NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS STABLE FUND

Quarter One, 2018

For the period ended 31 March 2018

INVESTMENT OUTLOOK AND FUND CONSTRUCTION

World:

- Global growth likely to expand further
- Inflation should rise
- US Interest rates trend higher
- Bond yields should track short rates higher
- US corporate earnings stronger
- Equity markets are fully priced

South Africa:

- Growth should improve but remain at low levels
- Public finances will remain stressed
- Inflation should remain well below SARB target
- Interest rates unlikely to fall much further
- Outlook for the rand remains negative

Fund construction:

- Non-resource rand hedge bias remains
- Foreign assets below higher prudential maximum
- Select listed property counters maintained
- High coupon government bonds retained
- Maintained commodity ETF position

EFFECTIVE ASSET ALLOCATION (previous)

	Fund %	%
JSE equities	16	(16)
Foreign assets	27	(27)
JSE property	5	(4)
Commodities	6	(6)
SA bonds	31	(28)
Cash	15	(19)
	100	

Sector Contribution to 31 March 2018

(Return x weight)

	JSE equities	JSE property	Interest bearing*	Other assets	Foreign assets	Fund
	%	%	%	%	%	%
1 year	0.7	- 0.2	5.1	- 0.4	- 1.0	4.2
3 months	- 0.5	- 0.3	1.9	- 0.1	- 2.2	- 1.2

* Bonds and cash combined

Selection to 31 March 2018

	JSE equities		JSE property		Interest bearing			Foreign assets	
	Fund	Capi Index	Fund	Real Estate Index	Fund	ALBI Index	AF Call Dep Index	Fund	Bench-mark*
	%	%	%	%	%	%	%	%	%
From inception (01/11/2007)	16.0	9.2	10.3	7.2	8.0	9.0	6.6	9.1	10.0
10 years	17.9	10.2	9.3	8.7	7.9	9.6	6.5	7.8	8.6
7 years	16.1	11.5	8.5	11.7	7.2	9.4	5.8	13.9	15.2
5 years	10.3	10.1	2.7	6.6	7.6	7.7	6.0	10.1	12.2
3 years	2.4	5.1	- 10.8	- 2.5	8.7	8.6	6.6	4.2	5.7
1 year	5.4	8.9	- 5.0	- 7.7	11.4	16.2	6.8	- 3.7	- 1.3
3 months	- 3.2	- 4.7	- 7.5	- 18.1	4.3	8.1	1.6	- 7.8	- 3.8

* 60% Morgan Stanley World Equity Index in rand
  40% Citi Group World Govt Bond Index in rand

QUARTERLY PERFORMANCE COMMENT

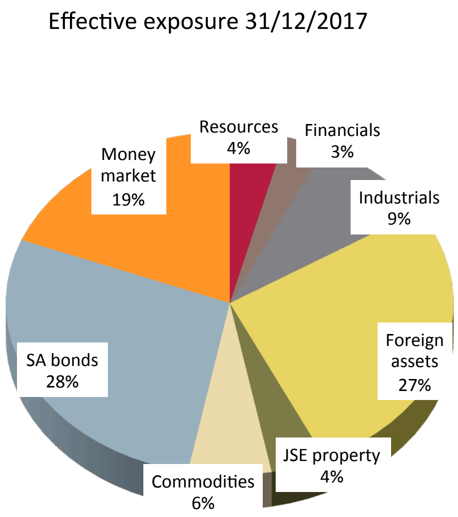
- R186 government bonds (+5.2%) delivered positive returns as yields declined
- Foreign assets (-7.5%) detracted on global market contraction and rand strength
- Mr Price (+16.4%) and Standard Bank (+11.8%) contributed positively as SA Inc shares continued to rally
- British American Tobacco (-15.1%) and Capital & Counties (-14.4%) accounted for most of the negative JSE equity and property returns

