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# Nedgroup Investments Contrarian Value Equity Fund

Quarter Two, 2021





## Nedgroup Investments Contrarian Value Equity Fund

The following commentary was produced by the sub-investment manager, First Pacific Advisors, LP (“FPA”).

USD performance to 30 June 2021	Nedgroup Investments Contrarian Value Equity <sup>1</sup>	S&P 500	MSCI ACWI
3 months	5.2%	8.5%	7.4%
12 months	48.9%	40.8%	39.3%

### Overview

The Nedgroup Contrarian Value Equity Fund (“the Fund”) gained 5.2% for the quarter and 48.9% for the trailing one-year.

The Fund’s performance is captured in the following table:

**Exhibit A: Performance versus Illustrative Indices<sup>2</sup>**

	Q2 2021	Trailing 12-month
Nedgroup Investments CV Equity Fund	5.2%	48.9%
MSCI World	7.7%	39.0%
MSCI ACWI	7.4%	39.3%
S&P 500	8.6%	40.8%
60% MSCI ACWI / 40% BBgBarc U.S. Agg	5.2%	22.2%
60% S&P 500 / 40% BBgBarc U.S. Agg	5.8%	23.0%

Source: FPA. Fund returns are net of fees per footnote 1 below.

### Portfolio review

As stewards of your capital, the FPA Portfolio Management Team presently find themselves feeling uncomfortably comfortable, which they find an odd sensation. The Team doesn’t mean to imply that they feel complacent; however, the Fund’s cash levels are significantly lower than in recent years. With a relatively modest amount of dry powder, they no longer wake each morning hoping for a market pullback that offers a flood of potential bargains. Instead, they would now be happy with a sale in just one section of the store, allowing the Team to pick up a few discounted securities to go along with a shopping cart that is already relatively full - and they may have tempted fate and invited such an opportunity with their opening line.

But just because we do not currently welcome a large drawdown for the markets, it does not mean that it will not happen. In fact, we are virtually certain at some point it will, but they just can’t tell you when. Though the portfolio will not be immune to the next selloff, whenever it may arrive, we remain committed to seeking equity market-beating total returns over complete market cycles.

<sup>1</sup> Source: Morningstar (monthly data series). Reflects the net USD return for the Nedgroup Investments Contrarian Value Equity Fund, D class.

<sup>2</sup> Comparison to the indices is for illustrative purposes only. An investor cannot invest directly in an index. The performance information shown herein is for illustrative purposes only and may not reflect the impact of material economic or market factors. No representation is being made that any account, product or strategy will or is likely to achieve profits, losses, or results similar to those shown. Performance does not represent the return an investor in the Fund can or should expect to receive. Fund shareholders may only invest or redeem their shares at net asset value.





Consistent with the above philosophy, back in Q3 2019 the Fund began reporting contributors and detractors on a trailing twelve-month basis rather than the most recent quarter. At the time we wrote “Quarterly price movements, however, are generally not much more than “noise,” frequently reversing in the coming months or quarters. It is therefore more informative to focus on what has happened in the most recent year.”

The top contributors and detractors to the Fund’s returns for the trailing twelve months are listed below: <sup>3</sup>

Winners	Performance contribution	Avg. weight	Losers	Performance contribution	Avg. weight
Alphabet	5.74%	8.4%	Just Eat Takeaway	-0.07%	0.2%
Comcast	2.39%	5.1%	JDE Peet's	-0.03%	0.1%
Baidu	2.34%	2.2%	Jardine Strategic	-0.02%	0.2%
Broadcom	2.30%	4.3%	LX Holdings Corp.	-0.01%	0.0%
Facebook	2.27%	3.8%			

Source: FPA

Truth be told, even one year does not align with how the Team views the world. Of course, a longer than average holding period does not guarantee higher than average returns, but it reflects how we are willing to manage your capital in a differentiated manner in our quest for differentiated returns.

In fact, there have been many situations where the Fund has held names for multi-year periods, and there were times during those periods where performance lagged. While it certainly would have aided Fund returns if it had been able to enter, exit, and ultimately re-enter each name to avoid the periods of fallow results, such ambidexterity is easier said than done. We say this with experience, having previously sold shares in high quality equities assured in the belief we would be able to repurchase them in the future at a lower price. Oddly, even when the shares did subsequently trade off, we demonstrated an uncanny consistency for proclaiming the right price for re-entry to be some 5-10% lower than where the shares ultimately bottomed. This has led us to conclude that when it comes to investing in quality equities, one of the keys to generating attractive compound returns is to not interfere with the process of compounding.

So, while at times it may look like the Fund is sitting on names that are stuck in the mud, it is fair to assume that we are not overly perturbed by short-term under-performance provided we remain confident that such securities are simply building kinetic energy ahead of delivering future gains. In this manner, you can think of the Team coming into the office each day and not eating the marshmallow lying on their desks, confident that the delayed gratification will be rewarded in the form of a much larger marshmallow at a future date.

