NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS MANAGED FUND

Quarter Four, 2022

Nedgroup Investments Managed Fund

Performance to 31 December 2022	Fund[1]	ASISA Category[2]
3 months	7.17%	6.91%
12 months	10.19%	-0.17%

Market Overview

China reopening gathering steam

The much-anticipated reopening of the Chinese economy ignited markets as the Chinese government, pressured by social unrest, adopted a surprising full-scale reopening of the economy as opposed to an expected slow-phased approach.

By the end of the quarter, the economic environment appeared to be shifting in a more business-friendly direction, in stark contrast to the unfriendly tone of the 20th Communist Party Congress held in October. Alibaba's subsidiary Ant Financial has been permitted to take up a capital raise, although founder Jack Ma has had to surrender control; whilst new game releases have finally received regulatory approval. The Chinese property sector, plagued with challenges over the last two years, will also receive more stimulus with plans for the relaxation of borrowing restrictions for property developers.

The sustainability of a more business-friendly environment in China remains to be seen. In the interim markets, seem to be giving China the benefit of the doubt with asset valuations rapidly accelerating in the last 2 months.

Chinese equities and foreign companies benefiting from the reopening and regulatory changes have seen a significant increase in valuations. JSE shares include Naspers/Prosus, diversified miners that have benefited from a higher iron ore price, and Richemont, which will benefit from a recovery in Chinese spend on luxury goods. Our exposure to China's reopening has been primarily via the Mining and Luxury sectors.

Emerging markets should benefit from China reopening its economy via improved commodity prices and demand for goods from emerging markets. Flows into EM markets as a result of this often benefits South African markets. This benefit might be more tempered than has historically been the case given our struggling economy.

US equity valuations facing headwinds

Market participants mostly expect a recession in 2023 which has become more likely given persistent inflation coupled with stringent monetary policy. Interest rates are expected to decline to 3% in 2 years with the US market pricing for inflation to return to approximately 2% by the end of 2023 and remain there. Long-term real rates are priced at approximately 1.4% which seems a reasonable level relative to sustainable US economic growth.

However, the risk of inflation staying elevated compared to levels over the last few decades seems high given that globalization benefits are no longer present. In the short term, a tight labor market will also keep the pressure on inflation (via wage inflation above 4%) once the benefit from goods deflation is worked out of the base over the next year.

Real yields staying elevated means falling bond yields are unlikely to be a source of help for equity markets. Currently, the equity market valuation does not appear to be reflecting a higher real yield environment. The S&P500 Price Earnings (PE) of 16.8x is in line with the average of the last 10 years when real rates averaged 0.35%. A multiple of 14x would be more reasonable assuming real rates remain above 1%.

If we use a lower earnings base than what appears to be captured in the optimistic consensus earnings forecasts, this will raise the PE further to over 18x. The US economy is slowing down indicated by weaker economic data (PMIs and ISM metrics), however, the market is not pricing for any meaningful slowdown.

Over the long term, there are several headwinds that could weigh on US earnings expectations including:

[1] Nedgroup Investments Managed Fund, A-Class.
[2] ASISA South Africa Multi Asset High Equity

- Higher taxes to fund growing budget deficits
- Less government spending
- Deglobalization may well depress profits if higher costs cannot be passed on to consumers
- Higher interest and debt funding costs

The US market is approximately 60% of the global equity market and may weigh on the overall market, however, equity valuations in other regions are reasonable relative to history. In the short term, a reopening of China and lower energy costs will be positive for European and Emerging Markets equities.

SA's persistent power pressures

Loadshedding increased and will continue to weigh heavily on the SA's economy placing further cost pressures on corporates and consumers (especially the lower LSM groups) over the next year. The resignation of the CEO is clearly disappointing.
On the political front, the positive outcome of the ANC elective conference helps offset some of the negative fallout from the well-publicised Phala Phala incident. President Cyril Ramaphosa will need to make a second term matter if SA is to escape a growth quagmire. The noise and uncertainty regarding the future leader who will ultimately replace Cyril Ramaphosa will amplify from here. This might be more of a medium-term concern.

We have positioned the portfolio more in favor of offshore exposed counters as a result of the concerns expressed above. However, we do concede that valuations of many domestically exposed shares are relatively cheap, and we therefore maintain some domestic exposure. Financials may deliver muted earnings growth but will pay out generous dividends over the next year. China's reopening is positive for commodity prices which should help our current account and budget deficit. This should help ameliorate some of the pressure that the rand would otherwise face. This should also be positive for domestic bonds.

2023 outlook more challenging

Globally, several factors driving the bull markets of the past decades have changed. From an interest rate perspective, any significant declines in long rates will likely be accompanied by recession while the disinflation benefits of deglobalization that helped lower rates are unlikely to repeat. This will have negative implications for equity and housing markets. More reasonable valuations outside of the US will ameliorate some of this pressure in respect of global equity portfolios.

Fiscal positions have weakened, and budget deficits and debt levels are high in many of the world's large economies. The need to reign these in will not be positive for global growth. We've seen the first sign of bond markets acting against reckless deficit spending by a developed market with the resultant resignation of the UK prime minister and Chancellor of the Exchequer. The desire from the world's Treasuries for higher inflation to erode debt levels versus Central Bank mandates to rein in inflation could be a source of additional volatility.