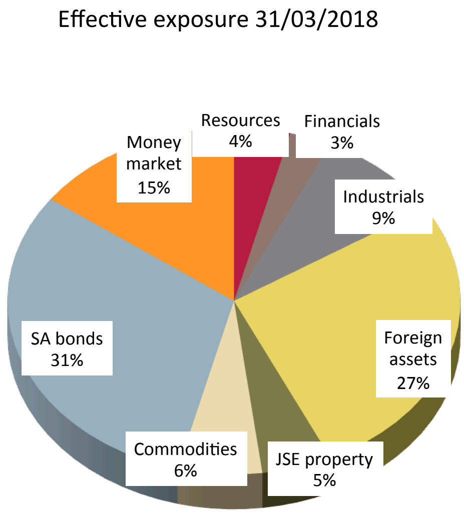
PORTFOLIO STRUCTURE

Mandate (%)		Fund Effective exposure 31/12/2017 %	31/03/2018 %	FTSE/JSE Capped Weightings %
	JSE equities: resources	4	4	3
	JSE equities: financials (ex property)	3	3	4
	JSE equities: industrials	9	9	9
0 - 40	JSE equities*	16	16	16
0 - 30	Foreign assets	27	27	
	Foord International Fund	16	17	
	Foord Global Equity Fund	11	10	
0 - 20	JSE property	4	5	
	Commodities	6	6	
0 - 60	SA bonds	28	31	
0 - 60	Money market	19	15	
		100	**100**	

*Size distribution of JSE equities	%	%	%
Large capitalisation	90	97	86
Mid capitalisation	10	3	11
Small capitalisation	0	0	3
	100	**100**	**100**

Exposure analysis	Domestic %	Foreign %	Total %
Equities	16	22	38
Listed property	5	0	5
Corporate bonds	5	0	5
Government bonds	26	0	26
Commodities	6	1	7
Money market	15	4	19
	73	**27**	**100**





MARKET BACKGROUND AND OUTLOOK

World Market Background

- Developed market economies continued to expand above sustainable long-term growth rates but inflation was contained – wage increases were surprisingly subdued despite falling unemployment rates.
- Developed market bond yields initially advanced meaningfully on expectations of a more hawkish Fed policy stance – but retraced latterly after more moderate Fed commentary.
- The US dollar weakened against other majors – the Fed forecast for three 2018 interest rate increases was unchanged against market expectation of potentially four.
- New Federal Reserve Chairman Powell announced a further 0.25% increase in the federal funds target rate, taking it to 1.75% – the “dot plot” continues to indicate a gradual path of rate increases into 2019.
- US President Trump announced tariffs on a range of Chinese imports and China retaliated with tit-for-tat tariffs on products imported from the US – fears of an all-out trade war intensified, threatening the late-cycle global economic expansion.
- Global commodity prices were mixed with iron ore and copper weakening as investors contemplated the trade war implications – but oil rose as OPEC producers and partners appear set to hold production limits.
- Despite expectations for increased corporate earnings, global equity markets fell when technology stocks retraced some of their 2017 gains – user data privacy concerns dragged down Facebook after revelations that millions of customers had been targeted to influence the US presidential election outcome.
- Geopolitical risks remain elevated – President Putin won a landslide Russian election, while North Korea warmed up to China having earlier committed to meeting US President Trump.

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South Africa Market Background

- Cyril Ramaphosa was sworn in as South Africa's president after Jacob Zuma reluctantly resigned following days of posturing – Ramaphosa appointed Nhlanhla Nene as new Finance minister and Pravin Gordhan as Public Enterprises minister, setting the course for a more effective and fiscally responsible government.
- Moody's confirmed South Africa's local currency rating at BBB-, the lowest investment grade rating, at the same time changing the outlook from negative to stable – bond yields continued to firm during the quarter.
- The South African Reserve Bank lowered the REPO rate by 25 basis points to 6.5% – inflation recorded a low of 4% while the rand gained on the back of continued foreign portfolio inflows and improved sentiment.
- The FTSE/JSE All Share Index tracked global share markets lower – index heavyweight Naspers declined 16% and share prices of the Resilient property stable more than halved on ongoing corporate governance concerns.
- Q4 2017 GDP growth surprised positively after household consumption advanced more than anticipated – but the current account deficit widened as increased payments of dividends and interest to foreign investors offset terms of trade gains.

