M&G Investments

M&G Insights

Market Observations Q1 2024

April 2024

Sandile Malinga
Chief Investment Officer of Multi-Asset

Market overview

The first quarter of 2024 (Q1) brought a continuation of the relatively bullish investor sentiment towards global equities seen in the last months of 2023, as prospects for growth in the US were buoyed by positive company earnings reports and supportive economic data that increased the likelihood of a "soft landing" for the economy. On the other hand, global bonds were weaker as inflation proved higher than expected and major central banks kept interest rates on hold, prompting pundits to move out their rate cut expectations to the second half of the year. Still, they and the US Federal Reserve are roughly aligned in their forecasts of a 25bp interest rate cut in each of Q2, Q3 and Q4, starting at the Fed's 11-12 June FOMC meeting.

The Japanese and US equity markets were the stand-out performers, while the UK disappointed and China continued to experience losses, although the magnitude of these fell as the quarter progressed, helped by small gains in March. Emerging markets were broadly in the red, with the exception of India, and South African equities remained in the doldrums on the back of slow growth and the approaching May national elections.

Global equity (as measured by the MSCI ACWI) delivered a total return of 8.2% in Q1 compared to 11.0% in Q4, while developed market equities produced 8.9% and emerging market equities returned only 2.4% (MSCI Emerging Markets Index – all in US$). Global bonds posted -2.1% (Bloomberg Global Aggregate Bond Index, in US$). In South Africa, the FTSE/JSE All Share Index and Capped SWIX Index underperformed, both delivering -2.3% in rand terms. The local market was dragged down by a 7.6% loss in Financials, while Industrials returned 0.6%, Resources 0.8% and Listed Property 3.5%, the latter continuing its rally from the previous quarters.

South African bonds recorded a -1.8% return for the quarter. This saw the yield on the 10-year SA government bond rise to 12% by quarter-end. Meanwhile, the rand lost 3.5% against the US dollar, 2.7% versus the UK pound and 0.9% against the euro.

Asset class	Total return Q1 2024 (Rand and US$)
SA equity – FTSE/JSE All Share Index (Rand)	-2.3%
SA equity – FTSE/JSE Capped SWIX All Share (Rand)	-2.3%
SA listed property – FTSE/JSE All Property Index (Rand)	3.5%
SA bonds – FTSE/JSE All Bond Index (Rand)	-1.8%
SA inflation-linked bonds – FTSE/JSE Composite ILB Index (Rand)	-0.4%
SA cash - STeFI Composite Index (Rand)	2.1%
Global equity – MSCI All Country World (Total, US$ net)	8.2%
Global equity – MSCI World (Developed) (US$ net)	8.9%
Global equity – MSCI Emerging Markets (US$ net)	2.4%
Global bonds – Bloomberg Global Agg Bond Index (US$ net)	-2.1%
Global property – FTSE EPRA/NAREIT Global REIT Index (US$ net)	-1.8%

Source: M&G Investments, Bloomberg, data to 31 March 2024

United States

In the US, investors continued to take heart from the encouraging outlook, with stubborn inflation (and the Fed's unwavering fight against it) one of the few negative factors denting investor sentiment. At 3.2% y/y, February CPI was marginally higher than its January levels, with rising energy prices making themselves felt. At the same time, the Core PCE Price Index, the Fed's preferred inflation measure, came in at 2.8% y/y, as expected. Also in line with expectations, the Federal Reserve kept benchmark interest rates on hold at its March FOMC meeting, and is forecast to do the same in May. US GDP for Q4 2023 was reported at 3.4% (q/q annualised), above earlier expectations and bolstered by brisk consumer spending and rising exports; the Fed forecasts that the economy will grow around 2.1% in Q1, a slower but still-respectable pace. For the quarter, the Dow Jones produced 6.1%, the Nasdaq 9.3%, and the S&P 500 10.6% (all in US$). The S&P's 12-month forward P/E ratio rose to a heady 21X at quarter end from 19.5X at the start of the quarter, with price gains outpacing those of earnings. Although the breadth of the gains improved from 2023's narrow focus around the "Magnificent 7" AI-related stocks, a look at the Equal-Weighted S&P Index shows that it was still large-cap shares driving the outperformance of the market during the quarter.

