NEDGROUP INVESTMENTS

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XS

QUARTERLY REVIEW

Quarter Four
2017

Nedgroup Investments
XS Quarterly Review

Quarter Three, for the period ended December 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 **Page 3**

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 **Page 7**

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 **Page 11**

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: Fund fact sheets **Page 17**

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 31 December 2017)

Asset class	Indicator	3 months	1 year	3 years	5 years	LT-average*
Equities	All Share Index	7.4%	21.0%	9.3%	11.9%	12.5%
Property	Listed Property Index	8.3%	17.2%	11.7%	13.9%	12.2%
Bonds	All Bond Index	2.2%	10.2%	6.9%	6.3%	6.9%
Cash	STeFI Call	1.7%	6.9%	6.5%	5.9%	5.9%
Inflation	CPI (one month in arrears)	0.9%	4.6%	5.3%	5.4%	5.7%

Source: Morningstar

Global asset classes (in dollars)

(Performance over periods to 31 December 2017)

Asset class	Indicator	3 months	1 year	3 years	5 years	LT-average*
Equities	MSCI AC World Index	5.8%	24.6%	9.9%	11.4%	8.6%
Property	S&P Developed Property Index	3.9%	13.2%	6.4%	8.0%	7.2%
Bonds	JPM Global Bond Index	1.3%	9.5%	1.3%	0.3%	4.6%
Cash	US 3-month deposits	0.3%	1.1%	0.6%	0.4%	4.4%
Inflation	US CPI (one month in arrears)	0.5%	2.2%	1.5%	1.4%	3.0%

Source: Morningstar

Currencies

(Movements over periods to 31 December 2017)

Currency	Value at month-end	3 months	1 year	3 years	5 years	LT-average*
Rand / Dollar	12.38	8.3%	9.5%	-2.3%	-7.9%	-5.5%
Rand / Sterling	16.75	7.6%	0.9%	2.5%	-4.0%	-4.1%
Rand / Euro	14.87	6.9%	-3.1%	-2.0%	-5.9%	-5.5%

Source: Morningstar

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

International market commentary – Q4 2017

The final quarter provided a solid end to what was an already strong year for investors. Better than expected economic data releases confirmed that the synchronised cyclical economic upswing remains on track, and is probably set to accelerate in 2018. As was the case throughout the year, financial market volatility remained unusually low, reflecting the improved global economic outlook and the continued anaesthetising effect of central bank bond buying. The improved outlook encouraged some central banks to edge towards a less supportive stance, with the Federal Reserve and Bank of England raising interest rates and the European Central Bank reducing its monthly target of bond purchases.

Political events dominated the headlines. In Asia, the 19th Chinese Party Congress confirmed President's Xi's growing power, while also mapping out China's high level political and economic priorities for the next five years. Also in Asia, the pro-growth incumbent Prime Minister Shinzo Abe received a resounding vote of confidence as his party was re-elected, setting the scene for a continuation of established policies.

In the US, Trump chose to back Jerome Powell to replace Janet Yellen as the Federal Reserve's FOMC Chairperson when her term comes to an end in February 2018. Since Powell's views on monetary policy are very similar to Yellen's (i.e. he is also a dove), the markets saw him as a "continuity candidate" who is unlikely to steer the FOMC away from its current path. Another notable event was the US Senate's narrow passing of the Tax Cuts and Jobs Act, which looks likely to be the largest overhaul of the US tax system since 1986. The most important element for financial markets is the cut to the corporate tax rate from 35% to 21%, which will boost most the net income of most companies. Additionally, the Act should also provide a strong incentive for US corporates to repatriate cash held in foreign bank accounts, which would enhance their ability to raise dividends and boost share buy-backs.

