



UNIT TRUSTS | INTERNATIONAL | RETIREMENT FUNDS

see money differently



# NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter One, 2023





## Nedgroup Investments Flexible Income Fund

Performance to 31 March 2023	Fund Performance <sup>1</sup>	Stefi*110%
3 months	2.3%	1.9%
12 months	8.0%	6.3%

The Fund performed well over the first quarter of 2023, easily outperforming its benchmark. Performance from nominal bonds (particularly offshore bonds), a weaker ZAR and an increasing yield from floating rate bonds contributed positively to returns. Inflation linked bonds contributed marginally, while Property and Preference Shares were the only detracting sectors.

Over the longer term the Nedgroup Investments Flexible Income Fund has delivered on its mandate to outperform cash with a predictable and low risk return signature. Its long-term performance is attributable to its philosophy of investing in a diversified range of fixed income asset classes, avoiding expensive asset classes and focusing on high credit quality.

### Market Commentary

The beginning of the quarter saw strong financial markets, and it looked like the difficulties of 2022 were potentially behind us. True to form, however, the woes of inflation and the extreme pace of interest rate hikes added to stresses in economies with a resulting increase in volatility. Overall, though, equities still performed well with the S&P 500 returning 7.5% for the quarter, the MSCI EM index returning 4.0% and the FTSE/JSE All Share Index returning 5.0%.

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). As the second largest bank failure in history, it generated concerns of contagion and central banks had to act swiftly. The market again revised their rate views, now believing the pace of hikes and quantitative tightening would have to moderate, and the US 10Y rallied down to 3.47% at quarter end. In contrast to 2008, where there were credit quality issues, these bank failures are rather attributed to liquidity/duration risk. Large unrealised losses on bank balances sheets (due to the fast and large pace of interest rate hikes) had to be realised, as large-scale deposits were withdrawn and had to be met. To resolve fearful depositors frantically withdrawing deposits across the banking industry and generating further potential solvency issues, the Treasury and Federal Reserve introduced the “Bank Term Funding Program” (BTFP). The BTFP allows banks to use securities at par for loan collateral, meaning they do not have to sell these securities and realise any losses, to generate liquidity. While this certainly assists in preventing panic withdrawals and failures, it fails to address the problem of low cash reserves due to continued quantitative tightening by the Fed and higher interest rates heightening unrealised losses on balance sheets. Large economic stresses such as this which result directly from tighter monetary policy, further exacerbate the Fed’s rate conundrum, as inflation remains problematic.

Following this 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

<sup>1</sup> Net return for the Nedgroup Investments Flexible Income Fund, A class. Source: Morningstar (monthly data series).





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.

On the local front, the SA market was surprised by a 50bp increase in the repo rate by the MPC in March. The market was expecting 25bps, as growth remains highly constrained, and inflation, despite being high, is not being driven by strong demand. The MPC however showed much higher inflation forecasts than outlined in previous meetings, fuelled 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.

## Current positioning and outlook

- Moderate Duration

As at the end of Q1 2023, domestic duration is 0.9 years in nominal bonds (18.2% exposure) and 0.2 years in inflation linked bonds (13.1% exposure). We continue to predominantly hold the SA 8-year nominal bond (R2030) and 3-year inflation linked bond (I2025). Bond valuations moderated in the last quarter of 2022, moving from cheap, into a fairer value territory. We have taken opportunities to reduce duration slightly and move exposure more into shorter dated money market instruments. We do, however, wish to retain a measure of duration as bonds still offer attractive real yields, and are generally good instruments to hold at the top of a hiking cycle.

- Offshore Bonds & Money Market

The Fund maintains an exposure to offshore bonds & money market instruments at 21.7% where an attractive yield pickup over domestic assets is available when hedged back to ZAR, while maintaining a high degree of credit quality and diversification. Our effective offshore currency exposure is at 4.0%; down from last quarter as we sold hard currency into strength. Our offshore currency exposure also acts as a hedge to portfolio duration and performed well as the ZAR weakened. We still view the local currency (ZAR) as being undervalued at current levels.

