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NEDGROUP INVESTMENTS Global Cautious Fund

Quarter Three, 2022

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 2022 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	-4.6%	0.5%	-3.3%
12 months	-8.8%	0.7%	-12.6%

Market Overview

Global market hopes of a more accommodative backdrop were quashed over the quarter as major central banks reaffirmed the need to enforce restrictive monetary policy to tackle inflation. The US Treasury 10-year moved sharply through its recent high of 3.43%, peaking at 3.96% towards quarter end. Indeed, concerns that rising interest rates will drive the global economy into a recession have been escalating as central banks tighten monetary policy aggressively to bring down the steepest inflation in four decades.

Whilst most central banks are aligned in raising rates, the Fed has made more progress in raising rates than most helping strengthen the US Dollar. The US Dollar hit a 20-year high based on the dollar index which measures the currency against a basket of peers, tightening financial conditions further. Conversely, the British Pound remains at levels not seen since 1971 due to recession fears and the cost-of-living crisis, not to mention the recently announced 'mini-budget' that caused concern across the market.

After the announcement of the 'mini-budget' UK pension schemes sold out of equities and bonds to raise cash. Most of the UK's 5,200 defined benefit schemes use derivatives to hedge against moves in interest rates and inflation, which require cash collateral depending on how the market moves. The sharp fall in the price of 30-year government bonds, triggered by the tax cut announcement, led to unprecedented margin calls. To raise the necessary cash, pension funds sold assets including government bonds, resulting in prices falling further. The Bank of England stepped in to stabilise the market by buying gilts, but the pension funds have been continuing to sell assets to meet margin calls.

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 led by the portfolio's overseas bond and overseas equity allocations though both were ahead of comparable indices. Hedging of the Australian Dollar was the main positive 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
Lowes	US	0.05%	Philip Morris International	US	-0.15%
Rockwell Automation	US	0.04%	Telenor	Norway	-0.12%
Automatic Data Processing	US	0.03%	Intel	US	-0.10%
Telkom Indonesia	Indonesia	0.02%	AIA Group	Hong Kong	-0.08%
Singapore Telecom	Singapore	0.02%	GSK	UK	-0.07%

In the US, the stock market had a volatile period – rising strongly in July before reversing these gains in the rest of the quarter. Inflation remained stubbornly high causing the Federal Reserve to change its narrative and become increasingly "hawkish" highlighting inflation as its main concern. This resulted in the Federal Reserve

[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

undertaking one of the fastest hiking cycles in its history. Investor sentiment remains fragile with consumer confidence at recessionary lows.
In the US, sectors such as energy led the market on continued geopolitical concerns while the consumer discretionary sector rebounded after having had a poor second quarter. Some of the better performing companies in the portfolio included Lowe's and Rockwell Automation. Lowe's performed well as mortgage rates in the US stabilised. Lowe's is one of the leading home improvement retailers in the US and continues to invest in both its physical and online stores which will allow it to gain market share from smaller competitors when the US housing market recovers. Rockwell Automation performed well after having had a poor start to 2022. The company remains well positioned to benefit from the long-term trend of increasing automation in factories. Companies that performed poorly for the portfolio included Intel which fell after posting results that were below market expectations. The company continues to invest and innovate for future technologies, and this has impacted near term results. With a 5% dividend yield in a growing semiconductor industry, it offers excellent value at current prices.

Overseas equities detracted led by names in Asia with Telenor and AIA Group both detracting. Telenor provides Nordic fixed line and mobile services and has an extensive array of mobile assets in developing markets. Telenor reported a net loss for Q2 2022, after an impairment charge on its Pakistan operation and currency losses brought about a drop in net income from the previous year. The Norwegian operator paid an impairment for Telenor Pakistan of $251 million, which it attributed to a "deteriorating macro-economic situation" as well as an "adverse ruling" of the country's Supreme Court about the renewal of spectrum licenses. AIA Group, the insurance and financial services group, reported a loss for 1H 2022 results as the lockdown in China weighed on new business. As the lockdown in key cities ended in early June, business is expected to recover. The interim dividend rose by 6% year on year and retains a strong capital position. On the positive side, our positions in Telkom Indonesia and Singapore Telecom added. Singapore Telecom has increased prices as the demand for 5G continues to grow and with the rise in inflation it has been able to pass on price increases to the customer which has increased revenue. Additional 5G capex has been aided by the sale of key assets, the proceeds of which will be used to fund.

The bond allocation detracted over the period, with overseas bonds detracting whilst the US bonds contribution was flat. The US yield curve flattened as did most major overseas yield curves. We are positioned at the short end, meaning that whilst the return from our bond allocation was negative, it was less negative than being positioned further out on the yield curve. The contribution from overseas bonds was hindered by a depreciation of both the Canadian Dollar and British Pound relative to the US Dollar which appreciated strongly following the steep rates hikes implemented by the Fed.

The Australian Dollar remains the only currency exposure hedged in the portfolio. The Australian Dollar weakened by around 7% against the US dollar meaning hedging the exposure helped protect client capital. 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.

Within the fixed income allocation, Pyrford adopts a very defensive stance by only 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 just 1 year. Whilst these very short duration bonds are unlikely to yield high returns they will provide significant capital protection for the portfolio and importantly they are highly liquid. In light of the increase in bond yields across the curve, we are currently reviewing our duration position. In the quarter there were no further changes to the overseas bond portfolio. 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 government debt.

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 an expensive currency, and we expect it to fall based on our purchasing power analysis.

Outlook

The world's economic woes have been building in the background for many years thanks to central bank and government largesse and a complicit consumer/borrower. Key interest rates were too low before the pandemic struck and were then pushed even lower. The one thing that we can say with conviction is that high market volatility is likely to persist until there's clear evidence that inflation is declining and central banks shift towards a less hawkish stance.

The rickety economic structure built in recent years has been based around ever-expanding levels of debt and extremely low interest rates. Add in the explosion of central bank money and government handouts and you end up with severely misallocated capital. Our guess is that the combination of cost-push and demand-pull will keep this inflation above target for some time.

We expect continued volatility with an increased focus on earnings expectations. Monetary policy operates with a lag which the market seems to be overlooking. The market took a lower inflation print in the US as a sign real yields will fall and valuations will be supported. The reality is that the impact of higher rates on earnings is ahead of us and whilst a reduction in inflation prints is welcome, inflation remains well above 2% inflation targets.

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 95 proposals in 9 company meetings in the quarter. We voted against management on 2 proposals in 3 of these meetings. We also engaged with 3 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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