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NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter Three, 2022

Nedgroup Investments Flexible Income Fund

Performance to 31 March 2022	Fund Performance[1]	Stefi*110%
3 months	1.6%	1.4%
12 months	4.9%	4.7%

The fund performed well, over what was another difficult quarter for fixed income markets. Poor performance from offshore bonds, as well as a pullback in domestic property detracted from returns. A weakening ZAR, higher resetting floating rate instruments and preference shares contributed positively to returns, successfully shielding the portfolio from a lot of the market volatility felt over the quarter.

Over the longer term the Nedgroup Investments Flexible Income Fund has delivered on its mandate to outperform cash with a predictable and low risk return signature. Its long-term performance is attributable to its philosophy of investing in a diversified range of fixed income asset classes, avoiding expensive asset classes and focusing on high credit quality.

Market Commentary

At the risk of sounding repetitive, the third quarter of 2022 again experienced continued volatility on the back of persistent high global inflation and increasing interest rates. The market is well-aware of problematically high global inflation, but it seems that upside surprises continue to be the narrative. While many developed market central banks were well behind the curve in curbing this inflation, the Federal Reserve in particular this quarter put to rest any doubt that they were serious about bringing inflation down to acceptable levels. The market has again had to digest an even higher potential trajectory for interest rates, causing volatility and drawdowns across various asset classes, especially higher duration assets.

On the offshore front, equity markets struggled with the S&P 500 index returning -4.9%, the MSCI world index returning -6.1% and the MSCI EM index returning -11.5% for the quarter. Developed market bonds continued to suffer with the US 10 year moving another 82bps higher. The US treasuries index depreciated by another 7.6% for the quarter, meaning US treasuries are now down 21.3% for the year. Emerging market bonds (USD) similarly depreciated 4.1% for the quarter, now down 20.5% for the year. There were very few places to hide from a return perspective over the quarter.

US headline and core inflation again surprised to the upside in August, with core in particular twice as high as expected from a MoM perspective (+0.6% vs +0.3% expected). While shelter and goods inflation remains elevated, there are indications these are likely coming down over the next couple of months. Services inflation (driven by a strong labor market) will really be the key in determining how successful the Federal Reserve are in decreasing demand. Off the back of these inflation revisions the Fed took the market by surprise, not by hiking the expected 75bps, but by projecting rate hikes to an even greater extent than previously anticipated. The projected rate as at end 2022 moved from 3.4% to 4.4%. This implies additional hikes are likely in both the November and December meetings. Interestingly, all but one FOMC members project that interest rates will remain above 4% for the duration of 2023, meaning the dovish 'pivot' the market was hoping for, is looking less likely. The increasingly hawkish rhetoric alongside relatively poor growth observed in China, the EU and UK, has resulted in the US dollar trading at a 20 year high, and the ZAR experienced an 11.1% depreciation against the USD over the quarter. Similarly, the EURO (-7.0%), Pound (-9.0%), Yen (-6.6%) and other emerging market currencies all suffered significant deterioration against the US dollar.

The UK was exceptionally newsworthy over the quarter, announcing fuel subsidies and tax cuts to the cost of over GBP150 billion. For a nation running over 9% inflation and large budget deficits (projected to be almost 7%

[1] Net return for the Nedgroup Investments Flexible Income Fund, A class. Source: Morningstar (monthly data series).

to 9% of GDP for 2023 and 2024, on the back of this stimulus package, according to Fitch), this announcement naturally saw a sharp depreciation in the pound and gilts, as it indicates a lack of seriousness to bring inflation under control, and to employ any kind of fiscal prudence. The deterioration in both currency and bonds was so extreme, that it put major UK pension funds at risk, and eventually the BOE had to step in with asset purchases. UK gilts were down 13.6% for the quarter, totaling 26.4% for the year so far. While providing liquidity in a distressed market was absolutely necessary, the need to perform QE is happening at a time when asset purchases are less than ideal, and we watch with interest whether these purchases will be necessary beyond the announced 13-day period.