We believe this approach has served us well over time at the portfolio level. Arguably, the Fund has done a respectable job of consistently delivering equity-like rates of return over extended periods. The kink of course is that one could only realize these returns by holding the Fund through periods of under-performance and resisting the urge to look for a tastier marshmallow elsewhere. We realise this style of investing with a multi-year outlook is not for everyone, but if you are reading this commentary, we thank you for partnering with us on the journey.

But past aside, the matter at hand is how the Fund is currently positioned and what prospective returns will be in the coming years. Unfortunately, we still do not have a crystal ball to tell us what the future holds for inflation, variants, or GDP growth. We can tell you with confidence that we like what the Fund owns in terms of quality and value and are comfortable with our current level of exposure. Though we do not view the market at large as particularly inexpensive at present - as we indicated in Q1 - we are not overly concerned with where the market

<sup>3</sup> Reflects the top five contributors and detractors to the Fund’s performance based on contribution to return for the twelve months (Q2 2021) through June 30, 2021. Contribution is presented gross of investment management fees, transactions costs, and Fund operating expenses, which if included, would reduce the returns presented. The information provided does not reflect all positions purchased, sold or recommended by FPA during the period. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities listed.



may trade, as we don't own the market. As for what we do own, as illustrated in the exhibit below, the Fund's equity holdings are cheaper than the market as measured by 1-year forward price to earnings and current price to book despite not making any sacrifices as it relates to historical or prospective earnings growth.

**Exhibit B: Fund Equity Holding Valuation and Earnings Growth vs Stock Market<sup>4</sup>**

	Price/Earnings 1 Year Forward		Price/Book		3-Year Trailing EPS Growth		3-Year Fwd Estimated EPS Growth	
	Jun 2020	Jun 2021	Jun 2020	Jun 2021	Jun 2020	Jun 2021	Jun 2020	Jun 2021
Fund - Equity Only	20.7x	<b>20.3x</b>	3.6x	<b>1.9x</b>	14%	<b>-2%</b>	19%	<b>32%</b>
vs. S&P 500	-17%	-9%	4%	-58%	110%		76%	28%
vs. MSCI World	2%	3%	46%	-36%	206%		74%	38%
vs. MSCI ACWI	-5%	5%	55%	-7%	288%		68%	40%
S&P 500	24.9x	<b>22.3x</b>	3.5x	<b>4.6x</b>	7%	<b>-1%</b>	11%	<b>25%</b>
MSCI World	20.4x	<b>19.8x</b>	2.5x	<b>3.0x</b>	4%	<b>-6%</b>	11%	<b>23%</b>
MSCI ACWI	21.9x	<b>19.4x</b>	2.3x	<b>2.1x</b>	4%	<b>-6%</b>	11%	<b>23%</b>

Source: FPA.

Stepping back for a moment, many managers start with an index benchmark when constructing their portfolio and then play a game of over- or under-weighting various names or sectors. In sharp contrast, the FPA Portfolio Management Team starts with a completely blank page and have a portfolio that looks nothing like any index they have ever observed. So, while the Fund owns many well-known companies, such as three of the FAANG constituents, which the Team believes are reasonably valued, the Team also rounds out the Fund's holdings with a collection of names that either remain starkly out of favour or are largely absent from the major indices.<sup>5</sup> Examples of such securities include the Fund's Asian holding companies such as LG Corp, Samsung C&T, Softbank, and Swire Pacific, as well as its "Chinternet"-focused positions in Alibaba, Naspers/Prosus, and Baidu.<sup>6</sup>

Though we have discussed the Chinese internet conglomerates regularly in prior commentaries and conference calls, LG Corp, Samsung C&T, and Softbank are names that were purchased in 2020, and have yet to be publicly profiled. Interestingly, LG Corp and Samsung C&T trade at discounts to our estimates of intrinsic value greater than 50% based exclusively on publicly traded marks, while also trading at a single digit multiple to their estimates of look through after-tax earnings for 2021.<sup>7</sup> As for Softbank, look-through earnings are challenging to calculate due to limited disclosure for many of the private holdings, but the discount to intrinsic value estimates based on private and public marks is similarly wide to the other two names.<sup>8</sup> Regardless, in all instances we are afforded the privilege of investing alongside the controlling family or founder, and moreover, we believe the underlying asset quality of each conglomerate has significant appeal.

<sup>4</sup> Source: CapIQ, Factset, Bloomberg, FPA calculations. 3-Year Forecasted EPS Growth is based on FPA calculations using consensus data from CapIQ, Factset and Bloomberg. Comparison to the S&P 500, MSCI World and MSCI ACWI Indices is being used as a representation of the "market" and is for illustrative purposes only. The Fund does not include outperformance of any index or benchmark in its investment objectives. Equity statistics noted herein do not represent the results that the Fund or an investor can or should expect to receive. Forward looking statistics are estimates and subject to change.

