NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter Four, 2021

Nedgroup Investments Opportunity Fund

Performance to 31 December 2021	Fund Performance[1]	ASISA category average[2]	FTSE/JSE ALSI
3 months	11.4%	6.7%	15.1%
12 months	31.2%	17.3%	29.2%

Market overview

It has been two years since the world learnt about the outbreak of a coronavirus strain in Wuhan, China. What followed is now well documented and we are still dealing with the after-effects and ever-increasing mutations of the COVID-19 virus. Yet most global stock indices are at, or close to, all-time highs. This asset price inflation has of course been driven by huge global monetary and fiscal stimulus.

It was a good year for risk assets. The MSCI World Index rallied by 21.8%. It is worth noting that the strength of the MSCI World Index was driven by a fairly narrow set of companies - the six largest companies listed in the US (Apple, Google, Microsoft, Facebook, Amazon and Tesla) gained 41% on average for the year - an outsized contribution given that combined they have a larger market capitalization than any other stock market in the world! This lack of market breadth suggests a crowding in these popular areas of the market and that some caution is warranted. Emerging markets, in contrast, retreated 2.5%, primarily on the back of waves of Chinese regulatory reforms that look set to undermine corporate profitability and dent investor confidence.

On the local front we finally had some joy. The FTSE All Share index gained 29.2%, with solid returns posted from all the major sectors. Despite the strong year (the first in many), the local market still appears reasonably valued, with no real signs of any excesses building up yet.

Over the course of the year we've spoken about reflation, stagflation and stimulus, but what's clear now is that we have ended up with good old inflation. The non-transitory kind. Global central banks have taken note, but markets so far have largely ignored the introduction of tighter monetary policy toward the end of the year. What is certain however, is that 2022 will experience significantly more tightening, both in terms of asset purchases and potential rate hikes. A more challenging year may play out in 2022 given the combination of this stimulus withdrawal and the high overall starting market valuations in many geographies.

Portfolio Commentary

The Nedgroup Investments Opportunity Fund produced a net return of 31.2% for the year, which was pleasing in both absolute and relative terms (peer-group + 17.3%).

Mid-2021 marked the 10-year anniversary of the Opportunity Fund. For the 10 years ending 31 Dec 2021, the Fund has a produced a satisfactory net return of 10.6% pa, which compares favourably to the peer-group return of 8.7% pa and positions the Fund among the top cohort of peers. Performance is not linear and there have been times where investors patience was tested. We are extremely grateful to the investors who have supported us through the years.

Our investment approach of sensible asset allocation and stock selection, combined with searching beyond the traditional to try and add value via a broader range of assets and strategies, has been consistently applied over the first decade of the Funds existence. This approach enables us to construct portfolios from a more diversified

[1] Net return for the Nedgroup Investments Opportunity Fund, A class. Source: Morningstar (monthly data series).
[2] ASISA Multi-asset medium equity category.

set of risk premia (sourced from areas of the market where fewer people are looking) in an attempt to improve risk-adjusted returns for investors. These strategies include the ability to analyse business across the capital structure and invest in hybrid securities where the most favourable risk-reward payoff exists (our convertible bond exposure, for example, has made a material contribution to returns over the years); the inclusion of quality smaller and mid-sized business in the portfolio that can add value over a full market cycle; the bespoke structuring of investment notes to produce pay-off profiles that align with the objectives of the Fund; and the inclusion of cost-effective hedging strategies (at an individual security or asset class level) to help manage risk.

We will continue to work hard to further refine and improve our approach in the hope that we will continue to deliver satisfactory results for our investors over the next decade.

Top 5 winners and losers for Q4 2021:

Top contributors	Performance contribution	Ave. weight	Top detractors	Performance contribution	Ave. weight
Royal Bafokeng	3.42%	3.00%	Turkish Lira bonds	-0.27%	0.42%
British American Tobacco	1.07%	8.71%	Balwin Properties	-0.11%	1.20%
African Rainbow	1.01%	1.80%	KAP Industrial	-0.08%	0.67%
ABAX Global Equity Fund	0.48%	4.69%	AVI Ltd.	-0.06%	0.60%
R2040 bond	0.29%	5.12%	S&P 500 hedge	-0.06%	0.04%
Total	**6.26%**				**-0.59%**