Events in Europe were less supportive. While Merkel tried and failed to form a workable coalition after the German election, the Catalonian government made an audacious bid for independence which was quickly snuffed out as the Spanish government moved aggressively to contain any prospect of the region's secession. Elsewhere, the UK and the EU reached an agreement of sorts on the three "phase one" Brexit issues relating to the divorce bill, citizens' rights and the Irish border. While this represented a degree of progress, the story is far from over as the two protagonists will now move to the even more contentious second round of talks on trade and security. On the face of it, events so far suggest that the UK is on a path towards a "Soft Brexit". However, this will not sit well with the so called "Hard Brexiteers" within the UK Government and Conservative Party, suggesting there is plenty more Brexit anxiety ahead.

Equity markets rose by +5.7% over the quarter when measured using the MSCI All Country World Index in US dollars. Among the majors, the best performers were Asia ex Japan (+8.2%) and Global Emerging Markets (+7.4%), while Europe ex UK (+0.9%) was the biggest laggard. At the sector level, cyclicals tended to outperform, with information technology (+8.2%), materials (+8.0%) and consumer discretionary (+7.8%) doing well, while more defensive areas such as utilities (-0.1%) and healthcare (+1.3%) disappointed. In terms of style, growth (+6.6%) outpaced value (+5.0%), while smaller and larger companies were tied on +5.7%.

In comparison to equities, fixed income markets were relatively subdued, even though most areas managed a positive return. The best returns were seen at the quality end, with the JP Morgan Government Bond Index rising +0.8%, while the Merrill Lynch Global Investment Grade Corporate Bond Index managed +1.2%. In other areas, the Merrill Lynch Global High Yield Bond Index rose +0.6% and the JP Morgan Global Emerging Market Bond Index delivered +0.5% (all in hedged to US dollar terms).

Encouraging economic data and an improving demand supply balance in oil helped commodities put in a spirited performance over the quarter, with the Bloomberg Commodity Index rising +4.7%, led by crude oil (+16.0%) and industrial metals (+10.7%). Other sub-sectors were relatively quiet, with gold up +1.9% and agriculture declining -2.0%.

The major currency markets were relatively quiet over the fourth quarter. Against the dollar, the yen was flat, and the euro and pound rose +1.8% and +1.0% respectively. Emerging Market currencies saw bigger moves, with one of the stand-out performers being the South African rand (+8.5% versus the US dollar), which responded positively to the election of Cyril Ramaphosa as the new ANC leader. Elsewhere, uncertainty about the North American Free Trade Agreement negotiations undermined the Mexican peso as it fell -8.5% against the US dollar.

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

Domestic market commentary – Q4 2017

After an extended period of highly depressed local confidence by both business and consumers, a slight recovery was experienced in the latest Business Confidence Index reading that was released on 6 December 2017 by the South African Chamber of Commerce and Industry (SACCI). This positive surprise was believed to have been brought about by business leaders expecting some degree of clarity in domestic policies in anticipation of Cyril Ramaphosa's win ahead of the ANC elective conference; combined with the continued support of global fundamentals. South African companies have been uncertain about domestic government policies and hence chosen not to expand operations locally; providing very little new fixed direct private investment into the economy. This type of investment is vital in terms of providing a stimulus to the economy to grow and provide employment. The South African economy continues to benefit from a healthy external global environment; with GDP growing by 2% quarter-on-quarter in Q3 2017, slightly ahead of expectation. The growth was selective, rather than broad-based, supported by the dominant contribution from the agricultural sector and the continued strength from mining and manufacturing.

This glimmer of hope was dampened when Markus Jooste, the CEO of Steinhoff, announced his resignation after being at the helm of this business for over 25 years. This was as a result of the Board of Directors revelation about the discovery of new information around accounting malpractices, on top of other ongoing accusations by the German regulators with regards to tax related investigations. A hefty 70% was wiped off

the share price overnight, with further loses to following several days. Once the dust had settled, well over $10 billion (R130 billion) had been wiped off Steinhoff's market capitalisation. Investors have chosen to remain cautious as more information is brought to the fore.

Some hope was injected in the country when Cyril Ramaphosa was subsequently elected as the new ANC president; with the rand sharing in the euphoria and strengthening by over 9% against the US dollar in December alone. This despite the composition of the ANC leadership depicting a compromised win that may possibly cause a challenge in the implementation of reforms.

