



**NEDGROUP**  
INVESTMENTS

see money differently

XS

QUARTERLY  
REVIEW

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Quarter Three  
2017

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# Nedgroup Investments

## XS Quarterly Review

**Quarter Three**, for the period ended September 2017

The purpose of this report is to provide our partners, with a review of the past quarter's performance of the investment solutions in which your clients are invested. The report is structured as follows:

### **Part one: Market review**

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This section provides a market review, which looks at the performance over the past quarter of local and global asset classes, as well as currencies, and puts this into perspective relative to longer-term performance. The purpose of this review is to provide a context in which the performance of the investment solutions can be assessed.

### **Part two: Investment solutions' performance**

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This section provides an overview of the performance of the investment solutions in which your clients are invested. This is a high-level performance review over both shorter and longer time periods.

### **Part three: Fund manager review**

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This section provides a detailed assessment of the performance of each of the underlying portfolio managers, comparing the managers' performance to their respective benchmarks.

### **Part four: Investment reflection**

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This section includes an article written by Fund Manager, Andrew Parsons and discusses the investment case for the Empire State Building.

### **Part five: Fund fact sheets**

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This section includes the latest fund fact sheets of the investment solutions.

## Part one: Market review

The table below provides a review of key domestic and international investment indicators for the past quarter, as well as over longer periods.

### South African asset classes (in rands)

(Performance over periods to 30 September 2017)

Asset class	Indicator	3 months	1 year	3 years	5 years	LT-average*
Equities	All Share Index	8.9%	10.2%	7.2%	12.5%	12.6%
Property	Listed Property Index	5.7%	9.5%	12.7%	12.7%	12.8%
Bonds	All Bond Index	3.7%	8.2%	7.6%	6.4%	6.9%
Cash	STeFI Call	1.7%	6.9%	6.4%	5.8%	5.9%
Inflation	CPI (one month in arrears)	0.6%	4.8%	5.1%	5.6%	5.0%

Source: Morningstar

### Global asset classes (in dollars)

(Performance over periods to 30 September 2017)

Asset class	Indicator	3 months	1 year	3 years	5 years	LT-average*
Equities	MSCI AC World Index	5.3%	19.3%	8.0%	10.8%	10.0%
Property	S&P Developed Property Index	2.2%	3.4%	7.5%	8.4%	7.0%
Bonds	JPM Global Bond Index	2.4%	-1.9%	0.7%	0.1%	4.5%
Cash	US 3-month deposits	0.3%	1.0%	0.5%	0.4%	3.8%
Inflation	US CPI (one month in arrears)	0.3%	1.9%	1.1%	1.3%	3.1%

Source: Morningstar

### Currencies

(Movements over periods to 30 September 2017)

Currency	Value at month-end	3 months	1 year	3 years	5 years	LT-average*
Rand / Dollar	13.50	-3.1%	1.8%	-6.1%	-10.4%	-7.0%
Rand / Sterling	18.12	-6.4%	-1.4%	0.4%	-6.3%	-5.3%
Rand / Euro	15.96	-6.8%	-3.3%	-3.8%	-8.5%	-6.7%

Source: Morningstar

\* Updated annually from 1900, or longest available period  
Returns for periods longer than 12 months are annualised.

## International market commentary

The third quarter was a rewarding period for investors, with stronger than expected economic data from a number of countries and regions (including the Eurozone, Japan and many emerging economies) reaffirming that the synchronised global recovery remains on track. Corporate earnings were also strong, with the majority of companies beating expectations on both revenues and earnings. This prompted many analysts to upgrade their forecasts, and it now looks as if global corporate earnings may grow as much as 14% in 2017 (in US dollars), with the strongest contributors being the Eurozone, the Emerging Markets and the UK, which are all recovering sharply from a low base.

Political news-flow was mixed, with the US and North Korea continuing to trade threats and insults over the latter's nuclear missile program. In Europe, Merkel won the German general election, but was seriously wounded by a marked decline in support for her CDU party and the SPD's decision to withdraw from her coalition. As a result, Merkel was forced to try and forge a more tenuous and weaker alliance with the Greens and the FDP. On other issues, the Brexit talks made little progress, with the enfeebled UK government appearing confused about its goals, and the two parties appearing to be very far apart on a number of key issues. In Japan, Prime Minister Abe called a snap election, the result of which is likely to strengthen his position and allow him to continue his reform programme.

While advanced economy inflation has generally remained subdued, strong growth and rising oil prices suggest that it may now be past its lowest point. Of late, central bank talk has mostly focused on how improving global economic activity is likely to prompt a gradual tightening of policies. In response, interest rate expectations have been moving higher, with most analysts now forecasting that the Bank of England will raise rates in November and the Federal Reserve following suit in December. On a related topic, the Federal Reserve also outlined plans to start reducing its bond holdings and the European Central Bank hinted at its intent to scale back its quantitative easing program.

Market volatility remained unusually low over the period. Against this background, the tone of financial markets was broadly positive, with riskier assets generally outperforming safe havens. Most equities performed well over the quarter, rising +5.2% according to the MSCI All Country World Index, when measured in US dollars. All major countries and regions were strong, with Emerging Markets (+7.9%) leading the way, while the US (+4.3) and Japan (+4.0%) lagged. At the sector level, cyclicals outperformed defensives, with energy (+9.7%) and materials (+9.2%) as the star performers, while consumer staples (-0.1%) fared poorly. Finally, on style, growth (+5.8%) beat value (+4.7%), while smaller companies (+6.3%) outpaced larger companies (+5.2%).

Fixed income returns were more muted, with worries about rising interest rates coming to the fore, particularly in September. Riskier sub-sectors generally did the best as credit spreads tended to narrow, encouraged by better economic and corporate earnings data.

The Bloomberg Commodities Index rose by +2.5%, helped in part by the weakness of the US dollar. Crude Oil (+11.2%) was the area of greatest strength as it rose off a low base in response to better demand and falling

inventories. Industrial metals (+9.9%) and gold (+3.1%) were also positive performers, with only agriculture (-6.1%) losing ground following a global glut in various key crops.

The US dollar weakened over the period, as the Trump reflation story lost steam and economic activity in other regions (such as the Eurozone) surprised on the upside. Over the period the euro rose by +3.3% versus the US dollar, while the British pound climbed by +2.9% and the Chinese yuan managed +1.9%. One notable exception was the South African rand, which slipped -3.7%.

*Notes: All quarterly data is quoted in US dollar terms unless otherwise stated.*

## **Domestic market commentary**

With constructive economic data coming out of the broader global market, South Africa as an open economy managed to rebound out of a technical recession and GDP growth improved by 2.5% quarter-on-quarter in Q2 2017. In addition to the healthy external global environment, the growth was supported by the continued strength from the agriculture sector and a mild recovery in consumer spending.

However, the country's GDP growth is still expected to be subpar, with the South African Reserve Bank (SARB) revising it lower to 0.5% for 2017. Attention will be paid to Finance Minister Gigaba's Medium-Term Budget Policy Statement on 25 October where both the market and credit rating agencies will expect concrete details on the how the government will address the lacklustre economic growth and the ailing state owned enterprises. The lead-up to the ANC Elective Conference in December is also adding to the concerns, thus increasing the risk of further sovereign downgrades.

In September, the Monetary Policy Committee disappointed the market when it left rates unchanged after having announced a surprise cut to 6.75% earlier in the quarter; citing political distractions, uncertainties around efforts of fiscal consolidation and global risks. This is despite subdued inflation, weak economic growth and a resilient currency all making a further rate reduction possible.

