M&G Investments

M&G Dividend Maximiser Fund

Equity

Q1 2023

Market overview

So far in 2023, global financial markets have experienced wild swings – particularly in the normally less volatile fixed income markets – dictated by the guessing game over the path of US interest rates, inflation and growth. January's sentiment was relatively bullish, dominated by expectations of a weaker US economy going into 2023, which would have increased the likelihood of softer inflation, lower-than-expected interest rates and a relatively imminent pause to the US Federal Reserve's rate hiking cycle. This was all 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 sparked by the sudden failure of specialist Silicon Valley Bank and the engineered buyout of Swiss banking giant Credit Suisse by UBS shocked markets even further, with swift central bank and government interventions preventing contagion to other sectors. Gold benefited and risk-off sentiment prevailed as global financial stocks sold off. Looking back, investment managers have rarely seen such sharp changes in market views in such a short period of time. Central banks suddenly had an even tougher policy balancing act, having to choose between their duties of fighting inflation, safeguarding national banking systems and supporting growth and employment. Ironically, this led back to more positive expectations of lower interest rates and sooner-than-expected rate pauses.

The US Fed hiked by a measured 25bps in March, as expected, as did the Bank of England (BOE), while the European Central Bank (ECB) and SA Reserve Bank (SARB) announced relatively robust 50bp increases given their higher inflation threats.

While the growth outlook improved in several key economies, making equities more attractive, risk aversion still made itself apparent over the quarter. Global equity returns outperformed bonds, while developed equity markets outperformed emerging equity markets. For the three months ended 31 March 2023, the MSCI All Country World Index returned 7.3%, the MSCI World Index (developed markets) delivered 7.7%, and the MSCI Emerging Markets Index produced 4.0% (all in US$). Global property stocks continued to generate among the weakest returns, with the FTSE EPRA/NAREIT Global REIT Index returning 1.4% (US$).

While global banking stocks did sell off, March's confirmed "small" 25bp increase by the Fed appeared to reinforce the idea that US rate hikes might be close to an end, and that therefore uncertainty had eased to an extent. Upward revisions to US growth forecasts, and for other key economies, also reinforced the broadly more positive outlook by the end of the quarter. US equity returns were positive for Q1: in US$, the Dow Jones produced 0.9%, the Nasdaq delivered 17.0%, and the S&P 500 returned 7.5%.

In the UK, the Bank of England (BoE) raised its key interest rate by a total of 50bps in Q1 to 4.25%, in line with forecasts, reaching its highest level in 14 years. February CPI came in unexpectedly high at 10.4% y/y, and financial markets are still pricing in another 25-50bps of increases by August 2023. With January GDP growth reported at 0.3% m/m, the economy has so far avoided the recession that had been forecast, growing more quickly than expected and having picked up pace from the 0% recorded in the last quarter of 2022. For Q1 2023, the FTSE 100 returned 6.4% in US$.

The European Central Bank continued its relatively aggressive pace of rate hikes in the first quarter as it found itself faced with still high, albeit falling, levels of inflation. It hiked by 50bps in March as CPI surprised to the upside at 8.5% y/y in February versus 8.2% expected, with core CPI (excluding food and energy) at 5.6% y/y versus 5.3% expected. The European Commission revised upward its 2023 GDP growth forecast for the region to 0.8% from 0.3% previously, on the back of falling energy prices, government policy support and resilient household spending. In European equity markets, France's CAC 40 returned 15.4% and Germany's DAX delivered 14.3% (in US$) in Q1.

Japan continued its recovery from the pandemic during Q1, as outgoing BOJ Governor Kuroda left interest rates unchanged at a supportive -0.1% after having implemented an effective 25bp interest rate hike in December by lifting the country's fixed 10-year bond yield trading range. The market expects new Governor Eueda, who takes over in April, to also adjust the yield range wider without changing the base interest rate. Japanese GDP grew 1.1% in 2022, with a 1.3% expansion expected in 2023. The Nikkei returned 7.6% in US$ for the quarter.

