NEDGROUP INVESTMENTS

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Quarterly review

Nedgroup Investments Core Global Feeder Fund

As at 30 June 2022

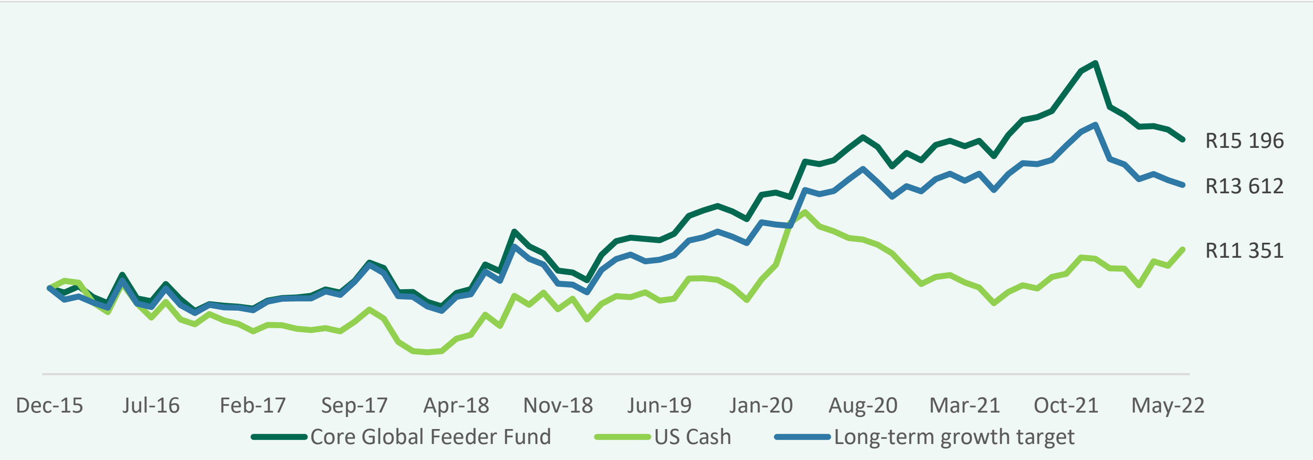
Markets continue to be extremely volatile

The market continued to be extremely volatile in the second quarter. The concerns in the market are around whether we are going into a recession or not and that is greatly depended on whether the Fed moves interest rates too high, stymies growth too quickly and causes the economy to go into recession. The Fed has been hawkish in its commentary throughout the quarter with the all-items Consumer Price Index having increased to 9.1 percent for the 12 months ending June, making it the largest 12-month increase since the period ending November 1981. It is still important to focus on the long-term and not being overly destructed by short term volatility but yet being mindful that there are shifts happening in the overall landscape. In the second quarter, the Nedgroup Investments Core Global Feeder Fund declined by -2.9%.

The table below compares an investment in Nedgroup Investments Core Global Feeder Fund to US bank deposits (cash) investment over various time periods. For every R10 000 invested in the Nedgroup Investments Core Global Feeder Fund at inception (4 January 2016), you would have R15 196 at the 30th of June 2022. This is much higher than the R11 351 you would have achieved had you invested your money in US bank deposits (cash) over the same period.

Value of R10,000 investment in Nedgroup Investments Core Global Feeder Fund versus US Cash[1]					
	3 Months	1 Year	3 Years	5 Years	Inception 4 January 2016
Growth of fund (after fees) ***(Growth in %)***	R9 715 *-2.9%*	R9 899 *-1.0%*	R13 009 *9.2% p.a.*	R15 611 *9.3% p.a.*	R15 196 *6.7% p.a.*
Growth of US Cash ***(Growth in %)***	R11 236 *12.4%*	R11 503 *15.0%*	R11 864 *5.9% p.a.*	R13 284 *5.8% p.a.*	R11 351 *2.0% p.a.*
Growth target (Global MA High Equity Mean) ***(Growth in %)***	R9 856 *-1.4%*	R9 732 *-2.7%*	R12 375 *7.4% p.a.*	R14 118 *7.1% p.a.*	R13 612 *4.9% p.a.*
Change in Dollar exchange rates ***(Change in %)***	R14.61 to R16.29 *-10.28 %*	R14.60 to R16.29 *-14.73%*	R14.35 to R16.29 *-5.13% p.a.*	R13.17 to R16.29 *-4.57% p.a.*	R15.40 to R16.29 *-0.80% p.a.*

Fund Return versus US Cash1 in Rand from inception ending 30 June 2022



Since the inception of the Nedgroup Investments Core Global Feeder Fund it has done better than US cash. However, it is to be expected that occasionally there will be periods where the fund does not beat US cash over 5 years. Over the long term[2], a portfolio such as Nedgroup Investments Core Global Feeder Fund would have delivered a higher return than US cash around 86% of the time over any 5-year period.