Top 5 winners and losers for CY 2021:

Top contributors	Performance contribution	Ave. weight	Top detractors	Performance contribution	Ave. weight
Royal Bafokeng	6.37%	3.10%	Naspers	-1.17%	5.84%
British American Tobacco	1.88%	8.09%	Balwin Properties	-0.38%	1.46%
EURO STOXX 50 note	1.32%	2.72%	Turkish Lira bonds	-0.27%	0.10%
ABAX Global Equity Fund	1.20%	4.75%	SSACB1 5.25% 261125	-0.18%	0.20%
Merafe Resources	1.01%	0.80%	S&P hedge	-0.09%	0.01%
Total	**11.79%**			**-2.09%**	

Royal Bafokeng was the biggest contributor to our performance over the last 3 months as well as over the last year. Our early investment into the convertible bond and the subsequent conversion into the equity rewarded the Fund well as a bidding contest developed for this prized asset between Northam and Implats. We have significantly reduced our position from a risk management perspective.

One of our portfolio “albatrosses”, namely British American Tobacco, came through strongly over the last 3 months culminating in a strong quarterly and annual contribution to returns. Despite this strong contribution we remain extremely optimistic about their future prospects as the benefit of de-gearing, growth in reduced risk products, share buybacks and a supportive dividend yield and valuation continues to support their outlook.

Abax Global Equity, managed by Steve Minnaar, was one of the top 5 contributors over both 3 months and one year as the Fund continues to build on the good established track record.

The only notable detractor to mention is Naspers. The severe under-performance of Naspers and Prosus on the back of increased regulatory intervention in China was countered by the hedges we held as protection on some of our larger positions. Post the sell-off in Tencent and Naspers, we view the risk-reward outlook to be more balanced taking into account the higher regulatory risk.

Current positioning and outlook

During the year, the focus shifted to rampant developed market inflation and the subsequent move by central banks to withdraw stimulus/liquidity at a faster pace than originally expected. We still believe central banks have thus far managed this process well but admit that 2022 will be more challenging given the overall reduction in global stimulus, the move to higher rates and high overall market valuations. We think a slightly more cautious approach is warranted at this juncture and retain a well-diversified portfolio with a more defensive bias than that with which we began 2021.

The largest change to the portfolio over the year was a significant increase in our bond exposure to the current allocation of 24%. We believe local nominal bonds are attractively valued. With medium-term inflation expectations at around 5%, 10-yr bonds infer a risk premium of about 5% - a level more typically associated with equities! Over the course of 2021, strong commodity prices led to good export revenue, tax revenue over-runs and a fiscal picture that benefitted significantly from this windfall. On the back of this, Fitch unexpectedly changed South Africa's credit rating outlook to stable from negative in December while keeping the rating at BB- citing improved fiscal and credit metrics as reasons for the change. The improved fiscal position (debt/GDP ratio now peaking at around 78%) anchored inflation expectations and low (albeit rising) global bond yields makes the SA bond risk premium seem excessive at these levels.

The increase in bond exposure has largely been funded through a reduction in equity exposure. As previously mentioned, quite a few holdings were subject to corporate action which effectively prompted us to realise the value of those holdings. These include Royal Bafokeng, Imperial, Vivo and Long for Life. We have also trimmed some of the holdings that have performed exceptionally well over the period in order to reduce their weightings and lock-in gains.

There is still an opportunity for a further re-rating in local equities as the South African equity market continues to trade at a significant discount to its own history as well as other global markets. We also take comfort that the Fund continues to invest in a diversified range of high-quality businesses.

We believe US equities are on the expensive side. We prefer more rationally priced European and Emerging market equities to their American counterparts. Our global equity composition reflects these considerations, but as always, we stay mindful of having a well-diversified portfolio of assets.

Conclusions

Having started the year fully weighted to risk assets, we have used the opportunity of strong market conditions to rotate to a more balanced portfolio in terms of asset class allocations. We still retain a healthy weight to equities, we have a decent exposure to SA bonds that we believe can deliver healthy real returns, and retain exposure to some interesting hybrid opportunities that we feel can provide equity like returns with lower risk.

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.

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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DATE OF ISSUE
16 October 2019