NEDGROUP INVESTMENTS

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Nedgroup Investments Global Property Fund

Quarter Four, 2020

Nedgroup Investments Global Property Fund

Commentary produced in conjunction with sub-investment manager, Resolution Capital

Indicator	3 months	1 year	3 years p.a.	Since Inception# p.a.
Portfolio*	6.70%	-4.25%	3.15%	3.76%
Performance indicator+	13.26%	-9.04%	1.52%	1.41%
Difference	-6.56%	4.79%	1.63%	2.35%

* Net USD return for the Nedgroup Investments Global Property Fund, C class. Source: Morningstar
\# 12 August 2016
\+ FTSE EPRA/NAREIT Developed Index (in USD Net Ret)

Summary points

- Breakthrough of effective Covid-19 vaccines dominated financial market behaviour, REITs included.
- Portfolio underperformed as there was a sharp rotation from "shelter-in-place" beneficiaries into real estate sectors most challenged by the pandemic.
- Remain heavily weighted to real estate benefiting from long term secular trends – data centres and logistics.
- Under exposure to "value stocks" which are trading below building replacement cost – hotel and retail.
- Underweight more highly levered REITs focussed on commodity real estate with limited rental pricing power.
- Tenant credit concerns elevated, particularly in retail property, leading to sharp increases in store closures.
- REIT rent collection trends improving, but many REITs reluctant to provide earnings and dividend guidance.
- 94% of the Portfolio as at the end of the fourth quarter has maintained or increased dividends.
- REITs do not offer the growth sizzle of other sectors, much like the late 1990's during the tech bubble.
- REITs trading at a discount to private market real estate values and began to see M&A activity this quarter.
- Office plays a critical role in employee collaboration, mentorship and business development activities.
- Gateway cities remain relevant as centres of business and culture, but the pandemic has tempered growth.
- Balance sheets generally in good shape and management teams remain disciplined.
- New building supply is one lingering concern for some segments, as elevated private market values continue to encourage developers to build.

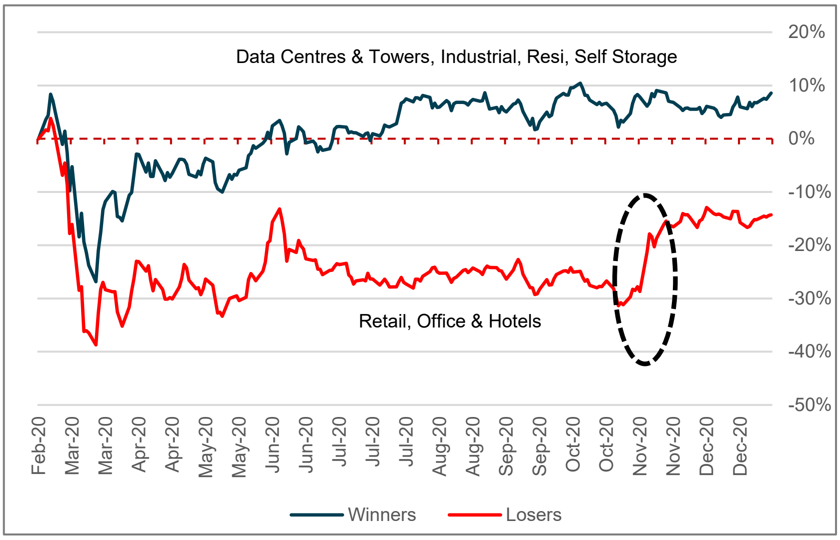
Market and portfolio commentary

Whilst the change in political power in the US was clearly significant, so too the UK's muddled exit from the EU, it was the breakthrough of several seemingly effective Covid-19 vaccines which dominated financial market behaviour, REITs included.

In this environment, a broader equities market rotation into value and cyclicals from growth and momentum quickly came into effect, particularly benefiting those sectors hardest hit by the pandemic. With stimulatory fiscal policy around the world combined with central banks determined to supress interest rates for an extended period of time, money continued to flow into equities and financial assets more broadly, while bond yields held relatively stable in the face of an increasing sense of optimism.

Successful vaccine developments provide a path to social normalisation and restoring customary business practices. For real estate, this greatly improves the prospect of returning to physical shopping, dining out at restaurants, watching movies in cinemas, business and leisure travel, and working in office business districts to a greater extent than has been possible during the pandemic.