1. We used the ICE Bank of America 3-month deposit rate for US cash returns converted into Rands
2. Based on Global market returns from 1997 to 2018 (source Morningstar) using the same long-term equity allocation and fees.

Market and economic commentary

Markets had a brutal second quarter and first half of 2022, with the latter being one of the worst six-month periods since the 1970s, as the US 10-year bond yield increased by c. 150bps since the start of the year and tighter financial conditions took hold. The S&P 500 dipped into official bear market territory several times in, ending the quarter down 16,1% and bringing the first half number to -20,0%. European indices slumped on higher inflation prints and higher vulnerability to recession given the ongoing Russia-Ukraine war, which was further emphasised as Russia decreased supply of natural gas to Europe in the month. China's economy is a mixed as the Bank of China maintains its accommodative stance in an effort to reach the targeted 5.5% economic growth - on the other hand, their zero-tolerance Covid approach may be a headwind.

In South Africa, May PMI data suggests a lingering impact of mining sector strikes but also recovery post the natural disaster in KZN. The ZAR has depreciated notably relative the USD due to the worsening inflation and broad-base dollar strength and intensified load shedding.

Loadshedding at Eskom worsened in June, in part due to industrial action amid tense wage negotiations. More constructively, the SOE announced 18 winning bids for renewable projects in Mpumalanga, which will lease land from Eskom and generate an estimated 1800MW of energy to be wheeled across the grid. While this will not alleviate the immediate energy crisis, it is illustrative of the energy reforms slowly being enacted. To add to the positive developments, the National Prosecuting Authority (NPA) made some high-profile arrests in May, a step forward in the journey to accountability.

Local equity markets lost ground over the quarter with the FTSE/JSE All Share down 11,7%. Outside of industrials, most sectors were down in June with notable weakness in the last month from resources, with a downdraft of 17,2%. The big news in June was corporate activity from Prosus and Naspers, which will see the company sell part of their stake in Tencent to fund a buyback of company shares to narrow the discount to net asset value and unlock value for shareholders. This helped Naspers and Prosus gain 42,3% and 32,6% over the quarter respectively. Corporate actions continue as we head into the next quarter, led by PSG's and RMI's value unlock strategies.

Inflation remains uglier for a little bit longer

The markets' prediction of inflation peaking in Q1 was met with disappointment as inflation prints surpassed levels that have not been experienced in the 21st century in developed markets. This was marked by the 40-year US inflation peak in Q1 being overshot by the most recent 8.6% inflation print in May – running further away from the Fed's 2% target. While South Africa breached the upper limit of the Reserve Bank's inflation target, with a 6.5% figure. Geopolitical uncertainty added to the supply chain, energy crunch and food induced inflation. In an effort to moderate the trend, central banks have since adopted more aggressive stances and committed to continuing on this very hawkish path – with the exception of the Bank of China and Bank of Japan, who remain the lone doves for now.

This has contributed to the normalisation of valuations from a high base and generalised asset price declines have which have not abated. Jittery market environments continued to dominate in the second quarter as they price in the rate hikes, the end of the ECB's bond buying programme, poor PMI prints and the ever-increasing likelihood of recession. The other side of the coin of DM rate hikes has been the unintended widening of yield spreads between the German bund and other EU countries, such as Italy. This is one of the collection of events that have proven so far that the 'soft landing' may be out of reach for all central banks.

On the commodities front, prices eventually formed part of the generalised market decline as the reality of cooling economic growth sets in globally. Energy sector prices drew back slightly towards quarter end due to the oil price decline, although inflation for the half year remains extremely elevated – the promise of the higher rate of increasing output from OPEC+ will be watched closely by the market for signs of whether this promise will materialise. Nevertheless, while there has been reprieve in one part of the inflation basket, the dominant theme continues to be a record high inflation environment.

