NEDGROUP
INVESTMENTS

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Quarterly review

Nedgroup Investments Core Global Fund

Marketing communication

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 Global Fund declined by -6.7%.

The table below compares an investment in the Nedgroup Investments Core Global Fund to US bank deposits (cash) and its growth target over various time periods. For every $10 000 invested in the Nedgroup Investments Core Global Fund at inception (16 November 2015), you would have $13 329 at the 30th of September 2022. This is better than the $10 798 you would have achieved had you invested your money in US 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.

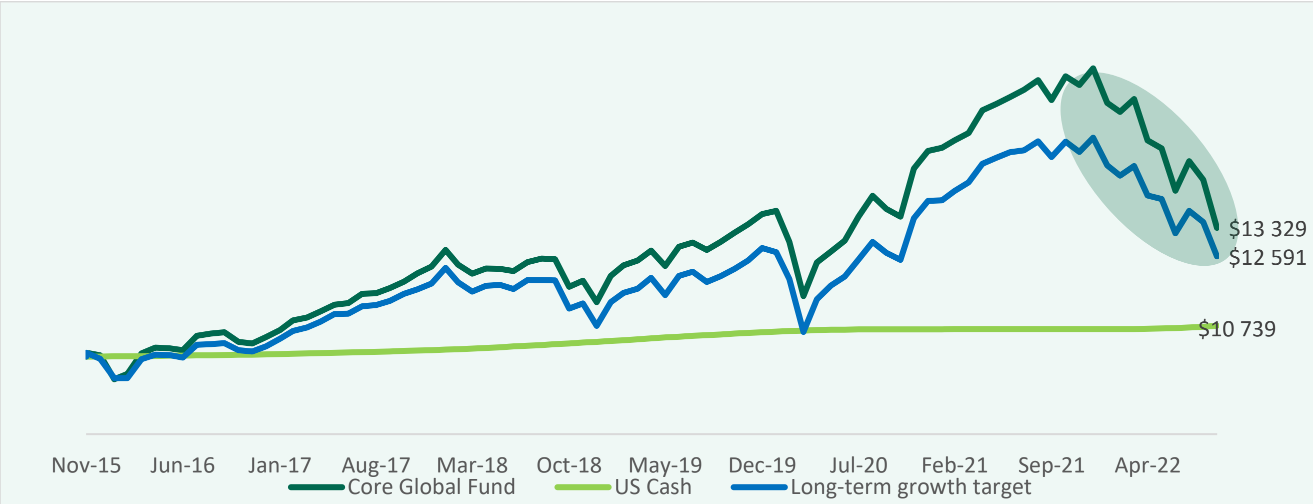
(Past Performance is not indicative of future performance and does not predict future returns)

	Value of $10,000 investment in Nedgroup Investments Core Global Fund versus US Cash[1]				
	3 Months	1 Year	3 Years	5 Years	Inception 16 November 2015
Growth of fund (after fees) ***(Growth in %)***	$9 332 *-6.7%*	$8 016 *-19.8%*	$10 285 *0.9% p.a.*	$11 325 *2.5% p.a.*	$13 329 *5.5% p.a.*
Growth of US Cash ***(Growth in %)***	$10 055 *0.6%*	$10 081 *0.8%*	$10 211 *0.7% p.a.*	$10 652 *1.3% p.a.*	$10 798 *1.1% p.a.*
Growth target (EAA Fund USD Aggressive Allocation) ***(Growth in %)***	$9 511 *-4.9%*	$8 304 *-17.0%*	$10 401 *1.3% p.a.*	$11 016 *2.0% p.a.*	$12 595 *3.4% p.a.*

Fund Return versus US Cash[1] from inception to 30 September 2022

Source: Morningstar

(Past Performance is not indicative of future performance and does not predict future returns)



Source: Morningstar

Since the inception of the Nedgroup Investments Core Global Fund, it has delivered returns in excess of 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 Fund would have delivered a higher return than US cash approximately 64% of the time over any 5-year period.