The global environment in which South Africa operates, where policy direction (in particular from the US) continues to command the most investor attention, caused the rand to be on the back foot and end weaker at R13.50 against the US dollar.

The broader domestic equity market as reflected by the FTSE/JSE All Share Index closed on a high note with a strong return of 8.91% for the quarter. Resources gave a handsome return of 17.69% as global growth prospects improved. This was followed by the Industrial 25, up by 8.30%, bringing the most recent one-year performance to 13.50%. The industrial sector was mainly driven by a few counters such as Naspers which has returned 50% year-to-date. Naspers is currently trading 10 times the price it was six years ago at R300.

Financials, being the more interest-rate-sensitive domestic equity sector and trading on less demanding valuations when compared to the industrial sector, had a quarterly return of 6.08%. The midcaps and small caps were up by 3.84% and 3.01% respectively.

Listed property was the second best performing asset class with a decent quarterly return of 5.73%. A consequence of this being that the dividend yield is now currently trading at around 5%, making it one of the lowest yielding domestic asset classes. This suggests that, even under very optimistic distribution growth assumptions, this asset class has demanding valuations and may thus be vulnerable to a meaningful pull back.

The domestic bond market gained 3.68% over the past quarter. While the disinflationary trend and continued support from foreign investors could have supported this asset class, the performance came with volatility as unsteady trends in data coming out of the US labour market increased investor anxiety around the timing of further rate hikes.

Cash returned 1.84%, while inflation-linked bonds returned a positive 1.39%.

## Part two: Investment solutions' performance

### XS Accelerated Class C

As at 30 September 2017		Q3 2017	1 year	3 years	5 years	7 years	10 Years	Inception*	Volatility*
<b>Fund of Funds</b>	XS Accelerated	4.2%	7.0%	6.9%	11.5%	<b>11.7%</b>	9.7%	14.7%	9.8%
<b>Benchmark</b>	CPI + 6-7%	2.2%	11.6%	11.9%	12.5%	<b>12.3%</b>	12.9%	12.7%	n/a
<b>Category average</b>	SA MA Flexible	4.8%	5.2%	5.7%	9.4%	<b>9.9%</b>	10.0%	8.1%	12.8%

### XS Diversified Class C

As at 30 September 2017		Q3 2017	1 year	3 years	5 years	7 years	10 Years	Inception*	Volatility*
<b>Fund of Funds</b>	XS Diversified	3.8%	7.2%	6.6%	<b>10.3%</b>	10.5%	9.4%	12.9%	7.3%
<b>Benchmark</b>	CPI + 4-6%	1.8%	10.0%	10.3%	<b>10.9%</b>	10.8%	11.3%	11.1%	n/a
<b>Category average</b>	SA MA High Equity	5.1%	6.0%	6.3%	<b>9.8%</b>	9.9%	9.8%	8.1%	12.2%

### XS Guarded Class C

As at 30 September 2017		Q3 2017	1 year	3 years	5 years	7 years	10 Years	Inception*	Volatility*
<b>Fund of Funds</b>	XS Guarded	3.0%	7.8%	<b>7.5%</b>	9.7%	9.7%	9.1%	10.7%	3.9%
<b>Benchmark</b>	CPI + 2-4%	1.3%	7.9%	<b>8.2%</b>	8.8%	8.6%	9.2%	9.0%	n/a
<b>Category average</b>	SA MA Low Equity	3.7%	6.5%	<b>6.8%</b>	8.4%	8.6%	8.7%	8.0%	9.5%

\* From 1 September 2004

For periods prior to launch of C-class, performance has been adjusted to be on an equivalent fee basis.

Returns for periods longer than 12 months are annualised.

## Portfolio performance

Over the past quarter, one of the key contributing factors to performance was the funds' offshore exposure via offshore-domiciled funds, as well as local equity funds which have meaningful exposure to rand hedge stocks (following the weakness of the rand).

The XS Fund of Funds produced positive returns, although showing slight underperformance relative to the respective category peers. However; over the longer more meaningful periods for the higher risk funds, returns remain in line with the respective benchmarks and well-ahead of their multi-asset category averages. Over five years the XS Diversified FoF returned around 10.3% per annum compared to the SA MA High Equity category average which returned around 9.8%. Over seven years the XS Accelerated FoF returned around 11.7% per annum compared to the SA MA Flexible category average which returned around 9.9%.

We would expect the performance differentials of the XS Fund of Funds to narrow over the next year, as South African inflation comes down (barring any internal and external shocks). August's inflation figure printed at 4.8%; a significant improvement from 2016's high number of around 7%. Additionally, stabilisation in economic growth - and consequently earnings growth (as the business cycle proceeds) - will also result in these strategies managing to close the current performance lags. This is largely the reason for the prevailing levels of anxiety around macroeconomic policy, as well as the outlook for capital markets, across the globe.

The table below highlights our rankings relative to respective peer fund categories, over various time periods. The appropriate measurement period for each solution is in bold. Over the past year, the XS Fund of Funds have performed well relative to their respective peer groups.

XS Solution (C Class)	Peer Category	1 year	3 years	5 years	7 years	10 Years	Since Inception*
XS Accelerated	South African – Multi Asset Flexible	21/64	24/57	13/45	<b>15/42</b>	11/33	4/14
XS Diversified	South African – Multi Asset – High Equity	52/178	61/120	<b>50/88</b>	35/67	17/45	16/20
XS Guarded	South African – Multi Asset – Low Equity	28/142	<b>30/101</b>	19/86	19/69	7/47	3/12

Source: Morningstar

\* 1 September 2004



## Portfolio positioning

The funds' asset allocation positioning has remained unchanged over the quarter.

As at the end of Q3 2017, the XS Fund of Funds were positioned as follows:

	Domestic	Offshore
<b>Equity</b>	Underweight	Neutral
<b>Property</b>	Neutral	Overweight
<b>Bonds</b>	Neutral	Underweight
<b>Cash</b>	Overweight	Neutral

The reason we have stressed the importance of being valuation conscious and driven, is due to South Africa (along with the US equity market) remaining an expensive equity market globally. In a market like South Africa, where the JSE All Share is currently trading at its highest PE levels (approximately two standard deviations above its mean); diversification remains paramount when investing. It is for these reasons that we have retained the underweight to equities (particularly on the domestic side). In addition, the current domestic weak fundamentals do not warrant a higher exposure. We will continue to assess the relative attractiveness of this asset class and will increase our exposure if the risk and return characteristics become more favourable.

With the domestic property sector also not supported by fundamentals, despite similar returns; we are of the view that the risk has elevated and have thus retained our neutral position. The relative attractiveness of the domestic property sector is less compared to its own long-term historical averages as well as against the yield on government's benchmark R186 bond. Given the political and downgrading risks, an opportunity of a great entry point (i.e. overweighting) could be provided over the next 12 months.

We are also mindful that there could be scope for the strength of the rand given valuations (on a PPP and REER basis) and stronger external factors (global risk appetite and strong demand for South African bonds). This possibility is barring our own internal political and fiscal risks that could cause further currency weakness. Therefore, in monitoring our investment strategy on a forward-looking basis, we continue to keep a balanced portfolio that does not have a distinct bias to a particular currency view. We remain focused on attractively valued investment opportunities, in our portfolios, which could benefit from either rand strength (rand-betas) or rand weakness (rand-hedges).

