December, however, management announced a change in their strategy to address our and market fears (focus on short-term delivery) causing a jump in the share price.
- **Quilter and PSG Konsult:** The Fund has no exposure to these two counters. This is not because we don't like their management teams or business models, indeed the contrary. It is simply a case of remaining focused on what we understand well.

Current positioning and outlook

Very few changes were made to the portfolio during the quarter. However, due to market movements, the FirstRand investment ended about 2% lower and the Denker Global Financial Fund 2% higher.

FirstRand's price fell following an investigation by the UK financial regulator into commissions earned on motor vehicle leasing contracts. The investigation is ongoing; however, FirstRand have raised a provision for any potential liability. They have also been granted permission to appeal two cases found in favour of clients at the UK Supreme Court.

Outlook

In SA, the past squandering of resources has resulted in a large debt burden, which inhibits further spending and needs strong action to reduce the debt levels and the interest expense bill in the budget. Therefore, financial sector returns in SA in 2025 will depend, now more than ever, on government actions. For the sector to re-rate further we need capital inflows attracted by growth and capital friendly regulation. Inflows will also help strengthen the rand and allow the SARB to cut interest rates.

Hence it is vital that, besides the debt burden, the growing water crisis in Gauteng is tackled and other hindrances and inefficiencies are removed.

The market does not have high expectations, so the financial sector generally is fairly valued. Thus, positive surprises will see further re-rating, but disappointments will lead to de-rating of the players with the largest SA component.

There are companies that have demonstrated they will grow, regardless of a poor economy, by taking market share (e.g. Capitec and OUTsurance) and an insurer like Momentum should re-rate based on its own internal actions. In addition, 20% of the portfolio is invested offshore for diversification and protection against rand weakness. The Fund has generated a compound annual growth rate of 9.1% over the past 10 years – which has been a difficult period of low growth and rand weakness. Generally, the valuations are lower now than they have been in the past 10 years. So, it is not unreasonable to expect similar returns in the future. However, stronger growth will boost the Fund's ability to generate higher returns in 2025.

Responsible Investment Comments

The Denker Capital financials team visited the executive teams of the large (and small) SA banks and insurers in 2024. One of the topics of these meetings was the role of a board of directors. This led to very insightful discussions, with the main take-aways being:

- The complexities of modern banking and insurance make it very difficult (impossible?) for directors to really understand the implications and nuances involved.
- Hence, the key roles of a board are to ask the right questions and provide insight, wisdom and guidance. For that one needs board members who have significant business experience, are informed, and are preferably well-connected.
- The most important role is for a board to ensure top level succession planning is in place (Old Mutual and Absa failed here).
- A weak board means poor or incorrect appointments will generally be made – which has repercussions for many years.

This gives more than enough food for thought for our equity analysts to think about, which they do in great detail. Good boards are seldom noticed, but it is when something goes wrong that a board proves its real strength and value.

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.

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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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