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NEDGROUP INVESTMENTS STABLE FUND

Quarter Two, 2023

Market Commentary

International

Global equity markets rallied broadly again in June, seemingly immune to sticky inflation and possible further US, UK and Eurozone rate hikes. This capped a robust first half to 2023, with the MSCI World Index returning 13.9% in US dollars despite escalating geopolitical tensions, slowing economic conditions, hawkish central bank rhetoric and the US regional banking crisis.

The US S&P500 Index rose 6.6% in June, driven narrowly by a handful of megacap tech stocks on the frenzied artificial intelligence narrative. Underscoring the dominance of big tech, Apple made Wall Street history by becoming the first company to reach a $3 trillion market value. Apple's rally helped the tech-heavy Nasdaq 100 Index post a blistering 40% return this year — its best first-half performance in history.

Despite one of the most aggressive tightening cycles in US history, the US economy is not slowing as expected. US inflation has moderated, but core measures remain stubbornly elevated. This is also true for the Eurozone and the UK, where rising prices are a key concern for central bank policymakers. Core inflation, which measures underlying pricing pressure by stripping out volatile food and energy prices, came in at 4.6% year-on-year for the US, 5.4% for the Eurozone and 7.1% for the UK — the highest level since 1992.

In a 'hawkish skip', the US Federal Reserve purposefully paused its tightening cycle in June. It nevertheless added two hikes to its peak rates forecast. The European Central Bank hiked 25 basis points and the Bank of England — in a determined bid to bludgeon down demand — surprised the market with a dramatic 50 basis points increase. All three central banks have worked hard to convince markets of their commitment to fight inflation. This reality appears to have finally hit home — US credit markets are now only pricing in rate cuts for 2024.

Global developed market bond yields increased close to multi-decade highs. US 10-year real rates are above 1.5% as the Fed's tapering programme resumed after the regional banking crisis scare. In South Africa, the All Bond Index was the best performing asset class as yields moderated from recent highs. The FTSE/JSE All Share Index tracked global bourses higher, despite the headwinds of rand strength. Financials stocks led the gains, while resource counters heavily underperformed.

South Africa

The JSE tracked global bourses higher, pulled up by index heavyweights Naspers / Prosus on China's COVID-19 reopening and easing of prohibitive tech regulations — but resources stocks were down on generally lower commodities prices (excluding precious metals).

SA bond yields tracked global yields lower, with the SA All Bond Index delivering a positive return — SA has one of the steepest yield curves, reflecting the country's long-term risks.

The rand weakened against the US dollar on deteriorating fundamentals — despite an intra-quarter rally after the SARB surprised the market with a 50bps repo rate increase.

Economic growth prospects are beset by persistent (and worsening) load shedding — while FATF's grey listing of SA for anti-money laundering failures added to the country's woes.

The SARB delivered a surprise 50 bps rate increase when all expectations were for a hike half this size — citing inflation risks from energy, administered prices and food, with rand weakness a key worry.

Portfolio Commentary

- Foreign assets were the largest contributor to returns driven by a combination of rand depreciation and a rally in global equities — markets were driven higher by the frenzied artificial intelligence narrative, despite sticky core inflation suggesting the possibility of further rate hikes in the US, UK and Eurozone

- South African equity investments also contributed to returns as the JSE tracked global bourses higher — powered by index heavyweight Naspers and a strong recovery in banking stocks

- SA bonds detracted as yields shifted higher across the curve, pushing bond prices lower — a hawkish South African Reserve Bank, continued load shedding, sales by foreign investors and rising diplomatic tensions surrounding South Africa's perceived Russian friendship led to a repricing of risk across the curve

- Although the allocation to listed property remains low, investments in the sector contributed positively to fund returns — with a recovery in Fortress, Shaftesbury Capital and NEPI Rockcastle all adding value

- The physical gold investment contributed positively with rand weakness more than offsetting the lower dollar price for bullion — the NewGold ETF serves a crucial portfolio diversification purpose as both a hedge against inflation and as an alternative store of value to fiat currency

Top contributors	Performance Contribution %	Holding Return %	Average Weight %
Foord Global Equity Fund	0.6	3.3	17.0
Foord International Fund	0.2	1.3	20.5
FirstRand	0.2	14.5	1.4
Newgold ETF	0.2	3.3	4.6
Sasol Conv. Bond	0.1	7.1	2.0

Top detractors	Performance Contribution %	Holding Return %	Average Weight %
Spar Group	-0.2	-25.6	0.6
Anheuser-Busch InBev	-0.1	-9.7	1.5
R2025 SA Gov. Bond	-0.1	-2.1	4.6
R2023 SA Gov. Bond	-0.1	-0.7	8.5
Anglo American	-0.1	-13.7	0.5

Investment Outlook

World:
Our view that rates would quickly rise and remain higher for longer has worked well to protect investors against negative returns in interest-rate sensitive asset classes. The global economy has now exited a period of massive fiscal and monetary policy stimulus. The surge in global inflation has shown that unconventional monetary policies bear costs. We are unlikely to see negative rates again. Surging government debt levels also limit fiscal capacity to counter slowing growth.