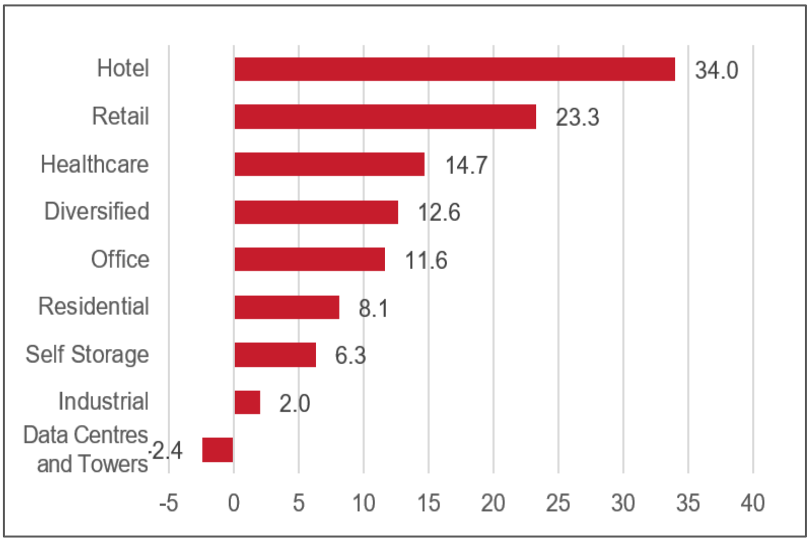
REIT winners & losers cumulative total returns



Source: FactSet, Resolution Capital

Against these developments, in producing only a modest absolute return, the Portfolio underperformed the Index for the quarter as positive vaccine news drove a sharp rotation from "shelter-in-place" beneficiaries into real estate sectors most challenged by the pandemic.

Quarter Ending 31 Dec 2020 – REIT Sector Total Returns



Source: FactSet, RCL, FTSE EPRA Developed Index (local currency)

Whilst it is not unexpected for us to surrender excess alpha when poorer quality stocks rally, the extent of short-term relative underperformance is disappointing. To what degree complacency played a part is a moot point, but one that we should not ignore. We have met our longer-term objectives but could have done better. Whilst we shouldn't fixate on an extraordinary three month or even a 12-month period, the pain of underperformance seems more intense than the satisfaction of outperforming almost regardless of the timeframe.

The substance of the quarter's performance can be explained by being somewhat caught out by:

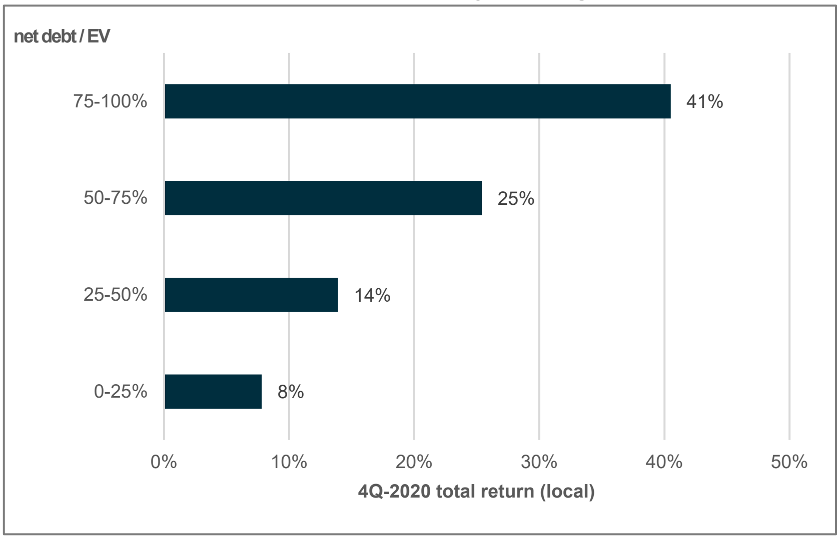
a. Remaining heavily weighted to real estate benefiting from long term secular trends, namely data centres and industrial, which the market judged had been factored in;

b. Under exposure to "value stocks" which, despite lower growth, are in some instances trading below building replacement cost (a pointer to lower supply) and should provide reasonable total returns from depressed pricing. Sectors including hotels, retail and urban apartments have bounced hard off their pre-vaccine lows and well in advance of any sign of operational troughs;

c. Underweight more highly levered REITs focussed on commodity real estate (i.e. limited rental pricing power) which enjoyed a relief rally induced by improved confidence in economic conditions and broad asset prices, together with relatively easy credit conditions. Indeed, high leverage was correlated with strong performance this quarter as demonstrated in the following chart.

