NEDGROUP INVESTMENTS

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Quarterly review

Nedgroup Investments Core Accelerated Fund

As at 31 December 2022

Signs of easing inflationary pressures lift markets

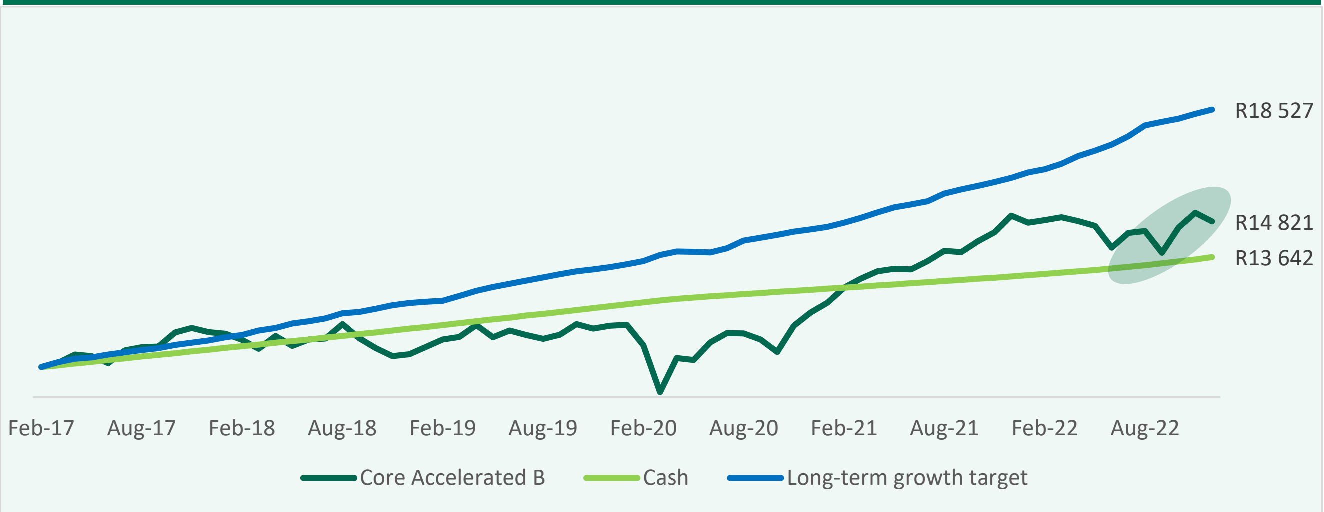
2022 was a tumultuous year, characterized by geopolitical tensions, rate hikes and inflation concerns across regions, with significant losses across asset classes. A turnaround that began in October was short-lived, leaving the S&P 500 with an annual decline of 18% - the worst since 2008. However, macro dynamics were a perfect embodiment of the soft-landing narrative, showing robust employment growth alongside noticeably slower wage inflation in the US. This easing inflationary pressure helped lift markets in the fourth quarter. In the fourth quarter, the Nedgroup Investments Core Accelerated Fund increased by 7.5%.

The table below compares an investment in Nedgroup Investments Core Accelerated Fund to a bank deposit (cash) investment and its growth target over various time periods. For every R10 000 invested in the Nedgroup Investments Core Accelerated Fund at inception (28 February 2017), you would have R14 821 at the 31st of December 2022. This is higher than the R13 642 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 recovery, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investment Core Accelerated Fund versus Cash[1] and the Growth target

	3 Months	1 Year	3 Years	5 Years	7 Years	Inception 28 February 2017
Growth of fund (after fees) *(Growth in %)*	R10 755 *7.5%*	R9 873 *-1.3%*	R13 041 *9.3% p.a.*	R13 285 *5.8% p.a.*	-	R14 821 *7.0% p.a.*
Growth of cash *(Growth in %)*	R10 153 *1.5%*	R10 490 *4.9%*	R11 351 *4.3% p.a.*	R12 900 *5.2% p.a.*	R14 731 *5.7% p.a.*	R13 642 *5.5% p.a.*
Growth target (inflation+6%) *(Growth in %)*	R10 224 *2.2%*	R11 389 *13.9%*	R13 917 *11.6% p.a.*	R17 034 *11.2% p.a.*	R21 356 *11.4% p.a.*	R18 527 *11.1% p.a.*

Fund Return versus Cash[1] from inception ending 31 December 2022



The Nedgroup Investment Core Accelerated Fund is designed for investment periods of 7 years and longer as it has a high exposure to shares (90%). This means that it can experience significant fluctuations over shorter periods but in the long-term has a growth target of 6% above inflation (around 12% per year), as demonstrated in the chart above.

