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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Four, 2020

Performance to 31 December 2020	Nedgroup Financials Fund	ASISA SA Equity Financials
3 Months	18.9%	18.4%
12 Months	-13.3%	-17.6%

Market commentary

Global markets rallied strongly in Q4 from still very undervalued territory as investors started looking forward to a post Covid-19 lockdown recovery in 2021, aided by the increasing certainty of the availability of a vaccine. Even the JSE in South Africa saw financials and industrials rallying despite the many problems the country still has.

This rally saw a rotation into value and the financials sector globally. Due to a weaker US dollar, emerging market (EM) currencies also performed well.

This all was visible in SA via a strengthening rand (5%) and the FTSE/JSE Financials 15 Index (Fini) outperforming the FTSE/JSE All Share Index (Alsi) (20.1% vs 9.8%).

It must be noted that despite the strong performance in Q4, due to the large declines in Q1 the Fini still ended the year -19.7% highlighting the excessive fear when the virus started spreading.

Fund performance, contributors & detractors for past quarter

The fund had a good quarter outperforming both its peer group and the ALSI.

Top 5 Contributors	Weight Mean	Return in rand	Contribution in rand
FirstRand Group	16.3	23.8	3.8
Denker Global Financial fund	18.9	16.8	3.0
PSG Group Ltd	5.7	34.3	1.8
Capitec Bank Holdings Ltd	4.8	38.4	1.8
Sanlam Ltd	11.9	13.0	1.6

Top 5 Detractors	Weight Mean	Return in rand	Contribution in rand
Santam Ltd	3.8	4.7	0.3
Trematon Capital Investment Ltd	1.4	12.8	0.1
Ninety-One Limited	1.4	2.8	0.1
Cash	0.5	0.4	0.0
JSE Ltd	6.7	-4.2	-0.2

The top 5 contributors were generally our largest holdings (the Denker Global Financial Fund gaining 31% in US dollars with PSG/Capitec, FirstRand and Sanlam all contributing strongly). Noteworthy of the quarter was that, except for JSE (the share), the detractors all generated positive performance. This helped the fund to a very good quarter outperforming both its peer group and the ALSI. It must be added that the JSE (the share) underperformed in Q4 due to its defensiveness after it had held up well and still closed the year positive gaining 1.8% over the 12 months versus Nedbank’s -34.8% for example.

Portfolio changes, current positioning and outlook

We made very few portfolio changes during the quarter due to the script playing out more or less to our expectations. The changes we did make were due to outflows and this forced us to sell some Investec, Nedbank, Santam and JSE.

JSE because it had been an outperformer and Santam due to continued uncertainty about the size of current and future claims.

Nedbank and Investec are very undervalued based on their PEs and P/NAV but due to the uncertainty about South Africa's growth rate we continue to prefer banks (and insurers) with higher returns on capital (which means they have a larger margin in case of unexpected negative events).

The outlook has changed dramatically over the past few months. Vaccination in the UK, the US, Europe and Japan (and India and China) means that global activity levels should normalize by Q2 and the economic recovery will most probably be stronger than anticipated. The stimulus packages and low interest rates as well as pent up demand will help as well. A Biden presidency will create more certainty regarding global relationships and global trade but its policies bring increased inflationary risks (more stimulus as well as funding for unproductive activities). The high US debt levels brought a weaker US dollar which in turn has caused flows into and benefitted EM currencies. In addition, the renewed focus on infrastructure spending (globally) and stronger Chinese growth seems to be pulling commodity prices out of a 13-year bear market.

This is all good for Emerging Market banks (including South Africa) and hence we've increased our global funds investment in a few of them.

The above scenario should also be good for specifically Standard Bank as well as Sanlam and Santam who have large exposure via subsidiaries in Africa.

Whilst the global outlook is improving and some forecast US GDP growth in excess of 6%, SA has the weights of a high debt burden, a big budget deficit, crumbling state institutions and the problem that our vaccination program will start later (and be less effective?) than the rest of the world.

Yet, we remain optimistic that on a 12-month basis the probability is high that our growth and company earnings will be better than expectations. And yes, a big reason is because expectations are low. Other factors like the very good rainfall, our continued positive trade balance and low interest rates will help as well.

The bank sector itself has come through the crisis very well but loan growth will depend on the factors above. In terms of valuations Standard Bank, Absa and Nedbank are trading at lowest levels since the mid-1980s.

In the absence of loan growth, the banks have doubled their investment in government bonds which means their yields will most probably improve (an investment in South African government bonds at current yields - even after risk hedging costs - will be more profitable than lending).

Due to the uncertain environment (as per above) we keep our largest investments in lower risk banks with a proven track record despite them being more expensive. Hence the fund's largest investments remain FirstRand and Sanlam. The remaining three of the top five are the fund's investment in the Denker Global Financial Fund, PSG/Capitec and JSE.

Conclusions

The valuation of the financial sector is the lowest in at least 25 years. The global economy should grow 4%-6% (from a depressed base) and pull South Africa along as well. We believe that the probability that bank and insurance earnings will surprise positively is high, coupled with the below long-term average valuations the sector should generate more than a 15% return (its ROE) and if it re-rates (quite likely) this will be higher and will most probably exceed 20%.

Responsible investment comments

Covid-19 seemed to at first bring a bit of an attitude of "let's just first get through this crisis". When your business is under pressure the focus is to make sure you retain directors with experience who know the business. At time of writing the December 2020 scores are not yet available but it seems as if most of the companies we are invested in (both locally and globally) maintained their ESG scores.

Our process focuses on corporate governance. Social scoring is important but often gives smaller growth companies a low score. PSG and Capitec are examples of companies who get low scores despite their involvement in social and upliftment programs.

In terms of corporate governance, a good example of constructive engagement was Tinkoff Credit Systems (TCS), the leading Russian fintech bank, in which our global fund has a large investment. After many interactions and communication with management (both ourselves and other shareholders) the founder (and still largest shareholder) converted his A-class shares to ordinary shares, thereby doing away with all the special rights he had (to the disadvantage of minority shareholders). This constructive dialogue with management led to a win-win result as subsequent to Oleg Tinkoff's decision the share price gained 15%.

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.

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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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