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Global Cautious Fund

Quarter One, 2021

Nedgroup Investments Global Cautious Fund

Performance to 31 March 2021 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	1.6%	0.0%	0.0%
12 months	12.4%	0.2%	2.9%

MARKET OVERVIEW

The market focus over the quarter was on rates as the rise in 10-year yields caught the attention. The move in yields is a corroboration by financial markets that an economic recovery is anticipated. Upbeat investor expectations have propelled equity and commodity prices higher in recent months.

Long-bonds experienced a marked increase in yield, the US 10-year Treasury increased by 83bps to end the quarter at 1.75%. Central banks have kept their foot on short yields but at the long-end they have watched as prices fall and yields spike. Indeed, this quarter the Bloomberg Barclays Index of Treasuries maturing in over 10 years generated a -13.5% return, the worst return since 1980.

Bond yields had been driven down to historically low levels by massive buying programmes of central banks, to support both markets and the economy. Inevitably central bank and government actions will impact the real economy, but we are sceptical that growth will catch up with the pace of debt expansion. The problem is that each extra dollar of debt produces less than a dollar of income/output.

The rise in yields has dampened support for momentum stocks with pro-cyclical value stocks such as financials and energy stocks being more in favour. The rotation into cyclical sectors highlights the market's belief that an end to the pandemic is in sight. One thing is clear, central banks are not looking to hike rates or subdue any inflationary pressures, particularly given the volatility generated by previous attempts to taper support. Inflation will help in devaluing the debt burden assumed by governments through the pandemic something of which central bankers are only too aware.

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 first quarter the portfolio produced a positive return.

Both the portfolio's equity and bond allocations contributed positively to returns over the quarter, whilst currency hedging detracted. The key contributor over the quarter was the portfolio's US equities which produced a positive +13.2%, outperforming the US market by over 7% (MSCI USA: +5.5%). US Investors were encouraged by the approval of vaccines to tackle the coronavirus pandemic as well as clarity on the US Senate race. With election uncertainty removed, the new President can now turn his attention to tackling the coronavirus as well as enacting material stimulus measures to stabilise and enhance the US economy.

This ultimately is expected to have inflationary implications as well as weakening the US dollar. In the US, cyclically orientated sectors such as energy, industrials and financials led the market rebound while sectors such as consumer staples and information technology lagged the market. The portfolio benefitted from having an underweight positioning in the utilities and information technology sectors and an overweight position in the financial and industrials sectors.

[1] Net return for the Nedgroup Investments Global Cautious Fund, C class. Source: Morningstar (monthly data series).
[2] US Libor 1 month
[3] Morningstar EAA Fund USD Cautious Allocation

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
Altria Group	US	0.21%	CH Robison Worldwide	US	-0.04%
General Dynamics	US	0.18%	Malayan Banking	Malaysia	-0.04%
Texas Instruments	US	0.14%	Fuchs Petrolub	Germany	-0.02%
American Express	US	0.12%	Axiata Group	Singapore	-0.02%
T Rowe Price	US	0.12%	Nestle	Switzerland	-0.02%

Some of the better performing companies in the portfolio during the quarter included Altria, General Dynamics and American Express. Altria rose during the quarter as an easing of restrictions enabled the company to start accelerating the roll out of its new “heat not burn” tobacco platform in the US. Investors also became more confident in the sustainability of the dividend. General Dynamics advanced as a loosening of travel restrictions would benefit the company’s aerospace business. Finally, American Express rose as the company posted a stable set of results and investors began to look towards a reopening of the US economy which would bode well for credit card spending.

The biggest detractor over the period was CH Robinson Worldwide which was sold over the quarter (see note below). Overseas, Malayan Banking fell 5% over the quarter. Having performed strongly during Q4 2020 Malayan Banking was weaker this quarter. The company announced its 2020 results during February which were impacted by pandemic-related credit costs. However, the bank is very well capitalised and well-positioned for economic recovery in Malaysia. Fuchs Petrolub (Germany) also fell over the quarter following Q4 2020 results. Whilst the company beat expectations the stock fell on what analysts felt was an overly cautious outlook for 2021.

PORTFOLIO CHANGES / OUTLOOK

There was one change to asset allocation in the first quarter as the investment team made the decision to reduce exposure to equities from 25% to 20%. The decision was made following strong equity market performance alongside a cut in underlying dividends, reducing the value of equities. The US market in particular has been amongst the best performing global markets and now has the lowest value indicator of any market we are invested in. The model allocation is 20% equities, 77% bonds and 3% cash.

Our positioning in bonds did not change in the quarter. Pyrford adopts a very defensive stance by owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields as we witnessed in the first quarter. At the end of the period the modified duration of the fixed income portfolio stood at just 1.5 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.

In the quarter one stock was sold outright (CH Robinson) and no new stocks were purchased. CH Robinson is North America's largest freight forwarder and has traditionally benefited from this position through economies of scale and network effects. There has, however, been increased competition with a number of technology-based start-ups entering the industry. This has been accompanied by margin pressure over the last few years. The company also did not increase its dividend last year, suggesting that management have less confidence in the immediate prospects for the business. At the same time we have companies with better value indicators and as such have added to our positions in these within North America.

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 based on our Purchasing Power Analysis. If the currency does fall, the portfolio will benefit.

CONCLUSIONS

The markets expect strong economic growth, the prognosticators (IMF, OECD etc.) expect strong economic growth and yet, and yet…we have our reservations. The economic reality since the middle of last year has not been anything close to a 'normal' reality. The world economy is floating on an artificial sea of subsidies, handouts, debt repayment moratoriums and the like. Bit by bit it will all end and what are we then left with? Massive government indebtedness and an economic growth path that is unlikely to be any better than that experienced over the last decade – that is, desultory. COVID-19 and its attendant restrictions will have modified behaviours, perhaps permanently, but we see no reason to expect this to lead to an acceleration of growth above pre-COVID-19 averages. In the meantime, we have pushed on to new stock market highs, crypto-mania and absurdly low official interest rates.

The latter has distorted the efficient allocation of scarce resources. If the price of money is next to nothing it is easy to make foolish capital investment decisions. Or pay a silly price for a house. It is easy to maintain businesses that are effectively 'zombies'. It is also too easy to build debt on a scale that eventually leads to a crisis.

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 362 ballots in 14 company meetings. We voted against management in 50% 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 met virtually with 68 companies worldwide. ESG issues are an agenda item in every meeting we conduct where we have identified ESG risk. For a detailed overview of ESG activity, please visit our website for our latest annual ESG report.

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