UK

In the UK, the Bank of England (BoE) kept its main interest rate unchanged at 5.25% at its February meeting, saying its next move would remain data-dependent. Similar to the US, the market is pricing in the start of rate cuts from June 2024. February CPI fell sharply to 3.4% y/y from 4.0% in January, helping reinforce the prospect of rate cuts. With Q4 2023 GDP growth reported at -0.3% after -0.1% in Q3, the economy entered a technical recession, and only slight improvement is expected in 2024: the BoE forecasts flat (0%) GDP growth for 2024 as a whole. In Q1 2024, the FTSE 100 returned 3.0% in US$.

Euro area

In the Euro area, optimistic corporate news sent European shares to record highs in mid-March, with upbeat earnings updates and some M&A news boosting investor confidence. Euro area CPI fell to 2.6% y/y in February, just above expectations of 2.5%, while core inflation was 3.1%, missing expectations of 2.9% and still uncomfortably above the ECB's target of 2.0%. As expected, the ECB left rates unchanged, even as a softer outlook for inflation and economic growth bolstered expectations for cuts starting in June. Q4 2023 GDP growth in the region was reported at a mere 0.1% (q/q annualised). In European equity markets, France's CAC 40 returned 6.6% in Q1, while Germany's DAX delivered 7.9% (both in US$).

Japan

It proved to be a momentous quarter for Japan -- the BOJ announced its first rate hike in 17 years, setting a new short-term rate target of 0-0.1% and ending eight years of negative interest rates. This came amid a rise in March CPI to 2.4% y/y, even as the latest GDP data showed the economy grew by only 0.4% (q/q annualised) in Q4 2023, and personal consumption marked its third consecutive quarterly decline. The mixed data added to uncertainty around how soon the BOJ could raise rates again, but the equity market reacted positively as the Nikkei was among the world's top-performing markets with a 13.2% return in Q1, after delivering a remarkable 22.6% in 2023.

China

China experienced a mixed quarter of sharp equity selling followed by some recovery, as the Chinese authorities enacted measures to stabilise the capital market and bolster economic growth. The PBOC cut the bank reserve requirement ratio by 50bps, followed by a historic 25bp cut in the 5-year Loan Rate. These moves significantly boosted market sentiment. GDP growth for Q4 2023 came in at 5.2% y/y, surpassing the government's 5.0% target level, and the new 2024 target was set at 5.0%, as expected. This is expected to be even more difficult to achieve, due to prevailing headwinds such as weak consumer demand, industry oversupply and lower consumer and business confidence. Analysts foresee further policy support in the months ahead to further support market confidence and sustainable growth. Chinese markets were still fairly weak in Q1, with Hong Kong's Hang Seng returning -2.7% and the MSCI China delivering -2.2%, both in US$.

