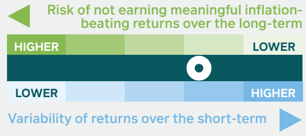
M&G Global Balanced Fund

Global Multi-Asset USD-denominated

Q4 2022

Risk profile



Fund facts

Investment manager
M&G Investment Management Limited (UK)

Fund managers
Craig Simpson

Morningstar category
Flexible Allocation

Benchmark
65% MSCI All Country World Index TR (Net), 5% FTSE EPRA/NAREIT Global REIT Index, 25% Bloomberg Global Aggregate Bond Index, 5% US 1m Treasury Bill

Inception date
19 June 2017

Fund size
USD 122.3 million

Market overview

In the final quarter (Q4) of 2022, global financial markets recovered some of the ground lost during the past three quarters. Although the outlook remained gloomy, some light emerged: in October and November buyers were attracted by cheaper asset valuations and somewhat improved clarity on company earnings prospects, as well as falling fuel and food prices. By mid-December, a slowdown in the pace of the interest rate hiking cycle added to the better sentiment. However, caution returned in December: still causing uncertainty were unknowns such as the severity of the expected 2023 global growth slowdown, the impact of the massive new Covid wave in China, the ongoing tragedies of the Ukraine-Russia war, and the stickiness of inflation in large economies. As such, markets retraced some of their earlier gains in December.

The risk-on sentiment over the quarter saw equities outperform bonds, while emerging market returns were in line with those of developed markets. For the quarter ended 31 December 2022, the MSCI All Country World Index returned 9.8%, the MSCI World Index (developed markets) also delivered 9.8%, and the MSCI Emerging Markets Index produced 9.7% (all in US$). Bonds also posted meaningful gains: the Bloomberg Global Aggregate Bond Index delivered 4.5% (in US$). Beaten-down property stocks were among the strongest performers, with the FTSE EPRA/NAREIT Global REIT Index returning 6.6% (US$).

Hong Kong and European equities were among the best performers for the quarter, while the technology-dominated Nasdaq in the US, as well as Japan and the broader US market, were among the weakest.

The oil price fell during the quarter on the back of expected lower demand and improved supply. Brent crude lost 2.3% in US$, ending the quarter at around US$83 per barrel. Over the past 12 months the oil price is now only 10.5% higher.

In the US, the US Fed hiked its Federal Funds rate by a combined 125bps in Q4 to 4.25%-4.5%, still considered an aggressive policy tightening by historic standards, even though its 50bp December hike represented a slower pace. The central bank also lifted its rate forecast for end 2023 by 0.5%, to 5%-5.25%, a more hawkish signal. This came despite falling CPI (at 7.1% y/y in November), as price increases became more widespread.

Meanwhile, after rising 3.2% y/y in Q3 on the back of surprisingly strong consumer spending, US economic growth for all of 2022 is forecast at around 1.9%, before slowing to below 1% for 2023. Data showed the US housing market is already slowing meaningfully and is expected to be a significant factor in the slowdown. However, consensus projections are for a relatively mild and brief recession lasting for the first three quarters of next year. US equity returns were in the black (apart from the Nasdaq) for the quarter: in US$, the Dow Jones produced 16.0%, the Nasdaq delivered – 0.8%, and the S&P 500 returned 7.6%. The S&P 500 recorded a -18.1% total return for 2022, the worst since the 2008 Global Financial Crisis.

In the UK, the Bank of England (BoE) finished off the year by raising its key interest rate by 50bps to 3.5% in December, in line with forecasts. Meanwhile, November CPI eased to 10.7% y/y vs October's 11.1%, largely due to falling energy prices. The Bank indicated more hikes are likely into 2023 in its bid to curb inflation at the expense of growth: the Office for Budget Responsibility (OBR) estimated that the U.K. economy was already in recession and that GDP will contract by 1.4% in 2023, while inflation is predicted to hit 9.1% in 2022 and 7.4% in 2023. For Q4 2022, the FTSE 100 returned 17.1% in US$, and -7.0% for 2022 as a whole.

