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NEDGROUP INVESTMENTS FINANCIALS FUND

Quarter Two, 2024

Nedgroup Investments Financials Fund

Performance to 30 June 2024	Nedgroup Investments Financials Fund[1]	Benchmark: FTSE/JSE SA Financials Index
3 Months	12.6%	15.9%
12 Months	27.1%	24.4%

Market Commentary

Global markets

Global equity markets delivered more modest returns in Q2 relative to Q1 2024. The S&P 500 and MSCI World indices gained 4.3% and 2.6%, respectively, in US dollar terms on a total return basis. AI was again a major contributor to the index returns. According to the Wall Street Journal, “within the S&P500, companies related to the theme gained 14.7% in market value this past quarter, whereas the rest lost 1.2%”. Inflation showed further signs of easing, but markets have not regained confidence that interest rates will be cut aggressively between now and year end. Yields on US government bonds increased modestly over the quarter. Geopolitical tensions and political developments in the European Core economy regions created bouts of market volatility.

At a global equity sector level, technology (+11.4%), communication services (+8.1%), and utilities (+3.2%) were the strongest performers. On the other hand, materials (-3.4%), real estate (-3.3%), and consumer discretionary (-2.3%) were the weakest performers.

South African markets

The second quarter saw no loadshedding in South Africa. The suspension of loadshedding has been attributed to a reduction in unplanned outages and an improvement in the energy availability factor. Strategic utilisation of the Open Cycle Gas Turbines remains lower than in the past two years. Eskom continued to anticipate loadshedding being limited to Stage 2 over the winter months.

The result of the national elections held on 29 May came as a surprise to markets. On the day after the election the rand weakened to R18.74 to the US dollar. Three weeks later the rand traded briefly below R18.00 to the dollar. The Government of National Unity (GNU) will need to navigate a range of political and economic challenges to accelerate reform and get the economy growing but the initial indicators in terms of appointments so far are promising.

Hence the FTSE/JSE All Share Index gained 8.2% over the month, the FTSE/JSE Property Index gained 5.5%, the domestic bond market (represented by the FTSE/JSE All Bond Index) gained 7.5%. The rand strengthened modestly against the US dollar from R18.92 at the beginning of the quarter to R18.19.

Fund performance

The Nedgroup Financials Fund (the Fund) closed strongly positive (12.6%) over the quarter, outperforming the JSE All Share Index total return (8.2%). The 20% offshore allocation within the Fund detracted from the strong local share portfolio returns (as the rand strengthened) hence the fund underperformed its benchmark (which returned 15.9% in total over the quarter).

Based on the increasingly attractive valuations of SA financials (refer our March 2024 quarterly), we switched about 6% from the offshore investment into South African banks/JSE ALSI to increase our exposure to ‘SA Inc.’ to a level that we felt relevant given the low valuations (and hence potential upside) of locally listed shares, but

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

also bearing in mind the risk of a negative election outcome. Right up to the announcement of the GNU, one did not know whether the ANC would select the EFF (or anti-capital partner) or a partner like the DA which we believe would hold it accountable and fight for improved governance. The market immediately rewarded the choice made by the ANC, but the risk of disappointments going forward remains real. Having said that, the economy will be recovering from an extremely low base, has been operating without loadshedding for more than three months and has been enjoying the benefits of the stronger rand which could bring fuel prices down. Hence, inflation could moderate, and interest rates could be decreased. This could make South Africa an attractive investment destination again for the foreign investors who sold out over the past few years - setting in motion a positive cycle.

Top/bottom contributors

Top contributors	Ave. weight	Performance attribution	Top detractors	Ave. weight	Performance attribution
Nepi Rockcastle plc	-	0.63%	Standard Bank Group Limited	6.66%	-0.16%
Reinet Investments	-	0.54%	Capitec Bank Holdings Ltd	8.05%	-0.20%
Sanlam Limited	12.45%	0.44%	Trematon Capital Investments	0.95%	-0.27%
Old Mutual Limited	-	0.16%	Investec plc & Ltd	11.08%	-0.67%
Discovery Holdings Limited	-	0.13%	Denker Global Financial Fund*	20.32%	-3.57%

Source: StatPro

*Including the Denker SCI Global Financial Feeder Fund

Note: Due to the concentrated nature of the Fund, attribution is in our opinion not that meaningful especially in this volatile quarter where most of the benchmark relative performance is attributed to shares not included in the Fund (but held in the benchmark).