## Top 10 holdings per investment solution as at 30 September 2017

	<b>XS Accelerated Solution</b>	<b>% of Fund</b>
1	Naspers Ltd	6.5%
2	British American Tobacco Plc	3.5%
3	Steinhoff International	2.4%
4	Old Mutual Plc	2.2%
5	Reinet Investments	1.7%
6	FirstRand Ltd	1.6%
7	Net1 UEPS Technologies Inc	1.6%
8	Barclays Africa Group Ltd	1.5%
9	BHP Billiton Plc	1.3%
10	Sappi Limited	1.2%

<b>Resources</b>	16.0%
<b>Industrials</b>	53.2%
<b>Financials</b>	30.8%

	<b>XS Diversified Solution</b>	<b>% of Fund</b>
1	Naspers Ltd	5.1%
2	British American Tobacco Plc	2.9%
3	Steinhoff International	1.9%
4	Old Mutual Plc	1.6%
5	Reinet Investments	1.5%
6	Sasol Limited	1.3%
7	FirstRand Ltd	1.2%
8	Barclays Africa Group Ltd	1.1%
9	BHP Billiton Plc	1.1%
10	Sappi Limited	1.1%

<b>Resources</b>	16.1%
<b>Industrials</b>	53.2%
<b>Financials</b>	30.7%

	<b>XS Guarded Solution</b>	<b>% of Fund</b>
1	Naspers Ltd	2.3%
2	British American Tobacco Plc	1.5%
3	Reinet Investments	1.1%
4	Steinhoff International	0.9%
5	Santam Limited	0.8%
6	Sappi Limited	0.7%
7	AVI Ltd	0.7%
8	KAP International Holdings Ltd	0.6%
9	Sasol Limited	0.6%
10	Old Mutual Plc	0.6%

<b>Resources</b>	16.3%
<b>Industrials</b>	53.3%
<b>Financials</b>	30.4%

## Part three: Fund manager review

The Nedgroup Investments investment philosophy is one that seeks to appoint specialist portfolio managers who are most appropriate for the achievement of each solution's benchmark. This allows us to implement the fund management of your investment solutions using a number of investment specialists with proven track records. The table below summarises the annualised performance of the underlying investment building blocks relative to their respective benchmarks over various investment time horizons. All performance is quoted in rands.

Fund Manager Performance as at 30 September 2017	3 Months	1 Year	3 Years (annualised)	5 Years (annualised)	10 Years (annualised)
<b>Local General Equity</b>					
Foord Asset Management	3.2	6.7	5.8	9.3	10.1
ABAX Investments	6.0	4.8	6.5	11.3	9.6
ASISA SA Equity General Peer Group	6.0	4.2	4.2	9.6	7.6
<b>Local Small/Mid Cap Equity</b>					
ABAX Investments	3.1	0.6	8.1	12.9	11.3
ASISA SA Small/Mid Cap Peer Group	-0.3	-3.6	3.0	8.2	5.4
<b>Local Flexible (1)</b>					
Truffle Asset Management	3.9	-	-	-	-
ASISA SA MA High Equity Peer Group	5.1	6.0	6.3	9.8	8.1
<b>Local Property</b>					
Bridge Fund Managers	1.8	8.9	11.2	12.3	-
ASISA SA Real Estate General Peer Group	5.3	8.8	11.9	12.3	12.5
<b>Local Fixed Income</b>					
ABAX Investments (flexible)	1.9	7.6	8.3	8.2	9.0
Taquanta Asset Management (bond)	2.4	7.7	7.3	6.4	8.7
Taquanta Asset Management (cash)	2.1	8.6	7.9	7.1	-
ASISA SA IB Money Market Peer Group	1.9	7.8	7.1	6.4	7.2
110% STeFI Call Deposit	1.9	7.7	6.9	6.3	7.3
<b>Global Equity</b>					
Veritas Asset Management	5.2	15.7	14.2	21.0	9.8
ASISA Global Equity Peer Group	7.2	13.7	11.5	19.1	8.9
<b>Global Flexible (2)</b>					
First Pacific Advisors (FPA)	4.5	9.1	11.1	17.6	10.0
ASISA MA Global Flexible Peer Group	6.4	9.1	9.6	16.2	9.1
<b>Global Property</b>					
Resolution Capital (3)	5.3	3.7	15.1	19.8	12.8
ASISA Global Real Estate Peer Group	4.0	-3.0	10.4	15.3	7.6

<sup>(1)</sup> Truffle Asset Management were appointed to manage this building block during December 2015 (performance prior to this was RECM)

<sup>(2)</sup> FPA were appointed to manage this building block during June 2012 (performance prior to this was Sarasin & Partners)

<sup>(3)</sup> Performance data based on Resolution Capital's long term track record

## **DOMESTIC GENERAL EQUITY**

The domestic equity building block managers (Foord and ABAX) continue to keep abreast of political developments as the outcome of the ANC Elective Conference will represent an important inflection point for South Africa's struggling economy and future growth prospects. In that light, they favour high quality businesses that are globally diversified and not reliant on the performance of the domestic economy; while complemented by select attractive SA Inc. companies.

ABAX expects the interest rate cycle to be shallow to meaningfully boost economic growth and therefore remains cautious about interest rate sensitive equities.

Foord favours non-resource rand hedges; and remains cautious with a sizeable cash holding (10.3%) that caused the manager to lag its peers in a quarter where the domestic equity market gave a strong return. This relatively high liquidity provides optionality in the event of increased volatility.

Over the longer term, both domestic equity building block managers have demonstrated their ability to outperform their peer group average.

## **DOMESTIC SMALL/MID CAP EQUITY**

ABAX who also manages the small/mid cap equity building block produced a positive return of 3.0% over the quarter, ahead of its ASISA SA Small/Mid Cap Peer Group that was flat. The manager holds no exposure to gold miners – which have a heavy weighting in the mid-cap index (Sibanye and Goldfields). The team does not see value in what they describe as highly unpredictable, risky and difficult-to-manage businesses; therefore in that regard, the gold miners are unlikely to ever be included in the fund. The small/mid cap equity building block has been a key contributor to domestic equity performance over the past three years, returning 8.1% per annum.

## **DOMESTIC FLEXIBLE**

Truffle currently remains overweight rand-hedge shares. The manager is of the view that due to the scarcity of value in many local sectors, their negative outlook for the local economy and the greater risk of a weakening rand, they maintain a significant exposure to rand-hedge companies. Their view is that many of these companies remain reasonably priced and are benefitting from the buoyant global economic environment with good earnings growth prospects. From a portfolio perspective, they continue to hold large positions in Old Mutual Plc, Steinhoff International, British American Tobacco, Reinet and South African banks (Barclays Group Africa, Nedbank, FirstRand Ltd and Standard Bank Group Ltd). On the fixed income portion of the portfolio, they remain underweight in long-duration assets and prefer exposure to short-duration corporate credit. They feel that this provides a higher yield with less sensitivity to interest rate changes.

## **DOMESTIC PROPERTY**

The local property building block managed by Bridge Fund Managers remains invested in small and mid-sized domestically focused listed property companies that trade at discounts to net asset value. The manager also shares our view that property fundamentals have deteriorated over the past 18 months; however, still feels that most companies appear capable of delivering distribution growth of between 6% and 8% per annum over the next three years in the absence of major tenant failures. The fund is currently offering investors an initial income yield (before fees) of 10.6% and distribution growth of approximately 6.4% per annum (inflation beating) over the next three years. The fund's lack of exposure to the SAPY Index heavyweights, introduces attractively valued rand-beta investment opportunities to the XS Fund of Funds, partly offsetting the rand-hedge bias of the local equity carve-out.

