Quarterly Commentary

M&G High Interest Fund

Income

This fund is capped to new investors.

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 the US, Treasuries rallied leading up to the Fed's decision, while rate cuts pressured the US 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$).

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.

South African bonds performed strongly, with the FTSE/JSE All Bond Index rising 10.5% (in Rand) over the quarter and adding more positive returns to the total for the year. Bond yields continued the downward move we have seen since the conclusion of the GNU election results.

Meanwhile, CPI decreased to 4.4% y/y in August, below the SARB's target and forecasts of 4.5%, down from 4.6% in July. This marks the third consecutive month of inflation slowdown. Following the Fed's lead, the Monetary Policy Committee (MPC) implemented a widely anticipated 25 basis point rate cut to 8%.

Performance

Over the past quarter the M&G High Interest Fund returned 2.2% (A-class, net of fees), which was 16bps head of its benchmark. For the 12 months ending 30 September 2024, the Fund returned 8.9% (A class, net of fees) versus the benchmark's 8.5%.

Due to the conservative way in which we manage the fund, and the lack of duration opportunities inherent in the mandate, as one would expect, the fund did not participate much in the post-election rally. However, given that the SARB only recently commenced its rate cutting cycle, the predominantly floating-rate exposure of the fund benefitted from the high level JIBAR rate. The fund therefore generated an absolute level of return over the quarter that falls on the high side of what it has achieved historically.

Positioning

The third quarter was a stellar one for South African fixed rate assets. The performance of the ALBI illustrates this well – the 10.5% return of the index for the quarter is the third best quarterly return that it has delivered since its inception in 2001. This return was underpinned by a number of factors, the most notable of which was the improvement in investor sentiment towards South Africa after the May election and the formation of the GNU.

Another significant driver of returns was the extent to which inflation receded, and the unexpected nature of this move. At the start of the quarter the most recently reported headline inflation print for SA was at 5.2% y/y, still well within the upper half of the SARB's target range. This has since dropped to 4.4% y/y, which moves it into the lower half of the target range. This is the lowest inflation print that SA has seen since the first half of 2021. Similarly, both core as well as producer price inflation have receded significantly. This inflation move has led to a material recalibration of economist forecasts. To use the SARB as an example, they now expect inflation to average 0.5% less for both 2024 and 2025 than what their forecasts suggested at the start of the quarter. Furthermore, they now expect headline inflation to remain below the mid-point of their target range for the remainder of their forecast period (to the end of 2026). Three months ago they were only expecting inflation to sustainably move to the lower half of the target band from the second quarter of 2025.

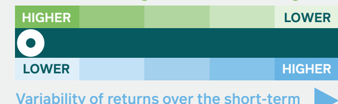
In line with this improving inflation forecast, the SARB cut the repo rate by 25bps in September, after having kept it unchanged for over a year. The confluence of all of these factors (SARB cut, inflation improvement and improved sentiment) led the market to significantly revise its interest rate outlook. At the start of the quarter the FRA market was expecting only a 50bp cutting cycle over the next two years. The market is now pricing in a further 100bps of interest rate cuts (i.e. a total cutting cycle of 150bps).

This backdrop resulted in some significant moves in money market assets. Over the past quarter the NCD curve has moved lower by more than the 25bps SARB rate cut, and the curve

Annualised performance	A class	Benchmark	X class	D class
1 year	8.9%	8.5%	9.1%	9.2%
3 years	7.3%	6.9%	7.4%	7.5%
5 years	6.2%	6.1%	6.3%	6.4%
7 years	6.6%	6.5%	6.7%	6.9%
10 years	6.9%	6.6%	7.0%	7.1%
Since inception	6.5%	6.3%	-	-

Sources: M&G Investments, Morningstar & Deutsche Securities

Risk profile



Fund facts

Fund objective

To maximise the current level of income above money market and current account yields, while providing maximum capital stability and a high degree of liquidity. This actively managed fund invests in slightly longer duration instruments than money market funds. The daily unit price will move slightly, in line with the performance of its holdings.

Investor profile

Individuals requiring a higher yield than that from a money market or current account, without taking on unnecessary risk. Capital stability and a high income yield are more important than long-term capital growth. The recommended investment horizon is 3-12 months, or longer depending on income needs and risk profile.

Investment mandate

The Fund invests in a flexible mix of non-equity securities. Its maximum weighted average duration is 180 days and the maximum tenor of any one instrument is 36 months. The Fund is managed to comply with regulations governing retirement fund investments (Regulation 28).

