NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter One, 2024

Nedgroup Investments Flexible Income Fund

Performance to 31 March 2024	Fund Performance[1]	Stefi*110%
3 months	1.3%	2.1%
12 months	8.1%	8.9%

The fund experienced a reasonable quarter, given how difficult an environment the market has been for fixed income assets. Although the fund lagged its benchmark, it still delivered a reasonable positive return, in a market where local nominal bonds, local inflation linked bonds and offshore bonds all delivered negative returns. The fund's floating rate component, and hard currency exposure shielded the fund well and contributed positively to returns over the quarter.

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 first quarter of 2024 saw a large dispersion in performance between global asset classes.

Developed market equities experienced a spectacular rally with the MSCI World index delivering 9.0% for the quarter. In the US, strong economic data continued to support a soft-landing narrative. The S&P 500 delivered 10.6%, bringing the one-year return to almost 30%. While weak economic growth is starting to show in some developed markets (e.g. UK, Ireland, Germany), monetary easing is expected and is generally supporting equity markets. The best performing equity market of the quarter was Japan, with the Topix delivering 18.1%. This despite the Bank of Japan embarking on monetary policy normalisation, officially announcing the end to its negative interest rate policy and yield curve control in March. Emerging market equities lagged, largely due to lingering concerns around growth in China, with the MSCI EM index returning a mere 2.4% for the quarter.

Conversely, bond markets struggled over the quarter. In the US, sticky inflation prints and strong economic data saw the market pricing in fewer interest rate cuts by the Fed. At the end of the quarter only three cuts were priced for the year, very much in line with what the Fed has communicated in its Dot plot, compared to between six and seven at the beginning of the year. The 10-year US Treasury yield moved 32 basis points wider on the quarter, ending at 4.2%. EU and UK government bond indices also posted negative returns (-0.6% and -1.8% respectively), as inflation remains a concern in these regions as well.

Even though inflation in the US has slowed to 3.2% (core inflation is 3.7%), this is still far from the Fed's two percent target, and our concerns around higher inflation for longer remain. The 'easy' disinflation from goods, which greatly contributed to the drop in inflation from its peak, is now baked in, and it is up to the services portion of the inflation basket to do the remaining heavy lifting down to 2%. Unfortunately, housing services inflation has been stickier than expected, and disinflation is not being seen in many other service areas of the basket. Stimulus from the fiscal side, also, shows no signs of abating, as mandatory outlays on entitlement programs consume an ever-larger share of fiscal expenditures and are politically difficult to cut. This means that rising interest payments will likely keep deficits gaping wide for the foreseeable future.

1 Net return for the Nedgroup Investments Flexible Income Fund, A class. Source: Morningstar (monthly data series).

The local market started the year on a weak footing, as election concerns, a deteriorating fiscus and a hawkish SARB kept the market bearish. The FTSE/JSE All Share index delivered a disappointing -2.2% return for the quarter, while Bonds (ALBI TR Index) delivered -1.8%. Inflation linked bonds fared slightly better compared to nominal bonds, delivering -0.4%. The ZAR also experienced a disappointing quarter, weaking 2.8% relative to the US dollar.

The most noteworthy event locally was the budget, delivered by Finance Minister Godongwana on 21 February. Positively, government kept deficit projections largely unchanged, and showed a lowering of the debt profile. They announced the much-anticipated draw down of R150bn of the unrealised profits from the gold and foreign exchange contingency reserve account (GFECRA) which will reduce the borrowing requirement and save on debt service costs. Despite what appeared to be a positive budget, the market did not respond particularly well. Unfortunately, a variety of concerns remain, with the FY23/24 deficit forecast appearing optimistic, GFECRA usage not leading to a reduction in issuance, additional pressures for more SOE support and the funding of the national health insurance to list a few.

Against the backdrop of higher-for-longer global rates, inflation risks skewed to the upside and upward pressure on the real neutral rate as a result of a deteriorating fiscus, the SARB has remained hawkish in MPC meetings so far. The MPC appears less confident that inflation settles back down to 4.5% this year, as the medical insurance upside surprise in February means a higher base for core inflation. Additionally, food inflation risks remain high (against a hotter and drier February and March) and inflation expectations remain above the target. This suggests a cutting cycle likely to only start later in the year (Q3), and a shallow one at that. One development that may completely change the monetary policy path over the foreseeable future, is if the SARB decides to change the inflation target from 4.5% to 3%. Kganyago has advocated for a lower inflation target for years, and it seems discussions with National Treasury are underway.

Current positioning and outlook

- Moderate Duration

As at the end of Q1 2024 domestic duration is 0.84 years in nominal bonds and 0.27 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 added nominal bonds opportunistically toward the end of the quarter as bond yields moved higher, slightly increasing the duration of the fund.

- Offshore Bonds & Money Market

The fund maintains an exposure to Offshore Bonds & Money Market instruments at 17.8% 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 4.1%. We still view the local currency (rand) as being undervalued at current levels but believe dollar strength may continue as rates 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 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 1.7% exposure to domestic property, a small exposure as we remain concerned around the fundamentals in this sector locally. We trimmed exposure over the quarter, as various stocks rallied significantly over the last quarter of 2023 and this quarter.

- 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 first quarter of 2024 saw a large dispersion in performance between global asset classes. Developed market equities experienced a spectacular rally over the quarter, with the US and Japan delivering stellar returns. Conversely, bond markets struggled over the quarter. Sticky inflation prints and strong economic data in the US saw the market pricing 3 to 4 less interest rate cuts than it did at the end of 2023. For US inflation to fall further, the services portion of the basket will have to experience greater disinflation, a high hurdle given continued economic strength. Loose fiscal stimulus also shows no sign of slowing in the foreseeable future, further adding to inflationary pressures.

Both the local equity and bond markets started the year on the backfoot, as election concerns, a deteriorating fiscus and a hawkish SARB kept the market bearish. The February budget was as good as could be expected, given the restrained growth environment we find ourselves in. Unfortunately, concerns around debt issuance (despite the use of GFECRA), potential slippage because of continued SOE pressure and optimistic deficit assumptions kept the market cautious post budget. Against the backdrop of higher-for-longer global rates, inflation risks skewed to the upside and upward pressure on the real neutral rate as a result of a deteriorating fiscus, the SARB has remained hawkish so far, and a shallow cutting cycle can be expected to only start later in the year (Q3).

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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