Quarterly Commentary

M&G Enhanced Income Fund

Multi-asset

Q3 2024

Market overview

US Treasury bond yields continued their recovering trend over the third quarter, making successive year-to-date lows. Monthly labour reports generally showed lower-than-expected monthly nonfarm payrolls and as expected average hourly earnings figures, alongside higher than forecasted unemployment rates. Prior nonfarm payrolls were continually revised lower too. The weak labour figures highlighted that from the lens of the FOMC's dual mandate the concern has shifted from high inflation to weak employment. The labour statistics helped drive a persistent bull steepening in yields over the quarter. The third quarter saw stronger real economic activity data surprises coupled with softer consumer inflation data surprises and this combination provided downward pressure for US bond yields over the course of the quarter.

The market was somewhat undecided heading into the July FOMC rate decision and positioning was decidedly less bearish than on previous occasions. Based on the prior tone of Fed speakers and inflation data prints, some participants in the US rates market were expecting a rate cut by the Fed. Although this did not materialise at the July meeting, it was the dovish tone of the statement and the ensuing press conference that allowed yields to continue rallying across the term structure with the front-end outperforming. The market subsequently repriced to fully expect a September rate cut. Interest rate cut expectations in the US grew stronger over August with the market discounting over 200bps worth of easing over the coming year. The July FOMC minutes released in August showed that the committee did discuss whether to cut rates then. The subsequent weakness in the labour market meant that that they probably regretted not cutting in July.

The US rates market was pushing for a 50bp cut by the FOMC at the 18 September meeting, however, the release of the August inflation reports a week earlier drove the market to price out a 50bp cut and instead priced in only 25bps. We suspect that the FOMC were unhappy with the market pricing in only a 25bp cut and they contacted the Wall Street Journal and Financial Times a few days before the meeting, asking them to publish dovish articles on the upcoming FOMC meeting. The market then raised the cut expectation to 40bps. The FOMC did lower rates by 50bps, although the tone was hawkish and supported a further increase in yields into quarter end.

Brent crude oil prices declined in each month over the quarter, initially reversing all the gains made year to date and then making new lows. The US dollar index lost its strengthening trend by weakening in every month of Q3 taking the greenback's performance to negative on the year. Dollar weakness helped the rand exchange rate strengthen, making the rand one of the best-performing currencies in the world this year. The lingering effects of pre-election position unwinding saw the RSA CDS market tighten over the course of the quarter to the tightest levels seen since pre-Covid.

Following the cabinet announcement, the new quarter began with another strong rally in SA government bonds as the market's nervousness was found to be misplaced. The rally had both local and global support underpins and continued for the remainder of July, which saw a mixed bag of local economic data outcomes. Market expectations on interest rates took a further step lower headed into the 18 July MPC meeting where the committee decided to hold the repo rate steady at 8.25%. The economist consensus was for unchanged rates while the market placed a one-third probability that rates would be lowered by 25bps. The market was accurate as the MPC voted by a margin of 4-2 to hold rates steady. The deliberations of the committee appear to have been very dovish and the decision was not easy. The market then widely expected the MPC to start the rate cutting cycle in September.

SA bond yields declined further in August. Lower global bond yields, a stronger rand and a weaker than expected CPI inflation print for July helped continue the post-election rally. Any seller of SA bonds since the election had sellers' remorse as the rally was unrelenting. Every uptick in yields was met with a strong wave of demand from both local and international buyers. High frequency real economic activity data releases were generally better than expected in August. The FRA market was discounting five successive interest rate cuts of 0.25% starting at the September MPC meeting, taking the repo rate down to the SARBs steady state of 7.00%. The MPCs view of the neutral repo rate currently sits at 7.25%. The contemporaneous real repo rate is high. The fact that the decision to keep rates steady at the July meeting was such a close call, and that the July CPI print was such a large downside surprise led the market to debate whether the size of the September rate cut would be 25bps or 50bps.

SA bond yields declined further in September. Lower global bond yields, a stronger rand, lower crude oil prices, weaker than expected CPI inflation for August and a lower Q3 2024 BER inflation expectations survey helped continue the rally. The MPC of the SARB lowered the repo rate by 25bps. This was in line with the economist consensus expectation, however, the market did price in some chance for a 50bp reduction. Despite the dovish economic data, the committee chose to focus on its risk assessment which was to the upside. The MPC made their decision prior to the FOMC announcement. The market read the statement and subsequent press conference as hawkish. This helped to flatten the yield curve over the month. The currency also benefitted from the decision.

Annualised performance	A class	Benchmark	T class	X class	D class
1 year	13.8%	8.5%	14.0%	13.8%	14.2%
3 years	9.3%	6.9%	9.5%	9.3%	9.6%
5 years	7.5%	6.1%	7.7%	7.5%	7.9%
7 years	7.1%	6.5%	7.4%	7.2%	7.5%
10 years	7.3%	6.8%	-	7.4%	7.8%
Since inception	7.9%	6.9%	-	-	-

Risk profile

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

HIGHER LOWER

LOWER HIGHER

Variability of returns over the short-term

Fund facts

Fund objective

To maximise total returns in excess of the benchmark over a rolling 36-month period, while seeking to protect capital and reduce volatility through active asset management.

Investor profile

Individuals requiring an actively managed income solution that provides a high income return together with moderate capital growth. The recommended investment horizon is 1 to 3 years.

Investment mandate

The Fund invests in a flexible mix of high-yielding securities. The intended maximum limits are Equity 10%, Listed Property 25% and Foreign 45%. No duration constraints apply. The Fund is managed to comply with regulations governing retirement fund investments (Regulation 28).

Fund managers

Roshen Harry
Bulent Badsha

ASISA category

South African - Multi-Asset - Income

Benchmark

STeFI Composite Index measured over a rolling 36-month period

Inception date

1 July 2009

Fund size

R891 300 303

Sources: M&G Investments, Morningstar & Deutsche Securities

M&G Investments

Performance

Over the 12 months to September 2024 the M&G Enhanced Income Fund delivered a total return of 13.8% (A class, net of fees), which compares favourably to both the benchmark (STeFI Composite) return of 8.5% and the ASISA category average gain of 12.7%. More importantly, over the past four years the Fund provided an annualised return of 8.8% (A class, net of fees), which was comfortably ahead of the benchmark return of 6.1% and the peer average of 8.2%.

Strategy and positioning

Over the quarter, the fund took advantage of the flattening of the Inflation Linked Bond (ILB) yield curve to make a switch trade where the real government bond exposure was shortened from the belly to the front end of the curve thereby reducing ILB duration. The implied real yields from nominal bonds have been more attractive than inflation linked bonds for some time, therefore most of the fund's duration exposure is to nominal rates instead of real rates, but some exposure to inflation-linkers is maintained due to the relatively high absolute level of real yields available and the fact that they provide a form of insurance to the portfolio. The preference remains in the shorter end of the yield curve. During the quarter the positioning in the property teams favoured defensive, yet high yielding SA listed property stocks was maintained. There was a switch in some foreign bond exposure in the quarter, adding short-dated US treasury bonds in favour of the existing floating-rate US investment grade bonds due to the tightness of credit spreads. A fully currency-hedged position for the foreign bonds was largely maintained, which was beneficial in the face of a resurging rand exchange rate. Over the quarter, duration risk was managed tactically while the local cash bond positions were maintained. This proved to be beneficial considering the rally that ensued. The fund remains drawdown focussed, cyclically aware and tactically alert.

Contact us

info@mandg.co.za

mandg.co.za

0860 105 775

Invest now

Application forms

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Disclaimer

Sources: M&G Investments, Morningstar & Deutsche Securities