We do not mind being wrong about the third aspect – high leverage ensures these stocks remain vulnerable to permanent impairment and the assets having limited intrinsic value. Their days in the sun tend to be short lived.

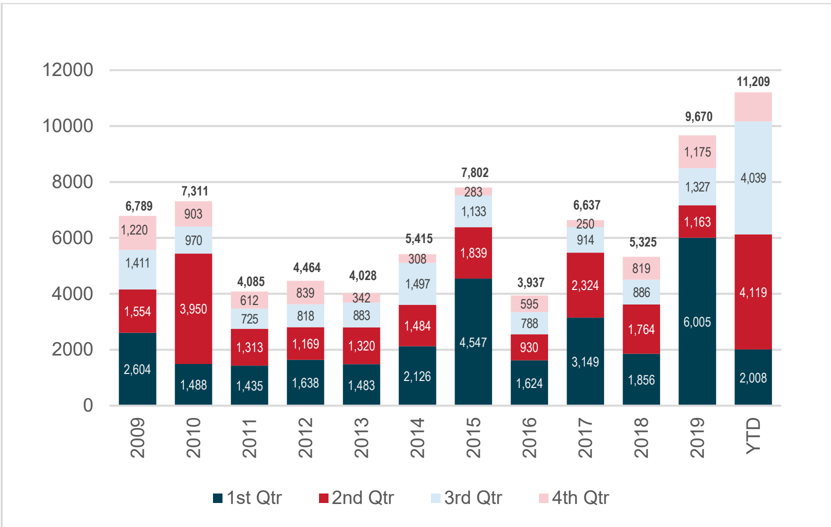
REIT 4Q-20 total returns by leverage band



Source: FactSet

Our biggest stumbling block to repositioning the portfolio more aggressively was that rental cashflow visibility remains ambiguous and, in some cases, the long-term secular headwinds have increased. Tenant credit concerns remain elevated, particularly in retail property which has already seen sharp increases in store closures. This is despite lender forbearance and huge fiscal stimulus which has seen household income actually rise in the US.

Announced US retail store closings



Source: ICSC, BofA Global Research

We remain concerned as to the scarring caused to some sectors of the economy, the permanency of changes in consumer spending behaviour and business functionality through the accelerated adoption of automation, e-commerce and remote working practices.

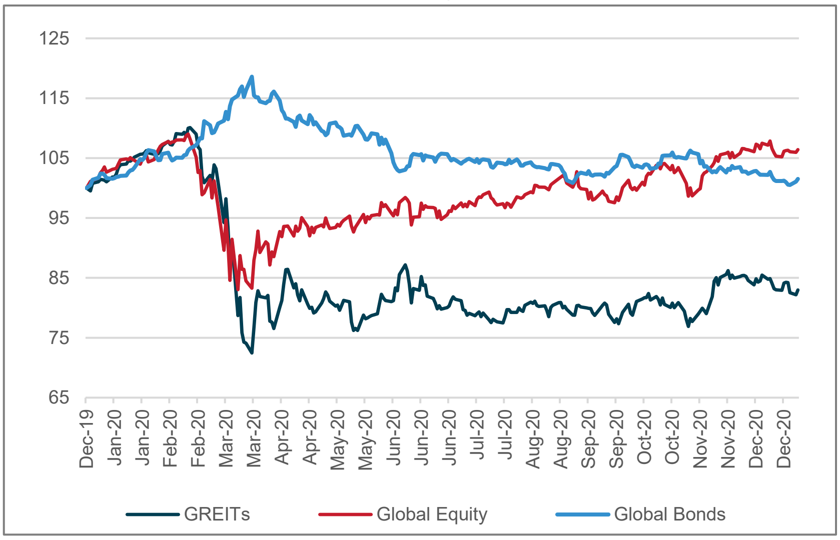
While REIT rent collection trends are improving, they remain below historic norms in some sectors, and many REITs are reluctant to provide earnings and dividend guidance.

