NEDGROUP INVESTMENTS

see money differently

NEDGROUP INVESTMENTS BRAVATA WORLDWIDE FLEXIBLE FUND

Quarter One, 2018

For the period ended 31 March 2018

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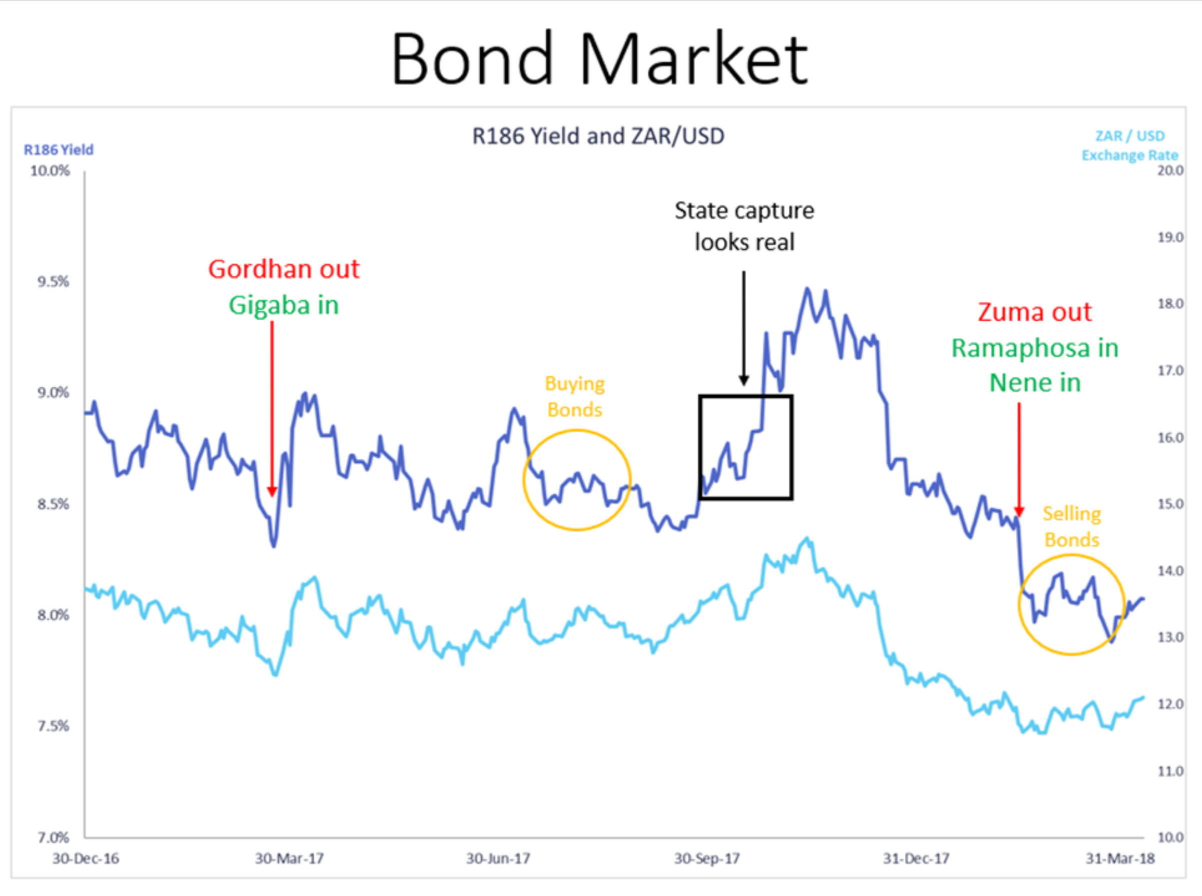
In the past we have written about the advantages that a worldwide mandate offers. From time to time the volatility of our local market gives local fund managers wonderful opportunities to take advantage of reduced asset prices and repatriate foreign funds to local markets. This is not restricted to equity markets, giving us access to all asset classes like bonds, property and local cash. It also allows us to take profits on offshore investments and redirect proceeds to local assets without reducing our equity exposure. Typically, these opportunities are driven by emotional news underpinned by political events.

