



**NEDGROUP**  
INVESTMENTS

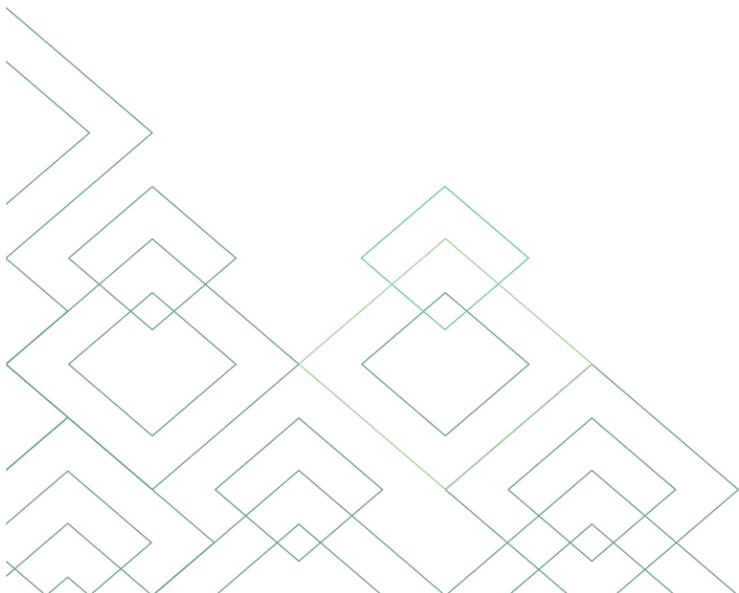
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# **NEDGROUP INVESTMENTS** **FINANCIALS FUND**

Quarter Three, 2021





Performance to 30 September 2021	Nedgroup Financials Fund	ASISA SA Equity Financials
3 Months	8.9%	11.5%
12 Months	49.2%	47.2%

## Market Commentary

The global economy recovered strongly and that growth brought with it inflationary pressures, driving a combination of increasing demand and supply bottlenecks. Specifically, energy and other commodity prices have been very strong. This helped the rand to continue its recovery from its oversold level in March 2020 gaining 9.8% in the 12 months to 30 September 2021.

Over that 12-month period the FTSE/JSE All Share Index (Alsi) was weak compared to its global peers partly as a result of sharp declines in the Naspers and Prosus share prices, driven lower by the unexpected market interventions of the Chinese government and hence the Alsi gained 23.2% relative to the FTSE/JSE Financial 15 Index's 49.7%. For the three months to September 2021 the Alsi declined 0.8% vs the 12.7% gain of the financial index.

## Fund performance, contributors & detractors for the past quarter

The rebound in GDP growth and (moderately) higher inflation are positives for the financial sector as it leads to better loan growth prospects and the possibility of higher net interest margins should the Reserve Bank move to hike rates. However, the recent riots on top of our already slow Covid-19 vaccination rate and high Debt/GDP ratio has stalled our potential growth rate. Despite this, the IMF has raised SA's 2022 GDP growth rate to 5% off the low base from 2020, but this comes off a depressed base.

The banks have all reported good results (post June quarter-end), mostly driven by a better than expected provision experience. Whilst relatively muted, loan growth has been predominantly retail driven. All of the banks have excess capital and reserves and have started paying dividends again.

The current quarter was dominated by the effect of the riots and so the financial results to June do not yet reflect this, hence for the quarter the returns of most bank shares were negative – with the exceptions of Investec (due to rand weakness) and Capitec. The table (below) shows the top 5 contributors.

In all but one case it was our decision to not own certain stocks that benefitted the fund. We remain circumspect of the investment case for property stocks hence our decision to not own Growthpoint or NEPI Rockcastle. However, we remain alert should we feel the margin of safety is attractive enough.

Our overweight in Investec resulted in a positive contribution as the Group reported strong results during the quarter whilst we still feel it remains undervalued despite delivering a 20% return for the quarter.

