Quarterly Commentary

M&G Investments

M&G Dividend Maximiser Fund

Equity

Q3 2024

Market overview

The third quarter of 2024 (Q3) witnessed notable fluctuations in global financial markets, driven by diverse economic signals, a shift among major central banks toward easing monetary policies and geopolitical tension. In mid-September, the US Federal Reserve (Fed) implemented a sizable interest rate cut of 50 basis points, lowering the target range to 4.75%-5.00%. This shift propelled global equity markets to new heights, while weakening the US dollar to major currencies.

In August, the Bank of England (BoE) reduced its main interest rate from 5.25% to 5%, maintaining this level through September. The BoE also announced plans to sell an additional £100 billion in bonds over the next year, thus scaling back its quantitative easing efforts.

The European Central Bank (ECB) also continued the easing trend, cutting its deposit rate by 25 basis points to 3.5% in September. Improved economic data and interest rate cuts in Europe and the US contributed to a recovery in European stocks following a selloff earlier in August.

In the US, Treasuries rallied leading up to the Fed's decision, while rate cuts pressured the U.S. dollar and led to a rally in US equities. This environment contributed to a rally in global bond markets, particularly reflected in the Bloomberg Global Aggregate Bond Index delivering 7.0% (US$) for the quarter.

Equity markets continued to perform well in the third quarter. Global equities (as measured by the MSCI All Country World Index) recorded a total return of 6.6% in Q3 compared to 2.9% in Q2, while emerging market equities (MSCI Emerging Markets Index) rallied another 8.7% in Q3 from 5.0% in Q2 (all in US$).

Emerging market equity returns were led by strong performances from China, South Africa and India. South Africa and India are still benefiting from a market-friendly election outcome while China saw a rebound amid the stimulus measures announced to aid its economy.

In South Africa, improving sentiment from a market-friendly election, better economic conditions, and easing monetary policy led to gains in asset prices and the Rand, with the FTSE/JSE All Share Index rising 9.6% in rand terms. Key contributors included Listed Property (19.1%), and Financials (13.7%) while Resources declined by 1.1%. Industrials was one of the standout performers benefitting from the month-end China rally as Naspers and Prosus prices reacted to the strong move in the Tencent share price. From a South African investor perspective, the move had beneficial implications as Tencent followed the market higher sending the share prices for Naspers and Prosus up by about 14% in September. In addition, the stimulus announcement led to higher commodity prices, which had a positive impact on the local resource sector.

Performance

The M&G Dividend Maximiser Fund delivered a return of 8.5% (A class, net of fees) for the third quarter of 2024, underperforming its benchmark (the average of the general equity funds) by 0.3%. For the year ended 30 September 2024, the fund returned 18.2% (A class, net of fees), underperforming its benchmark by 3.6%. For the three-year period ending 30 September 2024, the absolute performance of the Fund has been strong, with an absolute return of 11.3% per annum over this period, underperforming the benchmark by 0.2% per year.

The Fund's dual focus of buying undervalued companies with strong cash flows and dividends remains core.

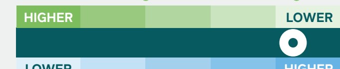
The main detractors from performance for the quarter related to the Fund's offshore exposure of approximately 21%, of which 18% is to the M&G Global Equity Fund and 3% is to the M&G Africa Equity Fund. The M&G Global equity Fund returned 1.4% over the quarter in South African rand, which was mainly due the strengthening of the Rand by approximately 5% over the quarter. This total offshore weighting of 21% can be viewed in context of the maximum allowable offshore limit of 45% for this fund. The Fund's fairly low weighting to offshore reflects that we think the South African market is relatively attractively priced.

The largest contributor to performance for the quarter was the Fund's holding in Southern Sun Hotels. The share price was up over 45% in the quarter as it is responding to increasingly positive news and sentiment around the South African market post the election results. We think that Southern Sun provides excellent low risk exposure to property within South Africa and is well-positioned to benefit from lower bond yields and an improving travel market. We think that the G20 Summit being hosted in South Africa next year, could also provide further momentum to a company which is very operationally leveraged to improve occupancies and higher room rates at their hotels. The company has a very strong balance sheet considering the underlying property base which it owns, and we think that dividends should grow strongly over the next few years.

Sasol was the second largest contributor to performance in the quarter. Sasol's share price was down almost 16% in the quarter, and we do not hold a position in this company. Within the oil and chemicals sector, our preferred company to own has been Omnia, which we think is very attractively priced for a world-class mining explosives and fertilizer business. We had previously commented that while Sasol was currently paying a high dividend yield that we were concerned that the dividend may need to be cut due to cash flows coming under pressure over the next five years given the substantial capex projects to transition the business to reduced carbon emissions. In the annual results released during

Risk profile

Risk of not earning meaningful inflation-beating returns over the long-term



Variability of returns over the short-term

Fund facts

Fund objective

To provide broad-based exposure to shares that offer value and medium- to long-term growth. The portfolio managers seek to invest in companies where returns can be achieved from any or all of growth in earnings, growth in dividends and a re-rating of its share price; however, there will be a bias towards companies offering high but sustainable dividend yields.

Investor profile

Investors with a higher risk tolerance looking for out-performance of the average SA General Equity Fund without taking on greater risk of loss. The recommended investment horizon is 7 years or longer.

Investment mandate

The Fund invests in companies that meet the portfolio managers' value criteria. The Fund will have a bias towards investment in companies offering high, sustainable dividend yields; however, it is not restricted from investing in companies offering earnings growth or possible market re-rating. The intended maximum limits are Equity 100%, Property 10% and Foreign 45%.