Fund managers

Roshen Harry

René Prinsloo

ASISA category

South African - Interest Bearing - Short Term

Benchmark

STeFI Composite Index measured over a rolling 12-month period

Inception date

8 December 2010

Fund size

R11 080 501 952

has also inverted. Both of these changes point to the market pricing in further rate cuts. Indeed, when you compare fixed NCD rates to their floating counterparts it would appear to us that the NCD market is pricing in approximately a further 100bps of rate cuts, or a total cycle of 125bps, roughly in line with the FRAs. Floating rate spreads are less impacted by expected interest rate changes and these have remained roughly unchanged, moving about 10bps lower over the quarter. The treasury bill curve also moved lower and has also inverted but remains at an attractive level relative to bank NCDs. We therefore maintain a significant holding in treasury bills (TB) across most money market mandates. For the High Interest Fund specifically, the fact that the fund can hold instruments up to three years in maturity, and the liquidity requirements of the fund, make this instrument class less suited to the fund's needs and we remain uninvested in TBs.

We made no significant changes to the positioning of the fund over the past quarter.

Credit

Total credit issuance (excluding government issuances) picked up 30% in Q3 2024 with R47.5bn issued, compared to R36.7bn in Q2 2024, with Q3 issuance being the largest quarterly issuance year-to-date. The Q3 issuance was up 63% compared to the same quarter in the prior year (Q3 2023: R29.2bn issued). Rolling 12 months issuance to Q3 2024 sits at R171.3bn compared to R157.4bn for the 12 months to Q3 2023.

The make-up of issuance for the quarter followed established trends - issuance being almost exclusively floating-rate notes, with auctions accounting for just over 55% of placements by volume.

Data compiled by RMB's Credit Research team indicates that banks and financial issuers dominated primary market issuance for the quarter contributing to 54% of gross issuance, followed by corporates at 18%. Q3 was the strongest quarter for banks year to date. ABSA Bank Limited was the largest bank issuer of the quarter, raising R3.3bn senior unsecured via green bonds and ABSA Group Limited raised R3bn Tier 2 paper via both private placement and auction. Nedbank Limited raised R3.1bn senior unsecured paper in July. Additionally, Nedbank Group Limited privately placed R3bn Additional Tier 1 paper. Transnet was the largest issuer of the quarter, issuing R6bn in September via private placement tap issuance. Q3 saw the smallest quarterly corporate issuance year to date with R8.8bn issued. Mobile Telephone Networks Ltd was the largest corporate issuer for the quarter, raising in total R2.9bn via an auction and a separate private placement.

July was the strongest issuance month year-to-date for banks with R10.3bn issued comprising purely of senior ranking issuance. ABSA Bank Limited, Nedbank Limited and The Standard Bank of South Africa Limited all issued senior notes carrying 3-year, 5-year and 7-year tenors, with investors showing the most interest in the 7-year note in each instance; reflecting investors being open to purchases further down the curve in search for yield. July further saw Telkom SA SOC Limited return to the local debt capital auction market, holding its first public auction since 2019.

August saw the strongest securitisation issuance year-to-date with R4bn issued across 3 structures. The issuance
GCR raised Transaction Capital's rating outlook from negative to stable during August as the Group is now in a net cash position following the successful unbundling of WeBuyCars and the subsequent settlement of the majority of its debt and liabilities including the listed bond TC001.

September was the strongest issuance month of Q3 with R18.6bn issued, R7bn of which was SOE issuance. In addition to Transnet's R6bn tap-issuance, the IDC privately placed R1bn.

After defaulting on its obligations four and a half years ago, the Land Bank was finally able to conclude a restructure with its lenders on the 16th of September. The restructure saw lenders exchange their existing Land Bank holdings for new amortising instruments maturing in March 2028. The implementation of the restructure allowed for the injection of an additional R5bn of equity into the Land Bank courtesy of National Treasury – a material benefit to lenders. Subsequent to the restructure, Land Bank repaid roughly a third of the amount it owed lenders - a positive outcome for all creditors. This repayment resulted in the proportional unwind of the impairment we hold against Land Bank exposures. The net effect of this change was a small positive contribution to the fund's performance of 3bps for the month of September. With the restructure concluded, the hope is that Land Bank can now focus on creating a sustainable business while continuing to service and ultimately repay existing lenders.

There was little move in credit spreads over the quarter, with both fixed rate credit spreads and floating rate credit spreads closing the quarter +1 bps wider. □

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Sources: M&G Investments, Morningstar & Deutsche Securities