



see money differently

A photograph of an open book with white pages, tied with a white string bookmark. The book is positioned on the left side of the cover, with the pages fanning out towards the right.

NEDGROUP INVESTMENTS

Global Cautious Fund

Quarter Four, 2020



Performance to 31 December 2020 (USD)	Fund ¹	Target Return ²	Peer Group ³
3 months	3.9%	0.0%	4.5%
12 months	3.3%	0.5%	5.5%

MARKET OVERVIEW

The final quarter of the year will be remembered for a number of events but for markets the key event was the emergence of a number of seemingly viable COVID-19 vaccines. In November we witnessed the announcement of three vaccines, one shortly after the other (Pfizer/BioNTech, Moderna and AstraZeneca/Oxford) that claim effectiveness against the virus and importantly have received approval. The news drove a rally in risk assets, with this year's biggest losers benefitting. European and the UK indices posted returns of 14.2% and 12.6% respectively in November alone. Cyclical value stocks, generally underperformers throughout the crisis, staged a late surge over growth stocks.

What was expected to be the main event of the year – the US election – passed without troubling markets, despite President Trump claiming election fraud and filing several legal challenges to contest state results. The margin of victory was large enough and the transition process from a Trump to a Biden administration is now firmly underway.

As the year closed, vaccine news euphoria quickly gave way to concerns about new virus strains and relentless third waves of infections. The availability of a choice of vaccines so quickly is nothing short of a triumph for the scientific community and the politicians who backed them. However, the manufacture, transportation, distribution and dispensing of hundreds of millions of doses appears to be a logistical challenge unrivalled in peacetime.

Until vaccines have been rolled out to a large percentage of populations economic and profit growth will be hard to find. Sectors that rely on large groups of customers voluntarily coming into close contact with one another as they spend their money face the toughest challenges. Airlines, hospitality, entertainment and high street retail are the most obvious members of this category. However, many other industries rely on spending on equipment, clothing, cosmetics and grooming by consumers in preparation for these activities, spending which is not happening at the moment. Unfortunately, we have not seen the last corporate failure of the pandemic and the OECD forecasts that in many countries it will not be before 2023 that economic activity recovers to 2019 levels.

This is not to say that the outlook is uniformly bleak. Co-ordinated government and central bank action have provided decent incomes to many in the developed world whilst reducing the burden of high levels of debt. As a result, after months stuck at home with little to do and limited chances to spend, household bank balances look healthy. So, when the coast looks clear there will certainly be some pent-up demand released.

The volatility that we expect stems from the fact that equity markets appear to have factored in an almost certain and fairly swift economic recovery in their performance since the trough in March. The UK is one of only a few major markets not to have already passed their pre-Covid-19 peaks, with those in the US, Japan, China, Brazil and India all significantly higher. However, with earnings and dividends much reduced from their February levels and likely to remain lower for some time, this unavoidably means that they are much more expensive.

Bond markets are also incredibly expensive, with Australia and Spain joining the list of nations able to issue bonds whilst being paid to do so. At the end of 2020 US\$18 trillion of investment grade bonds were owned by investors guaranteed to lose money by holding them to maturity, even before taking into account inflation. The longer the bond held, the riskier that stance is. The buyer of a 30-year German government bond can now only make money if they manage to sell to an investor willing to accept a more negative return than they would.

¹ Net return for the Nedgroup Investments Global Cautious Fund, A class. Source: Morningstar (monthly data series).

² US Libor 1 month

³ Morningstar EAA Fund USD Cautious Allocation



However, given the duration of that bond, if yields rise by 1 percentage point, to where they were only 2 years ago, they would lose 30% of their money. Heads you lose, tails you lose!

These ultra-low yields have been generated by central banks cutting base rates and actively buying government bonds to push yields down further. This financial alchemy has allowed governments to borrow cheaply to finance the massive amounts of fiscal stimulus they have provided this year. This links to the performance of the equity market by reducing the amount of interest payments diverted away from the shareholders of indebted companies and, in theory, encouraging companies to borrow and invest. Unfortunately, this didn't work when first tried after the GFC and seems even less likely to work now given the greater ambiguity about the future.

