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NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter One, 2023





Nedgroup Investments Opportunity Fund

Performance to 31 Mar 2023	Fund Performance ¹	ASISA category average ²	FTSE/JSE ALSI
3 months	2.8%	4.0%	5.2%
1 year	12.9%	5.6%	4.9%
3 years	22.2%	12.9%	24.2%
5 years	11.0%	7.4%	10.4%
10 years	9.6%	7.2%	10.2%

Market overview

The beginning of the quarter saw strong financial markets, and it looked like the difficulties of 2022 were potentially behind us. True to form, however, the woes of inflation and the extreme pace of interest rate hikes added to stresses in economies with a resulting increase in volatility. Overall though, equities still performed well with the S&P 500 returning 7.5% for the quarter, the MSCI EM returning 4.0% and the FTSE/JSE All Share Index returning 5.2%.

After a strong January, robust jobs data, high retail sales growth and sticky core inflation in the US saw bond markets again having to revise their rates views. Treasuries sold off through February and early March, with the 10Y moving from its low of 3.36% to over 4%. Despite the headline US CPI print looking within expectations (and behaving as expected, as energy prices fall), core CPI continues to surprise to the upside with services inflation being particularly problematic.

Just as the market was pricing in some of its most hawkish sentiment, the story of Silicon Valley and Signature Banks broke (followed by further news of Credit Suisse). As the second largest bank failure in history, it generated concerns of contagion and central banks had to act swiftly. The market again revised their rate views, now believing the pace of hikes and quantitative tightening would have to moderate, and the US 10Y rallied down to 3.47% at quarter end. In contrast to 2008, where there were credit quality issues, these bank failures are rather attributed to liquidity/duration risk. Large unrealised losses on bank balances sheets (due to the fast and large pace of interest rate hikes) had to be realised, as large-scale deposits were withdrawn and had to be met. To resolve fearful depositors frantically withdrawing deposits across the banking industry and generating further potential solvency issues, the Treasury and Federal Reserve introduced the “Bank Term Funding Program” (BTFP). The BTFP allows banks to use securities at par for loan collateral, meaning they do not have to sell these securities and realise any losses, to generate liquidity. While this certainly assists in preventing panic withdrawals and failures, it fails to address the problem of low cash reserves due to continued quantitative tightening by the Fed and higher interest rates heightening unrealised losses on balance sheets. Large economic stresses such as this which result directly from tighter monetary policy, further exacerbate the Fed’s rate conundrum, as inflation remains problematic. Local banks are not exposed to the same risks as their liability book is mostly floating. They are also well capitalized and well provided, so little spill-over effect is expected to our local banks.

Following the global bank turmoil, the Fed hiked by 25bps in the March FOMC. This was largely anticipated by the market, and although their tone was slightly more dovish, there was no sign of a ‘pivot’, as many market participants may have hoped. The dots for 2023 were left unchanged and suggest that there may be one hike left in the cycle. Importantly, unlike the market, they still do not foresee any policy easing this year.

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

² ASISA Multi-asset medium equity category.





On the local front, the South African market was surprised by a 50bp increase in the repo rate by the MPC in March. The market was expecting 25bps as growth remains highly constrained, and inflation, despite being high, is not being driven by strong demand. The MPC however showed much higher inflation forecasts than outlined in previous meetings, fuelled by higher food prices, core goods inflation and a weaker local currency (ZAR). Their concern around higher inflation, higher expected inflation and (we suspect) a vulnerable ZAR, prompted greater action. This certainly signals the intention from the SARB to bring inflation back toward the midpoint of the target band (3%-6%), but it remains a further constraint on growth.

Portfolio Commentary

The Nedgroup Opportunity Fund produced a net return of 2.8% over the last quarter, lagging the peer group with an average return of 4%. Performance of 12.9% over the last year compares very favorably to peers (5.6%) as well as the market (+4.9%). The Fund ranks amongst the top quartile of peers over longer investment time periods and has almost matched the market returns at lower risk.

