see money differently

Nedgroup Investments Global Behavioural Fund

Quarter Four, 2021

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Commentary produced in conjunction with sub-investment manager, Ardevora Asset Management

Indicator	3 months	1 year	Since Inception# p.a.
Portfolio*	5.44	10.26	17.93
Performance indicator+	6.68	18.54	17.84

* Nedgroup Investments Global Behavioural Fund A-Class, Net USD return. Source: Morningstar
\# 22 June 2019
\+ MSCI All Country World Index, net USD return

Market Overview

There was an outbreak of the OMICRON variant towards the end of November, compounding some already tricky trends for value stocks. Supply chain issues and building cost pressures in H2-2021 presented new risks for disappointment. We made changes to the composition of the portfolio, moving back towards growth. We thought growth stocks looked safer. However, after reviewing 2021, we have changed our view.

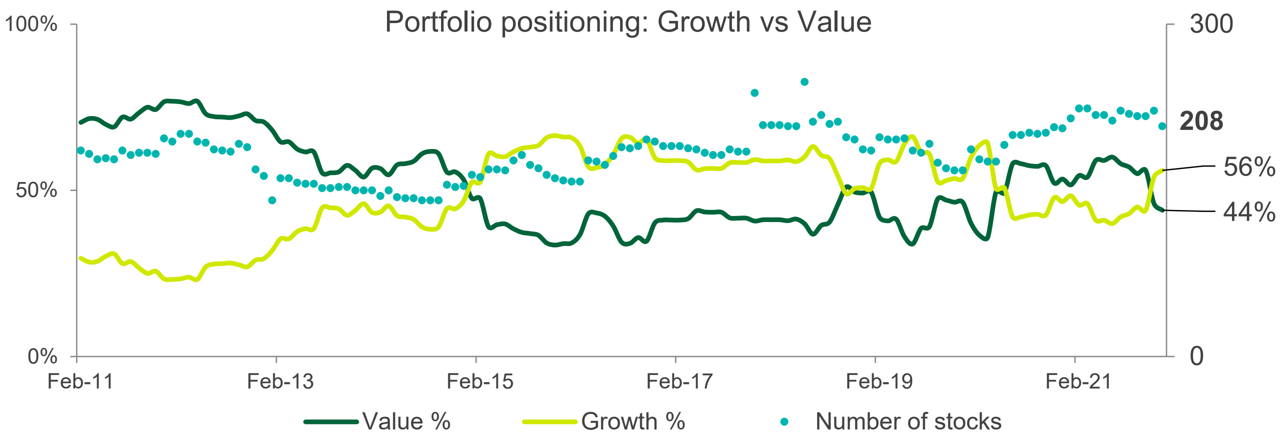
2021 was a year of poor reward for us. We found plenty of stocks that surprised, but the rewards for surprise, especially among growth stocks, were lacklustre. We have experienced such periods before, 2003-04 was the most protracted. Economic shocks, and their aftermath can cause us problems. 2022 is different to 2004. The economic shock has been deeper. The disturbance to economic variables more profound, the path back has been less predictable.

We think part of the problem last year was the unwinding of unusually low bond yields. We are now concerned the first half of 2022 could see a similar pattern: bond yields rising faster and further than expected. Initially Q1-2021 felt like a false dawn on the rotation away from growth stocks – for the rest of 2021 value stocks faded and large-cap growth did well. We worry this has become a false anchor for 2022.

Having surveyed the strategy pieces for 2022 we were surprised by the remarkably sanguine view for inflation and bond yields. The consensus wants to believe inflation will quickly ease, bond yields will modestly creep up, and the yield curve will flatten. There is considerable risk of a nasty surprise.

In the chart below we show the portfolio's tilt between Growth and Value stocks, with the number of names in the fund at 208. We started last year with an even mix of value and growth. This didn't help us. Our growth stocks lagged the mega-cap leaders. The rewards for value stocks were heavily skewed to financials and energy. We do not want to repeat the same mistakes in 2022. While many of the exciting structural growth themes are still strong, in the first half of 2022 they may not be rewarding. Investors must navigate the path back to a more balanced economy, no longer requiring government support, with yields and inflation back within a safe range. Growth stock surprises may not be rewarded during the transition.

Tactically we have significantly reduced our exposure to structural growth themes and shifted our portfolio mix back to value. There are still plenty of value stocks surprising, especially in areas investors prefer as bond yields rise.