FUND PERFORMANCE

The aim of the strategy is to provide a stable stream of real total returns over the long term with low absolute volatility and significant downside protection. In the final quarter the portfolio produced a positive return.

The largest contribution came from the portfolio's non-US bond position, almost entirely due to the depreciation of the US dollar. Pyrford currently invest approximately 40% of the portfolio in short dated government debt in the UK, Canada and Australia, with only the Australian dollar exposure hedged. The US dollar fell against the pound by -5.4% and the Canadian dollar by -4.6% in the quarter. Pyrford view the US dollar as a very expensive currency based on in-house Purchasing Power Analysis and therefore they maintain a significant exposure (45%) to non-US dollar assets. If the currency does fall, the portfolio will benefit as it has done over the quarter. The only currency hedge in place within the portfolio is against the Australian dollar which rose by +7.1% over the period so this gain is largely cancelled out.

US bonds were flat over the period, adding an incremental gain to the portfolio. Pyrford continues to adopt a very defensive stance by only owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields, as witnessed in many government bond markets over the period.

The equity portfolio produced strong returns for our investors with both US (+8.3%) and Non-US overseas equities (+13.8%) contributing positively. The following table highlights the top 5 equity and contributors and bottom 5 equity detractors over the quarter:

Top Performers	Country	Performance contribution	Bottom Performers	Country	Performance contribution
Woodside Petroleum	Australia	0.19%	CH Robinson Worldwide	USA	-0.09%
T.Rowe Price Group	USA	0.18%	S&P Global	USA	-0.05%
Texas Instruments	USA	0.16%	China Mobile	China	-0.04%
American Express	USA	0.15%	SAP	Germany	-0.02%
Malayan Banking	Malaysia	0.14%	Metro	Canada	-0.02%

*Note the contribution to portfolio return is weighted by 25%.

In the US, the stockmarket had a strong quarter rising over 10% and continued its strong recovery from the previous quarter. Investors were encouraged by the approval of vaccines to tackle coronavirus as well as clarity on the US Presidential election. With election uncertainty removed, the President-Elect can now turn his attention to tackling the coronavirus as well as enacting material stimulus measures to stabilise the US economy.

Some of the better performing US companies in the portfolio during the quarter included T. Rowe Price (+18.6%), Texas Instruments (+15.5%) and American Express (+20.9%). T Rowe Price benefitted from strong markets in Q4 which will ultimately lead to higher fee income for the company. Texas Instruments performed well over the quarter and year as the company has significant exposure to industrial customers who began to see improving business trends. Finally, American Express rallied after investor sentiment improved towards the company on

the announcement of the successful approval of a vaccine in November. This should lead to a gradual renormalisation for global economies and this in turn will help travel and entertainment spend which is an important revenue stream for American Express.

Outside of the US, Woodside (Australia) was up over 40%. The company, Australia's largest natural gas seller, was boosted by the improvement in the oil price in the fourth quarter. Imperial Oil (Canada) also rose +60%. The oil price rallied over 20% in the quarter in response to the positive vaccine news. Elsewhere Malayan Banking (+22.9%) has performed well in recent months as the outlook for credit losses caused by the pandemic has improved. The stock has also been a beneficiary of a shift of funds from several very expensive Malaysian stocks which were key beneficiaries of the demand for PPE equipment, into attractively valued stocks like Maybank which will prosper in more normal economic conditions.

The largest detractors in the US were CH Robinson (-7.6%) and S&P Global (-8.7%). CH Robinson had strong overall performance for the year but sold off as the company gave a more conservative outlook for last quarter of 2020. S&P Global was weak as it announced the acquisition of IHS Markit in an all stock deal. Longer term this deal will further consolidate S&P Global's position in the lucrative financial data provision market.

The largest detractor overseas in the quarter was China Mobile. The company fell -13.5% as outgoing President Trump signed an Executive Order banning US investors from holding stakes in a number of companies his administration believe are linked to the Chinese military. China Mobile is amongst those companies, though its operations are entirely in the delivery of mobile telecommunications on the Chinese mainland and Hong Kong. No other government has reached a similar conclusion nor did the Trump administration during its 4 years in office. The company is now trading at an attractive valuation.

