



Quarterly review

Nedgroup Investments Core Diversified Fund

As at 30 June 2020

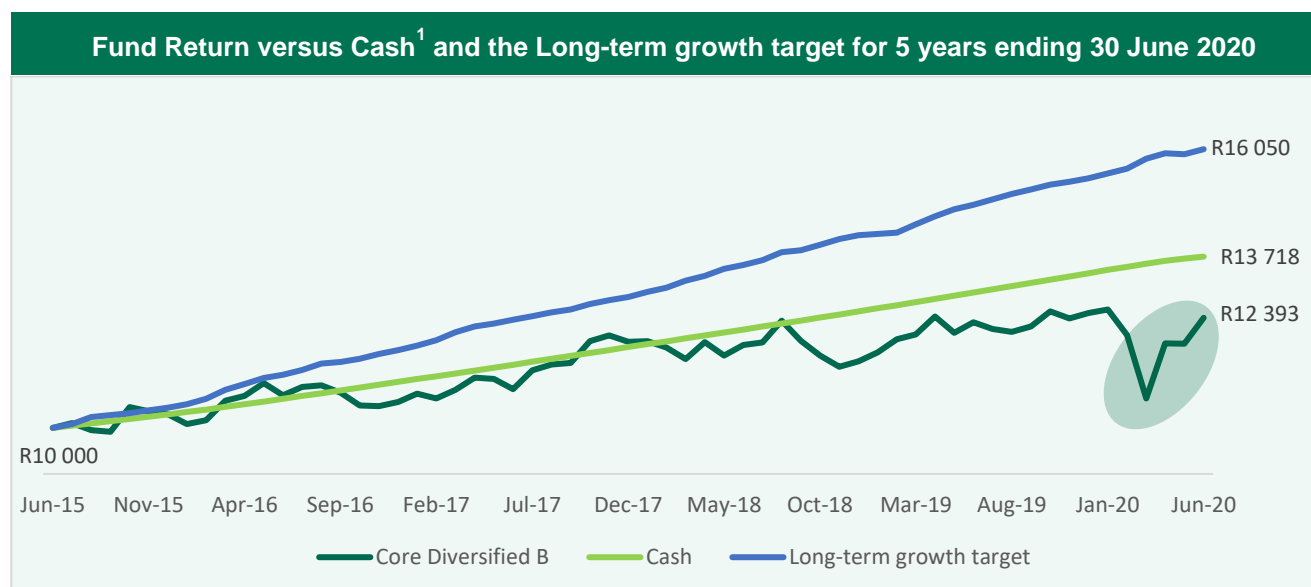


Best 3 months return since May 2009

With worldwide lockdowns easing, almost all asset categories logged sizable gains during Q2. Global risk assets have benefited most from government fiscal stimuli and coordinated central bank policies to restore liquidity back to the capital markets. SA equity and property market gained significantly, more than 20% for the quarter. This has benefited the fund significantly resulting in Nedgroup Investments Core Diversified Fund seeing solid gains of 16.5% returns for the quarter. But with concerns over slowing growth, uncertainty around economic and earnings outlooks due to Covid-19, investors should be prepared for potential volatility.

The table below compares an investment in Nedgroup Investments Core Diversified Fund to a bank deposit (cash) investment and its growth target over various time periods. For every R10 000 invested in the Nedgroup Investments Core Diversified Fund five years ago, you would have R12 393 at the 30th of June 2020. This is a lower than the R13 718 you would have achieved had you invested your money in bank deposits (cash) over the same period. The green circle in the chart below, highlights the recent market recovery, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investment Core Diversified Fund versus Cash ¹ and the Growth target						
	3 Months	1 Year	3 Years	5 Years	7 Years	Inception 31 August 2009
Growth of fund (after fees) (Growth in %)	R11 648 16.5%	R10 083 0.8%	R11 432 4.6% p.a.	R12 393 4.4% p.a.	R16 928 7.8% p.a.	R27 733 9.9% p.a.
Growth of cash (Growth in %)	R10 112 1.1%	R10 603 6.0%	R12 063 6.5% p.a.	R13 718 6.5% p.a.	R15 220 6.2% p.a.	R18 514 6.0% p.a.
Growth target (inflation+5%) (Growth in %)	R10 132 1.3%	R10 811 8.1%	R12 998 9.1% p.a.	R16 050 9.9% p.a.	R19 715 10.2% p.a.	R28 554 10.2% p.a.



The Nedgroup Investments Core Diversified Fund has a long-term growth target of 5% above inflation (around 10% per year) over 5-year periods. The fund has provided returns closer to cash over the past 5 years. However, history² demonstrates that two-thirds of the time a fund such as Nedgroup Investments Core Diversified fund would have achieved or surpassed its long-term target. This confirms the importance of being invested for the long term. In fact, if you increase your investment horizon, the risk of underperforming this target decreases.

