



NEDGROUP
INVESTMENTS

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NEDGROUP INVESTMENTS OPPORTUNITY FUND

Quarter One, 2018

For the period ended 31 March 2018

NEDGROUP INVESTMENTS OPPORTUNITY FUND

PERFORMANCE

Performance to 31 March 2018	Nedgroup Investments Opportunity ¹	ASISA category average	FTSE/JSE ALSI
3 months	-2.8%	-2.9%	-6.0%

After the volatile end to 2017 which contained the knife-edge conclusion of the ANC elective conference and the implosion of Steinhoff with the commensurate impact on the JSE and investor portfolios, we had hoped for a return to more reasonable levels of market volatility in 2018. This was not to be. The first quarter of 2018 has continued to be volatile and following the Steinhoff debacle investor nervousness is at very high levels.

This has been fuelled by a witch hunt to examine and expose any other companies that display any “Steinhoff-like” characteristics, the most dramatic of which has been the publicity surrounding the Resilient Group of companies (Resilient, Green Bay, NEPI Rockcastle and Fortress) and their inter-linked shareholdings. All of their share prices have collapsed and are trading at fractions of their values as of only 3 months ago. Several other once high-flying businesses have also seen substantial declines in their value and these include Aspen, Ascendis and EOH.

PORTFOLIO COMMENTARY

The fund's top five performing positions added +1.1% to our return while the bottom five detracted -3.2%.

Winners	Ave. weight	Total Return	Performance contribution	Losers	Ave. weight	Total Return	Performance Contribution
SNH CB's	0.9%	51.7%	0.34%	Naspers ²	9.4%	-16.2%	-1.34%
Truworths	1.0%	16.3%	0.18%	Impala CB	2.1%	-28.2%	-0.67%
JSE	0.6%	20.6%	0.18%	EuroStoxx 50	2.8%	-17.0%	-0.52%
FirstRand	3.1%	1.7%	0.17%	BTI / REI	2.5%	-15.8%	-0.37%
R2037 Bond	2.2%	9.8%	0.22%	Intu	1.7%	-16.4%	-0.30%
			+1.09%				-3.20%

Primary contributors to the fund's performance were firstly its avoidance of many of the abovementioned problems, but also the funds exposure to domestic orientated businesses and bonds. These include equity investments in Truworths, FirstRand and the JSE as well as our holding in government bonds. Our holding in Steinhoff offshore convertible bonds was the top contributor to performance over the quarter.

Steinhoff has started to dispose of its equity interests in the already public companies – at the inevitable liquidity discount. This started with PSG. PSG was additionally troubled by the short-seller report on Capitec (PSG's largest contributor to the firms' asset value), which although in our opinion fraught with inaccurate statements and conclusions, in the environment of a very nervous South African market caused substantial volatility in both companies share prices. Next up was the part disposal of Steinhoff's stake in KAP, which we had also anticipated and used the opportunity to add to our positions across the firm at an attractive price.

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

² Including portfolio hedges and stub notes.

Although these actions did little to improve the Steinhoff share price, which fell another 30% to finish the quarter at R3.30 per share, the offshore convertible bonds that we own rallied strongly, posting gains of over 50% for the quarter, making them the top contributor to the fund (+0.32%). Steinhoff also repaid early (at par plus accrued interest) their domestic bond programme in which we had a small holding. We currently retain a 0.3% allocation to SNH equity and 0.5% to SNH offshore convertible bonds.

We built a position in Truworths in the latter half of 2017 at which point we felt that an attractive asymmetric profile had emerged. We also believed that the market failed to appreciate the cash generative ability of the company - the cash realisation rate, which is a measure of how profits are converted into cash, was 100% in their latest financial result (the average rate for the last five full financial years is 88%).