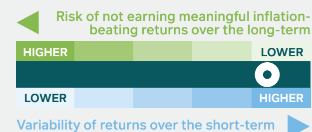
China also continued its recovery from its strict Covid-19 lockdown in Q1 2023, having posted GDP growth of only 2.0% in 2022. The government set a conservative 5% growth target for 2023. The People's Bank Of China (PBOC) left interest rates steady in Q1 to support the recovery. Hong Kong's Hang Seng produced 2.8% for the quarter while the MSCI China returned 4.7%, both in US$.

Larger emerging equity markets posted a broad range of returns over the quarter, led by South Korea's KOSPI with a 7.7% performance, and the MSCI China with 4.7% (both in US$). Other countries were in the red as the MSCI South Africa delivered -0.4%, Brazil's Bovespa -3.3%, the MSCI India -6.3% and Turkey -9.2% (all in US$).

The oil price fell during the quarter on the back of expected lower demand as global growth slowed, and improved supply. Brent crude oil lost approximately 7% in US$ terms, ending the quarter at roughly US$80 per barrel after having fallen as low as US$72 per barrel in mid-March. Other commodity prices were mixed in Q1 amid the uncertain sentiment, with gold the largest beneficiary. Nickel was the largest loser, down 24.2%, while zinc lost 3.9% and aluminium fell 1.0%, while copper gained 6.5%. Among precious metals, gold rose 8.0%, but platinum lost 7.6% and palladium was down 18.5%.

Annualised performance	A class	Benchmark	T class	B class	F class
1 year	4.5%	1.2%	5.2%	4.9%	5.5%
3 years	24.4%	20.9%	24.9%	24.8%	25.2%
5 years	9.8%	7.0%	10.2%	10.2%	10.6%
7 years	8.4%	5.9%	8.8%	8.8%	-
10 years	9.7%	7.2%	-	10.2%	-
20 years	16.6%	13.6%	-	-	-
Since inception	15.7%	12.8%	-	-	-

Risk profile



Fund facts

Fund managers
Ross Biggs
Kaitlin Byrne

ASISA category
South African - Equity - General

Benchmark
ASISA South African – Equity - General Category Mean

Inception date
2 August 1999

Fund size
R4 259 294 586

Awards
Raging Bull: 2006, 2008
Morningstar/Standard & Poor's: 2007, 2009

Sources: M&G Investments, Morningstar & Deutsche Securities

Finally, despite some late-March gains on the back of the SARB's larger-than-expected rate hike, the rand moved weaker against the major global currencies, losing 4.8% against the broadly weaker US$, 7.3% against UK sterling and 6.5% versus the euro over the quarter.

South Africa

In South Africa, the equity market was dented by risk aversion and weakness in Listed Property and Resources stocks during the quarter but buoyed by Industrial shares. The FTSE/JSE All Share Index (ALSI) returned 5.2% in Q1, while the more locally exposed Capped SWIX delivered 2.4% (both in rands). The South African Reserve Bank (SARB) surprised with a larger-than-expected 50bp interest rate hike on 30 March, citing strong inflationary pressures from food, administered prices and a depreciating rand. February CPI came in at 7.0% % y/y, aided by substantial increases in food, transport and medical services prices. Many had thought the Bank would follow the US and UK with a 25bp rise, especially given very weak local economic growth: Stats SA reported that Q4 2022 GDP contracted by 1.3%, more than expected, due to intensifying load-shedding. At the same time, National Treasury revised downward its projection for annual real GDP growth, now expected to average 1.4% from 2023 to 2025, versus 1.6% previously.

During the quarter, investors welcomed the 2023 National Budget's improved fiscal trajectory and the government's plans for Eskom debt relief, as markets reacted marginally favourably. Eskom remained in the spotlight for much of the period as its departing CEO reported high levels of corruption within the utility, prompting more intensive investigations from journalists and the government.

Meanwhile, South Africa was grey-listed by financial watchdog FATF, so that more scrutiny of the country's international transactions is necessary to root out money laundering and financing of terrorism. Higher costs and administrative hurdles will likely result, experts said, and banking shares fell 2% in reaction to the announcement. Bonds and the rand were little moved, however.