¹ We used the STeFI call deposit rate for cash returns

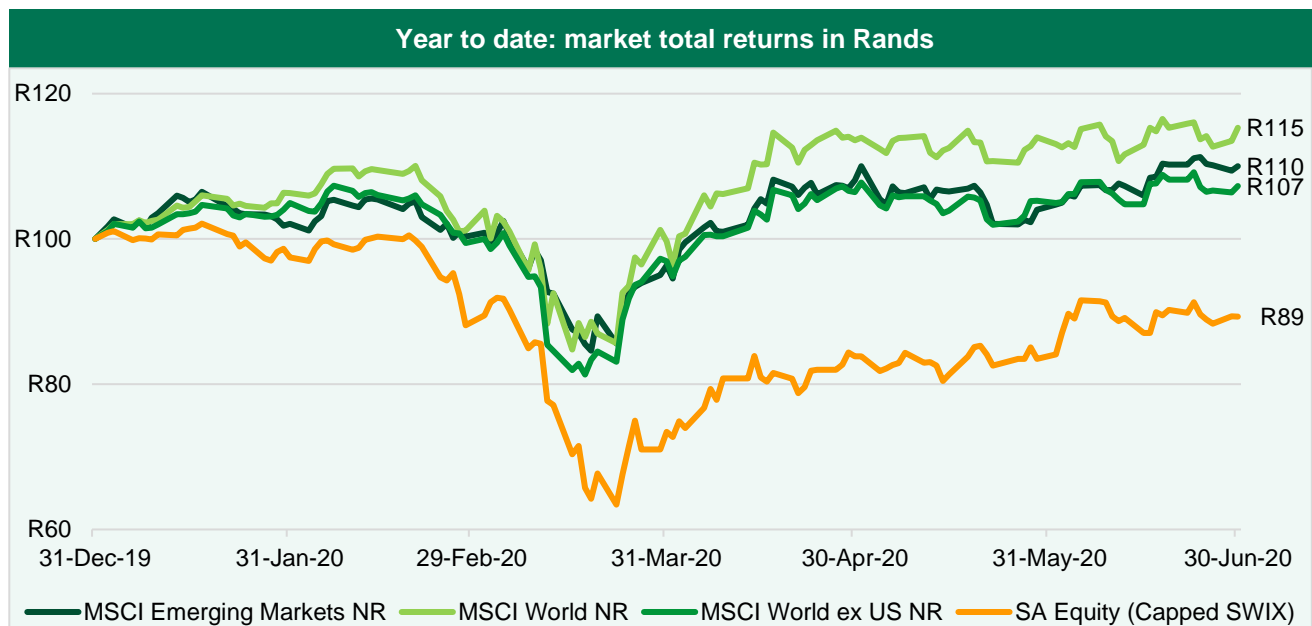
² Based on SA market returns from 1960 to 2018 (source Firer 2006) using the same long-term equity allocation and fees.



Market euphoria after the panic

The first quarter ended grimly with local and international markets falling by more than 30%. This is in stark contrast to the second quarter, which saw markets bounce back remarkably quickly. The chart below provides a good illustration of the recovery. It depicts the relative performance of emerging markets, developed markets (MSCI World), developed markets excluding the US (MSCI World ex US) and South African markets from 1 January to 30 June 2020.

In fact, a whole market cycle was condensed into just a few months. This is very unusual and unlike typical market cycles which are driven by structural or cyclical changes, was driven by an event, the COVID-19 pandemic. There are a few ways in which the rapid recovery can be interpreted. One view is that investor sentiment indicates that once the 'event' is over all is back to 'normal'. Other views include that the liquidity and relief provided by governments has artificially boosted asset prices or is expected to stimulate economic growth.



Moreover, both developed markets (MSCI World) and emerging markets not only recovered but reached a new high for the year (in rand terms). A portion of this can be attributed to rand depreciation but the main driver was strong underlying market returns. The chart also illustrates that the difference in performance between developed and emerging markets was primarily driven by the US. The developed markets index excluding the US (MSCI World ex US) had very similar performance to emerging markets. The outperformance of US markets may be ascribed to positive investor sentiment arising from the liquidity pumped into the market by the Fed and outperformance of the top 5 US stocks driven by increased demand for technology during the pandemic.

Unfortunately, South African markets didn't quite share in the same level of exuberance as global markets. Although they did recover somewhat, they have not yet reached their peak earlier this year. SA markets are still down by 11% relative to the start of the year and are significantly lagging other emerging markets (in rands).

