NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter One, 2021

Nedgroup Investments Flexible Income Fund

Performance to 30 September 2020	Fund Performance[1]	Stefi*110%
3 months	2.1%	0.9%
12 months	10.2%	4.2%

The fund started the year with a strong Q1 performance, easily outperforming its benchmark. Inflation linked bonds, floating rate notes, property, preference shares and convertible bonds all contributed positively to performance. Local nominal bonds, however, had a poor quarter and detracted slightly.

Over the longer term the Nedgroup Investments Flexible Income Fund has delivered on its mandate to outperform cash with a predictable and low risk return profile. Its long-term performance is attributable to its philosophy of investing in a diversified range of fixed income asset classes, avoiding expensive asset classes and focusing on high credit quality.

Market Commentary

The first quarter of 2021 was characterized by the reflation trade. As economic activity recovers, we are starting to see rising inflation expectations and long-term treasury yields rise quickly from very low levels. Economic activity is recovering for several reasons, including the successful rollout of the vaccination strategy in many countries around the world, but predominantly because of the significant monetary and fiscal stimulus injected into the global economy. We have seen inflation in many corners of the global economy over the past few months, most notably the commodities sector and asset prices (bonds and equities). However, inflation expectations for consumer prices are now rising in the US, and we are seeing breakeven inflation levels (a proxy for the markets' expectation of inflation rates) reach well above the Feds 2% target.

Inflation will be a key metric to watch over the coming months, and it will be interesting to see whether it remains high once the low base effect is out (the Fed has already prepared the market for short term overshoots), or perhaps stay as subdued as it did the last time we saw large scale QE in 2008.
Its easy to understand why this time may be different, and why many are concerned around inflation. Not only is the quantum of base money creation substantially more than what we have ever seen, but the translation of this base money supply into broad money supply through stimulus payments, unemployment payments, business loans etc., has been extensive. This means the everyday man on the street is the beneficiary of this "money printing", and not only financial assets, and therefore the potential for inflation is higher as developed economies emerge lockdowns after the rollout of vaccine programs and spending increases.

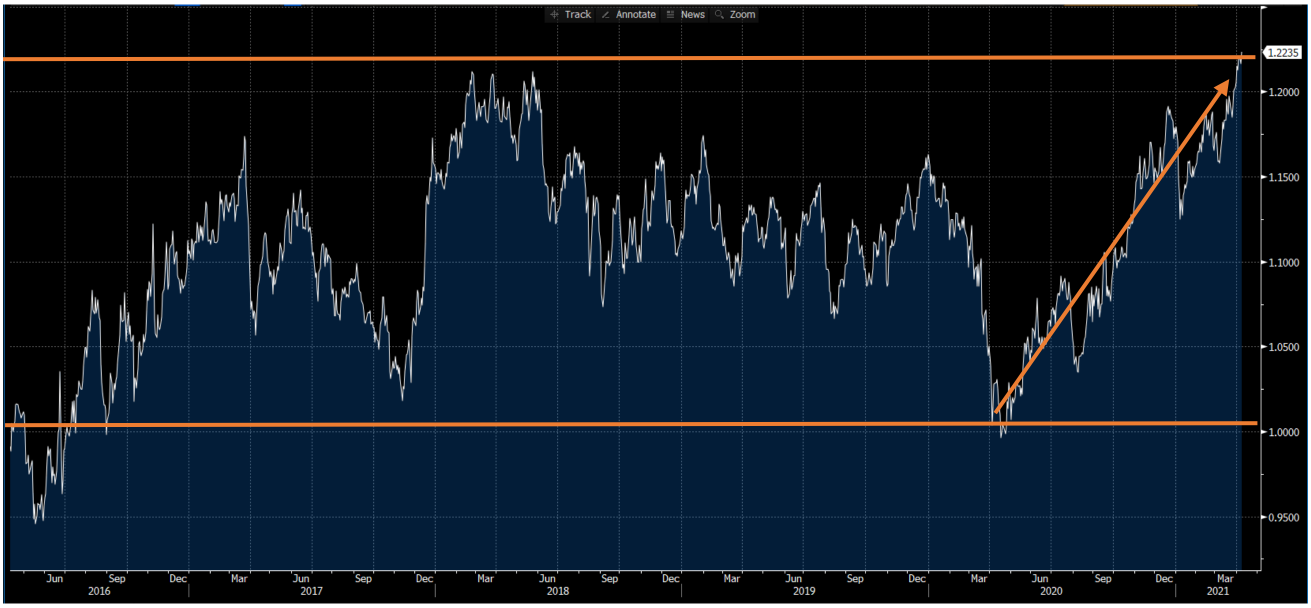
So what does a rise in treasury yield mean for markets? On the one hand the return of growth is positive, but on the other hand sharply rising treasury yields could certainly cause turmoil in the markets. Despite the obvious negative effect on bonds, equity valuations could also come under pressure due to future cashflows now being discounted at a higher rate. We have seen some of this start to play out in the markets and have seen value stocks (that are less sensitive to rising rates) outperform growth stocks quite significantly over the quarter (largest outperformance seen in 20 years!).

