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A photograph of an open book with white pages, tied with a white string around the spine, set against a light background.

NEDGROUP INVESTMENTS **Global Cautious Fund**

Quarter Three, 2021



Performance to 30 September 2021 (USD)	Fund ¹	Target Return ²	Peer Group Avg. ³
3 months	-1.1%	0.0%	-0.3%
12 months	5.2%	0.1%	6.6%

MARKET OVERVIEW

Risks are accumulating on the horizon with the market having to digest various China risks, Washington DC policy risks, energy risks, a weakening of earnings as well as a shift to central bank tightening. Virus risks have long been the primary concern, but infection rates continue to improve, and positive developments continue with Merck announcing positive test results for a pill to combat Covid.

The US 10-year bottomed at 1.17% over the quarter, widening by over 30 basis points to end September at 1.49%. The selloff in the US 10-year is understandable given the Fed has flagged they are ready to reduce the \$120bn a month of asset purchases but will remain “patient” with regards to rate rises. The market has been debating the timeline for the withdrawal of asset purchases for many months and initially took the news in its stride. That said, winding down the programme by mid-2022 implies a more aggressive rate of withdrawal than anticipated which woke the Treasury market. The move higher in Treasury yields was not limited to the US. From their respective lows, the yield on the UK 10-year increased by around 50 basis points to 1.02% and the German 10-year by 26 basis points to -0.23% over the quarter as a more hawkish sentiment descended on Treasury markets.

The current inflation surge is both cost-push and demand-pull. Demand-pull because the ‘free’ money handed out in one form or another pushed up savings rates and gave many people more liquidity than they had experienced in years – perhaps ever. Ultimately, the money started to chase goods and services. Cost-push because global supply chains were massively disrupted, ships and other forms of carriage were taken off-line, and many people left those industries.

On the question of transitory or permanent inflation, we come down on the side of the inflation scare being temporary – but ‘temporary’ may still be as long as several years. It means that central banks must navigate a journey through a confused economic narrative.

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 third quarter the portfolio produced a negative return. The key detractor over the third quarter was US dollar strength as the portfolio maintains a significant 45% position in unhedged non-USD assets. The dollar rose steadily in the third quarter as U.S. economic data generally outpaced those of rival economies.

As a result, Pyrford’s overseas bond portfolio (UK, Canada and Australia) was the largest detractor over the quarter. The dollar rose by +2.3% against the Canadian Dollar and +2.5% against the Pound. The Australian bond positioned is hedged. US Bonds were flat over the quarter.


In Equities, Pyrford’s US equity portfolio outperformed the wider market (+1.57% v +0.41%, MSCI USA Index) over the quarter. Overseas, the portfolio detracted (-1.17%) hampered by US dollar strength. The following table highlights the top 5 equity and contributors and bottom 5 equity detractors over the quarter:

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





Top Performers	Country	Performance contribution	Bottom Performers	Country	Performance contribution
AUTOZONE	US	0.07%	VTech Holdings Ltd.	HONG KONG	-0.07%
GENERAL DYNAMICS CORP	US	0.04%	PHILIP MORRIS INTL	US	-0.03%
MCDONALD'S CORP	US	0.04%	ALTRIA GROUP	US	-0.03%
SINGAPORE TELECOM	SINGAPORE	0.04%	NOVARTIS	SWITZERLAND	-0.03%
TELKOM INDONESIA	SWITZERLAND	0.03%	BRAMBLES	AUSTRALIA	-0.03%

In the US, the stockmarket had a positive quarter as economic activity continued to improve and restrictions continued to be eased. Concerns about a delay in the increase of the US debt ceiling and a stalling infrastructure packages on Capitol Hill weighed on investor sentiment. Another lingering issue that concerned investors was whether an increase in inflationary pressures was a transient or more permanent phenomenon. The Canadian market was lower over the period as oil and copper prices were weaker impacting the commodity centric sectors of the market. Over the quarter the portfolio was ahead of the benchmark.