<u>Top 5 contributors</u>

- **Nepi Rockcastle:** Nepi Rockcastle currently has a 3.84% weight in the index. The Fund does not have an investment in Nepi nor any of the other property REITs**.**
- **Reinet:** Similarly, the Fund has no exposure to either Reinet or Remgro often used by other investors to gain offshore exposure. We obtain our offshore exposure through investment in the Denker Global Financial Fund which was a large detractor due to the rand's strength over the quarter.
- **Sanlam:** Sanlam represents the Fund's third largest investment and performed very well as investors returned to the JSE. This holding does not only give access to arguably the best managed insurance company in South Africa, but also provides significant exposure to high growth India via its holding in Shriram Finance.
- **Old Mutual**: Despite its seemingly attractive valuation, we do not hold Old Mutual as we are not convinced about the management team's ability to consistently invest and allocate capital optimally.
- **Discovery Holdings**: As per our comments in past quarterlies, we rate the management team's ability to build businesses highly but feel that it tackled too many projects at the same time - which increases financial risk. Hence, we have no investment in Discovery Holdings currently.

<u>Top 5 detractors</u>

- **Denker Global Financial Fund:** The global fund generated a satisfactory result over the quarter measured in US dollars (+1.4% and 10.1% gain year-to-date) and is well poised to benefit from lower interest rates in the US and elsewhere towards the end of the year. But the rand's strength led to the investment generating a negative return of -6.7% measured in rands. Our investment in the global fund was trimmed from its peak of 26% to currently 18.5% to increase our exposure to South African banks and the JSE. One could argue that we should have reduced the investment even more, but the global financial sector remains significantly mispriced, and the fund offers access to some of the best placed banks and insurers in the world. Hence, we remain of the opinion that, on a risk adjusted basis, this investment remains very attractive and a good hedge against the risk of the GNU not working out.

- **Standard Bank Group:** The approximately 20% investment in the global fund means we have an underweight exposure to South African banks, notably Standard Bank and Nedgroup. Both these banks performed well in the quarter and could re-rate strongly if global investors continue to buy and reprice our 10-year government bonds as this reduces the banks' costs of funding and at the same time ensure they re-rate as well. In addition, SA banks will benefit from stronger demand for credit and lower bad debts. Standard Bank has the added feature of having more than 40% of its income derived from outside of South Africa, which could be a relative drag on earnings if the South African GDP grows strongly.

- **Capitec:** We used the recent weakness in share price to rebuild our investment in Capitec to where the Fund now has a larger than index weight at the end of the quarter. Capitec is really well positioned for increased demand for credit should we see rising employment and the bank also continues to take market share in the very lucrative insurance industry. Its most important feature is its low cost base which enables it to price services below its competitors and benefit from client growth which brings further cost advantages.

- **Trematon:** The Fund's investment in Trematon is now below 1%. It continues to trade at very attractive levels and pays an excellent dividend, but its illiquidity counts against it.

- **Investec Ltd and plc:** Since the spin-off from Ninety One and the establishment of the new team under CEO Fani Titi (three years ago), Investec has delivered very good operational results and shareholders have been well rewarded by the re-rating of the share. It remains undervalued, in our view, but the low valuations of its UK peers hold back further re-rating. Over time, however, we believe the superior management team will use the strong franchise and brand to continue growing shareholder value at an above average rate. The new UK Labour government seems to have a market friendly growth-oriented policy which should be good for Investec's UK operations.

Current positioning and outlook

As mentioned above, we used the attractive valuations of the SA banks to increase our exposure to this sector. The re-rating has potentially only just started and we believe considerable upside remains making the financial sector one of the most attractive investments on the JSE at the moment through the combination of being well capitalized, being strong franchises with good management teams, and having diversified into Africa.

In addition, the Fund continues to own a 20% investment offshore in the global financial sector which should benefit from a re-rating and stronger growth as US (followed by global) interest rates start coming down. If interest rates do not come down the sector will possibly not benefit from a strong re-rating, but it should continue to grow shareholder value at 10%-15% per annum (measured in US dollars).

Responsible Investment Comments

In the run-up to the election, ESG matters seemed less important for a while but obviously management teams had to focus on the issues at hand. Over the past few years, the ESG scores of the banks and insurers the Fund is invested in have consistently improved but are reaching a plateau. This is to be expected as the low hanging fruit has been plucked and, besides, corporate governance standards were always high. The main challenge in South Africa (and globally) remains improving inclusivity and diversity but in South Africa this will remain an issue as long as unemployment remains high and the government education system remains poor. The new GNU provides an opportunity to redirect government spending and move more in the direction of government-private sector partnerships which will uplift society.

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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