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# Multi-asset funds: More relevant than ever in the GNU South Africa

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## Leonard Krüger
Portfolio Manager

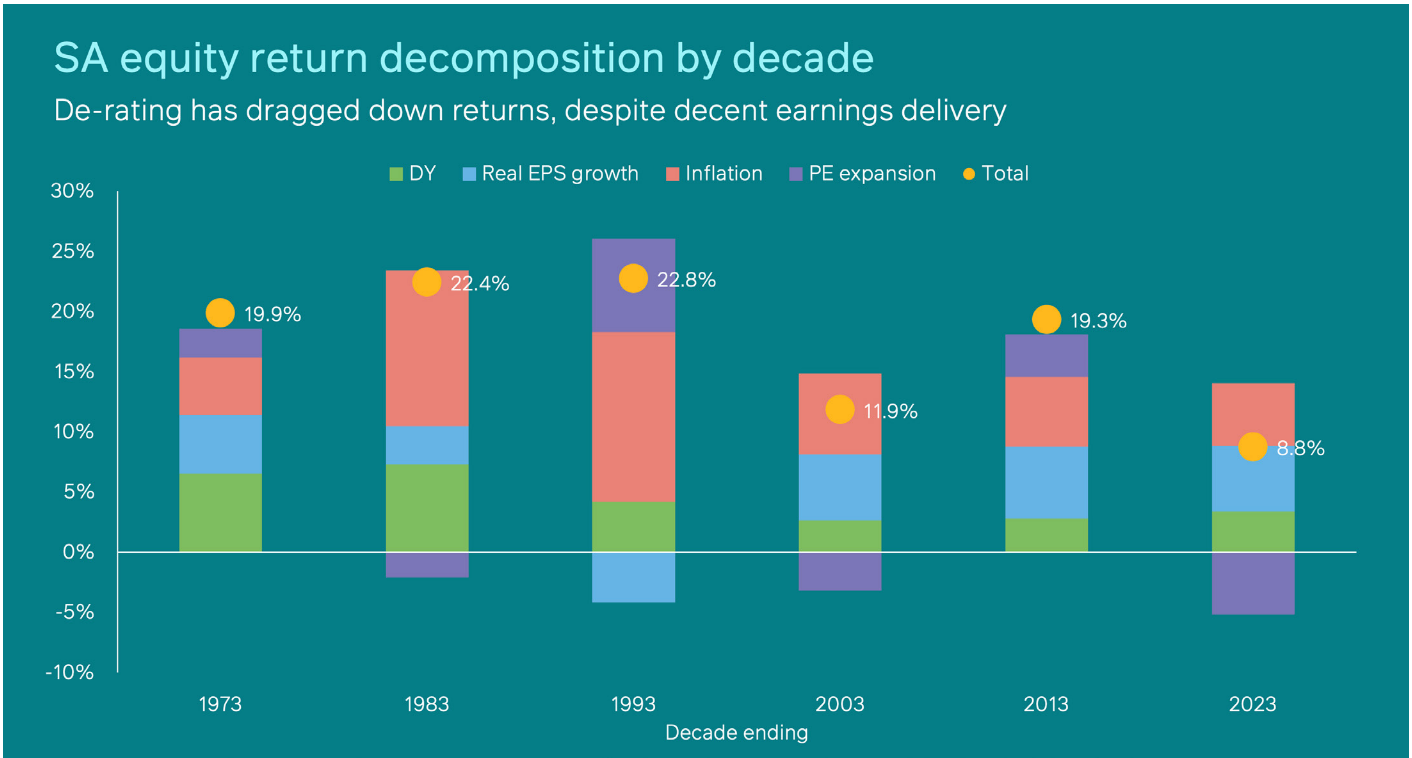

*It's been over 100 days of the GNU South Africa and, as I explored in my previous article, we're encouraged by the positive momentum. While it won't be without challenges, South Africa has a real opportunity to turn a corner. To help our clients meet their long-term investing needs in this environment, we believe multi-assets funds are more relevant than ever.*

*In this article, I'll be sharing insights on our multi-asset funds, specifically the M&G Balanced Fund and M&G Inflation Plus Fund - How they have performed, the prospective real returns on offer and how they are positioned to take advantage of the opportunities.*

### Solid long-term performance despite a challenging period for South African equities

The last decade has been tough for South African equities in terms of the real returns delivered, and they've underperformed relative to their long-term history and through-the-cycle expectations. To understand why, looking at the breakdown of long-term returns by decade offers key insights (See Figure 1 below).

