NEDGROUP INVESTMENTS

UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

see money differently

NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter Four, 2023

Nedgroup Investments Flexible Income Fund

Performance to 31 December 2023	Fund Performance[1]	Stefi*110%
3 months	3.4%	2.2%
12 months	9.2%	8.6%

The fund experienced a strong quarter, easily outperforming its benchmark as asset classes across the board rallied and contributed positively to the portfolio's return. The only negative contributor was the portfolio's small exposure to USD, which given the appreciation of the rand, detracted slightly.

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 ones and focusing on high credit quality.

Market Commentary

The fourth quarter of 2023 saw stronger markets as lower inflation, slowing economic indicators and a dialing back of various developed central bank's hawkish stances took place.

The S&P 500 returned an incredible 11.7% for the quarter, with the MSCI World index close behind, returning 11.5%. Emerging markets also performed well, but not quite to the same extent seen in the developed world, with the MSCI EM Index returning 7.8%. On the bond side, US Treasuries (+5.7%), US Corporate bonds (+8.5%), EU Government bonds (+7.0%) and UK Government bonds (+8.6%) all generated exceptionally strong positive returns. EM bonds also performed well off the back of global risk-free rates rallying, with the EM USD bond index returning 8.1% for the quarter.

After aggressive interest rate increases by the Federal Reserve, ECB and BOE in 2023, markets are betting that interest rates hikes are coming to an end across the board in 2024, as falling inflation and economic pressures are building. All three have put their tightening programs on hold, and the Federal Reserve in particular communicated a more dovish stance in its December meeting, showing projections by officials for rates to be 75pts lower by the end of 2024. Additionally, Powell mentioned that discussions around rate cuts have begun and communicated the risks of keeping policy rates tight for too long. The ECB and BOE continue to present a more hawkish tone to the market, saying it was too early to discuss rate cuts, but that has not stopped the market from pricing in rate cuts in March/April 2024 for all three central banks.

While inflation is coming down, it is worth noting that these numbers are not yet at (or even near) target and it is possible that the market is getting ahead of itself in the pace at which it is pricing rate cuts. US core inflation for example is still at 4% and a rally in market prices, as we have seen now in Q4, could further stoke the problem. Additionally, as the US continues to run loose fiscal policy, we are seeing high interest rates on large amounts of government debt resulting in even bigger runaway deficits. These ballooning interest rate payments ironically push more money into the economy, making this environment, in our opinion, an incredibly difficult one to tame inflation permanently.

On the local front, markets experienced a similar rally off the back of lowered global interest rate expectations. The equity market (FTSE/JSE All Share index) saw more meagre returns of 6.9%, but interest rate sensitive asset classes such as bonds (ALBI) and property returned an exceptional 8.1% and 16.4% for the quarter respectively.

The November MPC kept rates unchanged unanimously and it seems likely that rate hikes are done. The MPC, however, remains cautious around inflation, particularly around the possibility that higher food and fuel prices might fuel wage inflation. While the market is pricing cuts in the first half of 2024, a lot will also depend on the pace of developed market central banks, and the 2024 fiscal budget and national election (as these risks ultimately determine neutral rates).

The last quarter of 2023 also saw finance minister Godongwana deliver the MTBPS, which pleasingly seemed to demonstrate prudence and some commitment to fiscal consolidation. While the downward projections in revenues were expected (due to corporate income tax revenues disappointing, largely because of lower commodity prices), the positive surprise came from the expenditure side. Aggressive expenditure cuts have accommodated the extension of the social relief of distress grant, higher wage compensation and debt service costs, to the extent that outer year's non-interest expenditure slightly reduced over the coming 2 years. Embedded in these assumptions, however, are conservative wage bill increases, and ignores any further SOE assistance. Given the predicament Transnet is in, as well as the fact that we are in an election year, this does, however, seem unlikely and the market is left questioning the practicality of the budget. Despite the optimistic assumptions, two strong positive points from the budget was Treasury's commitment to limit nominal bond issuance increases and the other is them trying to implement a fiscal anchor into law (where some headway has been made with cabinet). Time will tell how serious these actions are, but in the absence of reforms, the market will continue to price large credit risk premia into government bonds.

Current positioning and outlook

- Moderate Duration

As at the end of Q4 2023, domestic duration is 0.82 years in nominal bonds and 0.30 years in inflation-linked bonds. We continue to predominantly hold the SA 6-year nominal bond (R2030) and 1.5-year inflation linked bond (I2025). We continued to add linkers to the portfolio opportunistically over the quarter, where real yields around the 5-year area of the curve looks fair to nominal bonds. We did, however, lighten our nominal bond exposure in December, when markets saw a strong rally, keeping our total local duration unchanged at 1.1 years.

- Offshore Bonds & Money Market

The fund maintains an exposure to Offshore Bonds & Money Market instruments at 20.8% where an attractive yield pickup over domestic assets is available when hedged back to rands while maintaining a high degree of credit quality and diversification. Our effective offshore currency exposure is at 3.8%. We still view the local currency (rand) as being undervalued at current levels, despite the small rally, but believe dollar strength may continue as rates may remain higher for longer than expected in the developed world.

- 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 investors' 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. We continue to look for opportunities in this space, but low yields (relative to nominal bonds), expensive offshore equity markets and stretched balance sheets continues to make this space unattractive.

- Property

The fund currently has a 2.0% exposure to domestic property, a small exposure as we remain concerned around the fundamentals in this sector locally. We did, however, slightly increase exposure to this sector over the quarter as sustainable dividend yields on a few select names (where balance sheets are intact) were looking attractive. This paid off in December when the sector saw an exceptional rally.

- Preference Shares

Preference share exposure is at 2.2%, 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

The fourth quarter of 2023 saw stronger markets as lower inflation, slowing economic indicators and a dialing back of various developed central bank's hawkish stances took place. After aggressive interest rate increases by the Federal Reserve, ECB and BOE in 2023, markets are betting that interest rates hikes are coming to an end across the board in 2024. While inflation is coming down, these numbers are not yet at (or even near) target and it is possible that the market is getting ahead of itself in the pace at which it is pricing rate cuts. Additionally, a rally in market prices (as we have seen now in Q4), loose fiscal policy and ballooning interest rate payments that push more money into the economy, could potentially further stoke the inflation problem.

On the local front the MPC kept rates unchanged, and it seems that hikes are done, but they remain cautious around inflation and dovish communication. While the market is pricing cuts in the first half of 2024, a lot will depend on the pace of developed market central banks, and the 2024 fiscal budget and national election. Should the numbers projected in the MTBPS pan out, it will be positive for SA rates, but election pressures and failing SOE's will likely continue to place pressure on the SA fiscus.

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
The Standard Bank of South Africa Limited is the registered trustee.
Contact details: Standard Bank, Po Box 54, Cape Town 8000,
Trustee-compliance@standardbank.co.za, Tel 021 401 2002.

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.

NEDGROUP INVESTMENTS CONTACT DETAILS
Tel: 0860 123 263 (RSA only)
Tel: +27 21 416 6011 (Outside RSA)
Email: info@nedgroupinvestments.co.za
For further information on the fund please visit: www.nedgroupinvestments.co.za

OUR OFFICES ARE LOCATED AT
Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001
WRITE TO US
PO Box 1510, Cape Town, 8000
DATE OF ISSUE
16 October 2019