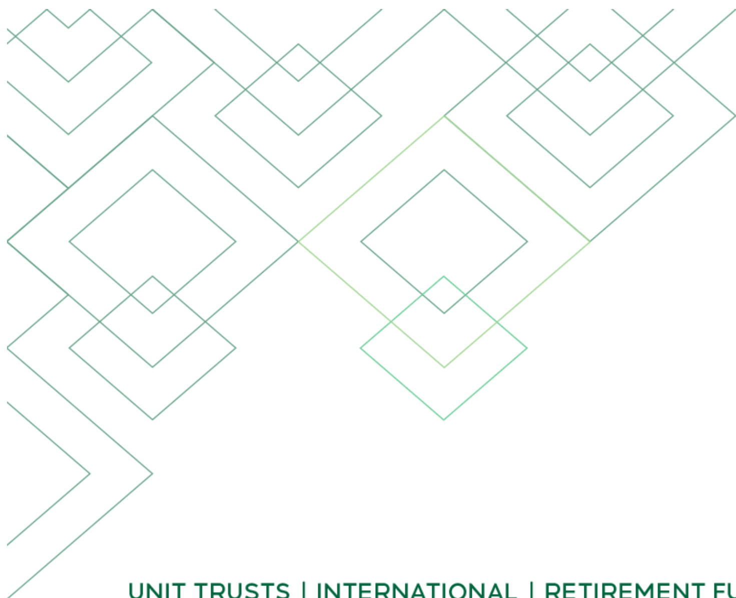
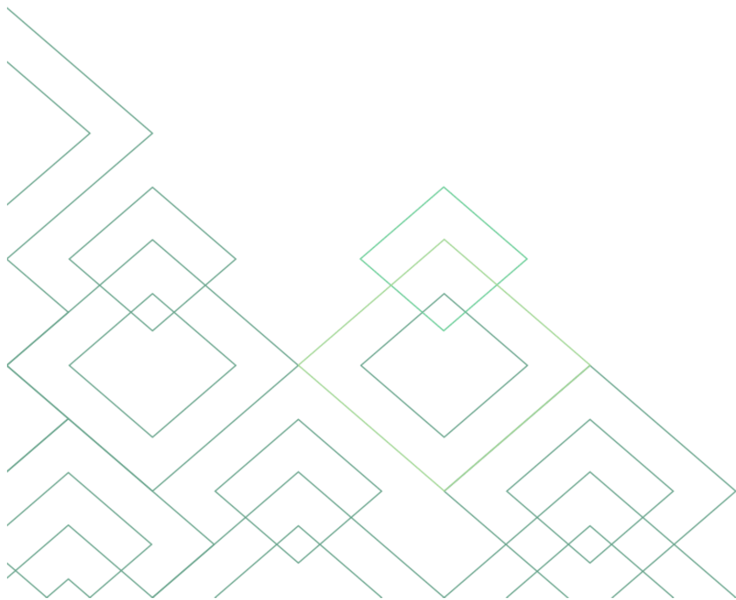


UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

see money differently

Quarterly review

Nedgroup Investments Core Bond Fund



As at 31 March 2022

The Russia-Ukraine war dominated headlines over the month

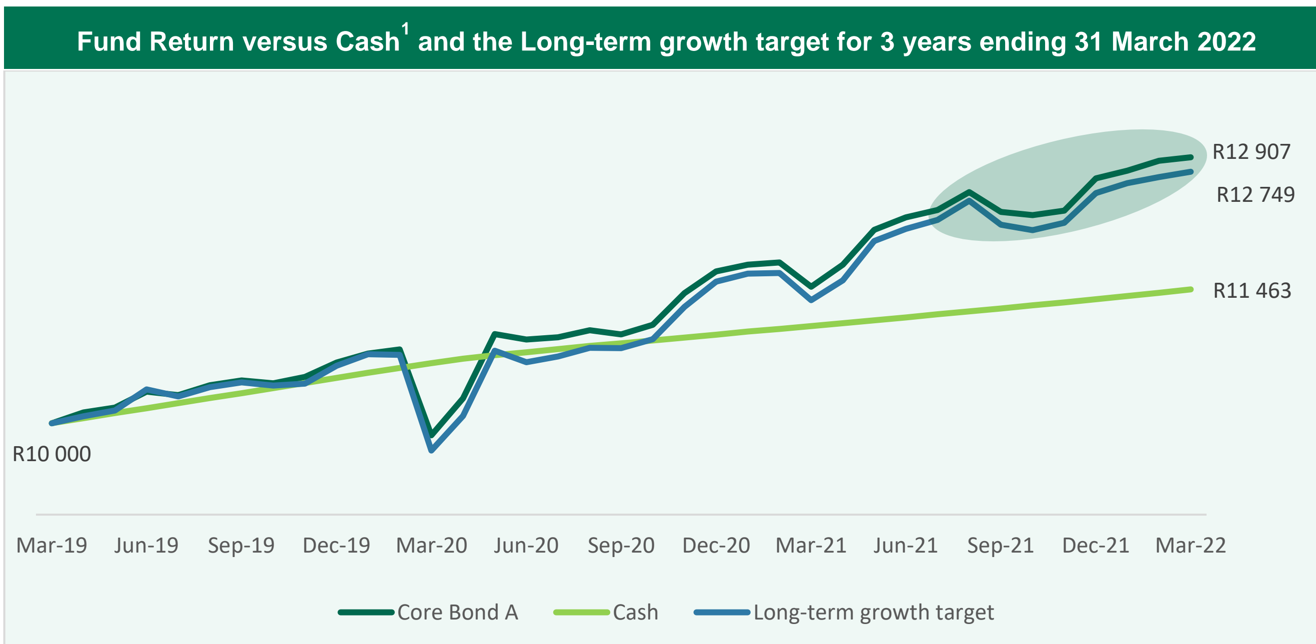
The raging conflict between Russia and Ukraine and the imposition of unprecedented levels of sanctions on Russia by the western nations have cast fresh uncertainty on global growth which was steadily recovering from the scars of the pandemic. The amplified hostilities between the two nations have resulted in a sharp rise in price of certain commodities such as crude oil, gas, wheat, fertilizers, coal etc. amid the creation of global supply-chain shock. What it means for a portfolio is that we likely to see further pricing pressure across the commodity chain and the risks to growth. In the first quarter, the Nedgroup Investments Core Bond Fund was up by 1.8%.