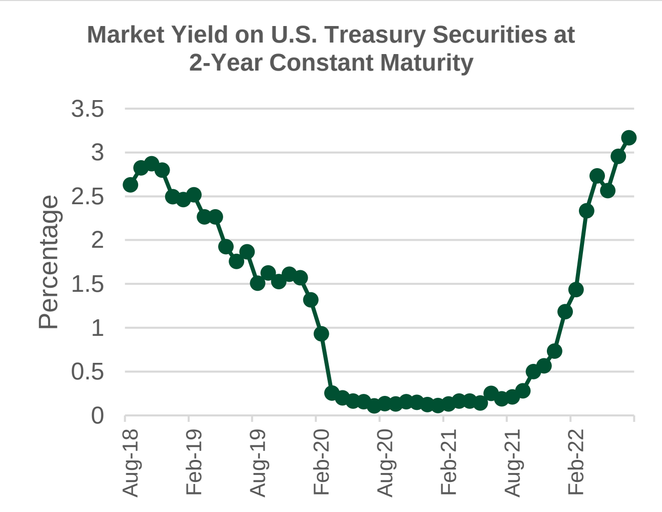
Central banks' reactions to the persistently elevated inflation have continued to weigh on asse prices and on a forward-looking basis will continue into the next quarter. The increase of 75bps in the US was the highest single hike by the Fed since 1994 and the Bank of England put through a 4th consecutive increase and penned down July as the end date of the bond buying programme.

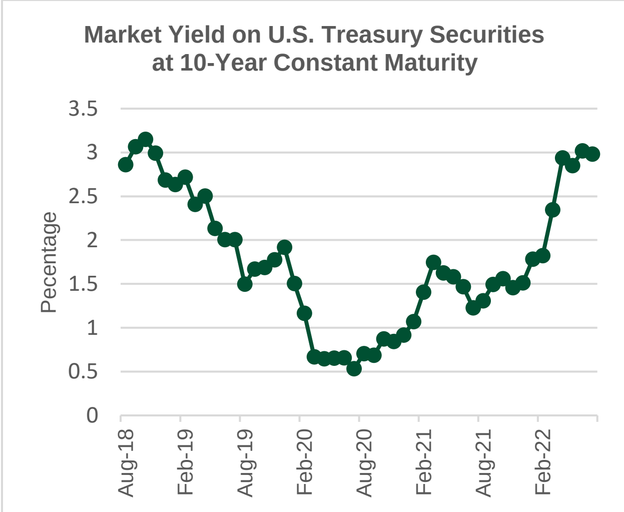
South Africa's rate hiking behaviour has largely mirrored that of the rest of the world as South Africa's inflation print of 6.5% breached the SARB's 6% upper limit. Input cost inflation and the increased frequency of power cuts has weighed on the economy as it tries to recover from the KZN unrest. The inflation rate differential South Africa and the US has done little to prevent the ZAR from depreciating, the dominating driving force into the market has been the pending global recession and therefore the USD has strengthened against most currencies.

Is the yield curve inversion showing signs of a recession?

In the second quarter of 2022 yield on the benchmark 10-Year and 2-Year Treasury shot up above 3% on the back of hawkish comments after the minutes from the June meeting for the Federal Open Market Committee were released indicating that they will raise rates to combat inflation, thereby, sparking fears of a recession and raising rates further. These are the sharpest increases in financial market history, so the rerating upwards in bonds has occurred over short period. This means that investors across the risk curve have seen asset prices reprice downwards and only cash has avoided the rout. For example, US Treasury Index is down 15% over the year to date.

See the charts below of show the rise in the yields for 2-year and 10-year US Treasury Bonds from the end of February. You will also notice in the chart that the spike in yields occurred in the last week of June in both charts on the back of hawkish comments from the Fed. The SA's government bonds have followed suit as all assets are priced off the US treasury curve.





Source: Board of Governors of the Federal Reserve System (US)

This part of the yield curve is the most closely watched and typically given the most credence by investors that the economy could be heading for a downturn when it inverts. The 2-year to 10-year spread was last in negative territory in 2019, before pandemic lockdowns sent the global economy into a steep recession in early 2020.