FIXED INCOME

The chart below shows the R186 South African government bond yield and the rand/dollar exchange rate and is a good illustration of the above point:



Source: *Bloomberg, April 2018*

Prior to the election of the new South African president, Cyril Ramaphosa, pessimism proliferated. Asset prices were depressed on all fronts, the exception being Western Cape property. This, however, did not last owing to the well-publicised looming water shortages. One struggled to find anything positive being reported about the country's future. It was as if it was a perfect storm of negative news. This ranged from the continued downgrades on the country's sovereign debt, dismissal of senior ministers, to a continued stream of daily updates of corruption allegations. Contracts with companies were being declared illegal and their share prices reflected the news. The bond market started to reflect negative news and the currency followed.

Through all the pessimism it is very difficult to envisage what the future looks like: the windscreen looks cloudy and we struggle to set the compass to true North. Fortunately, at Aylett and Co. we have never tried to forecast the future, nor have we tried to call the economy, the currency nor the direction of interest rates. Our efforts have, as always, been aimed in the direction of staying out of trouble or in other words, not losing permanent capital. The asset must reflect sufficient

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margin of safety and at the same time be a rational investment. This strategy of waiting for opportunities on our terms has stood us in good stead and returns over the long-term have underpinned the fund's investment success.

At one stage our bond market reflected rates more than double the inflation rate, a situation we felt was acceptable despite all the negative headlines. Interestingly, we do not employ a strategist or an economist to assist us in investing in local bonds, it just made common sense to invest in South African bonds. Subsequently, South African bonds have rallied and we were able to exit the position profitably.

EQUITY

It is well-known how fund managers find it difficult to beat market indices. One of the reasons is that if you lose five percent of the fund it means the other ninety five percent of the fund has to work much harder just to keep up with the market. We have been consistently advocating increasing exposure to South Africa over the last two years. This, however, could have been a disastrous decision had we invested in some of the many shares that suffered significant losses.

Below is a table of some of the underperforming shares we managed to avoid:

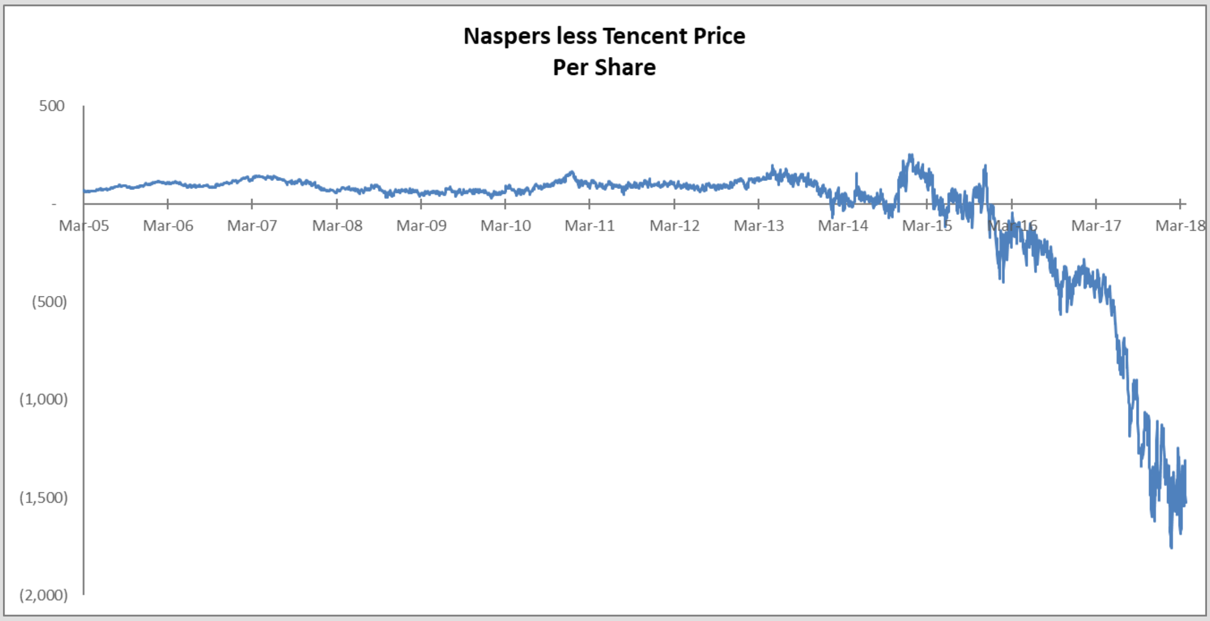
31 December 2016 - 31 March 2018

Company	Return
Rolfes Holdings Ltd	-30.7
Resilient Reit Ltd	-52.1
Anchor Group Ltd	-53.0
Brait SE	-58.3
Fortress Reit Ltd-B	-59.1
Ascendis Health Ltd	-61.0
EOH Holdings Ltd	-73.2
Taste Holdings Ltd	-76.2
Arcelormittal South Africa Ltd	-77.0
Consolidated Infrastructure Group Ltd	-84.2
Steinhoff International Holdings NV	-95.3

Source: *Bloomberg, April 2018*

The maths is simply not on your side if you lose fifty percent of the capital. It means, to recover it, you have to go back up one hundred percent just to break even. One of the many popular investments, not listed above, that seldom gets mentioned is the Naspers stub or rump product. The performance of the Naspers rump has been disastrous for those that bought it. For nearly two and a half years, the value of Naspers' interest in Tencent has been "worth" more than the market capitalisation of Naspers. A curious mind must ask – How can this be? How is it possible that MultiChoice, Media 24 and the many ecommerce investments owned by Naspers are worth less than nothing?

As a proxy for worth, we use the number of shares owned by Naspers multiplied by the current market price. It is debatable whether Naspers would get this full value from its stake as it seems likely any sale of that magnitude would require some sort of discount. When Naspers recently decided to sell 2% of its 33% stake, it did so at a 7% discount. Additionally, we suggest that there will be fees and taxes due.



Source: *Bloomberg, April 2018*

Without going into the many reasons why, the vast majority of holding companies (Naspers being one of them) trade at a discount to the sum of its parts. If a single investment becomes very large in that holding company's portfolio, even a small discount applied to the holding company can result in the rest of the portfolio trading at a "negative" valuation. That negative value has nothing to do with the quality of the smaller assets - it is just the maths.

A simple example can illustrate this. Assume a holding company (Holdco) owns two assets, A Ltd and B Ltd, each worth R50. Assume for argument's sake that a holding company discount of 10% is justified. The sum of the parts for Holdco is R100 and it trades at R90 after applying the holding company discount. Assume now B Ltd goes up in value 100 times. A Ltd is still worth R50, B Ltd is now worth R5 000. The sum of the parts value is R5 050. Apply the 10% holding company discount and Holdco will trade at R4 545. Using the Naspers stub thinking, you could fool yourself into believing A Ltd is trading at negative R505. Emails from your broker will try to convince you that you're being paid to own it. Unfortunately, if A Ltd and B Ltd never get spun out and they keep their value, there is no reason why that stub must ever trade positive. It is that simple maths that has kept us from buying the Naspers rump product.

Most books written on investing explain how to make money, but not enough text is spent on preserving capital and staying out of trouble. Purchasing is quite easy, but avoiding the popular stocks and investments is a difficult decision because it's hard to go against the crowd. While the investment process at Aylett & Co. gets more robust every day, one of the most important characteristics that make up our investment DNA is one that we have had from day one – we don't participate in investments that make no sense to us and we have the modesty to admit that sometimes we just don't know. If we can't understand the model; if the CEO's message sounds incomprehensible or unclear; if management display a total disrespect for minority shareholders or poor capital allocation we should stay away. We have avoided all of the stocks in the table of losers above because of these simple warning signs.

THE PORTFOLIO TODAY

Not much has changed in the portfolio other than the exposure to equities has increased to just below 70%. This is mainly as a result of a continued increase in exposure to South African companies; some withdrawals from the fund as investors switched back to South African assets; and the strength of the local currency.

There were only three notable transactions. Hospitality Property Fund Ltd is the hotel property REIT controlled by Tsogo Sun (largest hotel group in South Africa). It is our view that hotels are currently trading at, or near, to the bottom of the cycle. Because of this cyclicality in earnings, hotel assets are being bought and sold at levels approaching a fifty percent discount to what it would cost to build these assets today - representing an attractive asset for the long-term investor. Subsequently, however, a large transaction has been announced (which requires shareholder approval) for the REIT to also acquire the casino properties of Tsogo Sun, something we do not believe makes sense.