In a case of "shoot first, ask questions later", the market is betting on the worst being behind us and an assured and orderly recovery being under way. While we acknowledge that there are elements of deep value when prices trade below building replacement cost, this dynamic can persist for an extended period of time if there is structurally weak demand as we currently see in some real estate segments.

REITs relative to Equities and Private Markets

While REITs participated in the vaccine rally, they lagged the broader equities market over the quarter and year.

GREITs vs Global Equity vs Fixed Income



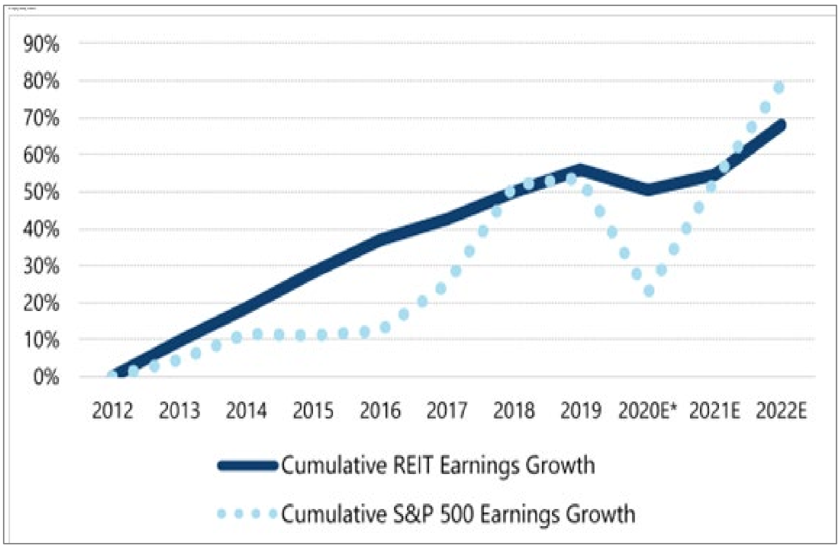
Source: FactSet, Resolution Capital; Priced @ close 31/12/2020

Global Equities: MSCI World Net Hedged Index; GREITs: FTSE EPRA Developed Net Index; Global Bonds: Bloomberg Barclays Global Aggregate Index

While at odds with the rebound of certain real estate sectors, perhaps this reflects investors questioning the relevance of some types of real estate and its ability to recover when Covid-19 has forced changes to the way occupiers use land and buildings.

An analysis of over 4,700 corporate earnings transcripts between July and December 2020 by Bloomberg found that about one in eight firms globally were re-assessing their real estate needs in an effort to cut costs. While debate rages over whether these trends will persist, earnings per share for the broader equities market are expected to rebound more strongly compared to REITs as depicted on the following chart. This belies the fact that REIT earnings fell less and have proven to be less volatile than the broader market through the pandemic.

Cumulative Earnings Growth – US REITs vs Equities

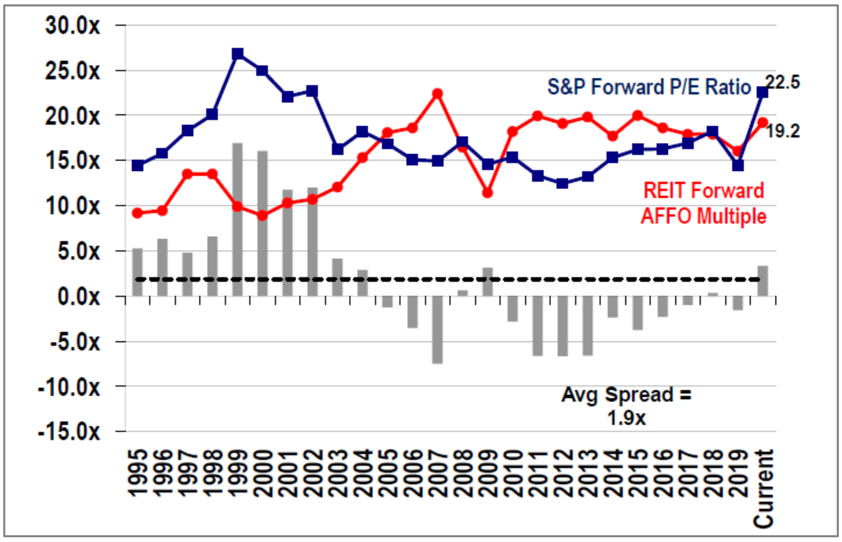


Source: Factset, Jefferies

Whilst the economic fall-out has been materially detrimental to certain areas of the REIT market, many property types, and the majority of the portfolio, have been resilient. This resilience is evidenced via dividends, with 94% of the portfolio as at the end of the fourth quarter having maintained or increased dividends through the pandemic.

