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NEDGROUP INVESTMENTS Global Cautious Fund

Quarter One, 2020

Nedgroup Investments Global Cautious Fund

Performance to 31 March 2020 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	-6.3%	0.4%	-7.8%
12 months	-4.6%	2.1%	-2.9%

MARKET OVERVIEW

The longest bull market in history came to a sudden end in the quarter as global markets plunged in panic following the outbreak of Coronavirus (COVID-19). At the time of writing the pandemic is having a dramatic and devastating effect on people around the world and the global economy, with no clear end in sight to this crisis. The virus has spread to almost every corner of the world, with over 2 million confirmed cases and a death toll rising sharply by the day. We extend our deepest sympathies to all those impacted by the outbreak around the world but obviously will only comment on markets and economies here.

Equities markets in particular suffered over the quarter as most countries moved to a state of lock-down, shutting all but essential industry and services. After a partial recovery towards the end of the quarter, Global Equities (MSCI ACWI) ended the quarter down -19.9% with Emerging Markets (MSCI EME) falling a similar -19.0%. The UK (FTSE AS) had its worst quarter for equities since 1987 falling 25.1% over the quarter, at one stage falling nearly 35%.

The coronavirus pandemic highlights the fragility of the global economy. It is now more interdependent than at any time in history and it is a world bathed in debt. As long as the orchestra keeps playing it is possible to pretend there is no looming problem but when the music stops abruptly all the flaws are exposed.

The private sector in most advanced economies is heavily leveraged as is the government sector – but it is the latter that will now see debts balloon beyond proportions, relative to GDP, that might have been glimpsed briefly during WW2 but never before or since. This time around, however, we also have the central banks playing a role that is new. They 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. The central banks will also own large slabs of mortgage-backed securities, corporate debt and, often, equities.

Even if the pandemic ends soon the legacies will last for years as world governments struggle to see their way out of the debt mountain. Economic growth was already set to be slow and this experience will do nothing to speed things up – quite the contrary.

In these circumstances it is difficult to place a fair value on equity markets. The fact that they are much less expensive than a couple of months ago is a comfort as they entered 2020 out of kilter with underlying growth and fundamentals. The problem is that we have no idea how far back the global economy will tumble before a solid base can be formed. It is therefore prudent to move gradually into risk assets. It would be foolishly optimistic to suggest that this downward leg in equity markets is over.

The traditional challenger to equities – government bonds – no longer offer a challenge. Yields are at or close to zero, or even below zero on a real basis, and will provide no sustenance to investment portfolios going forward. In previous share market debacles – of which there have been several – bonds always provided a viable option. No longer.

The other major event over the quarter was the fall-out between Russia and Saudi Arabia over the oil market resulting in all agreements about daily supply being torn up. This was a consequence of the dramatic drop in

[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

demand caused by COVID-19. Normally, supply would have been pulled back to roughly equate with demand but in an undisguised attempt to remove the North American shale producers from the market (the US is now the world's biggest supplier of oil) Russia was happy to actually increase supply and allow the price to fall dramatically. The price of Brent Crude is now hovering just above US$20 a barrel. When Russia walked out on the "friendly" agreement with Saudi Arabia it was around US$50 a barrel.

The shale producers are only breaking-even around $45-$50 a barrel so these prices will cause many to cease operations – particularly since the bulk are heavily indebted. The same dilemma applies to the major multinationals – they also need a price around $50 a barrel. Saudi Arabia can produce oil profitably around $10 a barrel but it needs around $80 a barrel to balance its budget.

So just when you thought things couldn't possibly get worse, we have the oil industry in significant chaos.

Economic growth in the first and second quarters will be non-existent. On a quarterly annualised basis, we are likely to see GDP contractions of as much as 20-25%. Over a full 12-month period it is doubtful that there will be any growth positives. Until we reach the stage of being able to state with confidence that we have seen the peak of the pandemic and are firmly on the downward slope forecasting is perilous and pointless.

FUND PERFORMANCE

Going into the quarter, the portfolio had a highly defensive positioning, with just 25% in equities, Pyrford's lowest ever equity weighting. This defensive positioning enabled the fund to largely avoid the worst of the equity fallout, although not entirely. Importantly, we were able to change our asset allocation as the quarter progressed and buy into value as it started to emerge within equities.

Despite the defensive asset allocation, the size of the negative return produced over the quarter was amplified by the portfolio's significant exposure to non-US dollar assets, as investors fled to perceived safe havens such as the dollar. Going into the period the portfolio had a maximum level of unhedged foreign currency exposure at 45%. Based on Purchasing Power Parity (PPP) analysis we consider the dollar to be extremely overvalued and expect it to fall, which will be to the advantage of the portfolio. The largest currency exposures within the portfolio are to the Canadian Dollar (16.6% of portfolio at quarter end) and the UK pound (13.9%). The Canadian dollar was down nearly 9% after the dramatic drop in the oil price, which it is heavily correlated with and the pound fell by over 7% as the Bank of England materially reduced interest rates, cutting by 65 basis points to 0.10%.

