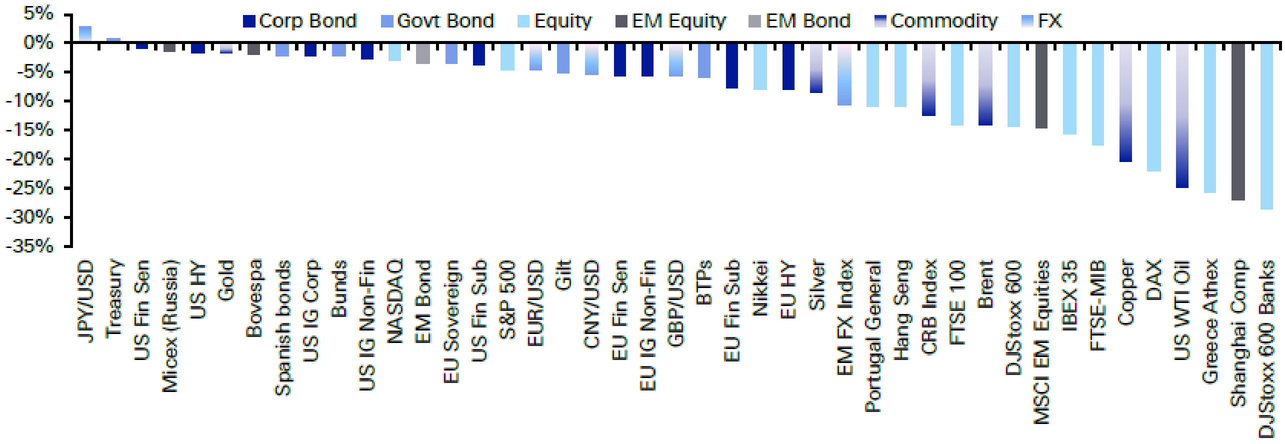
NEDBANK PRIVATE WEALTH – INVESTMENT REVIEW OF 2018

The past year started off positively, but unfortunately turned into a year of very weak returns across most asset classes, both for local and global investors. South Africans started the year optimistically following the favourable outcome from the ANC Conference in December 2017. Local markets enjoyed a "Ramaphoria" honeymoon period in early 2018. Global markets also started 2018 on a high note, with all round good economic news flow and markets setting new highs. The outlook and financial markets, however, deteriorated steadily thereafter over the remainder of the year to such an extent that the S&P 500 recorded its worst December month on record (-9%). What initially looked like what was going to be a good year for investors, turned out to be a very poor year.

While years like 2018 are unpleasant and unsettling for investors, investing is ultimately a long-term endeavour, where the outcomes should be measured over longer periods of time. It is also important to remain invested in times like these, as improved returns historically have followed years of weak returns.

There were few places to hide locally and internationally

Figure 7: Total Return Performance of Major Global Financial Assets 2018 (in USD)



Source: Deutsche Bank, Bloomberg Finance LP, Mark-It

It was a year where almost all asset classes globally posted negative returns, even an asset class like gold, that typically does well in an uncertain environment, lost 2% in value. In an environment where most asset classes posted negative returns, it was particularly difficult to find positive returns for investors. Riskier asset classes like equity and property were especially hit hard in 2018. One of the few places to shelter was in South African fixed income - cash, bonds and preference shares, which posted positive returns for the year.

Nedbank Private Wealth started the year conservatively positioned, with an underweight equity position, and overweight positions in more defensive asset classes. This favourable positioning contributed to our diversified multi-asset funds, on balance, outperforming their respective benchmarks in 2018. Nevertheless, these funds still reported weak to negative absolute returns for the year. The rand declined by 16% against the US dollar, from which our Funds benefitted, given their overweight offshore allocations. However, this was partly offset by the 8.2% decline in the MSCI World Index.

