NEDGROUP INVESTMENTS

see money differently

Nedgroup Investments Global Diversified Equity Fund

Quarter Three, 2020

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Performance to 30 September 2020	Nedgroup Investments Global Diversified Equity Fund[1]	MSCI ACWI[2]	EAA Global Fund Large-Cap Blend Equity[3]
3 months	8.9%	7.0%	7.8%
6 months	33.9%	26.6%	27.5%
12 months	16.2%	9.8%	9.4%

Six months should be long enough to form a habit

By using our understanding of the psychology of error and bias we look for opportunity in two types of stocks. We like stocks which face easy growth, but where the unusual ease of this growth is downplayed or under-appreciated by analysts and investors. In our view, the market tends to fixate on the level of growth and not pay enough attention to how easy that growth is to achieve for error-prone CEOs. We call these our Analyst Bias Stocks.

We also like stocks where investors and analysts may be holding a grudge. The grudge is usually anchored on a period when CEOs have behaved poorly and eroded trust. These stocks tend to feel uncomfortable and there seems to be plenty of highly visible reasons to distrust them. The key is "do investors distrust them for transient or permanent reasons". If the reasons are transient then anxiety can lift with time, fundamentals can improve, and valuations and stock prices can rise. If the reasons are permanent then anxiety never leaves, fundamentals grind lower, and valuations remained trapped or worse, and so do stock prices. We hunt for the stocks where we think there is a case for transient distrust. We call these our Investor Bias Stocks.

Currently there are plenty of stocks with plenty of reasons to be distrustful. Since the arrival of COVID-19 it has been tough for a lot of companies to do well: demand for their products and services has fallen. So, six months into COVID- 19 it seems like a good idea to ponder on whether any of the reasons for the loss of demand will dissipate; and whether any of the reasons to feel anxious and distrustful are transient.

COVID-19 has clearly changed the behaviour of a lot of people. The key, it seems to us, is which behavioural changes are likely to be permanent and which will be transitory. To help me do this I asked everyone in our office for two short lists. One was a list of five things COVID-19 has forced them to change which they would happily continue to do when COVID-19 disappears. The other was a list of the five behavioural changes they can't wait to see the back of.

Just about everyone would like to keep doing the following, regardless of COVID-19:

- Work from Home (WFH). I don't think there was a single person, even amongst the die-hard, workaholic, office lovers who didn't say they wanted to keep doing some WFH. Everyone wanted a mix of WFH and office. The benefits of WFH can, I think be summarised as follows:
    - Less commuting. Everyone agrees commuting is a waste of time. It's time you could spend (depending on who you are) sleeping, eating with your family, doing exercise or walking around your neighbourhood. It has no redeeming features. More WFH means less commuting. There was a general theme around the behavioural changes around 6 months of COVID-19 – more re-appraisal of how much of our lives we spend travelling and whether it is really worth it.
    - Better work-life balance. I think this is generally about the flexibility WFH brings, especially for those of us with families.
    - It makes a lot of the other good behavioural changes much easier to keep…

[1] USD Net return for the Nedgroup Investments Global Diversified Fund, A class. Source: Morningstar (monthly data series).
[2] USD net return
[3] USD net return

- Staying local and supporting local businesses. Almost everyone cited this as a big plus of COVID-19. It's tied up with WFH and not being able to get away at the weekends. While everyone wanted to get back to some travelling, pretty much everyone really enjoyed the opportunity to get to know their local neighbourhood more. Home sounds like it became less of a castle and more part of a community.
- Taking more responsibility for health through better diet and exercise. Almost everyone mentioned the ability to exercise more easily and eat better, which WFH made possible. Exercise featured highly. So did being able to have a proper breakfast and lunch and some even mentioned enjoying cooking evening meals.
- Spending more time with friends and family. Again, just about everyone said how much more they appreciated their friends and family, although most expressed frustration at being restricted to Zoom to keep in touch.
- Buying more things online. Everyone said they would continue to buy more stuff online. Some did miss the odd shop, but a bit like commuting, a lot put shopping for basic items in the "chore" category and agreed online was much better.

