

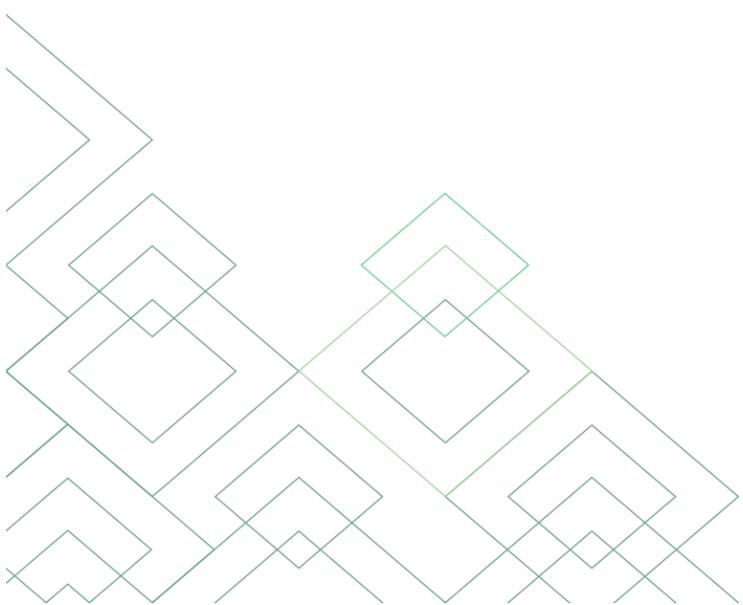
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# NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter Two, 2023





## Nedgroup Investments Flexible Income Fund

Performance to 30 June 2023	Fund Performance <sup>1</sup>	Stefi*110%
3 months	1.6%	2.1%
12 months	8.8%	7.2%

A difficult Q2 for fixed income markets meant that the Fund slightly lagged its benchmark for the quarter. Bond markets, both locally and offshore, sold off over the quarter, detracting from returns. A weaker ZAR and the floating rate component of the portfolio protected the portfolio from these volatile markets, and still allowed the portfolio to generate a reasonable return in such a difficult environment.

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

Increased rate hike expectations and political news created a difficult environment for local fixed income markets over the second quarter of 2023. May 2023 proved to be the third worst month for local bonds over the last 20 years (-4.8%), with only the height of the covid crisis and 'Nenegate' seeing worse returns. For the quarter, the ALBI returned -1.5% while inflation-linked bonds delivered a slightly better return at -0.7%. These pressures also translated to the ZAR, which deteriorated by 5.9% over the quarter relative to the USD. The equity market fared slightly better, with the FTSE/JSE All Share Index and Local Property index both returning +0.7% for the quarter.

Concerns around the South African economy were prominent in Q2 2023, and general sentiment in the market was quite negative. Persistent loadshedding shifted the market's focus to growth constraints, and the reality of weak commodity prices, both from a fiscal and current account point of view, was realised by market participants. The MTBPS will almost certainly show significantly larger deficits than forecast in the budget, as lower mining tax revenues and increased expenditures (most notably wages) will need to be incorporated. News that South Africa was being accused of supplying arms to Russia further exacerbated this negativity, and the market started speculating about sanctions and the future of the African Growth and Opportunity Act (AGOA). As a result, the ZAR plummeted to a new low of 19.80 to the US dollar and the SA 10Y bond reached over 12% intra-quarter (for reference, it was 10.6% as of the end of March 2023).

The SARB reacted by hiking rates another 50bps, to 8.25% in May. The Governor argued that monetary policy was firmly in restrictive territory post that hike, but still kept the door open for further rate hikes as they remain concerned around broader inflation risks stemming from the currency. These comments initially saw a sell-off in the ZAR, but better market conditions in June (largely due to better-than-expected load shedding) saw some recovery in local bonds and currency. South Africa's annual headline inflation rate has continued its downward trend, coming in at a year-on-year rate of 6.3% in May, and forecast to move back into the SARB's target range in June. The market is pricing in one more 25bps rate hike to the end of the year.

Global developed market equities performed well, with stronger than expected economic data out of the US in particular proving continued economic resilience. The S&P 500 and the MSCI World Index returned +8.7% and +7.0% for the quarter respectively. Emerging markets struggled in comparison, with the MSCI EM Index up only +1.0%.





For the first time since March 2022, the Fed decided to keep interest rates unchanged at their June meeting. As much as this was expected by the market, their continued hawkish tone, showing two more 25bp hikes to the end of the year, surprised markets. Despite a slowing in headline inflation, core inflation, however, remains elevated with shelter continuing to be a problematic area of the basket. This hawkish rhetoric acted as a headwind to the performance of developed market bonds, as markets started to price that interest rates are likely to stay elevated for longer than previously expected.

With stronger than expected economic data and sticky core inflation, the likelihood of any kind of recession coming out the US is being interpreted as less likely, and the actions of the Fed remain skewed to the hawkish side. However, headline inflation has moved down from a peak of 9.1% to 4.9%, and using current rental and housing data, core CPI is running under 2%. We remain aware that the lagging nature of monetary policy and the extreme nature of hikes (with additional hikes now on the cards), could be elevating the levels of downside risk in the market.

### **Current positioning and outlook**

- Moderate Duration

As at the end of Q2 2023, domestic duration is 1.0 year in nominal bonds (22.0% exposure) and 0.15 years in inflation linked bonds (13.6% exposure). We continue to predominantly hold the SA 8-year nominal bond (R2030) and 3-year inflation linked bond (I2025). Bonds sold off over the quarter, and this opportunity was used to increase duration, adding bonds at attractive yields. We predominantly purchased nominals bonds in the belly of the curve.

- Offshore Bonds & Money Market

The Fund maintains an exposure to offshore bonds & money market instruments at 20.2% 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 3.3%; down from last quarter as we reduced offshore currency into strength. Our effective FX exposure went as low as 2.5% at the end of May, when the ZAR was around its weakest levels. 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

We only have a small exposure of 1.8% to domestic property as we remain concerned around the fundamentals in this sector. Our exposure continues to be selectively allocated to names who are not highly leveraged and where liquidity is sufficient.





- Preference Shares

Preference share exposure is at 2.1% as of the end of the quarter, 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**

Continued central bank hawkishness and local political news created plenty of volatility during the second quarter of 2023. Extensive loadshedding generated negative market sentiment, with poor growth prospects and the implications of lower commodity prices on both the fiscus and current account being priced by markets. News accusing South Africa of supplying arms to Russia further exacerbated this negativity, and the ZAR and local bonds yields sold off significantly.

The SARB reacted with a hawkish 50bps rate hike as inflation risks are perceived to be to the upside off the back of a weak currency. The Fed paused their hiking cycle, but their rhetoric remains hawkish, as US growth remains above expectations while core inflation remains sticky. They have indicated a potential further 50bps of hikes to the end of the year, higher than what the market was expecting. While the market is seeming to believe that a recession in the US is looking less and less likely this year, the lagging nature of monetary policy and the extreme nature of hikes, with additional hikes now on the cards, could however mean that downside risks are becoming more dominant.

We continue to add duration opportunistically, while keeping the risk in the portfolio appropriate for an income fund, in a market where risks remain elevated.





## 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

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### 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.

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