The other two transactions were minor were additions to existing positions in Investec Plc and the Longleaf Asia Fund and not new investments. There were no major sales.

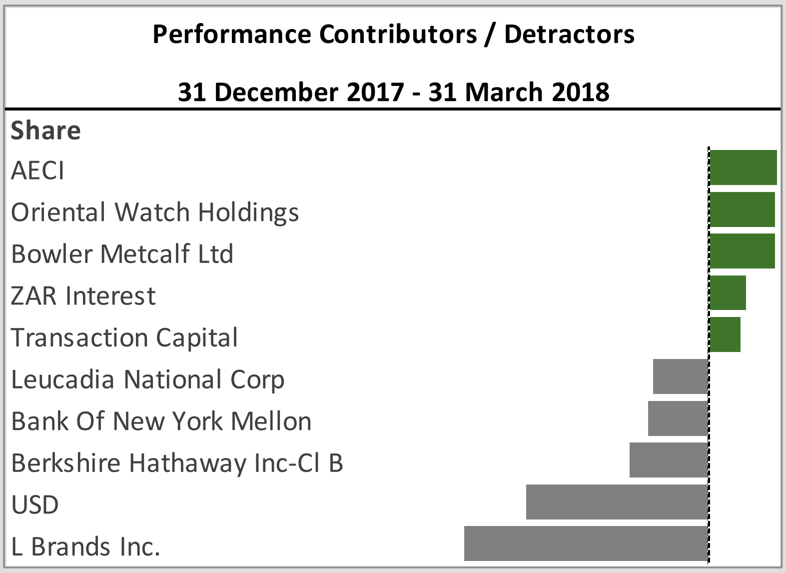
Buys & Sells:

Company	Nominal Exposure (%)	Percentage Change from 29 Dec 2017
Hospitality Property Fund Lt	2.0	2.0
Longleaf Asia Pacific Ucits	4.0	0.9
Investec Plc	0.7	0.4

Source: *Bloomberg, April 2018*

PERFORMANCE OF THE FUND

One of our significant detractors was exposure to the US dollar. In the past, exposure to the lender of last resort, the US government, has turned out well. In this quarter, that was not the case and we would have done well to be exposed to currencies such as the euro. At a stock level, L Brands and Berkshire Hathaway detracted on a quarterly basis but we believe that to be temporary. In the case of L Brands, it is still a new investment for us, and Berkshire Hathaway was just taking a breather. On a relative basis we have been underexposed to developed market assets and this has resulted in a muted performance from the fund.



Source: *Bloomberg, April 2018. The above is not exact but does give a good estimate of the relative contribution of the underlying securities*

OUTLOOK

The markets generally look fully priced, in particular if one feels that interest rates will rise. The US Federal Reserve is on track for at least two more rate hikes. This is not significant, but should it surprise to the upside we will have weak equity markets.

Our research shows that US companies are having to pay higher salaries to retain staff. We have seen this in two of the companies we have invested into in the US. Secondly the imposition of trade tariffs does not bode well for margins. Any retaliation from trading partners will not be useful. All of this may lead to inflation in the longer term. Politics around the globe is not conducive to good equity markets and we may see more unfortunate circumstances that will lead to further losses. In truth, we don’t know. We will continue to monitor our investments to ensure that our errors are of omission and not commission.

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
The Standard Bank of South Africa Limited is the registered trustee.
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PERFORMANCE
Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Certain unit trust funds may be subject to currency fluctuations due to its international exposure. 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.

PRICING
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
Certain Nedgroup Investments unit trust funds apply a performance fee. For the Nedgroup Investments Flexible Income Fund and Nedgroup Investments Stable Fund, it is calculated daily as a percentage (the sharing rate) of total positive performance, with the high watermark principle applying.

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.

DISCLAIMER
Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Nedgroup Investments has the right to close unit trust funds to new investors in order to manage it more efficiently. For further additional information on the fund, including but not limited to, brochures, application forms and the annual report please contact Nedgroup Investments.

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