M&G Investments

M&G SA Equity Fund

Equity

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.

Despite a solid annual return of 13.4%, the FTSE JSE All Share Index fell 2.1% in the fourth quarter. On a sector level, industrials posted modest returns of 0.2%, while financials (-1.2%) and resources (-10.1%) dragged on performance for the quarter (all in rand).

South African listed property posted a 0.4% loss in the fourth quarter, but still delivered strong annual returns of nearly 30%.

The FTSE All Bond Index (ALBI) returned 0.4% for the quarter, while inflation-linked bonds (ILBs) returned 0.8%. Notably, South African bonds finished the year with a robust 17% gain, while ILBs returned 7.8% (both in rand). Throughout the year, the nominal bond market experienced significant volatility, with the 10-year bond yield peaking at 12.50% in April before strengthening to around 10.30% by year-end. The yield curve also bull-flattened in 2024, with long-term bond yields falling more sharply than shorter-term ones. The ILB curve flattened slightly, coming off an already flat basis at the start of the year.

South Africa's consumer price index (CPI) rose by 2.9% y/y in November, up from 2.8% y/y in October. Despite this slight inflation increase, the South African Reserve Bank (SARB) Monetary Policy Committee reduced the policy rate by 25 basis points to 7.75% in November.

The country's third quarter GDP contracted by 0.3%, primarily due to a decline in agricultural output, following a revised 0.3% growth in the second quarter. Local equity and bond markets saw slight declines, with the biggest impact coming from the weakening of the rand.

Performance

The M&G SA Equity Fund delivered a return of -1% (F class, net of fees) for the fourth quarter of 2024, outperforming its benchmark which delivered a return of -2.1%. For the 12 months ended 31 December 2024, the fund returned 11.4% (F class, net of fees), underperforming its benchmark by 2%. Over the 3-year period ending 31 December 2024, both the absolute and relative performance of the fund has been satisfactory, with an absolute return of 8.1% per annum over this period, underperforming the benchmark by 0.4% per year.

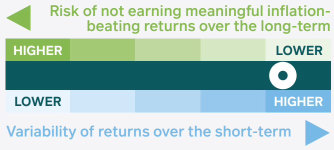
The largest contributor to outperformance this quarter was the fund's overweight holding in ABSA Bank. ABSA has shown a steady improvement in operating performance and is generating a Return on Equity of approximately 13% which is up substantially from the high single-digit returns it was generating just a few years ago. We think that the Return on Equity of the business will continue to gradually improve and support its share price which we think is still undervalued. It remains one of the top overweights that we have in the banking sector.

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 last half of 2024 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. We think that the bulk of the return in the second half of 2024 from these sectors came mainly from an increase in rating that many of the companies in these sectors enjoyed as a result of the lower bond yields. Looking forward into 2025, we would expect that the lower bond yields should continue to support growth in earnings and

Annualised performance	B class	Benchmark[1]	F class
1 year	12.7%	13.4%	11.4%
3 years	9.3%	8.5%	8.1%
5 years	11.5%	10.3%	10.2%
7 years	7.6%	6.5%	6.4%
10 years	8.2%	7.1%	-
20 years	13.4%	12.4%	-
Since inception	14.5%	12.8%	-

[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



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 - SA General

Benchmark

FTSE/JSE Capped SWIX All Share Index

Inception date

21 September 2000

Fund size

R38 434 503 549

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

dividends for these sectors.

South Africa has a very well-regulated banks 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 banks sector. Our underweight to Capitec though was the second largest detractor from performance for the quarter and the largest detractor from performance for the year. While we rate Capitec more highly in terms of quality banks and it has grown tremendously over the last decade, we cannot ignore that it is substantially more highly rated than other banks in the sector. Over the last year, it has rerated to a level where we think that the share is priced for perfection.

We think that lower bond yields, good earnings and dividend growth in the banking sector should provide a good opportunity to generate alpha within this sector by being overweight relatively undervalued banks. We continue to prefer Standard Bank, ABSA and Investec, which are substantially cheaper than Capitec.

A strong beneficiary of the lower bond yields and improving consumer sentiment during the quarter was the fund's overweight positions to Pepkor and The Foschini Group both in the retail sector. 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. The Fund's overweight holding to Foschini has been the top contributor to the performance of the Fund over the year. Despite the 57% rally in the share price over the last year, we still think it is attractively priced.

The third largest contributor to performance over the fourth quarter was due to the fund not holding any position in Sasol. Sasol had a negative return of 28% over the last quarter. Our concern around Sasol is due to the cash flows it generates coming under pressure over the next five years given the substantial capex projects to transition the business to reduced carbon emissions. Sasol revised it dividend policy over the last year so that the dividend will be based off cash flow rather than earnings. We think this change in policy is likely to result in a much lower dividend than previously expected over the coming years.

The resources sector has been mainly driven by China, which has been suffering from weak consumer and business sentiment, amongst other structural issues. Iron ore, which has been weak due to a weak Chinese property sector, has responded positively to stimulus announcements from China in the last quarter of 2024, as has copper which is normally a bellwether for expected economic growth. Fundamentally, although iron ore inventories are fairly elevated at ports, prices had fallen to the 90th percentile without much supply growth from the major miners, prices should be sustained above $90/t even absent 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. We therefore continue to hold overweight positions to Exxaro, Glencore, Anglo American and an equal weight position to BHP Billiton. Over the last quarter, we reduced our overweight position in BHP Billiton to neutral and allocated this capital to an overweight position in Anglo American as a result of relative price action between the two companies.

Overall, therefore, we are cautiously optimistic about the sector over the near-term as interest rate cuts, 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.

Our overweight position in British American Tobacco (BAT) was the fourth largest relative contributor to performance for the quarter and the third largest contributor to performance for the year. 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's reduction of debt has enabled it to 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.

The largest detractor from performance for the last quarter was due to the fund not holding a position in Discovery. Discovery's business consists mainly of an ex-growth South African Health business which it depends on for its strong cash flow to help fund its various ventures and life insurance businesses in South Africa and the United Kingdom. Discovery's poor group cash flow as a result is reflected in its low dividend yield which is marginally above 1% which we think is very low relative to the rest of the SA market. This low dividend yield requires one to believe in future growth as the primary source of shareholder return.

It is worth mentioning that when we construct our portfolios, we do not do so 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 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 December 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 significantly under a more favourable economic situation. The prospect of lower interest rates and bond yields both in the United States

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Sources: M&G Investments, Morningstar & Deutsche Securities

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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 fund continues to be on finding companies that are undervalued and which can grow earnings and dividends over the long run.

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Sources: M&G Investments, Morningstar & Deutsche Securities