World Market Outlook

- Global GDP should expand above sustainable long-term growth rates for the immediate future – European and Japanese growth rates remains buoyant amid increased demand for exports, while employment gains and associated wage growth power the US economy.
- The US Federal Reserve is likely to persist with only gradual interest rate increases through the year given contained inflation prints – escaping the need for more hawkish policy typical of a late-stage economic expansion.
- Interest rates in Europe and Japan may stay unchanged this year, while UK rate increases will depend on higher inflation brought about by sterling weakness – the BoJ and ECB may well withdraw monetary stimulus by concluding their respective quantitative easing programs, setting the course for an adjustment to interest rates.
- US bond yields should continue normalising, reflecting higher short-term policy rates and higher medium-term inflation expectations – US real interest rates are still only marginally positive, while yields in most other developed economies are negative, offering little capital protection.
- US corporate earnings expectations moved sharply higher following major tax cuts and fiscal spending announcements – but equity markets are precariously balanced given the S&P's lofty rating, threats of a full-out trade war and the negative consequences associated with lower external demand for US products and services.

South African Market Outlook

- Consumer confidence and business sentiment surged on Ramaphosa's investiture as new South African president and we expect further economic expansion in early 2018 – but sustainable long-term demand will depend on structural economic changes, confirmed by increased fixed capital investment by foreign firms.
- Benign inflationary conditions will probably persist given relatively poor internal demand – despite the immediate negative effects of the VAT increase.
- SARB's ability to further lower short-term interest rates is constrained by higher prevailing global interest rates – and will depend on continued rand strength and a more business-friendly labour market.
- The spread between South African 10-year bond yields and US treasuries is attractive – but higher US yields would reduce the relative attractiveness of South African bonds and halt the gains in South African government bond prices.
- The rand has recovered sharply in the last six months, in anticipation of a more business friendly government led by Mr Ramaphosa – although the new administration has moved swiftly to contain corruption, limited prospects of any material government policy changes are likely to result in restrained economic growth.

PORTFOLIO CONSTRUCTION

- Looking forward, portfolios are little changed today compared to end of the Q3 2017 (before the ANC elective conference when South Africa stepped back from its abyss). While some downside risk has abated, valuations of SA consumer discretionary businesses have moved from “somewhat expensive” to “very expensive”.
- Earnings growth prospects of consumer companies are subdued, yet share prices have risen substantially, with forward price-earnings multiples now significantly above fair value. This means there is little margin for error if earnings disappoint, with elevated risk of capital loss.
- Allocation to financial companies is predominantly in the highest quality banks. While not cheap, banks should achieve moderate, but highly predictable, medium-term earnings growth. There is also scope for positive earnings surprises if economic growth recovers and credit demand improves from current depressed levels.
- South African fixed coupon bonds offer the prospect of meaningful, inflation-beating returns in the medium term. The average 9.3% running yield of bonds in the portfolio should provide at least a 4% real return (i.e. after inflation) over the next three years. If the benign inflation environment persists, these real yields could be achieved for longer. We therefore prefer to hold high-yielding, fixed-coupon bonds over floating rate money market instruments.
- One of the consequences of the rapid rise in ‘SA Inc.’ share prices and rand appreciation is the improved relative attractiveness of global businesses to domestic companies. Earnings growth expectations from quality global companies listed on the JSE are more certain than domestic opportunities of similar quality, while the ratings are not as stretched. Consider the following:
    - British American Tobacco: +8% compound annual growth rate (CAGR) in pounds with a 4% dividend yield (DY)
    - ABInbev: +12% CAGR in US dollars and 4% DY
    - Aspen: +16% CAGR in rands.

- As a final comment, we believe rand strength has overshot our assessment of fair value and further material appreciation is unlikely even if SA’s moderate economic growth persists, despite the economy’s structural challenges. Holdings of direct foreign investments are high but not yet at the maximum prudential limit. Foreign equities remain our preferred asset class, but short-term volatility may allow an up-weighting to 30% at better prices.
- The portfolio remains very well positioned for the unfolding environment. Investors who understand long-term return patterns will continue to benefit from Foord’s proven long-term real return track record.

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
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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.

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