NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS Global Cautious Fund

Quarter Two, 2021

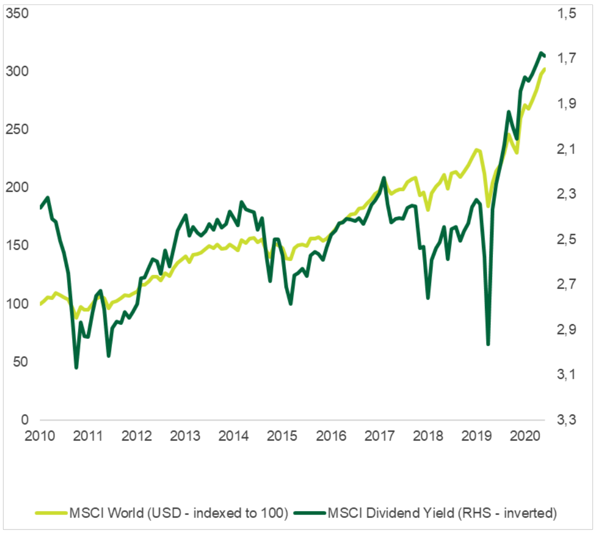
Performance to 30 June 2021 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	0.9%	0.0%	2.3%
12 months	8.3%	0.1%	9.4%

MARKET OVERVIEW

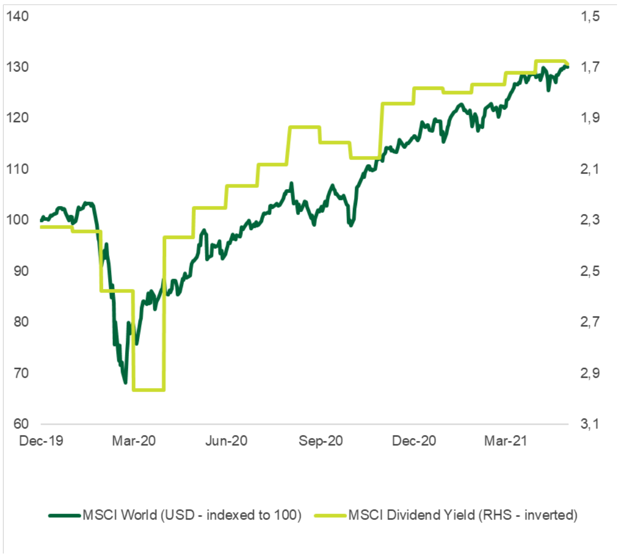
In the second quarter, equities advanced, boosted by the ramping up of vaccination programmes and the reopening of economies. The rebound in economic activity however, particularly in developed economics, continued to fuel inflation fears. Amidst all the Covid-19 induced pandemonium and the central bank and government responses the 'world' average stock market dividend yield has sunk to just 1.8% - comfortably below its long-term average.

In the US, the S&P500 dividend yield has tumbled to a measly 1.4%. At the same time the price earnings ratio has leapt to around 30. The infamous Shiller Cyclically Adjusted PE (CAPE) has now moved above 35 – rarefied atmosphere as it has only touched this level on one other occasion in the last 140 years and that was during the Tech bubble at the end of the 1990s. And let us not forget – this is happening in a world only now getting back to output levels equivalent to those prevailing in 2019.

MSCI World Performance and Dividend Yield since 2010
Data at 31 May 2021



MSCI World Performance and Dividend Yield since 2019
Data at 31 May 2021



Source: Thompson Reuters

The logic running through the market is not hard to discern: if bonds yield next to nothing and money in the bank yields nothing or even less why not buy equities which at least provide some income return? Hard to argue with. The only troublesome bit of nettle rash with this argument is that equities can tumble in value and dividends can be cut.

Is the stock market in a bubble? Yes. Will it buckle under its own over-valued weight? Undoubtedly, as overvaluation is always corrected. This could start tomorrow or it could take years since the normal rules of valuation have been suspended by the 'gaming' of the system by the central banks. Bubbles, of all kinds, are inevitable when interest rates are set at zero.

The market is getting itself in a lather over the possibility of a sustained inflation pick-up. Is it real this time around or another temporary spike? Looking at some of the recent inflation action around the world, the stand-out is the

Source for charts MSCI World Performance and Dividend Yields: Bloomberg [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

US with the CPI bouncing well over 4% on a year-on-year basis. It is little wonder that nerves have frayed and mutterings have commenced in the Federal Reserve and other central banks about an earlier than expected increase in official interest rates.

The first and obvious point to make is that inflation collapsed during 2020 so that any pickup from very low or even negative numbers looks remarkably strong on a year-on-year comparison (the so-called base-effect). Nevertheless, there are other factors at work – ongoing supply shortages being foremost together with emerging labour supply problems. The money pumped into the global economy is chasing too few goods – classic demand-pull, whilst some workers are finding life more comfortable receiving government hand-outs than re-joining the workforce. The lack of international travel and the consequent low supply of itinerant workers – be they fruit pickers or cappuccino frothers – is creating a demand/supply imbalance with inevitable pressure on wages. Add it up and you get an inflationary spike. In the US, durables, non-durables and services inflation have all surged from low levels.