The other major political event that dominated the news was the witnessing of a new era being ushered in our neighbouring country, Zimbabwe. It saw Robert Mugabe resign after a week of intense pressure via a military take-over and ending his 37-year reign as president.

Also in the last quarter of 2017, the poor state of the South African economy was reinforced by the Minister of Finance, Malusi Gigaba, during his Medium-Term Budget Policy Statement. The impact was evident in the shortfall of revenues most notably in personal income tax collection which threatens to widen the budget deficit as well as a meaningful increase in funding requirements including the recapitalisation of state-owned enterprises.

The lack of a credible plan to promote fiscal consolidation left the credit rating agencies with renewed concerns, causing S&P to downgrade South Africa's local and foreign currency debt by one notch each, formally moving the country to sub-investment grade and the outlook to stable from negative. Moody's opted to put the country on review for downgrade, to be concluded in a 90-day review period, highlighting the importance of the February 2018 budget speech to be presented in their analysis.

The South African Reserve bank disappointed the market and kept interest rates unchanged at 6.75%, quoting the main reasons as an increase in its inflation forecast coupled with uncertainty regarding several other inflation drivers. The decision was not unanimous as the vote was split 50/50 for keeping rates unchanged or cutting them by a further 25 basis points.

The domestic market has, for the most part of the year, on the back of a very strong global market been resilient. The South African All Share Index ended the year with a positive 21% return and for the last quarter to December the JSE produced 7.4%. The strengthening of the rand over the quarter hurt rand-hedge industrial stocks as well as the offshore portion of most South African investors' portfolios. The best performing equity sectors over the last quarter have been those that are more exposed to domestic demand on expectations that Cyril Ramaphosa will bring a favourable political and policy shift in the country. These include the interest-rate sensitive assets; with the banks (+28.3%), retailers (+22.6%), financials (+16.0%) and mid-cap stocks (+11.6%) being the strong performers. South African bonds, also supported by the Ramaphosa win and the subsequent strengthening of the rand, returned 10.2% for the year and 2.2% for the quarter. Listed property returned 8.3% for the quarter, while cash returned 1.8%.

Part two: Investment solutions' performance

XS Accelerated Class C

As at 31 December 2017		Q4 2017	1 year	3 years	5 years	7 years	10 Years	Inception*	Volatility*
Fund of Funds	XS Accelerated	0.9%	9.2%	6.3%	10.3%	**11.0%**	10.1%	14.4%	9.8%
Benchmark	CPI + 6-7%	2.5%	11.4%	12.2%	12.3%	**12.4%**	12.7%	12.6%	n/a
Category average	SA MA Flexible	2.0%	8.7%	5.4%	8.6%	**9.4%**	8.3%	12.7%	8.1%

XS Diversified Class C

As at 31 December 2017		Q4 2017	1 year	3 years	5 years	7 years	10 Years	Inception*	Volatility*
Fund of Funds	XS Diversified	0.4%	7.9%	6.1%	**9.3%**	9.9%	9.5%	12.6%	7.4%
Benchmark	CPI + 4-6%	2.1%	9.8%	10.6%	**10.7%**	10.8%	11.1%	11.0%	n/a
Category average	SA MA High Equity	2.2%	10.0%	6.2%	**9.2%**	9.6%	8.3%	12.1%	7.4%

XS Guarded Class C

As at 31 December 2017		Q4 2017	1 year	3 years	5 years	7 years	10 Years	Inception*	Volatility*
Fund of Funds	XS Guarded	-0.4%	6.5%	**6.5%**	8.9%	9.3%	8.9%	10.5%	4.0%
Benchmark	CPI + 2-4%	1.6%	7.8%	**8.5%**	8.6%	8.7%	9.0%	8.9%	n/a
Category average	SA MA Low Equity	1.5%	8.4%	**6.5%**	8.0%	8.4%	8.0%	9.4%	3.6%

** 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

The broader domestic equity market as reflected by the FTSE/JSE All Share Index closed on a high note with a strong return of 21.0% for the year and 7.4% for the last quarter. The industrial sector was mainly driven by a few dominant counters such as Naspers which has returned 76% year-to-date. In the last quarter of 2017, and more so in December, the best performing equity sectors were those that are more exposed to domestic demand on expectations that Cyril Ramaphosa will bring a favourable political and policy shift in the country. These include the interest-rate sensitive assets; with the banks, insurance companies, general finance and retailers being among the strong performers.

