NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Four, 2021

Market Commentary

The global economy continued the strongest rebound in recent history post the Covid-19 economic lockdowns. The resulting supply/demand disruptions pushed US inflation to levels last seen in the early 1990s, bringing both US Fed liquidity tightening and the start of the US interest rate hiking cycle forward. The end of US quantitative easing has in fact begun and we might see the first interest rate hike as early as March 2022. The possibility of higher US interest rates and SA's weak fiscal situation put pressure on the rand causing it to weaken 5.8% for the quarter and 9.1% for the 12 months to December 2021. In fact, was it not for higher commodity prices helping our trade balance the rand might have weakened more.

The long-term growth outlook for South Africa is weak, given the macroeconomic challenges we face. Despite this, SA banks have benefitted from the strong rebound in economic activity and all reported good results (post September quarter-end). This was followed by a positive round of trading updates towards the end of the year as well. Loan growth remains below longer term trends but the recovery in transactional activity, higher interest rates and better provisioning experience points to robust earnings growth. It appears as though the Omicron variant has had a limited impact on economic activity which is also positive for the banking sector. Contrary to this, the insurance sector, especially life-insurance, is at risk of further claims and had a comparatively poorer quarter with respect to share price performance.

Yet the FTSE/JSE All Share Index (Alsi) was resilient (thanks to the higher commodity prices) gaining 15% over the quarter and 24% for the full year.

Fund performance, contributors & detractors for the past quarter

The fund returned 6.4% for the quarter compared to the benchmark's return of 3.2%. Over the year the fund delivered a commendable 33% return ahead of the benchmark's 29% as well as the Alsi's 15%. The tables below highlight the main contributors and detractors for the quarter.

Top 5 contributors:

The fund generally maintains on an average a 20% investment in the Denker Global Financial Fund which provides exposure to world-class global financial services companies and also acts as a rand hedge. Strong performance by the US banking sector in particular and the depreciation of the rand meant this was the top contributor for the quarter.

Investec was a major contributor to the fund's strong performance both in the quarter but also over the full year. This was driven by a strong set of results, which was materially higher than previously guided - surprising the market positively. Albeit off a low base, Investec reported much improved client activity, solid loan growth along with much lower bad debts and limited further hedging losses. Investec also announced the decision to distribute a further 15% of their NinetyOne stake.

The fund's overweight position in PSG benefitted investors as the group delivered a solid set of results. A number of underlying investments have delivered strong operational performance, such as PSG Konsult and Stadio, whilst Curro and Evergreen are still feeling the effects of Covid-19 related issues.

Trematon and Sasfin also recorded strong price gains in the last quarter, driven by some corporate action and a recovery in the real estate sector. We are very mindful of liquidity when investing in these two shares and continue to evaluate our assessment of valuations.

Investments that detracted with negative or below index price performance this quarter:

- Our overweight position in Sanlam was our biggest detractor for the quarter. We rate the business and the quality of management very highly. However, the risk of further provisions linked to the Omicron variant impacted Sanlam's performance over the quarter. Despite this, the realisation that this variant wouldn't have the same devastating effects as previous variants meant the share price enjoyed a strong rally towards the end of the year. Sanlam also announced that they are in talks with the German insurer Allianz about a possible deal to exit some of its underperforming African businesses, which we view positively.
- After releasing a strong set of results and a solid trading update, Capitec outperformed the broader index and the banking index. As such our underweight position detracted from performance.
- The quarter saw strong gains in the REIT sector where we have very limited exposure currently. Our decision to not own any of Growthpoint, Redefine or Hyprop detracted from performance negatively. In our view, the sector will continue to face headwinds and we are not yet fully comfortable with the investment case.

