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NEDGROUP INVESTMENTS Global Cautious Fund

Q4 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 December 2023 (USD)	Fund[1]	Target Return[2]	Peer Group[3]
3 months	6.60%	1.37%	5.74%
12 months	8.37%	5.16%	7.65%
5 Years	2.87%	1.90%	2.74%

Market Overview

The victory laps have begun at the Federal Reserve as they cheer the soft landing that has blessed 2023. It's hard to argue with the data that has shown an immaculate disinflation with unemployment still at 3.7%. Equity markets have staged an impressive rally over the last two months meaning the Nasdaq Composite of US tech stocks ends the year up 44% and the S&P 500 up 25%. Major equity indices in the US and Europe sit at or close to record highs.

The rally in bond markets have been equally aggressive but perhaps overdone. After peaking at 5% in October, the US 10-Year Treasury yield finds itself almost back to where it started the year below 4%. Debt markets were encouraged by strong demand for US Treasury auctions with an auction of 20-year US Treasuries being well covered following a disappointing auction of 30-year US Treasuries earlier in November. These levels however are still more than double the average over the last decade. Every day that rates remain this elevated, debts mature and get rolled over at higher interest rates which eventually eat into household and business consumption.

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, driven by the portfolio's overseas and domestic bond allocation. The US Equities and overseas equities also contributed but both allocations underperformed the broader indices. Hedging of the Australian Dollar was a detractor given its strengthening 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
INTEL CORP	US	0.18%	WOODSIDE ENERGY GROUP	AUSTRALIA	-0.04%
AMERICAN EXPRESS	US	0.16%	ALTRIA GROUP	US	-0.02%
S&P GLOBAL	US	0.14%	SANOFI	FRANCE	-0.02%
TEXAS INSTRUMENTS	US	0.08%	ROCKWELL AUTOMATION	US	-0.02%
AMPHENOL CORP	US	0.08%	BP	UK	-0.02%

Source: Pyrford International

North American equity markets rose over the quarter. In the US, the stock market started the quarter focussing on upcoming inflation data to determine whether prices would continue to moderate. As prices continued to cool, the US Federal Reserve Chairman, Jerome Powell gave a press conference in early November that indicated that further interest rate rises were unlikely. This ignited the stock market with the US market having one of its strongest rallies in many years. The Canadian market also rose over the period as banking stock prices benefitted from the perception that interest rates had peaked. Over the period the portfolio was in line with the benchmark.

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

In the US, sectors such as information technology and financials led the market as these sectors are seen as beneficiaries of lower interest rates. More defensive sectors such as healthcare and consumer staples lagged in the rally. The portfolio benefitted from having an underweight position in the healthcare 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 Intel and S&P Global. Intel (semiconductor company) performed well due to positive news flow around some of its new Artificial Intelligence semiconductor chips that performed very well compared to some of its competitors. S&P Global (bond rating agency) rose as investors expect an increase in bond issuance as interest rates decline.

Companies that were behind the index over the quarter included Altria and Woodside Energy Group. Altria are in the consumer staples sector (tobacco). When the market strongly rises these “defensive” types of company tend to lag the market. It is worth noting that the company has an exemplary dividend track record and currently provides very attractive dividend yields. Woodside Energy, the major oil exploration and production company, lagged the market in reflection of the lower oil price. There is no official guidance on 2024 production, but capital expenditure is expected to be lower.

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, Australian Dollar and Canadian Dollar relative to the US Dollar.

The Australian Dollar remains the only currency exposure hedged in the portfolio. The Australian Dollar strengthened 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 positioning over the quarter. The model allocation is 78% bonds, 20% equities and 2% cash.

Global bond yields moved higher at the end of Q3 2023 rendering them better value as markets feared that the fundamentals were pointing to a period of higher for longer inflation. As a result of this, at the beginning of Q4 2023 the modified duration of the fixed income portfolio was increased from 3 years to 5 years. However, the mood in the market changed dramatically during the quarter, as central bank comments suggested that they would be able to ease rates sooner than previously expected. The subsequent reversal of bond yields meant that capital gains were made on the bonds bought at the start of the quarter. The bond portfolio remains of a very high credit quality and highly liquid. We will continue to monitor the modified duration of the portfolio. 15.7% of the model portfolio is invested in overseas bonds, with 6.3% in the US, 4.9% in Australia and 4.5% in Canada. 47.3% of the portfolio is invested in UK 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 a very expensive currency and we expect it to fall based on our purchasing power analysis.

Portfolio changes

This quarter we initiated a position in Nissan Chemical. Nissan Chemical has transitioned from a commodity chemical player to become a specialty chemical player. Most profits are derived from performance materials (LCD alignment film, semiconductor materials) and agrochemicals. Nissan Chemical holds leading global market positions in niche products. It has a well-balanced business portfolio that supports growth throughout the cycle. Nissan Chemical prioritizes OPM, ROE and shareholder returns. This differentiates it from peers and should support relative outperformance going forward. Sumitomo Rubber Industries, the Japan-based tire manufacturer was exited. The Sumitomo Rubber Industries share price has increased recently on the back of better-than-expected results as the company moves beyond the negative impact of COVID, high raw material costs and in particular very high shipping costs. In addition, the company has been struggling with an unprofitable factory in the US and has announced their intention to restructure or close this factory. These measures are welcome however in the short term the share price and valuation has run ahead of any profit improvement.

Telekom Malaysia was purchased for the portfolio, with Axiata Group reduced to accommodate the new position. Telekom Malaysia is the incumbent fibre broadband provider in Malaysia. It has a ~70% share in the retail market, via its Unifi brand, and closer to 85-90% when including wholesale provision (TM Global). TM One is the business solutions arm which provides cyber security, cloud, and connectivity services to corporates and the government. The investment case can be distilled into three key points: (1) as the incumbent, TM should be the main beneficiary as broadband coverage and penetration grows; (2) there are significant structural tailwinds from the government's intent to digitalize Malaysia, and (3) TM's financials are improving.

A position in Venture Corp was initiated. Venture is an electronic manufacturing services company based in Singapore. They manufacture and transform design concepts into physical electronic products. The company has industry leading margins due to its focus on low volume, high value products across sectors such as medical and life science where entry barriers are higher. Venture has a strong balance sheet with no debt and a very low capital intensity enabling it to maintain mid teen returns on invested capital. The low valuation currently reflects the current cyclical slowdown which we forecast to improve as customers introduce new products. We reduced ComfortDelGro and Singapore Telecom in the process.

We entered into a position in Croda International funded by exiting our position in Haleon and reducing Vodafone. Croda is exposed to the growth areas of Consumer Care and Health. The company provides chemical ingredients that enhance the sustainability credentials of their customers' products or allow for substantive claims of improved functional performance. A track record of innovation cements close customer relationships. Divestment of the bulk of its Industrial Chemicals focuses the business on its higher margin activities and it has a strong balance sheet.

Amphenol was purchased with Rockwell Automation eliminated and a small reduction made to Philip Morris. Amphenol is a supplier of electronic connectors and is expected to benefit from the increasing complexity and proliferation of electronic devices. Amphenol operates a diversified business model, participating in many verticals, with their devices representing a small cost but is integral to performance. Rockwell has struggled to grow profitability over recent years and is trading at elevated valuations resulting in a less favourable risk / reward.

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 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. 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 134 proposals in 7 company meetings in the quarter. We voted against management on 0 proposals. We also engaged with 113 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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