REITs also screen as value relative to broader equities and bonds – but perhaps these other asset classes are simply over-valued? Or it could be that REITs do not offer the growth sizzle of other sectors much like the late 1990's during the tech bubble when REITs sagged.

US REIT AFFO Multiple vs. SP500 P/E Multiple



Source: Citi Research and FactSet, based on one-year forward multiples

Not only have Listed REITs de-rated relative to equities, they now are trading at a discount to private market real estate values. Even though transactional evidence may be more limited in 2020, as some investors and lenders put off decision making, there have been real estate transactions in recent months that were done at materially higher values than those of comparable listed real estate portfolios.

With certain listed REIT segments offering both liquidity and relatively attractive value, it is not surprising that we began to see REIT M&A activity this quarter.

Office dichotomy

Rising office market vacancy rates and conjecture around the structural impact on office buildings of working from home (WFH) continue to make headlines. The uncertainty surrounding the extent of WFH is likely to persist for some time. Our position remains that the office will continue to play a critical role in employee collaboration, mentorship and business development activities. However, the pandemic has proven the effectiveness of technology in enabling many office workers to WFH at least part of each week. Therefore, net office utilisation will likely be lower than the pre-pandemic baseline, reducing landlord pricing power.

In response, office landlords will be encouraged to offer tenants more lease flexibility and amenities – as such the asset class becomes even more capital intensive and operationally complex. Larger landlords with advantages of scale and access to capital will be better placed to take market share.

Locations which offer better quality of life, more affordable living options and business friendly regulatory and tax environments should also benefit compared to expensive and crowded cities. In the US there has been a spate of corporates weighing plans to establish a presence or relocate to the Sunbelt including Oracle, Hewlett Packard and Tesla from San Francisco to Texas, and Goldman Sachs and Blackstone from New York to Florida. This also has consequences for other real estate sub sectors, including residential and retail.

Of course commuter congestion and high cost of living have long been attributes of gateway cities and often cited as reasons for out-migration, so to some extent there is nothing new here. What is not clear is whether the pandemic has induced a step change. Our current view is that gateway cities remain relevant as centres of business and culture, but that the pandemic has likely tempered their growth.

Despite these uncertainties, private market investors seem willing to accept higher risks and lower returns. During the quarter several notable transactions took place at (or near) pre-pandemic pricing levels as summarised in the table below, including to our surprise, some with relatively short lease durations.

Recent property transactions

Asset	Sector/ Locations	Buyer/Seller	Price	Yield	Price per square	Listed market (discount) premium
510 Townsend & 505 Brannan, San Fran	Office – US	Ascendas REIT / Alexandria	US$562	4.9%	US$1,250 / ft	-30%
1&2 New Ludgate, London	Office – UK	Sunventure / Landsec	£552	4.3%	£1,420/ft	-10%
Johnson Building, London	Office – UK	Eurazeo / Derwent London	£170	4.1%	£880/ft	-15%
1 Farrer Place, Sydney	Office – AUS	APPF / GPT	A$585	4.4%	$27,500/m	-28%
400 George St, Sydney	Office – AUS	Investa ICPF / M&G	A$300	4.6%	$23,500/m	-25%
Grosvenor Place, Sydney	Office – AUS	CIC / Dexus & DOP	A$925	4.9%	$22,000/m	-20%
Renaissance LA Airport Hotel	Hotel – US	Undisclosed / Sunstone	US$91.5	6.8%	US180k	-41%

Source: Company Reports

Self-storage and a fifth 'D'

Self-storage enjoyed a strengthening operating environment in the second half of 2020 and the outlook for 2021 is for improved growth. Most self-storage portfolios are at/near all-time high occupancy levels. Demand is proving to be durable in the face of the pandemic. Proving the old adage that storage demand is driven by the four 'D' life events; Divorce, Death, Dislocation and Downsizing, and perhaps adding a fifth; 'Disease'. Limited move-outs has been the positive surprise story of the year. As a result, landlords regained pricing power as they saw little pushback on the reinstitution of existing customer rent increases, as well as reducing discounting levels for new tenants.

