NEDGROUP INVESTMENTS

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NEDGROUP INVESTMENTS Global Cautious Fund

Q2 2023

Marketing Communication

Nedgroup Investments Global Cautious Fund

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

Performance to 30 June 2023 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	0.2%	1.2%	0.7%
12 months	2.5%	3.8%	2.4%
5 Years	1.3%	1.6%	1.3%

Market Overview

Sitting in 2019 and observing record debt levels across the global economy, most investors would have struggled to sense how the system would operate should interest rates ever leave the zero lower bound. Well now they're in the 3-5% range across advanced economies bar Japan. There's been a few hiccups along the way: the LDI blow-up in the UK, a regional banking crisis in the US and the collapse of Credit Suisse, yet the economy and asset markets continue to outperform expectations. The main reason for this in our view is that governments have overloaded the system with an endless list of untargeted fiscal support measures, blunting any pain from inflation or rising interest rates.

So, governments are keeping their foot on the accelerator whilst central banks are jamming the brakes. The direct outcome is spiking interest expense, something we haven't seen for 30 years. The interest bill for US government debt reached a record high of $1.2 trillion in nominal terms over the last 12 months, that's $100bn more than defense expenditures, straight in the pockets of bondholders who could go out and spend that on more goods and services. Could higher interest rates then lead to bigger deficits, more spending and higher inflation? Let's not go there...as a percentage of tax receipts, the figure is less worrying, but keep in mind the recession hasn't yet begun.

How does this all shake out? The key factor is liquidity risk. Our debt-fueled, hyper financialized system needs a constant stream of money just to keep the lights on. Ultimately, central banks will have to revert to printing money to alleviate this burden, but with inflation still sticky we believe we have not reached that moment yet. If central banks refuse to finance government debt, then money needs to be pulled from other pockets of the financial system. There's a laundry list of assets that have benefitted and relied on loose money over the last decade that would suffer should liquidity be pulled, and margin calls triggered. When do we reach breaking point? It's impossible to time. There is one central bank that has bucked the trend of global QT. With inflation rising in Japan a tightening of policy by the BOJ could be the trigger for a sudden liquidity squeeze.

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 and domestic equity allocations. However, the overseas bond and US bonds detracted but both allocations outperformed the broader indices. 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
S&P GLOBAL	US	0.11%	AXIATA GROUP	MALAYSIA	-0.04%
ALPHABET INC	US	0.10%	TELENOR	NORWAY	-0.03%
LOWE'S COMPANIES	US	0.09%	TEXAS INSTRUMENTS	US	-0.03%
ROCKWELL AUTOMATION	US	0.07%	UNITED OVERSEAS BANK	SINGAPORE	-0.03%
MITSUBISHI ELECTRIC CORP	JAPAN	0.04%	MALAYAN BANKING	MALAYSIA	-0.02%

[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

North American equity markets rose strongly over the quarter. In the US, the stock market had an encouraging period as inflation data continued to moderate giving investors confidence that the Federal Reserve would soon start to moderate or pause their interest rate tightening cycle. In addition, the market began to normalise as the contagion effects of the bankruptcy of Silicon Valley Bank looked contained. The Canadian market rose over the period as banking stock prices as well as commodity prices stabilised after a volatile first quarter. Over the period the portfolio was behind the benchmark.

In the US, sectors such as information technology led the market as investors focused on sectors that were perceived to offer superior earnings growth. The utilities sector lagged the market as higher yielding utility stocks competed with government bonds for investor funds. The portfolio benefitted from having an underweight position in the utility 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 S&P Global and Lowe's. S&P Global rose over the quarter as concerns around the financial sector began to alleviate after the Silicon Valley Bank problems in the first quarter. The company also posted results that met investor expectations and indicated that the IHS Markit integration was going well. Lowe's rose as the company will benefit from many US homeowners remaining in their current houses due to higher mortgage rates. This should drive remodelling activity which is much more profitable for the company.

Texas Instruments lagged over the quarter as the company posted results that were behind market expectations. The company indicated that customers were still working down inventories which would mean that sales would be lower than forecasts for the next few quarters. Telenor offers telecoms services across the Nordic region and mobile only services in several Asian countries. The shares were weak in Q2 2023 as Telenor reversed some of the good performance from the previous quarter. Pakistan has been a particularly weak market for Telenor since 2022 when the army manufactured a political coup to remove Tehreek-e-Insaf (PTI) from power. Political instability has been exacerbated by horrific floods and rampant inflation which have reduced the prospects for economic growth in Pakistan. Meanwhile elections in Thailand have added further uncertainty for Telenor. The most successful parties, including Move Forward, have proposed reforms in Thailand to increase competition. This includes ambitions to reduce the control of conglomerate Charoen Pokphand Group (CP). Move Forward had previously opposed the merger of DTAC (Telenor's mobile business in Thailand) with CP Group's True. This has created the number 1 mobile operation in Thailand. Telenor is now struggling to cover the dividend (yield over 8%) from free cash flow, while leverage has increased in recent years. Management comments and the new organisational structure imply that Telenor may look to exit from Asia over our investment horizon.

The bond allocation detracted 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

Over the quarter, we added to Singapore and Indonesia reducing the UK and Sweden. Singapore and Indonesia offer higher nominal expected returns. The model allocation is 78% bonds, 20% equities and 2% 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.

Portfolio changes

Toromont was purchased for the portfolio. Toromont owns all the Caterpillar franchises in Eastern Canada. The company also owns Battlefield, a rental business, and Cimco, an industrial cooling business. Over the years Toromont has successfully grown its Caterpillar footprint whilst maintaining a 20% ROE. The business is capital light and so produces significant levels of free cash flow whilst employing little debt.

Saputo was sold from the portfolio. Saputo is a global dairy company whose main operations are in North America but who also operate in Australia, Argentina and the UK. Historically, Saputo had a good track record of successfully integrating acquisitions into the business. More recently capital allocation has been weaker, with large acquisitions in Australia and the UK being dilutive to returns. The dairy industry has also become more challenged, with non-dairy alternatives becoming more popular.

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 1122 proposals in 69 company meetings in the quarter. We voted against management on 116 proposals. We also engaged with 48 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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