NEDGROUP INVESTMENTS

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Quarterly review

Nedgroup Investments Core Bond Fund

As at 30 September 2022

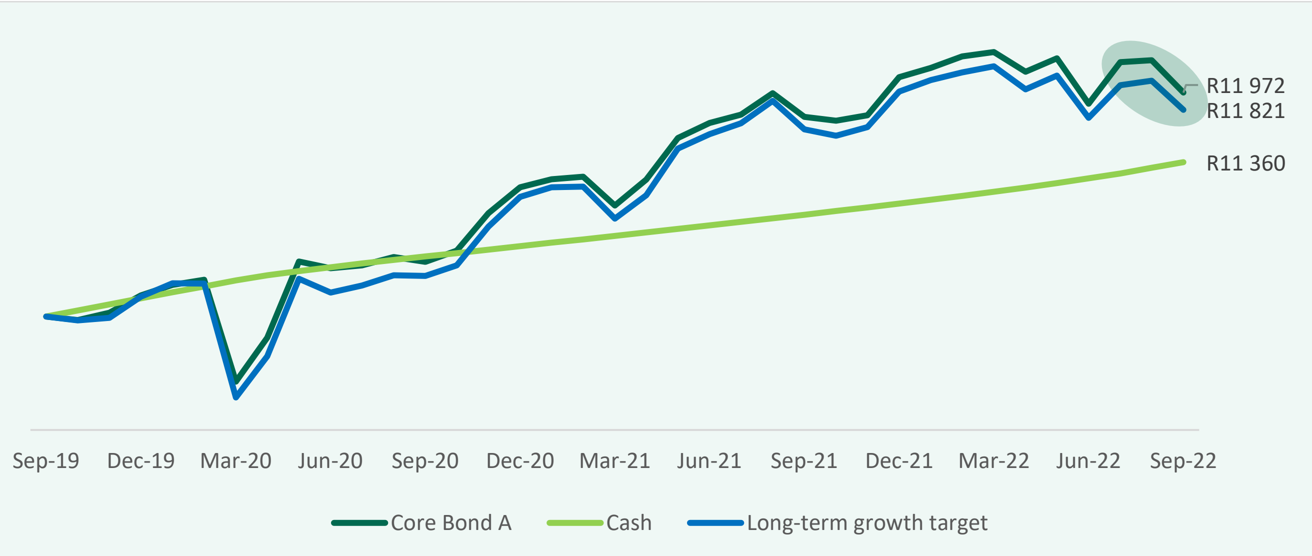
An all-out war to slay inflation

The global economy is rapidly slowing as a momentous monetary tightening cycle is unfolding at top speed, particularly in developed markets. Natural gas prices remain at record highs. Inflation continues to send shivers down the spines of global markets. Central banks have been withdrawing liquidity to arrest inflation's rampant resurgence. It is still important to focus on the long-term and not be overly destructed by short term volatility but yet be mindful that there are shifts happening in the overall landscape. In the third quarter, the Nedgroup Investments Core Bond Fund increased by 0.8%.

The table below compares an investment in the Nedgroup Investments Core Bond Fund to bank deposits (cash) over various time periods. This illustrates that over longer periods, investors have been rewarded for taking on interest rate risk. For every R10 000 invested in the Nedgroup Investments Core Bond Fund three years ago, you would have R11 972 at the 30th of September 2022. This is greater than the R11 360 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 decline, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investments Core Bond Fund versus Cash[1] and the Growth target						
	3 Months	1 Year	3 Years	5 Years	7 Years	10 Years
Growth of fund (after fees) ***(Growth in %)***	R10 084 *0.8%*	R10 182 *1.8%*	R11 972 *6.2% p.a.*	R14 304 *7.4% p.a.*	R16 750 *7.6% p.a.*	R19 700 *7.0% p.a.*
Growth of cash ***(Growth in %)***	R10 128 *1.3%*	R10 425 *4.2%*	R11 360 *4.3% p.a.*	R12 917 *5.3% p.a.*	R14 725 *5.7% p.a.*	R17 159 *5.5% p.a.*
Growth target (Beassa ALBI) ***(Growth in %)***	R10 060 *0.6%*	R10 148 *1.5%*	R11 821 *5.7% p.a.*	R14 111 *7.1% p.a.*	R16 436 *7.4% p.a.*	R19 197 *6.7% p.a.*

Fund Return versus Cash[1] and the Long-term growth target for 3 years ending 30 September 2022



Over most periods, the Nedgroup Investments Core Bond Fund has done significantly better than bank deposits (cash) as the Fund benefited from the yield enhancement from investing in longer dated bond instruments. Over the past ten years it has delivered more than 1.5% of additional return per annum, or R2 542 for every R10 000 invested.