## **DOMESTIC FIXED INCOME**

Over the quarter, the domestic flexible fixed income building block manager (ABAX), added to their corporate bond exposure via the secondary market, at attractive levels. The manager has avoided the primary market as credit spreads have tightened significantly over the past few months and most issuers no longer present compelling value relative to the credit and liquidity risk assumed. They also decided to increase allocation to NCDs issued by the banks as their returns are now relatively attractive compared to corporate bonds and they have greater liquidity. ABAX introduced some exposure to short-term inflation-linked bonds with real yields above 3.0%; and are expected to provide yield enhancement when inflation begins to move higher.

For their offshore exposure, they purchased Steinhoff convertible bonds after a selloff in the issuer's equity forced these bonds to cheapen dramatically. The fund's currency exposure is at 7.6% and has an additional 3.5% allocated to European property assets. Intu is their biggest holding (2.4%) and is now trading at a 6% yield in British pounds. The duration has remained broadly unchanged at 0.14 years, which is comparable to a money market fund, and thus introducing little interest rate risk. The current weighted average yield of the building block is 8.64%

The aim of the Bond Fund, managed by Taquanta, is to produce superior risk-adjusted returns relative to the peers. To achieve this goal, the fund has largely reduced its relative negative duration position (i.e. increased interest rate risk) although its position is still net short the All Bond Index. The manager has meaningful exposure to attractively yielding corporate credit. As at 30 September 2017, the yield on the Bond Fund was 9.13%.

## **GLOBAL EQUITY**

The Veritas Asset Management's Global Equity Fund lagged the MSCI Index over the quarter. Some of the larger positions pulled back in September having risen strongly earlier in the year. The key detractors over the quarter were Comcast, Sonic Healthcare Allergan, Aena and Capita. There were just as many key contributors (American Express, Airbus, Safran, Baidu, Dong Energy) but the position sizes were smaller. True to the manager's valuation based investment philosophy that is benchmark agnostic, the fund tends to struggle in strong markets, which are often led by lower quality / higher risk / more leveraged companies. With only 27 stock holdings, this Global Equity building block has a very high conviction.

## **GLOBAL FLEXIBLE**

From a style perspective, on a global level, growth (+5.8%) beat value (+4.7%) over the quarter. This caused First Pacific Advisors, the contrarian value manager of the global flexible building block to lag their composite benchmark (60 % MSCI World + 30% JP Morgan Global Bond + 10% US Cash). With equities and high yield bonds exhibiting historically high valuations, the manager remains mindful of their long-term focus and risk management approach to limiting the permanent impairment of capital. Their largest concentration remains in financials, followed by industrials and information technology. Over the longer, more appropriate investment horizon, the fund has managed to outperform both its composite benchmark and the category average peers.

## **GLOBAL PROPERTY**

It's been over a year since Resolution Capital was appointed as the global property manager, replacing Catalyst and Oasis. Resolution Capital is a value-oriented investment manager that aims to deliver superior risk-adjusted returns over the long term. The underlying securities are carefully selected and implemented in a concentrated portfolio. There is a strong focus on avoiding permanent capital impairment. The REIT sector has been a focal point for concerns around rising interest rates and the impact of technology disruption, most notably on the retail sector. These factors are likely to constrain performance for retail property in particular and the manager has positioned the fund's portfolio accordingly. The fund remains invested in sectors where the supply/demand and internal growth drivers are favourable, including data centre and tower REITs as well as office and industrial REITs. Quality assets, lower financial leverage and aligned management continue to be key characteristics of the fund.

## Part four: Investment reflection

### THE EMPIRE STRIKES BACK

by Andrew Parsons, Resolution Capital

While people would generally be able to rattle off the names of global listed equity companies quite easily, they might struggle to come up with more than 1 or 2 global listed property companies – it's just not an area that people are overly familiar with.

At the annual Nedgroup Investments' summit earlier this year, we shared our thoughts on a company that is held in our global property funds – Empire State Realty Trust. As the name suggests, the company owns an asset that has an iconic brand name: the Empire State Building.

#### The Empire State Building – a remarkable story

Located in mid-town Manhattan and standing approximately 440 metres tall with 102 levels crowned by an observation deck, the Empire State Building was the world's tallest building for 40 years after its completion in 1931. To put it in perspective it is twice the height of South Africa's tallest building – the Carlton Centre.

Its history is littered with fascinating stories: the fact that it (remarkably) took less than 14 months to build – today buildings of this size would take around 2 years to build; how it was hit by a US B-25 Bomber in 1945 and how it was once again New York's tallest building for a decade after the events of 9-11.

The building has been around for almost 90 years but it seems to be getting better with age and going public, as a REIT, has had a lot to do with this revitalisation.

While its history is fascinating, until relatively recently its financial performance wasn't fantastic. You see it was a victim of its birth and dysfunctional ownership structure.

Finished in the depths of the Great Depression, it struggled to lease and sat with a considerable amount of vacant space, so much so that it was nicknamed the Empty State Building.

For many years, the owners simply filled space with whomever would take it, to the point where most of its floors became a rabbit warren of small tenants including lawyers, jewellers, accountants and other small businesses. Some floors had over 40 tenants, which made it very hard to manage the building in an efficient fashion. Consequently, over time the tenant fit-outs, buildings services and infrastructure gradually deteriorated.

For a long period ownership of the building was split among three parties who did not have the capital nor shared vision on how to reposition the building. Consequently, it suffered from chronic under-investment and hence was unable to attract tenants except by effectively giving away the space in return for keeping the lights on and paying city taxes.

### **A second lease on life**

All of that changed around 10 to 15 years ago when the ownership was consolidated and ultimately the property listed on the New York Stock Exchange (NYSE) in 2013 as the key asset of Empire State Realty Trust (ESRT). This dedicated structure provided access to capital to accelerate the refurbishment and repositioning of the building.

Under an extensive modernisation program, the new management team added amenities such as a gym, restaurants and conference facilities while lobby and lifts were upgraded, lighting, and power replaced.

They did such a good job that, in spite of its vintage, the Empire State Building is now in the top 15% of the most energy efficient buildings in the US. The Empire was moving from an Empty State to a 'Tower of Power' - and is only getting better with age. The Empire was striking back!

And tenants get it. Occupancy has increased from 78% in 2013 to 92.5% today – that's better than the average premium grade New York office building. At the same time rents have grown from around US\$40 in 2013 to on average over US\$52 per square feet today with most recent deals at over US\$60 a square feet. Tenants now include high profile larger names such as LinkedIn, JC Decaux and Shutterstock. It is a phenomenal turnaround in perception and reality in terms of commercial outcomes.

I still haven't got to the jewel in the crown, the observation deck. Today it attracts more than 4 million visitors per annum and generates US\$100m of income per annum. In the past 20 years other decks have been launched including, Rockefeller's Top of the Rock and the One World Observatory but, almost everyone wants to go to the Empire State Building. Since 2001 (the worst year in terms of income from the observation deck) and through the Global Financial Crisis (GFC), the observation deck saw a drop in income of less than 1%. It's been an incredibly resilient cash cow for this property.

### **Why Resolution Capital invested in it**

Resolution Capital is a global real estate securities manager, with over a 10-year track record in analysing and investing in global listed property markets. We believe that listed property provides an excellent means of gaining an efficient exposure, to the returns of some of the world's highest quality real estate assets.