<sup>5</sup> The FAANG constituents include: Facebook (FB), Apple (AAPL), Amazon (AMZN), Netflix (NFLX), and Alphabet (GOOG).

<sup>6</sup> Portfolio composition will change due to ongoing management of the Fund. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities listed. This is not a recommendation for a specific security and these securities may not be in the Fund at the time you receive this commentary.

<sup>7</sup> Source: FPA, CapIQ. **For illustrative purposes only.** As of June 30, 2021, LG Corp and Samsung C&T were 1.9% and 1.3% of total net assets of the Fund.

<sup>8</sup> Source: FPA, CapIQ. **For illustrative purposes only.** As of June 30, 2021, Softbank was 1.3% of total net assets of the Fund.



As for Alibaba, Tencent and Baidu, we believe those securities trade at very wide discounts to intrinsic value estimates based on the “sum of the parts” – a four-word phrase analogous to a four-letter curse word for investors with time horizons shorter than our own. While we readily acknowledge many of these “parts” may not contribute to earnings for several years, as genuine long-term oriented investors, we relish the opportunity pick up cheap or even free options, as we believe exists in the form of autonomous driving within Baidu or the cloud business within Alibaba. This is no different to how we viewed asymmetric optionality in past years in the form of Waymo/YouTube within Alphabet, and Oculus/Whatsapp within Facebook.

### **Portfolio Activity:**<sup>9</sup>

The Fund increased its positions in two of its investments, made three additional investments, decreased one and did not exit any other investment during the quarter. The increases were continued purchases of JDE Peet’s and Just Eat Takeaway, new names from the prior quarter. The Fund decreased its position in Booking Holdings as valuation has continued to rise. The Fund’s newly added positions were Netflix, Flutter Entertainment, and LX Holdings.

### **Portfolio Profile:**

There are currently 45 equity positions in the Fund, with the top five holdings comprising 26.7% and the top 10 comprising 46.0% of the portfolio (based on total assets). The top three sectors, based on GICS sector classification, are Communication Services, Financials, and Consumer Discretionary, which comprise over 57.3% of the total assets of the Fund. The Fund has been able to find opportunity outside of the U.S. and, as a percentage of equity, currently has 34.9% non-U.S. exposure and 65.1% exposure in the U.S.<sup>10</sup>

### **Conclusion**

In order to optimize the likelihood of future success, the FPA Portfolio Management Team operates in a perpetual state of adaptation. We tackle each day in the hopes that we learn something new that helps us to be better prepared to face the inevitable challenges and act on new opportunities.

A long-time investor at FPA offered the Team this observation from the novelist, playwright, essayist, poet, and activist James Baldwin, *“Not everything that is faced can be changed, but nothing can be changed until it is faced.”* We can’t bend the world to our will, but we can always improve.

Thank you for entrusting us with your capital.

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<sup>9</sup> The information provided does not reflect all positions purchased, sold or recommended by FPA during the quarter. It should not be assumed that an investment in the securities listed was or will be profitable. Increases and decreases represent securities whose position size changed by at least 25% over the period and represent greater than 0.50% of the portfolio. Any exited position mentioned was fully removed, regardless of its representative portfolio size. Portfolio composition will change due to ongoing management of the Fund.

<sup>10</sup> *As a Percentage of Equity* excludes cash & cash equivalents. Portfolio composition will change due to ongoing management of the Fund.





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The Fund and certain of its sub-funds are recognised in accordance with Section 264 of the Financial Services and Markets Act 2000.

UK investors should read the Appendix for UK investors in conjunction with the Fund's Prospectus which are available from the Investment Manager [www.nedgroupinvestments.com](http://www.nedgroupinvestments.com)

The Fund has been recognised under paragraph 1 of Schedule 4 to the Collective Investment Schemes Act 2008 of the Isle of Man. Isle of Man investors are not protected by statutory compensation arrangements in respect of the Fund.

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## Index Definitions

Comparison to any index is for illustrative purposes only and should not be relied upon as a fully accurate measure of comparison. The Fund may be less diversified than the indices noted herein, and may hold non-index securities or securities that are not comparable to those contained in an index. Indices will hold positions that are not within the Fund's investment strategy. Indices are unmanaged and do not reflect any commissions, transaction costs, or fees and expenses which would be incurred by an investor purchasing the underlying securities and which would reduce the performance in an actual account. You cannot invest directly in an index.

**S&P 500 Index** includes a representative sample of 500 hundred companies in leading industries of the U.S. economy. The Index focuses on the large-cap segment of the market, with over 80% coverage of U.S. equities, but is also considered a proxy for the total market.