Investment capital remains keenly focused on self-storage, attracted by its simple business model and limited periodic capital expenditure needs.

During the quarter, there were several transactions which provided strong pricing evidence. Additionally, activist investor Elliot Associates emerged as a substantial investor in Public Storage (PSA), the largest listed self-storage owner. Soon after, PSA announced the replacement of three sitting Board Trustees, including founder Wayne Hughes. The changes coincided with publicly disclosed pressure from Elliot over the operating performance and capital allocation strategy of PSA in recent years.

Outlook

The December quarter would indicate we missed a trading opportunity to capture a vaccine induced rebound. In the longer term we believe the portfolio performance will benefit greatest by focusing on secular trends in real estate. We believe Covid-19 has served to reinforce, if not accelerate these trends: short term rebounds reflect relief that imminent obsolescence has been delayed.

While the path to ending the pandemic is now clearer, the nature of the economic recovery, the cost of the stimulus programs and the degree to which societal norms are permanently changed by the pandemic remain uncertain. To some extent, the pandemic has purged many parts of the economy, reducing cost structures and marginal competitors.

Real estate operating conditions in most markets had begun to stabilise before a surge in cases wrought more disruption. Many major cities around the world are again facing restrictions on social mobility and constraining the ability of businesses to operate normally. The roll-out of effective vaccines and ongoing policy support remain central to emerging from the pandemic.

Despite the uncertainties we see a supportive backdrop for REITs, with the sector trading at discounts to private market values and attractively valued compared to broader equities. We also take comfort that REIT balance sheets are generally in good shape (with only few outliers) and management teams remain disciplined.

New building supply is one lingering concern for some segments of the real estate market, as elevated private market values continue to encourage developers to build.

We believe the liquidity and diversity of the global REIT market provides ample opportunity to position the portfolio to house a range of segments of the global economy where real estate is an essential element. Consistent with our long-term investment philosophy, we continue to focus on holding a diversified portfolio of real estate generating resilient cash flows with robust balance sheets which provide down-side protection and a long-term store of wealth.

ESG Matters

ESG Benchmarking: it's never plain sailing.

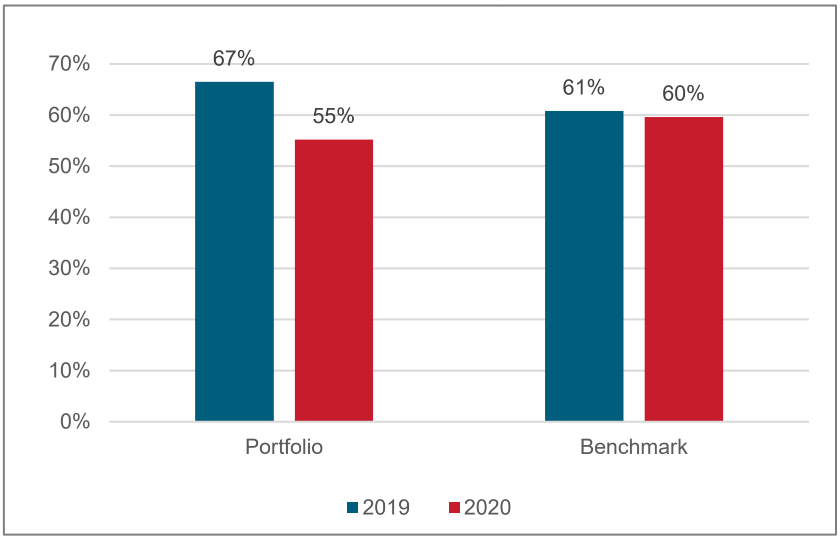
This quarter the Global Real Estate Sustainability Benchmark (GRESB) released its annual survey results, together with a suite of methodology changes.

The most significant change to the survey was the requirement that participants report various ESG metrics at the asset level, introduced to make comparisons more meaningful across different sectors. GRESB also announced that they will be replacing some of the more subjective elements of the assessment with quantitative indicators that measure actual environmental and social outcomes, a change which should make the survey less susceptible to green washing.

Whilst the shift to performance orientated metrics is relatively uncontroversial, the asset level requirement produced a great deal of pushback from participants. Consequently, some companies decided not to participate this year. Notable exits included: Vonovia (VNA), which is the largest listed owner of apartments globally, Equinix (EQIX), the largest listed data centre REIT in the world, and Host Hotels (HST), the largest listed hotel REIT in the U.S.