In 2013, when the IPO for the Empire State Building was launched, the general perception was that it was a novelty, if not a tired old building and not a serious investment. It is fair to say that there was reasonable but not overwhelming demand for the stock. Nevertheless, for us, it had the bones of a good building, an



improving location and the character was consistent with what an increasing number of tech and media tenants were drawn to. We saw the enormous potential of a well-run building, with a better balance sheet to be able to extract returns. It reminds us of The Tea Building in London's Shoreditch – a century old tea warehouse that retains a number of its raw features and has a waiting list of tenants.

The Empire State Realty Trust listed at US\$13 per share and the stock now trades at US\$20 per share. Along the way, it has paid a good and increasing dividend, with earnings expected to grow at 7% pa in the decade after its IPO. Better still, last year the company did a placement of 10% of its issued capital at US\$21 per share and using the proceeds to significantly deliver what was already a solid balance sheet. Now the loan to value (LTV) across the consolidated portfolio is less than 15%.

So this is why we get excited about selective listed global real estate opportunities. They give you the ability to gain access to great real estate, with management that is focused and strong balance sheets, which allow this value to be unlocked.

### **Access to an exceptional strategy through Nedgroup**

The interesting investment case study provided in the narrative above is just one example of the real estate companies held within the Global Property Fund. The Resolution Capital team invests in a select and diverse group (no more than 55 stocks) of real estate companies capable of generating superior risk adjusted returns for investors.

The stringent filtering process focuses on identifying and exploiting three key attributes:

1. High barrier property markets where landlords have pricing power; and
2. Strong balance sheets, which can successfully withstand and exploit market cycles; and
3. Management teams with skill, discipline and alignment.

## Part five: Investment reflection

This section includes the detailed fund fact sheets of the following funds:

- Nedgroup Investments XS Accelerated FoF
- Nedgroup Investments XS Diversified FoF
- Nedgroup Investments XS Guarded FoF

## Investment review

### Investment philosophy

A successful investment strategy is based on a few simple principles. Investors should invest with a clear objective in mind, in well-diversified portfolios and should make use of the most appropriate investment managers available. Investors should also focus on increasing their real wealth over the long term in a rational and clearly thought through manner, rather than getting caught up in the destructive short-term emotional approach that is so prevalent in investment markets.

### About Nedgroup Investment Advisors

Nedgroup Investment Advisors Limited (NIA) is licensed as a discretionary financial services provider under FSP license number 1652 in terms of the Financial Advisory and Intermediary Services Act (FAIS). It is a wholly owned subsidiary of Nedgroup Investments, a division of Nedbank Group Limited. NIA was established to house the multi-manager investment expertise of Nedgroup Investments.

### Solution objective

A sound investment objective should provide clarity on three elements: the desired return; the risk involved in achieving that return and the minimum time horizon over which the return is likely to be achieved. The investment objective of the XS Accelerated Solution is to secure the steady growth of capital.

**Target return:** The solution aims to outperform local inflation by 6.5% per annum after fees.

**Risk:** The risk of the investment solution is determined by looking at the probability of negative returns (with 95% confidence) over different time periods, as outlined in the table below:

Period	Probability (per period)
One year	Once in 4 years
Three years	Once in 8 years
Five years	Unlikely

**Time horizon:** The minimum recommended time horizon for this solution to achieve its target on a consistent basis is 7 years.

### Risk reward profile

Equity and property investments are volatile by nature and subject to potential capital loss. For credit and income instruments, while unlikely, capital loss may also occur due to an event like the default of an issuer. The portfolio may be subject to currency fluctuations due to its international exposure.

### Asset allocation

The asset allocation for this solution has changed over the past four quarters as follows:

Asset class	Likely weighting	Actual weighting			
		December 2016	March 2017	June 2017	September 2017
Local equity	70 - 90%	54%	56%	54%	55%
Local fixed interest	0 – 10%	17%	15%	14%	14%
Local property		6%	6%	6%	5%
Foreign equity	0 – 20%	15%	16%	18%	17%
Foreign fixed interest	0 – 10%	5%	4%	5%	5%
Foreign property		3%	3%	3%	3%

### Investment approach

The XS Accelerated Solution achieves its objective through investment in a diversified portfolio of local equity, local fixed interest, foreign equity and foreign fixed interest portfolios. The solution is structured as a Fund of Funds. The asset allocation for the solution is determined by Nedgroup Investment Advisors who seeks to achieve optimal diversification of the asset classes by making use of proprietary research and portfolio optimiser tools. A strategic asset allocation is set for the solution and tactical asset allocation changes are made when deemed appropriate. Given the time horizon over which the solution aims to achieve its objective, there are unlikely to be dramatic changes to the asset allocation.

## Manager allocation

The manager allocation for this solution at 30 September 2017 is as follows:

Mandate	Investment manager	Investment house	Weight
Local equity	Omri Thomas	Abax Investments	31%
Local equity	Dave Foord	Foord Asset Management	24%
Local flexible	Team Approach	Truffle Asset Management	6%
Local income	Rashaad Tayob	Abax Investments	4%
Foreign equity	Andrew Headley & Charles Richardson	Veritas Asset Management (UK)	18%
Foreign flexible	Steven Romick	First Pacific Advisors	5%
Local property	Ian Anderson	Grindrod Asset Management	3%
Local bonds	Team Approach	Taquanta Asset Managers	4%
Foreign property	Andrew Parsons	Resolution Capital	3%

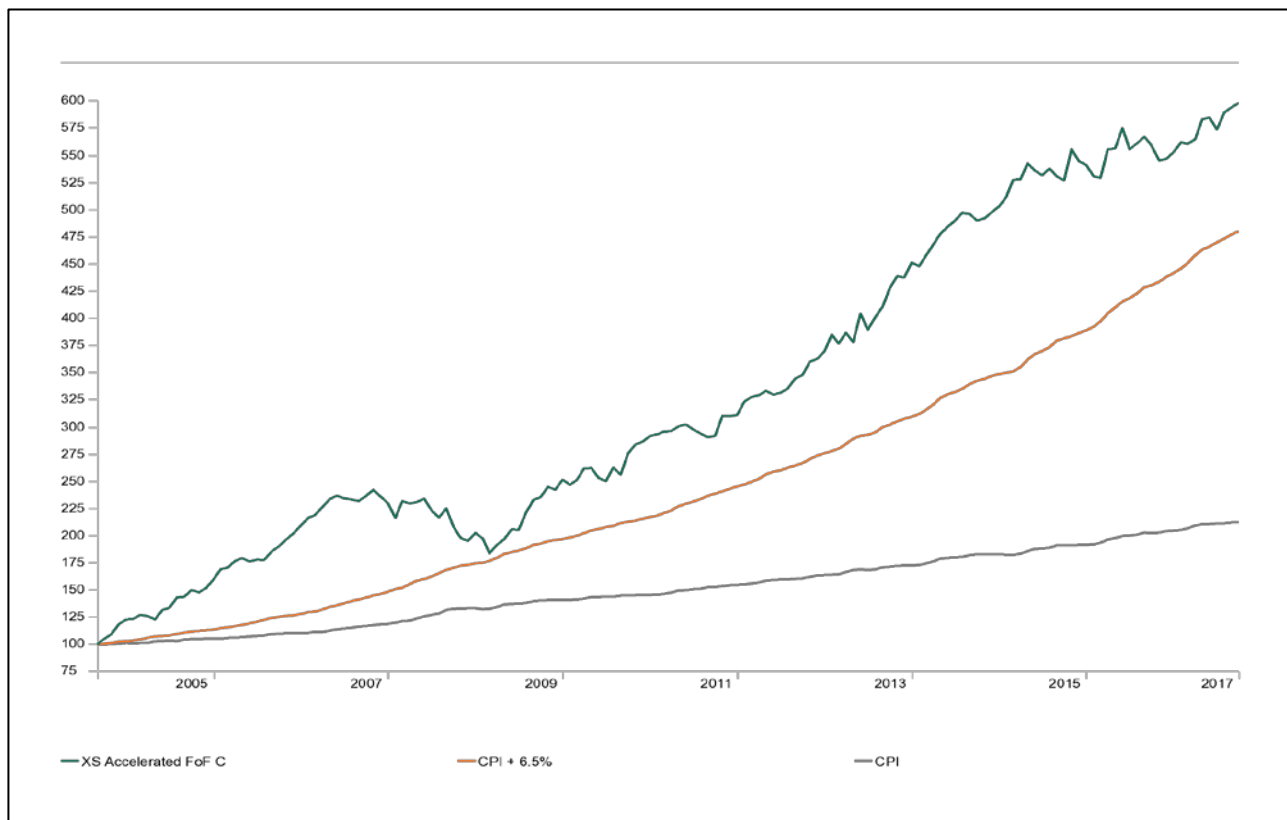
\* The above mentioned investment houses are authorised as Financial Service Providers under FAIS.

