NEDGROUP INVESTMENTS

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Quarterly review

Nedgroup Investments Core Accelerated Fund

As at 31 March 2022

The Russia-Ukraine war dominated headlines over the month

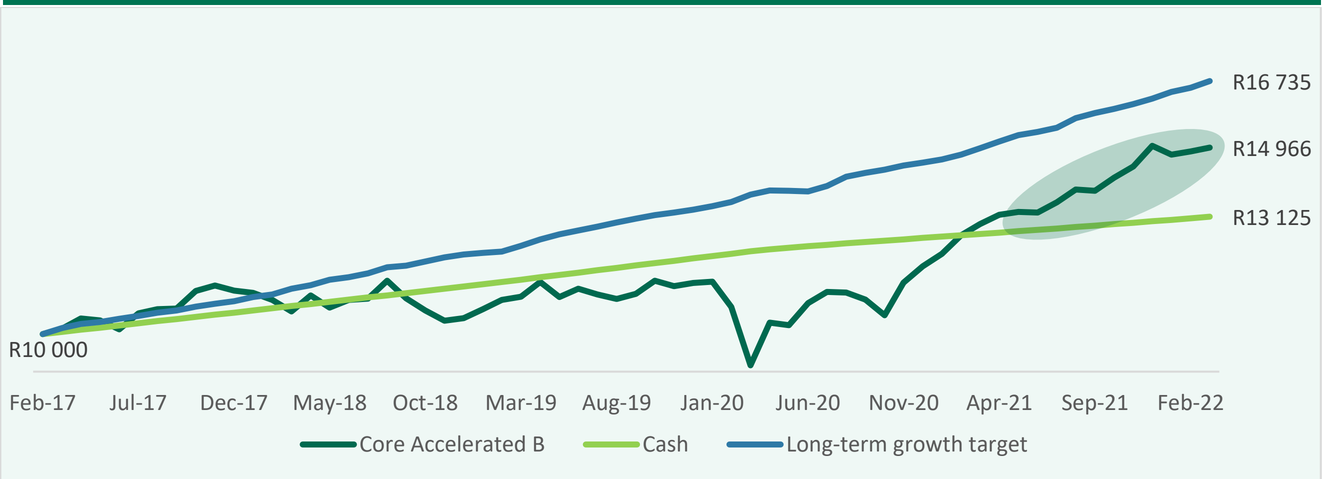
The raging conflict between Russia and Ukraine and the imposition of unprecedented levels of sanctions on Russia by the western nations have cast fresh uncertainty on global growth which was steadily recovering from the scars of the pandemic. The amplified hostilities between the two nations have resulted in a sharp rise in price of certain commodities such as crude oil, gas, wheat, fertilizers, coal etc. amid the creation of global supply-chain shock. What it means for a portfolio is that we likely to see further pricing pressure across the commodity chain and the risks to growth. In the first quarter, the Nedgroup Investments Core Accelerated Fund declined by -0.3%.

The table below compares an investment in Nedgroup Investments Core Accelerated Fund to a bank deposit (cash) investment and its growth target over various time periods. For every R10 000 invested in the Nedgroup Investments Core Accelerated Fund at inception (28 February 2017), you would have R14 966 at the 31st of March 2022. This is higher than the R13 125 you would have achieved had you invested your money in bank deposits (cash) over the same period. The green circle in the chart below, highlights the recent market recovery, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investment Core Accelerated Fund versus Cash[1] and the Growth target

	3 Months	1 Year	3 Years	5 Years	7 Years	Inception 28 February 2017
Growth of fund (after fees) ***(Growth in %)***	R9 970 *-0.3%*	R11 579 *15.8%*	R13 614 *10.8% p.a.*	R14 760 *8.1% p.a.*	-	R14 966 *8.3% p.a.*
Growth of cash ***(Growth in %)***	R10 095 *0.9%*	R10 362 *3.6%*	R11 463 *4.7% p.a.*	R13 050 *5.5% p.a.*	R14 795 *5.8% p.a.*	R13 125 *5.6% p.a.*
Growth target (inflation+6%) ***(Growth in %)***	R10 287 *2.9%*	R11 200 *12.0%*	R13 551 *10.7% p.a.*	R16 470 *10.5% p.a.*	R21 052 *11.2% p.a.*	R16 735 *10.7% p.a.*

Fund Return versus Cash[1] from inception ending 31 March 2022



The Nedgroup Investment Core Accelerated Fund is designed for investment periods of 7 years and longer as it has a high exposure to shares (90%). This means that it can experience significant fluctuations over shorter periods but in the long-term has a growth target of 6% above inflation (around 12% per year), as demonstrated in the chart above.