1. We used the ICE Bank of America 3-month deposit rate for US cash returns
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

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 (Past Performance is not indicative of future performance and does not predict future returns)

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.

Asset Allocation in Turbulent Times: What goes up must come down

The increase in volatility around the world's asset classes, that followed the pandemic, is likely here to stay if inflation expectations are informed by today's multitude of weak macroeconomic conditions. Off the back of the wave of inflation, the mantra of 'Trust the Fed' no longer exists - unless we see a change in the mindset of Central Banks about arresting inflation.

On the other side of the coin of high inflation are:

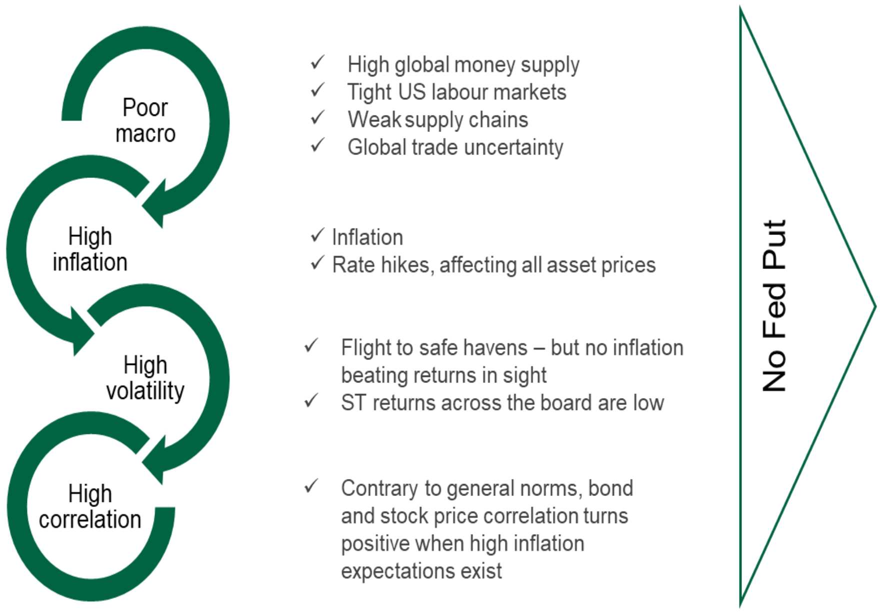
- the high US and DM money supply that is still circulating,
- the tight US labour market,
- and uncertain global trade conditions

With all the existing data on hand, it is not hard to assume that inflation remains high in the short to medium term. We tend to steer clear of macroeconomic predictions, so we aim to highlight that a combination of these types of factors have historically resulted in different asset classes behaving in a more uniform manner than we are used to.

Additionally, we note that correlations between different type of companies in the US have increased since 2017 and the correlation between developed and emerging market assets increased substantially since their lowest correlation of c.0.14 in 2017. [1]When macroeconomic conditions are strong, asset class correlations tend to be low. However, as noted above, this is not the type of environment we are in. At present, the environment is characterised by macroeconomic conditions are broadly weak. Therefore, return expectations across the board in real terms are weak. Earnings or income from assets are informed by the health of economies.

With no Fed Put in sight – in the short-term, we see how there's nowhere to hide anymore. Volatility is likely to remain high and correlation between assets will likely be a dominant risk for navigating short to medium term market conditions. However, in the long run, diversifying, staying the course and keeping costs low will play a key role in capturing long term returns from different asset classes. As the markets ebb and flow – what goes up must come down, we envisage this is true for volatility and asset class correlation too.

Conditions are ripe for volatile asset price environment



Source: Jenna Ross (2021), Nedgroup Investments

[1] Jenna Ross, 2021, Visualizing Asset Class Correlation Over 25 Years (1996-2020)

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