NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS PROPERTY FUND

Quarter One, 2018

For the period ended 31 March 2018

NEDGROUP INVESTMENTS PROPERTY FUND

PERFORMANCE

Performance to 31 March 2018	Nedgroup Investments Property Fund[1]	ASISA category average	SAPY
3 months	3.1%	-15.8%	-19.6%

MARKET COMMENTARY

During the first quarter of 2018, the FTSE/JSE SA Listed Property (SAPY) index declined by almost 20%. The steep decline in the value of the SAPY Index can be attributed to large price declines in Fortress B, Greenbay, NEPI Rockcastle and Resilient ("the Resilient group"). At the end of 2017, the Resilient group accounted for 42% of the market capitalisation of the SAPY Index and traded on extremely large premiums to the underlying value of their property portfolios. Those premiums have now been completely wiped out following allegations of price manipulation and significant corporate governance failings which were brought to light in a number of reports, most notably from 36ONE Asset Management and Arqaam Capital. The allegations are being investigated by the JSE and other regulatory bodies, but in the meantime the market capitalisation of the Resilient group has more than halved since the start of the year. During this period, the fund had no exposure to the Resilient group, having sold its position in NEPI Rockcastle in the second and third quarters of last year. This resulted in the fund significantly outperforming the SAPY Index during the quarter and over the past 12 months.

Away from the Resilient group and the rand-hedge property companies, most of the South African-listed property companies responded positively to increased political and policy certainty which followed Cyril Ramaphosa's victory at the ANC's elective conference in December last year. Further positive political developments in the first quarter of 2018 included Jacob Zuma's resignation as President of South Africa and a cabinet reshuffle which saw Nhlanhla Nene reappointed Minister of Finance and Pravin Gordhan appointed Minister of Public Enterprises. Other positive developments which helped improve investor sentiment towards South Africa's listed property companies included a 0.25% reduction in the repo rate in March and Moody's decision to keep South Africa's sovereign credit rating at the lowest level of investment grade and upgrade the rating outlook from negative to stable.

There has also been a marked improvement in business and consumer confidence in South Africa which should result in higher levels of economic activity during 2018 and 2019. An acceleration in economic growth will help reduce vacancy rates; which have been rising for the past two years, and ultimately lead to an increase in market rental levels in 2019 and beyond. Given the rather muted recovery in the listed property sector, even after stripping out the significant impact of the Resilient group in the first quarter, listed property is one of the few sectors not to have rerated since the beginning of December last year. Compared to South Africa's banking and retail stocks, listed property appears not to have benefitted from the improved sentiment towards South Africa, a stronger rand, lower bond yields and lower official interest rates. The headlines around the Resilient group have obviously scared off some investors but it should be noted that the issues are company-specific and not a systemic failure of South Africa's listed property sector.

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

PORTFOLIO COMMENTARY

Winners	Ave.weight	Performance contribution	Losers	Ave.weight	Performance Contribution
Arrowhead	10.1%	1.1%	Rebosis	9.9%	-1.3%
Accelerate	10.2%	0.9%	Delta	9.8%	-0.5%
Octodec	6.9%	0.8%	Equites	6.9%	-0.4%
Tower	7.7%	0.6%	Spear	2.5%	-0.1%
Indluplace	5.7%	0.6%	New Frontier	0.2%	-0.1%
		4.0%			**-2.4%**

During the first quarter, the fund significantly outperformed the SAPY Index as well as the average of the peer group. The fund has advanced by more than 3% since the start of the year with the top five performing positions adding 4% to the return, while the bottom five detracted 2.4% from the return. While the significant outperformance is largely attributable to the fact that the fund had disposed of its positions in the Resilient group during 2017, there were also significant recoveries in the prices of several South African-focused listed property companies, including Accelerate, Arrowhead, Fairvest, Indluplace, Octodec and Tower. The fund was able to acquire and/or add to these positions throughout January and capitalise on their strong price gains in February and March. It is worth noting that many of these companies were the major detractors from performance last year and by the start of this year were offering investors extremely attractive entry points (large discounts to net asset value and initial income yields well in excess of bond yields in South Africa).

The major detractors from performance in the first quarter were Delta and Rebosis, both of which suffer from a lack of investor confidence due to their large government-tenanted office portfolios. That risk appears to be diminishing due to improvements at the Department of Public Works (through which all government leases are signed) and a number of companies in the sector have reported more favourable engagements with government over the signing of longer leases that incorporate market-related, annual escalations in the rent paid to landlords.

While distributions are only forecast to grow between 3% and 5% this year, the improving economic and political environment in South Africa should result in an acceleration in distribution growth in both 2019 and 2020. Over the medium-term, distribution growth is therefore forecast to exceed South African consumer inflation and maintain the fund’s impressive track record since it was launched in July 2010.

Based on a combination of FactSet, IRESS and Bridge Fund Managers’ forecasts, the weighted average forward yield of the portfolio is currently 11.1%. Based on the same forecasts, the weighted average forward yield on the FTSE/JSE SA Listed Property (SAPY) Index is 7.8%, while the yield on government’s R186 bond is 8.1%. The fund continues to invest predominantly in small and mid-sized, domestically-focused listed property companies. Notwithstanding the recovery in prices in 2018, these companies continue to trade at discounts to net asset value due to a lack of meaningful institutional support. This provides a significant opportunity for smaller investors or institutional investors that intentionally limit their absolute exposure to listed property (like Bridge Fund Managers). These property businesses also continue to offer investors attractive initial income yields well above the yields on long-dated government bonds, while at the same time offering growth in distributions that are forecast to exceed inflation over the medium and long term.

DISTRIBUTIONS

Some investors may have noticed that the first quarter distribution this year is lower than the corresponding distribution in 2017 and substantially lower than the bumper distribution paid in the fourth quarter of 2017 due to several factors:

1) The first quarter distribution is historically the lowest distribution of the year (last year it accounted for just 13% of the total distribution paid to investors in 2017).
2) No dividend was received from either Arrowhead Properties or Indluplace Properties in the first quarter because both companies have moved from quarterly to semi-annual dividend payments starting in 2018. The fund will receive the first semi-annual dividend payments in the second quarter.
3) The fund disposed of its investment in Hospitality Property Fund which paid dividends in the first and third quarter and used the proceeds of that disposal to add to the fund's positions in Octodec and Indluplace, both of which pay their dividends in the second and fourth quarters.
4) The fund reduced exposure to South African Corporate Real Estate which pays dividends in the first and third quarters and used the proceeds of that disposal to add to positions in companies that, for the most part, pay their dividends in the second and fourth quarters.

As a result; and based on IRESS, Bloomberg and FactSet consensus forecasts, the second quarter distribution this year will be at least 15% higher than the corresponding distribution paid in 2017. The second and fourth quarter distributions are forecast to make up close to 80% of the total distributions of the Nedgroup Investments Property Fund in 2018.

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

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