Top 5 Contributors	Weight Mean	Return in Rand	Contribution
Denker Global Financial Fund	20.27%	8.14%	0.97%
Investec Ltd and Plc	7.47%	37.25%	0.93%
PSG Group Ltd	5.46%	20.47%	0.74%
Sasfin Holdings Ltd	2.50%	23.64%	0.50%
Trematon Capital Investments Ltd	1.69%	36.12%	0.47%

Top 5 Detractors	Weight Mean	Return in Rand	Contribution
Redefine Properties Ltd	1.53%	9.44%	-0.11%
Hyprop Investments Ltd	0.63%	28.88%	-0.14%
Growthpoint Prop Ltd	2.83%	12.30%	-0.26%
Capitec Bank Holdings Ltd	5.43%	12.92%	-0.39%
Sanlam Ltd	10.51%	-7.25%	-0.46%

Portfolio Changes, current positioning and outlook

Looking back over the 12-month period we reduced the funds' investment in Sanlam and Santam (due to both their expensive ratings and (at that stage) our expectations of the high business interruption and death claims). In addition we cut the JSE position due to a very weak outlook – declining listings, limited opportunities to grow and diversify revenues and the difficulty in attracting foreign capital. We also sold a portion of our Sasfin holding when we received a good offer. The sell was simply due to its illiquidity: The offer received was for a fairly large number of shares but we decided to only sell a portion given we believe it remains undervalued based on our assessment of forecasted growth.

The proceeds were used to increase the fund's holdings in Investec, Absa, Capitec and RMI. In all four cases the franchises were incorrectly priced by the market especially in the light of a stronger growth, rising interest rate environment but, more importantly, in the case of both Investec and Absa we believed that management actions would have their desired effect. Capitec remains an unbelievable franchise with management on the front foot and we used a period of price weakness to add to our holding at attractive prices.

<u>Outlook</u>

The global outlook could be one of the best we've seen for banks and insurers globally since 2006. Loan growth is expected to pick up in 2022 at higher net interest margins (thanks to higher interest rates), lower bad debts (thanks to a strong economic environment) and off a good capital base as well as a lower expense base.

2021 might prove to have been an inflexion point in terms of globally low interest rates which means the financial sector should have both higher ROE's and ratings for a few years.

South African banks and insurers should also benefit from this global trend, but SA's high government debt levels, excessively high unemployment and the lack of action by government in terms of much needed policy reform will place a cap on our GDP growth rate and hence re-rating.

Nevertheless, the financial sector, especially banks, are well positioned and should see further re-rating even against this background. In addition, investors should receive a dividend yield of +6% (after tax).

Conclusions

After a fairly strong 2021 investors might be tempted to take profits. We would argue that the environment will favour the sector and it remains inexpensive compared to its past and hence could well re-rate further.

As already mentioned, the banking sector released a very encouraging round of trading updates which bodes well for the continuation of the recovery witnessed in 2021. In addition, dividend yields remain very attractive and could well lead to a period of strong share price performance as investors seek these income generating opportunities.

Hence, based on our outlook and the valuations we remain confident that the sector will continue to generate good returns for investors.

Responsible Investment Comments

Eskom's latest 20.5% tariff request has drawn the ire of the country and again highlighted the need for structural reform in the energy sector (Denker Capital's Madalet Sessions wrote a piece in December 2021 proposing a way to restructure Eskom debt, solve their balance sheet challenges and free up cash resources: https://www.denkercapital.com/eskom-the-big-question-for-which-there-is-a-solution-for-everyone-except-vested-interests/). Fixing the financial issues will go a long way to assisting the country to transition to more environmentally friendly and renewable energy sources. South Africa's reliance on coal-fired power plants has attracted heavy criticism from climate change activists and rightly so. The banking sector has over the last 12 months committed to phasing out the funding of fossil fuels which we commend. In our view, it is imperative for the country to proactively fix the current crippling energy issue and continue to promote the use of independent renewable power producers. We continue to monitor our investee companies in their ESG related targets and commitments and will engage with management teams on issues which will lead to better value for all stakeholders.

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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