**Figure 1**




Source: Bloomberg, FactSet, M&G Investments calculations. Note: The components are not additive, but multiplicative, hence gap between "total" dot and top of stacked bars when all components are > 0

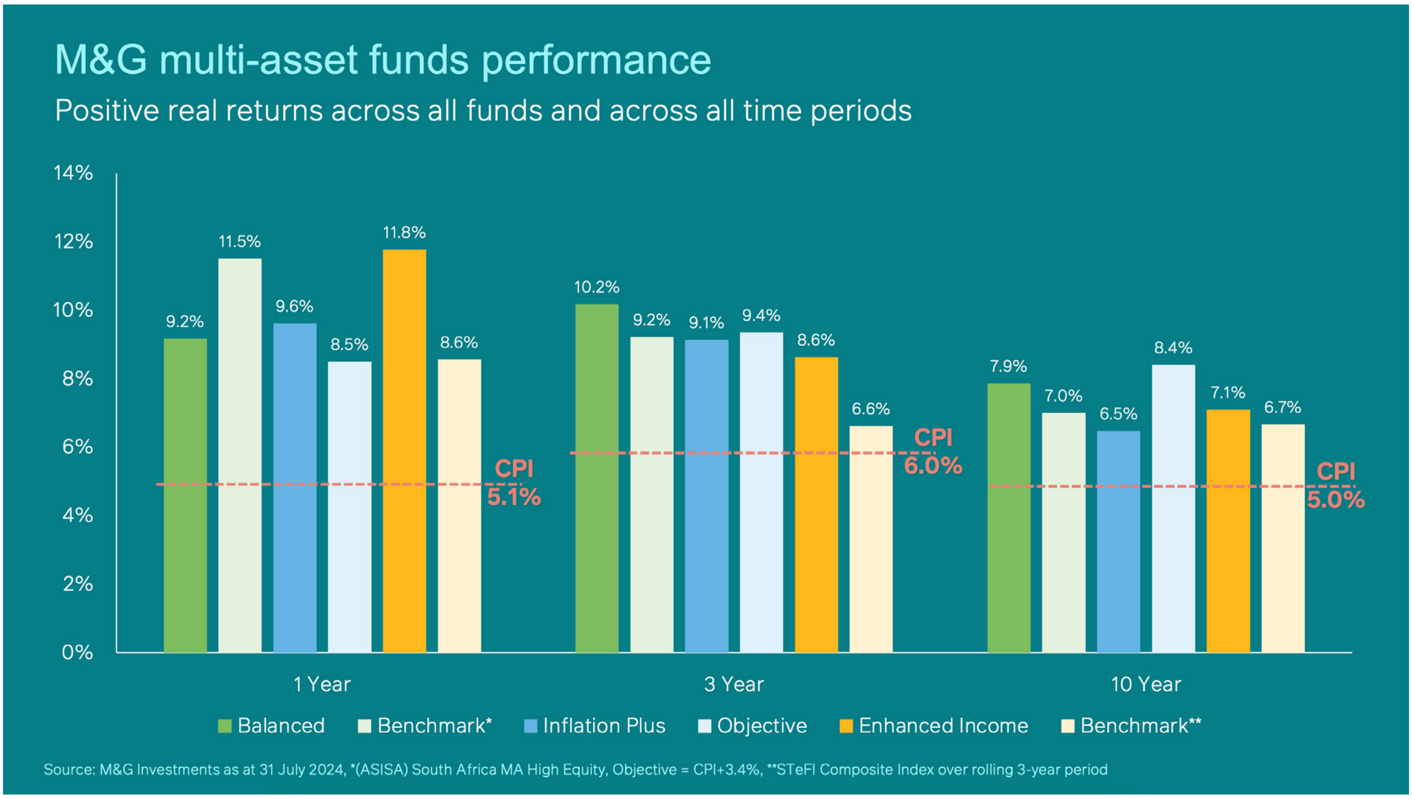
Returns come from two main sources: Either from companies growing their profits on a per share basis (Real EPS growth + Inflation + dividend yield (DY)) and/or what the market is willing to pay for those profits (price to earnings ratio). In the most recent decade starting in 2014 and ending in 2023, aggregate earnings delivered by SA-listed companies has been on par with normal expectations and very similar to that of the prior two decades.

