M&G Investments

M&G Income Fund

Income

Q4 2024

Market overview

In the fourth quarter, global markets and sentiment were shaped by political shifts and central bank actions.

November was dominated by the US election, starting with the lead up to the election date and results announcement to the subsequent nominations for key office position appointments. The Trump victory led to a further increase in the US dollar accompanied by a strong rally in US equity markets.

Central banks globally continued to adjust their policies well into the latter part of December. Several rate cuts were announced in December, including the US Federal Reserve (Fed), European Central Bank (ECB), Canada, Switzerland, Mexico, and Turkey. The Bank of England (BOE) and Bank of Japan (BOJ) held rates steady. The Fed's rate cut, accompanied by a hawkish tone, suggested that it could be the last cut for a while, and the market reacted by selling off as expected. Meanwhile, China's stimulus package announcement in September resulted in volatility in equity markets continuing into the quarter.

Global equities experienced a slight decline of 1% in the fourth quarter, but showed a strong annual gain of 17.5%, as measured by the All Country World Index (ACWI). Both developed and emerging market equities saw negative returns in the fourth quarter, with developed markets down by 0.2% and emerging markets down by 8.0%. In emerging markets, sentiment was dampened by President Trump's victory, which raised concerns over trade tariffs, especially with China. Brazilian equities struggled, with the Bovespa falling by 29.5%, while China underperformed by 4.9% due to tariff fears. Other markets such as India (-10.6%) and Turkey (-3.1%) also contributed to weaker performance. Despite this, for 2024, the MSCI Emerging Market Index added 7.5%, though it lagged behind the ACWI's 17.5% return, primarily due to the stellar performance in US markets. Global property also faced losses, down 9.2% for the quarter but ended the year in positive territory with 1.6%.

Global bonds were one of the weakest asset classes, with the Bloomberg Global Aggregate Index showing a 5.1% decline for the quarter and a 1.7% decline for the year. This was unexpected, considering the start of a rate-cutting cycle. However, market expectations for a shallow cutting cycle, coupled with concerns over persistent US inflation above the 2% target, dampened bond market performance. Volatility in the bond market was driven by rising inflation expectations and central bank actions, leading to selloffs in key government bond markets, particularly US Treasuries and UK Gilts.

Performance

Over the past quarter the fund returned 2.4% (A class, net of fees), outperforming its benchmark by 37bps.

For the year the fund returned 10.1% (A class, net of fees), beating its benchmark by 1.7%.

We typically do not take large duration positions in the M&G Income fund. The fund invests largely in government debt and high-quality corporate paper which is predominantly floating rate in nature. This immunizes the fund against interest rates risk and minimizes the risk of capital losses associated with bond market selloffs. The result of this approach is that the M&G Income Fund delivers a return profile that is less volatile.

Positioning

The GNU fueled SA bond rally since mid-May lost its momentum during the fourth quarter of 2024. This resulted in a meagre 0.4% return for the All Bond Index (ALBI) for the quarter. Despite a sell-off in bonds, the ALBI delivered a stellar return of 17.2% for the year with longer dated bonds delivering almost 21%.

Headline CPI inflation rose 0.1pp to 2.9% y/y in November due to slower fuel price deflation. This print was however lower than the 3.1% median Bloomberg survey of economists. Nevertheless, the market still expects the South African Reserve Bank (SARB) to continue on its rate cutting path.

In November the Monetary policy committee (MPC) at the SARB reduced the repo rate by 25bp to 7.75% which was broadly in line with analyst expectations. The MPC unanimously voted in favour of the 25bp cut and there was no discussion of a 50bps cut as was the case in September meeting. The overall tone of the MPC statement was cautious, and the committee noted that the outlook was uncertain given the challenging global environment.

As at the end of the year the Forward-Rate Agreements (FRA) market signalled that the SARB would be lowering the policy rate over the following 12 months by about 50bps to 7.25%. This is notable change to the depth of rate cuts relative to the beginning of the quarter where the FRA market expected the SARB to reduce the repo rate to about 6.8% within 12 months.

