

Through the looking glass: Capturing structural change

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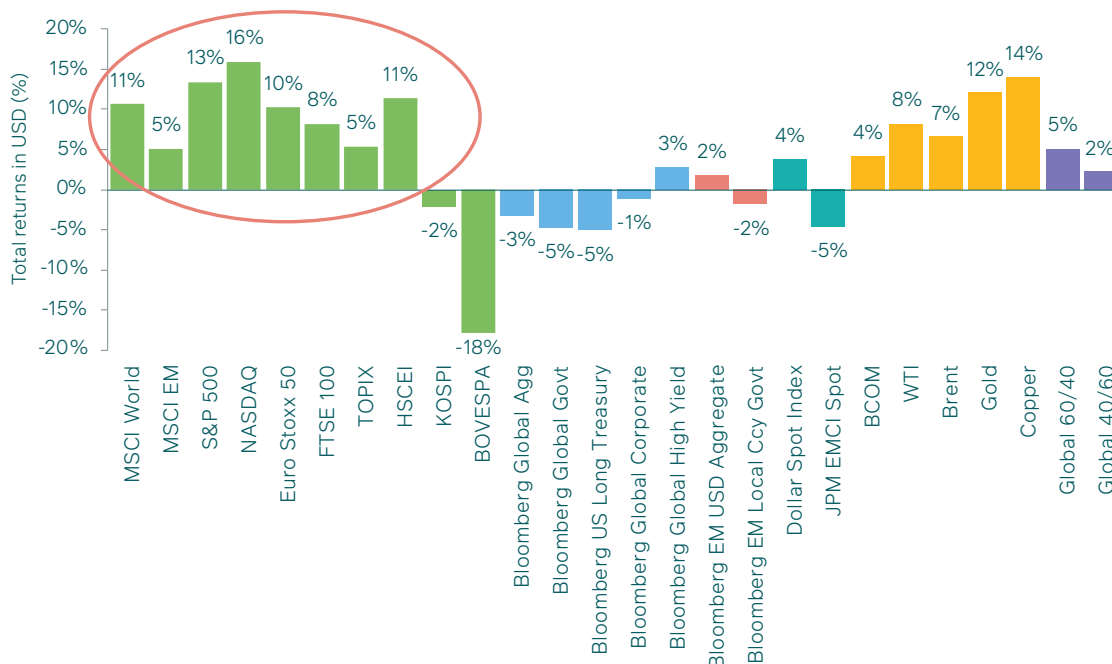
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What are the hidden gems among global stocks -- those that are most likely to become the “super-performers” of the next decade? While we don't have a magic looking glass, Fabiana shares the M&G team's thinking on this exciting topic and examples of some of our top global stock picks. She also discusses the dynamics and drivers behind the global equity market's surprisingly robust performance so far in 2024. This article is based on her presentation at the recent M&G Investments Global Investor Day event in London.

To date, 2024 has been another year of surprises in global financial markets, with global equities managing to outperform expectations across many markets. The MSCI World Index (developed markets) returned an impressive 11% over the six months to 12 June 2024 despite major headwinds such as interest rates remaining higher for longer than expected, national elections in 64 countries, significant geopolitical conflicts in Ukraine and the Middle East, and escalating economic tension between the US and China, among others. Even Europe and the UK, both with sluggish economies, delivered 10% (Euro Stoxx 50 Index) and 8% (FTSE 100 Index), respectively, but emerging market equities lagged, with a 5% return recorded by the MSCI Emerging Markets Index.

Equities continue to surprise in 2024

Year to date through 12 June 2024.



Source: Bloomberg, 12 June 2024 13.00 GMT. Bloomberg Global EQ:FI 60:40 Index – designed to measure cross asset market performance globally. The index rebalances monthly to 60% equities and 40% fixed income (vice versa for the Global 40/60 index) Asset classes are represented by Bloomberg Developed Markets Large & Mid Cap Total Return Index (DMTR) and Bloomberg Global Aggregate Index (LEGATRUU) respectively.

Why have equities outperformed?

In our view, there are two key reasons for this broad outperformance, which were also in play in 2023. First, for investors to beat the currently high US cash yield of 5%, it is difficult for them to justify considering any other asset class than equity, which has the best potential for achieving a higher return. Equity earnings yield in most major markets (apart from the US) are also elevated -- at or above 5% on a nominal basis and generally above their 10-year average – which gives them a higher chance of outperforming going forward. On this basis, equities make for an attractive option for investors in the current conditions.

Secondly, the fundamentals of some companies continue to surprise on the upside. A high percentage of listed companies reporting have beaten their earnings-per-share (EPS) estimates in the latest earnings season, with the highest being 81% of S&P 500 companies reporting in Q1 2024. The Nasdaq was not far behind with 78% of companies topping EPS estimates, and 67% of reporting FTSE 100 corporates also beat their forecasts.

Even more importantly for investors, the characteristics of this year's outperformance provide a valuable diversity of choice. There is a large differential between investment returns recorded by the top 100 performers listed on the MSCI All Country World Index: the highest, US-listed Super Micro Computer Inc, returned 170% in the past six months, and the lowest, US-listed Meta, "only" 43%. And unlike 2024 where a handful of US technology companies dominated global markets, so far this year there is a wide mix of countries with top performers – US-listed companies hold only 22 of the top 100 performers in the MSCI All Country World Index over the past six months. Equally we see strong returns across sectors other than technology, including consumer staples, financial, industrial and even utilities. Non-technology companies are also taking advantage of advanced technology like artificial intelligence (AI) to improve their fundamentals through increased efficiencies and enhancements in many areas of their businesses.