This might come as somewhat of a surprise to some investors that, despite the low-growth local economy, the underlying companies making up the equity market have largely gone about their business and delivered real earnings growth roughly in line with historical trends. We have numerous theories why this may be the case, including offshore earners, local companies benefitting from a weakening rand environment and listed companies gaining market share from unlisted domestic businesses, amongst others.

The second source of returns, the market rating, has however been a drag on total returns over the last decade (lower price earnings ratios, lower price to book ratios, higher dividend yields etc.). This is reflected in figure 1 by the purple bars, effectively detracting circa 5% per annum from total returns over the last decade. Market ratings have been mean reverting historically, and while we don't know when or if a market upward rerating would occur, a simple end to the recent derating would deliver meaningfully better total equity returns.

For multi-asset funds, this means that a significant part of the real returns you typically expect from equities has not delivered in recent years. Comparing the returns of our multi-asset funds over the past 10 years in figure 2, returns have been very similar, ranging between 7-8% per annum, despite a very meaningful difference in the amount of risk assets (i.e. SA equities) that were included in the portfolios. Simply put, higher risk-seeking portfolios have not delivered higher returns despite taking on more risk. It is unusual to see a high-equity portfolio, like the M&G Balanced fund, performing roughly like an income-type portfolio holding limited equities over such a long period, but with greater volatility. We think the next decade might look very different to the last.

**Figure 2**




More recent returns have been strong post the formation of the GNU, as can be seen from the 1-year returns, and riskier multi-asset portfolios (Balanced and Inflation Plus) have delivered returns higher than the income alternatives.

Despite a decade of subpar performance from South African equities, M&G Investment funds have delivered returns in excess of inflation from all funds and across all time periods, growing clients' savings in real terms.

Apart from the M&G Balanced Fund over the past year, our funds have also performed well compared to their benchmarks within their respective categories. The recent Balanced Fund underperformance has primarily been down to two specific reasons:

Firstly, we've held less offshore assets than the average balanced portfolio due to our more optimistic view on the outlook for South African asset returns. Until very recently, this positioning incurred an opportunity cost as offshore markets performed strongly.

