Quarterly Commentary

M&G Investments

M&G Global Bond Feeder Fund

Global Income ZAR-denominated

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. US Treasury bonds, for example, experienced high volatility of around 10%, with the 10-year UST yield falling by 50bps from around 4.0% to 3.5% between February and March – an exceptionally big move in that market.

Central banks 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 its repo rate by 25bps at both its February at March meetings, moves that were expected by the market. February's core CPI, at 5.5% y/y, showed inflation was more deeply entrenched than thought. This data, combined with hawkish language from the US Fed, led investors to expect higher interest rates for longer and sparked global equity and bond sell-offs. Upward revisions to US growth forecasts, and for other key economies, reinforced the broadly more positive outlook by the end of the quarter.

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.

Meanwhile, Chancellor of the Exchequer Jeremy Hunt's three-year Spring Budget introduced higher taxes and spending, sparking labour protests on Budget day in mid-March. However, it also contained improved economic growth projections, including no recession for 2023. The UK economy is the only one of the G-7 not to have recovered to its pre-pandemic size.

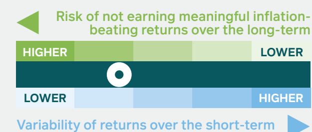
The ECB continued its relatively aggressive pace of rate hikes in Q1 as it found itself faced with still high, albeit falling, levels of inflation. It hiked by 50bps in March as CPI surprised to the upside at 8.5% y/y in February versus 8.2% expected, with core CPI (excluding food and energy) at 5.6% y/y versus 5.3% expected. The bank also signalled its readiness to supply the banking system with extra liquidity should it be required. Financial markets now expect further hikes will be less aggressive going forward, having cut back their forecasts by a full 1.0%.

In February the European Commission revised upward its 2023 GDP growth forecast for the region to 0.8% from 03% previously, on the back of falling energy prices, government policy support and resilient household spending. Meanwhile, large and widespread public protests and strikes arose across France in March as a result of French President Emmanuel Macron's public pension reform, which sees the retirement age rise from 62 to 64.

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. Meanwhile, February CPI fell to 3.3% y/y from a 40-year high of 4.3% in March. Price increases have been driven by strong consumer demand, higher commodity prices and a weaker yen. Japanese GDP grew 1.1% in 2022, with a 1.3% expansion expected in 2023 on the back of stronger consumer demand, the government's October 2022 fiscal support package, rising tourism numbers and supply chain improvements.

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, with the IMF forecasting 5.2%, which would account for around 30% of global growth for the year. Pent-up consumer demand is driving the current expansion, along with consumer services, while the property sector remains weak.

Risk profile



Fund facts

Investment manager of the underlying fund
M&G Investment Management Limited (UK)

Fund managers of the underlying fund
Jim Leaviss
Eva Sun-Wai

ASISA category
Global - Interest Beating - Variable Term

Benchmark
Bloomberg Global Aggregate Bond Index

Inception date
27 October 2000

Fund size
R634 220 039

Annualised performance	A class	Benchmark	B class
1 year	11.3%	11.7%	11.7%
3 years	-1.4%	-3.6%	-1.1%
5 years	6.6%	7.0%	-
7 years	2.5%	2.4%	-
10 years	6.5%	6.8%	-
20 years	7.4%	7.1%	-
Since inception	7.6%	7.7%	-

Sources: M&G Investments, Morningstar & Deutsche Securities

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The PBOC left interest rates steady in Q1 to support the recovery, while also implementing a surprise cut to bank reserve requirements to support liquidity and steady any nervousness associated with global banks. The ongoing monetary policy divergence between China and the US has kept pressure on the yuan and caused some capital to leave the country.

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.

While the growth outlook improved in several key economies, making equities more attractive, risk aversion still made itself apparent over the quarter.

Performance

For Q1 2023, the fund returned 7.8% (net of fees) versus its benchmark, the Bloomberg Global Aggregate Bond index, which returned 7.9 %. For the 12 months ending 31 March, the fund delivered 12.2% compared to the benchmark's 11.7%.

In terms of absolute performance, positive returns were generated by the fund's meaningful holdings of government bonds. The primary contributors included US government bonds, US corporate bonds and global investment grade bonds. The main detractors comprised German government bonds and emerging market bonds.

Strategy and positioning

In hard currency bonds, we added euro duration after short-term German Bund yields rose sharply in recent months. In March, we added a year of duration (sterling and euro assets) during the banking crisis following a sell-off at the short end of the yield curve. This was achieved by buying bonds from the Netherlands, Belgium, Spain and Germany.

We added Japanese index-linked bonds in January. Although inflation is trending lower, it is still nowhere near target levels. In our view, this has not been sufficiently priced in by markets. In March, we switched US inflation-linked bonds into short-dated US Treasuries after bond yields had jumped in the preceding weeks.

In local currency bonds, we switched out of 10-year Mexican bonds into shorter-term bonds as these became more attractive after yields rose in February.

As spreads tightened during the quarter, we reduced our corporate exposure by closing out of some high yield and investment grade names that had performed well. Later, we reduced our credit exposure to financials and selected sterling bonds. We added credit protection through credit default swaps towards the end of the review period.

Looking ahead, we believe that expectations around inflation and recession risk will drive market performance. Inflation is currently heading in the right direction, particularly in the US, which is positive for bonds. However, the possibility of a recession remains elevated as central banks continue to tighten financial conditions. In this environment, we will adopt a balanced and diversified approach across duration and credit. The yields available from investment grade bonds remain elevated, providing investors with a good overall cushion to further absorb any future volatility.

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Application forms

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Sources: M&G Investments, Morningstar & Deutsche Securities