On the local front, markets were not immune to the risk-off environment, although faring slightly better. The FTSE/JSE All Share Index returned -1.9% for the quarter, with bonds (ALBI) returning 0.6% and linkers (ILBI) returning -1.0%. Property performed the worst returning -3.4%. Preference shares, however, returned 11.2% with banks continuing to buy back these instruments as they no longer qualify as regulatory capital under BASEL III.

On the monetary policy side, we saw the SARB keep up with the hawkish Federal Reserve and hike rates by 75bps, taking the repo rate to 6.25%. What initially sounded to be a more dovish address by the governor, ended in surprise with two members of the MPC actually voting for a 100bps hike. Despite low growth and what seems to be a downward revision to CPI forecasts, the MPC appears to prefer a cautious approach and follow the path of other major central banks. They have already hiked further than what was indicated by the QPM for this year (and almost all of next year). Therefore, despite poor local growth forecasts and perceived easing inflation, the continued hikes indicated by the US means that another large hike in November is likely.

Current positioning and outlook

- Moderate Duration

As at the end of Q3 2022, domestic duration is 0.9 years in nominal bonds and 0.2 years in inflation linked bonds. We continue to predominantly hold the SA 8-year nominal bond (R2030) and 3-year inflation linked bond (I2025). Rising global rates has seen the relative valuation of SAGBs become slightly more expensive than what we have seen over previous quarters. However, the strong real yield and still elevated risk premium priced into bonds means we are still bullish this asset class, particularly nominal bonds.

- High Credit Quality

The portfolio has a high degree of credit quality. Our credit process has historically shielded the fund from capital loss due to credit events in SA and we are confident in our ability to protect investor's capital in the fixed income space. We retain our preference for a diversified portfolio of senior bank debt and low risk / high grade corporates.

- Convertible Bonds

Locally, we maintain a 20bp position in the Sappi convertible bond. Additionally, we maintain a 0.8% exposure to some offshore convertible bonds. We continue to look for opportunities in this space, but currently yields are low compared to nominal bonds, with increased uncertainty from a share performance point of view given the rising global interest rate environment and recessionary concerns.

- Property

The fund currently has a 2.1% exposure to domestic property. This exposure was slightly decreased over the quarter, as certain counters (such as Nepi Rockcastle) performed relatively well, despite the stress experienced in the sector and market. Other asset classes, such as bonds, are also providing a more attractive relative investment opportunity at present. Our exposure continues to be selectively allocated to names who are not highly leveraged and where liquidity is sufficient.

- Preference Shares

Preference share exposure is at 2.4% quarter end, with the majority in the large banks. The pre- and post-tax yield remains attractive and with institutions buying back their preference shares, this asset class has rallied appreciably over this, and previous, quarters.

- Offshore Bonds & Money Market

The fund maintains an exposure to Offshore Bonds & Money Market instruments at 21.0% where a very attractive yield pickup over domestic assets is available when hedged back to ZAR while maintaining a high degree of credit quality and diversification. Our effective offshore exposure is at 3.5%; lower from last quarter as we sold USD into ZAR weakness. Our offshore currency exposure acts as a hedge to portfolio duration and protected the portfolio well over the quarter as bonds and ZAR weakened together. We view the local currency (ZAR) as being undervalued, in particularly relative to the US dollar. We will continue to reduce exposure into further weakness, all the while remaining cognisant that this asset class is a valuable diversifier in volatile times.

Summary and Conclusion

The continued hawkish rhetoric, and subsequent recessionary concerns continue to wreak havoc on global financial markets. While this volatility creates opportunity in many areas of the market, adding risk in an environment when the ultimate extent of monetary policy intervention is unknown remains a risk, and many valuation models need to be recalibrated to incorporate higher global rates. We do, however, believe that this quarter has brought the market far closer to the truth in what will eventually happen with interest rates. We have therefore continued to steadily lean into the weakness and add exposure in a way that allows for the best risk/return payoff profile. The current fund yield of over 8% is a great income underpin for investors and the highest it has been for a number of years.

Disclaimer

WHO WE ARE
Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. It is a member of the Association of Savings & Investment South Africa (ASISA)..

OUR TRUSTEE
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HOW ARE OUR FUNDS PRICED
Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

FEES
A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

DISCLAIMER

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Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

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