NEDGROUP INVESTMENTS

see money differently

Quarterly review

Nedgroup Investments Core Global Fund

Marketing communication

As at 31 March 2023

60/40 stocks and bonds portfolio have its best start in 10 years

In 2022 investors were dealt with very disappointing results in both stocks and bonds. What we have seen in 2023 so far is a complete reversal of that. When one looks at 60% stocks and 40% bonds portfolio, it is off to its best start in 10 years. Investors are looking beyond what we have seen as very weak economic growth, likely recession this year, even the banking crises that occurred in the first quarter of 2023 and focusing on the fact that the federal reserve may be close to being done on the aggressive tightening cycle. This easing inflationary pressure helped lift markets in the first quarter. In the first quarter, the Nedgroup Investments Core Global Fund increased by 5.0%.

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 $15 125 at the 31st of March 2023. This is better than the $11 024 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 recovery, 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 %)***	$10 503 *5.0%*	$9 033 *-9.7%*	$13 001 *9.1% p.a.*	$12 382 *4.4% p.a.*	$15 125 *5.7% p.a.*
Growth of US Cash ***(Growth in %)***	$10 111 *1.1%*	$10 288 *2.9%*	$10 329 *1.1% p.a.*	$10 789 *1.5% p.a.*	$11 024 *1.3% p.a.*
Growth target (EAA Fund USD Aggressive Allocation) ***(Growth in %)***	$10 437 *4.4%*	$9 352 *-6.5%*	$13 115 *9.5% p.a.*	$11 990 *3.7% p.a.*	$13 974 *4.6% p.a.*

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.

Economic and market review

After a strong January, robust jobs data, high retail sales growth and sticky core inflation in the US saw bond markets again having to revise their rates views. Treasuries sold off through February and early March, with the 10Y moving from its low of 3.36% to over 4%. Despite the headline US CPI print looking within expectations (and behaving as expected, as energy prices fall), core CPI continues to surprise to the upside with services inflation being particularly problematic.

Just as the market was pricing in some of its most hawkish sentiment, the story of Silicon Valley and Signature Banks broke (followed by further news of Credit Suisse). Following the banking sector induced turmoil, the Fed hiked rates by 25bps in the March FOMC. This was largely anticipated by the market, and although their tone was slightly more dovish, there was no sign of a 'pivot', as many market participants may have hoped. The dots for 2023 were left unchanged and suggest that there may be one hike left in the cycle. Importantly, unlike the market, they still do not foresee any policy easing this year.

The year started off with a bang, reminding us just how precarious a position global markets and economies are in. An early rally in markets was halted by strong economic data and sticky core inflation in the US, and markets quickly reacted with more hawkish pricing, even pricing a 50bp hike for the March FOMC at a stage. This again had to be revised after the second largest banking failure in history, occurring off the back of high interest rates and limited liquidity, had the market then questioning whether the Fed could hike at all. Ultimately the FOMC hiked a largely expected and more neutral 25bps, failing to 'pivot' but certainly sounding more dovish than previous meetings.

The market continues to grapple with how policy makers will react to sticky inflation, while serious economic failures and stresses are starting to show because of tight monetary policy.

As at the end of Q1 2023, domestic duration is 0.9 years in nominal bonds and 0.2 years in inflation linked bonds. Bond valuations moderated in the last quarter of 2022, moving from cheap, into a cheaper value territory. Overall the market seems to have reacted by moving to shorter term money market instruments although longer term duration bonds are offering attractive real yields and are in most cases favorable instruments to hold at the top of a hiking cycle. High credit quality instruments have received a higher level of attention as investors seek low risk, high grade debt instruments to park their money. On the other hand, opportunities to pick up yield are diminishing, even in the convertible bond space given the low yields relative to nominal bond and the stretched balance sheets of issuers.

The banking system issues and its impact on Core Funds

Although markets appear to have regained some composure, it has been an unsettling period for investors. The spectre of a systemic banking crisis has created significant volatility in equity and bond markets in the wake of the collapse of Silicon Valley Bank in the US and the fears over Credit Suisse in Europe.

The current situation partly has its roots in the significant interest rate hikes seen in 2022. Bond markets have moved to reflect expectations that the turmoil would force a significant change in interest rate policy from the Federal Reserve (Fed) and other central banks. This may be premature. An observation is that the key data continues to show that the inflation print remains on hold and not on track to settle at Fed's target. The February CPI report and tight US labour market show inflationary pressures remain. The Fed's decision to raise interest rates by 0.25% on the 22 March balanced the need to tackle elevated inflation while also maintaining financial stability. This was lower than the 0.5% increase expected by markets at the start of the month, signalling that the Fed intends to tread carefully as it navigates volatility in the banking sector.