## Performance

The performance for the period 1 September 2004 to 30 September 2017 for this solution is reflected in the table and graph below:

Period till end September 2017	Solution [Class C]	Benchmark (CPI + 6.5%)
1 year	7.0%	11.6%
3 years (annualised)	6.9%	11.9%
5 years (annualised)	11.5%	12.5%
7 years (annualised)	11.7%	12.3%
10 years (annualised)	9.7%	12.9%
Since inception (annualised)	14.7%	12.7%
Lowest 1 year return	-21.2%	-
Highest 1 year return	36.7%	-

\*The annualized total return is the average return earned by an investment each year over a given time period.



Source: Morningstar Direct

The investment performance is for illustrative purposes only; the investment performance is calculated by taking the actual fees into account for the amount shown; and income is reinvested on the reinvestment date.

## Administrative details

<b>ASISA Category</b>	South African Multi Asset Flexible
<b>Inception date</b>	1 September 2004
<b>Fund size</b>	R6471m
<b>Unit price at 30 September 2017</b>	4 765.07 cents per unit
<b>Income distributions</b>	
<b>Frequency</b>	Annually
<b>Latest distribution</b>	31 December 2016: 96.01 cents per unit
<b>Previous 12 months</b>	96.01 cents per unit
<b>Fees</b>	
<b>Initial financial planner fee (excl. VAT)</b>	Maximum 3% commission
<b>Annual management fee (excl. VAT)</b>	0.45% per annum: - <b>Excludes</b> the underlying funds' annual fees.
<b>Annual financial planner fee (excl. VAT)</b>	0% -1% per annum
<b>Total expense ratio</b>	1.67%
<b>Transaction costs</b>	0.12%
<b>Total investment charges<sup>3</sup></b>	1.79%

## Mandatory disclosures:

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2. 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.
3. Total Expense Ratio (TER), expressed as a percentage of the Fund, relates to expenses incurred in the administration of the Fund. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER may not necessarily be an accurate indication of future TER's. Transaction Costs (TC), expressed as a percentage of the Fund, relates to the costs incurred in buying and selling the underlying assets of the Fund. TC are a necessary cost in administering the fund and impacts fund returns. It should not be considered in isolation as returns may be impacted by other factors over time including market returns, the type of fund, the investment decisions of the investment manager and the TER. The Total Investment Charges expressed as a percentage of the Fund, relates to all investments costs of the Fund. Both the TER and TC of the Fund is calculated over period of 3 years on an annualised basis, beginning 1 July 2014 and ending 30 June 2017.

Unit trusts are generally medium to long term investments. The value of your investment may go down as well as up. 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. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Certain unit trust funds may be subject to currency fluctuations due to its international exposure. Nedgroup Investments has the right to close unit trust funds to new investors in order to manage it more efficiently. A fund of funds may only invest in other unit trust funds, that levy their own charges, which could result in a higher fee structure. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

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### Nedgroup Investments contact details

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Email [info@nedgroupinvestments.co.za](mailto:info@nedgroupinvestments.co.za)

For further information on the fund please visit

[www.nedgroupinvestments.co.za](http://www.nedgroupinvestments.co.za)

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Clocktower Precinct

V&A Waterfront

Cape Town

### Write to us

P O Box 1510

Cape Town

8000



## Investment review

### Investment philosophy

A successful investment strategy is based on a few simple principles. Investors should invest with a clear objective in mind, in well-diversified portfolios and should make use of the most appropriate investment managers available. Investors should also focus on increasing their real wealth over the long term in a rational and clearly thought through manner, rather than getting caught up in the destructive short-term emotional approach that is so prevalent in investment markets.

### About Nedgroup Investment Advisors

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### Solution objective

A sound investment objective should provide clarity on three elements: the desired return; the risk involved in achieving that return and the minimum time horizon over which the return is likely to be achieved. The investment objective of the XS Diversified Solution is to secure the steady growth of income and capital.

**Target return:** The solution aims to outperform local inflation by 5% per annum after fees.

**Risk:** The risk of the investment solution is determined by looking at the probability of negative returns (with 95% confidence) over different time periods, as outlined in the table below:

Period	Probability (per period)
One year	Once in 5 years
Three years	Once in 13 years
Five years	Unlikely

**Time horizon:** The minimum recommended time horizon for this solution to achieve its target on a consistent basis is 5 years.

### Risk reward profile

Equity and property investments are volatile by nature and subject to potential capital loss. For credit and income instruments, while unlikely, capital loss may also occur due to an event like the default of an issuer. The portfolio may be subject to currency fluctuations due to its international exposure.

### Asset allocation

The asset allocation for this solution has changed over the past four quarters as follows:

Asset class	Likely weighting	Actual weighting			
		December 2016	March 2017	June 2017	September 2017
Local equity	40 - 70%	39%	41%	39%	43%
Local fixed interest	20 – 40%	31%	30%	29%	25%
Local property		7%	7%	6%	6%
Foreign equity	0 – 20%	13%	14%	16%	15%
Foreign fixed interest	0 – 10%	8%	6%	7%	7%
Foreign property		2%	2%	3%	3%

### Investment approach

The XS Diversified Solution achieves its objective through investment in a diversified portfolio of local equity, local fixed interest, foreign equity and foreign fixed interest portfolios. The solution is structured as a Fund of Funds. The asset allocation for the solution is determined by Nedgroup Investment Advisors who seeks to achieve optimal diversification of the asset classes by making use of proprietary research and portfolio optimiser tools. A strategic asset allocation is set for the solution and tactical asset allocation changes are made when deemed appropriate. Given the time horizon over which the solution aims to achieve its objective, there are unlikely to be dramatic changes to the asset allocation.

