M&G Investments

M&G SA Equity 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 European Central Bank (ECB) also continued the easing trend, cutting its deposit rate by 25 basis points to 3.5% in September.

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$). The Bloomberg Global Aggregate Bond Index delivering 7.0% (US$) for the quarter.

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.

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%.

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.

Performance

The M&G SA Equity Fund delivered a return of 9.2 % (F class, net of fees) for the third quarter of 2024, slightly behind its benchmark which delivered a return of 9.6%. For the 12 months ended 30 September 2024, the Fund returned 19.5% (F class, net of fees), underperforming its benchmark by 5.9%. Over the 3-year period ending 30 September 2024, the Fund delivered a return of 11.3% per annum over this period, underperforming the benchmark by 1.1% per year.

The 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, causing the share pricing to fall by 15% for the quarter. We continue to think that this business is expensively valued and see better opportunities in the market.

Over the last quarter, we sold our remaining shares in Sasol. This underweight position to Sasol was the second largest contributor to performance in the quarter. 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 the quarter, Sasol has indeed revised it 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 outperformance from Sasol was offset by our overweight exposure to energy and iron ore stock, Exxaro, in the resources sector. Exxaro is exceptionally attractively valued relative to the cashflows it receives from its stake in the Sishen Iron Ore company and its large coal business mainly supplying coal to Eskom power stations. On the ESG front, we have been very engaged with Exxaro to understand their coal transition and how they are utilising the cash flows from thermal coal to invest in renewable energy and the potential opportunities and risks to invest in battery commodities.

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 struggling property sector, has responded positively to the stimulus announcements, as has copper, which is normally

Annualised performance

	B class	Benchmark[1]	F class
1 year	20.9%	25.4%	19.5%
3 years	12.6%	12.4%	11.3%
5 years	12.6%	11.9%	11.3%
7 years	9.0%	8.1%	7.7%
10 years	8.4%	7.5%	-
20 years	14.1%	13.0%	-
Since inception	14.7%	13.0%	-

[1] The Fund's benchmark changed from the FTSE/JSE All Share Index (TR) to the FTSE/JSE Capped SWIX All Share Index (TR) on 1 July 2017.

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 provide broad-based exposure to South African 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 (a) growth in earnings, (b) growth in dividends and (c) a re-rating by the market of the company's share price.

Investor profile

Investors with a higher risk tolerance who are looking for out-performance of the South African equity market, while limiting volatility relative to the fund's benchmark. The recommended investment horizon is 7 years or longer.

Investment mandate

The Fund can invest in any company listed on the JSE that meet the portfolio managers' value criteria. The Fund seeks out value by attempting to capture all components of return over time, including high dividend yield, earnings growth and possible market re-rating. The Fund will not invest in any foreign markets. The intended maximum limits are Equity 100%, Property 10% and Foreign 0%.

Fund managers

Ross Biggs
Chris Wood
Aadil Omar
Leonard Krüger

ASISA category

South African - Equity - General

Benchmark

FTSE/JSE Capped SWIX All Share Index

Inception date

21 September 2000

Fund size

R39 661 322 286

Please note that the B Class is only available to large retirement funds and institutional investors. The F Class was launched on 01/07/2016.

Sources: M&G Investments, Morningstar & Deutsche Securities a bellwether for expected economic growth. Fundamentally, although iron ore inventories are fairly 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 are attractive. Therefore, we continue to hold overweight positions to Exxaro, Glencore, BHP and an equal weight position to Anglo American.

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 were 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 banking 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 banking sector. Our underweight to Capitec though was the second largest detractor from performance for the quarter. While we rate Capitec more highly in terms of quality banks and its has grown tremendously over the last decade, we cannot ignore 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. Our continued preference remains Standard Bank, ABSA and Investec, which are substantially cheaper than Capitec.

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

A strong beneficiary of the lower bond yields during the quarter was the Fund's overweight position to The Foschini Group. Lower interest rates and home loan repayments, together with expected lower fuel prices and much less disruption from Eskom, should mean an improvement to consumer disposable income. Despite the almost 25% share price increase of Foschini in the quarter, we still think it is attractively priced.

Our overweight position in British American Tobacco (BAT) was the fourth largest relative contributor to performance for the quarter. We believe that the investment case remains very strong as the company is trading with an exceptionally attractive dividend yield of 9%. We anticipate continued strong cash flows from BAT to drive a repayment of debt, enable significant share repurchases, as well as continue to fund investment into next generation low risk products. BAT has also been able to take advantage of its very highly rated Indian associate company, by selling down approximately 4% of its stake in ITC this year, such that it still owns 25% of ITC. Due to the exceptionally high rating of ITC, the 4% sale raised approximately GBP 1.5 billion. This sale has enabled BAT to reduce debt and restart its share buyback programme. Shareholders are therefore receiving an exceptionally attractive 9% dividend yield, as well as a share buyback program to further enhance this yield.

BAT is at the forefront, together with Philip Morris International, of offering its customers alternative products which reduce harm and we expect this trend to continue. We think that BAT can continue to grow profits while helping its customers switch to much lower risk and less harmful products. We think BAT is a high yielding "insurance" like asset due to its defensive cash flows.

It is worth mentioning that we do not construct our portfolios based on a particular view or outcome as we think it is not possible to consistently predict what oil prices or inflation rates might do... or when and where countries may go to war for instance. We rather look to construct portfolios with many different and diversified ideas, all of which we think have favourable pay-off profiles. In this way, we hopefully have portfolios which can deliver good returns under many different economic environments.

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 make money for our clients through these cycles and continue to try and 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 significanly 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 focus of the M&G SA Equity Fund continues to be on finding companies that are undervalued and which can grow earnings and dividends over the long run.

Contact us

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Invest now

Application forms

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Disclaimer

Sources: M&G Investments, Morningstar & Deutsche Securities