The table below compares an investment in the Nedgroup Investments Core Bond Fund to bank deposits (cash) over various time periods. This illustrates that over longer periods, investors have been rewarded for taking on interest rate risk. For every R10 000 invested in the Nedgroup Investments Core Bond Fund three years ago, you would have R12 907 at the 31st of March 2022. This is greater than the R11 463 you would have achieved had you invested your money in bank deposits (cash) over the same period. The green circle in the chart below, highlights the recent market recovery, which helps to contextualise the returns experienced in the past few years.

Value of R10,000 investment in Nedgroup Investments Core Bond Fund versus Cash[1] and the Growth target

	3 Months	1 Year	3 Years	5 Years	7 Years	10 Years
Growth of fund (after fees) ***(Growth in %)***	R10 183 *1.8%*	R11 233 *12.3%*	R12 907 *8.9% p.a.*	R15 470 *9.1% p.a.*	R17 253 *8.1% p.a.*	R22 030 *8.2% p.a.*
Growth of cash ***(Growth in %)***	R10 095 *0.9%*	R10 362 *3.6%*	R11 463 *4.7% p.a.*	R13 050 *5.5% p.a.*	R14 795 *5.8% p.a.*	R17 191 *5.6% p.a.*
Growth target (Beassa ALBI) ***(Growth in %)***	R10 186 *1.9%*	R11 237 *12.4%*	R12 749 *8.4% p.a.*	R15 331 *8.9% p.a.*	R16 916 *7.8% p.a.*	R21 880 *8.1% p.a.*

Fund Return versus Cash[1] and the Long-term growth target for 3 years ending 31 March 2022



Over most periods, the Nedgroup Investments Core Bond Fund has done significantly better than bank deposits (cash) as the Fund benefited from the yield enhancement from investing in longer dated bond instruments. Over the past ten years it has delivered more than 2.7% of additional return per annum, or R4 839 for every R10 000 invested.

