NEDGROUP INVESTMENTS

see money differently

NEDGROUP INVESTMENTS MINING & RESOURCE FUND

Quarter One, 2018

For the period ended 31 March 2018

MARKET OVERVIEW

The first quarter of 2018 has been a bumpy ride. A busy reporting season, for the 2017 financial year confirmed the healthy cash generation of the general (industrial) miners relative to the precious miners, and the aftermath of favourable political changes domestically provided a more positive underpin. However, policy uncertainty globally and soft seasonal Chinese data capped the re-rating opportunity for the sector.

- Our current view of the cycle is constructive.

What started as aggressive, but unsustainable Chinese monetary stimulus in early 2016 has transformed into a burgeoning recovery driven by three robust pillars.

Firstly, improved synchronised global growth that appears increasingly commodity intensive (improving manufacturing PMI and IP's), even as China slows and becomes less commodity intensive. Commodity prices in general seldom decline year-on-year when global GDP growth exceeds 3%.

Secondly, targeted Chinese supply-side reform has replaced the blunter monetary stimulus, and switched the driver from demand to supply. Specifically, this has resulted in a slowdown of supply of raw materials, as well as industries like steel and aluminium, and tightened the sea-borne trade in commodities like iron ore, thermal and coking coal and manganese. Furthermore, this policy has increased the quality differential for commodities broadly and steepened the cost curves, thus increasing the base prices of commodities like iron ore, but further enhancing the attractiveness of the generally higher quality sea-borne trade. For iron ore this is seen in lump premiums as well as grade premiums.

Thirdly, supply discipline from the global miners remains entrenched, as they continue to focus on de-gearing and shareholder returns over reinvestment and growth. Generally, there is a lag of 5-7 years from increasing CapEx to supply response, so the ability for increased supply to derail the current commodity cycle appears very limited.

- What could derail the cycle is slowing demand.

It is unlikely that the economic metrics can continue to grow at the current rate, and a slowing rate of growth may limit the miners' ability to rerate, even as they trade at valuations below 1 standard deviation relative to general global equities. Despite very healthy cash flows and Free-Cash-Flow yields in excess of 10%.

It is policy risk that threatens suddenly and unexpectedly changing the positive narrative. Examples specific to commodities include the Chinese supply-side reform, that would likely be negative if this were to be reversed, or OPEC's support for the oil price. More general economic policy risks that could impact growth and commodity demand include escalation of trade tariffs (specifically between the US and China, and potentially broader) or acceleration of rate rises from the US Federal Reserve. Policy changes are particularly difficult to forecast and anticipate in our investments, hence we attempt to build robustness into our core positions to limit risk.

Another risk to the sector and its rerating is the threat of rising volatility. This would likely translate into lower ratings, and favour defensive precious metals over commodities geared to growth, such as base metals.

- From a shorter-term perspective two observations of this quarter.

Firstly, while Chinese forward-looking indicators have been constructive (e.g. growth estimates, excavator sales, contractor order books, and even growth in electricity consumption), the seasonally weak winter period, together with Chinese New Year, has presented multi-year highs in steel stocks (bearish) and delays to that destocking that have provided some reasons for concern, as a resources investor.

Secondly, an observation from reporting season was the differentiation of the market reaction to stocks with high financial gearing, high operating gearing and rising debt/negative cash flow (that are generally viewed as negative), relative to companies showing good cash flow/de-gearing balance sheet, production efficiencies and capital discipline (positive). At some point growth CapEx will return and the market may even reward good growth, but that is largely not the case currently.

The large diversified dual listed miners (Anglo American, BHP Billiton, and Glencore) are largely in the positive group and the South African domiciled miners (including the precious metals miners) in the negative group.

FUND PERFORMANCE

The fund returned -6.1% (gross of fees) for the three months ended March 2018. For the 12 calendar months to 31 March 2018, the fund generated a gross of fees return of 6.4%.

Contributors	3 Month Returns	Detractors	3 Month Returns
Tharisa	18.4%	Northam	-31.5%
PPC	12.3%	Impala Platinum	-28.5%,
Anglo American	10.4%	African Rainbow Minerals	-25.3%,
Omnia	2.1%	Sappi	-12.3%
Mondi	0.4%	Sasol	-5.8%,

PORTFOLIO CHANGES, CURRENT POSITIONING, AND OUTLOOK

During the quarter Sasol was added to and a new position in Sibanye Gold was created. African Rainbow Minerals, Exxaro Resources and BHP Billiton were trimmed and the Palladium ETF position was closed.

Our analysis of Sasol indicates that it is approaching a material cash flow inflection associated firstly with declining CapEx for the ($11bn) Lake Charles Cracker Project (in the US) over the next 12 months and then the associated ramp-up to an estimated $1.3bn Ebitda over the next three years. We also consider the earnings potential from the existing business to be troughing, associated with the relatively depressed rand oil price since 2014. The market appears to be valuing Sasol as it has historically on a multiple of earnings and thus not discounting the rapid value unwind from the delivery of the company transforming cracker.

With regard to Sibanye Gold, we have a dichotomy. The share price has fallen due to high operating gearing, high financial gearing (above 2.5x debt/Ebitda) and weak cash flow, exacerbated by the impact of the proposed acquisition of Lonmin, on these metrics, at prevailing currency and commodity prices. Offsetting this is a valuation that appears to undervalue the company transforming acquisition (in 2017) of the Stillwater business in the US. Our position still reflects a cautious view on the stock, while we closely monitor the ability to redeem the debt.

RESPONSIBLE INVESTMENT

While we had many engagements with the management teams of most of our investments in the period, we did not take any significant actions in relation to ESG (Environment, Social, and Governance).

While the labour environment currently appears less of a challenge than it has over the past five years, we do take note of potential pressure from the high ratio of highest to lowest pay. With the multinational companies that compete in the global market for senior level management skills, this problem is more easily justified than with the pure domestic operators. We note that the gold miners (and Northam Platinum) enter wage negotiations from mid-2018.

A greater concern than labour currently appears to be the potential disruption from communities around the mining operations, due mostly to lack of service delivery from their municipalities, but also from demands for greater benefits from mining to be retained in the regions (e.g. employment, as well as services).

Finally, we take some comfort from the recent high court ruling that entrenches the once empowered always empowered principle but acknowledges the need (and cost) for ongoing transformation within the industry.

DISCLAIMER

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.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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.

NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Fax: 0861 119 733 (RSA only)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT
Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001

WRITE TO US
PO Box 1510, Cape Town, 8000

NEDGROUP INVESTMENTS