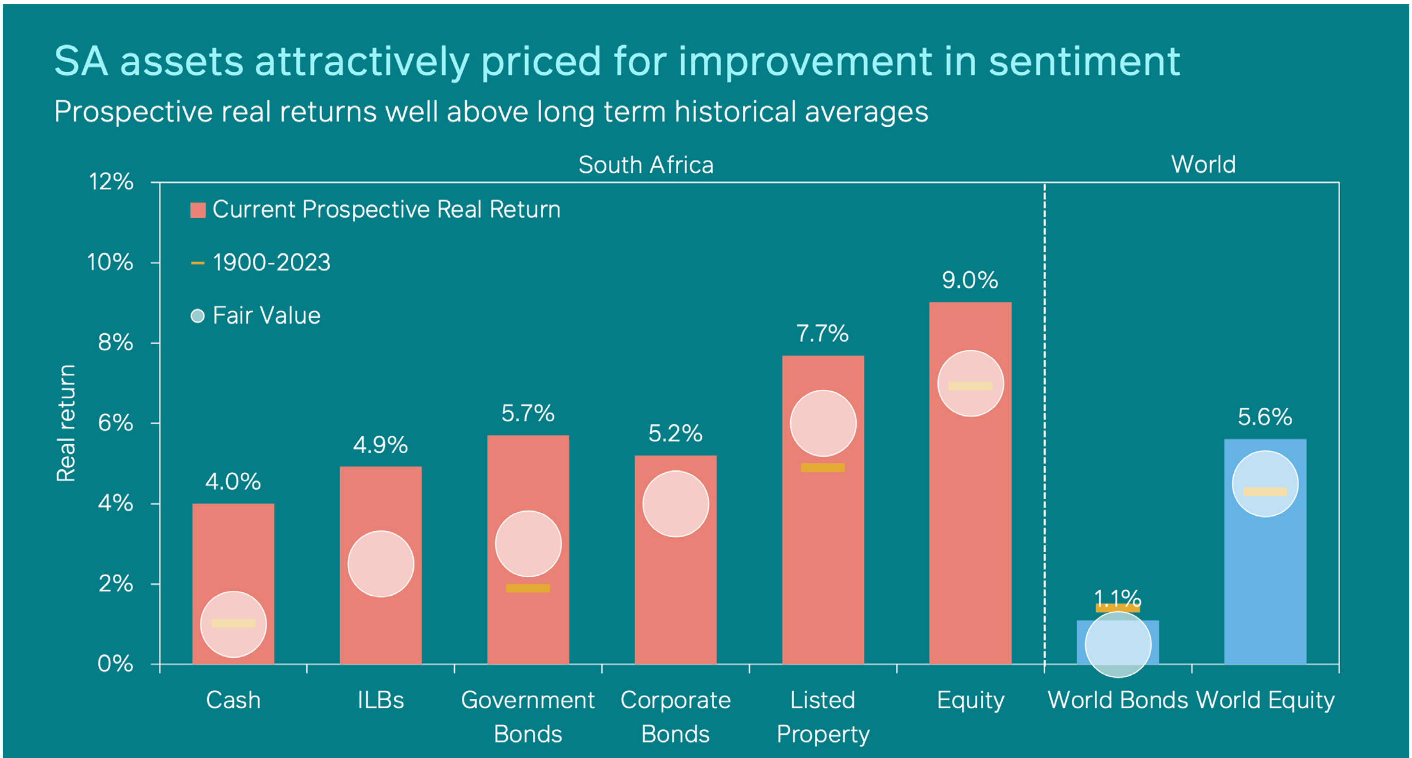
Secondly, our South African equity selection has detracted slightly where we haven't held some of the more popular names that have done well. For example, we haven't held Capitec in client portfolios, and the share price has done exceptionally well. We believe Capitec is an excellent business that has executed its strategy well but that the market valuation is quite demanding. We have preferred to deploy capital elsewhere, for example to other banks and domestic retailers. These have done well and added value to portfolios, but they have not done quite as well as Capitec.

Within the resources space, we've allocated capital towards the diversified miners and, given the strength of the gold price, we own a significant amount of the gold counters in the portfolios. We continue to find value in offshore earnings like Naspers, Prosus, British American Tobacco and MTN where we hold overweight positions.

### Attractively priced opportunities for investors across South African asset classes

Looking at the whole suite of asset classes available to multi-asset funds, we believe we are quite spoiled for choice, particularly in South African assets. As per Figure 3 below, we see opportunity across the spectrum of South African asset classes, with the potential for real returns to be higher than the long-term average and fair-value returns required for these asset classes.

**Figure 3**




Source: Bloomberg, Credit Suisse, M&G Investments 15.08.2024

The prospective returns in South Africa are in stark contrast to the rest of the world, in our opinion. While there will always be pockets of opportunity globally, and we position our portfolios to exploit those in our offshore allocations, the returns for the world in aggregate, both from a bond and equity point of view, don't look as attractive or compelling as those available locally.

The beauty of multi-asset portfolios, and a key reason why they are so relevant for investors in an ever-changing world, is the vast array of different asset classes available for investment. Considering the improved sentiment towards South Africa, finding the balance between a highly diversified portfolio of both domestic and offshore assets and sufficient exposure to cheap but riskier assets is critical.

As an investor, whether you have savings invested in M&G Balanced Fund or M&G Inflation Plus Fund, you benefit from our flexibility to adjust exposure towards areas where we think returns could potentially be better or risks lower.

