NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS PROPERTY FUND

Quarter One, 2023

Nedgroup Investments Property Fund

Performance to 31 March 2023	Fund[1]	Peer group[2]	Benchmark[3]
3 months	-4.4%	-5.2%	-5.1%
12 months	-0.7%	-5.6%	-3.4%

Market Overview

The collapse of Silicon Valley Bank (SVB) in the United States and Credit Suisse in Switzerland during the first quarter of 2023 highlight some of the issues regulators are facing in trying to contain inflation by aggressively raising interest rates. While both banks are not representative of the global banking sector generally, the repricing of bank assets held in government bonds is a risk to the sector as a whole and is a function of higher inflation and higher interest rates. Regulators were quick to act in both cases, with the US Federal Reserve guaranteeing all deposits at SVB, while the Swiss regulators quickly engineered the takeover of Credit Suisse by its largest competitor, UBS. While the crisis was short-lived, it did have a material impact on the share prices of most banks in the United States and Europe and is also likely to place a dampener on economic growth as banks reassess the quality of their asset books and adopt more stringent lending criteria. On the other hand, central banks are likely to be more circumspect about the pace and magnitude of further interest rate hikes given the fragility of certain banks in the financial system.

During the first quarter, global bond yields fell on expectations that central banks (and the US Fed in particular) will reduce the magnitude of rate hikes at upcoming policy meetings and start cutting interest rates again before the end of the year. The US Fed did raise official interest rates by 25 basis points at both the February and March meetings of the Federal Open Market Committee, but these were lower than the 50 basis point increase in December 2022 and the 75 basis point increases in June, July, September and November last year. The yield on 10-year US Treasuries fell more than 40 basis points during the quarter to trade below 3.5%, having touched 4.25% towards the end of last year. Lower bond yields helped growth stocks stage a significant rally in the first quarter, with the tech-heavy NASDAQ Index gaining 17%, while the Dow Jones Industrial Average (DJIA) was up just 0.9%. The NASDAQ underperformed both the DJIA and S&P 500 last year as bond yields in the United States rose by around 250 basis points.

South African bond yields dropped approximately 35 basis points in the first quarter, despite a significant pick-up in the level and frequency of loadshedding since the beginning of the year. Despite the fact that consumer inflation appears to have peaked in South Africa, the Monetary Policy Committee of the South African Reserve Bank raised official interest rates by a further 75 basis points during the quarter, including a surprise 50 basis points hike at the end of March, when most other central banks had surprised by either hiking less than expected or not hiking at all, given the wobbles in the global banking sector. Despite the fall in bond yields, South Africa's listed property sector declined by 5% during the quarter. Those companies with exposure to Europe suffered the steepest declines as the cost of debt continued to increase while asset values for most property types in the region remain under pressure. Several South African companies with European exposure have Euro-denominated debt expiring this year, including Growthpoint (in May) and Hyprop (in the fourth quarter). With loan-to-value ratios having risen, thanks to falling asset values, refinancing that debt is likely to prove problematic and costly.

[1] Net return for the Nedgroup Investments Property Fund, A class. Source: Morningstar (monthly data series).
[2] Peer group is the (ASISA) Real Estate General category average
[3] FTSE/JSE South African Listed Property Index

Portfolio Commentary

The Fund outperformed the peer group and the market in the first quarter of 2023. The outperformance during the first quarter was driven primarily by the Fund's large underweight positions in companies with exposure to Eastern Europe, as well as the Fund's large position in Indluplace, which is the subject of a friendly takeover by SA Corporate at 340c per share. The deal has received irrevocable support from Indluplace's largest shareholder, Fairvest, as well as several large institutional shareholders. While the price being offered by SA Corporate is below net asset value, it does represent a significant premium to Indluplace's average share price over the past 6 to 9 months. The Fund has given its irrevocable support to SA Corporate to support the transaction. The proceeds of the transaction, should it succeed, will be invested across a range of South African property companies offering more attractive yields and improving longer-term growth prospects.

