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NEDGROUP INVESTMENTS Global Cautious Fund

Q2 2022

Marketing Communication

Nedgroup Investments Global Cautious Fund

Past performance is not indicative of future performance and does not predict future returns.

Performance to 31 March 2022 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	-4.3%	0.1%	-6.6%
12 months	-5.8%	0.2%	-9.9%

Market Overview

World real GDP in 2022 is now forecast to expand by 2.9% cut dramatically from a January forecast of 4.1%. Forecasting is always a perilous business but given that several countries have already announced negative March quarters, including the US and Japan, it seems to us that the latest World Bank forecast could be considered optimistic. Whether that is the case or not it is clear that in an environment of resurgent inflation and rising interest rates economic performance in the next few years will be volatile at best.

The US Federal Reserve has begun the process of shrinking its balance sheet through halting the reinvestment of proceeds from maturing Treasury and mortgage-backed securities into the government debt market. Not only are interest rates increasing in the US but the backstop of expanding Federal Reserve liquidity is now reversing. According to the 'Fed' the shrinkage will start at around USD47 billion this month increasing to around USD95 billion in September.

The ECB appears to be about to join the rate-increase party as it has announced it is likely to start on that path in July. The market quickly pointed out this could be disastrous for the fragile southern European economies. In a nutshell this explains why the Eurozone has always been financially conflicted -19 sovereign nations with entirely different economic structures yet with one currency and one central bank rate.

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.

The portfolio produced a negative return led by the portfolio's overseas bond and US equity allocations though both were ahead of comparable indices. Hedging of the Australian Dollar was the main positive contributor given the depreciation over April. The following table highlights the top 5 equity contributors and bottom 5 equity detractors over the quarter:

Top Performers	Country	Performance contribution	Bottom Performers	Country	Performance contribution
Philip Morris Int'l	US	0.06%	American Express	US	-0.24%
AutoZone	US	0.04%	T Rowe Price	US	-0.21%
ABC-Mart	Japan	0.03%	Altria	US	-0.19%
VTech Holdings	Hong Kong	0.02%	Rockwell Automation	US	-0.17%
AIA Group	Hong Kong	0.01%	Texas Instruments	US	-0.14%

In the US, the stock market had one of the most difficult quarters in recent years. Inflation remained stubbornly high causing the Federal Reserve to change its narrative and become more aggressive in raising interest rates culminating in a 0.75% increase in June which was one of the largest increases in the last 25 years. As commodity prices rose due to compromised supply chains, the inflationary outlook materially has worsened. Investor sentiment remains fragile with consumer confidence at recessionary lows.

In the US, sectors such as energy led the market as commodity prices rose while sectors such as technology and consumer discretionary were impacted by the spectre of rising interest rates. Some of the better performing

[1] Net return for the Nedgroup Investments Global Cautious Fund, A class. Source: Morningstar (monthly data series).
[2] SOFR USD 1-month from 1 Feb 2022 (previously US Libor 1 month)
[3] Morningstar EAA Fund USD Cautious Allocation

companies in the portfolio included Philip Morris International and AutoZone. Philip Morris announced the acquisition of a competitor, Swedish Match which would increase its addressable market. The acquisition provides a Philip Morris with a foothold in the US and provides additional smoke-free brands. AutoZone rose as the company benefitted from strong sales growth in its “do-it-for-me” category, taking market share in the process. Companies that performed poorly for the portfolio included Rockwell Automation and American Express. Rockwell Automation was impacted by expectations of an economic slowdown in the US. The company remains well positioned in the longer term from trends such as onshoring and increased automation of factories to increase efficiency. American Express lagged the market on worries that consumer spending would decrease, and bad debts would increase as customers struggle to pay their credit card bills. Longer term the company will continue to benefit from the shift away from physical cash to card based payments.

Overseas equities detracted led by names in Asia with United Overseas Bank (UOB) and Axiata Group both detracting. Having performed strongly last quarter, UOB gave back some performance after missing consensus expectations. Net interest margins were flat over the quarter and there was a decline in credit card, wealth and fund management fees. Axiata’s share price fell on concerns over their exposure to the unfolding economic crisis in Sri Lanka. The currency weakness caused by a potential default and rampant inflation in Sri Lanka means the translation of their earnings there is impacted, as is the cost of capex. On the plus side the Celcom-Digi merger seems still to be on track for completion later this year. On the positive side, ABC-Mart continues to benefit from increased customer footfall and increased customer spend assisted by the Golden Week holidays in early May. All product categories saw double digit YoY growth with the leisure casual category up 55%.

The bond allocation detracted over the period, with overseas bonds detracting more than US bonds. The US yield curve flattened as did most major overseas yield curves. We are positioned at the short end, meaning that whilst the return from our bond allocation was negative, it was less negative than being positioned further out on the yield curve. The contribution from overseas bonds was hindered by a depreciation of both the Canadian Dollar and British Pound relative to the US Dollar which appreciated strongly following the steep rates hikes implemented by the Fed.

The Australian Dollar remains the only currency exposure hedged in the portfolio. The Australian Dollar weakened by around 9% against the US dollar meaning hedging the exposure helped protect client capital. Pyrford view the US dollar as significantly overvalued 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 Positioning

There were no changes to asset allocation in the quarter. The model allocation is 77% bonds, 20% equities and 3% cash.

Within the fixed income allocation, Pyrford adopts a very defensive stance by only owning short duration securities to minimise the impact on the portfolio from interest rate rises. At the end of the period the modified duration of the fixed income portfolio stood at just 1 year. 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. 45% of the portfolio is invested in overseas bonds, with 17% in Canada, 16% in the UK and 12% in Australia. 32% of the portfolio is invested in US government debt.

Within the equity portfolio the companies we hold are defensive names, which we would expect to perform well during volatile periods. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. Within Europe there are no holdings in the peripheral Eurozone countries where sovereign debt concerns remain. The European portfolio is concentrated in Switzerland and the relatively healthy economies of core Europe and the UK. In Asia, we prefer the Southeast Asian markets over Japan. The potential growth rate in Japan remains low given the poor demographics and low productivity growth. Economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations.

Finally, there was no change to the unhedged non-USD exposure in the portfolio. 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.

Outlook

The world's economic woes should not be blamed only on the conflict in Ukraine and Covid-19. The reality is the economic woes have been building in the background for many years thanks to central bank and government largesse and a complicit consumer/borrower. Key interest rates were too low before the pandemic struck and were then pushed even lower. The one thing that we can say with conviction is that high market volatility is likely to persist until there's clear evidence that inflation is declining and central banks shift towards a less hawkish stance.

The rickety economic structure built in recent years has been based around ever-expanding levels of debt and extremely low interest rates. Add in the explosion of central bank money and government handouts and you end up with an 'everything' bubble – a bubble, which, inevitably, is now in the process of bursting.

Our guess is that the combination of cost-push and demand-pull will keep this inflation rabbit running for some time. The Fed and other central banks have intimated that several rate increases are likely over the next few quarters. We see no reason to attempt to dissuade them from this plan.

Responsible Investments

As long-term shareholders of companies, we have the ability, and in our view the responsibility, to try and influence the business practices of companies.

Pyrford voted 1,068 proposals in 67 company meetings in the quarter. We voted against management on 65 proposals in 32 of these meetings. We also engaged with 41 companies worldwide and ESG issues are a standing agenda item in every meeting we conduct.

For a detailed overview of ESG activity, please visit our website for all voting records and our latest annual ESG report.

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