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NEDGROUP INVESTMENTS Global Cautious Fund

Q3 2023

Marketing Communication

Nedgroup Investments Global Cautious Fund

Past performance is not indicative of future performance and does not predict future returns.

Performance to 30 September 2023 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	-1.41%	1.33%	-1.31%
12 months	5.56%	4.64%	4.42%
5 Years	0.49%	1.74%	0.90%
10 Years	1.97%	1.22%	1.49%

Market Overview

The realities of a higher for longer interest rate world are slowly setting in. For 40 years, bonds have been in a secular bull market with central banks coming to the rescue any time the trend was close to being broken. From its low of 0.56% in August 2020, the US 10-Year Treasury yield hit a 16-year high of 4.56% this quarter (equivalent to a ~30% fall in price). We're in completely new territory. Unless we get a big rally in bonds before the end of the year, it will be the first time ever that 10 Year Treasuries post 3 consecutive years of losses.

It's worth reiterating the importance of government bonds (primarily US but also other developed markets) to our financial system. We all know of their role in setting a risk-free rate used to value other risky assets. But after the GFC, regulators elevated the status of government bonds even further. Since 2008 unsecured lending through the traditional banking system has contracted significantly. In its place has stepped in collateralised lending by nonbank financial institutions (NBFIs), with government bonds being the only source of 'safe' collateral. If the value of that collateral base falls, system-wide liquidity also contracts.

All of this is to say – maintaining a stable value of government debt is vital to financial stability. Take the most recent examples, first in March 2020 and then October 2022 (UK LDI), where supposedly safe government bonds have been the epicentre of a crisis originating from actors outside of the traditional banking system (hedge funds, pension funds). With bond prices plummeting this far in such a short space of time, we are certainly entering dangerous territory.

Fund Performance

The aim of the strategy is to provide a stable stream of real total returns over the long term with low absolute volatility and significant downside protection.

The portfolio produced a negative return over the quarter, driven by the portfolio's overseas bonds allocation and domestic equity allocation. The overseas bonds and US bonds detracted but both allocations outperformed the broader indices. Overseas equities slightly detracted but outperformed the broader index. Hedging of the Australian Dollar was a small contributor given the depreciation over the quarter. The following table highlights the top 5 equity contributors and bottom 5 equity detractors over the quarter:

Top Performers	Country	Performance contribution	Bottom Performers	Country	Performance contribution
ALPHABET INC	US	0.06%	AMERICAN EXPRESS	US	-0.10%
AUTOMATIC DATA PROCESSING	US	0.04%	TEXAS INSTRUMENTS	US	-0.09%
TELENOR	NORWAY	0.04%	AIA GROUP	HONG KONG	-0.06%
COMFORTDELGRO	SINGAPORE	0.04%	LOCKHEED MARTIN CORP	US	-0.06%
IMPERIAL OIL	CANADA	0.04%	S&P GLOBAL	US	-0.06%

Source: Pyrford International

[1] Net return for the Nedgroup Investments Global Cautious Fund, A class.
[2] SOFR USD 1-month from 1 Feb 2022 (previously US Libor 1 month)
[3] Morningstar EAA Fund USD Cautious Allocation
Source: Morningstar (monthly data series).

North American equity markets fell over the quarter. In the US, the stock market had a volatile period as inflation data continued to fall but remained above desired targets. Other US economic data remained strong indicating that the Federal Reserve would need to keep policy rates “higher for longer” which disappointed investors who

had been looking for interest rate cuts in the early part of 2024. The Canadian market also fell over the period as banking stock prices continued to be pressurised by higher interest rates and potential impact this could have on property prices. Over the period the portfolio was behind the benchmark.

In the US, sectors such as energy (strong oil price) and financials (stabilisation after a weak first half of the year) led the market. The utilities sector lagged the market as higher yielding utility stocks competed with government bonds for investor monies. The portfolio benefitted from having an underweight position in the utility and REITs sector. In terms of country performance, the US market (SP500) outperformed the Canadian market (TSX) (in local currency terms).

Some of the better performing companies in the portfolio included Telenor and Imperial Oil. Telenor offers telecom services across the Nordic region and mobile only services in several Asian countries. The shares were weak in Q2 2023 but then recovered in Q3. The company published quarterly results that beat expectations. Notably, Telenor produced revenue and EBTDA growth in Norway, Sweden, Finland, Pakistan and Bangladesh. We met Telenor’s CEO Sigve Brekke to discuss the business and the long-term industry dynamics. Management is confident that Telenor can cover the dividend by 2025, through a mixture of steady growth in the Nordic region, combined with cost cutting in both Thailand and Malaysia. The CEO reiterated a key point about the sector: many markets have too many players and consolidation is needed to set profitability at a structurally higher level. Telecoms faces a crucial period as regulators and competition authorities will consider the merits of proposed M&A in European markets. Imperial Oil rose as a strong oil price buoyed sentiment around the stock. The company has strategically advantaged reserves that will produce for many decades.

