NEDGROUP INVESTMENTS

see money differently

NEDGROUP INVESTMENTS
Global Cautious Fund

Quarter Three, 2020

Nedgroup Investments Global Cautious Fund

Performance to 30 September 2020 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	1.8%	0.0%	2.3%
12 months	2.3%	0.9%	3.0%

MARKET OVERVIEW

In the third quarter Covid-19 continued to cut a swathe through the world economy thanks to government mandated lock-downs and restrictions. Global economic growth is now forecast to experience a real GDP decline of 4.5% in 2020 with growth in 2021 expected to bounce back with an increase of 5.0% but this and other medium-term forecasts are prone to heavy revisions.

The ongoing problem is that much of the economic "activity" of the last half year has been courtesy of extraordinary levels of 'fantasy' money provided by panicking governments – all of which will gradually come to a tapered end. The US presents an excellent example: the fiscal response involving support for households, businesses and the health system amounts to almost 15% of GDP. This has pushed the gross Federal debt from 108% of GDP in 2019 to an alarming 138% (projected as at the end of 2020). If unfunded pension liabilities are included the percentage increases to 164% (source: IMF). In other parts of the world many of the fiscal responses have been more extreme. In the eurozone, Germany and Italy, in particular, have provided quite extravagant levels of fiscal support. Thus, a temporary and expensive cushion has been pushed beneath the labouring world economy. The key word is temporary. Valuations simply do not reflect this risk.

The US Federal Reserve has given up on their 2% inflation target, a target they have consistently failed to achieve. Should inflation rise above 2% in the future the Fed will no longer be obliged to automatically raise lending rates to help club it into submission. In other words, extended periods of below 2% inflation could be followed by extended periods above 2%. Our view is that it is very brave of central banks to believe they can manipulate the rate of inflation.

Equity markets painted a mixed picture over the third quarter. Asian (ex-Japan) equities returned over 10% over the quarter and, along with the US, are now up nearly 6% over the year. US equities added nearly 9%, whilst Japan was up over 5% in the third quarter. Europe (1.8%) and notably the UK (FTSE AS: -2.9%) continued to underperform the world over the period. Europe is down over 7% year to date whilst the UK is down a staggering 20%. Brexit uncertainty dominates the outlook in the UK and with a year-end deadline looming for a UK/ EU trade deal, the current state of negotiations does not inspire confidence in a positive outcome.

So despite the fact that the world remains locked in the grips of a global pandemic why do equities, with the exception of the UK, continue to do well? Obviously, a lack of alternatives is part of the answer but the other is that the great gush of cash from central banks has wormed its way into the markets - as it always does and as is intended. Why give up on the opportunity to inflate a bigger asset bubble? Since the beginning of the year the US Federal Reserve has "printed" US$3 trillion and the European Central Bank US$2.5 trillion. A trillion here, a

[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

trillion there… The balance sheet of the Federal Reserve has increased seven-fold since the Global Financial Crisis of 2008.

Finally, government bonds markets were unremarkable over the quarter although yields did begin to creep up in the markets Pyrford currently invest in. At the 10-year benchmark level we witnessed the following small yield movements: USA: 0.64% to 0.66%; UK: 0.16% to 0.21%; Canada: 0.50% to 0.53% and Australia 0.83% to 0.85%. With yields remaining at rock bottom, Pyrford remain very comfortable at the short end of the yield curve heading into the final quarter of the year.

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 positive return.

The largest contribution came from the portfolio's non-US bond position, almost entirely due to the deprecation of the US dollar. Pyrford invests 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 -4.42% and the Canadian dollar by -1.93% in the quarter. Pyrford views 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 also fell by -3.94% 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 (+8.77%) and Non-US overseas equities (+2.01%) 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
CH ROBINSON WORLDWIDE	USA	0.30%	WOODSIDE PETROLEUM	Australia	-0.07%
MCDONALD'S CORP	USA	0.19%	GENERAL DYNAMICS CORP	USA	-0.07%
TAIWAN SEMICONDUCTOR MFG	Taiwan	0.14%	SINGAPORE TELECOM	Singapore	-0.05%
TEXAS INSTRUMENTS	USA	0.14%	IMPERIAL OIL	Canada	-0.05%
LOWE'S COS	USA	0.12%	AXIATA GROUP	Malaysia	-0.04%

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

In the US, the stock market had a strong quarter rising nearly 10%. Some of the better performing companies in the portfolio during the quarter included CH Robinson, Texas Instruments, Lowe's, and McDonalds. CH Robinson and Texas Instruments performed well as both companies have a strong exposure to industrial customers who began to see improving business trends. Lowe's reported strong results during the quarter and investors were cheered by an improving outlook for the company as it invests heavily in its IT infrastructure to catch its main competitor, Home Depot. McDonald's performed well as stores reopened and saw strong customer demand.

Outside of the US Taiwan Semiconductor (Taiwan) was up over 36% in the third quarter as the company continued to report steady increases in its monthly revenues as consumer spending on electronics and investment in 5G networks by telecoms operators remained buoyant.

Oil stocks have been heavily out of favour in 2020. The demand picture has soured as economic activity levels collapsed due to the restrictions imposed in an attempt to limit the spread of coronavirus. There are also concerns that the Energy Transition involving a move away from carbon intensive energy sources to renewable ones will burden the oil majors with billions of dollars of stranded assets.