[1] We used the STeFI call deposit rate for cash returns

Market and economic commentary: Inflation remains uglier for a little bit longer

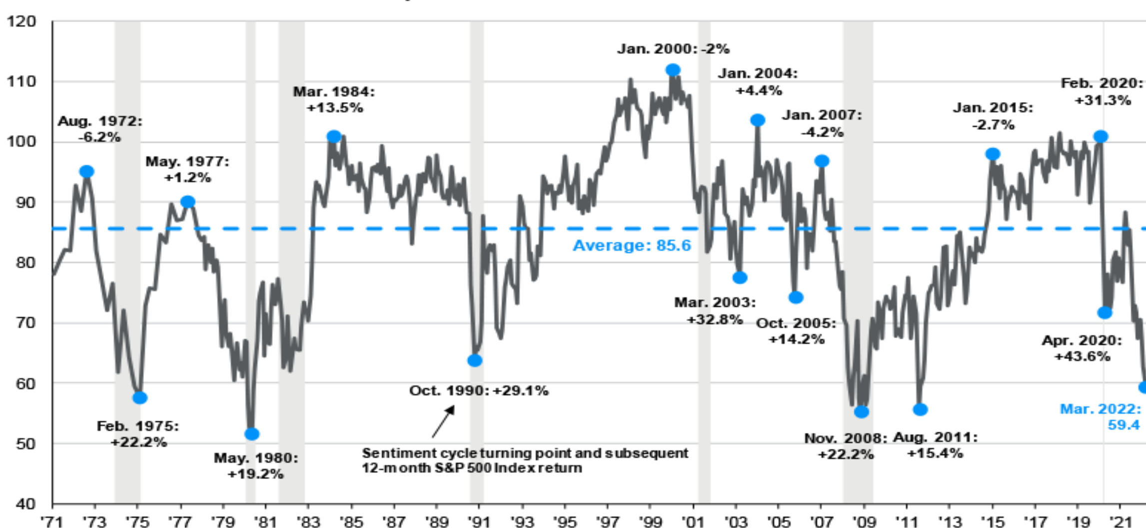
Just when the world was expecting some much-needed relief from living with the COVID-19 pandemic for the last two years, Russia invaded Ukraine in late February sending shockwaves through the world and markets alike. Markets around the globe declined and volatility returned after a relatively calm 2021. Although some of the market fall may in part be attributed to valuations normalising off a base of high historical valuations of developed countries, other significant contributors include the geopolitical uncertainty and changes in the economic environment.

One of the notable changes in the economic environment was the rapid rise in inflation and the fear that this may persist for longer than initially anticipated. Energy prices soared with sanctions being imposed on Russia; one of the world's top energy producers. Furthermore, other essential commodity prices also increased sharply with fears of further supply chain disruptions. The upside of this is that commodities have been one of the few sectors in the market that have performed well in the first quarter.

Add to this, labour shortages in many countries, price hikes to recoup losses during the pandemic and the high demand for goods that are in short supply, and you have the perfect storm for inflation. In the US, inflation reached 40-year highs with their annual inflation rate reaching 7.9% in February, well above its 2% target. The UK was not far behind with inflation of 6.2% per annum to the end of February and the Eurozone at 5.9% at the end of February and with an expectation[2] that inflation will tick up to 7.5% in March.

In an attempt to reign in rapidly rising inflation, central banks have begun hiking interest rates. The Federal Reserve has increased interest rates by 0.25% and signalled their intent to increase rates at each of the six meetings this year. The Bank of England has announced two consecutive interest rate hikes with a combined increase of 0.5%, the European Central Bank has not yet increased interest rates but plans to end bond purchases by the end of September and South Africa has had two interest rate hikes this year with a combined increase of 0.5%.

Rising interest rates, higher inflation and potentially low growth are all expected to put pressure on households and disposable income. In America, this has led to the lowest consumer sentiment in a decade. However, investors are cautioned not to let their feelings rule their investment decisions. The table below from J.P. Morgan is a good illustration of this. Typically, the best returns (on average 24.5%) are earned on investments made when consumer confidence is at a low, in comparison to investments made when consumer confidence is at a high (with investors only earning subsequent returns of 4.4% on average). This serves as a good reminder not to make emotional investment decisions.



Source: JP Morgan Asset Management

---

[2] According to Eurostat

The opposing forces impacting the bond market

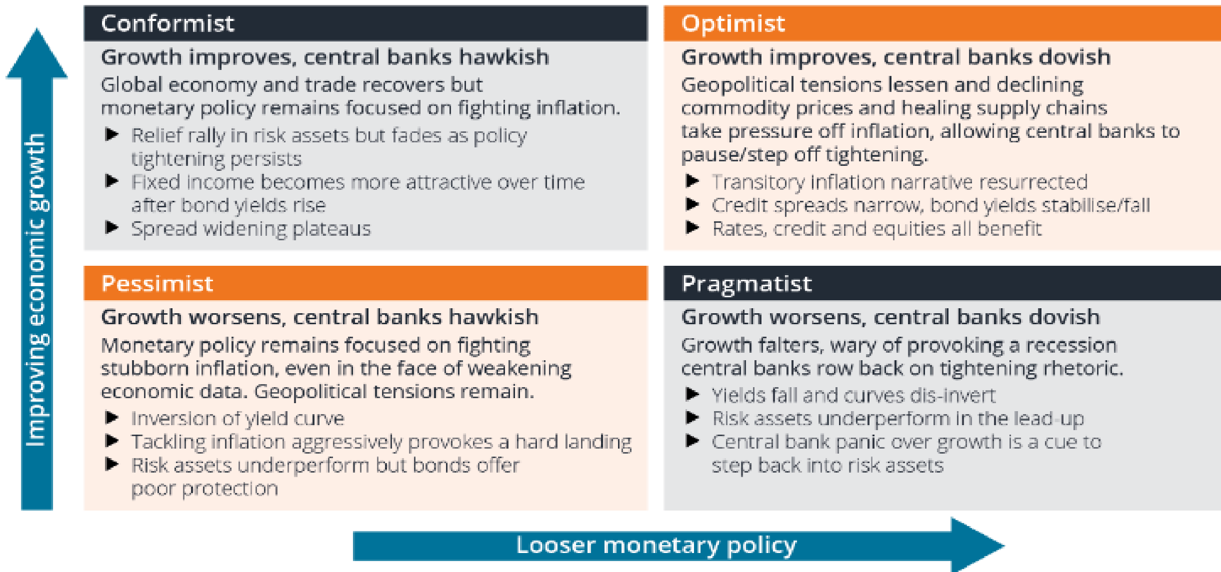
F. Scott Fitzgerald famously wrote: "The test of a first-rate intelligence is the ability to hold two opposing ideas in mind at the same time and still retain the ability to function." Such is the conundrum facing central banks as they seek to rein in inflation without choking off economic growth.