The BER inflation expectations survey for the fourth quarter of 2024 indicated further moderation in inflation expectations across all the time horizons. Inflation expectations are backward looking and the moderation in headline inflation experienced over the last couple of months would be reflected in the inflation expectations of the participants being surveyed. The same goes with higher past inflation prints of 2022 which were at the time projected well into the future. For example, the December 2023 survey showed that average inflation expectations for 2024 then increased to 5.7%.

Average inflation expectations for participants being the

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

The Fund's objective is to maximise income while providing investors with relative capital stability. This is achieved by investing in a diversified portfolio of non-equity securities in the South African market.

Investor profile

Investors who are looking to maximise their income return over the short-to-medium term without assuming too much risk of capital loss. The recommended investment horizon is 1-2 years, or longer depending on income needs and risk profile.

Investment mandate

The Fund invests in a flexible mix of non-equity securities in the South African market. It is suitable for short-to-medium term investors looking for an actively managed interest-bearing fund. Compared to traditional money market and enhanced cash funds, the Fund can have a longer weighted average duration (max 24 months) with no limit on the maximum maturity period for any one instrument. The Fund is managed to comply with regulations governing retirement fund investments (Reg. 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

6 December 2016

Fund size

R349 377 740

Annualised performance	A class	Benchmark	D class
1 year	10.1%	8.5%	10.3%
3 years	8.8%	7.2%	8.9%
5 years	7.2%	6.2%	7.3%
7 years	7.6%	6.5%	7.8%
Since inception	7.7%	6.6%	-

Sources: M&G Investments, Morningstar & Deutsche Securities

Analysts, Business and trade unions for 2025 fell from 4.8% to 4.5% and for 2026 fell from 4.8% to 4.6%. It is interesting to note that the inflation expectations of trade unions for 2025 was at the midpoint of the SARB inflation target of 4.5% and for 2026 it was at 4.3% which is encouraging. Businesses surveyed were slightly higher than the SARB mid-point coming in at 4.8% for both 2025 and 2026. Five-year inflation expectations over all groups averaged 4.6% compared to 4.8% in the third quarter survey. This trajectory is welcome by the SARB, and they anticipate inflation expectations to moderate further given their policy stance coupled with experience of lower inflation will serve to anchor inflation expectations more firmly at lower levels.

Interestingly the IMF published a statement in November that SA's outlook is improving supported by recovering domestic demand and stable electricity supply and upwardly adjusted SA's real GDP growth to 1.5% in 2025 from 1.1% in 2024. However, the IMF warned that the risks to the outlook were to the downside highlighting protectionist policies and delays in the reform implementation. They also suggested a fiscal consolidation strategy to lower public debt-to-GDP and the implementation of a fiscal rule which would enhance credibility and lower bond yields. This could result in lower financing costs for the fiscus allowing funds used to service debt to be allocated to other initiatives.

These developments resulted in the NCD market repricing over the quarter as the interest rate cuts came through. At the end of the third quarter the money market curve was inverted pointing to rate cuts. As the rate cuts came through the money market curve regained its upward slope taking short rates to below 8%. Treasury bill (TB) rates offer attractive levels relative to NCDs especially in the 6- and 9-month tenors and we hold these instruments in money market funds. The M&G Income Fund can hold longer dated instruments which renders TBs less compelling as an investment and the fund is mandated to harvest additional risk premium via term, illiquidity and credit spread to meet its performance objective.

Credit trends

Total credit issuance (excluding government issuances) picked up 14% in Q4 2024 with R54.1bn issued, compared to R47.5bn in Q3 2024, with Q4 issuance being the largest quarterly issuance of the year. The Q4 issuance was down 2% compared to the same quarter in the prior year (Q4 2023: R55.4bn issued). Full-year 2024 issuance was R170.1bn up 3.6% from 2023 total issuance of R164.1bn.

The make-up of issuance for the quarter followed established trends - issuance being almost exclusively floating-rate notes, with auctions accounting for just over 67% of placements by volume. December saw a slightly different trend in issuance, with 79% of December's R13.8bn issuance being via private placement.