Of course, the market response to COVID-19 is just one side of the coin. The other side is the economic reality people are facing. National Treasury estimates that job losses in South Africa could reach up to R1.8 million during the pandemic with a worst-case scenario of an unemployment rate as high as 50%. South Africa is not the only country facing such challenges. Even the US saw its unemployment rate leap from 3.8% in February to 13% in May, the second highest rate since World War II. Experts estimate that it may be as high as 20% now.

Nobody can predict how long it will take for economies and the unemployment rate to bounce back. In the meantime, governments are doing their best to soften the blow by providing support to those most in need and implementing measures to stimulate economic growth.



Retirees solve their own retirement dilemma

We are really excited to have launched the MyRetirement Solution in May 2020; a solution co-created with retirees, empowering them to solve their own retirement dilemma. This solution is designed for South Africans who are close to retirement or already retired and incorporates the Core Fund range.

For most South Africans, their retirement savings are the largest sum of money they will ever have. As they approach retirement, making a decision on what to do with their entire life savings is a daunting task. Unfortunately, the odds are stacked against them with less than 6% of South African's being able to retire without financial assistance. This statistic is not new, it hasn't improved in decades despite all the new products, innovations and legislation that has attempted to turn it around.

As a financial industry we are often guilty of developing solutions with a range of experts giving input but without including the retiree themselves and hearing their voice throughout the process. This leads to good solutions but not necessarily the right solution. A fresh approach is needed, one that includes the voice of the retiree.

At Nedgroup Investments we have taken a new approach to solve this age-old dilemma. With this approach, the retiree is integrally involved in every step of the journey, giving feedback and guiding the outcome. Using this feedback, Nedgroup Investments developed a solution called the MyRetirement Solution. The MyRetirement Solution is the first retirement investment planning offering of its kind in South Africa.

During development, every few weeks, we conducted user tests with South Africans from all walks of life who are approaching retirement. This feedback is used to amend the solution and so, the solution evolves into something that retirees understand, leads to positive behavioural changes and meets their needs. In fact, you could say that retirees are solving their own retirement dilemma. What emerged from our findings is that the majority of people share three key needs. The MyRetirement Solution addresses these three needs.

Need 1: Human touch

Retirees wanted an actual human to walk them through this decision. This is understandable as it's a daunting decision to make with significant ramifications. MyRetirement Solution includes a retirement coach or financial planner, who is with the retiree (physically or via a video call) when they complete the online portal.

Need 2: Advice

Retirees, even the well informed, wanted to be told that they were making the right decision and needed reassurance. Therefore, it is important that an actual recommendation is given to retirees as opposed to presenting them with options and facts.

The MyRetirement Solution includes an online portal which provides advice. Retirees are also given an opportunity to 'play around' with their plan and compare the outcomes. This is where we witnessed positive behavioural changes and people taking ownership of their retirement.

Need 3: Innovative retirement products

The MyRetirement Solution portal recommends a life annuity, living annuity or the Nedgroup Investments new innovative solution called the Living Annuity Plus depending on the retirees needs. The Living Annuity Plus combines some of the best annuity features in one product. It offers retirees the flexibility of a living annuity (i.e. to choose their income and investments) but with an increased probability that their income will last for life. Nedgroup Investments pays extra money (called top-ups) into the retiree's investment account over and above their investment returns to make their income last longer. The top-up paid depends on the percentage that the retiree elects to leave to their partner and/or dependants on their death. The lower this percentage, the greater the top-ups are.

To learn more about the MyRetirement Solution, which we co-created with retirees, please visit:

<https://www.nedgroupinvestments.co.za/content/NGISingleSiteContent/Local/Institutional/post-retirement---myretirement-solution.html>.



Lessons from past pandemics

There is no doubt that the spread of the COVID-19 pandemic has resulted in a dual public health and economic crisis. With 10.1 million confirmed cases and 534,000 deaths worldwide as at the beginning of July 2020, the coronavirus pandemic has become a global tragedy unlike any other in our lifetimes. But, as historians remind us, this is neither our first nor our most deadly war with an infectious disease (see figure below).

History of Pandemics - Source: CDC & WHO



A look at the history of pandemics can be useful when looking for context and lessons learned from the past. History is very positive about how economies get out of pandemics. If we go way back to the Black Death pandemic in 1347 where one-third of the European population was destroyed, the implication was that Europe was going to go into some trauma after. However, the opposite happened, we had the starting of the flourishing Italian literature and printing press. The world responded incredibly positively to what was a trauma.

