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Quarterly review

Nedgroup Investments Core Bond Fund

As at 31 March 2023

Traditional 60/40 stocks and bonds portfolio have its best start in 10 years

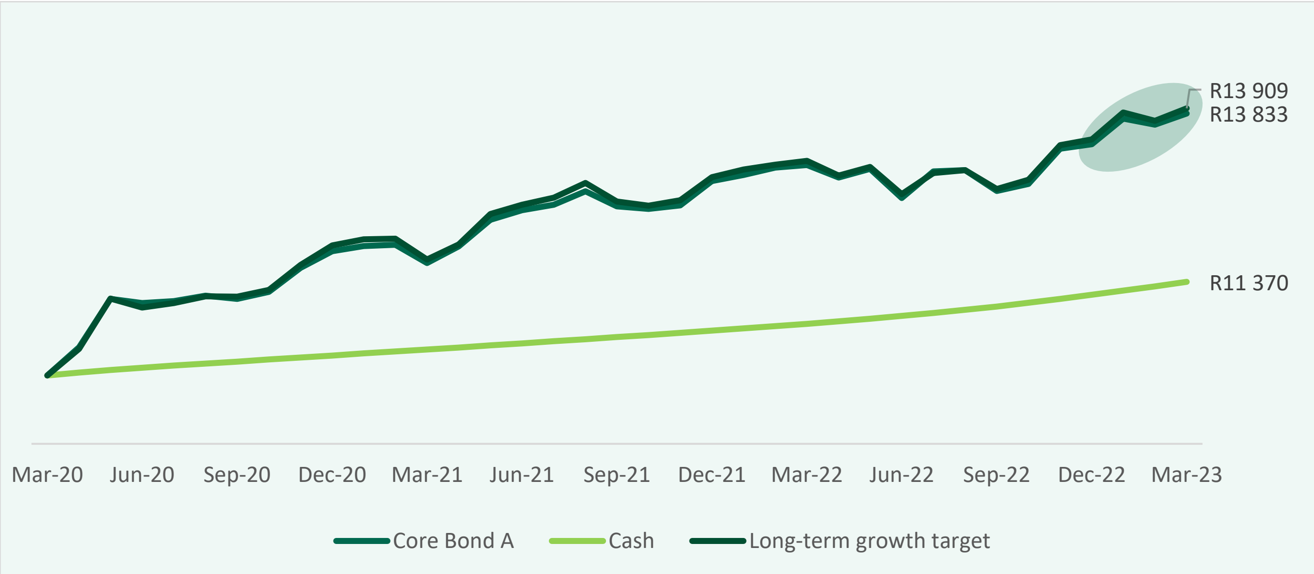
In 2022 investors were dealt with very disappointing results in both stocks and bonds. What we have seen in 2023 so far is a complete reversal of that. When one looks at 60% stocks and 40% bonds portfolio, it is off to its best start in 10 years. Investors are looking beyond what we have seen as very weak economic growth, likely recession this year, even the banking crises that occurred in the first quarter of 2023 and focusing on the fact that the federal reserve may be close to being done on the aggressive tightening cycle. This easing inflationary pressure helped lift markets in the first quarter. This easing inflationary pressure helped lift markets in the first quarter. In the first quarter, the Nedgroup Investments Core Bond Fund increased by 3.3%.

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 R13 833 at the 31st of March 2023. This is greater than the R11 370 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 334 *3.3%*	R10 575 *5.8%*	R13 833 *11.4% p.a.*	R14 163 *7.2% p.a.*	R18 230 *9.0% p.a.*	R20 784 *7.6% p.a.*
Growth of cash ***(Growth in %)***	R10 170 *1.7%*	R10 571 *5.7%*	R11 370 *4.4% p.a.*	R12 913 *5.2% p.a.*	R14 753 *5.7% p.a.*	R17 313 *5.6% p.a.*
Growth target (Beassa ALBI) ***(Growth in %)***	R10 339 *3.4%*	R10 583 *5.8%*	R13 909 *11.6% p.a.*	R13 959 *6.9% p.a.*	R18 013 *8.8% p.a.*	R20 251 *7.3% p.a.*

Fund Return versus Cash[1] and the Long-term growth target for 3 years ending 31 March 2023



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 1.9% of additional return per annum, or R3 471 for every R10 000 invested.

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

Economic and market review

South African markets started off the year on a good recovery in 2023 as the tailwind from China's re-opening benefited the local market. However, for the remainder of the quarter, loadshedding and the grey listing outcome decreased the appeal of investing capital in South Africa. In addition, the fears of contagion from the SVB fallout weighed on SA markets due to market volatility increasing. Even though the FTSE/JSE lost ground in the last two months of the quarter, it managed to return 5.2% over the quarter.

On the economic front, South Africa's inflation remained slight elevated and above market expectations, leading the Monetary Policy Committee (MPC) to hike the key lending rate by 50bps. This was higher than the market's 25bps expected hike. The risk of higher-than-expected inflation is expected to continue to be a pain point in addition to the mentioned headwinds. The MPC however showed much higher inflation forecasts than outlined in previous meetings, fueled by higher food prices, core goods inflation and a weaker ZAR. Their concern around higher inflation, higher expected inflation and (we suspect) a vulnerable ZAR, prompted greater action. This certainly signals the intention from the SARB to bring inflation back down to the midpoint of the target band, but it remains a further constraint on growth. Bonds returned a reasonable 3.4% for the quarter (with the back-end outperforming as global rates lower), and outperformed inflation linkers which returned only 0.8% despite increased inflation expectations.

After a strong January, robust jobs data, high retail sales growth and sticky core inflation in the US saw bond markets again having to revise their rates views. Treasuries sold off through February and early March, with the 10Y moving from its low of 3.36% to over 4%. Despite the headline US CPI print looking within expectations (and behaving as expected, as energy prices fall), core CPI continues to surprise to the upside with services inflation being particularly problematic.