Emerging markets

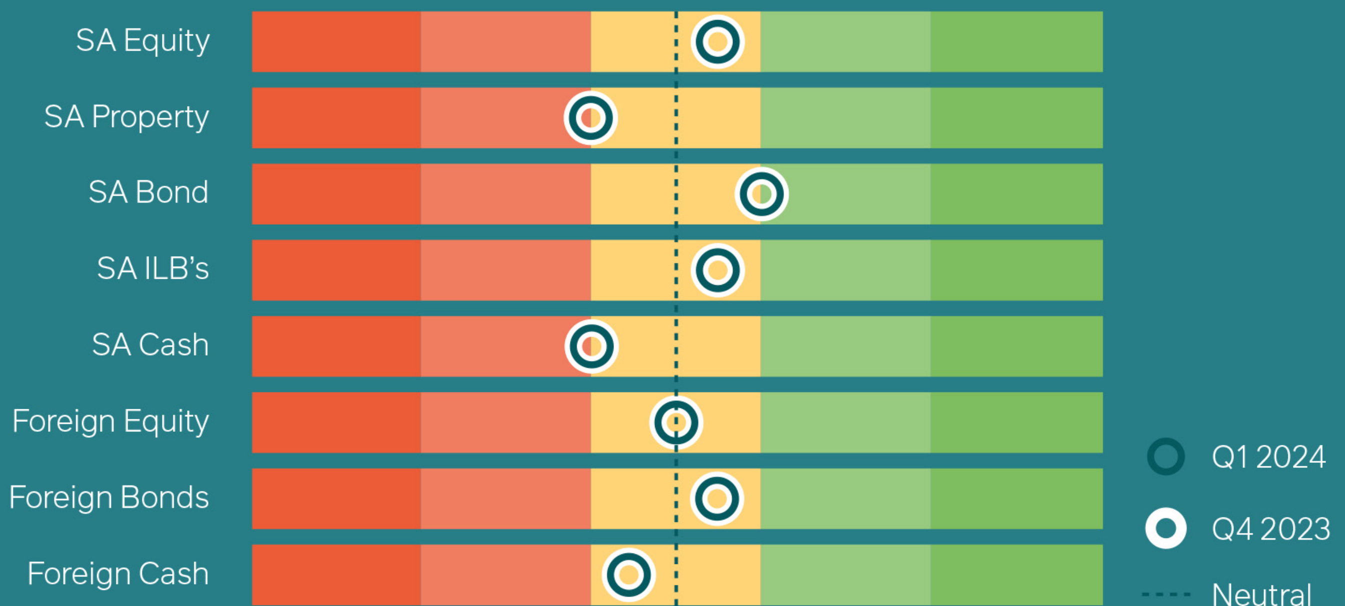
With the exception of India, which returned 6.1% (in US$) for the quarter, larger emerging equity markets performed poorly. Brazil's Bovespa was among the weakest with a return of -7.4%, while the MSCI Turkey fell -5.6%, the MSCI South Africa delivered -6.7% and South Korea's KOSPI produced -0.3% (all in US$).

Commodities

Global inflationary pressures picked up in Q1 after having eased somewhat at the end of 2024, due partly to rising energy costs: the price of Brent crude oil rose from approximately US$75/bbl in January to around US$86/bbl at the end of March for a 14% gain. This came on the back of production cuts from OPEC+ members, an escalation in Middle East tensions which could lead to further supply restrictions, and signs of increasing demand from the US and China. Other major commodity prices were mixed. Among precious metals, gold gained 8.2%, while platinum lost 8.7% and palladium dropped 8.6%. Zinc was the largest loser, down 10.4%, while aluminium fell 1.2%, copper was up 2.6% and nickel rose 0.2%.

South Africa

In South Africa, at its March policy meeting the SA Reserve Bank voted unanimously to keep the repo rate steady at 8.25%, as expected. Governor Lesetja Kanyago remained hawkish regarding stubbornly high inflation (with CPI rising to 5.6% y/y in February from 5.3% y/y in January, well above the expected 5.4% y/y) and relatively high inflation expectations for 2024 among businesses and consumers. The economy managed to eke out growth of 0.1% (q/q annualised) in Q4 2023 worse than expected, for an annual rate of 0.6% for 2023 as a whole. The SARB has projected GDP growth at 1.2% in 2024 and 1.3% in 2025, the acceleration due largely to improved electricity supply. Equity returns remained depressed by the country's low growth prospects and uncertainty over the upcoming national elections, both of which are keeping foreign investors on the sidelines.



How have our views and portfolio positioning changed in Q1 2024?

The graph above indicates that our positioning at the end of Q1 2024 remains unchanged from that of the beginning of the quarter – we remained comfortable with our portfolios given changes in asset valuations over the period.

Starting with our view on offshore vs local asset allocation in our house-view portfolios, during the quarter we did not adjust our positioning, although the valuation gap between the two widened: global equities became more expensive, while South African equities cheapened slightly. We are comfortable with our ongoing positioning favouring more attractively valued SA assets compared to their global counterparts.

Within our global holdings, during Q1 we took profits on a small portion of our global equity holdings following the strong rally. However, we remained broadly neutrally positioned in global equity, with an underlying underweight in the US market. Proceeds went into global cash holdings.

In global equities, the MSCI ACWI 12-month forward P/E rose to 17.9X at quarter-end from 16.8X at the beginning of the quarter, pulled up by the stellar US market performance as both stock prices and earnings gained ground, prices more so than earnings. We took profit on a small portion of our global equity holdings following the quarter's strong rally, but we remained broadly neutrally positioned. Within this positioning, we remained titled away from the expensive US market (with the S&P on a 21X forward P/E), preferring cheaper markets such as the UK, Japan, China and other emerging markets.