The Nedgroup Investments Core Accelerated Fund has fallen short of this target since inception. However, history demonstrates that two-thirds of a fund such as the Nedgroup Investments Core Accelerated Fund would have achieved its long-term growth target of 6% above inflation (around 12% per year) over any 7-year period. In fact, as the time horizon extends, so the risk of underperforming this target decreases.

[1] We used the STeFI call deposit rate for cash returns

Market and economic commentary: Inflation remains uglier for a little bit longer

Just when the world was expecting some much-needed relief from living with the COVID-19 pandemic for the last two years, Russia invaded Ukraine in late February sending shockwaves through the world and markets alike. Markets around the globe declined and volatility returned after a relatively calm 2021. Although some of the market fall may in part be attributed to valuations normalising off a base of high historical valuations of developed countries, other significant contributors include the geopolitical uncertainty and changes in the economic environment.

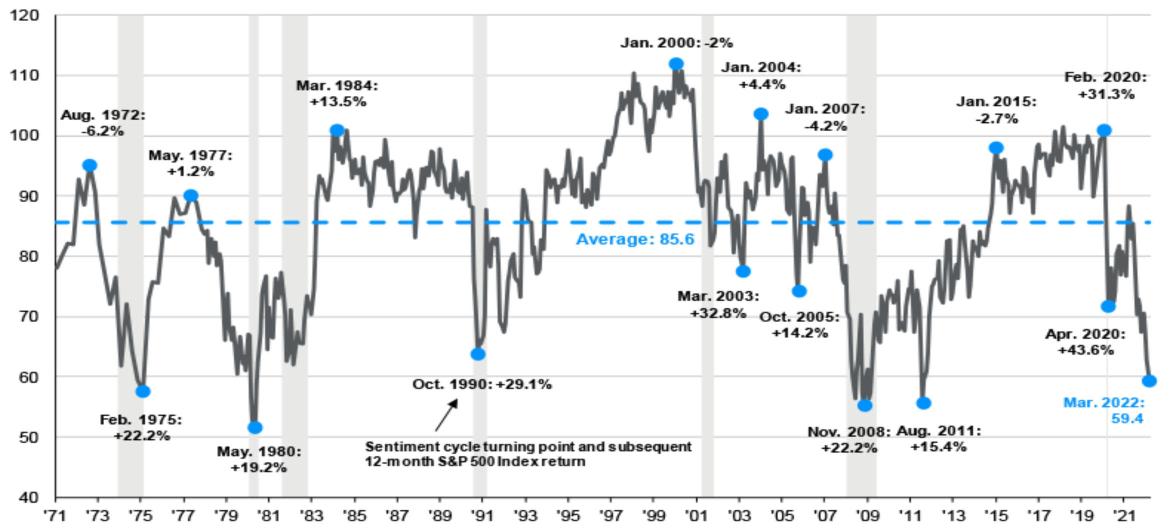
One of the notable changes in the economic environment was the rapid rise in inflation and the fear that this may persist for longer than initially anticipated. Energy prices soared with sanctions being imposed on Russia; one of the world's top energy producers. Furthermore, other essential commodity prices also increased sharply with fears of further supply chain disruptions. The upside of this is that commodities have been one of the few sectors in the market that have performed well in the first quarter.

Add to this, labour shortages in many countries, price hikes to recoup losses during the pandemic and the high demand for goods that are in short supply, and you have the perfect storm for inflation. In the US, inflation reached 40-year highs with their annual inflation rate reaching 7.9% in February, well above its 2% target. The UK was not far behind with inflation of 6.2% per annum to the end of February and the Eurozone at 5.9% at the end of February and with an expectation[2] that inflation will tick up to 7.5% in March.

In an attempt to reign in rapidly rising inflation, central banks have begun hiking interest rates. The Federal Reserve has increased interest rates by 0.25% and signalled their intent to increase rates at each of the six meetings this year. The Bank of England has announced two consecutive interest rate hikes with a combined increase of 0.5%, the European Central Bank has not yet increased interest rates but plans to end bond purchases by the end of September and South Africa has had two interest rate hikes this year with a combined increase of 0.5%.