Source: Ardevora Asset Management

Performance

Key contributors	PF weight (%)	BM weight (%)	Base return (%)	Excess return contribution (bps)	Designation
Cloudflare	0.32	0.04	16.14	28	Growth
Xilinx	0.50	0.07	40.06	22	Value
Dollar Tree	0.56	0.04	45.97	20	Value
TopBuild	0.52	--	34.16	19	Value
Capri Holdings	0.52	--	34.11	17	Value
SK Hynix	0.78	0.09	27.01	14	Value
Fortescue Metals Group	0.72	0.03	28.18	14	Value
Eagle Materials	0.52	--	26.54	13	Value
BJ's Wholesale Club	0.55	--	21.43	11	Value
Signature Bank	0.51	0.03	18.18	11	Growth

Key detractors	PF weight (%)	BM weight (%)	Base return (%)	Excess return contribution (bps)	Designation
Apple	0.61	4.18	25.05	-73	Growth
Microsoft Corporation	0.51	3.42	18.91	-49	Growth
Affirm Holdings	0.39	0.01	-34.79	-19	Growth
Sea Ltd. (Singapore)	0.47	0.04	-30.08	-17	Growth
Enphase Energy	0.37	0.03	-28.46	-16	Growth
Alphabet	0.51	2.43	7.87	-15	Value
Twist Bioscience Corp.	0.42	--	-35.75	-15	Growth
Pinterest	0.44	0.03	-28.99	-15	Growth
Unity Software	0.37	0.01	-27.52	-14	Growth
Block	0.38	0.09	-33.01	-13	Growth

Source: Ardevora Asset Management, Factset

Our Rest of World bucket and Europe added alpha this quarter. North America and Japan (marginally) detracted relative to the benchmark.

- Rest of World: strong performance from SK Hynix (South Korea) and Fortescue Metals (Australia) helped boost the region whilst the Singaporean stock Sea Ltd picked up the rear. Copa Holdings (Panama) also lagged.
- Europe: Nemetschek (Germany), Ferguson (UK) and Sika (Switzerland) topped the region whilst Vestas Wind Systems (Denmark), Airbus (France) and Dufry (Switzerland) dragged on performance.
- Japan: Stanley Electric and Sony Group were the best performing stocks with marginal relative outperformance whilst Nihon Kohden, and to a lesser extent Hoya Corp, led the detractors.
- North America: Cloudflare (US) and Xilinx (US) outperformed, however, overall underperformance was driven by significant structural underweights to the mega-caps Apple (US) and Microsoft (US).

Key sectors for relative performance were Consumer Discretionary and Industrials, whereas relative detraction came from Information Technology and Health Care.

- Consumer Discretionary: alpha was driven by our allocation effect and stock selection, with US stock Dollar Tree leading the way.
- Industrials: Fastenal Company (US) was the best performing stock in the sector. Alpha was driven by good stock selection.
- Information Technology: our underweight to mega-caps Apple and Microsoft hurt us the most.
- Health Care: underperformance was driven by poor stock selection; Twist Bioscience (US) lagged the most

Outlook

We think the Fed's change of direction in December signals we are firmly on the path to normality. Most economic variables should return to normal ranges in 2022, as the distortions of the COVID shock wash through. OMICRON looks like it may be a blessing in disguise – a highly contagious variant with lower risk. The combination of wider natural immunity, widespread vaccinations and better treatment hold out the tantalising prospect of a world that can live with COVID.

There have been some profound behavioural changes during the COVID-19 pandemic and the structure of the economy has changed. We think many of the changes will stick. But we still have the final stages of post-COVID recovery to navigate: consumers have lots of savings, governments have provided lots of support, and supply chains are dislocated. Everything needs to get back into balance and the potential for friction along the way is high.

Inflationary expectations have the juxtaposition of three interesting anchors. First, we have the 1970s scar – the lingering dread of inflation. Second, we have a very long period when inflation has generally fallen, and forecasts for inflation were generally too high, ending in the most recent decade, when the even more dormant fear – deflation - prevailed. And third, within the last year, we have an established pattern of error in the opposite direction – inflation forecasts have been too low.

We reach two conclusions:
1. Inflation forecasters are in gentle denial, forecast error is skewed, forecasters will keep underestimating.
2. Anxiety about inflation will keep rising.

It is easy to forget we have been through a very unusual period for the economy. Bond yields collapsed to 0.5%, deflation anxiety soared, economies shrunk at an unprecedented rate. Things are returning to normal – normal growth, normal inflation, and normal bond yields. We expect the route to normal to be faster than consensus, and investors to be overly anxious. "Normal", here we come. We are optimistic about prospects for the second half of 2022, and well beyond.

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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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