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

Market and economic commentary

Market declines in the third quarter were an extension of market movements seen year to date. Reprieve from market volatility has not been seen yet. The war between Russia and Ukraine and the ramifications of global rate hikes continued to be dominating the market. Weaker economic prints around the world point to the crystallization of the global economic slowdown. The standout macro data came from the strength in the US labour market as non-farm payrolls improved to the point where US unemployment reached levels last seen in 1969. However, there are indications of a US labour market strength slow down as unemployment reached 3.7% in August from 3.5%.

To add to injury, the Nord Stream pipelines increased the intensity of energy insecurity in the Eurozone winter approaches. This has not necessarily changed the trajectory of the easing of energy inflation which is positive. However, the full impact of the caused capacity constrained will be gauged during winter.

On the inflation reaction front, central banks remain hawkish notwithstanding the slight moderation in the increase in price levels - surprises on the upside are the main cause. EU inflation reached 9.1%, while the US reached 8.3%. The US Federal's rate hikes have contributed significantly to the strength of the currency relative to the rest of the world and on a relative basis, the Sterling saw notable volatility as the market corrected for the relative real returns between the two countries. The new UK prime minister, Liz Truss, started her term on the back foot as the market responded unfavourably to the announcement to implement an expansionary strategy during a high inflation era.

On the South African front – the Q2 GDP contraction of -0.7% showed the impact of the KZN floods, loadshedding and the mining strikes. Loadshedding should be the damper in Q3 data, although optimism is noted in the PMI numbers. Consumers in SA also face higher than normal inflation rates (7.6% in August), combined with unemployment levels well above pre-pandemic levels. When taking Producer inflation into account, which came in at 16.6% for the same month, it provides a more complete perspective. South Africa's central bank has followed the rest of the world with reliably aggressive hikes. The ZAR however, like most currencies, has lost ground to the USD with a 11.5% depreciation in the third quarter. In sympathy with global markets, the local equity market declined by c.4.1% in September and 1.9% over the quarter.

Outside of the usual macro concerns – South Africa's review by the Financial Action Task Force (FATF) for potential grey listing is a potential landmine of some sorts faced by SA businesses. Slowdown in business due diligences, transactions, and the increased cost of doing business that come with being grey listed are some of the perils business owners hope to avoid. The market will be looking to the government and business to land this one together.

Interest rates: When does a "A lot" Become "Too Much"?

There is no question that the biggest macro story in the United States over the past three months has not been the data flow per se, but the Fed's reaction to it. The hawkishness kept building and reached fever pitch with the third consecutive 75 bp hike in September and a new dot plot that incorporates another 125 bp worth of hikes through the year-end plus 25 bp more in 2023. The speed and aggressiveness of these hiking moves around the world has been very concerning for market participants but also signals the all-out war to fight inflation.

The inflation problem remains acute and, compared to the start of the year, with Russia's willingness to cut off Nord stream gas supply to Europe; the continued fighting between Ukraine and Russia, with neither side willing to negotiate a cease-fire yet. Hence, inflation forecasts have been revised higher raising the question when does "A Lot" Become "Too Much"? All reserve banks hope to bring inflation under control by slowing the economy and bringing demand down by hiking interest rates. However, they are faced with a limited scope of increasing interest rates quickly due to concern of growth. The chart below shows that inflation will remain high for most regions. Central banks' singular focus on inflation deepens most convictions that they will overtighten policy in the near term which might send the real GDP growth lines below zero and as a result a recession period. What it means for a portfolio is that we likely to see further pricing pressure across the commodity chain (and this may also mean the risks to growth which affects most returns.

Developed Markets: Growth, Unemployment and Inflation

Source: State Street

We have entered a regime of higher macro and market volatility. Hiking interest rates will inevitably cause some collateral damage in terms of growth and employment. But, given the reasonably robust starting point, the feeling—for now at least—is that this is an acceptable trade-off. Some short-term pain for long term gain, some short-term volatility for longer term stability.

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