Data compiled by RMB's Credit Research team indicates that banks and financial issuers dominated primary market issuance for the quarter contributing to 57% of gross issuance, followed by corporates at 28%. Q4 was the strongest quarter of the year for banks/financials with R30.9bn issued. FirstRand Bank Limited (FirstRand) was the largest bank/financials issuer of the quarter, having raised R7.5bn. FirstRand raised R2.6bn via its first social bond auction in November, upsized from its initial target issuance size of R2bn – R2.5bn given the R4.7bn bids received. FirstRand raised a further R2.5bn via the placement of a Tier 2 note during November with the remainder of the issuance raised via a Tier 2 and an AT1 private placement tap issuance. Q4 further saw the highest quarterly corporate issuance of the year, with R15.3bn issued. Woolworths Holdings Limited was the largest corporate issuer for the quarter, raising R2.25bn across five privately placed notes. Unusual for listed credit in the SA market, the notes carry a provision for redemption at the option of the issuer – commencing 29 January 2025 for WHL15 and 29 July 2026 for the other four notes. Daimler Truck Southern Africa Limited (DTSA) was the second largest corporate issuer for the quarter having issued R2.2bn across both auction and private placement in October and November, respectively. DTSA's auction which raised R1.5bn was 6.4x subscribed and banks which accounted for 26.5% of bids received 40.9% of the final allocation.

Attacq Limited, the listed REIT, held its inaugural debt capital markets auction in October 2024. With more than R4bn in bids received, R760m was issued across a 3-year and 5-year note offering.

November was the strongest issuance month of Q4 with R24.8bn issued, further making it the largest issuance month for 2024. Banks/financials issued R16.5bn in November, equally making it the largest issuance month for the sector for 2024.

November saw Industrial Development Corporation return to the local debt capital auction market, holding its first public auction since January 2020.

Numerous rating actions took place during the quarter.

During October 2024 Moody's downgraded five securitisation notes in Amber House Fund 2 (RF) Ltd (2021 refinancing) as well as The Thekwini Fund 18 (RF) Ltd, prompted by the correction of a model input error. Moody's further downgraded both the global and national scale ratings of seven notes in Transsec 4 (RF) Ltd and Transsec 5 (RF) Ltd, reflecting the decrease of credit enhancement available for the affected notes, as well as worse than expected collateral performance.

During November 2024, S&P revised South Africa's outlook to positive from stable and subsequently revised the outlook on six South African financial institutions to positive from stable and raised the national scale ratings on four South African banks (ABSA Bank Limited, FirstRand Bank Limited, Investec Bank Limited and Nedbank Limited) upward by one notch, from zaAA to zaAA+.

GCR downgraded Burstone Group Limited's (Burstone) national scale long and short-term credit ratings in November 2024 to A+(za) and A1(za) from AA-(za) and A1+(za) respectively following the sale of its majority stake in its Pan European Logistics portfolio to Blackstone Inc. GCR noted that while the transaction is a major advancement in Burstone's funds and asset management strategy, in the short to medium term Burstone will report a much smaller direct investment portfolio with a material increase in exposure to its South African assets.

Furthermore, Moody's upgraded Discovery Limited's long-term national scale rating in November to Aa3.za from A1.za to reflect reduced execution risk in its business model as more recent investments, such as its bank, approach operational maturity.

During December, S&P assigned Telkom a zaAAA national scale

Contact us

info@mandg.co.za

mandg.co.za

0860 105 775

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Sources: M&G Investments, Morningstar & Deutsche Securities

long-term rating viewing its ability to pay and meet its financial commitments as extremely strong in relation to other issuers in the domestic market. Following this Moody's withdrew its Telkom SA SOC Limited rating following the review of the issuer's request to withdraw its rating.

There was little move in credit spreads over the quarter, with fixed rate and floating rate credit spreads closing the quarter -1.8bps and -2.8bps narrower, respectively.

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