In our opinion, Truworths is ripe for improvement – their domestic challenges should fade during the next 12 months, aided by improving consumer health and the recent favourable court ruling on the affordability regulations. We regard Truworths as a responsible credit provider, but their ability to extend credit had been curtailed in 2015 when new affordability assessment regulations were enforced. In March 2017, the Cape Town High Court set aside aspects of the regulations to the benefit of the credit retailers (70% of Truworths South African sales are generated via credit). In addition to improving sales activity, earnings growth should be further enhanced by de-gearing, share buybacks, as well as a better bad debt outcome.

Pleasingly, the Truworths share price has appreciated approximately +40% since we acquired our shareholding. The fund retains its exposure to the company as the dividend yield (+4.8%) and relative price-earnings rating remains attractive (Truworths trades at a 20% discount to South African-listed apparel peers). In addition, Truworths is most geared to a better South Africa, unlike several peers (Foschini, Woolworths) who have substantially increased their offshore presence.

The JSE was also a key contributor to the funds outperformance in the quarter. The company recently reported a better-than-expected 2017 financial result. We were particularly pleased with the earnings performance in the second half of the financial period as well as the strong cash generation. We anticipate these positive trends to continue in 2018 - equity value traded is up sharply year-to-date which bodes well for revenue delivery and significant work has been done to reduce their cost base. This, coupled with the businesses strong cash generative ability bodes well for earnings and dividend growth in the year ahead.

As always, we did not get everything right and the disappointing performance from our reduced Rand Hedge exposure through Naspers and British American Tobacco / Reinet detracted from the fund's performance.

In our December report we commented extensively on the Naspers position in the fund. The Q1 2018 update on this position is disappointingly further damage done to the firm's valuation through mismanagement. Naspers sold a very small portion (6%) of their position in Tencent for cash. Tragically management communicated a message of using all the proceeds (US\$10 billion) to reinvest in their existing other businesses which continue to consume cash. This is quite illogical in the context of the alternative to buy back shares considering the discount trapped in the firm's market valuation. Unsurprisingly this decision was punished by the market with the discount widening still further as the deep scepticism with which the market views management commercial judgement widened still further. The losses in NPN were somewhat mitigated by our hedges.

The Impala convertible bond was another large detractor over the quarter, and is currently trading at a 17% discount to par with 4.5 years remaining to maturity. We see very little downside from these levels (barring an unexpected credit event), as the equity option is currently being ascribed almost no value despite a highly volatile share price. With a current YTM of 11.5% p.a. and potential equity upside should the Impala share price rally, this provides attractive asymmetry in the fund. We have a 2.1% position.

MARKET OUTLOOK

The election of Cyril Ramaphosa as head of the ANC and his subsequent appointment as state president following the resignation of Jacob Zuma is the most positive political development in the country for more than a decade. Mr Ramaphosa's immediate changes especially to key economic positions of political power and within some state-owned enterprises are additionally very encouraging. Despite these, our analysis shows that it will require skill, continuity, conviction and many years of investment before the severe economic damage done during the Zuma years can be recovered. As a consequence, despite the low base, we do not anticipate a very fast acceleration in economic growth in the short term. This is exacerbated while policy uncertainty remains in many sectors of the economy (Mining Charter, Land Expropriation without compensation, BEE Charter requirements) and considering the diverse opinions on these matters between stakeholders are unlikely to be resolved in the short term.

As a consequence, we are somewhat sceptical of the sustainability of the strong rally we have seen in the last quarter in select sectors and have reduced our exposure to some of the top performers there. In addition, the further strength of the rand has caused some high-quality businesses with non-South African generated profits to under-perform and where to our mind valuations are beginning to look more attractive. We continue to unearth several other neglected domestic oriented businesses where the valuations are more appealing on a relative basis.

The fund currently has an equity **exposure of 60% (excluding Property)**, with hedges on some of our biggest positions, including Naspers, ABSA, British American Tobacco, FirstRand and Tiger Brands. We continue to believe this creates an attractive asymmetric return profile for the fund.

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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