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Global Cautious Fund

Quarter Four, 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 2022 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	4.3%	0.9%	2.6%
12 months	-5.6%	1.5%	-11.1%
5 Years	0.9%	1.3%	0.4%

Market Overview

A series of unprecedented events throughout 2022 hit asset prices across all markets. Global growth slowed through 2022 on fiscal and monetary tightening, China's Covid restrictions and property slump, and the Russia-Ukraine war. Equity markets have experienced double-digit percentage falls. In fact, all the major world equity markets are down although, interestingly, the FTSE 100 in the UK fell less than most other markets. We say interestingly because the UK has had more than its fair share of political and economic troubles in 2022. Perhaps the surprising thing is that markets haven't fallen further given the extraordinary and unanticipated leap in official interest rates throughout 2022.

The common theme of most forecasts in recent weeks is that 2023 is likely to see many of the major economies dip into recession. Since most forecasts usually miss the intended target, we probably shouldn't pay too much attention but perhaps this time they may just be right. Of relevance is that equity valuations began 2022 in rich territory - with low average dividend yields and high earnings multiples. Valuations have come back as markets have derated, but it is a stretch to claim major markets trade at cheap valuations. If a recession does eventuate in 2023, and official interest rates continue to climb, as indicated by almost all the world's central bankers, it could make a much bigger mess of equity valuations.

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 positive return over the quarter led by the portfolio's overseas bond and followed closely by overseas and domestic equity allocations. Hedging of the Australian Dollar was a detractor given the appreciation 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
PHILIP MORRIS INTL	US	0.21%	ALPHABET A	US	-0.06%
MCDONALD'S CORP	US	0.16%	TELKOM INDONESIA	INDONESIA	-0.04%
LOCKHEED MARTIN CORP	US	0.14%	ROCHE HOLDING GENUSS	SWITZERLAND	-0.01%
ROCKWELL AUTOMATION	US	0.13%	VODAFONE GROUP	UK	-0.01%
ALTRIA GROUP	US	0.13%	ENDEAVOUR GROUP	AUSTRALIA	0.00%

North American equity markets rose over the quarter. In the US, the stock market had a volatile period – rising strongly in October before reversing some of these gains during the rest of the quarter. Inflation began to moderate further during the quarter, but the Federal Reserve continued with its hawkish narrative keeping pressure on equity markets. This also resulted in the Federal Reserve continuing with one of the fastest hiking cycles in its history. Investor sentiment remains fragile with consumer confidence at recessionary lows.

[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

The Canadian market rose over the period as commodity prices such as oil and copper were very volatile due to economic and geopolitical factors.

In the US, sectors such as energy led the market on continued geopolitical concerns and a sustained higher oil price. The consumer discretionary sector lagged the market as the companies in the online retail sector continued to struggle due to their higher valuations. The portfolio benefitted from having an overweight position in the consumer staples sector and an underweight position in the communication services 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 Philip Morris, Lockheed Martin and Rockwell Automation. Philip Morris was up strongly following backing by Elliot Management in the acquisition of Swedish Match, the smokeless tobacco specialist. Elliot Management are the largest shareholder in Swedish Match and are expected to prove crucial in finalizing the deal. Philip Morris also announced the launch of a new heat-not-burn system called Bonds which looks to address concerns on taste and up-front costs. Lockheed Martin performed well as it has become increasingly clear that global defense budgets will need to rise because of the geopolitical events of 2022. In addition, the US will have its largest ever defense budget spending in 2023 which bodes well for Lockheed's long-term prospects. 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 and reshoring of manufacturing capacity to the US.

Alphabet was the notable detractor after reporting revenues that missed market expectations. The core search advertisement business reported a severe slowdown causing the share price to drop and driving fears of an economic slowdown in the US. We remain constructive on Alphabet, adding over the quarter.

Vodafone, Telekom Indonesia and Roche detracted slightly this quarter. Vodafone was weak as concerns mounted that European regulators would continue to look unfavourably on efforts by incumbents to reduce competition through a process of consolidation. For a long time European regulators have favoured low prices for consumers over a pro-investment environment for the network operators, which has damaged the return on capital generated by the sector. Furthermore, Vodafone reduced profit guidance during the quarter due to competitive difficulties in the German market and pressures on energy and debt costs. This culminated in the announcement that the CEO, Nick Read, would leave his position at the end of 2022.

Telekom Indonesia detracted due to the marked to market loss on their investment in GoTo, a super app which provides transport/logistics, payments, food, shopping, etc. This investment has declined by over 50%, which is a drag to earnings. Note there is no impact to the dividend which is based on core earnings. Core operations continue to perform well in line with expectations.

Roche underperformed in the quarter, following outperformance earlier in the year. In the last quarter Roche presented results that reflected the declining sales for COVID-19 related medicines and testing, versus 2021. However, newer medicines continued to grow and the group confirmed their 2022 outlook. Additionally, the company reported the failure of its phase 3 trial of Gantenerumab in Alzheimer's disease. This trial result was highly anticipated by the market given the large potential market for such a medicine and a competitor showing success in this area earlier in the year.

The bond allocation contributed over the period, with overseas bonds performing best and the US bonds slightly positive. UK government bonds rallied in December after the Bank of England slowed the pace of its interest rate rises, but warned that further tightening was needed to bring down inflation. The contribution from overseas bonds was aided by the appreciation of the Canadian Dollar, Australian Dollar and British Pound relative to the US Dollar.

The Australian Dollar remains the only currency exposure hedged in the portfolio. The Australian Dollar strengthened by around 5% 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 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 owning short duration securities to minimise the impact on the portfolio from interest rate rises. We used the turmoil in the bond market as an opportunity to add some duration to the portfolio at the start of this quarter. At the end of the period the modified duration of the fixed income portfolio stood at around 3.0 years. 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 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.

In terms of stock selection, McDonald's was sold from the portfolio during the quarter and the proceeds invested into an increase to S&P Global Inc and Alphabet. While the business fundamentals for McDonald's remain intact the valuation had reached historically high levels; a decade high PE and decade low dividend yield. Due to this run up in valuations, the Pyrford total return was no longer competitive when compared with other investment opportunities and so McDonalds was eliminated, with proceeds reinvested into holdings that we believe offer a better return profile.

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

From our perspective the key issue is that policy interest rates have been too low for too long and the distortions caused by market meddling will take time to pass. In most economies official interest rates have been below inflation rates for some time whilst dividend yields have provided bond yields with a run for their money. This is not how the market should work. Bank deposits should provide Investors with a real yield on their money whilst equities, which offer the prospect of capital growth, should, on average, provide dividend yields lower than bond yields.

Our biggest concern is the overhang of debt in the world. It's not just a private sector problem. Governments also have interest bills to pay and the luxury of the negligible interest rates of the last few years is a thing of the past. The clear challenge is to lift real economic growth to a level that helps pay the bills during 2023 and beyond. And that's where we begin to have serious doubts.

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 65 proposals in 9 company meetings in the quarter. We voted against management on 1 proposal. We also engaged with 2 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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