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Nedgroup Investments Global Cautious Fund
A strategy for de-risking your portfolio

Pyrford International

NEDGROUP INVESTMENTS

As global central banks begin to scale back monetary stimulus, which has been the main catalyst driving equity market valuations, this note considers how to use the Nedgroup Investments Global Cautious Fund as a defensive allocation strategy to de-risk a diversified global portfolio.

Monetary stimulus has driven market valuations

The MSCI World Index returned 100% from March 2020 to end of December 2021. The injection of liquidity by global central banks through asset purchases after the onset of Covid-19 has been one of the major factors driving the returns of global equity markets. As central banks begin to taper these programs, what does this mean for equity markets? As seen in Chart 1, global equity markets followed the trajectory of asset purchases, which would lead us to believe that central banks tapering may result in a decrease in global equity markets.

Equities are expensive

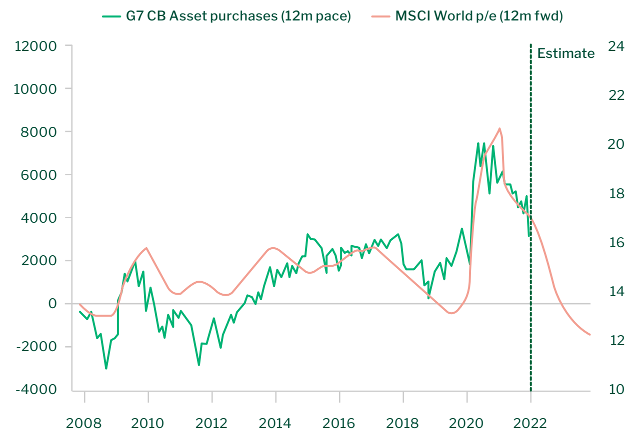
From a valuation perspective, equity markets have risen to record highs compared to fundamentals. Chart 2 shows how equity valuations (measured by Price/Earnings+12m) have only ever been this expensive twice before. Other valuation charts such as dividend-to price or price-to-economic output (GDP) all draw the same conclusion that market valuations are at historical highs. The long and the short is that central bank QE programs have been good for equities prices.

Markets are anxious

We certainly aren't suggesting a collapse in equity markets when rates rise with the market broadly pricing in 4-5 US rate hikes of 25bps each during 2022. The US Fed has also been proactive in their communication of tapering their bond buyback program. However, what isn't known, is the pace and size of these hikes, which is creating uncertainty in an environment where inflation prints are consistently above the Fed's target rate.

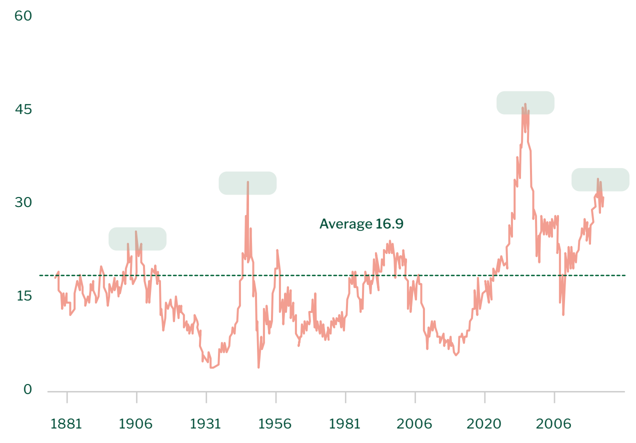
The Fed has a tricky balancing act as they manage inflation expectations, while at the same time protecting a rebounding US economy and avoiding stunting the US governments fiscal receipts as it embarks on an ambitious infrastructure spending plan. The market jitters have been seen in the CBOE VIX index (measure of implied volatility), which spiked in December and January. This increased volatility is not uncommon at the top of a monetary cycle.

1. Global equity follows central bank stimulus



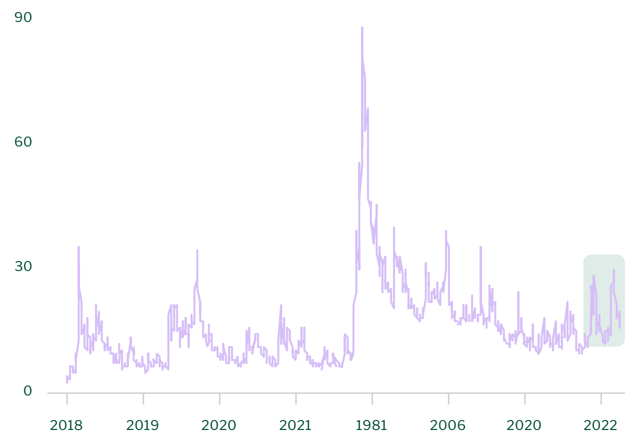
Source: Bloomberg, TS Lombard

2. CAPE Ratio of US Equity Market



Source: Refinitiv

3. VIX showing recent market jitters

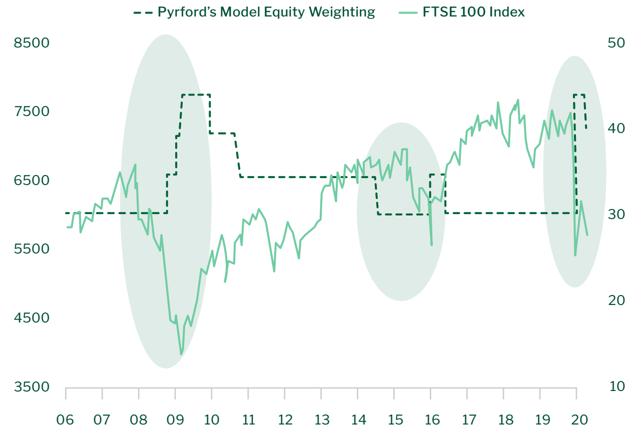


Source: Bloomberg

Liquidity and allocation skills are key

Pyrford, manager of the Nedgroup Investments Global Cautious Fund currently holds 80% of the fund in short-dated sovereign bonds with high liquidity and relative downside protection in the face of rising rates. The other 20% is held in a portfolio of quality global equities. The liquidity of these bonds is key to their strategy. It allows the active manager to rotate into higher risk assets, such as equities, efficiently during periods of market stress, with a very low risk of locking in losses on their defensive income assets. Combined with Pyrford's proven track-record of allocating to equities when markets have slumped in the past (2002, 2008, 2014 and 2020), this provides investors access to a fund that can deliver a defensive cash kicker in a portfolio mix and provide significant capital preservation, to help de-risk an investor's overall portfolio.

4. Active Equity Weighting



Source: Pyrford International, Morningstar

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