These exits were the main reason for the decline in the percentage of the portfolio holdings that reports to GRESB, from 67% at the end of 2019 to 55% at the end of 2020.

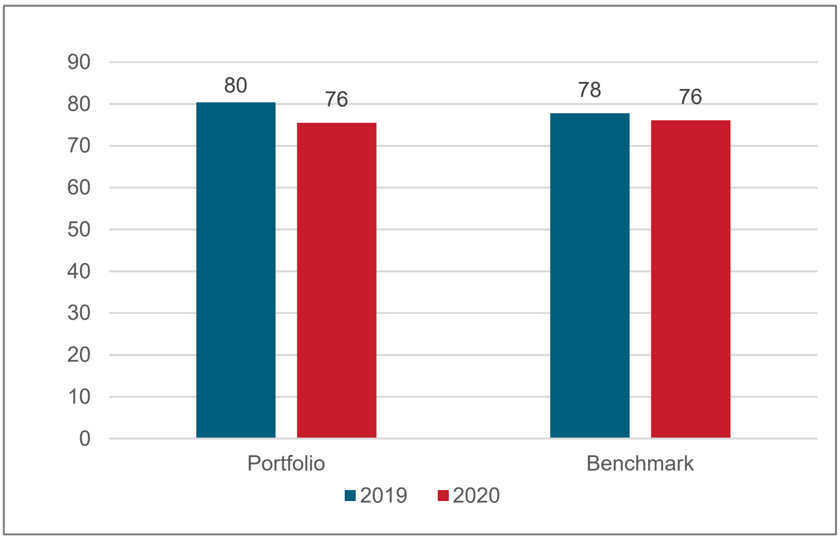
GRESB coverage



Source: GRESB, Resolution Capital

Meanwhile, the portfolio weighted average GRESB score as at the end of the year was in-line with the index at 76. The year over year decline in the portfolio weighted average score was principally due to portfolio positioning, as we decreased our exposure to the typically highly rated office sector and increased exposure to the less highly rated data centre and self-storage sectors.

GRESB score



Source: GRESB, ResCap. Percentage based on portfolio and index weights.

We have engaged with both GRESB and individual companies that have chosen not to participate in this year's assessment. We have sympathy for the participants concerns, which range from privacy issues, selective disclosure risk, and the cost of creating a whole new reporting mechanism relevant for just one of many ESG surveys they report to.

To their credit, GRESB issued somewhat of a mea culpa, simultaneously releasing a raft of governance and organisational changes to ensure that future changes to the assessment are done in a more consultative manner. Pleasingly, many of the companies we spoke to indicated they are in productive dialogue with GRESB and hope to re-join the survey in the future.

Of note, we know of several significant portfolio holdings reporting to GRESB for the first time this year, but these results were not disclosed publicly as they fall within GRESB's one-year grace period.

The changes at GRESB this year highlight some of the challenges and shortcomings of ESG ratings. We have always used third party ratings as a useful input factor in terms of company due diligence and engagement. Ultimately nothing beats direct communication with the companies we invest in to gain a deeper understanding of their ESG culture and performance.

German carbon tax

Germany introduced a carbon tax effective from 1 January 2021 on fuels used in transport and for heating buildings. According to energy market research group AEG, existing buildings accounted for approximately 15% of Germany's greenhouse gas emissions in 2019.

Initially the tax is fixed at €25 per tonne increasing to €55 per tonne by 2025 and thereafter moves to market-based pricing. At this point it is not expected to materially impact landlord cashflows even if the tax burden is to fall entirely on them. Nevertheless, landlords argue that for the carbon tax to be effective in reducing emissions, it should be paid by tenants such that it influences their behaviour. Whilst this perspective has merit, we believe landlords should also be motivated to continue improving the energy efficiency of their assets via renovation, increased electrification of buildings and use of renewable energy.

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FEES

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NEDGROUP INVESTMENTS CONTACT DETAILS

Tel: toll free from South Africa only 0800 999 160

Email: helpdesk@nedgroupinvestments.com

For further information on the fund please visit: www.nedgroupinvestments.com

OUR OFFICES ARE LOCATED AT

First Floor, St Mary's Court

20 Hill Street, Douglas

Isle of Man

IM1 1EU