Performance

The M&G Dividend Maximiser Fund delivered a return of 2.8% (net of fees) for the first quarter of 2023, outperforming its benchmark (the average of the general equity funds) by 0.6%. For the year ended 31 March 2023, the fund returned 4.5% (net of fees), outperforming its benchmark by 3.3%. It is particularly pleasing to report that over the three-year period ending 31 March 2023, both the absolute and relative performance of the Fund has been strong, with an absolute return of 24.4% per annum over this period, outperforming the benchmark by 3.5% per year.

The Fund's dual focus of buying undervalued companies with strong cash flows and dividends remains core.

The Fund's investment in Richemont was a top contributor during the quarter as its share price rose 27%. Richemont's sales were surprisingly resilient over the COVID period and have been growing well above expectations since then, especially at the watch and jewellery masons of Cartier and Van Cleef & Arpels. We think that these are exceptionally strong brands and that their brand value with consumers has never been higher.

Exceptionally strong sales of Richemont products in the United States have resulted in retail capacity expansion to meet demand. With increased travel and as the Chinese market reopens post-COVID lockdowns, we are likely to see even higher sales. Sales growth is likely to continue to lead to improving margins, earnings and dividends ahead of what we consider to be conservative market expectations. The company has an exceptionally strong balance sheet with a substantial net cash position. We think that cash flows and dividends from Richemont will be much higher in five years' time. After many years of restructuring the watch businesses inside the company, there is potential for this business to surprise the market on the upside.

During the quarter, certain commodity prices continued to be under pressure, notably coal and platinum group metals. Glencore, which has substantial exposure to coal, fell over 10% in the quarter, and as a result and was a top contributor to relative performance as we do not own this share in the Fund.

Within the platinum group metals, both rhodium and palladium prices continued to fall. This sector's fortune has rapidly improved after many years of earnings margins which on average were not sufficient to compensate the mines for the capex required for ongoing maintenance. Today, margins in the sector are at near-record highs and cash generation is very strong. We are cognisant of the high margins that companies are currently earning and remain in an underweight position in the platinum sector.

This underweight positioning continued to benefit the fund in the first quarter as our underweight to Anglo American Platinum and Impala Platinum were among the larger contributors to performance. We have strategically shifted our preference for companies within the sector towards the higher-quality platinum companies, which are likely to see production growth as a result of their investment in capacity, and we therefore continue to be overweight Northam Platinum. The recent news that Northam Platinum has withdrawn its full bid for Royal Bafokeng Platinum was welcomed. We think that given the deterioration of the rhodium and palladium prices, the risks attached to the acquisition of further shares has materially increased.

Staying in the resources sector, the largest detractor from performance for this quarter was the Fund's underweight to the gold sector and Goldfields in particular. We tend to be underweight to the gold sector over the long term in this Fund. This is due to the poor cash flows generated by gold companies and consequently, the poor dividend growth over a long period of time. The Fund holds a position in Anglogold.

One of the top five contributors to performance was the overweight position to Prosus, whose share price appreciation was 18% for the quarter. Prosus benefitted from a change in risk appetite for companies exposed to China due to the country's relaxation of its strict COVID policy in late 2022. Further to this, easing of licensing restrictions around internet games also bodes well for future revenue growth of the company after years of growing concerns around this matter.

We believe there is a strong investment case to be made for Prosus. Tencent, which is the main underlying asset of the group, has a market-leading position in China, which gives it a very strong competitive advantage in terms of expanding its network of products and monetising those products. It is a high-quality company with significant growth potential which we think is trading on an undemanding valuation. In addition to our favourable view of Tencent, we believe that Naspers and Prosus are trading at a material discount relative to their underlying investments, offering a significant margin of safety for the investment. The continued share repurchase programs by Prosus, Naspers and Tencent and continued focus on unlocking value within the group (through the sale of Tencent shares and investments) are quite promising.

The M&G Dividend Maximiser Fund holds a 5% allocation to the M&G Global Dividend Fund, and this was a top contributor

Sources: M&G Investments, Morningstar & Deutsche Securities

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to performance over the quarter. The Fund returned 10.6% (in rand) over the quarter, of which approximately half was due to rand depreciation versus the US$.