How to find the next winners

At M&G, we believe the biggest winners that will emerge over the next decade will be companies operating in the space at the intersection of three strong structural growth themes. In our view, these businesses are most likely to receive cash flows regardless of the vagaries of the global economy and its cycles. These structural growth themes comprise:

1. The move to a low-carbon world
2. Infrastructure investment
3. Innovation

When it comes to the energy transition, it's important to note that not only will demand for cleaner energy sources be increasing, but also that a larger portion of that demand will be met by a variety of renewable sources. This leads to a more fragmented power distribution system with less predictable energy flows. AI is fundamental in ensuring that this more complex system operates successfully, and companies that can provide this service should see strong long-term demand going forward.

At the same time, there is estimated to be a US\$94trn shortfall in infrastructure spending that is needed globally over the next 40 years to keep economies growing, and in South Africa the gap is approximately US\$441bn. This makes it a significant growth area.

Finally, we look for a high degree of innovation. When we see innovation in companies that are also operating in or adjacent to the energy transition and infrastructure fields, we view this intersection of the three as probably the most powerful way to identify those businesses that will most likely be the super-performers of the next decade.

Some M&G picks

M&G has a large team of experienced analysts and portfolio managers around the world that are able to find these hidden gems through both deep and broad global research and regularly collaborating and sharing ideas and information across geographies and sectors.

Examples of companies we have uncovered around the world that share these characteristics include the following:

Equinix, based in the US, is the second-largest data centre manager in the world, specialising in global digital infrastructure. It is responsible for operating, safeguarding and maintaining data for some of the largest internet exchanges in the world across many carriers, spanning the financial, manufacturing, commerce, telecommunications and renewable energy sectors, among others. The fast-growing demand for huge quantities of data, driven partly by AI's increasing adoption, makes the company a strong candidate to deliver outperformance going forward.

Japan's **NTT** is the world's third largest data centre operator in the world, helped by its long history in the communications industry. What is more exciting, however, is that it has developed a new high-efficiency network using a new technology based on light waves (photonics) that increases its transmission capacity by 125 times, while also lowering its energy usage by 100 times. This sets the stage for strong expansion at lower costs.

Jiangsu Zhongtian Technologies (China) develops and manufacture undersea high-voltage power transmission and fibre optic communications cables, both of which will continue to experience high demand.

Nexans, a European-listed but global company, has inputs across the entire electrification value chain, with a focus on distribution through developing and manufacturing power transmission cable solutions.

Schneider Electric is another leader in its field of electricity grid management. Listed in Europe, it uses advanced AI to connect new power sources to existing grids and manage power distribution. It digitises and automates the data in networks to reduce costs and optimise distribution.

Australia's **APA Group** owns and operates a portfolio of gas, wind, solar and electricity assets. Their activities include gas transportation, distribution and storage, asset management, and renewable and gas-fired power generation. They also provide off-grid renewable energy to communities and businesses far removed from larger urban electricity grids. Besides isolated towns, mining companies also have operations that must be supplied with independent energy and are starting to transition away from traditional diesel power sources.

Japan's **Toray Industries** is a materials manufacturing business that has used its expertise to develop advanced composite carbon fibre materials that are lighter and stronger than the current generation and used primarily in the construction of wind turbines and airplanes. The group produces around 50% of the materials used in wind turbines globally, and its materials are also being used to improve the energy consumption of airplanes by some 20% thanks to improved flight efficiency. Apart from carbon fibre, its production is diversified across areas like other fibres and textiles, performance chemicals, pharmaceuticals, medical devices, and certain types of environmental and engineering equipment.

Looking ahead

What we can see from the developments of 2024 so far is confirmation that forecasts are often proved to be wrong (sometimes very wrong), and investors will continue to be surprised by short-term financial market moves. Trying to predict what will happen and which companies will benefit the most from short-term events is a risky approach to investing at best and one that will likely lose money.

Rather, at M&G Investments we believe a more successful approach is to invest in attractively valued companies that are likely to withstand the ups and downs of the global economic cycle over time. These businesses will be underpinned by rapid growth in demand for their products and services, and by their ability to innovate or to adapt and use advances in technology to continue growing over the longer term. Our equity team based around the world focuses on finding these hidden gems which, when included in our portfolios, help increase the likelihood of delivering outperformance for our clients over time.

We offer our South African clients a range of 10 global unit trust funds tailor-made for our Southern African clients in both rands and US dollars and managed by our large and experienced London-based team. These include the unique M&G Global Equity and Property Funds, which employ advanced AI to aid in the analysis of the vast universe of global stocks, and the **M&G Global Balanced** and **Inflation Plus Funds**, expertly diversified across asset classes. We have also developed specialised global funds to meet institutional clients' needs such as the **M&G (Lux) Global Listed Infrastructure Fund** and the **M&G (Lux) Sustain Paris Aligned Fund**, also available in South Africa.

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