Rising interest rates, higher inflation and potentially low growth are all expected to put pressure on households and disposable income. In America, this has led to the lowest consumer sentiment in a decade. However, investors are cautioned not to let their feelings rule their investment decisions. The table below from J.P. Morgan is a good illustration of this. Typically, the best returns (on average 24.5%) are earned on investments made when consumer confidence is at a low, in comparison to investments made when consumer confidence is at a high (with investors only earning subsequent returns of 4.4% on average). This serves as a good reminder not to make emotional investment decisions.

Consumer Sentiment Index and subsequent 12-month S&P 500 returns



Source: JP Morgan Asset Management

[2] According to Eurostat

The new offshore limits and resulting changes to the asset allocations

On the 23rd of February 2022 an announcement was made that the offshore limits would be increased from the 30% global plus 10% Africa to a single combined allocation of 45%. Given the home bias research we conducted in 2020 we could apply the new limits across our South African Core range.

We have modelled multi-asset funds with different offshore allocations - ranging from a 30% (old offshore limit) to 100% offshore. This allowed us to study the trade-offs between broader diversification and increased volatility due to the rand exchange rates. We also studied the tax benefits within compulsory and tax-free investment structures for funds with different home biases.

Our research indicated that the offshore allocations of the Nedgroup Investments Core Accelerated Fund could be increased to 50% while still delivering similar outcomes to investors, but with less concentration risk. Given the high growth allocations we will increase the offshore exposure within the fund to the maximum 45%. This reduces the concentration risk to SA listed property and should lead to better risk adjusted returns.

Asset Class	Current Core Accelerated	New Core Accelerated
Local Equity*	53.5%	41.8%
Local REITs	9.0%	7.2%
Local Bonds	2.5%	2.0%
Local Inflation Linked Bonds	2.5%	2.0%
Local Cash	2.5%	2.0%
Global Equity	22.5%	34.0%
Global REITs	5.0%	7.0%
Global Bonds	1.0%	1.5%
Global Inflation Linked Bonds	1.0%	1.5%
Global Cash	0.5%	1.0%
Limits		
Total Equity and Property	90.0%	90.0%
Total Foreign	30.0%	45.0%

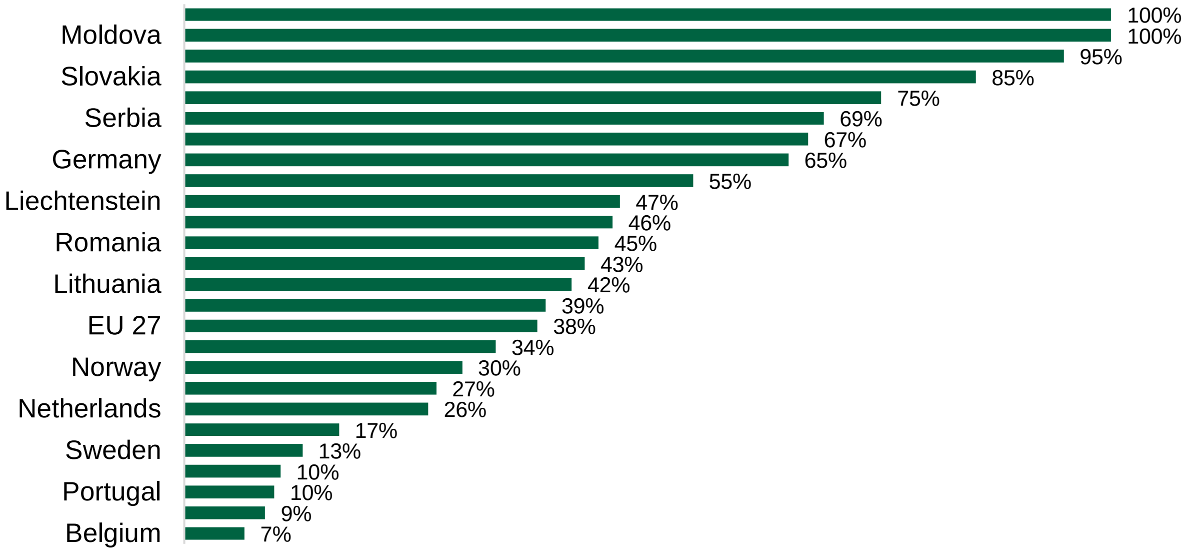
What does the war in Russia mean for investors?

Putin's decision to invade Ukraine has upended assumptions about the sanctity of borders and has the world fearfully questioning whether this may lead to a world war. The humanitarian crisis in Ukraine has been devastating with many civilians affected.