## Manager allocation

The manager allocation for this solution at 30 September 2017 is as follows:

Mandate	Investment manager	Investment house	Weight
Local equity	Omri Thomas	Abax Investments	25%
Local equity	Dave Foord	Foord Asset Management	18%
Local flexible	Team Approach	Truffle Asset Management	7%
Local income	Rashaad Tayob	Abax Investments	14%
Foreign equity	Andrew Headley & Charles Richardson	Veritas Asset Management (UK)	13%
Foreign flexible	Steven Romick	First Pacific Advisors	8%
Local property	Ian Anderson	Grindrod Asset Management	4%
Local bonds	Team Approach	Taquanta Asset Managers	8%
Foreign property	Andrew Parsons	Resolution Capital	3%

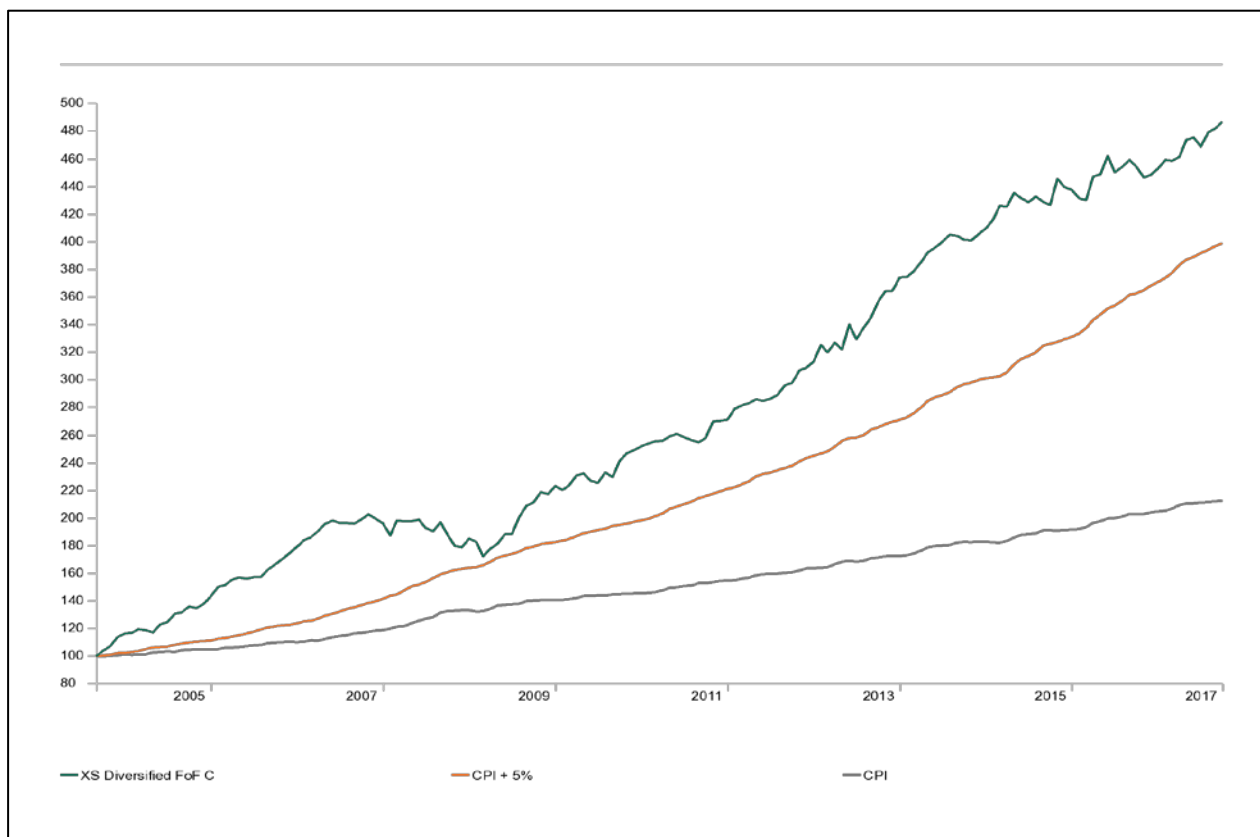
\* The above mentioned investment houses are authorised as Financial Service Providers under FAIS.

## Performance

The performance for the period 1 September 2004 to 30 September 2017 for this solution is reflected in the table and graph below:

Period till end September 2017	Solution [Class C]	Benchmark (CPI + 5%)
1 year	7.2%	10.0%
3 years (annualised)	6.6%	10.3%
5 years (annualised)	10.3%	10.9%
7 years (annualised)	10.5%	10.8%
10 years (annualised)	9.4%	11.3%
Since inception (annualised)	12.9%	11.1%
Lowest 1 year return	-13.6%	-
Highest 1 year return	29.7%	-

\*The annualized total return is the average return earned by an investment each year over a given time period.



Source: Morningstar Direct

The investment performance is for illustrative purposes only; the investment performance is calculated by taking the actual fees into account for the amount shown; and income is reinvested on the reinvestment date.

## Administrative details

<b>ASISA Category</b>	South African Multi Asset High Equity
<b>Inception date</b>	1 September 2004
<b>Fund size</b>	R4 906m
<b>Unit price at 30 September 2017</b>	3 358.00 cents per unit
<b>Income distributions</b>	
<b>Frequency</b>	Bi-annually
<b>Latest distribution</b>	30 June 2017: 63.54 cents per unit
<b>Previous 12 months</b>	100.14 cents per unit
<b>Fees</b>	
<b>Initial financial planner fee (excl. VAT)</b>	Maximum 3% commission
<b>Annual management fee (excl. VAT)</b>	0.45% per annum: - <b>Excludes</b> the underlying funds' annual fees.
<b>Annual financial planner fee (excl. VAT)</b>	0% -1% per annum
<b>Total expense ratio</b>	1.6%
<b>Transaction costs</b>	0.11%
<b>Total investment charges<sup>3</sup></b>	1.71%

## Mandatory disclosures:

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2. 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.
3. Total Expense Ratio (TER), expressed as a percentage of the Fund, relates to expenses incurred in the administration of the Fund. A higher TER does not necessarily imply a poor return, nor does a low TER imply a good return. The current TER may not necessarily be an accurate indication of future TER's. Transaction Costs (TC), expressed as a percentage of the Fund, relates to the costs incurred in buying and selling the underlying assets of the Fund. TC are a necessary cost in administering the fund and impacts fund returns. It should not be considered in isolation as returns may be impacted by other factors over time including market returns, the type of fund, the investment decisions of the investment manager and the TER. The Total Investment Charges expressed as a percentage of the Fund, relates to all investments costs of the Fund. Both the TER and TC of the Fund is calculated over period of 3 years on an annualised basis, beginning 1 July 2014 and ending 30 June 2017.

Unit trusts are generally medium to long term investments. The value of your investment may go down as well as up. 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. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Certain unit trust funds may be subject to currency fluctuations due to its international exposure. Nedgroup Investments has the right to close unit trust funds to new investors in order to manage it more efficiently. A fund of funds may only invest in other unit trust funds, that levy their own charges, which could result in a higher fee structure. A schedule of fees and charges and maximum commissions is available on request from Nedgroup Investments.

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Clocktower Precinct

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## Investment review

### Investment philosophy

A successful investment strategy is based on a few simple principles. Investors should invest with a clear objective in mind, in well-diversified portfolios and should make use of the most appropriate investment managers available. Investors should also focus on increasing their real wealth over the long term in a rational and clearly thought through manner, rather than getting caught up in the destructive short-term emotional approach that is so prevalent in investment markets.

### About Nedgroup Investment Advisors

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### Solution objective

A sound investment objective should provide clarity on three elements: the desired return; the risk involved in achieving that return and the minimum time horizon over which the return is likely to be achieved. The investment objective of the XS Guarded Solution is to secure the steady growth of income as well as preservation of capital.