### Five investments detracted with negative or below index price performance this quarter.

- Our large investment in PSG Group detracted this quarter after a very stellar period leading up to June. We are attracted by the diversified nature of the business and the quality of management but are watching developments closely especially after the unbundling of its most successful investment in Capitec.
- The fund sold its investment in Old Mutual after the Peter Moyo case highlighted its extremely poor corporate governance (the board appointing a CEO and allowing him to remain CEO of a related but conflicted company). This meant we missed out on the short-term rerating during the quarter but remain unconvinced by the longer-term investment case at this stage.
- We have reduced our JSE position but remain overweight and this has been a detractor. The outlook for the JSE is challenged given the lack of market breadth and inability to diversify revenue streams in such a concentrated market. However, it is considered a defensive element of the portfolio especially in volatile market conditions.
- Sasfin is another detractor and the share price has been very volatile given its illiquidity and remains very geared to SA's economic recovery and especially that of the smaller and medium sized businesses. In the meantime, its wealth management business is growing and showing good returns.
- Despite its almost 10% return for the quarter, the investment in the Denker Global Financial Fund detracted despite the weaker rand (due to the 11% return of the index). We believe global growth prospects are more attractive than local currently and have therefore consistently maintained a c.20%



exposure. In our assessment, the Denker Global Financial Fund still offers attractive upside and is a good rand hedge for the fund.

Top 5 Contributors	Weight Mean	Return in Rand	Contribution
Growthpoint	-	-4.03%	0.52%
Reinet Investments	-	2.65%	0.25%
Investec	6.14%	19.5%	0.22%
Quilter PLC	-	-0.13%	0.21%
NEPI Rockcastle	-	6.41%	0.16%

Top 5 Detractors	Weight Mean	Return in Rand	Contribution
PSG Group	6.19%	-7.04%	-1.12%
Old Mutual Ltd	-	24.68%	-0.50%
JSE Ltd	3.92%	-1.99%	-0.49%
Sasfin Holdings	2.44%	-4.11%	-0.45%
Denker Global Financials Fund	19.56%	9.65%	-0.45%

## Portfolio Changes, current positioning and outlook

We made a few changes during the quarter, most notably increasing our exposure to Absa whilst taking some profits in Investec, JSE and Coronation.

### Outlook

The global outlook continues to improve and in many cases the supply shortages are causing sharp price increases resulting in inflationary pressure. Based on current macro developments the probability is (very) high that both short- and long-term interest rates rise which will end a 30-year downward trend in interest rates. If this happens, the world and 'what's worked and not worked' in investments will dramatically change. Warren Buffett says "*higher interest rates have the same effect on markets that inflation has on matter*". If interest rates do indeed move higher for a few years it will reveal many injudicious capital allocation decisions and result in a derating of growth shares trading at very expensive valuations. The financial sector (and in the medium term the energy sector) will be big beneficiaries as we move past this inflection point.

For South Africa this scenario won't be as good. Whilst higher commodity prices will be a big boost to our trade balance, budget deficit and also our debt/GDP ratio, globally higher interest rates could mean outflows unless we hike interest rates as well which is a negative for our budget deficit and could place a dampener on growth if the SARB chooses to hike too quickly.



## Conclusion

The financial sector is well placed and offers attractive valuations at current levels. The sector is generally very well capitalised and has made big strides in reducing its cost base. So, based on our outlook and the valuations we remain confident that the sector will continue to generate good returns for investors.

As we've said consistently this year: the biggest boost in terms of growth and the sector would be strong and meaningful government reform policies. Successfully delivering on this agenda would restore investor confidence and free up the private sector to create jobs. Unfortunately, that is unlikely to happen in the run-up to the election.

## Responsible Investment Comments

We've been commenting in the past few quarters on how banks in SA and globally have been reacting to pressure curtailing funding to ecologically damaging industries – specifically coal mining. Warren Buffett and bank CEO's have also consistently warned that whilst it is imperative that we embrace the right policies, doing it too quickly can have disastrous effects on economies and societies. These warnings are now coming true and we're seeing the shortage of energy supply putting significant pressure on commodity prices, especially that of coal (up more than 300%). In Europe this means the price of energy for warming has risen more than 80% and this shortage will persist for a few years unless coal mines increase supplies. The managements are however saying they can only do this if they have certainty that they will be able to deliver the larger quantities for a few years. This is adding to inflationary pressures and hence the need for higher interest rates.

It does highlight that economies are intricate systems and it is dangerous to make changes too quickly without carefully considering the second-round effects, especially in South Africa. We note that the SA banks have stated their intentions of reducing exposure to coal projects. But this has to be conducted in an orderly manner to avoid any economic or political strain. Their stance of not funding any new coal projects is correct but calling an immediate halt to existing financing would jeopardise SA's macroeconomic prospects.





## 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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