This means that risks to global growth for developed economies are skewed to the downside. We are safeguarding portfolios against drawdowns. However, high prevailing real yields mean the opportunity set is also greater. To take advantage, we have been cautiously but steadily increasing our allocation to shorter dated bonds in the Foord International Fund.

The era of easy money was the rising tide that lifted all boats. Markets rewarded excessive risk taking, not diligent fundamental analysis. Euphoria and subsequent investment returns are almost always inversely correlated. Accordingly, we have been careful to limit our exposure to shares and sectors that have been driven to extreme valuations by any popular theme — latterly the tech rally. Rather, we prefer well-priced investments in high-quality, sustainable businesses.

Looking ahead, we should not confuse the narrow market rally with the health of the global economy. Higher borrowing costs will continue to test economic and fiscal resilience. Government policy changes are also likely to add to macro volatility. And the more central banks feel compelled to raise rates, the more uncertainty there will be for the lagged, real-economy impact.

All these factors add risk. However, market volatility also provides diligent investors with attractive entry points for long-term investment. We continue to invest in a diverse array of opportunities across the globe — in businesses with solid growth prospects and at valuations which still imply significant upside potential.

South Africa:
The country's economic growth is currently insufficient to effectively tackle its socio-economic challenges. This is evident as business and consumer confidence, along with other reliable leading indicators, all point towards weak economic conditions that lie ahead.

The market is factoring in an additional 50 basis point interest rate increase within the next 12 months. However, there is a growing likelihood that interest rates might peak at their current levels. This is due to the persistently weak economic conditions and the stress faced by consumers.

The South African Reserve Bank's (SARB) forecasts of a return to the 4.5% mid-range level by late 2023 may be overly optimistic. Instead, a more probable scenario is a medium level of inflation between 5-6% within that time frame.

Despite victories for President Ramaphosa's ANC in the national elective conference, the energy crisis is likely to persist in the near term. Nonetheless, there is hope that these victories might accelerate the unblocking of much-needed private sector investment in renewables and industry self-generation initiatives. However, the constraint of grid capacity remains a significant challenge.

The current account deficit is expected to persist, mainly due to the fading benefits of the export commodity price boom. Although the rand may seem marginally undervalued at its current levels, it remains susceptible to vulnerability in the longer term. This vulnerability is driven by structural economic weaknesses, a lack of global competitiveness, and unsustainable public finances.

Conclusion

A high weighting in foreign assets was maintained at 44% of total — measured together with non-rand earnings of JSE-listed companies, total foreign economic exposure is significantly higher on a look-through basis.

Foreign equity investments prioritize companies with strong pricing power, offering better capital protection against rising inflation — portfolio hedges are still maintained to mitigate potential earnings risks arising from higher interest rates or recession.
The allocation to foreign government bonds comprises short-duration US Treasuries with a preference for inflation linked instruments — while listed property is counter-specific with an otherwise low weight given unattractive valuations.

Exposure to SA equities was brought lower through the trimming of banking stocks after a strong recovery in the sector — despite attractive valuations, ratings for domestically oriented stocks are likely to remain below long-term averages given low prospects for economic growth coupled with higher cost of capital.

The allocation to SA nominal bonds was kept at moderate levels given the country's elevated fiscal and political risks with minimal exposure to SA credit assets — a pullback in breakeven yields afforded the opportunity to increase exposure to short-duration inflation linked bonds which in our view offer attractive real yields and inflation protection.

Listed property is limited to a low weighting given poor fundamentals for the asset class, despite optically attractive yields — sector risks include excess capacity, weak rental trend, consumer headwinds, rapidly escalating municipal costs and rising interest rates.

The physical gold ETF position is maintained on supportive fundamentals given the likelihood of nominal interest rates nearing a peak, a weaker US dollar and rising stagflation risks — the position provides attractive portfolio diversifying properties during periods of market stress.