A**nd there were a few things which polarised views, with as many wanting to keep vs. wanting to dump:**
- Taking exercise at home vs. going to the gym. Just as many missed the gym as didn't.
- Wearing face masks. Just as many were quite happy to keep wearing face masks, especially on public transport (generally safer) as were upset by them.
- Staycations. Just as many found them unrelaxing and frustrating as enjoyable and habit forming.

On the other side of the coin, everyone wants these things back:
- Live events without social distancing: music, sport, pubs, theatres, restaurants, cafes. Everyone agreed there is no substitute and it is a crucial part of enjoying life.
- Socialising with friends and family in person. Zoom doesn't cut it, although a few will keep using it where there is no option (like friends living overseas).
- Foreign holidays. Even the staycation brigade admitted to missing overseas holidays. Some wanted weekend breaks in Europe back, others really miss the hotels and beaches in exotic, far-away places.

And most of us wanted…
- At least one day in the office. We all wanted a mix and agreed that a monopoly of either WFH or office doesn't really work. The office gives you a bit of variety, is easier to get team things done and is better for sharing ideas and learning.

I think the main conclusion from all of this is the idea that most of us are not going back to working five days a week in the office. This makes our home and local neighbourhood much more important. There is an overwhelming desire to spend more time at home (working) and to use home as a base to establish more local connections. I think this will inevitably encourage more spending on the home environment (furniture, moving to bigger houses) and to spend more time and money supporting genuinely local (rather than chain) services.

I also got the sense there was a greater desire to be closer to friends and family, which is more possible with less time and money spent on commuting into the office. This is good for property prices outside of big office-centric cities, and for small businesses (and the bigger tech businesses which help them) in service industries outside of cities. Perhaps generation-rent might shift their priorities and think it is better to save up for a place rather than pay high rents for a flat share in a city? Spending more time at home means we are all going to be travelling to work a lot less. This will release a lot of time and money.

A few subsidiary themes also emerge. First, apart from niche, quirky shops, we are all going to spend a lot more time online shopping. Conventional retailing is going the way of the coach and horses. Second, as soon as the rules allow us, we are going to be out there eating, drinking and being entertained in close proximity to each other; it's a matter of when, not if. The same goes for overseas holidays and flying; leisure travel will come back.

Third, I got the sense people will do a bit less but will trade up where they can. There was a sense of that appreciating life is a bit more about quality rather than quantity. Fourth, most of us are still a bit worried. The confusing responses of Government has further weakened our trust. A lack of clarity on the risks of COVID-19 has made us even more suspicious of information and the news. Despite living in an era of limitless access to information most of us struggle to work out which bits are important and can be trusted.

From a stock market perspective this probably means the following:

- Leisure companies will recover if they can survive the COVID-19 lockdown. Pubs, restaurants and holidays (hotels and planes) are likely to feel the recovery the earliest. However, business-orientated hotels, especially the low-end ones, won't do well; luxury hotels, especially outside of cities should be fine (and the franchise/chains probably have scope to pick up new builds outside of city centres). I think airlines will be fine, but it will take a lot longer for aircraft makers to do well as a lack of business travel will lead to quite a few idled planes.
- A lot of cafes, bars, and restaurants may be in the wrong places. If people are going to be more home-based then chains which have opened lots of places near offices are going to be in trouble. Enterprising locals outside of the main cities have a great opportunity to start their own businesses (and it's never been easier with loads of tech to help them). I think this is also good for SME orientated tech companies.
- Conventional retail will not recover; people will spend their money elsewhere, either a local small business or online.
- There will be some economic fallout. There are potentially a lot of stranded assets out there – businesses in the wrong places and the jobs that go with them. This will cause problems as the economy adjusts.

Our conclusions: there are plenty of transient reasons for companies to be struggling at the moment. Hence there are plenty of reasons to believe some Investor Bias stocks can work as successful investments. However, there are plenty of permanent changes brought in by the COVID-19 jolt to behaviour, so beware the value traps.

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NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: toll free from South Africa only 0800 999 160
Email: helpdesk@nedgroupinvestments.com
For further information on the fund please visit: www.nedgroupinvestments.com

OUR OFFICES ARE LOCATED AT
First Floor, St Mary's Court
20 Hill Street, Douglas
Isle of Man
IM1 1EU

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