Geopolitical tension with the potential increased conflict between large powers and the rise of populism is difficult to quantify. They will also create volatility as witnessed in 2022.
Valuation opportunities will no doubt arise as the above factors play out. This will require a more dynamic investment process.

Locally, positive political moves and an ability to repair power issues remain the biggest challenges to the 2023 growth trajectory.

Portfolio Positioning

We maintained our exposure to Investec and remain overweight banks. We have been building a position in Anheuser-Busch as they would be well-positioned into a weakening dollar and the valuation is compelling. We switched some British American Tobacco into Anglo American to better position for the China reopening.

We continued to reduce exposure to consumer retail given the weakening SA economy and further reduced our holding in MTN as Nigerian forex markets look increasingly fragile.

Performance Commentary

Market volatility continued over the quarter however South African indices ended the quarter strongly with the Capped SWIX up 12,2% and the ALBI up 5,6%. Stronger equity performance was largely driven by the Luxury, Resources and Technology stocks as investors responded to China's surprising full-scale reopening.

We maintained exposure to domestic equity and fixed income over the quarter in favour of cash given many SA shares still offer meaningful value while the 10-year bond still offers a compelling real yield.
Meaningful exposure to Investec contributed positively to performance although local banks came under some pressure in December as markets priced for political uncertainty. We remain overweight banks and especially like banks with credit exposure to the higher income groups given their ability to stay resilient during a recessionary environment.

British American Tobacco detracted as the defensive nature of the share underperformed in a risk-on market.

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Investec Limited	3.46%	1.52%	Thungela Resources Limited	0.74%	-0.33%
Impala Platinum Holdings Limited	3.50%	0.80%	Sasol Limited	4.00%	-0.28%
Absa Group Limited	7.69%	0.76%	Mondi Limited	0.34%	-0.12%
Glencore plc	3.97%	0.75%	Sanlam Limited	1.88%	-0.10%
R2035 8.875% Govt Bond	12.54%	0.72%	Telkom SA SOC Limited	0.21%	-0.10%

Responsible Investing:

Mining and resources
We are continuing to engage with mining companies, especially those in the platinum and gold sectors, on the risks of tailings dams, with specific reference to safety issues, additional capex spend that might be needed and environmental impact studies.

In 2020, we engaged with Anglo American Platinum and discussed their specific plans and progress in reducing their carbon footprint. They will switch out of their diesel trucks (one of the biggest emitters of CO2 on the mines) for hydrogen trucks. These trucks will be rolled out to the rest of their mines. We also engaged with Exxaro on their Scope 1, 2 and 3 emissions and their strategy around reducing these emissions with their Cennergi (Wind power) JV.

Sasol Ltd
We met with various Sasol executives in 2019 to discuss their carbon footprint and how they could reduce this given their specific chemical processes. The meeting also covered how they could improve on their carbon disclosure vs. global peers. Sasol undertook to provide a more comprehensive report on their impact on climate change by 2020. They also undertook to improve their carbon footprint disclosure. We have attended multiple decarbonisation conferences globally which we use to benchmark Sasol and provide feedback to the company in this regard.

Following that meeting in 2019, we went through their 2020 Climate Change report and attended a group ESG meeting in June 2021 to discuss the level of ambition in that report. Sasol stated that they were aware that their commitment of reducing greenhouse gas emissions by 10% to 2030 might fall short of expectations. They were in the process of revising these targets and would give further detail at the Capital Markets Day later in the year.

We noted the increased ambition in Sasol's Capital Markets' Day in 2021 – from 10% emissions reduction by 2030 to 30% reduction. After engaging them on a number of climate-related topics, Sasol were planning to table their own climate change resolution and explained the main driver behind the increase in ambition. We had some concerns around how their more ambitious climate targets would come through in remuneration, and whether the right people were being incentivised in the right way.

Give the ESG concerns facing fossil fuel producers, we have set internal limits as to our maximum active position we would take in Sasol in the portfolios. These limits are set at a much lower levels than we would have been the case historically.

Naspers
Over many years we have engaged with Naspers management and industry specialists on many of the issues around the control structure of Naspers and its low voting N shares. This means that shareholders have little sway over effecting the necessary changes within the business. We also raised concern around the re-election of BJ van der Ross, MF Phaswana and RCC Jafta as their years of service have now rendered them non-independent.

We have consistently voted against endorsing the Naspers remuneration policy, as well as amendments to any of the share incentive schemes. Many of these concerns raised are not new and have been part of the broader Naspers governance debate for quite some time.

In June 2021, Truffle teamed up with 35 other managers to question the complex shareholding structure and lack of management alignment in the new Naspers/Prosus deal. We found several aspects of the proposed transaction problematic. We were of the view that it introduces elements which serve to increase complexity in the overall company structures, thereby reducing the likelihood of further value unlock, whether immediate or longer-term. The collaborative engagement was a way to escalate our commonly held concerns directly with the non-executive directors of Naspers and Prosus.

In addition to those core matters, we also had concerns over the more commercially based aspects of the proposed transaction, including the exchange ratio in respect of the Naspers share offer and the future potential tax liabilities. The engagement was unsuccessful since the transaction went through, but we managed our risk through the portfolio construction process.

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.

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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