NEDGROUP INVESTMENTS

UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

see money differently

NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter Three, 2021

Nedgroup Investments Flexible Income Fund

Performance to 30 September 2020	Fund Performance[1]	Stefi*110%
3 months	1.9%	1.0%
12 months	7.9%	3.9%

The fund had a strong Q3 performance, outperforming its benchmark. All asset classes contributed positively to performance over the quarter, with our Offshore component doing particularly well given the weakening of the ZAR.

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 third quarter of 2021 saw markets begin to unwind some of the incredible gains experienced since the lows of the COVID crisis. This reversal was largely seen in September, during which the repercussions of the FOMC (and general central bank tightening), a spike in energy prices, global supply chain disruptions and increased Chinese regulation were digested by the market. Despite a very negative September (-4.7%), the S&P still managed to end the quarter with a slightly positive return of 0.6%, while local markets were harder hit with a -0.8% return for the All Share Index. The US 10 year rose to 1.5% (from 1.3%), and as a result, local bond yields moved 50 points higher in September. The ALBI index thus experienced a negative -2.1% return for September and generated only 0.4% for the quarter. This risk off environment also saw the rand depreciate by 5.5%, ending the quarter at 15.07 to the US dollar.

The September FOMC was a notable event, as the Fed signaled to the market that tapering is likely to start, even as soon as the November meeting. With the US economy having experienced a massive economic and employment recovery from the lows of the COVID crisis, and higher and more persistent inflation being recognized (and now an energy crisis to exacerbate this), the time to start considering monetary policy normalization has come. This means that the $120bn per month of asset purchases by the Federal Reserve will likely start to decline. The extent of QE in the US has been phenomenal, with an estimated $1.7 trillion in direct payments to households being made since the onset of the COVID crises. The ECB similarly announced they would start slowing the pace of their asset buying under the pandemic emergency program. Many emerging markets, as a result of increasing inflationary pressures, have also started tightening monetary policy, with the central banks of Brazil, Russia and Mexico all having started interest rate hiking cycles. The SARB has yet to hike rates locally, but the hawkish tone of the MPC in their September meeting has the market believing that rates will also start increasing from November. Unlike many other emerging markets, South Africa has not experienced inflationary pressures; however, the effect of a highly elevated oil price, a weakening ZAR and generally higher global inflation could mean inflation comes out higher than what was previously assessed by the SARB. We believe this should not be too concerning as the higher levels are likely to be transitory. South African core inflation was at 3.1% yoy for August while headline inflation printed at 4.9% yoy.

Another event that attributed to the market volatility seen in September was the news that Evergrande, the Chinese real estate developer that has more than $300bn of debt, was struggling to meet interest payments. This generated fear of potential financial market contagion, as the effects on the Chinese financial system are unknown. This quarter also saw China implement significant further regulatory clampdowns under its common

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

prosperity campaign. This campaign is aimed at addressing inequalities of income and wealth, and has seen new regulations promulgated that are aimed at Chinese internet platforms, cryptocurrency, e-cigarettes, alcohol consumption and celebrity fan culture. The aim of this is to effectively grow the middle class in China, which although conducive to long term economic growth, is currently causing capital markets to demand a higher risk premium for investment in the region.

Washington also provided a lot of news over the quarter. The need for the debt ceiling extension is becoming more urgent, as failure to do so could mean an unprecedented debt default by the US. Congress passed a stopgap spending bill, permitting the government to stay open until 3 December to deal with this matter. The consequences of not approving the increased ceiling would be catastrophic, so we have no doubt it will be resolved. Opposition by Republicans in Congress to raising the debt ceiling seems to be on the grounds that it would implicitly endorse Bidens multi-trillion-dollar spending plans. This includes a $1.2trn infrastructure plan, as well as a $3.5trn plan, which includes investments to help fight climate change and expand government support for education, childcare and healthcare. This will be financed with changes to the tax code and is naturally stirring a significant debate. Stimulus packages such as these, that aim to advance productivity and long-term growth, are however becoming an increasingly important tool in an environment where inflation is running higher and more persistently than expected. Policymakers will have to rely on these measures to keep growth at acceptable levels, as central banks cannot run perpetually ultra-loose monetary policy in this environment for much longer. In the absence of this balance between high fiscal policy stimulus (to generate growth), and more moderating monetary policy stimulus (to temper inflation), the US might find themselves in a dreaded stagflationary environment, which would naturally have great repercussions to global financial markets.

Current positioning and outlook

Moderate Duration

As at the end of Q3 2021, SA duration is 0.78 years in nominal bonds and 0.35 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 on nominal bonds are at very attractive levels and are pricing in a SA risk premium that we believe more than compensates for any fiscal risk. We added R2035s and R2037s over the quarter, as we believe that coming interest rate hikes may be a catalyst for yield curve flattening. The real yield on inflation-linked bonds have been fairly stable over the quarter as concerns over global inflation remain a prominent theme. These appear to be more fairly priced at current levels (on the short end of the curve) but provide a nice hedge should these fears escalate over the coming months.

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. We retain our preference for a diversified portfolio of senior bank debt and low risk / high grade corporates.

Convertible Bonds

Locally, we maintain a 30bp position in the Sappi convertible bond. There are more convertible bond opportunities offshore, and we have small allocations to Mail.Ru and Twitter convertible bonds. We continue to look for opportunities in this space, but given the strength of equity markets, it remains on the expensive side.

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 outlook 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 2.9%, with the majority in the Big 4 banks. The pre- and post-tax yield remains attractive in this environment. The trend of institutions wanting to buy back their preference shares continues, and Nedbank indicated this consideration over the quarter.

Offshore Bonds & Money Market

The fund maintains an exposure to Offshore Bonds & Money Market instruments at 19.3% where a very attractive yield pickup over domestic assets is available when hedged back to ZAR while maintaining a high degree of credit quality and diversification. Our effective offshore exposure is at 8.2%; this was reduced over the quarter as the ZAR weakened to close to fair levels against the USD. Our offshore exposure is however still fairly high, as it provides a nice hedge to the healthy duration in the portfolio. Should the currency continue to weaken, however, we will endeavour to protect the portfolio against rand strength and lighten this exposure.

Summary and Conclusion

This quarter saw markets start to digest the consequences of a move back to "normal". Much of the world is experiencing higher inflation and central banks globally have begun to indicate the need to start tapering asset purchases and start raising interest rates. This means the liquidity that market participants have become accustomed to since the onset of the COVID crisis will now likely start to reverse, and from a very high base. Central banks have thus far managed this process well, and markets have come through these announcements relatively unscathed - but the process is yet to play out. We have no doubt, however, that the new "normal" is different, as the system is too leveraged for the old "normal" to resume. Our view is that we will likely find ourselves in an extended period of financial repression with negative real rates. In such an environment we maintain our preference for real assets, but will also take advantage of outsized risk premia in other asset classes that emerge from time to time. This has certainly been the case with South African government bonds, where the risk-off sentiment has pushed the risk premium to attractive levels and has resulted in us adding duration to our portfolios.

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
The Standard Bank of South Africa Limited is the registered trustee.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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.

NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT
Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001
WRITE TO US
PO Box 1510, Cape Town, 8000
DATE OF ISSUE
16 October 2019