Top 5 winners and losers for Q1 2023:

Top contributors	Avg. weight	Performance contribution	Top detractors	Avg. weight	Performance contribution
Alphabet	2.1%	0.4%	Thungela Resources	1.8%	-0.6%
Autohome	2.4%	0.4%	British American Tobacco	1.8%	-0.4%
Abax Global Equity	3.3%	0.3%	Transaction Capital	0.3%	-0.2%
Meta Platforms	0.5%	0.3%	Sasol	1.6%	-0.2%
African Rainbow Capital	1.2%	0.3%	Impala	1.1%	-0.1%
Total		1.7%			-1.5%

The first quarter marked a strong recovery in global technology shares which benefitted 4 out of our top 5 positions. Alphabet had a decent recovery and continues to show strong potential. Autohome (Chinese version of Weby cars), was a strong performer as Chinese re-opening plays recovered from extremely oversold levels. We used the recent strength in Meta to exit our position (prematurely).

After being a strong contributor to performance (+1.1% over the last 12m), Thungela detracted 0.6% from Fund performance on the back of weaker coal prices. British American Tobacco detracted 0.4%. We have added to our position as we find a favorable valuation, especially taking their investment in India Tobacco Company into account. Transaction Capital underperformed after the release of weak results on the back of the write down of their investment in SA Taxi. We have used recent weakness to tactically add to our position.

Top 5 winners and losers last 12m:

Top contributors	Avg. weight	Performance contribution	Top detractors	Avg. weight	Performance contribution
United States Dollar	1.2%	2.1%	Sasol	1.2%	-0.7%
Naspers	3.1%	1.7%	MTN	1.5%	-0.5%
British American Tobacco	3.7%	1.2%	Raubex	1.0%	-0.4%
Thungela Resources	1.9%	1.1%	Structured notes	1.3%	-0.4%
Hello Group	0.8%	0.9%	Transaction Capital	0.2%	-0.2%
Total		7.0%			-2.2%





Our investment in Thungela Resources was one of the top contributors over the last 12 months whilst detracting slightly over the last 3 months. The share remains extremely cheap, but as expected is highly geared to the coal price. At current coal spot prices they continue to generate attractive cashflows and we would expect good dividends at the next reporting period.

After a disappointing year in 2021, British American Tobacco had a strong 2022. After a strong run, we reduced our position towards the end of last year, but tactically added into weakness in the first quarter of this year. We remain optimistic about their 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.

Naspers recovered strongly over the last twelve months on the back of a strong Tencent recovery as investors appetite for Chinese tech shares returned, driven by optimism on China re-opening.

Sasol detracted from performance on the back of a lower oil price. We remain constructive on the outlook for oil.

Current positioning and outlook

Further fallouts from tightened global monetary conditions are expected. The headwinds facing global risk assets are unlikely to abate soon. Years of excess and easy money are not usually dealt with in one year. In markets such as the US, earnings projections still seem way too optimistic given that inflationary pressures must still impact sky-high corporate profit margins.

We continue to be defensively positioned. We have lowered our exposure to equities whilst increasing our exposure to US bonds which are starting to offer decent yields. Investors are getting paid a decent yield to wait on the sidelines as global short rates have increased. We also maintain a high exposure to local bonds which continues to offer an attractive real yield. Our basket of structured notes provide us with upside participation whilst the embedded capital protection offers us some comfort.

It seems likely that the path forward may remain bumpy for a while yet, and we will look for tactical and strategic opportunities this might create.

Conclusions

Heightened global risks justifies a more defensive stance. Our exposure to SA bonds is expected to deliver healthy real returns. Continued loadshedding in South Africa is becoming a major headwind. Valuations are attractive in select local stocks and we continue to shift our focus to offshore companies in search for better value. We retain a high exposure to hybrid instruments including convertible debentures as well as structured notes. Our defensive portfolio is well balanced with foreign currency exposure to protect against a risk-off scenario.





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.

NEDGROUP INVESTMENTS CONTACT DETAILS

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