



see money differently

A photograph of an open book with white pages, tied with a white string around the spine, set against a light background.

NEDGROUP INVESTMENTS

Global Cautious Fund

Quarter Four, 2021

Nedgroup Investments Global Cautious Fund

Performance to 31 December 2021 (USD)	Fund ¹	Target Return ²	Peer Group ³
3 months	0.6%	0.0%	0.9%
12 months	1.9%	0.1%	2.9%

MARKET OVERVIEW

Inflation and how central banks react was front and centre of investors' concerns through Q4 2021 and remains a primary concern as we head into 2022. Interest rates are too low, and they have been too low for too long. Have low rates resulted in a leap in underlying economic growth, a positive turn in productivity? No. Central banks have resorted to the world of zero or near zero official interest rates whilst flapping their arms and blaming everyone else for insipid economic growth.

The consequence of pricing credit at very low levels is an asset price explosion. The privileged few have benefited, and the world's wealth imbalance has widened. If money is ultra-cheap and available in vast quantities, it is inevitable that economic distortions will occur. The hurdle rate for business investment is set too low, unprofitable businesses start to dot the landscape, debt skyrockets in hands that will often struggle to pay it back, savers are disenfranchised, speculation is encouraged – and a growing list of asset prices go from absurd to simply ridiculous.

We have previously expressed optimism that the inflationary burst will fade but conceded that it will take quite some time. Our current thinking is that the word “quite” may not be strong enough.

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 final quarter the portfolio produced a positive return with the portfolio's equities providing the key contribution to returns. Pyrford's US equity portfolio returned +8.0%, underperforming the wider market (+10.1%, MSCI USA Index). Overseas, the equity portfolio added +2.8%. 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
AUTOZONE	US	0.14%	ABC-MART	Japan	-0.06%
LOWE'S COS	US	0.13%	KDDI	Japan	-0.03%
ROCKWELL AUTOMATION	US	0.12%	AIA GROUP	Hong Kong	-0.03%
AUTOMATIC DATA PROCESS	US	0.12%	SUMITOMO RUBBER IND	Japan	-0.03%
MCDONALD'S CORP	US	0.10%	WOODSIDE PETROLEUM	AUSTRALIA	-0.03%

In the US, economic activity continued to improve as restrictions were eased and the impact from new coronavirus variants was contained. The main issue that occupied investors' minds was the tapering schedule of the Federal Reserve and the initiation of interest rate increases. One clue was provided to financial markets when the Federal Reserve stopped talking about “transitory” inflation indicating that the Federal Reserve was preparing to fight inflation by raising interest rates – the expectation is that a tightening cycle will now start in 2022.

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



Cyclically orientated sectors such as materials and technology led the market while sectors such as financials and energy lagged the market. Some of the better performing companies in the Pyrford portfolio included Lowes' (+27.7%) and AutoZone (+23.5%). AutoZone rose as the company continued to make inroads into the commercial auto parts market as the investments the company had made into larger distribution centres begins to increase sales. Lowes' posted a strong set of results ahead of market expectations as a buoyant housing market boosted demand for construction materials and associated fittings. American Express lagged the market as concerns about travel restrictions impacted investor sentiment. The company has a moderate exposure to travel and entertainment so any restrictions would impact the business in the short term. In the medium term however, the company has always bounced back after restrictions are eased.

The largest detractors over the quarter were all within Asia, including ABC Mart (Japan) and AIA (Hong Kong). ABC Mart (-24.9%) is Japan's leading sports shoe retailer. Although Japan has fared much better than most countries in relation to COVID a series of "soft" lockdowns has had a large impact on bricks & mortar retail spending, which has not been fully offset by online sales. Roughly 10% of sales historically where from tourists (Chinese) and this has also effectively fallen to zero. The company has a very strong balance sheet, is net cash, and is in a much stronger position than many of its smaller competitors. They are ultimately in a good position to gain share once normality returns. The dividend has been maintained despite earnings weakness. The pandemic has had an impact on sales for AIA (-13.1%) as they rely on the relationship of trust between their agents and clients. This has moved online successfully for existing clients but is harder to establish for new clients. Nonetheless the vast opportunity for growth in the under-penetrated insurance markets of Asia remains and AIA's century-long track record in the region will continue to be an advantage in attracting both agents and customers. The share price weakness during Q4 coincided with the announcement that Prudential planned to raise funds on the Hong Kong market to invest in Africa and Asia, though we do not consider this development to impact the attraction of AIA.

The portfolio's bonds were flat over the period, adding an incremental gain to the portfolio. The short end of the yield curve advanced higher in the US as the market anticipated faster rate hikes. As a result, Pyrford underperformed within the US slightly over the period (-0.3% v +0.2%, JPM US - All Maturities TL), due to our positioning at the short end of the curve. In the overseas bond portfolio, Pyrford outperformed the wider market by over +2% (+0.3% v -1.8%, JPM Global Govt Bond Ex USA). 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 quarter.


Finally, the portfolio has a single position within its currency hedging allocation, the Aussie dollar. The currency strengthened against the US dollar by +0.7% and therefore detracted from returns. 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 expected, the portfolio will benefit.

PORTFOLIO CHANGES / OUTLOOK

There were no changes to asset allocation in the quarter. 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 0.8 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 remains defensively positioned with an underweight to the QE fuelled markets and an overweight to the Southeast Asian markets. The European portfolio is concentrated in the UK, Switzerland and the relatively healthy economies of core Europe. Economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations. In terms of sectors, we have limited exposure to more cyclical sectors such as financials and consumer discretionary. Overweight positions are held in defensive sectors such as industrials and communications. These sectors offer predictable revenue streams and attractive valuations. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value.



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 and we expect it to fall based on our Purchasing Power Analysis. If the currency does fall, the portfolio will benefit.

CONCLUSIONS

The travails of the next few years will be exacerbated by a rise in interest rates. A semblance of financial normalcy must return. Let's get it over with. Swallow the medicine. We can't continue to live on the borrowed dollar.

The shock of Covid has not been the virus itself but the manner in which it exposed the fragility of global supply chains. In retrospect, it is a miracle they haven't fractured before. The global inter-connectedness, just-in-time-ordering, lack of redundancy and the sheer complexity have rocked our "she'll be right" complacency. Manufacturers, farmers, miners, transport operators, builders, wholesalers, retailers, international traders and all of the rest are scrambling to restore normality, but it isn't happening – at least not without a very long delay. Inflation has been an obvious consequence and labour shortages another. Vaccine mandates are now exacerbating the latter. We have previously expressed optimism that the inflationary burst will fade but conceded that it will take quite some time. Our current thinking is that the word "quite" may not be strong enough.

And so, 2021 ends without any clear idea about when Covid and its impact will wane into relative insignificance. Add in many other bothersome issues, some of which we have canvassed in this paper, and you end up with a crowded and troubled brain.

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 285 ballots in 10 company meetings. We voted against management in over 10% 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

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.

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