Performance	1-year	Benchmark	5-year	Benchmark	10-year	Benchmark
NPW Cautious Fund	2.2%	0.7%	6.1%	6.4%	7.9%	7.6%
NPW Balanced FoF	-2.9%	-6.8%	5.5%	6.5%	10.5%	10.8%
NPW Diversified Growth Fund	-4.8%	-5.9%	4.9%	6.7%	9.9%	10.5%

Source: Nedbank Private Wealth, Morningstar. Performance figures are annualised, after fees and costs

At an asset allocation level, Nedbank Private Wealth used the weakness in 2018 to increase our local equity exposure. We reduced our underweight allocation to property by adding select property counters to our portfolios like Fortress (A-linked units). These changes were funded by utilising some of our cash holdings, as well as reallocating some of our profits made on preference shares, following that asset class's outperformance in 2018.

SA Property had a particularly difficult year

The SA Listed Property sector declined by 25.2% in 2018. Although the underperformance was broad based, Resilient and its associated companies had a particularly tough year. Some stocks in the stable declined more than 65%. This was caused by corporate governance concerns which emerged in early 2018, as well as very demanding starting valuations. Property fundamentals in South Africa deteriorated over the year, which negatively affected the results of the listed SA property companies. The pain was not limited to SA shares though, with international counters like Hammerson and Intu also underperforming significantly as uncertainty around Brexit intensified during 2018.

Performance	1-year	Benchmark	5-year	Benchmark	10-year	Benchmark
NPW Property Fund	-14.1%	-25.3%	5.9%	5.7%	11.6%	12.1%

Source: Nedbank Private Wealth, Morningstar. Performance figures are annualised, after fees and costs

The Nedbank Private Wealth Property Fund was not immune to the developments in the property market, but weathered the storm better than most, outperforming the market by 11.2% in 2018. The Fund had no exposure to Resilient at the start of the year, which contributed to the outperformance over the year. The Fund, however, gradually added Resilient after gaining comfort on the corporate governance issues raised earlier in the year. Defensive holdings like A-linked units worked well in the weak environment, since shareholders of A-linked units have preferential claims on distributions and are therefore more protected against deteriorating fundamentals of property companies. Valuations are more attractive now, which bodes well for future returns. However, property fundamentals remain weak and balance sheets are more stretched, which limits the upside potential for now, in our view.

Preference Shares performed well and provided useful diversification

After a weak performance in 2017, the stage was set in terms of attractive starting valuations for preference shares. Together with favourable corporate action in the sector, preference shares returned 15% during the year, in stark contrast to the performance of most other asset classes. This serves as a good reminder for investors that it pays to focus on the long term and stay the course, especially during periods of weak performance, as these normally precede periods of improved performance.

Performance	1-year	Benchmark	5-year	Benchmark	10-year	Benchmark
NPW Preference Share Fund	16.9%	15.0%	6.5%	5.1%	8.1%	7.1%

Source: Nedbank Private Wealth, Morningstar. Performance figures are annualised, after fees and costs

The Nedbank Private Wealth Preference Share Fund returned 16.9% over the year and capitalised on the attractive yields that were available at the beginning of 2018 in quality names such as PSG. It is interesting to note that Capitec has continued to buy back its own preference shares in the open market, and paid par (R100) for its most recent purchases. This resulted in returns of more than 30% from the lows in early 2018 for Capitec's preference shares. This illustrates the corporate action potential that exists in the sector. We remain positive on the after-tax return outlook for this asset class and retained our overweight position in preference shares, despite taking some profits during the year.

Equity markets experienced another year of volatility

After a difficult 2017 in which Steinhoff collapsed, 2018 initially started off well. However, the calm did not last long. The subsequent weakness that persisted for the rest of the year was broad-based and, in some cases, severe, with names such as British American Tobacco, Mediclinic, Aspen, Coronation and Tigerbrands down over 40% for the year. The SWIX 40 Index declined 12.1% over the year. Resources was one of the few sectors that posted positive returns for the year.

Our equity strategies did not escape the turmoil and posted negative returns for the year. The Nedbank Private Wealth Equity Fund declined by 11.8%, but its relative performance improved towards the end of the year, and outperformed its benchmark by 0.4% over the year.