Some of the better performing companies in the portfolio included McDonalds, General Dynamics and AutoZone. McDonalds reported an improving set of results during the quarter as customers began to return to the company restaurants and announced new menu initiatives that are expected to boost sales. General Dynamics benefitted from more worldwide travel activity, which is a tailwind for their business jet subsidiary, Gulfstream. Gulfstream also announced that it would be producing two new business jets, the G400 and G800 which would enhance their current production line up. AutoZone rose as the company posted results that were well ahead of market expectations as the company continued to increase their market share in the commercial auto parts after-market.

Altria and Philip Morris lagged during the quarter as both companies were impacted by a Court ruling that restricted the sale of their flagship heat not burn tobacco device: IQOS in the US due to potential patent infringement issues. It is worth noting that the companies have won similar patent lawsuits in other parts of the world. After the Court ruling Altria and Philip Morris announced that they would be appealing the US Court decision.

Key contributors overseas included two Asian Telecom companies: Singapore Telecom and Telkom Indonesia. For Singtel, easing COVID 19 restrictions saw the return to growth, with improved performance at Optus (Australia consumer) from higher revenue per user across prepaid and post-paid subscribers, continued growth in its enterprise business, combined with a turnaround at Bharti Airtel in India. The pandemic led to increased demand by corporates to digitise their businesses creating higher revenue in their enterprise division. Telkom Indonesia saw sequential growth across all segments in the second quarter with non-mobile growing faster than mobile. They continue to see strong traction in their fibre broadband business with steady increase in subscribers and higher revenues per subscriber as they take on dual or triple play services. Competition in mobile also eased and is likely to remain lower given the announced consolidation amongst the smaller operators. The company is also in an advanced stage to list their tower subsidiary Mitratel by year end which will lead to a sizable valuation gain.

The largest detractor overseas was Vtech (Hong Kong) which fell over 20% in the quarter after the company issued a profits warning in mid-September. Vtech announced that the combination of rising raw material and shipping costs, appreciation of the Chinese Renminbi and shortages of key components, meant that they expected profits for the first half of their 2022 financial year to be 35-40% lower than the prior year. Though this is disappointing, we do not believe it changes the long-term investment case for Vtech. If dividends for the full year were cut by 40% the stock would still have a yield of 7%.

The portfolio's 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 quarter.



Finally, the portfolio has a single position within its currency hedging allocation, the Aussie dollar. The currency weakened against the US dollar by nearly 4% and therefore contributed a positive return to the portfolio. Despite this position, Pyrford view the US dollar as a very expensive currency based on in-house Purchasing Power Analysis and therefore maintain a significant exposure (45%) to non-US dollar assets. If the currency does fall, as it did do against a number of currencies in the quarter, the portfolio will benefit.

PORTFOLIO CHANGES / OUTLOOK

There were no changes to asset allocation in the quarter. The model allocation is 20% equities, 77% bonds and 3% cash.

Our positioning in bonds also did not change in the quarter. Pyrford adopts 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 earlier in the year. 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 remains defensively positioned with an underweight to the QE fuelled markets and an overweight to the Southeast Asian markets. The European portfolio is concentrated in the UK, Switzerland and the relatively healthy economies of core Europe. Economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations. In terms of sectors, we have limited exposure to more cyclical sectors such as financials and consumer discretionary. Overweight positions are held in defensive sectors such as industrials and communications. These sectors offer predictable revenue streams and attractive valuations. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value.

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

Central banks rarely have any better idea than anyone else about what is really going on in the economy yet their actions, by artificially distorting the price of money, have profound implications for every part of an economy. Do you want a bond bubble? Sally forth into the market and buy bucket-loads of government debt. Do you want a housing bubble? Crush lending rates to the lowest on record. A stock market bubble? Give money away. Do you want a boat-load of 'zombie' companies? Keep rates on the floor. And so it goes.

Our hope is that the interplay of market forces will, one day, be allowed to control the key components of an economy – with no component being more key than the cost of money. Wishful thinking? More than likely.

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 238 ballots in 9 company meetings. We voted against management in over 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 met virtually with 51 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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FEES

A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

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