In line with much of the oil sector Woodside (Australia) wrote down the value of its oil producing assets and reserves during the quarter. Though these adjustments were non-cash items and the company balance sheet remains strong, they did little to improve sentiment towards the company. The stock fell over 17% over the quarter. Imperial Oil (Canada) also remained under pressure as the oil price was volatile and competitors reported poor results during the quarter.

General Dynamics (USA) suffered as it remained unclear when there would be a resumption in demand for air travel as various parts of the world remained in different stages of lockdown affecting one of its subsidiaries, the business jet maker Gulfstream. Singapore Telecom (down over 13%) has been affected from increased competition in Australia and Singapore. Singapore Telecom has also been impacted by Covid-19 impacting roaming revenues & handset sales due to lockdowns. The company cut their dividend by 30% citing Covid-19 uncertainties. Finally, Axiata fell over 17% after the company announced weak second quarter results in late August. These reflected the full impact of Covid-19 across its operations, particularly on the "pre-paid" market. However, the company also reported seeing encouraging signs of a recovery as Q3 progressed.

PORTFOLIO CHANGES / OUTLOOK

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

There was a change in our bond duration target in July as it was reduced from 2.5 to 1.5 years following further falls in bond yields. 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 period the actual 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 one change to the country exposure within the fund as an allocation was made to Indonesia (0.4%), being funded by a reduction to the weight in Sweden. The Indonesian economy trades at an attractive dividend yield, close to historic highs and boasts an economy with low debt to GDP and trend economic growth of around 5%. As a result, two new stocks were purchased in the third quarter: Bank Rakyat Indonesia and Telekomunikasi Indonesia.

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 investment world continues to digest the threat that coronavirus (Covid-19) poses to the world economy. Global supply chains remain fragile and global demand has been decimated whilst governments scramble to understand and contain the virus. The length of national lockdowns is uncertain and whilst some lockdown measures are easing, we are also seeing restrictions being reintroduced to combat localised outbreaks.

What is undeniable is that a big slice will be taken off world economic growth. The consensus view among investors was for a sharp economic rebound but this view seems increasingly questionable. It is impossible to time the bottom as each crisis is different, this one certainly is unprecedented. It is no surprise that governments and central banks around the world are responding to try to offset this negative shock.

Central banks have moved to ease monetary policy but have little room to cut rates further hence the raft of large-scale fiscal spending plans that continue to be announced. These measures are a welcome support but a reduction in the spread of the virus is economically more important.

The private sector in most advanced economies is heavily leveraged as is the government sector. 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.

Oil stocks have suffered since the turn of the year initially on broad fears of a global slowdown, before oversupply concerns and the more recent issues around storage given the lack of demand. US shale production is unviable with prices at current levels without government support. Recent oil price weakness has been driven by Saudi Arabia cutting prices in light of weak demand.

Valuations reflect the view that earnings growth will recover over 2021 despite continued uncertainty on the duration of a recovery and the impact of unprecedented government borrowing. As we've discussed before, such swift and sizeable rescue packages were a necessity, but they come at a price. A legacy of greater debt and challenging demographics suggests global growth will remain subdued for many years.

Investors are looking through the pandemic and disappointing earnings announcements to 2021 to justify pushing equity valuations higher despite the reduction in corporate profits and dividend payments. We admire the optimism but it is premature. The economy and the stock market have totally disconnected and, with familiar geo-political issues returning to the fore, opportunities for continued volatility through the end of the year remain.

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 262 ballots in 11 company meetings. We voted against management in 45% 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 36 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.

Disclaimer

Nedgroup Investments Funds PLC (the Fund) is authorised and regulated in Ireland by the Central Bank of Ireland. The Fund is authorised as a UCITS pursuant to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 (S.I. No. 352 of 2011) as amended from time-to-time.

Nedgroup Investment (IOM) Limited (reg no 57917C), the Investment Manager and Distributor of the Fund, is licensed by the Isle of Man Financial Services Authority.

Nedgroup Investment Advisors (UK) Limited (reg no 2627187) is authorized and regulated by the Financial Conduct Authority.

The Fund and certain of its sub-funds are recognised in accordance with Section 264 of the Financial Services and Markets Act 2000.

UK investors should read the Appendix for UK investors in conjunction with the Fund's Prospectus which are available from the Manager www.nedgroupinvestments.com

The Fund has been recognised under paragraph 1 of Schedule 4 to the Collective Investment Schemes Act 2008 of the Isle of Man. Isle of Man investors are not protected by statutory compensation arrangements in respect of the Fund.

The Prospectus of the Fund, the Supplement of its Sub-Funds and the KIIDS are available from the Investment Manager and the Distributor or from its website www.nedgroupinvestments.com

This document is of a general nature and intended for information purposes only. Whilst we have taken all reasonable steps to ensure that the information in this document is accurate and current on an ongoing basis, Nedgroup Investments shall accept no responsibility or liability for any inaccuracies, errors or omissions relating to the information and topics covered in this document.

This document is not intended for distribution to any person or entity who is a citizen or resident of any country or other jurisdiction where such distribution, publication, or use would be contrary to law or regulation. The value of shares can fall as well as rise. Investors may not get back the value of their original investment.

Changes in exchange rates may have an adverse effect on the value price or income of the product

Funds are generally medium to long-term investments. The value of your investment may go down as well as up. International investments may be subject to currency fluctuations due to exchange rate movements. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital and not getting back the value of the original investment.