Nevertheless, we recognise the temporary nature of much of the above. The helicopter drop of money will inevitably taper. The global supply chains will pick-up as the pandemic's impact weakens. International travel will resume and inexpensive casual labour will again become available. Who knows, some workers may even tire of sitting at home.

Our guess, and that is all it is, is that inflation will subside to the relatively low levels that the world has experienced in recent years. However, and this is the key point, be it a permanent inflation uptick or temporary, interest rates are far too low. The economic distortions caused pre-pandemic were significant thanks to absurdly low interest rates and nothing has changed. The efficient allocation of capital relies on competition for that capital. If money is plentiful and virtually free, the allocation mechanism fails. An economy needs money to cost more than the prevailing rate of inflation.

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 second quarter the portfolio produced a positive return.

The portfolio's equities, bonds and currency hedging positions all contributed positively to returns in the quarter.

The key contributor over the quarter was the portfolio's US equities which produced a positive +6.2% (gross), although underperformed the wider market (+8.9%, MSCI USA Index). In the period, the market was led by growth and quality stocks with momentum stocks recovering following a sharp selloff in mid-May. Outside of the US, the portfolio's overseas equities added +3.8% (gross). The US market had another strong quarter as economic activity continued to improve and restrictions continued to be eased. In addition, continued talk of stimulus packages for the US economy on Capitol Hill encouraged investors. The one lingering concern that remains surrounds the increase in inflation expectations and whether this is transient or something more permanent.

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
PRICE (T. ROWE) GROUP	US	0.15%	ALTRIA GROUP	US	-0.05%
AMERICAN EXPRESS	US	0.12%	INTEL CORP	US	-0.05%
PHILIP MORRIS INTL	US	0.11%	SINGAPORE TELECOM	SINGAPORE	-0.03%
S&P GLOBAL	US	0.07%	CANADIAN NATL RAILWAY	CANADA	-0.02%
ROCHE HOLDING GENUSS	SWITZERLAND	0.05%	WOODSIDE PETROLEUM	AUSTRALIA	-0.02%

T. Rowe Price had a strong quarter following the announcement of a dividend hike of +20% and also a special dividend of $3 per share. The company's share price rose nearly 18% over the second quarter. American Express also enjoyed a strong quater as the company posted a further set of positive results and investors began to look towards a reopening of the US economy which would bode well for credit card spending. In addition, the company was given clearance by the regulator to restart capital return policies that would benefit shareholders. Outside of the US, Roche Holdings (Switzerland) was the largest overseas contributor. The company benefited from the FDA's approval of Biogen's Alzheimer drug Aducanumab. Roche has a drug in the pipeline which operates along a similar pathway targeting amyloid beta. There was also some good data released on one of its growth drivers, Tecentriq, during recent medical conferences.

The largest detractor over the quarter was Altria which fell over 5% in the quarter. The company underperformed following a first quarter rally where the company rose over 26%. Intel also lagged as the company faced delays to the launch of some its new products as many companies remain capacity constrained in the semiconductor industry. In addition, investors remain sceptical about the dual production strategy that the company is undertaking. In the short run, Intel will face pressures as the new CEO – who joined in January – restructures the business but over the longer term these measures should position the company well for growth in the semiconductor industry.

Outside of the US, Singapore Telecom reported year end results which were soft due to COVID. Lockdown measures reduced high margin roaming revenues and reduced handset sales. They also did two large impairments on Amobee, their digital advertising business and Trustwave, their cyber security business. Canadian National fell over 8% over the quarter after agreeing to pay what is seen as a high price for Kansas City Southern. Whilst we agree that the price is high, this could well be the last major rail asset that is sold in North America (because of competition issues) and would provide the company with a footprint that reaches from North Western Canada down into Central Mexico, improving their competitive position over the long term.

The portfolio's 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 earlier part of the year.

Finally, the portfolio has a single position within its currency hedging allocation, the Aussie dollar. The currency weakened against the US dollar by -1.5% and therefore contributed a positive return to the portfolio. Despite this position, Pyrford view the US dollar as a very expensive currency based on in-house Purchasing Power Analysis and therefore maintain a significant exposure (45%) to non-US dollar assets. If the currency does fall, as it did do against a number of currencies in the quater, the portfolio will benefit.

PORTFOLIO CHANGES / OUTLOOK

Following a small reduction in equities in the first quarter, there was no further changes to asset allocation in the second. The model allocation is 20% equities, 77% bonds and 3% cash.

Our positioning in bonds also did not change in the quarter. Pyrford adopts 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 earlier in the year. At the end of the period the 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 no change to the country exposure within the portfolio.

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.

CONCLUSIONS

Every bubble ends with much hand-wringing, some tears and a vow never to be caught-out again – until the next time. Human nature is human nature. Repetitive. We think it likely that the central bank-sponsored boom that we are currently living through will, in time, be written about in similar terms to the booms/bubbles referred to above. Enjoy the experience but don't confuse extravagant returns and investment acumen.

RESPONSIBLE INVESTMENTS COMMENTS

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

In the quarter Pyrford voted 1716 ballots in 67 company meetings. We voted against management in over 40% 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 met virtually with 61 companies worldwide. ESG issues are an agenda item in every meeting we conduct where we have identified ESG risk. For a detailed overview of ESG activity, please visit our website for our latest annual ESG report.

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FEES

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