Within equities, Pyrford's non-US dollar holdings ("Overseas Equities") provided downside protection, outperforming the wider market by +2.8% over the period (Pyrford: -21.4% vrs. -24.2% MSCI World Ex US). The Pyrford US portfolio fell 21.4% whilst the MSCI USA index fell -21.0%. The following table highlights the top 5 equity performance and bottom 5 equity performers over the first quarter*:

Top Performers	Country	Performance contribution	Bottom Performers	Country	Performance contribution
Roche Holding	Switzerland	3.8%	**Texas Instruments**	USA	-21.6%
KDDI	Japan	1.03%	**General Dynamic**	USA	-24.7%
Metro	Canada	-1.0%	**American Express**	USA	-31.5%
Reckitt Benckiser	UK	-4.52	**ComforDelGro**	Singapore	-39.4%
Mitsubishi Electric	Japan	-5.73%	**Woodside Petroleum**	Australia	-50.3%

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

Within the overseas equity allocation, Swiss Pharmaceutical company Roche has seen limited impact on its operations from Covid-19 as its Diagnostics business is active in refining the testing process for the virus and the company has also been scouring its portfolio for any existing treatments that might have the potential to fight the virus. Japanese telecom KDDI added as defensive yielding stocks have performed well. Recent earnings were in-line with expectations, but we await updated guidance on earnings and dividends in coming weeks.

Having performed strongly last quarter, Woodside Petroleum underperformed as production output decreased due to planned maintenance whilst also facing the headwinds of a lower oil price. Woodside converts oil and gas into LNG for onward shipping. They benefit from pricing in the LNG market, which is predominantly long-term. American Express also detracted as they are expected to be negatively impacted by the reduction in consumer spending.

Within government bonds, a “flight to safety” saw high quality bond markets rally with longer-duration bonds outperforming. Pyrford’s US Bond portfolio returned a positive +1.8%. The wider US bond market (mixed durations) returned +8.8%. Pyrford continues to adopt a very defensive stance by owning short duration securities only to protect the capital value of the portfolio from expected increases in yields, as we saw in the final quarter of 2019. Overseas bonds fell -7.5% due to the strength of the dollar, as discussed above. Pyrford holds government bonds in the UK, Canada and Australia.

The Australian dollar is hedged so part of this negative return is captured within currency hedging. The Australia dollar fell by nearly 15% against the US dollar and as a result the Pyrford portfolio benefitted significantly with currency hedging contributing +1.6% over the first quarter, the single largest contributor.

PORTFOLIO CHANGES / OUTLOOK

In the quarter, Pyrford increased exposure to equities by 5%. The increased exposure was invested pro-rate in the existing non-US equity portfolio. At quarter end, the model allocation is now 30% equities, 67% bonds and 3% cash.

The equity portfolio remains 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 Asia, we have a preference for the Southeast Asian markets over Japan as the economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations. Within the equity portfolio there were no new stocks purchased or sold outright over the quarter.

The positioning in bonds remains the same. 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 1.3 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. The portfolio management team have had sufficient liquidity to sell these positions and switch into equities. In the quarter there were no further changes to the overseas bond portfolio, although position sizes reduced in line with the increase equity exposure. 39.1% of the portfolio is invested in overseas bonds, with 13.9% in the UK, 14.6% in Canada and 10.6% in Australia. The remaining bond portfolio is invested in US Treasuries.

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 an expensive currency.

CONCLUSIONS

At Pyrford we believe that a long-only, fundamental, quality and value-based approach utilising a long-term outlook with the ability to move allocations flexibly and appropriately between the key asset classes – global equities, cash and sovereign debt - will provide a rewarding and stable real return stream for our clients.

We had for a while believed that the strong performance in equity markets meant that increased uncertainty could lead to weakness in markets. Markets are most vulnerable when valuations are expensive and markets have been in expensive territory for several years. Whilst the coronavirus may have been the catalyst that has caused markets to correct, our positioning reflected the value opportunities available coming into this were scarce.

In these circumstances it is difficult to place a fair value on equity markets. The fact that they are much less expensive than a couple of months ago is a comfort. The problem is that we have no idea how far back the global economy will tumble before a solid base can be formed.

It is therefore prudent to move gradually. It would be foolishly optimistic to suggest that this downward leg in equity markets is over

RESPONSIBLE INVESTMENTS COMMENTS

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

In the quarter Pyrford voted 252 ballots in 14 company meetings. We voted against management in 64% of meetings. All voting records and rationale is available to view on our website (www.pyrford.co.uk), contained within our responsible investment section.

Finally, in the quarter, Pyrford's 14 member Investment team engaged with nearly 43 companies worldwide 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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The Information Agent in Germany is ACOLIN Europe AG, with registered office at Reichenaustraße 11a-c, 78467 Konstanz. The basic documents of the Fund, including the prospectus (in English) and the KIID (in German), may be obtained free of charge at the registered office of the German Information Agent.

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