Just as the market was pricing in some of its most hawkish sentiment, the story of Silicon Valley and Signature Banks broke (followed by further news of Credit Suisse). Following the banking sector induced turmoil, the Fed hiked rates by 25bps in the March FOMC. This was largely anticipated by the market, and although their tone was slightly more dovish, there was no sign of a 'pivot', as many market participants may have hoped. The dots for 2023 were left unchanged and suggest that there may be one hike left in the cycle. Importantly, unlike the market, they still do not foresee any policy easing this year.

The year started off with a bang, reminding us just how precarious a position global markets and economies are in. An early rally in markets was halted by strong economic data and sticky core inflation in the US, and markets quickly reacted with more hawkish pricing, even pricing a 50bp hike for the March FOMC at a stage. This again had to be revised after the second largest banking failure in history, occurring off the back of high interest rates and limited liquidity, had the market then questioning whether the Fed could hike at all. Ultimately the FOMC hiked a largely expected and more neutral 25bps, failing to 'pivot' but certainly sounding more dovish than previous meetings.

The market continues to grapple with how policy makers will react to sticky inflation, while serious economic failures and stresses are starting to show because of tight monetary policy.

As at the end of Q1 2023, domestic duration is 0.9 years in nominal bonds and 0.2 years in inflation linked bonds. Bond valuations moderated in the last quarter of 2022, moving from cheap, into a cheaper value territory. Overall the market seems to have reacted by moving to shorter term money market instruments although longer term duration bonds are offering attractive real yields and are in most cases favorable instruments to hold at the top of a hiking cycle. High credit quality instruments have received a higher level of attention as investors seek low risk, high grade debt instruments to park their money. On the other hand, opportunities to pick up yield are diminishing, even in the convertible bond space given the low yields relative to nominal bond and the stretched balance sheets of issuers.

Markets continue to be volatile

South Africa continues to suffer from several own goals. During the quarter the country was, as expected, grey listed by the Financial Action Task Force because of its poor controls governing the flow of illicit financing, such as money laundering and terrorist financing. The experience, from similar countries suffering this fate will means that South Africa will suffer a significant additional damper on GDP growth.

The electricity crisis continues with increasing hours of rotational blackouts. The appointment of an electricity minister further blurs the lines between an independent professional public administration and the ruling party.

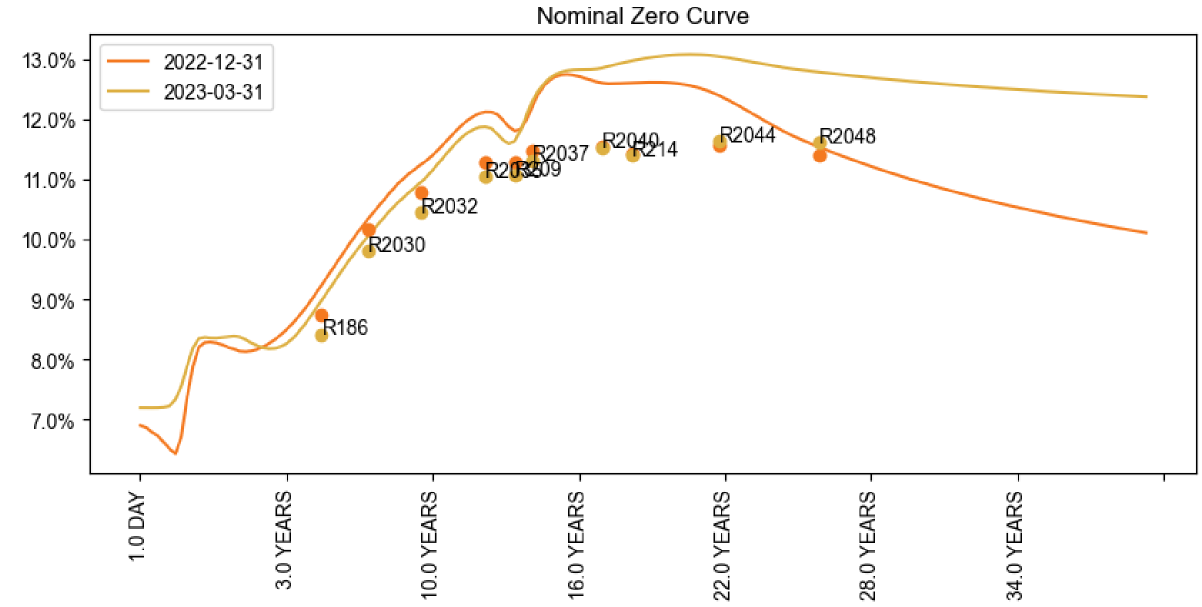
In November, the Reserve Bank said that load-shedding would cut around 0.6% of growth from GDP in 2023. With growing levels of power outages expected, this number may well be higher and there is still no credible plan to deal with the crisis.

South African political risk and geo-political tensions also seem to be rising. The prospect of an ANC-EFF coalition alliance post the 2024 election will dim the short to medium term prospects of South African businesses, further dampening GDP growth with the negative consequences for the South African fiscus. East-West tensions are also growing which may further the decline in commodity prices which the South African economy is linked to.

Globally, there are signs that inflation in the US may have peaked as the FED continued to hike rates, albeit at 25bp rather than 50bp per meeting. The concern is that the US engine for global growth may enter a recession.

Global yields during the quarter first initially rose into renewed inflation fears, especially out of the US, and then rallied as increased inflation expectations waned.

Local yields followed this trend on the short-end of the curve, however (see chart below) long yields rose in response to the increasing risks facing the South African economy.



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