Fund managers

Ross Biggs
Kaitlin Byrne

ASISA category

South African - Equity - General

Benchmark

ASISA South African - Equity - General Category Average

Inception date

2 August 1999

Fund size

R4 393 313 951

Awards

Raging Bull: 2006, 2008

Morningstar/Standard & Poor's: 2007, 2009

Annualised performance	A class	Benchmark	T class	B class	F class
1 year	18.2%	21.8%	18.6%	18.5%	19.0%
3 years	11.3%	11.6%	12.0%	11.7%	12.3%
5 years	13.0%	11.3%	13.4%	13.3%	13.8%
7 years	9.5%	7.9%	10.0%	9.9%	10.3%
10 years	8.4%	6.8%	-	8.8%	-
20 years	14.5%	11.8%	-	-	-
Since inception	15.4%	12.8%	-	-	-

Sources: M&G Investments, Morningstar & Deutsche Securities

the quarter, Sasol has indeed revised its dividend policy, in that the dividend will now be based off cash flow rather than earnings. We think this change in policy is likely to result in a lower dividend than previously expected.

The third largest contributor to performance this quarter was due to the Fund not holding any Aspen shares. We have generally held the view that Aspen's shares have been expensively valued over long periods of time. We think that the market tends to pay up for the potential growth in this company and its potential ability to fill its pharmaceutical manufacturing overcapacity. The full year results released at the beginning of September were disappointing, resulting in the share pricing falling by 15% for the quarter. We continue to think that this business is expensively valued and see better opportunities in the market.

Generally, within the resources space, the recent announcement from China to support its economy and the stock market is potentially positive for base and bulk metals. In our view, China has been suffering from weak consumer and business sentiment, amongst other structural issues, and the recent stimulus package should go some way to improving sentiment. Iron ore, which has been weak due to a weak property sector, has responded positively to the stimulus announcements, as has copper which is normally a bellwether for expected economic growth. Fundamentally, although iron ore inventories are elevated at ports, prices had fallen to the 90th percentile and without much supply growth from the major miners, prices should be sustained above $90/t even in the absence of a positive impact from the announced stimulus. Similarly copper supply is constrained and the recent surge in copper related M&A and exploration, is likely to keep copper prices well above cost support. Therefore, against this backdrop we still think that exposure to well-diversified commodity companies with optionality is attractive. We therefore continue to hold positions to Exxaro, Anglo American, BHP and Glencore.

Overall, therefore, we are cautiously optimistic about the sector over the near-term as interest rate cuts, a weaker US dollar, a stimulative China and rational mine supply should be good for prices. However, we are yet to see the leading indicators such as manufacturing PMIs or China property sales turn convincingly positive.

In the financials sector, we think that South African banks continue to trade at undemanding valuations. We think that bond yields are still elevated although bond yields have fallen materially over the quarter as the SA election results in June where favourably viewed by the market. As a result, we have seen strong share price rallies from the interest rate sensitive sectors such as the banks, insurers, retailers and property companies.

South Africa has a very well-regulated banks sector and credit risk within the large banks have generally been very well managed through cycles. We therefore continue to think that Banks look relatively attractively valued and we remain overweight the banks sector. We retain our underweight to Capitec which, while we rate more highly in terms of quality, we cannot ignore that that it is substantially more highly rated than other banks in the sector and over the last six months has rerated to a level where we think that the share is priced for continued high growth and perfection. We continue to prefer Standard Bank, ABSA and Investec, which are substantially cheaper than Capitec.

We think that the banks that we own are trading on undemanding valuations, especially given that earnings and dividend growth is exceptionally strong currently. We think there is also good opportunity to generate alpha within this sector by being overweight relatively undervalued banks.

We acknowledge that while it is very difficult to forecast the future and we do not make any attempt to do this, we do spend a lot of time thinking about the economic cycles that various sectors are in, and where valuations are. In this way, we aim to try to make money for our clients through these cycles and continue to buy companies that have proven dividend and cash flow track records, and which can withstand the normal upheavals that occur in markets over time. We aim to continue building risk-cognisant portfolios that seek to add value through stock selection relative to the benchmark.

Strategy and positioning

We remain optimistic regarding the South African equity market returns over the medium term due to the prevailing excessive levels of pessimism reflected in share prices and valuations. The Price to Book of the JSE remains close to 1.8X as at the end of September 2024, which we think is a very attractive valuation level.

South African assets appear to be undervalued relative to emerging and developed markets and have the potential to rerate significantly under a more favourable economic situation. The prospect of lower interest rates and bond yields both in the United States and South Africa, as well as the favourably viewed Government of National Unity in South Africa, may continue to support a re-rating of equities in South Africa.

The Fund's relatively low offshore exposure reflects that we think the SA market and SA currency represent very good value. Today, we continue to think that Emerging Markets and African equities represent particularly good value, and we think the SA rand is still attractive. Your Fund has approximately 18% allocated offshore. We also have a further 3% in African markets excluding South Africa which we think are very attractively priced.

The focus of the fund continues to be on finding companies that are undervalued and are paying good dividend yields with the potential to pay growing dividends over the long run. We are confident that we have built a portfolio of attractively priced stocks that in aggregate is cheaper than owning the index, yet still capable of delivering attractive underlying growth independent of the economic cycle in which we find ourselves.

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Invest now

Application forms

An electronic copy of this document is available at www.mandg.co.za

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Sources: M&G Investments, Morningstar & Deutsche Securities