The speedy and decisive response from policymakers supports a more optimistic outcome. Which is that;

'*These events prove isolated. The problems are brought under control, confidence returns to markets and the economy remains resilient. In this situation, the Fed would continue with its original plan to keep rates tight throughout 2023'*

The US Federal Deposit Insurance Corporation, an independent agency which focuses on maintaining financial stability, has moved in to protect deposits. Meanwhile the Fed enacted the Bank Term Funding Programme, which increases lending to banks. The Swiss central bank acted swiftly to get the UBS/Credit Suisse deal over the line. It's been a robust response, which should help settle investors' nerves. However, there are arguments against this being an isolated event. There remain significant unrealised losses at smaller US commercial banks. It is not yet clear whether they have hedged these risks and whether they will be forced to divest assets (and crystallise losses). Equally, there may be other sources of stress in the system that have not yet been uncovered.

Exposure to Credit Suisse, SVB and Signature bank

Nedgroup Investments Funds	Core Global
Effective Credit Suisse exposure	0.026%
Effective SVB exposure	0.009%
Effective Signature bank exposure	0.005%
Total	**0.041%**

Sources: Blackrock

It is important to note that Core Funds are diversified portfolios, hence, the exposures to some of the regional banks are generally small as shown in the table above. However, there is potential impact on real estate side. This is because the regional banks are large players in commercial lending. Constraints of availability of capital might impact upcoming construction activities. Hence, further regulation changes on the availability of capital could intensify this risk cycle in real estate.

Finally, it does appear that sentiment is stabilising. There has been an increase in investment grade issuance, which is an important signal to markets from moving from this period of crises/paralysis to one where we see the resumption of capital formation process, which might be a catalyst to further calm markets and sentiment. There was clearly a failure in a duration mismatch and regulators might be focused in understanding how to prevent the replication of this mistake in the future, so new regulation may have to be factored in.

There are a lot of moving parts when it comes to judging the investment implications. The global banking system remains well-capitalised. Tier 1 capital is significantly higher than during the last crisis, allowing banks to withstand negative shocks. It will be important to monitor the situation as it evolves. We remain cautious and continue to assess the fallout from these events.

ChatGPT, the rise of artificial intelligence and impact on the way we work

Recently there has been a renewed focus on artificial intelligence (AI) further catapulted with the recent launch of ChatGPT, a freely available AI chatbot. Within 2 months of launch the chatbot was estimated to have reached over 100 million active users. A UBS analyst noted that over the last 20 years, that they cannot recall a faster ramp in a consumer internet app. The take up has been phenomenal.

One may ask, what all the hype is about? At face value, ChatGPT is good at mimicking human speech and providing fairly accurate and realistic answer to a broad spectrum of questions. To test it out, I asked it a question from my own line of work: If I have a company retirement fund, should I still consider making regular contributions to a retirement annuity? I was astounded by the answer. I could have pretty much pasted and copied it directly without editing. The chatbot picked up that the context of the question related to South Africa, accounted for the nuances in the two options, the pertinent points to look out for and it was well written. For me at least, this was the first time I have personally experienced AI where I thought that this could have done an aspect of my job without intervention or changes; both an exciting and scary prospect. It is realisations such as this, that has got the general public very excited about the impact AI can have in their lives and jobs. It's no longer a distant concept but something tangible that more and more people have now personally experienced.

Moreover, AI is crossing over into the realm of the 'creative' which in the past was an area that was believed would not be possible. For example, there are text to image applications where you provide a description of the image you would like, and the relevant style and it will generate a new image. The picture below was generated in NightCafé using the prompt "distressed woman lost in the mountains when it is snowing" in Modern Comic style. The fact that AI has crossed this barrier, has further heightened the excitement and fear of the impact on a broader spectrum of jobs.

Source: NightCafé.

Until recently, there was a common misconception that AI would predominantly impact technology companies and jobs, at least in the short term. However, the broader public is now coming to the realisation that the impact will be far-reaching and will impact their jobs in the very near future, if not already. Personally, I can already see how much ChatGPT alone could significantly improve my own efficiency. Ethics aside, for example, I could have asked ChatGPT to write this very article you are reading. Even if I didn't do a straight copy and paste of the response, chances are I could have written this article notably faster using ChatGPTs response as an outline.

There are so many examples of the impact of AI is and can have on jobs E.g., doing work while in your autonomous vehicle that is constantly improving giving you an increasing safe journey, an employee in an e-commerce company can now deliver customised and personalised images to online shoppers boosting sales and customer satisfaction, already in existence is AI that filters job applicants and technology that helps job seekers improve their odds of getting a job and matching them to the most suitable jobs.

The way we all work is changing and a lot faster than many of us thought. The key is to embrace this technology and see where it can help do our jobs more efficiently rather than focussing on its short comings. This is not to minimise some of the serious shortcomings, such as AI reproducing biases and prejudices that it picks up when gathering knowledge or that it can't judge right from wrong; but to use it where it can add value and to use it wisely. The companies and employees that are able to make this shift and leverage the significant AI developments are the ones likely to see enhance returns.

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