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Consider this: Q1 2023 - CEO Letter

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So far in 2023, global financial market volatility has been dictated by the guessing game over the path of US interest rates. January's sentiment was dominated by more bullish views of a weaker economy, softer inflation, lower interest rates and a relatively imminent pause to the US Federal Reserve's rate hiking cycle, only to be up-ended in February by surprisingly strong economic data, including more widely embedded inflation than previously thought. With the Fed signalling its intention to continue hiking, this sent market uncertainty higher and global asset prices lower, an environment that continued well into March. Then the emergence of banking sector turmoil seen in the sudden failure of three mid-size US banks and the buyout of Swiss banking giant Credit Suisse shocked markets even further, with swift central bank interventions and rescues preventing contagion from spreading. Consequently, central banks were more cautious in their subsequent rate hikes: the US Fed's 25bp increase in March (versus the 50bp expected), in particular, was seen as a balanced response to

stubbornly high inflation data and banking turmoil. Investment managers have rarely experienced such sharp swings in market expectations as those seen in the past quarter.

Global caution proves merited

Our cautious view on these uncertain global conditions meant that our funds were well positioned for just such developments in the first quarter of the year. We have believed that both global equity and bond markets have been vulnerable to stronger-than-expected US data, with bonds pricing in an optimistically quick return to pre-Covid 2% inflation and interest rate levels, even though this scenario is not certain. Equally, despite downgrades to corporate earnings and lower valuations, global equities have been trading slightly above our assessed fair value, especially in the US, making them expensive for the risk involved. As such, we have preferred to hold global cash over global bonds and equities in our multi-asset portfolios, being neutral to slightly underweight in both asset classes. This has given us the ability to act tactically by capitalising on any asset mis-pricing that could arise.

Amid the risk-off global environment, emerging markets fared poorly, and South Africa was no exception: local bonds and equities gave up some of January's good gains. Although local sentiment was helped by the positive news of lower government debt projections from February's 2023 Budget, investors were discouraged by several developments: the mounting costs of persistent loadshedding; the grey-listing of South Africa by global financial watchdog FATF, which is expected to add costs and complexities to international transactions; and news of the 1.3% contraction in the country's GDP in Q4 2022, among others. Read about our views on the grey-listing in David Knee's insightful Q&A.

Best South Africa Equity Fund

In March we were very pleased to learn that the **M&G Equity Fund** was nominated as one of the three finalists for the **2023 Morningstar Fund Awards** in the category of "Best South Africa Equity Fund". Although the fund was not named number-one, this independent recognition is important, in that the nomination acknowledges "those funds and asset managers that have served investors well over the long term and which Morningstar's manager research team believes will be able to deliver strong risk-adjusted

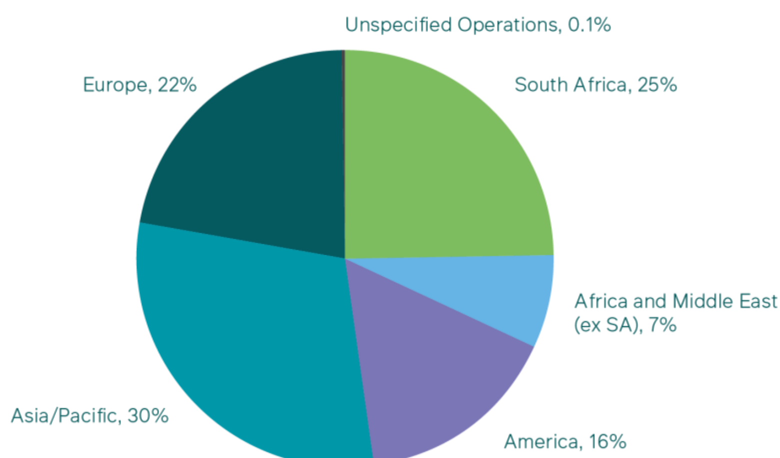
returns over time". As of 28 February, the M&G Equity Fund ranked in the top quartile of its ASISA category for its performance over all measured periods out to 20 years by Morningstar.

A comment on fund performance

Many of our South African funds continued to perform strongly relative to both their benchmarks and their peers over different time periods in Q1 2023, as we stuck with our time-tested, valuation-based approach despite the changing sentiment. Among our funds, the M&G Global Equity and Balanced Feeder Funds stood out for their robust absolute returns in rand terms over the past 12 months.

Speaking of performance, it is worth bearing in mind that, even though the local growth outlook is far from rosy, that doesn't mean that JSE equity market returns will necessarily be disappointing. The graph below shows how only 25% of earnings from companies listed on the JSE are sourced from South Africa these days, with 30% coming from Asia, 22% from Europe and 16% from America. Statistically, there is also no correlation between South Africa's annual GDP growth and the JSE's annual returns. Investors shouldn't hesitate to invest in equities should their goals call for it – often weak economies offer excellent buying opportunities for astute investors.

Graph 1: Source of JSE listed companies' earnings by geography



Source: FactSet data as at 31 January 2023

Promotions within M&G Investments
During the quarter I was proud to announce no fewer than four portfolio manager promotions for our hard-working and talented people in our investment team. As a leading global investment manager, we are able to attract some of South Africa's most gifted people, encouraging their passions and offering them excellent foundations for growth. This has helped us nurture and expand our highly rated team of long-standing portfolio managers over the years, supported by a strong group of investment analysts, all of whom form the core of our business. If you missed the announcement, you can find out more here.

M&G plc annual results
In March, M&G plc announced its annual results, reporting £342 billion (R7.5 trillion) of assets under management and administration as of 31 December 2022. The Group experienced positive net client inflows, helping to offset the decline in market values during the year, and maintained a strong capital position with a 199% Shareholder Solvency II coverage ratio. This included returning nearly £1.0 billion to shareholders through dividends and share buy-backs. It also generated capital of £821 million during the year, with improved underlying capital generation of £628 million demonstrating the resilience of the business model. M&G Investments currently serves over 5 million retail investors and 800 institutional clients around the world, having built up a long and proud history of innovation and investment excellence over more than 80 years. For more information on the M&G plc results, click here.

Looking ahead
In our view, both SA equity and SA bond valuations remain the most attractive among the different asset classes, offering the best potential for market outperformance over time. On the other hand, SA property, SA inflation-linked bonds, global equity and global bonds, we believe, do not present enough potential return for the risks involved. Given the still-high levels of inflation and mounting costs related to loadshedding for companies, investors should continue to be discerning in their portfolio selection, and choose those companies with strong balance sheets, management teams proven to produce reliable results in uncertain, low-growth conditions, and

companies able to pass on price increases to consumers and suppliers. Our article "South African Retailers: Is load-shedding weighing too heavily?" in this edition offers our thoughts on how retailers are navigating the energy crisis. Based on our current holdings and asset valuations, we are confident that we should be able to continue to produce alpha for our clients going forward. Remember that returns are not delivered in a straight line over time, no matter how strong the economy, so to be successful it's essential to ignore the many short-term market dips and look to the long-term.

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