While it is extremely difficult to forecast the future, we do spend a substantial amount of time discussing the economic cycles that various sectors are in, and where valuations are. In this way, we aim to add value for our clients through these cycles and continue to buy companies that we believe have proven dividend and cash flow track records, 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 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 value (P/E) of the JSE has fallen to 1.7X (as at the end of March 2023) which we think is now a very attractive valuation level. Within the South African market, many commodity companies continue to experience elevated revenue and earnings, as the prices of platinum group metals, coal and iron ore remain at high levels.

South African assets appear to be undervalued relative to emerging and developed markets. We do, however, highlight the risk of rising interest rates and bond yields in the United States and many developed and emerging markets. While South African bond yields are already elevated and remain attractive, we think that rising bond yields in the US present headwinds to equities valuations. The hurdle rate has increased. This higher rate not only decreases equity valuations, but also increases the real financial risk to companies via a higher cost of debt.

Over the last two years, we have substantially reduced the offshore allocation of the Fund as we thought that the SA market and SA currency represented very good value. Today, we continue to think that Emerging Markets and African equities represent particularly good value, and we think the SA rand is still attractive. The Fund has approximately 21% allocated offshore, of which 9% is allocated to the M&G Global Equity Fund, 5% to the M&G Global Dividend Fund and 3% to the M&G Africa Equity Fund.

The focus of the fund continues to be on finding companies that are undervalued and which are paying good dividend yields with the potential to pay growing dividends over the long run. We are confident that we have built a portfolio of attractively priced stocks that in aggregate is cheaper than owning the index, yet still capable of delivering attractive underlying growth independent of the economic cycle in which we find ourselves. □

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Application forms

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Collective Investment Schemes (unit trusts) are generally medium-to long-term investments. Past performance is not necessarily a guide to future investment performance. Unit trust prices are calculated on a net asset value basis. This means the price is the total net market value of all assets of the unit trust fund divided by the total number of units of the fund. Any market movements – for example in share prices, bond prices, money market prices or currency fluctuations - relevant to the underlying assets of the fund may cause the value of the underlying assets to go up or down. As a result, the price of your units may go up or down. Unit trusts are traded at the ruling forward price of the day, meaning that transactions are processed during the day before you or the Manager know what the price at the end of the day will be. The price and therefore the number of units involved in the transaction are only known on the following day. The unit trust fund may borrow up to 10% of the fund value, and it may also lend any scrip (proof of ownership of an investment instrument) that it holds to earn additional income. A M&G unit trust fund may consist of different fund classes that are subject to different fees and charges. Where applicable, the Manager will pay your financial adviser an agreed standard ongoing adviser fee, which is included in the overall costs of the fund. A unit trust summary with all fees and maximum initial and ongoing adviser fees is available on our website. One can also obtain additional information on M&G products on the M&G website. The Fund may hold foreign securities including foreign CIS funds. As a result, the fund may face material risks. The volatility of the fund may be higher and the liquidity of the underlying securities may be restricted due to relative market sizes and market conditions. The fund's ability to settle securities and to repatriate investment income, capital or the proceeds of sales of securities may be adversely affected for multiple reasons including market conditions, macro-economic and political circumstances. Further, the return on the security may be affected (positively or negatively) by the difference in tax regimes between the domestic and foreign tax jurisdictions. The availability of market information and information on any underlying sub-funds may be delayed. The Manager may, at its discretion, close your chosen unit trust fund to new investors and additional investments by existing investors to make sure that it is managed in accordance with its mandate. It may also stop your existing debit order investment. The Manager makes no guarantees as to the capital invested in the fund or the returns of the fund. Excessive withdrawals from the fund may place the fund under liquidity pressure and, in certain circumstances; a process of ring fencing withdrawal instructions may be followed. Fund prices are published daily on the M&G website. These are also available upon request. The performance is calculated for the portfolio. Individual investor performance may differ as a result of initial fees, the actual investment date, the date of reinvestment and dividend withholding tax. Purchase and repurchase requests must be received by the Manager by 13h30 (11h30 for the Money Market Fund) SA time each business day. All online purchase and repurchase transactions must be received by the Manager by 10h30 (for all Funds) SA time each business day.

Sources: M&G Investments, Morningstar & Deutsche Securities