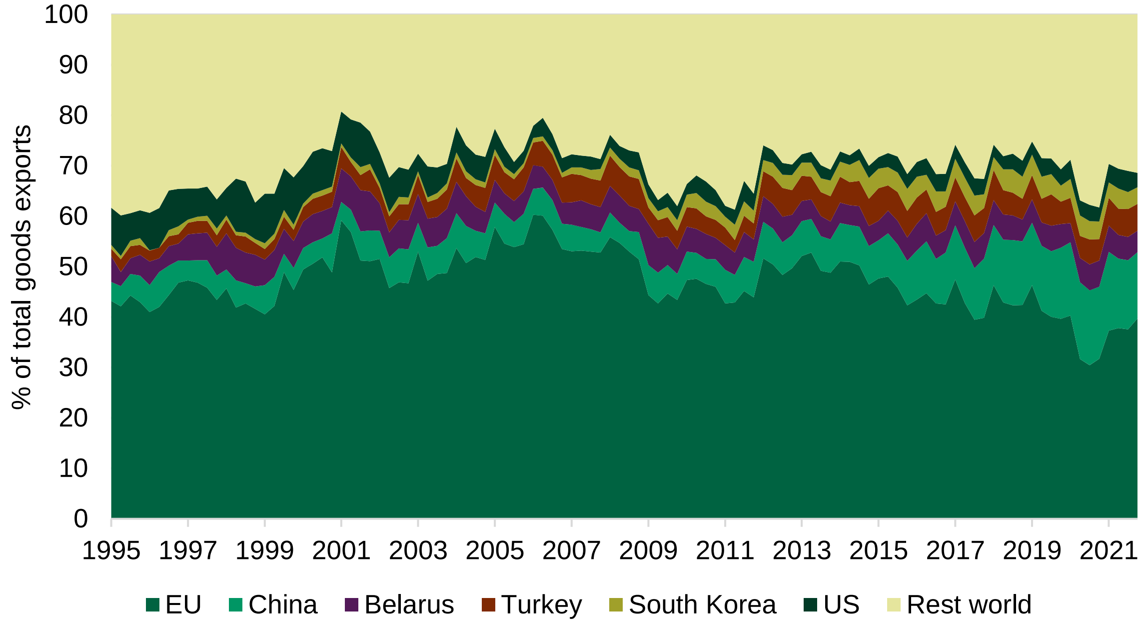
The world chose to fight back with economic rather than military sanctions. In fact, the response was surprisingly unified, solidifying the West with even Sweden and Switzerland abandoning neutrality. Unfortunately, economic sanctions are a blunt instrument and have had a significant impact on Europe, which was heavily reliant on energy and other imports from Russia, as depicted in the charts below. The impact on the US has been a lot smaller as they are essentially self-sufficient in oil due to the growth in their shale oil industry. Moreover, the rise in energy prices has been beneficial for US producers.

Europe natural gas imports from Russia

% of total natural gas imports (2020)



Russia goods exports by destination



Russia has spent many years positioning themselves to be self-reliant. They are among the top energy producers in the world and have been described as an energy superpower with natural gas, coal, oil and oil shale reserves. Furthermore, they are the world's largest exporter of wheat, largest producer of barley, buckwheat, oats and rye and second largest producer of sunflower seeds. Besides having ample energy and food, Russia has also amassed significant foreign reserves. However, they have lost access to some of these reserves under the sanctions imposed. These are just a few examples of the self-sufficiency of Russia. Unfortunately, this reduces the delays the effectiveness of the economic sanctions and means that it will take longer for these measures to hurt.

The ripple effect on the world has been further supply chain disruptions, a spike in commodity prices, higher inflation, and the potential for slower economic growth. The longer the war and sanctions persist the greater the chances are of a global economic slowdown.

So, what does this all mean for markets and your investors? The implications are broader than just direct exposure to Russian investments. There has been a widening in the equity risk premium, meaning that investors are demanding higher expected returns from shares to compensate them for the perceived additional risk, leading to a decline in markets. Another reason for the decline is that many central banks have begun hiking interest rates in response to rapidly rising inflation and in some regions, markets were overvalued. Additionally, investors may also have indirect exposure to Russia via companies that earn some of their revenue from Russia. For example, Mastercard, used to earn from Russian transactions prior to the sanctions imposed.

The best response is to remain calm and avoid making emotional investment decisions. It is also a good reminder of why it is so important to hold a well-diversified portfolio which helps reduce risks that are predominantly concentrated to a region.