The Nedgroup Investments Core Accelerated Fund has fallen short of this target since inception. However, history demonstrates that two-thirds of a fund such as the Nedgroup Investments Core Accelerated Fund would have achieved its long-term growth target of 6% above inflation (around 12% per year) over any 7-year period. In fact, as the time horizon extends, so the risk of underperforming this target decreases.

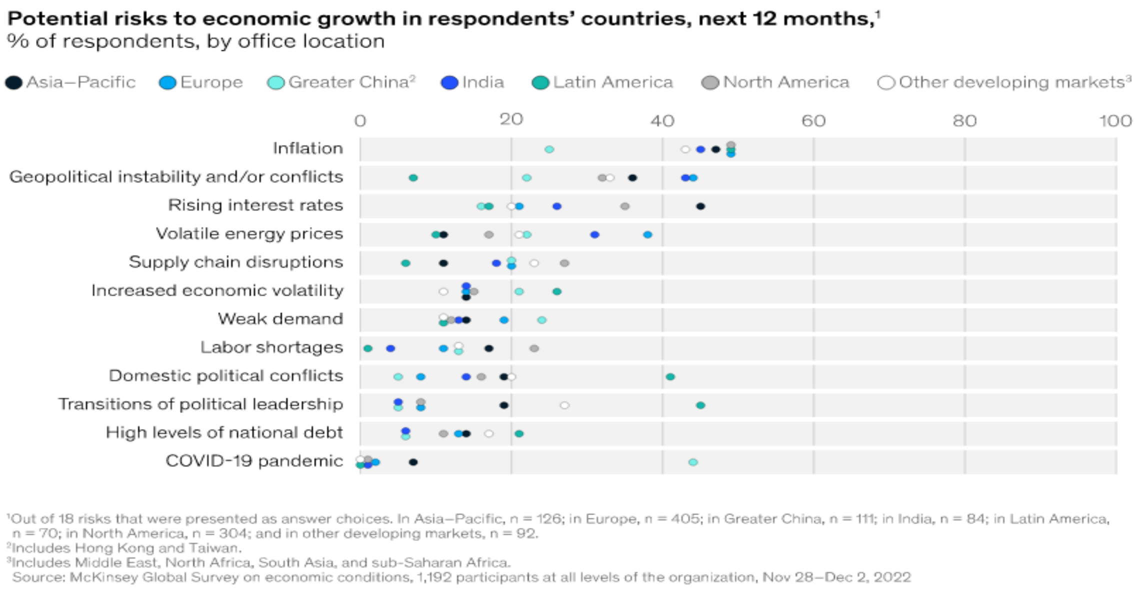
[1] We used the STeFI call deposit rate for cash returns

Economic and market review of 2022 and thoughts for the year ahead

The year 2022 was tough all round, and markets were no exception. Both global equity and bonds yielded double-digit negative returns (in USD). Developed markets (MSCI World Index) were down 18%, emerging markets (MSCI Emerging Markets Index) declined by 20% and global bonds (Barclays Global Aggregate Bond Index) were down by 16%, leaving investors with little place to hide. These losses were largely driven by rising global interest rates, which led to the repricing of assets. South African markets provided some respite with local equities returning 3.6% (FTSE/JSE All Share Index) and local bonds returning 4.3% (FTSE/JSE All Bond Index) in Rands for the year.

Looking ahead, expectations of economic growth in 2023 are very muted and some anticipate a recession. The anticipated challenges to economic growth are highlighted below in the McKinsey Global survey results from executives. Across most regions, inflation is the primary concern, followed by geopolitical instability and then rising interest rates. Both inflation and interest rate outcomes can be heavily influenced by central banks. Central banks face the challenging task of walking an interest rate tight rope; raise interest rates too much and risk further exacerbating the economic slowdown or, underestimate the interest rate hikes required and risk high inflation.

McKinsey Global Survey response on economic conditions December 2022



Source: Mckinsey (economic conditions outlook 2022)

In addition to influencing economic growth, the level of interest rates is also a notable determinant of asset prices. Generally, when interest rates rise, the price of assets (shares, bonds etc.) tends to decrease as investors require higher compensation on 'risk' assets relative to the interest rate they could earn on cash. Therefore, in the year ahead, one of the key influences to market returns is likely to be how inflation plays out and the responding actions taken by central banks.