The ECB followed the US Fed and BoE with its own 50bp hike in December, while also suggesting similar-size hikes at its next two meetings. Eurozone inflation fell to 10.1% y/y in November from a record 10.6%, as energy costs eased. However, the ECB still expects a short and shallow recession in 2023 as the energy crisis is seen weighing heavily in the shorter-term while the Ukraine-Russia war drags on. In France, the CAC 40 returned 22.6% in Q4, and -12.4% for 2022 (in US$). Meanwhile, Germany's DAX delivered 25.2% for the quarter and -17.4% for 2022 (in US$).

In Japan, the Bank of Japan (BOJ) surprised markets in mid-December with its first effective interest rate hike, raising its 10-year bond yield range by 0.25% to 0.50% after long periods of stability. The market had been pricing in no rate increases through 2023. Finally, the BOJ revised downward its real growth outlook for 2022 to 2.0% from 2.4% previously, and for 2023 to 1.9% from 2.0%, but no recession is expected. Following other global equity markets higher, the Nikkei returned 10.6% in US$ for the quarter but was down 19.1% for the year.

In China, it was a fairly chaotic end to the year as the government responded to widespread social protests against its strict zero-Covid policy by removing almost all restrictions. However, this came as a large new wave of Covid infections was spreading. Although economists welcomed the move to help free up the economy and kick-start growth, the uncertain impact of the virus weighed negatively on markets. Meanwhile, consensus forecasts for China's economy call for only 3.3% GDP growth in 2022, far below the government's 5.5% target and the slowest since the 1970s. For 2023, a new government target of 4.5%-5% is reported to be most likely, but many consider this optimistic. Hong Kong's Hang Seng produced 15.8% for the quarter and -12.6% in 2022 (in US$). The MSCI China returned 13.5% in Q4 and -21.8% in 2022, both in US$.

Annualised performance	B Class	Benchmark
1 year	-13.6%	-17.0%
2 years	-1.4%	-3.5%
3 years	1.1%	1.7%
5 years	1.8%	3.4%
Since inception	2.9%	4.2%

Sources: M&G Investments, Morningstar & Deutsche Securities

M&G Investments

Performance

For Q4 2022, the fund produced a return of 8.6% (net of fees in US$), outperforming the 7.9% recorded by its benchmark. For the 12 months to 31 December, the fund delivered -13.6% compared to the benchmark's -17.0% return.

On an absolute return basis, the main contributors to performance were the fund's holdings in global and European equity, global fixed income, US Treasuries, and US and European corporate bonds. The main detractors were emerging markets government bonds, notably Brazil.

Within equities, holdings of European, global and Japanese stocks added value. On the other hand, the overweight US stocks cost some performance.

Strategy and positioning

While there is a lot of negativity about the prospects for growth, there are few signs of capitulation in asset markets. At the same time, there is a strong consensus that inflation has peaked, which has been supportive of asset prices recently.

Valuations have improved almost everywhere but, as always, are dependent on the path for cash interest rates and the extent of optimism in profit forecasts. In these extremely volatile, narrative-driven times we remain alert to opportunities that are created by 'episodic', or sentiment-driven, changes in asset prices. As the likelihood of economic downturn has increased, we remain cautious and have adopted a more neutral positioning. However, we continue to hold a reasonable level of cash, enabling us to act quickly if and when market turbulence presents attractive opportunities.

We remain highly active within the global bond asset class, responding to the significant price movements we have seen during 2022. Price behaviour remains consistent with that of market participants, being sharply focused on the direction of interest rates: markets are changing direction at every inflation data release or FED governor's statement.

As highlighted above, in these extremely volatile, narrative-driven times we remain alert to opportunities that are created by 'episodic', or sentiment-driven, changes in asset prices. The effect of recent asset price weakness has been to restore valuations to more interesting levels in certain areas, in our view. However, the assumptions behind these valuation signals appear even more vulnerable than usual to shifting economic conditions.

We believe the economic and policy background we are facing now is very different from the last decade and risks today are much more established. As the likelihood of an economic downturn has increased, particularly in Europe, we remain cautious and continue to hold an elevated level of cash, providing scope to respond to future volatility as it arises.

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Application forms

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Sources: M&G Investments, Morningstar & Deutsche Securities