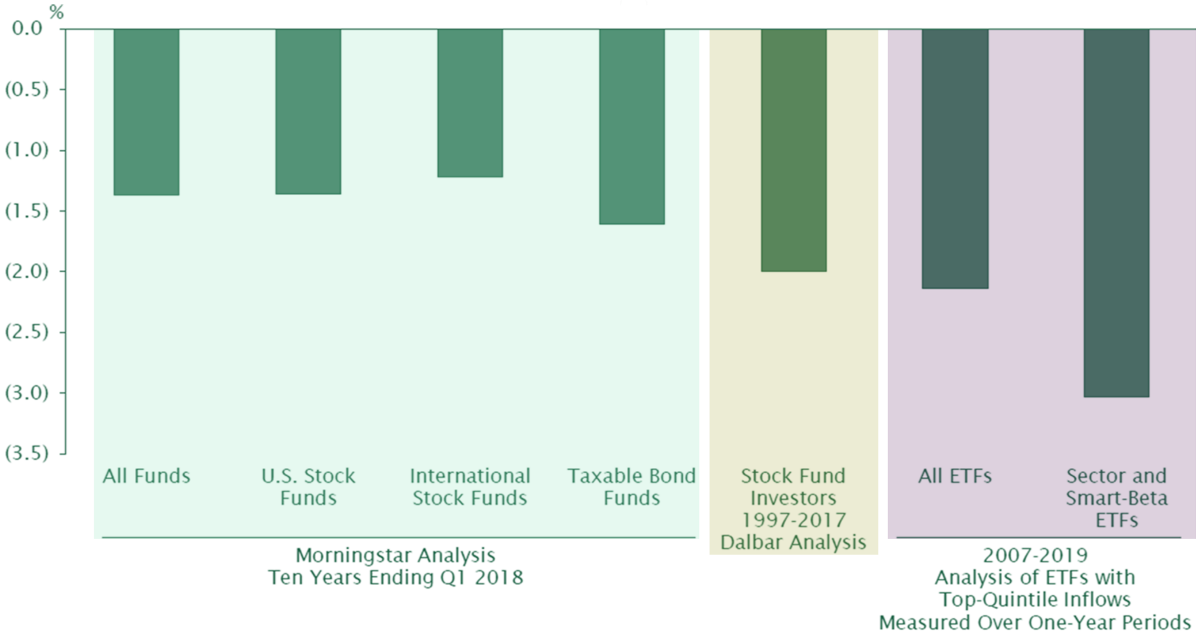
While the yield curve has sent somewhat reliable signals about pending recessions, there is often a long-time lag and there needs to be corroborating evidence before investors need to fear a recession is around the corner. Some of those other signals could include a slowdown in hiring and a sudden increase in unemployment, or early warnings in ISM and other data that manufacturing activity could be slowing. The yield curve's inversion could also reverse should there be a resolution to the war in Ukraine or the Federal Reserve pauses in its rate-hiking cycle.

At the end of June 2022, a strong US jobs report fuelled investor optimism about avoiding a recession, but stocks declined amid fears of the federal reserve response. The nice thing about the last 30-year history is that there's been so few recessions that you don't want to say something is a golden rule, particularly when there are not enough observations and there's one big standout to that rule. If anything, this should be looked at as a time of opportunity and not a time to panic as history tells us that patience is rewarded.

The behavioural benefits of the Nedgroup Investments Core funds

The Nedgroup Investments Core funds were designed to fit into a holistic financial planning model that focuses on matching clients' future expected cash flow needs with portfolios that target specific real returns objectives. These funds were also designed to avoid the investor behaviour penalty that is often associated with clients moving from underperforming funds into recent top performing funds, just at the wrong time. The illustration below summarises three separate investor behaviour studies where we can see that investors typically received lower returns than the published fund returns.

Timing is a challenge for fund selectors – difference between fund returns and investor returns



Source: Michael Goldstein, Issues Facing the U.S. Money Management Industry - Presentation to the SEC Asset Management Advisory Committee, 2019

In investing, just like tennis, success is determined by reducing the number of unforced errors rather than by picking the next big winner. The illustration above shows how mistakes are often costlier than the gains made when picking winners so there is a lot to be gained by getting the basics right – and getting the necessary training and assistance.

Avoiding some of these "unforced errors" in portfolio management is the most effective way to achieve this two-part investment goal of consistently delivering the real return targets over minimum investment horizons while making sure that the investor stays the course. In designing the Nedgroup Investments Core range we tried to avoid the following unforced errors in investing:

- Not taking enough diversified risk – this leads to having too little growth assets when markets rally.
- Taking too much concentrated risk – increases the risk of single event having a big negative impact on a fund, e.g. Steinhoff.
- Timing markets at an asset allocation or share level - this is notoriously difficult and introduces behavioural biases in the implementation of the fund, e.g. buying too early or selling too late.
- Buying and selling too frequently and incurring unnecessary costs and taxes, e.g. brokerage and STT.
- Underestimating the impact of costs and taxes on investment growth, e.g. investment management fees and dividend withholding taxes on offshore investments.

Over the past 13 years this strategy has led to some of the most consistent performance outcomes in the industry. Over shorter rolling periods (1,3 and 5 years) the Nedgroup Investments Core funds rarely underperform the peer average while over longer rolling periods (7 years and longer) they are consistently in the top quartile.

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