Performance	1-year	Benchmark	5-year	Benchmark	10-year	Benchmark
NPW Equity Fund	-11.8%	-12.1%	4.5%	5.6%	12.8%	12.8%
NPW Small & Midcap Fund	-12.6%	-11.1%	1.2%	5.7%	10.9%	13.5%
NPW Non-tax Model Portfolio*	-14.1%	-12.1%	5.0%	5.6%	14.1%	12.8%
NPW Private Client Model Portfolio*	-17.9%	-12.1%	3.6%	5.6%	13.0%	12.8%

Source: Nedbank Private Wealth, Morningstar. Performance figures are annualised, after fees and costs.
**Model portfolios are reference portfolios. Performance is before fees and trading costs.*

We drew on recent experience and acted timeously when risks started to emerge for British American Tobacco (BAT)'s investment case. This has been a long standing and very rewarding investment for our clients. However, increased regulatory uncertainty and more competition in the form of electronic smoking devices has increased BAT's risk profile in our view, and we therefore reduced our exposure at relatively favourable prices. In other instances, like in Aspen's case, the share price reacted rapidly and very negatively post the release of its FY18 results, and our Aspen holdings underperformed as a result.

We added to our holdings in Mediclinic during the year, because in our view the market has taken an overly punitive view on the regulatory risk that Mediclinic faces in Switzerland. We took profits on our Tigerbrands holdings in early 2018, following strong gains that resulted in an unattractive valuation at the time. It turned out to be a very tough year for Tigerbrands, because of subdued consumer spending and the listeriosis crisis. We bought back into Tigerbrands towards the end of the year at an attractive valuation, despite the negative newsflow that currently surrounds the company. Based on our estimates, some of Tigerbrands' problems are not of a recurring nature, and therefore we expect an improved financial performance going forward.

Our equity portfolios are positioned to participate in a potential local economic recovery, while at the same time having significant 'insurance' in the form of offshore exposure in case of negative economic or political surprises in South Africa. We are encouraged by the changes implemented to date by President Ramaphosa, although the effects have not yet filtered through to the economy or financial markets. Valuations of SA orientated businesses have become attractive following years of weak returns. While this creates the potential for good returns from current levels over the next few years, this is not without risks. South Africa's structural problems are deep, and the political environment remains fluid, which adds risk to the potential recovery scenario. For this reason, we have decided to retain overweight allocations to offshore assets for our clients.

Outlook for 2019 - More uncertainty, but at a more attractive valuation

As mentioned earlier, we have gradually added more exposure to our portfolios and reduced the conservative positioning that we held over the last few years. This is based on the increased chances of an economic recovery in SA, as well as improved valuations. The outlook for SA has improved following the appointment of Cyril Ramaphosa as the new President, but there are still significant fault lines. These include our stretched fiscal position, the poor state of our SOEs and structurally embedded social and economic challenges including high unemployment, persistent inequality, poor educational outcomes and labour productivity. We have retained a significant offshore allocation in our portfolios to diversify against these risks.

On the global front, political and economic uncertainty is likely to persist in 2019. We take comfort though from the improved valuation levels, and more normalised US interest rates (2.5% now), after a period of abnormally low interest rates. These ultimately serve as potential shock absorbers to risk events. Risks on our mind include a potential infrastructure slowdown in China, and the effect that this could have on emerging markets as well as how the 'trade war' is going to evolve and the effect that this could have on globalisation and company profits. There is a significant amount of previous 'quantitative easing' by central banks around the world that will have to be rolled back over the next few years, which could have far reaching consequences for global markets.

As with previous years, there are likely to be positive and negative surprises in 2019 that will have an impact on financial markets. Therefore, we continue to advocate balanced and diversified portfolios, both at an asset allocation and equity level, that will do well in a range of different scenarios. We will be looking to take advantage of any long-term investment opportunities that may arise during the course of the year. We remain focused on growing our clients' wealth ahead of inflation in a sensible manner, over time. Thank you for your continued support.

Regards

Nedbank Private Wealth Investment Team