- High Credit Quality

The portfolio has a high degree of credit quality. Our credit process has historically shielded the Fund from capital loss due to credit events in SA and we are confident in our ability to protect investor's capital in the fixed income space. We retain our preference for a diversified portfolio of senior bank debt and low risk / high grade corporates.

- Convertible Bonds

We maintain a 15bp position in the Sappi convertible bond. We continue to look for opportunities in this space, but low yields (relative to nominal bonds) and stretched balance sheets continues to make this space unattractive.

- Property

The Fund currently has a 1.9% exposure to domestic property, a small exposure as we remain concerned around the fundamentals in this sector. This exposure was reduced over the quarter, as we took some profit in names that performed. Our exposure continues to be selectively allocated to names that are not highly leveraged and where liquidity is sufficient.





- Preference Shares

Preference share exposure is 2.3% at quarter end, with the majority in the large banks. The pre- and post-tax yield remains attractive and with institutions buying back their preference shares, our allocation is naturally decreasing.

### **Summary and conclusion**

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 as a result of tight monetary policy. On the local front, the SARB provided a large surprise to the market, hiking 50bps in the face of higher projected inflation and around concerns of higher expected inflation (and we suspect, a vulnerable ZAR). In a low growth economy, where inflation is certainly not driven by strong demand, many are questioning whether the actions of the SARB are too hawkish.

In the face of continued uncertainty, our strategy remains to steadily lean into weakness and avoid holding assets when they become expensive. The current Fund yield of 9.0% (gross of fees) is a great income underpin for investors and the highest it has been for a number of years, making the return prospects for 2023 attractive.





## Disclaimer

### WHO WE ARE

Nedgroup Collective Investments (RF) Proprietary Limited is an authorised Collective Investment Scheme and the representative of Nedgroup Investments Funds PLC in terms of the Collective Investment Schemes Control Act. It is a member of the Association of Savings & Investment South Africa (ASISA)..

### OUR TRUSTEE

The Standard Bank of South Africa Limited is the registered trustee.  
Contact details: Standard Bank, Po Box 54, Cape Town 8000,  
[Trustee-compliance@standardbank.co.za](mailto:Trustee-compliance@standardbank.co.za), Tel 021 401 2002.

### HOW ARE OUR FUNDS PRICED

Funds are valued daily at 15:00. Instructions must reach us before 14:00 (12:00 for Nedgroup Money Market Fund) to ensure same day value. Prices are published daily on our website and in selected major newspapers.

### FEES

A schedule of fees and charges is available on request from Nedgroup Investments. One can also obtain additional information on Nedgroup Investments products on our website.

### DISCLAIMER

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. Our funds are traded at ruling prices and can engage in borrowing and scrip lending.

Some funds may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks, which could include foreign exchange risks, market conditions and macro-economic and political conditions.

A fund of funds may only invest in other funds, and a feeder fund may only invest in another single fund, both will have funds that levy their own charges, which could result in a higher fee structure.

The Nedgroup Investments Money Market Fund offering aims to maintain a constant price of 100 cents per unit. A money market fund is not a bank deposit. The total return to the investor is made up of interest received and any gain or loss made on any particular instrument held. In most cases the return will merely have the effect of increasing or decreasing the daily yield, but in an extreme case it can have the effect of a capital loss. Excessive withdrawals from the fund may place the fund 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. The yield is calculated using an annualised seven day rolling average as at the relevant dates provided for in the fund fact sheet. Nedgroup Investments has the right to close its funds to new investors in order to manage it more efficiently.

### NEDGROUP INVESTMENTS CONTACT DETAILS

Tel: 0860 123 263 (RSA only)  
Tel: +27 21 416 6011 (Outside RSA)  
Email: [info@nedgroupinvestments.co.za](mailto:info@nedgroupinvestments.co.za)  
For further information on the fund please visit: [www.nedgroupinvestments.co.za](http://www.nedgroupinvestments.co.za)

### OUR OFFICES ARE LOCATED AT

Nedbank Clocktower, Clocktower Precinct, V&A Waterfront, Cape Town, 8001  
WRITE TO US  
PO Box 1510, Cape Town, 8000  
DATE OF ISSUE  
13 April 2023