The majority of the XS Fund of Funds underperformance, relative to the respective category peers, happened over the last month of the year and was largely due to two factors:

1. The strengthening of the rand by close to 9% for the month of December after the ANC elective conference. This detracted from performance on our offshore holdings where we are close to the maximum allowed of 25%. As with other managers, the allocation to the domestically listed rand-hedge shares also saw muted or negative returns that struggled to outperform the strengthening rand.
2. The relatively larger than peer group exposure to Steinhoff. Steinhoff's share price fell by around 90%, thus having a serious knock on effect on to the portfolios that held it. It was held in both of the equity portion as well as in the flexible income portion of the XS Fund of Funds portfolios.

The returns for the quarter lagged the ASISA peer group averages and respective CPI target benchmark returns. Over the longer, more meaningful three-, five- and seven-year periods, the portfolios continue to produce good returns, ahead or in line with their respective ASISA peer averages.

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.

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	33/63	27/58	14/45	**16/43**	10/33	4/14
XS Diversified	South African – Multi Asset – High Equity	132/174	75/120	**51/86**	37/66	16/46	14/18
XS Guarded	South African – Multi Asset – Low Equity	118/139	**58/101**	18/80	22/65	7/46	3/12

Source: Morningstar
** 1 September 2004*

Portfolio positioning

In order to understand the growth assets that should dominate our risk budget in the current market environment, we seek to identify the most prudent balance between exposures to risk-seeking ideas (for capital growth purposes) and exposures to risk avoiding ideas (for capital preservation purposes).

Given that the current valuation backdrop is not exciting; in that from an asset class valuation perspective, there are no profiles that are outright cheap, we have therefore kept the XS Fund of Funds' asset allocation positioning unchanged over the quarter.

As at the end of Q4 2017, the XS Fund of Funds were positioned as follows:

Asset class	Positioning	Rationale
Domestic Equity	UNDERWEIGHT	• JSE expensive, trading at high P/E levels • Remained cautious, while taking advantage of pockets of value • Diversification is paramount within the equity market
Domestic Property	NEUTRAL	• Not supported by fundamentals, despite similar returns • Relative attractiveness less vs. long term historical averages and R186
Domestic Bonds	NEUTRAL	• Reasonable value • Underweight duration in bond exposure
Domestic Cash	OVERWEIGHT	• To provide dry powder and deploy cash when markets offer value • To offer a consistent return profile • Warranted for capital preservation purposes
Offshore Equity	NEUTRAL	• Valuations are tight, but still supported by constructive macro-economic backdrop • To offer diversification (in terms of wider universe and multiple currencies)
Offshore Property	OVERWEIGHT	• Broadly fairly valued • Being a growth asset, the prevailing macro-economic backdrop suggests that the asset class is well supported
Offshore Bonds	UNDERWEIGHT	• Extended valuations, with global bond yields depressed • Warranted for capital preservation purposes
Offshore Cash	NEUTRAL	• Defensive buffer • Warranted for capital preservation purposes

Top 10 holdings per investment solution as at 31 December 2017

	XS Accelerated Solution	% of Fund
1	Naspers Ltd	5.0%
2	British American Tobacco Plc	4.7%
3	Sasol Limited	3.2%
4	BHP Billiton Plc	2.5%
5	Standard Bank Group Ltd	2.4%
6	Santam Limited	2.3%
7	RMB Holdings Limited	1.9%
8	FirstRand Ltd	1.9%
9	Remgro Ltd	1.9%
10	Hudaco Ind Ltd	1.7%