However, it's important to contextualise the present as it helps to avoid making emotionally driven investment decisions. Current interest rates are by no means high relative to historical rates over the past 70 years and the recent hikes are considered by some to be a normalisation of interest rates. Below is a chart illustrating this, using the United States interest rates as an example. Although the recent rate hikes have occurred relatively quickly, they are by no means anywhere as aggressive as the US rate hikes in the late 70's and early 80's. The chart also illustrates that relative to history, current interest rates are not high and are well within historical depicted of between approximately 0% to 21%.

US Federal Funds Interest Rate

Source: https://www.macrotrends.net/2015/fed-funds-rate-historical-chart

The History of Formalising Investing with a Purpose

Investing in companies on behalf of shareholders also entails representation on matters that are not easily quantifiable but are equally as important as valuation outcomes. Softer elements of pricing companies had largely been left out in public conversations. However, the absence of these public conversation did not mean these factors were simply ignored because material information does tend to reflect in asset prices even when it is difficult to quantify at first. This is still a widely debated point although it is becoming mainstream. As the field of ESG, Responsible Investing and Impact Investing mature, more divergent ideas will come together.

This can be seen when we look at the beginning of ESG. We find that Corporate Social Responsibility was entangled with ESG in corporate integrated reports. With adverse events such as the BP oil spill, shareholders realised that other qualitative factors at play were not explicit in discussions (even if companies addressed them in private) and yet they were material to shareholders and society at large. This brought about the greater need to address, with intent, the impact of 'invisible' financial statements footnotes. With this increased focus on adding qualitive factors to investment assessment, was an availability of richer information and data that could be used to make decisions.

As more information presented more opportunity, we saw the launch of self-proclaimed ESG and Impact funds. These developments came with more complexity too. The growth of ESG rating organisations became the trend that sought to address this complexity and so the ESG fund and ESG rating company growth waves swelled in tandem. As more people invest in such funds and the next generation of shareholders become more intentional about the impact of their savings – the world now looks to gain a better understanding of what it means when they say they are invested in an ESG or Impact fund. People seek to know where the ratings come from and whether all ESG fund labels are made equal.

So far what has been found by the world, even by the most prominent leaders in the field, such as Blackrock, is that not all ESG measures are comparable and not all ESG strategies change the world as we had hoped. More importantly, although people seek to improve the world and its future by voting with their money, there is a growing realisation that having information and having a convergence of information are only two steps of a layered process. Now we are faced with the questions of *what to do* now that we know more, and whether *what we are doing* is having the desired outcome. As people around the world try answer these questions, we learn that the trend of divestment or exclusion will not change the world.

Nedgroup Investments Core Range is walking this journey with clients. How we're making progress and how we represent shareholders is detailed in the 2022 maiden Annual Stewardship Report.

Geopolitics – America's fourth institutional crises

Over the past decade we have seen an increase in social divisions across the World (such as Brexit, Trump's presidential election and an increase in "populist" political parties across the world to name a few). George Friedman recently published a book called "The Storm Before the Calm" in which he delves into the current crises in America and contextualises this crisis by looking at previous crises in its history.

In his book he identifies three institutional cycles since gaining independence from Britain. Each of these cycles followed major wars and resulted in a transformation of the governing institutions. The Institutional cycles were:

1. The Revolutionary war which allowed independence from Britain and installed a union of states and a republican form of government (1787 to 1865).
2. The Civil War which established the primacy of the federal government over the states (1865 to 1945).
3. The Second World War which extended the power of the federal government over American society and put a government of experts in place (1945 to present)

According to Friedman there is an institutional crisis currently taking place which will result in the next institutional cycle. This crisis he dubs as the "technocratic crises" as the COVID-19 pandemic revealed the ineffectiveness of the technocratic federal government in applying solutions over a large and diverse country.

The crisis of experts can be seen at the institution that underpins any technocratic society, namely the University. In the US student debt currently stands at $1.6 trillion which is of a similar magnitude to the amount borrowed by homeowners before 2008. If a major default were to occur, it could result in a crisis of similar proportion to the subprime mortgage crisis.

Friedman's argument is therefore that "technocracy is built on experts, and that experts, while necessary, tend to have a narrow focus. To lack generalists is to lack common sense, and a lack of common sense gave us another train wreck, one that will end with a transformation of how government works".

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