The distribution investors received at the end of the first quarter was low, as is normal given the limited number of companies in the sector declaring and paying dividends between January and March. This quarter was lower than usual as the Fund accepted the Nepi Rockcastle capital repayment alternative, which resulted in a significantly more favourable return than the cash dividend, but which lowered the expected distribution paid by the Fund. Nepi was only one of three companies from whom the Fund was expecting a dividend in the first quarter, hence the material impact on the distribution versus expectations.

Top 5 winners and losers for Q1 2023:

Top contributors	Average weight	Performance contribution	Top detractors	Average weight	Performance contribution
Indluplace	6.24%	0.63%	**Resilient**	4.55%	-0.68%
Grit	4.21%	0.50%	**SA Corporate**	3.66%	-0.58%
NEPI Rockcastle	5.03%	0.23%	**Growthpoint**	5.28%	-0.54%
Emira	4.48%	0.20%	**Stor-Age**	7.38%	-0.53%
Safari	1.07%	-0.04%	**Equites**	5.56%	-0.51%

Current positioning and outlook

The Fund continues to maintain a thematic approach to portfolio construction, favouring property types and geographic locations where fundamentals remain strong or are improving. The Fund's largest single theme exposure remains to convenience and neighbourhood shopping centres in South Africa, with very little exposure to regional and super-regional shopping malls. The Fund has also maintained a high exposure to logistics properties (through Equites and Investec Property Fund) and self-storage properties (through Stor-Age), while the large position in Spear maintains the Fund's above-average exposure to the Western Cape as a region. The Fund has very little exposure to the UK and Western or Eastern Europe, where rising discount rates are likely to put significant downward pressure on property values over the next 12 to 18 months. The refinancing of debt in Europe is also likely to prove problematic for several property companies, given high loan-to-value ratios and the low interest rate on maturing debt. Those companies in South African with large exposure to Europe are likely to see material earnings downgrades over the course of this year, as the picture on refinancing risk becomes clearer.

The Fund's exposure to residential property in South Africa is also very high on a relative basis but will decline if SA Corporate's takeover of Indluplace is successful (the offer is an all cash offer and the proceeds will be invested across other property sectors). The Fund will still maintain a high relative exposure to residential through Octodec as the higher costs associated with home ownership are likely to drive rental demand for well-located residential properties, reducing vacancies and driving up market rental levels in the medium-term.

The Fund's overall exposure to office remains below the market average and is expected to remain at these lower levels given declining market rentals in the sector. Most of the Fund's office exposure is in the Western Cape (and Cape Town specifically) where fundamentals are far stronger than in Gauteng or KZN.

The Fund's geographic exposure remains heavily weighted towards South Africa (78%) versus the SAPY index weight of just 50%. Within South Afriica, the Fund is overweight the Western Cape as well as rural areas (through convenience retail) and is underweight urban areas in Gauteng and KZN.

This approach to portfolio construction, favouring relevant themes and property fundamentals over the size and make-up of the various market benchmarks, means the Fund can and often does look very different to the market and the peer group. This differentiation has contributed to the Fund's significant outperformance since 2020 as the pandemic accelerated the rapidly emerging trends of online shopping (negative for large shopping malls but positive for logistics and self-storage properties) and changing office behaviour (work from home and hybrid models).

Based on a combination of Bloomberg, FactSet, IRESS and Counterpoint forecasts, the current one-year forward yield on the Fund is 11.6%, with growth in that income likely to approximate inflation over the next 2 to 3 years. Distributions are likely to decline moderately in 2023 because of declines in the dividends paid by Dipula B and Fairvest following corporate restructurings during 2022. Although the restructurings are dilutive to profits and dividends in 2023, they do position the companies for stronger growth beyond 2023. The current one-year forward income yield of the SAPY index, based on the same forecasts, is 9.2% while the yield on government's benchmark R2030 bond is 9.9%.

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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