Sector	%
Resources	18%
Industrials	52%
Financials	30%

	XS Diversified Solution	% of Fund
1	Naspers Ltd	3.9%
2	British American Tobacco Plc	3.7%
3	Sasol Limited	2.5%
4	BHP Billiton Plc	1.9%
5	Standard Bank Group Ltd	1.8%
6	Santam Limited	1.8%
7	RMB Holdings Limited	1.5%
8	FirstRand Ltd	1.5%
9	Remgro Ltd	1.5%
10	Hudaco Ind Ltd	1.3%

Sector	%
Resources	18%
Industrials	52%
Financials	30%

	XS Guarded Solution	% of Fund
1	Naspers Ltd	1.6%
2	British American Tobacco Plc	1.5%
3	Sasol Limited	1.1%
4	BHP Billiton Plc	0.7%
5	Standard Bank Group Ltd	0.7%
6	Santam Limited	0.7%
7	Old Mutual Plc	0.6%
8	Remgro Ltd	0.6%
9	RMB Holdings Limited	0.6%
10	FirstRand Ltd	0.6%

Sector	%
Resources	18%
Industrials	50%
Financials	32%

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 31 December 2017	3 Months	1 Year	3 Years (annualised)	5 Years (annualised)	10 Years (annualised)
Local General Equity					
Foord Asset Management	2.7	7.5	6.1	8.2	11.0
ABAX Investments	6.6	17.2	7.7	11.2	10.4
ASISA SA Equity General Peer Group	5.7	12.8	5.5	9.1	8.3
Local Small/Mid Cap Equity					
ABAX Investments	6.3	7.7	7.9	12.6	12.0
ASISA SA Small/Mid Cap Peer Group	4.3	-1.5	3.0	7.5	5.7
Local Flexible (1)					
Truffle Asset Management	-0.1	5.47	-	-	-
ASISA SA MA High Equity Peer Group	2.2	10.0	6.2	9.2	8.3
Local Property					
Bridge Fund Managers	-3.6	-1.2	6.0	10.4	-
ASISA SA Real Estate General Peer Group	5.7	14.1	10.2	12.8	13.2
Local Fixed Income					
ABAX Investments (flexible)	0.0	5.9	7.7	7.7	8.7
Taquanta Asset Management (bond)	3.0	10.9	7.3	6.8	8.9
Taquanta Asset Management (cash)	2.0	8.5	8.0	7.2	-
ASISA SA IB Money Market Peer Group	1.8	7.7	7.2	6.5	7.1
110% STeFI Call Deposit	1.8	7.6	7.1	6.4	7.2
Global Equity					
Veritas Asset Management	-6.3	10.1	10.8	18.9	9.5
ASISA Global Equity Peer Group	-3.4	9.7	9.5	17.4	8.8
Global Flexible (2)					
First Pacific Advisors (FPA)	-5.9	-1.2	7.3	15.2	9.2
ASISA MA Global Flexible Peer Group	-5.1	5.1	7.1	14.1	8.6
Global Property					
Resolution Capital (3)	-3.8	3.5	9.5	16.9	13.9
ASISA Global Real Estate Peer Group	-4.7	1.0	5.1	13.0	8.3

(1) Truffle Asset Management were appointed to manage this building block during December 2015 (performance prior to this was RECM)
2) FPA were appointed to manage this building block during June 2012 (performance prior to this was Sarasin & Partners)
3) Performance data based on Resolution Capital's long term track record

NEDGROUP INVESTMENTS

DOMESTIC GENERAL EQUITY

The domestic equity block is managed by ABAX Investments and Foord Asset Management.