Companies that were behind the index over the quarter included Lockheed Martin and American Express. Lockheed Martin was impacted by concerns over a US Government shut down. It is worth noting that this would in the worst case, delay payments for the company as development programs and production schedules are multi decade in nature. American Express (Amex) was impacted by concerns about how a slowing economy would impact delinquencies at the company. Amex has some of the most affluent customers so any uptick in delinquencies will only be a short-term headwind for the company.

The bond allocation detracted over the period, with overseas bonds slightly outperforming US Bonds. The contribution from overseas bonds was aided mainly by the appreciation of the British Pound and Canadian Dollar relative to the US Dollar.

The Australian Dollar remains the only currency exposure hedged in the portfolio. The Australian Dollar weakened slightly against the US dollar. Pyrford view the US dollar as significantly overvalued based on in-house Purchasing Power Analysis and therefore maintain a significant exposure (45%) to non-US dollar assets. If the currency does fall as expected, the portfolio will benefit.

Portfolio Positioning

There were no changes to positioning over the quarter. The model allocation is 78% bonds, 20% equities and 2% cash.

Within the fixed income allocation, Pyrford adopts a defensive stance by owning short duration securities to minimise the impact on the portfolio from interest rate rises. At the end of the period the modified duration of the fixed income portfolio stood at around 2.5 years. Whilst these shorter duration bonds are unlikely to yield high returns, they will provide significant capital protection for the portfolio and importantly they are highly liquid. 49% of the portfolio is invested in overseas bonds, with 18% in Canada, 17% in the UK and 13% in Australia. 29% of the portfolio is invested in US government debt. Given the recent rise in yields we will be reviewing the duration target in the portfolio.

Within the equity portfolio the companies we hold are defensive names, which we would expect to perform well during volatile periods. The focus of the portfolio is on balance sheet strength, profitability, earnings visibility and value. Within Europe there are no holdings in the peripheral Eurozone countries where sovereign debt concerns remain. The European portfolio is concentrated in Switzerland and the relatively healthy economies of core Europe and the UK. In Asia, we prefer the Southeast Asian markets over Japan. The potential growth rate in Japan remains low given the poor demographics and low productivity growth. Economies in Southeast Asia offer sustainable economic growth supported by increased labour output or productivity growth and trade at more reasonable valuations.

Finally, there was no change to the unhedged non-USD exposure in the portfolio. 45% (the maximum level) of the portfolio remains exposed to unhedged foreign currencies, representing the view that the US dollar is a very expensive currency and we expect it to fall based on our purchasing power analysis.

Portfolio changes

Steel Dynamics was purchased this quarter, funded by reducing Rockwell Automation's position. Steel Dynamics together with its subsidiaries, operates as a steel producer and metal recycler in the United States. It operates through three segments: Steel Operations, Metals Recycling Operations, and Steel Fabrication Operations. The company also exports its products. In our view, the company trades at low valuation, the US Government Legislation and product expansion offers attractive opportunities for growth. In addition, the corporate culture incentivises employees and management to make shareholder value creating decisions.

Outlook

Pyrford retains a cautious outlook for international economic growth and expects the necessary adjustments to corporate and personal balance sheets in the developed West to take a prolonged period to achieve. This is a deflationary process and represents a significant headwind to economic growth.

Following the rally in North American equity markets over the last few years, valuations are in aggregate less attractive than they were. Even after recent declines, North American equity markets remain overvalued in absolute terms given the earnings and dividends per share growth that can be reasonably expected. Equity investors will be best rewarded by concentrating on high quality companies selling at low valuations relative to a defensive and visible stream of earnings. Financial leverage should be avoided, and investors should focus on companies which are very well capitalised and whose business models have proved resilient during previous periods of poor economic growth.

Responsible Investments

As long-term shareholders of companies, we have the ability, and in our view the responsibility, to try and influence the business practices of companies.

Pyrford voted 93 proposals in 8 company meetings in the quarter. We voted against management on 9 proposals. We also engaged with 104 companies worldwide and ESG issues are a standing agenda item in every meeting we conduct.

For a detailed overview of ESG activity, please visit our website for all voting records and our latest annual ESG report.

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