A look at the Russian Flu in the 1890s which killed a million people offers us the same lesson. After the pandemic we had the age of science and mass production. Things started to speed up with several key inventions in the 1900s. Think gasoline engines, airplanes, chemical fertilizer. All inventions that helped us go faster and do more. The 'Spanish' influenza pandemic of 1918-1919 was the most severe in recorded history as shown in the chart above, affecting approximately 25% of the world's population and killing in the order of 50 million people. However, the reaction after the pandemic technologically was phenomenal in the 1920s, where we saw the introduction of electricity, the radio and massive stock market boom. Inventions such as this transformed the way people lived and communicated. When you stop and think about it, it was this industrial revolution, the second one, that resulted in the modern world. The economics profession teaches us that in order to understand the economy you need to understand human nature. This brings us to our first lesson, which is that when humans get faced with something as unbelievably traumatic where the implication is to go into some trauma after the pandemic, the speed of adoption of existing innovation trends gets accelerated which changes how we do things.

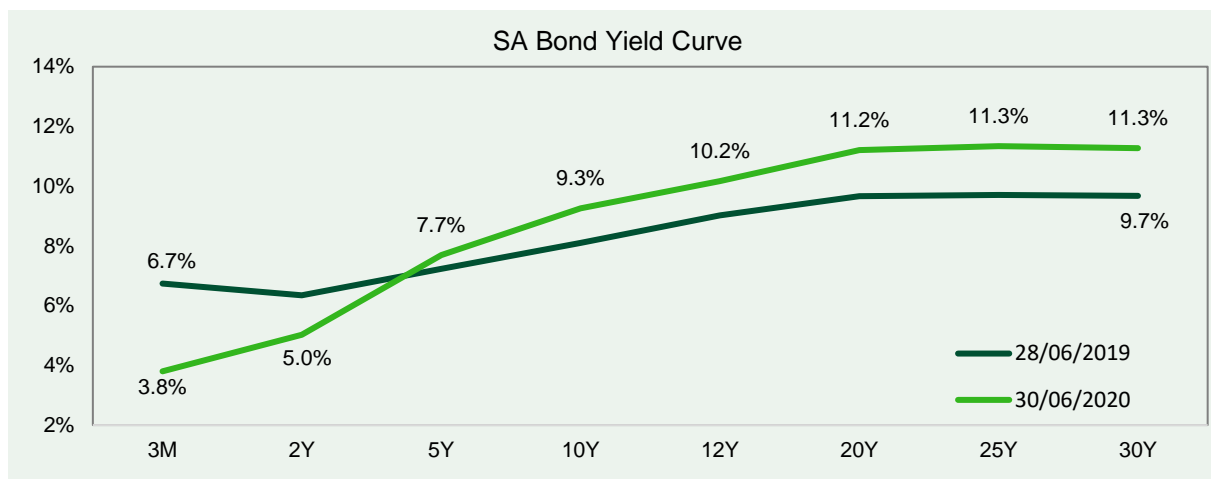
The second profound lesson to be learned is that this can end. As horrific as COVID-19 is, its death toll may not reach the meteoric levels of the flu epidemic of 1918. Our public health systems, scientific tools and medical supplies are far better. The coming months will no doubt be painful, but with collaborative work underway to develop treatments and a vaccine, all we need is time.

It is understandable why investors find it hard to find context while keeping track of the unfolding news about the COVID-19 outbreak. Every day there is new research, new reports of deaths, new policy controversies and debates about the economy, our public health system and whether the world will ever be the same. However, the history of pandemics offers considerable advice, but only if people know the history and respond with wisdom. History is kind to humanity with respect to how we get out of pandemics, put simply, history in this case teaches us that a few years after the pandemic, we will react in an incredibly positive way.



The search for yield – caught between a rock and a hard place

Over the past few months we have seen a steepening of the yield curve as interest rates have come down while bond yields have gone up. As one can see from the chart below, following the recent aggressive rate cuts, longer term government bond yields have become quite attractive relative to short-term rates, with the current 10-year government bond yield sitting at around 9%. This has resulted in many investors increasing their bond exposure.



Some investors, however, feel that they are caught between a rock and a hard place as the higher yields on longer term government bonds come with its own risks. Growth reforms, reprioritisation and expenditure cuts are critical to getting the country's debt burden under control. Should these not materialise or take much longer, the fiscal deterioration will get much worse. These factors are likely to keep government bond valuations under pressure.

While many investors have increased their bond exposure, the strategic weightings to this asset class in the Nedgroup Investments Core Diversified Fund has remained unchanged. This is because the fund was designed with reliability in mind and follows a robust long-term strategic asset allocation strategy. Within this strategy the bond and cash allocations each play an important role in creating more predictable outcomes over shorter investment horizons. The global bond and cash allocations provides additional downside protection through turbulent times and big market drops.



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