ABAX had a decent 2017 relative to the peer group, although most active funds struggled to keep pace with a very strong momentum-driven market last year (the All Share Index was up 21% for the year). A significant weighting to Naspers helped, with an average exposure of close to 20% for most of last year. ABAX remains confident on the prospects for Naspers (and Tencent, which they are accessing at a discount via the Naspers position), although they did take some profits towards the end of last year, by trimming the position down to approximately 15%. The Steinhoff holding hurt the fund with a +/-4% exposure as at end of November 2017, and a 90% decline in the share price. However, ABAX had repositioned the portfolio toward the end of last year, pre-ANC elective conference to have a more balanced domestic vs. “offshore” (in the form of rand hedges) exposure which benefitted the fund in December given the banks and retailers exposure which did well in December off the back of what was seen to be a positive outcome for SA focused companies. These interest-rate sensitive positions thus helped mitigate some of the Steinhoff losses, while the rand-hedge exposure detracted given the strength of the rand over the past quarter.

The domestic equity portion managed by Foord continues to run with a defensive block, although the local cash holding has over the quarter reduced to 6%. This cautious stance, is a theme that is currently consistently running across all of Foord’s products. This is informed by a generally sceptical view on domestic fundamentals, which has resulted in Foord retaining a low allocation to domestic facing local businesses, and in favour rather, of companies whose earnings are derived offshore. Their bias towards rand-hedge industrials has thus remained intact, despite having a zero allocation to Naspers (in line with their value investment style, however further explaining the underperformance). They have also kept a near benchmark exposures to the financial sector and the local resource sector. Their holding in Steinhoff detracted from performance over the past quarter. The investment thesis behind the manager owning the Steinhoff share was premised on their fundamental analysis, in line with their investment process. Unlike almost all leading SA general equity funds, which hold up to 25% of their portfolios offshore, the fund maintains no direct foreign exposure to mitigate the any SA-specific risks. The mandate permits investment only in JSE-listed companies. Accordingly, fund’s exposure to Steinhoff, a significant non-resource rand-hedge counter, was at 5.0% at the time of Markus Jooste’s resignation (5 December 2017). Foord did not own any Steinhoff-connected companies with material inter-company balances such as Steinhoff Retail (STAR). They also did not own any Steinhoff debt or convertible instruments.

The managers recognise that it will take time for Steinhoff’s management to address the various issues and regain the market’s trust; and until they have more information related to the issues raised by the auditors and subsequent investigations, they are exercising extreme caution with regards to the company and any related entities. 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

In contrast to domestic general equity portion that the investment team at ABAX manages, the small/mid cap equity building block experienced a positive December (+1.7%). However, the relevant indices delivered much stronger returns, with the JSE Mid Cap Index up 4.7% and the JSE Small Cap Index up 3.8%. The primary contributors to the fund's underperformance relative to these two indices were the exposures to rand hedges (notably Naspers, Reinet and Sappi) against the headwind of further rand strength. Despite no direct exposure to Steinhoff, the fund experienced the fallout experienced via weakness in their positions in STAR and KAP (companies in which Steinhoff has a shareholding) as the market speculated that these Steinhoff-owned positions would likely be sold under distress conditions. In contrast the fund's broad but targeted exposure to several domestic-oriented firms under conditions of rand strength made a very positive contribution. Notable examples include the JSE, Truworths, Barloworld, Italtile, AVI and a recent addition; Massmart. Over the quarter, the fund produced a positive return of 6.3% over the quarter, ahead of its ASISA SA Small/Mid Cap Peer Group that gave 4.3%. For the 2017 calendar year the fund returned a reasonable +7.7% which compares more favourably with the JSE Mid Cap and Small Cap Indices' returns of +7.3% and +3.1% respectively.

