



NEDGROUP
INVESTMENTS

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NEDGROUP INVESTMENTS VALUE FUND

Quarter One, 2018

For the period ended 31 March 2018

NEDGROUP INVESTMENTS VALUE FUND

SOUTH AFRICAN INVESTMENT OUTLOOK

- 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

Sector Contributions to 31 March 2018 (returns x weight)

	<u>1 year</u>		<u>3 months</u>	
	<u>Fund</u> %	<u>ALSI</u> %	<u>Fund</u> %	<u>ALSI</u> %
Precious metals	- 0.7	- 0.6	- 0.7	- 0.4
Overseas companies	- 1.4	- 0.1	- 1.4	- 0.7
Commodity cyclicals	2.1	2.8	- 1.1	- 0.4
Capital goods/construction	0.2	0.1	0.1	0.1
Information technology	- 1.9	- 0.2	- 1.6	- 0.1
Industrials/transport	3.3	0.6	0.9	- 0.3
Health	0.0	- 0.1	0.0	- 0.1
Consumer/services	- 6.0	- 0.9	0.0	0.2
Telecommunications	0.1	0.1	0.1	- 0.2
Media	0.0	4.0	0.0	- 3.2
Financials	7.1	4.3	2.6	0.3
Property	- 0.3	- 0.4	- 0.9	- 1.2
Money market	0.5	0.0	0.1	0.0
	3.0	9.6	- 1.9	- 6.0

Note: There may be slight discrepancies in the totals due to rounding

QUARTERLY PERFORMANCE COMMENT:

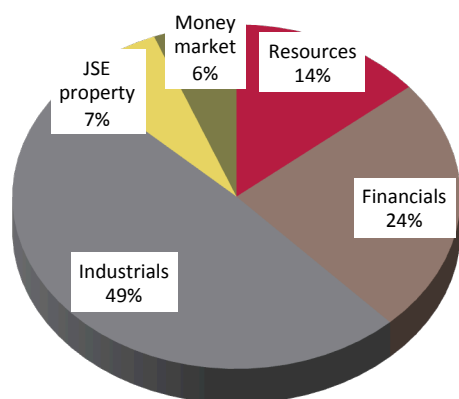
- Mr Price (+16.4%) and Standard Bank (+11.8%) contributed positively as SA Inc shares continued to rally.
- British American Tobacco (-15.1%) and Datatec (-41%) accounted for most of the negative return.

PORTFOLIO STRUCTURE

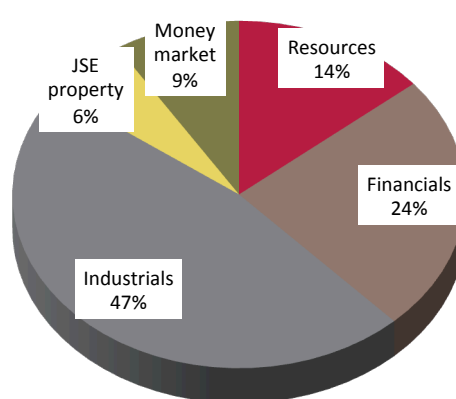
	Fund		FTSE/JSE ALSI
	Effective exposure		Weightings
	31/12/2017	31/03/2018	%
JSE equities: resources	14	14	16
JSE equities: financials (ex property)	24	24	19
JSE equities: industrials	49	47	51
JSE property	7	6	5
JSE equities*	94	91	91
Money market	6	9	
	100	100	

*Size distribution of JSE equities	%	%	%
Large capitalisation	63	61	88
Mid capitalisation	25	22	9
Small capitalisation	12	17	3
	100	100	100

Effective exposure 31/12/2017



Effective exposure 31/03/2018



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.

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 remain 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.
- 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
 - 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. The portfolio remains very well positioned for the unfolding environment.

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