Having retired the word 'transitory,' the US Federal Reserve (Fed) has performed a 180-degree turn and now worries about the elevated headline inflation levels becoming ingrained in people's expectations. In the press conference following the March Fed policy meeting, Fed Chair Jerome Powell stated, "basically across the economy, we'd like to slow demand so that it's better aligned with supply." This is a firebrand comment from a Fed chair, and suggests he is prepared to aggressively tighten policy to defeat inflation. Supply chain problems are acknowledged but the Fed seems prepared to address the imbalance between supply and demand through the demand side of the equation.

Inflation should recede as the Fed appears determined to follow its new path. Over the coming months it is hard to see it performing yet another U-turn without losing credibility. Like a guided bus, the Fed is unable to depart from the current track until it reaches a key junction. That junction point may be when alarm bells start sounding around the strength of growth. Just as it is hard not to raise rates when headline inflation is elevated, it may become equally hard to carry on raising them when economic participants are suffering. This is tomorrow's story, however, and central banks are firmly fixated on inflation today. Growth will need to roll over convincingly to evoke a retreat.

So, we are presented with four potential scenarios for the global economy over the coming year, as depicted in Figure 1.

Figure 1: Central bank policy versus growth



Source: Janus Henderson Investors

What the above conundrum and Russia-Ukraine conflict means for a portfolio is that we likely to see further pricing pressure across the commodity chain and the risks to growth. In the near term we are likely to see higher energy prices which will reduce global GDP. This presents opposing forces, as the central bank doesn't want to hike interest rates aggressively amidst concerns around weaker growth.

Looking ahead, the domestic bond market is currently pricing in another 250-bps worth of rate hikes over the next 2 years. In the absence of costs associated with trade wars and supply-side rigidities, elevated inflation pressures appear less likely to be maintained by a moderating macroeconomic backdrop. To this end, we anticipate a more gradual hiking cycle (up 75 - 100bps in 2022) in the interest of sustainable economic recovery.

Disclaimer

Nedgroup Collective Investments (RF) Proprietary Limited is the company that is authorised in terms of the Collective Investment Schemes Control Act to administer the Nedgroup Investments unit trust portfolios. Unit trusts are generally medium to long term investments. The value of your investment may go down as well as up. Past performance is not necessarily a guide to future performance. Nedgroup Investments does not guarantee the performance of your investment and even if forecasts about the expected future performance are included you will carry the investment and market risk, which includes the possibility of losing capital. Unit trusts are traded at ruling prices and can engage in borrowing and scrip lending. Certain unit trust funds may be subject to currency fluctuations due to its international exposure. Nedgroup Investments has the right to close unit trust funds to new investors in order to manage it more efficiently. A schedule of fees and charges and details of our awards are available on request from Nedgroup Investments. A fund of funds may only invest in other unit trust funds, that levy their own charges, which could result in a higher fee structure. Nedgroup Investment Advisors (Pty) Ltd (the 'Investment Manager') an authorised as a financial services provider under the Financial Advisory and Intermediary Services Act (FSP No. 1652), is the appointed Investment Manager of the Management Company.

Certain Nedgroup Investments unit trust portfolios include international assets, whereby a change in the exchange rates may cause the value of those investments to rise and fall. Excessive withdrawals from the portfolio may place the portfolio under liquidity pressures and that in such circumstances a process of ring-fencing of withdrawal instructions and managed pay-outs over time may be followed.

Please note that Nedgroup Collective Investments (RF) Proprietary Limited is not authorised to and does not provide financial advice. This presentation is of a general nature and intended for information purposes only. It is not intended to address the circumstances of any investor and cannot be relied on as legal, tax or financial advice, either express or implied. Whilst we have taken all reasonable steps to ensure that the information in this document is accurate and current on an ongoing basis, Nedgroup Investments shall accept no responsibility or liability for any inaccuracies, errors or omissions relating to the information and topics covered in this presentation. Nedgroup Collective Investments (RF) Proprietary Limited is a member of the Association for Savings & Investment SA (ASISA).