Within global bonds, we did not make any changes to our slightly overweight duration positioning during the quarter, given that there was no meaningful change in market valuations. We continue holding some 30-year US Treasuries, which adds duration to our portfolios, as well as moderate levels of local currency sovereign EM bonds where the real yields are high and the currency is trading at fair-to-cheap levels.

Our house-view portfolios also remained underweight global corporate credit at quarter-end, based on our view of credit spreads as unattractive for the risk involved versus their government counterparts.

Our house-view funds still favoured SA equities at the end of Q1 2024, with no changes to our positioning. SA equity valuations (as measured by the 12-month forward P/E ratio of the FTSE/JSE Capped SWIX Index) cheapened somewhat during the quarter, from 10.0X to 9.7X, as share prices fell while earnings moved largely sideways. Market conditions remained relatively depressed, and continued to favour stock-picking.

In Q1 we did not change our underweight exposure in SA listed property, although there are some indications from recent company results that fundamentals are starting to improve. The sector could also gain some impetus from the expected interest rate cuts in the second half of the year, but for now we remain cautious. Property sector risks continue to be high relative to other sectors, and cash yields are at attractive levels. We still prefer exposure to non-property shares that we believe offer better value propositions for less risk.

We also did not change our overweight positioning in SA nominal bonds in our house-view portfolios. The yield on the 10-year SA government bond rose to around 12% at quarter-end, for a very attractive real yield of 7.5% compared to both history and other global sovereign bonds. We continue to believe SA nominal bond valuations are attractive relative to other fixed income assets and to their own longer-term history, and will more than compensate investors for their associated risks over time.

Although our house-view portfolios have no meaningful exposure to SA inflation-linked bonds (ILBs), we hold them in our real return portfolios such as the M&G Inflation Plus Fund. We did not make any adjustments to our ILB positioning during Q1, continuing to marginally favour these assets. Their real yields remain relatively attractive (compared to their own history and to our long-run fair value assumption), but their valuations are less attractive than nominal bonds, giving them lower return potential. We also prefer to add value to client portfolios by taking advantage of the changing interest rate outlook reflected in nominal bonds.

Lastly, our portfolios remained tilted away from SA cash at quarter-end, despite the attractive positive real cash rate. This is because we prefer the relatively better risk-adjusted prospective returns on offer from higher-risk asset classes such as SA equity and bonds. Furthermore, bonds should enjoy a re-rating and hence capital gains resulting in additional returns, while returns to cash decline, should the widely expected easing of interest rates occur.

Disclaimer.

This document is for information purposes only and is not an offer to or solicitation for investors to invest in any of the capabilities or products offered by MandG Investment Managers (Pty) Ltd [M&G Investment Managers] (Registration no. 2013/051515/07) and MandG Investments (Namibia) (Pty) Ltd (Registration no. 1996/85) [M&G Namibia] or any of their associates, being MandG Investments Unit Trusts South Africa (RF) Ltd (Registration no 1999/005242/06) and MandG Investments Unit Trusts (Namibia) Ltd Registration no. 2007/609. M&G Investment Managers is an authorised discretionary financial services provider by the Financial Sector Conduct Authority of South Africa [FSP45199] in terms of the Financial Advisory and Intermediary Services Act, and has it's registered offices at 5th Floor Protea Place, 30 Dreyer Street, Claremont, 7708. M&G Namibia is an approved person in terms of section 4 of Stock Exchanges Control Act and has it's registered offices at 6 Feld Street, Windhoek, Namibia. Information given in this document has been obtained from, or based upon sources believed to be from an accurate and timely source but M& Investment Managers and M&G Namibia make no representations or warranty, express or implied, with respect to the correctness, accuracy or completeness of the information and opinions. This information is not intended to constitute a basis for any specific investment decision. Investors are advised to familiarise themselves with the unique risks pertaining to their investment choices. Investors should seek the advice of a properly qualified financial consultant/adviser before investing. The value of an investment will fluctuate and past performance is not necessarily an indication of future returns.