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NEDGROUP INVESTMENTS FLEXIBLE INCOME

Quarter Three, 2023

Nedgroup Investments Flexible Income Fund

Performance to 30 September 2023	Fund Performance[1]	Stefi*110%
3 months	1.6%	2.2%
12 months	8.7%	8.1%

Another difficult quarter for fixed income markets meant that the fund lagged its benchmark for the quarter. Bond markets, both locally and offshore, sold off, detracting from returns. Some positive return, although marginal, was seen from local inflation-linked bonds. A weaker rand and the floating rate allocation protected the portfolio and allowed the portfolio to still 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 ones and focusing on high credit quality.

Market Commentary

The continued hawkishness of developed market central banks remains front and centre in the market narrative. While market participants keep hoping for signs of pivots in this rhetoric, policy makers continue to disappoint in this regard. The third quarter of 2023 saw markets under pressure as higher yields and slower economic performance continue to take effect. The S&P 500 lost 3.3%, largely in line with other developed markets, with the MSCI World Index returning -3.4%. Emerging markets in general fared slightly better, with the MSCI EM Index returning -2.9%. South Africa, however, fared worse than the average EM, with the FTSE/JSE All Share Index returning -3.5% for the quarter. Rates saw a significant uptick, with the US 10Y yield moving out 73bps, ending the quarter at 4.57%. As base rates rose, local bonds experienced a similar widening in yields. The high yield level on local bonds does, however, substantially mitigate the return impact from this move, with the ALBI and ILB indices returning -0.3% and +0.8% respectively. Local property lost 1.0% over the quarter.

The September FOMC meeting was particularly newsworthy and initiated the latest re-calibration of rates by the market. Although they kept the federal funds target range of 5.25%-5.5% unchanged, it was their projection of future rates that caught the market off guard. They continue to imply one more 25bp hike later this year, but the median projections for next year and end 2025 shifted higher, implying a slower pace of cuts than previously communicated. The Fed's reasoning behind this shift pointed to stronger economic activity, with policy makers projecting a much shorter and shallower period of below potential GDP growth. With rates expected to stay higher for longer, the dollar again saw strong appreciation over the quarter (DXY +3.9%).

The "higher for longer" narrative has been consistently communicated by other major developed market central banks as well, most notably the ECB and BOE. The ECB hiked rates by another 25bps in September, despite fears of an economic slowdown. The BOE paused its hiking cycle in September but warned against expectations of cuts anytime soon.

There is a divergence starting to grow in policy rates between developed markets and emerging markets. While developed markets remain hawkish, some emerging market central banks – such as Brazil, Chile and Poland - have started to cut. The recent jump in oil prices may, however, cause some uncertainty around how quickly the easing cycles progress.

On the local front, fixed income markets have had to deal with bad news on both the monetary policy and fiscal front. On the fiscal side, the market is coming to terms with what is now expected to be a very poor MTBPS on

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

1 November. Data suggests that the fiscal deficit for the 2023/24 fiscal year will be more than 1% wider than Treasury's -3.9% forecast, on the back of weaker commodity prices, growth impacted by electricity cuts and growing expenditure. Murmurs of spending cuts or VAT hikes have gone quiet, a highly unpalatable action in an election year. It seems likely that bond issuance will have to increase and debt stabilisation, in the absence of any change, is not possible.

On the monetary policy side, in contrast to many of our peers, the September MPC was more hawkish than expected. The committee kept rates on hold, but with two of the five members still voting for a hike. The committee remains acutely aware of hawkish global central banks, upside inflation risks (particularly from oil) and a deteriorating fiscus that might require a higher neutral real rate, communicating they are ready to act with additional hikes if necessary.

Current positioning and outlook

- Moderate Duration

As at the end of Q3 2023, domestic duration is 0.85 years in nominal bonds (19.7% exposure) and 0.25 years in inflation-linked bonds (16.6%). We continue to predominantly hold the SA 6-year nominal bond (R2030) and 1.5-year inflation linked bond (I2025). We lightened our nominal bond exposure in July, when markets saw a rally post the selloff in May. This tactical positioning worked well, as bonds saw another significant selloff thereafter. We have started to add linkers to the portfolio, where real yields around the 5-year area of the curve is looking fair to nominal bonds.

- Offshore Bonds & Money Market

The fund maintains an exposure to Offshore Bonds & Money Market instruments at 21.4% where an attractive yield pickup over domestic assets is available when hedged back to rands while maintaining a high degree of credit quality and diversification. Our effective offshore currency exposure is at 3.6%. We still view the local currency (rand) as being undervalued at current levels but believe dollar strength may continue as the "higher for longer" rhetoric is being accepted by the market.

- 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 investors' 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), expensive offshore equity markets and stretched balance sheets continues to make this space unattractive.

- Property

The fund currently has a 2.1% exposure to domestic property, a small exposure as we remain concerned around the fundamentals in this sector. We have, however, slightly increased exposure to this sector over the quarter as sustainable dividend yields on a few select names (where balance sheets are intact) are looking attractive.

- Preference Shares

Preference share exposure is at 2.1%, 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

Once again, we saw markets selling off on the back of central bank communication that was more hawkish than expected. The "higher for longer" rhetoric was made clear by the major developed market central banks (Fed, ECB and BOE) and the market again had to re-calibrate the fair level of rates. In the case of the US, a soft landing is now being assumed likely, as economic growth continues to look resilient despite decades-high interest rates. Interestingly, this quarter we saw some emerging market central banks – such as Brazil, Poland and Chile - start their cutting cycles. The recent jump in oil prices may, however, cause some uncertainty around how quickly the easing cycles progress. South Africa, however, does not appear to be close to its cutting cycle. The September MPC messaging was also more hawkish than the market expected, and it appears that the committee is acutely aware of hawkish global central banks, upside inflation risks (particularly from oil) and a deteriorating fiscus that might require a higher neutral real rate. Not only is monetary policy putting pressure on local bonds, so is the deteriorating fiscal situation, particularly on longer-dated bonds. Monetary and fiscal pressure has moved local bonds into cheap territory from a valuation perspective, and we will continue to be tactical, leaning into weakness when opportunities arise.

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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