DOMESTIC FLEXIBLE

In November, the underperformance of locally exposed shares gave the Truffle investment team an opportunity to switch rand-hedge shares into domestic shares resulting in a more balanced portfolio. However, this was not enough to offset the occurrence of the Steinhoff debacle which negatively impacted the domestic multi-asset portion of the portfolio in the fourth quarter of 2017. In the manager's view; although there appears to be significant upside from the current price level using a conservative valuation basis, a liquidity crunch where creditors and bond holders refuse to roll their funding to Steinhoff could result in insolvency. The sizable €6 billion of potential asset write-offs results in a high level of financial gearing and hence, significant sensitivity in equity value to small changes in asset value. These factors have in all likelihood been responsible for the significant volatility in the share price; and has thus reduced the manager's confidence in their intrinsic value and their exposure by 42%. They have also reduced their STAR holding given concerns regarding potential loan guarantees from STAR to Steinhoff International and the risks of potential claims against STAR from Steinhoff debt and equity holders. Without knowing the full extent of the irregularities within the Group, the manager (along with many others) is following the developments very closely. More recently, post the euphoria of the Ramaphosa victory and the outperformance of domestic shares; the manager shifted the portfolio back to a higher rand-hedge exposure, as they see little value in most locally exposed counters including retail and diversified industrials like Imperial and Bidvest. Hence, their exposures to these sectors is negligible. Their exposure remains predominantly in banks, insurers via Old Mutual and select industrials where valuations are not overly stretched. On a purchasing power of parity basis, the rand / dollar is now close to fair value. On other bases such as profitability of exporters including the miners, the currency seems expensive. Hence, notwithstanding valuation considerations, they are comfortable positioning a higher portion of the portfolio in rand-hedge shares. They also feel the credit spread in unsecured bank debt is preferable to receiving the term premium on government bonds and hence, they remain short of duration in fixed income.

DOMESTIC PROPERTY

A very disappointing year for the domestic property building block managed by Bridge Fund Managers. The fund delivered a return of -1.2% for 2017 while the SA Listed Property (SAPY) was up 17.2% (and main competitors around +13-15%). The South Africa's listed property sector also benefitted from the outcome of the ANC's elective conference and the SAPY Index advanced 4.2% in December, despite the fact that almost 50% of the index is now invested outside South Africa. While some of the fund's exposure to domestically focused stocks did well in December, the fund's relative underperformance over the quarter can be attributed to lack of exposure to industry-heavyweights Growthpoint, Hyprop and Redefine, all of which benefitted from a strong finish to the year by domestically-focused companies. The fund is currently offering investors an attractive initial income yield (before fees) of 11.1%, which is significantly higher than the 6.8% forward yield on the SAPY Index. Therefore, the fund still offers a very compelling initial distribution yield and growth, in that the income stream is projected to match inflation over time. The manager remains invested in small and mid-sized domestically-focused listed property companies that trade at discounts to net asset value.

DOMESTIC FIXED INCOME

The All Bond Index (ALBI) performed very strongly in December (+5.7%) on the back of what was seen to be a positive outcome at the ANC elective conference, with the long end of the curve benefitting the most (7-12year and 12+ year area delivering the strongest returns of 5-6%+). This brought the one-year return on the ALBI to 10% for 2017. The local flexible fixed income portion of the Nedgroup Investments XS Fund of Funds in contrast delivered a disappointing 6% for 2017, underperforming both its benchmark of STeFI*110% (+7.6%) and the main competitors who delivered in the 8-9% range on average. ABAX Investments' low duration was a significant relative detractor for 2017 as was positioned in more floating than fixed rate exposure and did not benefit from the ALBI and rand strength. In addition, the preference shares did not do well in 2017 and rand strength was also a detractor for offshore positions; particularly the property counters with offshore exposure. The Steinhoff exposure was a detractor in December (The fund was down 0.6% for the month). However the ABAX team is confident that there are sufficient guarantees from associated entities, STAR/PEP/PSG, for the local bonds to be sound and best placed in the Steinhoff capital structure. Despite the local bonds being fairly illiquid, with little-to-no trade in December, ABAX fully expect these positions to recover in due course as more information becomes available. In the meantime, investors are urged to exercise caution as these positions have already been marked down in the portfolio to reflect the uncertainty. The current weighted average yield of the building block remains strong at around 9%.

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 31 December 2017, the yield on the Bond Fund was 9.31%.

