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NEDGROUP INVESTMENTS Global Cautious Fund

Quarter Two, 2022

Marketing Communication

Nedgroup Investments Global Cautious Fund

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

Performance to 31 December 2021 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	-4.2%	0.1%	-6.6%
12 months	-5.3%	0.2%	-9.9%

Market Overview

Increasingly stringent economic sanctions and the subsequent shockwaves has created a difficult environment for investors to navigate given the complex interchange between the financial sanctions imposed on Russia, rising commodity prices, more fragile global economic growth from heightened geopolitical uncertainty, and any response that central banks may take.

Inflation is one of the most direct and obvious ramifications of the conflict. Petrol prices have leapt and with them everything that has a fuel input into its cost structure. Prior to the Russian invasion inflation was already high, and rising thanks mainly to the supply chain disruptions and shortages caused by the Covid pandemic. We have previously advised, with wavering confidence, that the current inflationary spurt is likely to be transitory. Recent geo-political events have further shaken our confidence. We, nor any central bank, knows quite where this is headed but one thing of which we are certain is that interest rates are simply too low. The UK, US and Canada have commenced their hikes. Get ready for more.

The quarter saw notable moves in bond markets with key 10-year government bonds in the US, UK, Canada, Australia and Japan all widen. Indeed, the German 10-year yield moved into positive territory. Such moves represent a significant diminution in capital value. Fundamentals are starting to reassert themselves in bond markets, perhaps other markets may soon follow.

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 with the portfolio's US bond and equity allocations detracting. The equity allocation added led by the overseas equities with US equities weighing on returns. The following table highlights the top 5 equity and contributors and bottom 5 equity detractors over the quarter:

Top Performers	Country	Performance contribution	Bottom Performers	Country	Performance contribution
General Dynamics	US	0.17%	T Rowe Price	US	-0.22%
Woodside Petroleum	Australia	0.16%	Rockwell Automation	US	-0.14%
American Express	US	0.12%	Lowes	US	-0.13%
Computershare	Australia	0.10%	McDonalds	US	-0.07%
Altria	US	0.10%	S&P Global	US	-0.06%

In the US, the stock market had a positive start to the year before falling away quickly as concerns about inflation and interest rates started to take hold. In addition, rising geopolitical tensions also had a major impact on investor sentiment. As commodity prices rose due to compromised supply chains, the inflationary outlook

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

materially worsened. The final blow to investor sentiment came when the US Federal Reserve increased interest rates in March, as had been telegraphed and expected.

Cyclically orientated sectors such as financials and energy led the market as commodity prices rose while sectors such as technology and consumer discretionary were impacted by the spectre of rising interest rates. General Dynamics rose as increasing geopolitical tensions around the world made it likely that defence spending will increase in many countries. American Express also added following robust spending across their credit card network with travel and entertainment spending growing strongly. Management increased their revenue target and dividend. Imperial Oil rose as increasing commodity prices will directly benefit to company's sales and profits. Results beat expectations with higher refinery utilisation and record production being achieved through 2021. In addition, the company announced improving capital returns to its shareholders.

Overseas equities added led by Australian names. Within the domestic equity allocation Woodside Petroleum performed strongly assisted by a higher oil price, improved efficiency and cost savings. Woodside's production is linked to the oil price, whether through direct sales of liquid products or liquified natural gas contract prices based on the oil price. In addition, shortages in Europe and Asia have highlighted that demand for gas will be robust for many years to come, despite the energy transition, and that is not currently reflected in the levels of investment in an industry whose assets deplete through natural operations. Computershare added following strong performance last year. Earnings will benefit from interest rate rises globally. Computershare earns "margin" income on the flow of funds between its clients and their various counterparties. This income has been suppressed in recent years but now looks set to recover. In Singapore, United Overseas Bank added due to the expectation of higher interest rates as net interest margins improve in an increasing interest rate environment. Combined with that, they have the largest exposure to ASEAN markets which are seeing an economic recovery coming out of pandemic hence they should see higher demand for loans.

The bond allocation detracted over the period, with US bonds detracting more than overseas bonds. The US yield curve flattened as did most major overseas yield curves in reaction to central bank tightening. The short end widened more than the long end with the US 2-year widening by around 1.5% compare to around 0.9% at the 10-year point of the curve. We are positioned at the short end, meaning that whilst the return from our domestic bond allocation was marginally negative, it was less negative than being positioned further out on the yield curve. We are also positioned at the short end within our overseas bond allocation. Both the UK yield curve and the Canadian yield curve flattened over the quarter, meaning our position at the short end detracted. The appreciation of the Canadian Dollar against the US Dollar aided returns.

The Australian Dollar remains the only currency exposure hedged in the portfolio. The Australian Dollar strengthened against the US dollar and therefore detracted from returns. 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 asset allocation in the quarter. The model allocation is 77% bonds, 20% equities, and 3% cash.

Pyrford adopts a very defensive stance by only owning short duration securities in order to protect the capital value of the portfolio from expected rises in yields as witnessed earlier in the year. At the end of the period the modified duration of the fixed income portfolio stood at 1 year. Whilst these short duration bonds are unlikely to yield high returns they will provide significant capital protection for the portfolio and importantly they are highly liquid. 45% of the portfolio is invested in overseas bonds, with 17% in Canada, 16% in the UK and 12% in Australia. 32% of the portfolio is invested in US Treasuries.

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.

Outlook

Heightened uncertainty muddies the outlook as the global economy tries to digest a shock that is negative for growth and will likely spur further inflation. Whilst the reopening of economies will support economic growth, risks remain given the potential for the Russian invasion in Ukraine to escalate and as central banks look to manage inflationary pressures.

Governments are turning their attention to fiscal consolidation and many central banks have commenced the move to higher interest rates. In the US, quantitative easing has finally ended, and the Fed is talking about shrinking its bloated balance sheet. The backstop to equity markets has been removed meaning markets will return to rising or falling dependent on their ability to grow earnings.

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 230 proposals in 13 company meetings in the quarter. We voted against management on 16 proposals in 9 of these meetings. We also engaged with 53 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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NEDGROUP INVESTMENTS CONTACT DETAILS

Tel: toll free from South Africa only 0800 999 16
Email: helpdesk@nedgroupinvestments.com
For further information on the fund please visit: www.nedgroupinvestments.com

OUR OFFICES ARE LOCATED AT

First Floor, St Mary's Court
20 Hill Street, Douglas
Isle of Man
IM1 1EU

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