PORTFOLIO CHANGES / OUTLOOK

Following a number of asset allocation changes in the first half of the year there were no further changes in the second half. At quarter end, the model allocation is 25% equities, 72% bonds and 3% cash.

Our positioning in bonds remains the same, following a slight reduction in our duration target from 2.5 to 1.5 in July. Pyrford continues to adopt a very defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields. At the end of the quarter the modified duration of the fixed income portfolio stood at just 1.2 years.

Whilst these very short duration bonds are unlikely to yield high returns they will provide significant capital protection for the portfolio and importantly they are highly liquid. In the quarter there were no further changes to the overseas bond portfolio. 42% of the portfolio is invested in overseas bonds, with 15% in the UK, 16% in Canada and 11% in Australia. The remaining bond portfolio is invested in US Treasuries.

The equity portfolio is positioned in traditionally defensive sectors which offer predictable revenue streams and attractive valuations. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. In the quarter there was no change to the country exposure within the portfolio.

Finally, there was no change to the unhedged non-USD exposure in the portfolio over the quarter. 45% (the maximum level) of the portfolio remains exposed to unhedged foreign currencies, representing the view that the US dollar is a very expensive currency and we expect it to fall further based on our Purchasing Power Analysis. If the currency does fall, the portfolio will benefit.

CONCLUSIONS

The path of the Covid-19 pandemic in 2021 remains the biggest uncertainty we face. Euphoria in November as multiple vaccines were released and approved in record time quickly gave way to concerns about new virus strains and relentless third waves of infections. The availability of a choice of vaccines so quickly is nothing short of a triumph for the scientific community. However, the manufacture, transportation, distribution and dispensing of hundreds of millions of doses appears to be a logistical challenge unrivalled in peacetime.



Ultra-low yields have been generated by central banks cutting base rates and actively buying government bonds to push yields down further. This financial alchemy has allowed governments to borrow cheaply to finance the massive amounts of fiscal stimulus they have provided this year.

Coordinated government and central bank action has provided income support to many in the developed world whilst reducing the burden of high levels of debt. As a result, increased household savings providing the potential for pent-up demand to be released.

The ongoing problem is these extraordinary levels of government support will gradually come to a tapered end. Central banks are effectively acting as the buyer-of-last resort and adding staggering sums to their already bloated balance sheets. Many government bond markets will end up being largely owned by their central banks. A temporary and expensive cushion has been pushed beneath the labouring world economy. The key word is temporary.

The most obvious reason why rates won't stay low forever is the return of strong inflation. Economic uncertainty, high and rising unemployment, excess capacity and already high levels of debt suggest very limited inflation is likely. However, the vast amounts of fiscal and monetary stimulus, elevated cash balances in banks and Covid-related capacity constraints could create pressures nonetheless.

Even if inflation does appear, rate rises may not follow as quickly as they have in the past. The US Federal Reserve has shifted to targeting long term "average" inflation rather than stamping on it with rate rises immediately. Indeed, many governments may be tempted to deal with record-breaking public debt levels by inflating them away, rather than paying them back, which may mean inflation returns without much of a response. The volatility that we expect stems from the fact that equity markets appear to have factored in an almost certain and fairly swift economic recovery in their performance since the trough in March. However, with earnings and dividends much reduced from their February levels and likely to remain lower for some time, this unavoidably means that they are much more expensive.

Weak and uncertain economic growth matched with expensive bond and equity markets is not a good combination. Elevated valuations can be seen not just in equity markets, but in the price of Bitcoin, gold, residential property and many other assets and only heightens risk. Given that, ending 2021 having preserved the value of one's assets, particularly if you've preserved their spending power too, will be a good outcome.

RESPONSIBLE INVESTMENTS COMMENTS

As long-term shareholders of companies, we have the ability, and in our view the responsibility, to try to influence the business practices of companies.

In the quarter Pyrford voted 228 ballots in 11 company meetings. We voted against management in ~20% of meetings. All voting records and rationale are available to view on our website (www.pyrford.co.uk), contained within our responsible investment section.

Finally, in the quarter, Pyrford's 15-member Investment team engaged with 53 companies and ESG issues are a standing agenda item in every meeting we conduct. For a detailed overview of ESG activity, please visit our website for our latest annual ESG report.



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FEES

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