GLOBAL EQUITY

The global equity building block, with sub-investment manager Veritas Asset Management (UK), has a concentrated global equity mandate comprising of 28 (as at December 2017) carefully chosen shares of high quality businesses from around the world. With a significant emphasis placed on capital preservation, Veritas is able to appropriately diversify and manage risk to produce outstanding long-term outperformance. Over the long-term, this disciplined process has resulted in Veritas being able to outperform its peers by 4% p.a. since inception of the strategy in 2001. Interestingly, an analysis of their return profile over rolling three-year periods does indeed show that they tend to lag their peers in upward trending markets, while strongly outperforming when market returns are more tempered. The geographical allocation of the fund is currently mainly split between US (51.0%), European (19.1%) and UK (9.4%) equity markets. The fund has smaller holdings across Asian equity markets (6.9%) and a foreign cash allocation of (13.2%), which decreased by approximately 2.5% over the past quarter. Veritas's process is strictly-disciplined to the extent that they are willing to allow cash levels to rise in the portfolio, rather than invest in companies where they are not fully comfortable with the investment thesis and/or share price valuation. The Top 10 holdings amount to approximately 44% of the total portfolio and includes companies like Comcast (6.4%), Airbus Group (6.1%), American Express (5.3%) and Charter Communication (4.1%). With the bull market in equities entering its ninth year and valuations extended, identifying companies with strong, sustainable competitive advantages at attractive valuations is becoming increasingly difficult. Veritas believes that if opportunities are not available at attractive valuations, they will remain patient. While such discipline can lead to not "keeping up with" benchmark indices in the short term, the team believe that over the long term it will help them to deliver strong absolute- and relative-performance over full investment cycles (i.e. including both bull and bear markets) which continues to be the ultimate goal. The fund lagged the MSCI index over the quarter, as was negatively impacted by both stock selection and its overweight to healthcare.

GLOBAL FLEXIBLE

For the month of December, the contrarian-value-oriented global flexible building block portion of our portfolios delivered -8%. This detraction in performance was entirely due to a strong rand, which strengthened by more than 9% in December 2017 alone. There has not been much changes to the manager's positioning over the past quarter, with the fund remaining cautious with approximately 40% allocation to cash and 60% to risk assets. The manager remains mindful of their long-term focus and risk management approach to limiting the permanent impairment of capital; and the current positioning reflects their view that markets are not sufficiently compensating investors for the risks to which they're being exposed. The manager has slightly trimmed their large holding in financials, as well as taken some profits from the high yield bond positions during the course of last year. However, they have not found many compelling opportunities to redeploy capital. The new measured additions over the quarter was a 1.4% position in Expedia Inc., a travel website with a significant market share at attractive valuations; and an 0.8% exposure to the Puerto Rico Municipal bonds, taking advantage of the attractive valuation levels following the hurricane damages to the sewage systems. Over the longer, more appropriate investment horizon, the Fund has managed to outperform both its composite benchmark and the category average peers.

GLOBAL PROPERTY

The FTSE EPRA NAREIT Developed Index produced a total return of -4.8% in rand terms for the quarter ending 31 December 2017, while the ASISA Global Real Estate Peer Group returned -4.7%. The global property building block, managed by Resolution Capital outperformed both the benchmark and the peers, producing a total return of -3.8% for the quarter. The fund has maintained an underweight position to the retail sector; while overweight sectors where supply/demand drivers remain favourable. These include data centre and cell tower REITs, and office and industrial REITs with exposure to high barrier markets.

With elevated property occupancy levels and real estate values above replacement costs triggering more construction, the manager is not surprised to hear more talk of real estate being “late cycle”. In some sectors the manager has seen signs of tenant duress – most notably retail which has seen a significant increase in tenant closures/bankruptcies this year. With a backdrop of improving economic growth, low unemployment and corporate earnings generally increasing, the team does not expect tenant duress to spread rapidly to other sectors but they remain alert to the risks - particularly in cycle unproven sectors. The manager also recognises the risk that REITs earnings growth may lag broader equities, resulting in rotation out of the sector. The fund continues to be focused on companies with quality assets, strong balance sheets and management teams which can create value throughout the cycle.

Part four: Fund fact sheets

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