**S&P 500 Value Index** is a subset of the S&P 500 index. Companies within the index are ranked based on growth and value factors including three-year change in earnings price/share, three-year sales/share growth rate, momentum, book value/price ratio, earnings/price ratio, sales/price ratio. The companies at the bottom of this list, which have a higher Value Rank, comprising 33% of the total index market capitalization are designated as the Value basket.







**S&P 500 Growth Index** is a subset of the S&P 500 index. Companies within the index are ranked based on growth and value factors including three-year change in earnings price/share, three-year sales/share growth rate, momentum, book value/price ratio, earnings/price ratio, sales/price ratio. The companies at the top of this list, which have a higher Growth Rank, comprising 33% of the total index market capitalization are designated as the Growth basket.

**MSCI ACWI Index** is a free float-adjusted market capitalization weighted index that is designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 26 emerging markets.

**Consumer Price Index (CPI)** is an unmanaged index representing the rate of the inflation of U.S. consumer prices as determined by the U.S. Department of Labor Statistics. The CPI is presented to illustrate the Fund's purchasing power against changes in the prices of goods as opposed to a benchmark, which is used to compare the Fund's performance. There can be no guarantee that the CPI will reflect the exact level of inflation at any given time.

**Bloomberg Barclays U.S. Aggregate Bond Index** provides a measure of the performance of the US investment grade bonds market, which includes investment grade US Government bonds, investment grade corporate bonds, mortgage pass-through securities and asset-backed securities that are publicly offered for sale in the United States. The securities in the Index must have at least 1-year remaining in maturity. In addition, the securities must be denominated in US dollars and must be fixed rate, nonconvertible, and taxable.

**60% S&P500/ 40% Bloomberg Barclays U.S. Aggregate Bond Index** is a hypothetical combination of unmanaged indices and comprises 60% S&P 500 Index and 40% Bloomberg Barclays U.S. Aggregate Bond Index.

**60% MSCI ACWI/ 40% Bloomberg Barclays U.S. Aggregate Bond Index** is a hypothetical combination of unmanaged indices and comprises 60% MSCI ACWI Index and 40% Bloomberg Barclays U.S. Aggregate Bond Index.

### Other Definitions

**Earnings Per Share (EPS)** is calculated as a company's profit divided by the outstanding shares of its common stock. The resulting number serves as an indicator of a company's profitability.

**Earnings Per Share Growth** is defined as the percentage change in normalized earnings per share over the previous 12-month period to the latest year end.

**Market Capitalization** refers to the total dollar market value of a company's outstanding shares of stock. Commonly referred to as "market cap," it is calculated by multiplying the total number of a company's outstanding shares by the current market price of one share.

**Market Cycles**, also known as stock market cycles, is a wide term referring to trends or patterns that emerge during different markets or business environments.

**Net Risk Exposure** is a measure of the extent to which a fund's trading book is exposed to market fluctuations. In regards to the Fund, it is the percent of the portfolio exposed to Risk Assets.

**Price to Book** is used to compare a firm's market capitalization to its book value. It's calculated by dividing the company's stock price per share by its book value per share (BVPS). An asset's book value is equal to its carrying value on the balance sheet, and companies calculate it netting the asset against its accumulated depreciation.

**Price to Earnings** is the ratio for valuing a company that measures its current share price relative to its EPS. The price-to-earnings ratio is also sometimes known as the price multiple or the earnings multiple.

**Sum-of-the-Parts** valuation is a process of valuing a company by determining what its aggregate divisions would be worth if they were spun off or acquired by another company.

**Trailing Price to Earnings** is a relative valuation multiple that is based on the last 12 months of actual earnings.

**Forward Price to Earnings** is a version of the ratio of price-to-earnings (P/E) that uses forecasted earnings for the P/E calculation.

**Price to Sales** is a valuation ratio that compares a company's stock price to its revenues. It is an indicator of the value that financial markets have placed on each dollar of a company's sales or revenues.

**Risk Assets** is any asset that carries a degree of risk. Risk asset generally refers to assets that have a significant degree of price volatility, such as equities, commodities, high-yield bonds, real estate and currencies, but does not include cash and cash equivalents.

**Standard Deviation** is a measure of the dispersion of a set of data from its mean.

**Trust Value** per Share or Net Asset Value per Share (NAV) – The NAV (Net Asset Value) or Trust Value per Share is generally \$10 (the standard offer price per SPAC unit) plus the interest accrued. It is calculated as the Trust Size / Outstanding Redeemable Shares.

**Volatility** is a statistical measure of the dispersion of returns for a given security or market index. In most cases, the higher the volatility, the riskier the security. Volatility is often measured as either the standard deviation or variance between returns from that same security or market index.