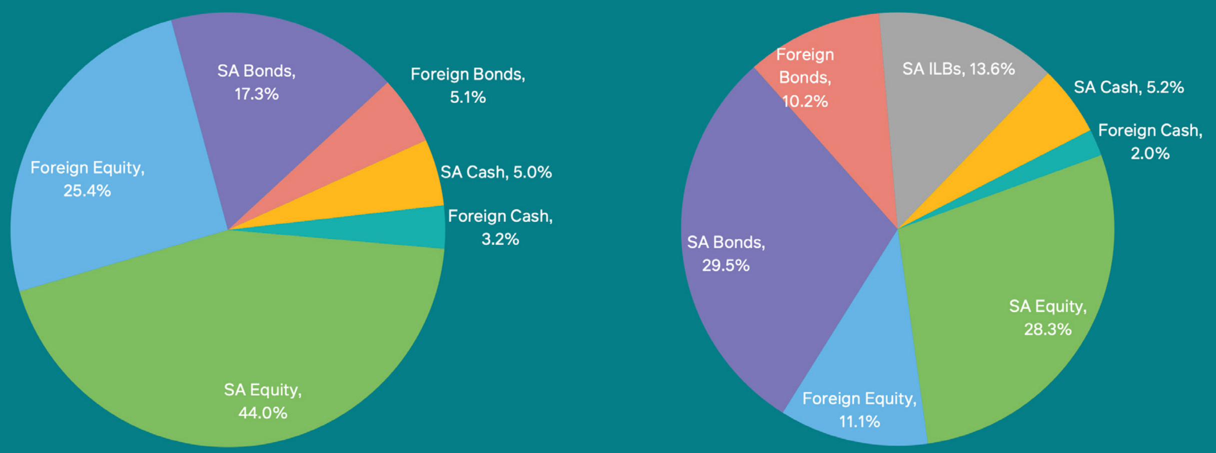
**Current positioning:**

## Asset allocation as at 31 July 2024

Diversified exposure to many attractive asset classes

Current position – M&G Balanced Fund

Current position – M&G Inflation Plus Fund




| Total Equity + Property | Total Bonds | Total Foreign |
|---|---|---|
| 69.4% | 22.4% | 33.7% |

| Total Equity + Property | Total Bonds | Total Foreign** |
|---|---|---|
| 39.4% | 53.3% | 23.3% |

Source: M&G Investments

- **M&G Balanced Fund positioning**

At the end of September, roughly one third of the portfolio is invested offshore in a combination of foreign equities, cash, bonds, credit and property. This is well below the regulatory maximum allowed. With two thirds of the fund invested in South Africa, a substantial allocation of 45.5% is currently in South African equities given our view detailed above of the potential future risk-adjusted returns on offer.

- **M&G Inflation Plus Fund positioning**

The low-equity portfolio is, by definition, more conservative than our balanced fund. It holds more bonds given the high government and inflation-linked (ILB) bond returns on offer, with half of the total portfolio in bonds and about a quarter invested offshore. Within our offshore exposure, we tend to hold a little more offshore cash and bonds as opposed to offshore equities due to the diversification benefit derived for the more risk-averse investor. During periods of volatile equity markets, as experienced during August, these diversification assets once again proved their worth.

In terms of foreign equity, one of the longer-term themes in the portfolio has been keeping a fairly cautious approach to US equities. US markets have dominated global equity market returns in recent years, particularly in the technology sector's so-called 'Magnificent 7'. While the portfolios do have some exposure to these names, we've invested capital in other areas where we see more attractive prospective returns, for example in other developed markets like Japan and the UK. Other areas of opportunity, in our opinion, include the European financial sector and other select emerging markets like China, Mexico, Taiwan and Korea.

### Consistently delivering for our clients over the long term

Reflecting on our strong long-term performance in our multi-asset funds, we're proud of the returns delivered to our clients that stayed the course with us. We're also cautiously optimistic that we can deliver better returns over the medium to long term than has been the case in the recent past, given our view that prospective returns are above long-term historical averages. We'll continue to seek out opportunities for our clients and will adjust portfolios as needed to take advantage of them.

To explore more, we invite you to watch this webinar in which Portfolio Manager Leonard Krüger and Client Director Zyron Melton explore investment strategies for navigating the new GNU-normal as well as an update on the M&G Inflation Plus Fund and M&G Balanced Fund.

To invest in our funds today, speak to a trusted financial adviser or contact our Client Services Team on 0860 105 775 or email us at info@mandg.co.za for more information.