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NEDGROUP INVESTMENTS Global Cautious Fund

Q1 2023

Marketing Communication

Nedgroup Investments Global Cautious Fund

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

Performance to 31 March 2023 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	2.7%	1.1%	2.4%
12 months	-2.1%	2.6%	-5.1%
5 Years	1.5%	1.4%	1.0%

Market Overview

What a mighty mess is stewing in the financial world. Keep interest rates too low for too long. Pump vast amounts of money into the system. Encourage speculation, greed, and bubbles (of different varieties) and then use public money to bail the whole lot out (again). It is often said that each generation forgets the mistakes and follies of the previous. We think that the current generation forgets what happened in the recent past - after all, the global financial crisis was only a decade and a half ago.

The latest panic set in when Silicon Valley Bank (SVB) went under following a classic "run" on the bank. Credit Suisse, a 167-year-old institution, needed its rival UBS to step in to avoid bankruptcy in an arrangement hastily cobbled together by Swiss authorities. In the case of SVB, the trigger point for the collapse was massive investment in US Treasuries and other securities at extremely low yields which then suffered significant price declines when yields rose. To repay depositors, the bank was forced to sell the securities at a loss. Did the risk controllers at the bank believe that interest rates and bond yields were going to hover near zero forever? How could they possibly place such a massive bet? There will be plenty of questions.

Despite the crisis that rippled through banks in the US and Europe, central banks didn't waiver in hiking rates further. The battle with inflation remains firmly in focus with core inflation remaining stubbornly high. Hopes for rate cuts in the short-term seem overblown.

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 US bonds, followed by overseas and domestic equity allocations. Hedging of the Australian Dollar was a small 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
TEXAS INSTRUMENTS	US	0.11%	COMPUTERSHARE	AUSTRALIA	-0.07%
INTEL	US	0.09%	AUTOMATIC DATA PROCESS	US	-0.05%
ALPHABET A	US	0.09%	PHILIP MORRIS INTL	US	-0.03%
ROCKWELL AUTOMATION	US	0.09%	ROCHE HOLDING GENUSS	SWITZERLAND	-0.02%
AMERICAN EXPRESS	US	0.09%	BRITISH AMERICAN TOBACCO	UK	-0.02%

North American equity markets rose strongly over the quarter. In the US, the stock market had a volatile period – rising strongly in January before reversing most of those gains in February and then recovering in March. Inflation continued to moderate during the quarter but not at a fast enough rate to nullify the US Federal Reserve's "hawkish" stance. The US faced a mini banking crisis as Silicon Valley Bank (SVB) collapsed and the contagion spread to a few other regional banks. Global Central Banks were quick to act, and it appears that

[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

a widespread banking crisis has been avoided, at least for now. The whole affair has impacted US consumer confidence, and this may help to moderate inflation as banks pull back from lending which will in turn tighten credit conditions. Financial markets are now forecasting interest rate cuts in the US by the end of 2023 due to an increasingly probable recession. The Canadian market rose over the period as banking stock price weakness was offset by stronger performance in the share prices of commodity producers.

In the US, sectors such as information technology led the market as investors focussed on sectors that were perceived to be safe from the banking contagion. The financial sector lagged as the collapse of SVB caused investors to consider which other banks could be at risk of failure. The portfolio benefitted from having an underweight position in the financial and energy sectors. 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 Texas Instruments, Intel and Alphabet. Texas Instruments performed well for the portfolio as the company held an investor event. The company gave a positive medium and longer term outlook for its business as well as announcing an expansion its manufacturing capacity. Additionally, Texas Instruments reiterated its capital allocation policy which would continue to reward shareholders with increasing dividends and stock buybacks.

Intel performed well as it held a launch event showcasing some its latest products and innovations. This encouraged investors that the worst could behind the company and that it could start to ramp up production of these new higher value-added products. Rockwell Automation continued its good performance from 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.

Computershare, Automatic Data Process and Philip Morris detracted slightly this quarter. Computershare Ltd in Australia was a very strong performer during 2022 as central banks around the world battled to control inflation with interest rate rises. As Computershare is a temporary custodian of flows of cash between its customers and their stakeholders it is a direct beneficiary of rising rates. During Q1 2023 market panics about Silicon Valley Bank and then Credit Suisse caused expectations of future interest rates to fall. However, these expectations change rapidly and it should be remembered that inflation shows no signs of being under control in the key markets for Computershare – the UK, US and Europe.

Automatic Data Process lagged the market as investors worried about the effect a deteriorating employment situation (especially in the US) would have on the company's earnings. In addition, the company is seen as relatively defensive and so it held up very well during 2022 in a difficult period for stockmarkets, this pushed the valuation of the company to the top end of its valuation range. It is worth noting that ADP is part of a very select group of companies in the US that continuously grown their dividends for over 25 years.

Philip Morris International lagged as investors focussed on more growth orientated parts of the market as interest rates declined. Investors began to factor in the possibility that recent banking troubles would limit interest rate increases in the US. It is worth noting that the company has a very attractive dividend yield that has grown annually over many decades.

The bond allocation contributed over the period, with overseas bonds slightly outperforming US Bonds. The contribution from overseas bonds was aided mainly by the appreciation of the British Pound and Canadian Dollar relative to the US Dollar.

The Australian Dollar remains the only currency exposure hedged in the portfolio. The Australian Dollar weakened slightly 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. At the end of the period the modified duration of the fixed income portfolio stood at around 3.0 years. 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. 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

Pyrford retains a cautious outlook for international economic growth and expects the necessary adjustments to corporate and personal balance sheets in the developed West to take a prolonged period to achieve. This is essentially a deflationary process and represents a significant headwind to economic growth.

Following the rally in North American equity markets over the last few years, valuations are in aggregate less attractive than they were. Even after recent declines, North American equity markets remain overvalued in absolute terms given the earnings and dividends per share growth that can be reasonably expected. Equity investors will be best rewarded by concentrating on high quality companies selling at low valuations relative to a defensive and visible stream of earnings. Financial leverage should be avoided, and investors should focus on companies which are very well capitalised and whose business models have proved resilient during previous periods of poor economic growth.

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 248 proposals in 13 company meetings in the quarter. We voted against management on 10 proposals. We also engaged with 10 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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