**Target return:** The solution aims to outperform local inflation by 3% per annum after fees.

**Risk:** The risk of the investment solution is determined by looking at the probability of negative returns (with 95% confidence) over different time periods, as outlined in the table below:

Period	Probability (per period)
One year	Once in 13 years
Three years	Unlikely
Five years	Highly unlikely

**Time horizon:** The minimum recommended time horizon for this solution to achieve its target on a consistent basis is 3 years.

### Risk reward profile

Equity and property investments are volatile by nature and subject to potential capital loss. For credit and income instruments, while unlikely, capital loss may also occur due to an event like the default of an issuer. The portfolio may be subject to currency fluctuations due to its international exposure.

### Asset allocation

The asset allocation for this solution has changed over the past four quarters as follows:

Asset class	Likely weighting	Actual weighting			
		December 2016	March 2017	June 2017	September 2017
Local equity	20 – 40%	14%	15%	14%	17%
Local fixed interest	40 – 70%	57%	58%	56%	54%
Local property		6%	6%	6%	6%
Foreign equity	0 – 20%	11%	11%	13%	12%
Foreign fixed interest	0 – 10%	10%	8%	9%	9%
Foreign property		2%	2%	2%	3%

### Investment approach

The XS Guarded Solution achieves its objective through investment in a diversified portfolio of local equity, local fixed interest, foreign equity and foreign fixed interest portfolios. The solution is structured as a Fund of Funds. The asset allocation for the solution is determined by Nedgroup Investment Advisors who seeks to achieve optimal diversification of the asset classes by making use of proprietary research and portfolio optimiser tools. A strategic asset allocation is set for the solution and tactical asset allocation changes are made when deemed appropriate. Given the time horizon over which the solution aims to achieve its objective, there are unlikely to be dramatic changes to the asset allocation.

## Manager allocation

The manager allocation for this solution at 30 September 2017 is as follows:

Mandate	Investment manager	Investment house	Weight
Local equity	Omri Thomas	Abax Investments	9%
Local equity	Dave Foord	Foord Asset Management	7%
Local flexible	Team Approach	Truffle Asset Management	5%
Local income	Rashaad Tayob	Abax Investments	30%
Local property	Ian Anderson	Grindrod Asset Management	4%
Local cash	Team Approach	Taquanta Asset Managers	13%**
Local bonds	Team Approach	Taquanta Asset Managers	11%
Foreign equity	Andrew Headley & Charles Richardson	Veritas Asset Management (UK)	9%
Foreign flexible	Steven Romick	First Pacific Advisors	9%
Foreign property	Andrew Parsons	Resolution Capital	3%

\* The above mentioned investment houses are authorised as Financial Service Providers under FAIS.

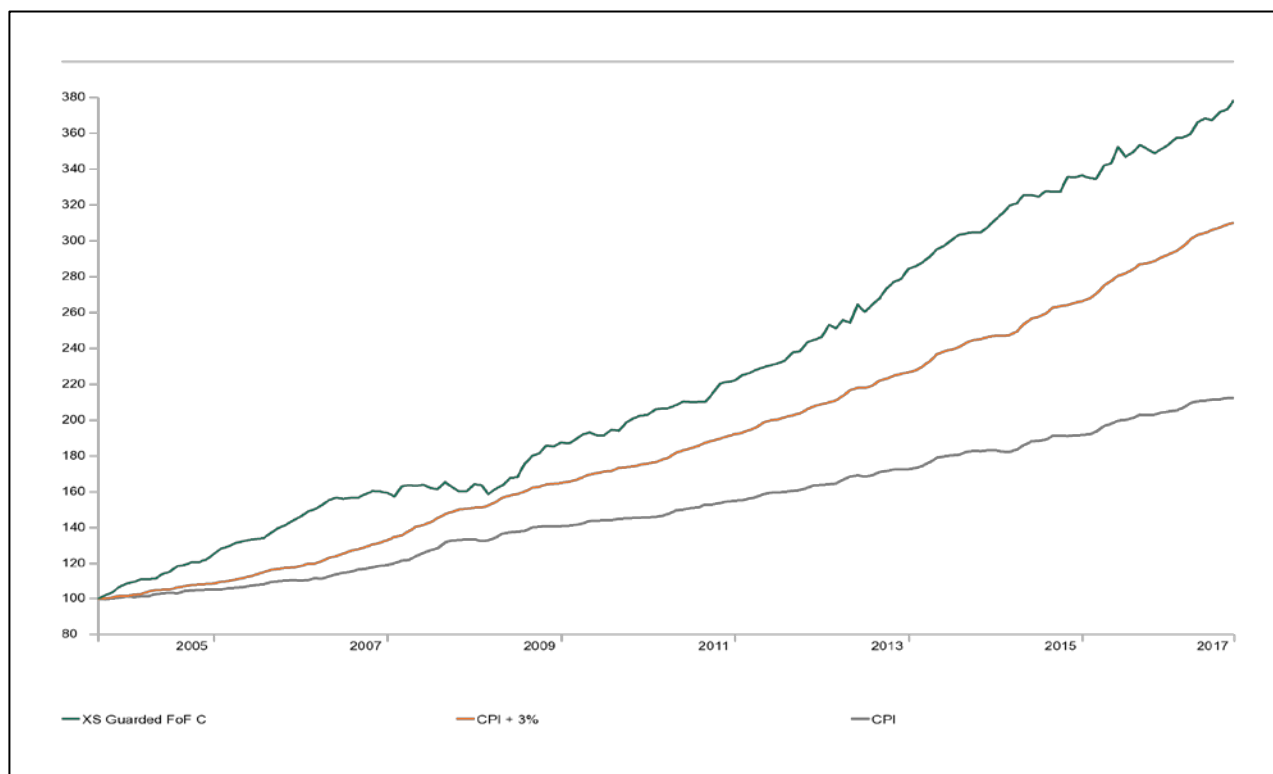
\*\* This includes an exposure of 1% to the Nedgroup Investments Core Income ABIL Retention Fund

## Performance

The performance for the period 1 September 2004 to 30 September 2017 for this solution is reflected in the table and graph below:

Period till end September 2017	Solution [Class C]	Benchmark (CPI + 3%)
1 year	7.8%	7.9%
3 years (annualised)	7.5%	8.2%
5 years (annualised)	9.7%	8.8%
7 years (annualised)	9.7%	8.6%
10 years (annualised)	9.1%	9.2%
Since inception (annualised)	10.7%	9.0%
Lowest 1 year return	-3.2%	-
Highest 1 year return	19.0%	-

\*The annualized total return is the average return earned by an investment each year over a given time period.



Source: Morningstar Direct

The investment performance is for illustrative purposes only; the investment performance is calculated by taking the actual fees into account for the amount shown; and income is reinvested on the reinvestment date.

## Administrative details

ASISA Category	South African Multi Low Equity
Inception date	1 September 2004
Fund size	R1 378m
Unit price at 30 September 2017	2 130.87 cents per unit
<b>Income distributions</b>	
Frequency	Quarterly
Latest distribution	30 September 2017: 24.61 cents per unit
Previous 12 months	101.10 cents per unit
<b>Fees</b>	
Initial financial planner fee (excl. VAT)	Maximum 3% commission
Annual management fee (excl. VAT)	0.45% per annum: - <b>Excludes</b> the underlying funds' annual fees.
Annual financial planner fee (excl. VAT)	0% -1% per annum
Total expense ratio	1.47%
Transaction costs	0.06%
Total investment charges <sup>3</sup>	1.53%

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