NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter Four, 2022

Nedgroup Investments Flexible Income Fund

Performance to 30 December 2022	Fund Performance[1]	Stefi*110%
3 months	3.0%	1.7%
12 months	5.7%	5.4%

The Fund performed well over the last quarter of 2022, easily outperforming its benchmark. Strong performance from bonds, both local and offshore, as well as a rally in domestic property contributed positively to returns. A weakening USD marginally detracted from returns, but given the expensive valuation, we're at a low overall allocation (currency exposure). The 1-year return is reasonable given the very challenging local and global fixed income markets experienced during 2022.

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

The last quarter of 2022 provided some reprieve after a difficult and volatile year. Softer inflation, a weaker US dollar and the fact that the pace of US interest rate hikes decreased in December, all contributed to risk-on sentiment. Additionally, expectations that Chinese demand will recover as authorities re-open the economy and provide further economic stimulus also contributed positively.

Despite generating 7.6% for the last quarter, the S&P 500 was still down 18.3% for the year. Similarly, the MSCI World index was down 17.7% for the year, but up 9.9% for the quarter. On the local front, equity markets fared better, with the ALSI generating 15.2% for the quarter, even ending the year in positive territory (3.6%). Bond markets, after a particularly brutal year, also experienced a better quarter. This was particularly true for EM bonds, with EM USD bonds[2] generating 6.6% (-15.3% for the year) and the ALBI index delivering 5.7% for the quarter (4.3% for the year). US treasuries[3] were marginally positive, generating 0.7% for the quarter (-12.5% for the year). The best performer was certainly the local property market, with the listed property index delivering 19.3% for the quarter (0.6% for the year).

Softer inflation prints, despite still printing an incredible 7.1%, and slower interest rate hikes led markets to believe that interest rate cuts will come sooner than the Fed is communicating. With moderating energy prices, easing supply chain bottlenecks and some signs of economic slowdown (seen in the housing market, lower spending and reduced savings rate) it's easy to see why the market is not believing the Feds continued hawkishness. Hawkish, however, they remain. The December FOMC saw Powell again present more hawkish projections, with the dot plot showing US rates over 5% at end 2023. Other indicators, such as the labor market, are also showing great resilience, supporting the narrative for more restrictive rates for longer. Should this be the case, we could experience further pain in bond markets in 2023, and a rebound in USD strength after a weaker fourth quarter.

The SARB predictably raised rates by 75bps in the last meeting of the year, taking the repo rate to 7% and fully reversing the cutting cycle experienced over the covid crisis. The November CPI data came in slightly softer than expected dropping from 7.6% in October to 7.4% in November. With 2 of the 5 members voting for a 50bp hike, and developed market central banks slowing' pace, it's likely the SARB will follow suit. The market however, is expecting further hikes, with a further 75 bps priced in for this hiking cycle.

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

Local news was particularly busy over the quarter, with rumors of President Ramaphosa's resignation over the Phala Phala incident, and the ANC elective conference causing market uncertainty. The decision to remain in power and the fact that he was re-elected for a second term as ANC president calmed market nerves, especially since the majority of the top 7 come from the president's preferred slate. This leadership should limit the risk to macro and fiscal policy, but as we were reminded this quarter, political risk can take us by surprise quickly and should continue to be appropriately considered in our bond valuations. This quarter also saw the MTBPS delivered by Finance Minister Godongwana. Overall, it was a market friendly budget but as always, deeply lacking in detail and somewhat unrealistic from an expenditure point of view. Not only was nothing considered for Eskom, but the size of wage increases and SRD grants were likely under-stated. Overall, however, the fiscus is not causing as much market anxiety as it did 2 years ago, with revenue over-runs (predominantly from mining taxes) bringing the deficit and debt burden to more manageable levels for the foreseeable future.

Current positioning and outlook

- Moderate Duration

As at the end of Q4 2022, domestic duration is 0.94 years in nominal bonds (22.4% exposure) and 0.22 years in inflation linked bonds (12.9% exposure). We continue to predominantly hold the SA 8-year nominal bond (R2030) and 3-year inflation linked bond (I2025). Local news provided an opportunity for increasing our allocation to local nominal bonds, which subsequently had a nice rally into year-end.

- Offshore Bonds & Money Market

The Fund maintains an exposure to Offshore bonds & money market instruments at 22.6%, 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 5.0%; up from last quarter as USD weakness was seen over the quarter. Our offshore currency exposure also acts as a hedge to portfolio duration and protected the portfolio well over the year in general as bonds and the rand weakened together. We still, however, view the local currency (ZAR) as being slightly under-valued.

- 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

We maintain a 15bp position in the Sappi convertible bond. All offshore convertible holdings moved out the portfolio in Q4 with the Twitter convertible bond being redeemed at par in the now well publicised Elon Musk takeover. We continue to look for opportunities in this space, but currently yields are low compared to nominal bonds, and therefore relatively less attractive.

- Property

The Fund currently has a 2.4% exposure to domestic property. Depressed price levels have supported maintaining this holding, but we have been hesitant to add exposure as other asset classes (such as bonds) have generally provided a more attractive relative investment opportunity over the year. 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 2.3%, with the majority in the large banks. The pre- and post-tax yield remains attractive and with institutions buying back their preference shares, our allocation is naturally decreasing.

Summary and conclusion

We will remember 2022 as a difficult year for financial markets. Risk assets, long the beneficiary of low inflation, monetary stimulus, globalisation and geopolitical stability had to digest a sharp reversal in all of these factors almost simultaneously. We saw sharp interest rate hikes and quantitative tightening around the world. For the first time in most investors' memory, bonds and stocks in the developed world correlated as rates spiked and valuations fell. While inflation remains high, and central banks stick to their hawkish sentiment, the possibility for this continued volatility remains. However, should indicators of a recession become clear, we can expect a more bullish run in fixed income markets.

As uncertainty around these outcomes remains, our strategy remains to steadily lean into weakness and avoid holding assets when they become expensive. The current fund yield of over 8.5% is a great income underpin for investors and the highest it has been for a number of years, making the return prospects for 2023 attractive.

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

Unit trusts are generally medium to long-term investments. The value of your investment may go down as well as up. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

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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DATE OF ISSUE
16 October 2019