Responsible Investment Summary

Voting resolutions for Q2 2023

Portfolio	Total count	For	Against	Abstain
Adopt Financials	7	7	0	0
Auditor/Risk/Social/Ethics related	21	21	0	0
Buy Back Shares	10	9	1	0
Director Remuneration	24	24	0	0
Disapply Pre-emptive rights	5	0	5	0
Dividend related	1	1	0	0
Issue Shares	4	0	4	0
Loan / Financial Assistance	3	1	2	0
Other	11	10	1	0
Political Expenditure/Donation	1	0	1	0
Re/Elect Director	55	55	0	0
Remuneration Policy	11	6	5	0
Shares under Director Control	6	0	6	0
Signature of Documents	2	2	0	0
	161	136	25	0

Foord Global Equity Fund	**Total count**	**For**	**Against**	**Abstain**
Adopt financials	23	23	0	0
Auditor/risk/social/ethics related	111	68	43	0
Buy back shares	26	23	3	0
Dividend related	18	17	1	0
Issue shares	53	5	48	0
Political expenditure/donation	1	0	1	0
Re/elect director or members of supervisory board	444	444	0	0
Remuneration policy including directors' remuneration	67	30	37	0
Signature of documents/ratification	46	36	10	0
Others	1	0	1	0

Foord International Fund	**Total count**	**For**	**Against**	**Abstain**
Adopt financials	16	16	0	0
Auditor/risk/social/ethics related	45	35	10	0
Buy back shares	15	11	4	0
Dividend related	9	9	0	0
Issue shares	28	2	26	0
Political expenditure/donation	1	1	0	0
Re/elect director or members of supervisory board	243	243	0	0
Remuneration policy including directors' remuneration	32	9	23	0
Signature of documents/ratification	28	21	7	0
Others	1	0	1	0

General comments:

- There are few abstentions. We apply our minds to every single resolution put to shareholders. When there is an abstention, it would typically be intentional or for strategic reasons

- We typically vote against any resolution that could dilute the interests of existing shareholders. Examples include placing shares under the blanket control of directors, providing loans and financial assistance to associate companies or subsidiaries and blanket authority to issue shares. On the rare occasion we have voted in favour of such resolutions, we could gain the required conviction in the specifics of the strategic rationale for such activities and could gain comfort that such activities are indeed to be used to the reasons stated

- The firm also has a strong philosophy regarding management remuneration models. We believe in rewarding good managers with appropriate cash remuneration on achievement of relevant performance metrics that enhance long-term shareholder value. We are generally not in favour of share option schemes given the inherent asymmetry between risk and reward typical of such schemes. In addition, we do not believe that existing shareholders should be diluted by the issuing of new shares to management as is the case with most option schemes. We are in favour of the alignment created between management and shareholders when management has acquired its stake in the company through open market share trading and paid for out of management's own cash earnings

Notable company engagements (Q2 2023)

Company	Topic	Company Attendees	Event Notes
Absa Group Limited	Governance	Investor relations	During our interaction with management regarding the proposed BEE scheme, we expressed our concern over its perceived generosity. Our observations led us to view the scheme as resembling more of an employee share scheme, as it included all staff, including those who were non-BEE and located outside of South Africa. Furthermore, it came to our attention that Barclays had provided some shares on exit, which seemed to mitigate the dilution when assessed at face value. Ultimately, our primary reason for voting against the scheme was its impact on diluting shares for non-South African staff members.
Life Healthcare	Social	CFO and Investor Relations	The nursing shortage continues to pose a significant risk, potentially impacting both the quality of services and increasing costs. Management is actively engaging with the Department of Health and Nursing Council in an effort to address this issue. However, the limited opportunities for nurse training remain a challenge. Despite this, the company is committed to maximizing its current training allocation and exploring alternative strategies, such as employing agency staff, as well as retaining and attracting nurses. The CFO reassured that the company has experience in managing this issue effectively in the past.
Netcare	Environmental	CEO, CFO and Investor Relations	The company is proactively investing in wind power projects to mitigate Eskom costs and diversify its purchasing agreements. These wind power investments are expected to yield attractive Internal Rates of Return (IRRs). Additionally, the company is also allocating resources to water projects with the goal of achieving independence within 5-7 years. These water projects not only contribute to sustainability but also offer promising IRRs. By strategically pursuing these initiatives, the company aims to reduce operational expenses, increase self-sufficiency, and foster sustainable growth.

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NEDGROUP INVESTMENTS

WHO WE ARE
Nedgroup Collective Investments (RF) Proprietary Limited, is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust funds. It is a member of the Association of Savings & Investment South Africa (ASISA).

OUR TRUSTEE
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For the Nedgroup Investments Bravata World Wide Flexible Fund it is calculated monthly as a percentage (the sharing rate) of outperformance relative to the fund's benchmark, with the high watermark principle applying. All performance fees are capped per fund over a rolling 12-month period. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

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