Despite the increased forward inflation expectations, treasury yields are still trading well below this, and have thus far done relatively little damage to markets. Communication and intervention from central banks will be key to watch, and their dovish tone thus far has largely managed to mitigate a renewed taper tantrum. Should the market continue to put upward pressure on treasury yields as a result of increased inflation expectations however, the Fed will find themselves in a difficult position whereby they have to choose between controlling inflation through less QE and higher rates, or the economic consequences of removing stimulus in an economy

[1] Net return for the Nedgroup Investments Flexible Income Fund, A class. Source: Morningstar (monthly data series).

that is highly indebted and far from full employment. In a bid to avoid either, a likely outcome will be increased bond purchases as a first step, and ultimately official yield curve control should this not be successful.

The rise in treasury yields translated into a poor quarter for local bonds, with the ALBI returning -1.74%. The increasing inflation expectations globally have however conversely allowed inflation linked bonds to outperform, generating 4.1% for the quarter. The rise in long end treasury yields also weighed on the broader EM complex but the ZAR is proving to be extremely resilient and remains at strong levels, outperforming most of its EM peers. The below chart shows the ratio of ZAR to a weighted basket of EM FX, showing how strong the outperformance has been.



Source: Bloomberg

Current positioning and outlook

- Moderate Duration

As at the end of Q1 2021, SA duration is 0.72 years in nominal bonds and 0.45 years in Inflation Linked Bonds. We continue to predominantly hold the SA 10 Year nominal bond (R2030) and 5 Year SA Inflation Linked Bond (I2025). Yields at current levels remain attractive for nominal bonds, whereas we view inflation linked bonds to be around fair value. We do however remain cautious around local fiscal risk factors and will therefore look to maintain a moderate position to government bonds, always managing this alongside its natural hedge, foreign currency.

- High Credit Quality

The portfolio has a high degree of credit quality. Our credit process has historically shielded the fund from capital loss due to credit events in SA and we are confident in our ability to protect investor's capital in the fixed income space. Generally, corporate balance sheets have deteriorated because of the crisis and continue to remain challenged. We retain our preference for a diversified portfolio of senior bank debt and low risk / high grade corporates.

- Convertible Bonds

The position in Royal Bafokeng Convertible Bonds continue to be a top contributor to the fund's performance, fuelled by the rally in commodity prices. We believe that convertible bonds can provide an inflation hedge, and in an environment of financial repression represent a differentiated way for income funds to hold real assets. We continue to look for opportunities in this space, and over the quarter added 50bps of Twitter convertible bonds.

Property

The fund currently has 2.7% exposure to domestic property. We have maintained a conservative exposure, as the levels of debt and reduced economic activity make the yield outlook highly uncertain. We continue to selectively allocate to names who are not highly leveraged and where liquidity is sufficient,

- Preference Shares

Preference Shares exposure is conservative at 2.6%, with the majority in the Big 4 banks. We are comfortable with the capital value and the post-tax yield remains very attractive in this environment.

- Offshore Bonds & Money Market

The fund maintains an exposure to Offshore Bonds & Money Market instruments at 18.3% where a very attractive yield pickup over domestic assets is available while maintaining a high degree of credit quality and diversification. Our FX exposure is maintained at 8.6%; this exposure remains high given the strength of the rand and provides a natural hedge to our higher duration; it also reflects our view that the Rand is slightly overvalued at current levels.

Summary and Conclusion

The year so far has continued to be characterized by negative real rates, fiscal expansion and QE. Real assets continue to perform exceptionally well, and we retain our positive view on these assets in this environment. Given the return of global economic activity, and the significant stimulus, markets are starting to get nervous around inflation and the implications of this could be significant for fixed income markets. We maintain a diversified portfolio that can perform in various market conditions and should higher-than-expected inflation come to light, we maintain positions in asset classes that will benefit from this. Ultimately, however, we believe the Fed cannot afford to control inflation through rate hikes or reduced stimulus now and would rather engage in yield curve control of sorts. These concerns should lead to volatility and ultimately provide attractive opportunities to add to our fixed income asset universe in the fund.

Disclaimer

WHO WE ARE
Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. It is a member of the Association of Savings & Investment South Africa (ASISA)..

OUR TRUSTEE
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HOW ARE OUR FUNDS PRICED
Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

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.

DISCLAIMER

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. 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. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

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